Cambridge City Council Item

To:	Executive Councillor for Finance and Resources: Councillor George Owers
Report by:	Caroline Ryba, Head of Finance
Relevant scrutiny committee:	Strategy & Resources Scrutiny Committee 18/1/2016
Wards affected:	All

CONSIDERATION OF AN ETHICAL INVESTMENT POLICY
Non-Key Decision

1. Executive summary

1.1 At the meeting of Full Council on 22 October 2015 a motion was passed asking the Head of Finance to:

‘author a report to Strategy and Resources Committee outlining the options for and the opportunities, risks and limitations associated with developing an ethical investment policy, in relation to both direct investments and our Treasury Management Strategy, with a particular emphasis on the issues of companies that are associated with investments in fossil fuels and fossil fuel divestment.’

1.2 This report summarises the issues around developing an ethical investment policy for inclusion in the Treasury Management Strategy and proposes a wording for such a policy.

2. Recommendations

2.1 The Executive Councillor is recommended:

To approve insertion of the following in the Council’s 2015/16 Treasury Management Strategy which is for consideration later at this meeting:

“Cambridge City Council notes the risks to both the planet and Cambridge from climate change and the need to show leadership in advocating a fossil-free future, including its investments. Where consistent with our fiduciary responsibilities the Council will avoid direct investment in institutions with material links to environmentally harmful activities including fossil fuels.

Cambridge City Council, in making investments through its treasury management function, fully supports the ethos of socially responsible investments. We will actively seek to communicate this support to those institutions we invest in as well as those we are considering investing in by:

- Encouraging those institutions to adopt and publicise policies on socially responsible investments;

- Requesting those institutions to apply those deposits in a socially responsible manner.

Counterparties will be advised of this statement."

3. Background

Current Treasury Management Policy and Operations

3.1 The Council's funds are invested in line with the Treasury Management Strategy agreed before the start of each financial year. The Council invests predominantly in banks, building societies, money market funds and other local authorities. The Council does not have access to information as to where these counterparties place their funds. The Council also has an investment in the CCLA Property Fund which invests in a diversified commercial and industrial property portfolio.

3.2 At 30 November 2015 total treasury deposits (including the CCLA fund) are £116.6 million.

3.3 As part of its diversified treasury operations the Council does not invest in equity shares or in company debt and therefore does not have any direct investments with any fossil fuel companies. It is currently unlikely that equity investments would be considered due to the risks involved and the statutory requirement for the purchase of equities to be treated as capital expenditure.

3.4 It is a requirement that the Council's treasury operations follow the DCLG Guidance on Local Government Investments and the CIPFA Treasury Management in the Public Services: Code of Practice.

3.5 Investments should be legal and included within the approved investment strategy. To comply with these requirements investments should prioritise security, liquidity and yield in that order. From a purely treasury management point of view any demand to take into consideration any other priority could lead to investments that are less secure and yield less.

3.6 Ethical considerations may also be difficult to evaluate objectively and may require the establishment of complex monitoring arrangements, which will need to rely on external information that is costly or difficult to obtain.

Legal Opinion

3.7 In 2014 the Local Government Association obtained legal opinion on behalf of its members on the duties owed by local government pension funds and the factors that they can legitimately take into account when making investment decisions. The view of the Head of Legal is that the principles expressed can apply equally to investment decisions made by local authorities generally.

3.8 Public bodies making investments have both fiduciary duties and public law duties (which in practice are likely to come to much the same thing).

3.9 The power to invest must be exercised for investment purposes, and not for any wider purpose. Investment decisions must therefore be directed towards what is best for the financial position of the fund (or Council in this case). However, so long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as this does not risk significant financial detriment.

3.10 The Council could therefore only use other considerations (including those around ethical considerations and fossil fuels) to choose between investments which were otherwise broadly equivalent in terms of security, liquidity and yield.

3.11 The Law Commission also looked at the duty of pension trustees to act solely in the interests of pension fund members (their fiduciary duty) in 2014. The Head of Legal's view is that this does not change the legal opinion given to the Local Government Association. It does not consider the public law overlay, which applies to the exercise of local authority statutory powers; In particular the principle that a power must be exercised primarily for the purpose for which it is given, and not for some ulterior purpose.

3.12 The Law Commission work is useful in considering what can be determined a ‘financial factor’ in decision making. Environmental, social or governance factors (often referred to as “ESG” factors) may present risks to an organisation’s long-term sustainability and can therefore be borne in mind when they may be financially material to a decision.

The Effectiveness of Fossil Fuel Divestment

3.13 Evidence shows that proven fossil fuel reserves are more than three times higher than we can afford to burn in order to stay below the generally agreed threshold for dangerous climate change. Fossil fuel companies are currently planning on extracting these reserves and selling them – and are actively prospecting for more. By supporting these companies, it has been said by various commentators that investors not only continue to fund unsustainable business models that are likely to make climate change worse, but they also risk their financial assets losing value if international agreements on climate change are met.

3.14 A 2103 report by Lord (Nicholas) Stern, a professor at the London School of Economics, and the Think Tank Carbon Tracker, said that far from reducing efforts to develop fossil fuels, the top 200 companies spent $674bn (£441bn) in 2012 to find and exploit even more new resources, a sum equivalent to 1% of global GDP, which could end up as "stranded" or valueless assets. Stern's landmark 2006 report on the economic impact of climate change – commissioned by the then chancellor, Gordon Brown – concluded that spending 1% of GDP would pay for a transition to a clean and sustainable economy.

3.15 The world's governments have agreed to restrict the global temperature rise to 2^{o}C, beyond which the impacts become severe and unpredictable. But Stern said the investors clearly did not believe action to curb climate change was going to be taken. "They can't believe that and also believe that the markets are sensibly valued now."

3.16 Friends of the Earth contend that “Shareholder engagement can work in some sectors, where the change required does not challenge the companies’ core business model, for example getting a company to remove a certain product from its supply chain. Engagement does not work well where the core business model requires change”.

3.17 Carbon Tracker argues that “true engagement needs the pressure created by divestment. Engagement without divestment is like a criminal legal system without a police force.”

3.18 Friends of the Earth go further and suggest that “Engagement is not working on fossil fuel companies, and even if it could, it is believed to be unlikely that UK local authorities could exert adequate influence on them to do so. Divestment is a strategy that will increase pressure for action. Divestment has been successful in the past, for example as part of global efforts aimed at changing the actions of Apartheid South Africa. Divestment helped to increase the political pressure for action. This is happening now on fossil fuels, with thousands of institutions worldwide divesting.”

Wider Ethical Investment Statements

3.19 An approach taken by some local authorities, in addition to or instead of a statement around what they will not invest in, is to include an ethical investment statement which applies to all treasury investments made. These statements call on institutions to adopt and publicise ethical investment policies and apply deposits in a socially responsible manner. Those councils adopting such policies include Brighton & Hove City Council and South Kesteven.

Direct Investments Outside of Treasury Activities

3.20 The Council can chose to purchase equity shares, outside of its Treasury operations. Such expenditure is treated as capital expenditure by regulation and as such is therefore subject to the Council’s procedures around the approval of capital expenditure. On a case by case basis it would therefore be necessary to consider the powers the Council is relying on to purchase the shares, and therefore what considerations can be bought to bear.

Ethical Investment Policy

3.21 Given the legal considerations above the Council cannot prioritise ethical or fossil fuel considerations above those of security, liquidity and yield in its investment decisions. However environmental, social and governance issues (ESG) will themselves impact on these financial considerations to a degree. For example, the Council could choose to not to invest in a company manufacturing products considered to be harmful to health because the risk of litigation raises questions about future financial performance.

3.22 Recognising the Council's aspirations in respect of climate change, the following could be incorporated into the Treasury Management Statement in respect of direct investments:

"Cambridge City Council notes the risks to both the planet and Cambridge from climate change and the need to show leadership in advocating a fossil-free future, including its investments. Where consistent with our fiduciary responsibilities the Council will avoid direct investment in institutions with material links to environmentally harmful activities including fossil fuels."

In practice this means that security, liquidity and yield considerations being equal, when selecting investments the Council will choose those which are not related to fossil fuels.

3.23 As indicated above the Council does not currently have any direct investments. It is not possible to reliably access information on where our current counterparties invest their funds. In addition to the statement above the Council could also add an investor statement to the Treasury Management Strategy, similar to that adopted by other councils:

'Cambridge City Council, in making investments through its treasury management function, fully supports the ethos of socially responsible investments. We will actively seek to communicate this support to those institutions we invest in as well as those we are considering investing in by:

- Encouraging those institutions to adopt and publicise policies on socially responsible investments;

- Requesting those institutions to apply those deposits in a socially responsible manner.

Counterparties will be advised of this statement.'

4. Implications

(a) **Financial Implications** As outlined in the Legal Opinion section of this report ethical considerations should not override the primary considerations of security, liquidity and yield. There is therefore no expectation that adoption of an ethical policy will have a financial impact on the Council.

(b) **Staffing Implications** None

(c) **Equality and Poverty Implications** None

(d) **Environmental Implications** +L – low positive impact

(e) **Procurement** None

(f) **Consultation and communication** A news release will be prepared on adoption of this policy.

(g) **Community Safety** None

5. Background papers

These background papers were used in the preparation of this report:

Nigel Giffin advice to the LGA 2014

6. Inspection of papers

To inspect the background papers or if you have a query on the report please contact:

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