

SUPREME COURT DECISION REGARDING INVESTMENT GUIDANCE

Introduction

1. This report updates Committee on the Supreme Court decision regarding the case brought by the Palestinian Solidarity Campaign against the MHCLG guidance on preparing and maintaining an investment strategy statement.

Recommendation

2. The Committee is asked to note the contents of the report and the proposed approach to the review of Fund communications with respect to investment activity.

Background

3. LGPS Regulations were amended in 2016 to require Administering Authorities to “formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State”.

4. In September 2016, MHCLG issued guidance on preparing and maintaining an Investment Strategy Statement. In relation to policies on social, environmental or corporate governance considerations the guidance stated that Administering Authorities must not:

"[use] pension policies to pursue boycotts, divestment and sanction against foreign nations and UK defence industries...other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government." or

"Pursue policies that are contrary to UK foreign policy or UK defence policy".

5. The Palestinian Solidarity Campaign and Another (PSC) launched judicial review proceedings against the inclusion of these provisions in the guidance. In June 2017, the High Court upheld the PSC challenge. MHCLG removed those provisions from the guidance, pending outcome of further appeals.
6. MHCLG successfully appealed the High Court decision in the Court of Appeal, followed by PSC appealing the case to the Supreme Court.
7. On 29 April 2020, the Supreme Court, by a margin of 3 to 2, upheld the PSC appeal, reinstating the High Court's original decision that it was unlawful for the Secretary of State to use statutory guidance as set out in the original guidance.
8. A key element of the Supreme Court ruling appears to have been consideration of whether the Secretary of State was using statutory guidance for purposes that were not within the remit of the original act. In the view of the Court, it was not the intention of Parliament that these powers should be used to determine the specific assets which LGPS funds may or may not hold. Rather the guidance was just that; a guide to the principles that LGPS funds should consider when setting their own investment strategy and any direction contained within it should be relevant only to that principle.



9. As MHCLG had amended the guidance to remove the challenged content following the original High Court Decision in 2016, the regulatory position is unchanged. Administering Authorities continue to have the power to set their own policy on how social, environmental, or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.
10. The judgment does provide some clarity that an LGPS fund may make a conscious decision not to invest in specific sectors or a specific foreign country. Such decisions must always be subject to the general legal principles that such decisions must not involve significant risk of financial detriment to the scheme and the fund should have good reason to think that scheme members would support their decision. In practical terms, these two existing principles create a significant threshold for any LGPS fund wishing to implement a sector wide or country boycott.
11. The ruling might affect how MHCLG use statutory guidance in future. MHCLG held back updated investment pooling guidance pending the Supreme Court ruling. The ruling is not expected to change the underlying principles of, or requirements to, pool investments. Further reports will be provided when this updated guidance is available.

Cheshire Pension Fund position

12. Committee approved the Fund's updated Investment Strategy Statement and Responsible Investment (RI) Policy in March 2020.
13. The Fund continues to build on an approach founded on the principle that engagement has greater capacity to bring about Environmental, Social and Governance improvements than disinvestment. The RI policy does reserve the Fund's right to disinvest.
14. The Fund receives regular approaches from a small number of individual scheme members and from some lobby groups on matters relating to Responsible Investment. These approaches predominantly lobby for disinvestment either from individual companies or from sectors in which the Fund holds equity shares.
15. As at 31 March 2020 the Fund held equities valued at £1.4bn (some 25% of total assets) as summarised below:

Table 1: Equity Holdings 31 March 2020

Fund	Active/Passive	Shares or Units held	AuM £m
Baillie Gifford LTGG	Active	Shares	309
Baillie Gifford Global Alpha	Active	Shares	284
LGPS Central Climate Factor Fund	Passive	Units	453
LGPS Central Global Active Equity	Active	Units	226
LGIM Equity Fund	Passive	Units	134
			1,406



16. Where the Fund invests in passively managed funds that track general market indices, the Fund will be indirectly invested in all the companies which make up that index. This will include companies targeted by lobby groups or individual scheme members.
17. The Fund has already taken steps to move to more tailored passive equity indices, such as that used by the LGPS Climate Factor fund. This reduces, but does not eliminate, the risk that the Fund will hold equities targeted by lobby groups or individual scheme members.
18. The Fund has £134m of assets that remain invested in a general market passive equity-tracking fund. This fund has a bias towards 'value' and therefore holds a higher proportion of investments with energy and fossil fuel companies. Officers are exploring possible alternatives to this fund.
19. For actively managed equities, the managers have discretion to select the equities they wish to hold, consistent with their performance mandate and the Fund's RI Policy (Central Funds) or industry best practice (Baillie Gifford funds).

Palestinian Solidarity Campaign activity

20. Officers are aware that the PSC is contacting LGPS funds since the Supreme Court ruling. At the time of writing this report, the Fund has not directly received an approach from the PSC. We have been sent copies of the PSC approach, the text of which is extracted below

Extract of message sent to other LGPS Funds by PSC:

"We are concerned with companies that are involved in the following activities:

- 1) *Supplying the Israeli military with weapons and other technology used to oppress Palestinians.*
- 2) *Providing technology and equipment used to maintain Israel's infrastructure of military occupation, such as its checkpoints and the apartheid wall.*
- 3) *Investment and other activity in Israel's illegal settlements in the West Bank and East Jerusalem, based on stolen Palestinian land.*

We believe LGPS must have adequate procedures within their investment strategy to ensure companies involved in these activities are subject to robust, time-limited engagement policies, and, if these fail, be subject to divestment. Companies involved in these activities can be found on the attached sheet, which includes a short description of the company's practises. Please ask for more information if it is needed.

Some of the companies attached are included in the United Nations Human Rights Council report on companies involved in Israel's illegal settlements (A/HRC/43/71). While this report isn't comprehensive, and provides information on companies found to be active within a limited time-period, it also provides an indication of companies involved in such activities"

21. The PSC letter encloses a list of 53 companies stated to be involved in the activities listed. A copy of the full list of names sent by the PSC is in the Annex to this report.



The Fund has holdings in a number of these companies via its passively managed funds (highlighted amber in the Annex) and via its active equity funds (highlighted blue in the Annex).

Ongoing Responsible Investment Communications

22. The Administering Authority's primary duty is to manage the Fund's assets to meet its pension promises at the same time as maintaining stable and affordable employer contribution rates. The updated Investment Strategy Statement has increased the emphasis on ethical, social and governance objectives and sets out a clear approach to how these will be managed.
23. There is a growing community of interest in the Fund's approach to RI and a great deal of information is available on RI activity and on delivery of the Investment Strategy outcomes. Not much of this information is shared in a structured way with scheme members and participating employers.
24. Over the coming months it is proposed that officers review the Fund's communication approach with regard to RI with the aim of sharing information, where permitted under contract provisions with third parties, more proactively on Fund's website. The review will include:
 - Development of proactive topical briefing to support Committee members or the wider community of Councillors and employers respond to approaches on Fund investments.
 - At present, the Fund's investment holdings are produced as a snapshot each quarter. Officers will review whether this information could be extended with further narrative and to highlight changes in assets held over time.
 - Progress in delivering outcomes in the Climate Stewardship plan (once approved).
 - Exploring options with investment managers for them to provide summaries of voting activity taken on the Fund's behalf which could be shared more publicly.
 - Options to expand existing employer briefings to include updates on investment activity.
25. Reviewing communication provision in relation to RI may also highlight the need to strengthen communication resources more generally, particularly to address any outcomes of the Good Governance review.



Annex

Companies listed in Palestinian Solidarity Campaign approach to LGPS Funds

Company	Company
ABB Ltd	Qinetiq
Airbus	Rafael
Airtanker	Raytheon
Albemarle Corp	Richemont
Applied Materials	Rockwell Collins
AXA	Rolls Royce
Babcock International	Sabra
BAE Systems	Safran
Barclays	Serco
Boeing	Siemens
Caterpillar	Smiths Group
Check Point Software Tech	Sony
Cisco Systems	Thales
Cobham	Ultra Electronics
Elbit	United Technologies
Exxon Mobil Corp	Valero Energy
G4S	Volvo
General Dynamics	Bank Hapoalim BM
GKN	Bank Leumi Le-Israel
Harris	
Hewlett Packard (HP)	
High Precision Systems	
Honeywell	
HSBC	
Huntington Ingalls	
L3 Technologies	
Leonardo-Finmeccanica	
Lockheed Martin	
Meggitt	
Mitsubishi	
Morgan Advanced Materials	
Motorola	
Northrup Grumman	
Puma	
Key To Shading Above	
Held By Active Equity Managers	
Held In Passive Equity Funds	

