

**North East Derbyshire**

**Audit and Corporate Governance Scrutiny Committee**

**28 April 2021**

**Ethical Fund Management**

**Report of the Head of Finance and Resources**

**Classification:** This report is public

**Report By:** Jayne Dethick

**Contact Officer:** Jayne Dethick

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**PURPOSE / SUMMARY**

To update Members of the Audit and Corporate Governance on ethical fund management.

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**RECOMMENDATIONS**

1. That the Audit and Corporate Governance Scrutiny Committee note the report on ethical fund management.
2. That the Audit and Corporate Governance Scrutiny Committee consider undertaking a further review following the outcome of the results from the Bank of England's biennial review later this year

Approved by the Portfolio Holder – N/A

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**IMPLICATIONS**

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**Finance and Risk:** Yes  No

**Details:**

The security and liquidity of investments (governance) remains the main factor of the three ESG factors when the Council is assessing credit strength and its worthiness of inclusion of a product within its portfolio.

On Behalf of the Section 151 Officer

**Legal (including Data Protection):**

Yes

No

**Details:**

[Click here to enter text.](#)

On Behalf of the Solicitor to the Council

**Staffing:** Yes

No

**Details:**

[Click here to enter text.](#)

On behalf of the Head of Paid Service

## DECISION INFORMATION

Decision Information	
<b>Is the decision a Key Decision?</b> 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:  <b>BDC:</b> Revenue - £75,000 <input type="checkbox"/> Capital - £150,000 <input type="checkbox"/> <b>NEDDC:</b> Revenue - £100,000 <input type="checkbox"/> Capital - £250,000 <input type="checkbox"/> <input checked="" type="checkbox"/> <i>Please indicate which threshold applies</i>	No
<b>Is the decision subject to Call-In?</b> (Only Key Decisions are subject to Call-In)	No
<b>District Wards Significantly Affected</b>	None
<b>Consultation:</b> Leader / Deputy Leader <input type="checkbox"/> Cabinet / Executive <input type="checkbox"/> SAMT <input type="checkbox"/> Relevant Service Manager <input type="checkbox"/> Members <input checked="" type="checkbox"/> Public <input type="checkbox"/> Other <input type="checkbox"/>	No  Details: <a href="#">Click here to enter text.</a>

**Links to Council Ambition (BDC)/Council Plan (NED) priorities or Policy Framework including Climate Change, Equalities, and Economics and Health implications.**

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1. [Click here to enter text.](#)

## REPORT DETAILS

### 1 **Background** *(reasons for bringing the report)*

- 1.1 The purpose of this report is to update Members of the Audit and Corporate Governance on ethical fund management

### 2. **Details of Proposal or Information**

- 2.1 At its meeting on 20 January, the Committee received a presentation from the Council's Treasury Management Advisors, Arlingclose Ltd. Following this, the Committee requested that a report on ethical fund management be brought to a future meeting.

- 2.2 Environmental, Social and Governance (ESG) factors are playing an increasing part in the decision making processes of treasury managers when deciding how and where to invest. Government policy and developments in banking regulation and supervision are also increasing ESG risk disclosure and transparency. However, given the lack of visibility of most banks' lending and investment activity, it can be challenging to assess ESG issues without specialist tools and data sources, most of which are unlikely to be cost-effective for cash investors.

- 2.3 Financial institutions are principally exposed to ESG risks directly and indirectly through their loans and investments. In its December 2019 discussion paper the Bank of England estimated that:

- In the UK, loan exposures to fossil fuel producers, energy utilities and emission-intensive sectors amount to around 70% of the largest UK banks' equity.
- Around 10% of the value of mortgage exposures in England is on properties in flood-risk zones and some UK banks have large direct exposures to regions particularly vulnerable to climate change, such as South-East Asia.
- For UK insurers, around 12% of equity and 8% of corporate bond portfolio exposures are in 'high carbon' technologies.

- 2.4 The Bank of England has outlined its intention to stress test the UK financial system's resilience to the physical and transition risks of climate change. It will be the first regulator to do so. As expertise in modelling these risks is in its infancy, the Bank intends to use their biennial review in 2021 as a learning exercise. The

Bank will also use this review to provide a comprehensive assessment of the UK financial system's exposure to climate-related risks and the scale of adjustment that will need to be undertaken in coming decades for the system to remain resilient. It will examine how major financial firms expect to adjust their business models and its collective impact on the wider economy. The Bank will disclose high level results of the financial sector's resilience, including highlighting the main sources of loss by sector and geography, later this year.

2.5 With regards to the Council's current portfolio, the list of recommended counterparties for cash investments provided by our advisors assesses financial creditworthiness but this process does not currently include a specific assessment of ESG factors beyond governance issues at this time.

2.6 However, the credit ratings used to assess creditworthiness do include such an assessment. Fitch and Moody's assess ESG factors and capture ESG risks in all their rating decisions. Fitch also assigns ESG relevance scores although these are not made public. Neither make judgements on how good or bad an entity's ESG practices are; they focus on how the different elements of ESG will impact the credit ratings it assigns to the entity.

2.7 In line with its current strategy, the Council has an investment with a registered provider who takes the environmental aspects of ESG very seriously as well as having a clear equality, diversity and inclusion policy. However, the majority of the Council's investments are still held in Money Market Funds (MMF's). Given that bank securities make up the largest proportion of a non-government MMF, governance remains the dominant of the three ESG factors when assessing the issuer's credit strength and its worthiness of inclusion in an MMF portfolio.

2.8 None of the MMFs currently utilised by the Council are managed with specific ESG-related criteria as part of the investment process as there is currently limited availability of MMF's which meet the overriding need for governance (the security and liquidity of the investment). At the current time, there are only 34 MMFs which explicitly tie ESG into the fund's investment objectives, strategies and processes. Of these, over 80% are domiciled in France. However, with investors increasingly interested in taking account of ESG issues, some money market fund products have been launched in recent years aiming to apply exclusionary criteria based on ESG factors.

2.9 For example, in 2019 BlackRock launched an environmental focused product the BlackRock Liquid Environmentally Aware Fund. The fund's ESG criteria seek to limit exposure to fossil fuels, thermal coal, nuclear energy, controversial weapons, civilian firearms, tar/oil sands and tobacco. The criteria mainly place exclusions on investing in issuers who derive 15% or more of their revenues from the areas described above, as well as issuers not having below-average environmental practices.

2.10 Goldman Sachs also added similar non-financial exclusion criteria to its existing European MMF and it is likely that other MMFs will follow suit over time as investor demand for these types of product grow.

2.11

### **3 Reasons for Recommendation**

3.1 This report provides an initial overview on the Council's position and the wider global position on ethical fund management. A lot of this work is still in its infancy but there is clearly a growing interest in financial products that better meet all ESG factors

### **4 Alternative Options and Reasons for Rejection**

4.1

## **DOCUMENT INFORMATION**

<b>Appendix No</b>	<b>Title</b>
<b>Background Papers</b> (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)	