A cleaner footprint

Hertfordshire County Council cabinet member for resources and performance, and chairman of the Pension Committee, Councillor Ralph Sangster, chats with Duncan Ferris about responsible investment (RI) and divestment from fossil fuels

Hertfordshire County Council is the administering authority for the Hertfordshire Local Government Pension Scheme (LGPS). Over 300 employer bodies and 100,000 members contribute to the fund and it has assets of more than £5 billion. The scheme has almost halved the size of its investments in fossil fuels, from £94 million in December 2019 to £48 million in June 2020.

What are some of the current top priorities for the Hertfordshire LGPS?
One of the principal priorities for any pension fund is to ensure that it has enough assets to pay current and future pensions. In its role as administrator of the Hertfordshire LGPS, the fiduciary role of the Pension Committee, that has oversight of the LGPS, is to put in place an investment strategy that achieves this objective.

The fund is exposed to various risks such as asset performance and protecting its funding level. The protection of the funding level is a key priority for this fund and over the past 12 months officers and the committee have worked together with external advisers to put in place an equity option strategy to mitigate losses from volatile equity markets.

Another priority for the fund is to review its approach to RI and put in place an action plan to develop its RI policy. The Pension Committee is evolving its approach to RI and will use evidence to inform any changes to its investment strategy. This has included commissioning a review of its carbon footprint and a frequent review of this footprint either annually or following asset allocation decisions.

Understanding the fund's investment managers' approach to RI is also important as they manage the assets of the membership and comparisons to peers will inform how engaged these managers are on ESG-related issues.

How has the fund weathered the difficulties presented by pandemic-related market volatility?
The Hertfordshire LGPS is a long-term investor and will experience on occasion market volatility; the current pandemic has caused some significant asset price volatility, which did impact this fund, as it did others. The fund has a diversified portfolio of growth and defensive assets and has also put in place an equity option strategy to mitigate potential losses from equity markets. Additional monitoring and engagement with the fund's third-party providers have been key to ensuring that minimal disruption has been experienced by the various stakeholders in the fund.

Why did you decide to so drastically reduce the size of the fund's investments in fossil fuels?
The Hertfordshire fund invests in equity markets both passively and actively. The fund gives discretion to its active investment managers on making the decisions on the companies the fund's money is invested in.

The fund has not, at the moment, put in any restrictions on sector disinvestment and the fund believes that the investment managers through their research and investment process have an informed insight into the companies the fund is invested in and exercise those decisions on the fund's behalf.

Through the investment managers' direct engagement with companies, the fund can have more influence on the behaviours of companies and make decisions whether to continue to invest in those companies.

A recent example of one of the fund's investment managers acting was the decision by our UK equity manager to disinvest from Shell. The manager's long-term growth focus had already heavily skewed the fund's portfolio away from the oil and gas companies, and the sale of Shell is consistent with their long-term outlook for the industry.

Did pressure groups, such as the Divest Herts group, contribute at all to the decision, or the way in which divestment was executed?
The reduction in the fund's holding in fossil fuels has been driven by investment manager decisions and at no time were the fund's investment managers fettered

in their ability to make investment and disinvestment decisions.

However, it's important to recognise that engagement and dialogue with third-party pressure groups is important so that the fund can explain its investment strategy, the evolution of its approach to RI and increase its understanding of these groups' concerns.

How have you been working to create a RI policy?
The Pension Committee has established a cross-party working group of members to look at the fund's approach to ESG and stewardship policies and an action plan has been agreed by this working group.

The plan will look at understanding the fund's current position and how well the fund's current roster of investment managers integrate ESG factors into their investment process. A report will also be commissioned to understand the fund's carbon footprint and use this as a baseline to understand the impact of future investment decisions on the fund portfolio's exposure to carbon.

The working group will also seek to agree how to communicate the fund's policy to its managers and stakeholders, as well as a programme of regular review and engagement with the fund's manager on RI issues.

Finally, the team will review the managers' positions against the 2020 Stewardship Code and whether the fund should become a signatory, and consider whether portfolio changes are appropriate.

Have these efforts involved collaboration or consultation with any external parties, such as campaign groups, ESG specialists, or others?
The fund recognised at an early stage that it would require external support to understand and develop its approach to RI and also that any decisions that were made to change investment asset allocations and potential screening out of certain types of investment would need to be supported by evidence and be informed by a rigorous process of challenge.

To evolve this work, the fund's officers and the cross-party group of members has worked with its investment consultants and one of their ESG specialists to review its approach to RI.

The working group has and will continue to meet to develop its RI approach and recognises that this will take time and cannot be done overnight. As a fund managing over £5 billion of assets, fund officers and the Pension Committee recognise their responsibility to its various stakeholders and it's important that the fund manage and effectively mitigate risks that the fund is exposed to, whether these are climate redundant assets or cyber risks, while ensuring enough liquidity to pay our pensioners.

How have you communicated any changes or new objectives with scheme members?
It is important for the fund to be more transparent with its scheme membership and external groups.

The need for good, clear communications explaining how and why certain decisions have been made is fundamental in enabling the fund to engage with scheme members, and how the Pension Committee administer the fund on their behalf.

The fund needs to improve its interaction with stakeholders and external parties and will look to develop its communication approach, underpinned by sound reporting and policies that benefit members, while helping the fund partner with its investment managers and detail its position on sensitive topics for pressure groups.

Do you think that LGPS funds have a responsibility to take the lead on RI, or is this trumped by their responsibility to consider the wellbeing of their members' retirement savings?
The role of LGPS funds as a collective can have a significant bearing and influence on approaches to RI. As responsible investors we can have significant influence on the stewardship of investments that are managed on our behalf through common voting policies, and how funds are invested. Asset pools such as Access, which the Hertfordshire Fund is a member of, will develop their respective approaches to RI, taking into consideration local fund requirements and this will lead no doubt to the pools becoming more influential as responsible investors within the pension sector.

It's important that funds manage member and employer contributions responsibly to ensure that there are enough assets to meet current and future pensioners' pensions. That is the fiduciary responsibility of the fund. However, that is not to say that one should ignore RI matters such as poor governance; the impact of investments socially and environmentally can have significant financial implications on financial returns and this fund's funding position.

Written by Duncan Ferris