North East Derbyshire District Council

Audit and Corporate Governance Scrutiny Committee

1 December 2021

Ethical, Social and Governance Investments

Report of the Assistant Director – Finance & Resources (S151 Officer)

Classification:	This report is public
Report By:	Jayne Dethick – Assistant Director – Finance & Resources (S151 Officer)
Contact Officer:	as above

PURPOSE/SUMMARY

To update the Audit and Corporate Governance Scrutiny Committee on ethical fund management.

RECOMMENDATIONS

That the Audit and Corporate Governance Scrutiny Committee note the update on ethical fund management.

IMPLICATIONS

Finance and Risk **Yes** ✓ **No**

Contained within the report

On Behalf of the Section 151 Officer

Legal including Data Protection **Yes** **No**✓

A decision to become an opted in authority must be taken by Council in accordance with Regulation 19 of the Local Audit (Appointing person) Regulations 2015.

On Behalf of the Solicitor to the Council

Staffing **Yes** **No** ✓

There are no staffing issues arising directly from this report.

On Behalf of the Head of Paid Service

DECISION INFORMATION

Is the decision a Key Decision? A Key Decision is an executive decision which has a significant impact on two or more District wards or which results in income or expenditure to the Council above the following thresholds: *BDC:* *Revenue - £75,000* ☐ *Capital - £150,000* ☐ *NEDDC:* *Revenue - £100,000* ☐ *Capital - £250,000* ☐ ☑ *Please indicate which threshold applies*	N/A
Is the decision subject to Call-In? (Only Key Decisions are subject to Call-In)	N/A
Has the relevant Portfolio Holder been informed	N/A
District Wards Affected	All
Links to Corporate Plan priorities or Policy Framework	All

REPORT DETAILS

1 Ethical, Social and Governance (ESG) Investments

1.1 At its meeting in April, the Committee considered a report on ethical fund management and resolved to consider undertaking a further review once the outcome of the results from the Bank of England's biennial review were available. This reports provides an update on the current position.

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1.2 The Covid pandemic delayed the start of this work, but in June the Bank of England published their *Climate Biennial Exploratory Scenario (CBES)* to assess the nature and severity of risks faced by the UK financial system as a result of climate change. This will be UK's first such system-wide assessment of these risks.

1.3 This exercise aims to test the resilience of the current business models of the largest banks and insurers, and the financial system to the physical and transition risks from climate change. It includes both banks and insurers for the first time. By testing both banks and insurers using the same scenarios, the CBES will allow the Bank of England to explore the risks presented by climate change across the financial system more fully.

1.4 The CBES will explore three different climate policy scenarios, which generate a range of possible future outcomes for global temperatures and the economy, each spanning 30 years. It also identifies two sources of financial risks from climate change to be tested: the risks associated with actions to reduce greenhouse gas emissions known as transition risks; and risks associated with the higher global temperatures likely to result from taking no further policy action known as physical risks.

1.5 The financial risks from climate change affect the safety and soundness of firms the Bank of England regulates and the stability of the wider financial system that it oversees. Climate-related financial risks therefore have a direct impact on the delivery of the Bank's prudential policy objectives, as set out in relevant legislation.

1.6 The desired outcomes of the CBES are to:

- Measure the financial exposures of participants and the financial system more broadly to climate-related risks.

- Understand the challenges to participants' business models from these risks; and gauge their likely responses and the implications for the provision of financial services.

- Assist participants in enhancing their management of climate-related financial risks. This includes embedding these risks in business as usual risk management, engaging counterparties to understand their vulnerability to climate change, and encouraging boards to take a strategic, long-term approach to managing these risks.

1.7 The Bank of England intends for their CBES to be a learning exercise. Expertise in modelling climate-related risks is in its infancy, so the exercise is planned to develop the capabilities of both the Bank and the participants. The results will enhance the Bank's understanding of the financial stability implications of climate change and supplement supervisors' knowledge of participants' governance and climate-related risk management. There are no plans at this stage for the exercise to result in regulation or requirements. Participants' submissions are expected to inform the approach to system-wide policy issues, and future policy.

1.8 In addition to measuring the financial risks from climate change, the exercise will explore how participants might change their business models to mitigate risk in the scenarios – their 'management actions'. The CBES is also designed to enable the Bank of England to assess participants' present and future planned approaches to managing climate risks. It will also explore risks from climate litigation.

1.9 They do not intend to disclose the results of individual firms to reflect the exploratory nature of the exercise. Instead, they intend to disclose system-level results of the financial sector's resilience to climate change, including highlighting the main sources of loss by sector and geography. Results are expected in May 2022.

1.10 The financial sector awaits the outcome of the Bank of England's CBES with great interest as these days, it is almost impossible to have a conversation about investing without ESG being mentioned. In the meantime local authorities are beginning to ask themselves how "ESG" they are.

1.11 Starting with “Environmental”, many local authorities have now declared a climate emergency. Councils are taking steps to reduce their own carbon emissions within their area and in doing so are helping to achieve the UK’s target of becoming net-zero on all greenhouse gases by 2050. Local authorities have a huge role to play in alleviating the climate crisis by encouraging greener working practices and implementing more energy-efficient measures such as solar panels or low-carbon heating through their own housing stock and through the wider planning process. The proactive approach being adopted by local authorities has led investors to begin to explore how councils can help meet the ESG investment objectives.

1.12 Next to “Social”. Local authorities excel at this, providing services with significant social value to its residents. Local authorities also provide and maintain many a range of recreational services such as parks, playgrounds and leisure centres to benefit their communities further.

1.13 Last but not least, “Governance” factors are hugely influential in an organisation’s decision-making process and procedures. Local authorities look to uphold the highest standards of conduct, behaviour and prudent use of the public purse, therefore strong governance is essential. Council decisions must be lawful and based on objective and reliable advice if needed so this factor is critical when making investment decisions.

1.14 CIPFA has recently consulted on integrating ESG into the Treasury Management Code, raising its profile and highlighting its importance in today’s world. Respondents to the consultation were not in agreement with the enforcement of a new treasury management practice in the Code at this time as there are still so many unknowns so the revised code will make reference to ESG issues instead. Whilst local authorities are not yet legislated to apply ESG’s to investment decisions it is clearly something that all councils need to be considering.

1.15 Interestingly, there has been a shift in local authority investing over recent years from traditional investments such as bank and building society deposits to lending to LA peers and registered providers of housing. This shift satisfies the requirement of security, liquidity and yield, as well as upholding an ESG overlay so is a positive move.

1.16 One topic that is gaining momentum in the investment world it is that of ESG risks. These are increasingly being analysed alongside traditional financial risks as investors become ever more aware of their impact on outcomes for all businesses, as well as society and the planet, and therefore returns. ESG is fundamental to carrying out not just investment but moving to *responsible investment*.

1.17 Local authorities tend to invest in pooled funds rather than directly, essentially outsourcing to fund managers and so when working towards responsible investing it becomes appropriate to ‘engage with the engagers’ and consider each fund managers’ approach to active investment, company engagement and ESG issues.

1.18 Responsible investing and assessment of ESG factors is still in its infancy and there are no standardised approaches. Ultimately it is down to each local authority to decide upon its own approach to responsible investment. There have recently been a number of reports highlighting some ESG investments which are not as green and credible as they appeared and very volatile so a robust due diligence framework is essential.

1.19 So where are we currently with ESG and responsible investing? Wherever possible we invest with money market funds that are demonstrating that they are integrating, or are working towards integrating, sustainable investments in their portfolios. We are also investing with more registered providers and local authorities. However, the volatility and credibility of "ESG" investments and the lack of regulation or a standardised approach currently means we still have to prioritise governance and the security of the investment to protect public funds. Our treasury advisors, Arlingclose, have an *'ESG and Responsible Investment in Local Authority Treasury Management'* service which provides an in-depth report designed to assist local authorities incorporate and monitor ESG factors into their treasury investment decisions. In addition, the service includes a series of presentations with fund managers which will look at their engagement and other relevant ESG issues in more detail.

2 Reasons for Recommendation

2.1 Whilst still in their infancy, responsible investing and ESG factors are becoming an increasingly important part of treasury management and investment decision making. .

4 Alternative Options and Reasons for Rejection

4.1 There are no alternative options for consideration.

DOCUMENT INFORMATION

Appendix No	**Title**
Background Papers (These are unpublished works which have been relied on to a material extent when preparing the report. They must be listed in the section below. If the report is going to Cabinet (NEDDC) or Executive (BDC) you must provide copies of the background papers)	
Report Author	**Contact Number**
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