BABERGH and MID SUFFOLK DISTRICT COUNCILS

COMMITTEE:	**Joint Audit and Standards Committee**	**REPORT NUMBER: JAC/20/21**
FROM:	**Katherine Steel, Assistant Director, Corporate Resources**	**DATE OF MEETING: 17 May 2021**
OFFICER:	**Melissa Evans, Corporate Manager, Finance, Commissioning & Procurement.** **Rebecca Hewitt, Assistant Manager – Financial Accountant**	**KEY DECISION REF NO. N/A**

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CONSIDERATIONS FOR THE COUNCILS' JOINT TREASURY MANAGEMENT STRATEGY

1. PURPOSE OF REPORT

1.1 At its meeting on 25th January 2021, the Joint Standards and Audit Committee requested that a report on ESG Investments be brought to this meeting with a view to proposing recommendations to Council.

1.2 This report presents the key considerations for developing an ESG policy for the Councils in order to facilitate discussion on the preferred policy for the Councils.

1.3 The Councils declared a climate emergency in 2019 and committed to investigate ways to achieve their ambition of making the organisation carbon neutral by 2030. Suffolk Public Sector Leaders have also committed to work together towards the aspiration of making the county of Suffolk carbon neutral by 2030.

1.4 In light of climate change-related risks in particular, increasing attention is being given to responsible investment by investors globally, resulting in an increasing appreciation that assessing ESG factors is not only a moral issue to be addressed, but also a key part of understanding long-term investment risk.

1.5 In developing an ESG policy, the approach of the Councils current investments, alternative approaches to ESG, the financial performance of the Councils investments and ESG investments currently available in the market need to be considered.

2. OPTIONS CONSIDERED

2.1 No options were considered for recommendation.

3. RECOMMENDATION

3.1 That the key considerations for developing an ESG policy for treasury management investments be noted and discussed.

REASON FOR DECISION
Not relevant for this report.

4. KEY INFORMATION

Introduction

4.1 The Councils Joint Treasury Management Strategy for 2021/22 was approved for Babergh at its Council meeting on 18th February 2021 and for Mid Suffolk at its Council meeting on 23rd February 2021, following recommendation for approval by the Joint Audit and Standards Committee on 25th January 2021.

4.2 At its meeting on 25th January 2021 the Joint Audit and Standards Committee recommended that a report on ESG investments be brought to the meeting for the Committee in May, with a view to proposing recommendations to Council.

4.3 The Councils have declared a climate emergency and committed to work together with other members of the Suffolk Climate Change Partnership with the aim to make Suffolk carbon neutral by 2030.

4.4 This report considers how an ESG policy could incorporate environmental considerations into the Councils investment decisions to reflect this commitment and sets out the key considerations in developing an ESG policy for the Councils.

4.5 The principles of Security, Liquidity and Yield, as set out in the CIPFA Treasury Management Code and MHCLG Investment Guidance, remain at the heart of local authority treasury decisions and risk management. Incorporation of an ESG policy must not lead to a greater risk of incurring losses from defaults or of receiving unsuitably low investment income.

ESG considerations

4.6 ESG is an emerging theme within local authority treasury management and any policy adopted will require further refinement as further information emerges and the market matures.

4.7 There is increasing awareness and inclusion of ESG issues within investment products for two key reasons;

- Long-term investment risk: as Government policies and customer/investor preferences change to address climate change, companies who do not or cannot adapt to meet these changes could become unsustainable.

- Ethical considerations: investors are increasingly interested in the impact that their investments are having on the world, rather than only being concerned with the financial returns.

4.8 The United Nations has sought to bring some commonality to the consideration of ESG with its Principles for Responsible Investment (PRI). Its approach is outlined in six guiding principles for investors in their role as owners of assets:

(i) incorporation of ESG issues

(ii) active ownership

(iii) seeking appropriate disclosure on ESG issues from investee entities through the Global Reporting Initiative

(iv) wider promotion of the principles in the investment industry

(v) working together to enhance effectiveness and

(vi) investor reporting on activities and progress made.

4.9 Incorporation of ESG issues can be via one or a combination of three approaches:

(i) **Integration:** explicitly building the impact of ESG factors into investment analysis, assessing how these factors impact the valuation of security and a company's balance sheet strength.

(ii) **Screening:** non-financial filters based on the investor's preference, values or ethics which are applied to the investable universe to determine eligible securities.

(iii) **Thematic:** identifying challenges and opportunities and allocating capital that will contribute towards particular goals and which have measurable outcomes. Impact investing is a subset of thematic investing with the purpose of achieving meaningful, additional environmental or social outcomes which, in the absence of that investment, would not have been achieved.

4.10 The UN views active ownership – often referred to as 'stewardship' - as one of the key principles of responsible investing. Its report How ESG Engagement Creates Value for Investors and Companies states:

"the shift in institutional investor practices towards 'active' forms of ownership indicates that institutional investors recognise that their fiduciary duty to clients and beneficiaries should involve purposeful consideration, monitoring and intervention regarding ESG factors affecting investee companies".

4.11 A major focus for an ESG policy that seeks to address climate change in particular is fossil fuels. There are two main approaches to addressing investments relating to fossil fuels – to engage and to exclude.

4.12 There are two methods to implementing exclusion:

- Industry classification: defining exclusions based on the company's sector classification.

- Proportionate exposure: By focusing on companies' actual exposure to specific activities by share of revenues, investors can take a more nuanced approach to companies whose revenues span a range of sectors.

4.13 For fossil fuel screens it needs to be considered whether exclusions apply only to extractors and producers or whether it extends further in the value chain to equipment and service providers, refiners, transporters and end of chain sellers such as supermarkets. Alternatively, a revenue threshold can be applied. Fund managers often use the 'no more than x% share of revenue' approach for screening, typically deeming a 5%-10% of revenues threshold as being appropriate.

4.14 Divesting fossil fuel investments may not be the most effective solution to combat climate change. By remaining shareholders investors can preserve their seat at the table and through dialogue and collaborative pressure influence change and demand tangible commitments and timelines from the energy and extractive industries in their transition to low carbon models.

4.15 There is a strong view that investors should shift their focus more to supporting companies that are helping the transition to net zero and using their ownership clout to force change at transgressors, rather than just screening out the climate problem from their portfolios.

4.16 Some of the large companies that would be excluded as part of an exclusion approach are taking significant steps to transition to cleaner energy. For example, BP is one of the leaders in the global energy transition and committed to reducing carbon emissions in line with the Paris Climate Agreement. It has a greater share of natural gas in its portfolio and is also investing in renewables similar to its peers. In February this year BP's new chief executive announced five aims to get BP to net zero by 2050 or sooner which include a commitment to net zero on carbon in BP's oil and gas production on an absolute basis, cutting the carbon intensity of products BP sells, increasing the proportion of investment into non-oil and gas businesses and focus on low carbon solutions.

4.17 In determining whether to engage or exclude, consideration must be given to the reasons for implementing the ESG policy. If the values of the Council and stakeholder pressure are the key driver an exclusion policy could be appropriate. If the aim is to encourage change, a policy of engagement may be more suitable.

4.18 Although regulations on ESG investments are gaining more clarity and standardisation, careful due diligence is required to ensure that a fund lives up to the claims being made and its ESG principles match the Councils priorities for environmental / ethical investing.

4.19 Fund management companies can sign up to the UN Principles of Responsible Investment (PRI) and can opt to file comprehensive reports annually through the PRI framework to be assessed and scored against the six guiding principles as set out in 4.7 above. These UN PRI assessment scores are widely considered to provide the most objective measure for assessing managers' approach to ESG.

Approach of existing funds

4.20 The Councils use Money Market Funds and the Government's Debt Management Office deposit account for short-term investment purposes and to manage daily cash flow requirements.

4.21 As bank securities make up the largest proportion of a Money Market Fund, governance is the dominant of the three ESG factors considered when deciding on an issuer's inclusion in a portfolio.

4.22 In recent years however, some Money Market Funds have been launched which apply exclusionary criteria, such as limiting exposure to fossil fuels. Given that most of a Money Market Fund's investments are with financial institutions, whose revenues from the excluded sectors are typically below the thresholds set, these exclusions are

unlikely to make a substantial difference to a Money Market Fund's investable universe.

4.23 In addition to its Money Market Funds, each Council has £11m of externally managed strategic pooled equity, property and multi assets funds where short-term security and liquidity are lesser considerations and the primary objectives instead are regular revenue income and long-term price stability.

4.24 These funds are held with different counterparties and cover a range of asset classes to reduce risk. The funds in which the Councils are invested are detailed below.

Fund	**Asset class**	**Investment Amount**
CCLA: LAMIT Property Fund	Property	£5,000,000
Ninety One (Investec): Diversified Income Fund	Multi Asset	£2,000,000
Schroders: Income Maximiser Fund	UK Equity	£2,000,000
UBS: Multi Asset Income Fund	Multi Asset	£2,000,000

4.25 Each of the above fund management companies is a signatory to the UN PRI, files comprehensive reports annually through the PRI reporting framework and are scored on their submissions, with the top score being A+. The scores for each fund and the median score for 2020 are as follows:

UN PRI Transparency Report: Assessment scores 2020	**Median score**	**CCLA**	**Ninety One**	**Schroders**	**UBS**
Strategy & Governance	**A**	**A+**	**A+**	**A+**	**A+**
<u>Direct and Active Ownership</u>					
Listed Equity – active ownership	**B**	**A+**	**A+**	**A+**	**A+**
Incorporation - screening		A+	A+	A+	A
Incorporation – integration		A+	A+	A+	A
Individual engagement		A+	A+	A+	A+
Collaborative engagement		A+	A+	A+	A+
Proxy voting		A+	A+	A+	A
Fixed Income – Sovereigns, Supranational and Agencies (SSA)	**B**	**--**	**A+**	**A**	**A**
Fixed Income – Corporate Financial	**B**	**--**	**A+**	**A**	**A**
Fixed Income – Corporate Non-Financial	**B**	**--**	**A+**	**A**	**A**
Fixed Income – Securitised	**B**	**--**	**--**	**A**	**A**
Private Equity	**A**	**--**	**A**	**A+**	**--**
Property	**B**	**A+**	**--**	**A**	**A+**
Infrastructure	**A**	**--**	**A+**	**--**	**A+**

4.26 Extracts of the Fund Managers' ESG reporting in their UN PRI Transparency Reports are included in Appendix A. The overall approach of each is summarised below.

CCLA (Property)	CCLA incorporates the consideration of ESG factors prior to the acquisition of any property, during all refurbishments and in day-to-day management. CCLA seeks to be an active owner of property assets and sets an explicit target to reduce the footprint of the largest assets within the portfolio. This has required targeted interventions and detailed dialogue with occupiers.
Ninety One (Investec)	Ninety One has not phased out fossil fuel holdings but undertakes scenario analysis and/or modelling to assess future climate-related risks and opportunities, uses emissions data or analysis to inform investment decision making, seeks climate change integration by companies and has sought climate supportive policy from governments.
Schroders	Schroders integration approach spans ownership, engagement, voting and reporting. Equity, fixed income, ESG and data teams work together to identify areas that warrant discussion with companies. Schroders has been voting on climate change resolutions since 2000 and have recorded engagements on the topic since 2002. In their 'Aiming for A' investor coalition, Schroders has co-filed climate change resolutions at Anglo American, Glencore and Exxon and has supported the climate change resolutions filed at Shell and Rio Tinto. In 2018, they had more than 100 individual climate change-related engagements with companies identified in their research as being materially exposed to climate risk.
UBS	UBS believes that Sustainable and Impact Investing ('SI') can protect and enhance the value of clients' investments by adding value to portfolios within the same risk /return profile. UBS Group manages its environmental program through an Environmental Management System (EMS), in accordance with the ISO 14001 standard. The Group manages climate change risks and opportunities via this certified EMS and monitors implementation on an ongoing basis. The EMS helps to systematically reduce environmental risks, seize climate change / environment-related market opportunities and to continuously improve UBS's climate change/environmental performance and resource efficiency.

4.27 The CCLA, in which the Councils have the largest investment at £5m each, scores A+ in all areas against the PRI framework. The Councils invest in its property fund and therefore holdings in the fossil fuel industry are not a concern. However, ESG considerations and initiatives can play an important role in real estate and infrastructure ownership and management and the CCLA seeks to ensure it minimises the carbon footprint of its property investments.

4.28 The Councils other strategic funds, in each of which both Councils have invested £2m, have also scored well against the PRI framework, with A or A+ in each area. Although, none of these are badged specifically as ESG funds, they each take steps to analyse the ESG impact of their investments and engage with companies to address climate change risks.

Performance of ESG funds

4.29 An increasing number of ESG focussed funds are emerging that follow certain criteria for investments, such as abiding with the UN Principles of Responsible Investment, or not investing in certain industries such as weapons, fossil fuels or alcohol and tobacco.

4.30 The effect of screens on income strategies is pronounced as it reduces the range of investible high yielding stocks.

4.31 Oil and gas and utility companies have traditionally paid sizeable dividends and income funds are materially affected by their exclusion. Royal Dutch Shell, BP and HSBC have historically been among the top five UK dividend payers (although 2020 will have been different, as both Shell and BP cut their dividends and HSBC, like other banking institutions, was under regulatory pressure to defer dividends). Utilities and companies involved in mining and materials also often feature in the top 20-25 dividend paying stocks.

4.32 The Councils treasury adviser Arlingclose has advised that there are equity funds with income strategies that screen out fossil fuel extractors, or whose focus is on renewable energy and/or decarbonisation, but the income generated would be considerably lower than what the Councils receive from their existing funds.

4.33 The yield (i.e. income) for these funds ranges between 0.5% to 3.3%, with most in the lower to mid end of this range. The income returns for the Councils existing funds from 18th March 2020 to 18th March 2021 are shown below.

Fund	**Investment**	**Income Yield**
CCLA	£5m	4.34%
Ninety One (Investec)	£2m	4.18%
Schroders	£2m	9.31%
UBS	£2m	5.79%
Total	**£11m**	**5.2%**

4.34 The upper end of the range of 3.3% for the fossil screening funds is 1.9% lower than the average yield of the Councils existing funds of 5.2%. For the Councils £11m investment this would equate to a reduction in income of £209k per annum for each Council.

Cost of exiting pooled funds

4.35 The Councils strategic pooled funds are held as long-term investments. Although the total overall return for each of these funds since investment has been positive, they have incurred unrealised capital losses.

4.36 Since 2018/19 the International Financial Reporting Standards for pooled funds states that changes in valuations must be taken through the Comprehensive Income and Expenditure Statement (CIES). The MHCLG has granted a statutory override until 2022/23 so these changes will have no impact on the “bottom line” until 2023/24.

4.37 However, upon sale/redemption of these funds any unrealised capital loss has to be recognised in the CIES. This would be a real cost to the Councils and impact on revenue budgets.

4.38 The revenue cost to the Councils of redeeming the existing pooled funds, based on valuations at 31st March 2021 would be as shown below:

Babergh	**Purchase Price**	**Valuation at 31st March 2021**	**Cost to revenue**
CCLA – LAMIT Property Fund	£5,000,000	£4,790,694	£209,306
Ninety One (Investec) Diversified Income Fund	£2,000,000	£1,994,824	£5,176
Schroder Income Maximiser Fund	£2,000,000	£1,540,466	£459,534
UBS Multi Asset Income Fund	£2,000,000	£1,830,842	£169,158
Total	**£11,000,000**	**£10,156,826**	**£843,174**

Mid Suffolk	**Purchase Price**	**Valuation at 31st March 2021**	**Cost to revenue**
CCLA – LAMIT Property Fund	£5,000,000	£4,716,595	£283,405
Ninety One (Investec) Diversified Income Fund	£2,000,000	£1,994,824	£5,176
Schroder Income Maximiser Fund	£2,000,000	£1,540,466	£459,534
UBS Multi Asset Income Fund	£2,000,000	£1,827,607	£172,393
Total	**£11,000,000**	**£10,079,491**	**£920,509**

ESG policy considerations

4.39 In developing an ESG policy for the Councils investments, the following needs to be considered:

(i) The Councils key objective in holding strategic pooled funds – to generate a source of revenue income for the Councils.

(ii) The principles of Security, Liquidity and Yield.

(iii) The difference in yield for ESG funds and what an acceptable cost would be to move to these funds.

(iv) The costs of redemption of the Councils existing funds.

(v) Whether to exclude fossil fuels or focus on engagement with companies in the fossil fuel industry.

(vi) How the Councils existing investments score against the PRI framework and which, if any, of the existing funds should be retained.

(vii) Timescales for implementation and options for transition to a new policy.

5. LINKS TO THE JOINT CORPORATE PLAN

5.1 This report links to the ambition to be carbon neutral by 2030 in the Joint Corporate Plan. Adoption of an ESG policy would not directly reduce emissions in our districts, but would assist in changing conditions more widely. The fund managers for the

Councils strategic pooled funds are performing well with regards to the integration of ESG factors into their investment decisions and company engagement.

5.2 The income generated by the Councils pooled fund investments contributes to the resources available to the Councils to meet the ambitions of the Joint Corporate Plan.

6. FINANCIAL IMPLICATIONS

6.1 The Councils each generate approximately £500k per annum net of fees from its strategic pooled fund investments. This would reduce if the Councils invested in fossil fuel screening funds with the cost estimated to be in the region of £200k per annum, based on estimated returns as set out in paragraph 4.33.

6.2 If the existing pooled funds were redeemed to invest in alternative ESG investments, the Councils would incur a cost of approximately £840k to £920k as set out in paragraph 4.38.

7. LEGAL IMPLICATIONS

7.1 There are no legal implications arising from this report.

8. RISK MANAGEMENT

8.1 This report is most closely linked to significant risk No. 13 – We may be unable to respond in a timely and effective way to financial demands and also Corporate Risk No. 5E05 – if the Finance Strategy is not in place with a balanced position over the medium term the Councils will not be able to deliver the core objectives and service delivery may be at risk of not being delivered. Key risks are set out in the following table:

Risk Description	Likelihood	Impact	Mitigation Measures
If a strict ESG policy for treasury management investments is adopted the Councils could lose a significant amount of revenue income.	2-Unlikely	2-Noticeable	A policy that incorporates ESG into investment decision making, but also has parameters for the financial impacts of those decisions.

9. CONSULTATIONS

9.1 None.

10. EQUALITY ANALYSIS

10.1 An equality analysis has not been completed because the report content does not have any impact on the protected characteristics.

11. ENVIRONMENTAL IMPLICATIONS

11.1 All Council activities are being reviewed as part of the work recommended by the Climate Change Task Group and the subsequently agreed Action Plan to support the Councils ambition to be carbon neutral by 2030.

11.2 A key focus of this report is the consideration of the environmental impact of the Councils treasury management investments.

12. APPENDICES

Title	Location
A - Summary of current fund managers' approach to ESG in relation to fossil fuels / carbon reduction	Attached

Appendix A

SUMMARY OF CURRENT FUND MANAGERS' APPROACH TO ESG IN RELATION TO FOSSIL FUELS / CARBON REDUCTION

CCLA

General approach

Responsible investment and stewardship are at the core of the investment approach, its philosophy is based upon three principles:

(i) Over the long term, conventional financial modelling only gives part of the answer as to what makes a company a good investment. Companies in the most carbon intensive sectors or with either the poorest standards of corporate governance/other unmitigated ESG risks are likely to under-perform over the medium to long-term; strict processes identify and then restrict these companies from the investment universe. There is also an ongoing process of monitoring and engagement to improve investee companies' ESG risk management.

(ii) Investments will only be able to deliver sustainable, long-term, returns if they are in a healthy environment and stable society, therefore seeking to allocate capital for a positive environmental or societal benefit.

(iii) To invest in a manner that reflects clients' values.

Policy on controversial weapons: CCLA has an exclusion policy for companies involved in the production of weapons banned by international treaties (specifically landmines and cluster munition). CCLA believes that these products are unacceptable and place clients' reputations at risk.

CCLA's norms-based screening is guided by the UN Global Compact Principles.

Participation in Investor Initiatives

CCLA advocates stable progressive legislation that will accelerate the transition to a low carbon economy which includes their joint action with the UK and Canadian governments to create the Powering Past Coal Alliance which seeks to increase the pace of countries' attempts to phase out coal-fired electricity generation from their energy mix.

Recognising its duty to be at the forefront of institutional investors acting on climate change, CCLA was involved in the creation of the 'Aiming for A' investor initiative, the pre-cursor to the Climate Action 100+ initiative, to which CCLA is also a signatory, bringing together institutional investors to engage with UK-listed oil, gas and mining companies on the low carbon transition.

CCLA provides funding to and is on the Steering Group of the Transition Pathway Initiative, an initiative which provides a useful, and readily available tool for investors and asset owners to test the alignment of companies' against the transition to a low carbon economy.

Property

CCLA's Responsible Property Investment Policy applies to the selection, management and refurbishment of all property assets under their stewardship. Considerations prior to any purchase include:

- Environmental risk issues that may manifest as liabilities, for example contaminated land, flood risk, presence of hazardous substances etc
- Environmental audit scores and risk assessments, including energy use, water consumption, greenhouse gas emissions and waste management

- Social factors, such as the availability of public transport and the facilities available for tenants
- The ability to drive improvements through refurbishment.

Following purchase, CCLA seeks to be an active owner and see if they can refurbish to improve environmental and social performance. Among the managing agents' tasks are monitoring and setting targets for the reduction of energy use, water consumption, waste and CO2 emissions and procuring energy from renewable sources.

Integrating ESG into property

CCLA incorporates the consideration of ESG factors prior to the acquisition of any property, during all refurbishments and in day-to-day management.

Recognising the need for specialist knowledge, CCLA has employed BNP Paribas Real Estate Services to provide additional due diligence and property management. This ensures that CCLA receives comprehensive information on properties' ESG standards, allowing them to properly assess the assets' value, and benefit from their network of service providers. This relationship is monitored through the Property Investment Committee and Quarterly Responsible Investment in Property meeting.

CCLA notes that a combination of legislation, regulation and tenant preferences are likely to penalise the worst ESG rated properties and for this reason have developed bespoke ESG criteria to be considered prior to property acquisition. This includes details such as, but not limited to

- flood risk,
- contaminated land risk (which can affect the value of the property asset and the health and safety of those working and living in and around the facility);
- energy efficiency (CCLA supports the government's Minimum Energy Efficiency Standards for property asset and also recognises that restrictions upon leasing the worst rated assets place the value of properties with poor EPC ratings at risk);
- building safety and materials: this is a core part of the due diligence process and has led to CCLA walking away from prospective investments in previous years
- health safety and wellbeing (properties are assessed on a wellbeing metric prior to acquisition);
- public transport (when reviewing office assets CCLA reviews the ability for tenants' employees to travel via public transport or other environmentally conscious modes of transport).

Other considerations include sustainable construction materials, water efficiency requirements, waste management plans at sites.

CCLA also screens prospective tenants against their anti-corruption and bribery criteria.

CCLA believes that ESG criteria are likely to affect the long-term value of property assets. They will reject investment opportunities where they believe that poor ESG standards place value at risk. They place specific covenants within lease agreements and alter the price of their investments. They sometimes identify ESG risks that they do not believe pose a threat to invested value. These are logged and prioritised for remediation through refurbishment (where possible).

CCLA seeks to be an active owner of property assets. The approach ranges from taking general steps to improve the performance of buildings to concentrating on specific assets where key issues have been identified.

Sustainability information is included in occupier handbooks that are distributed at multi-let properties and sustainability is a standing agenda item for all occupier meetings which they hope will gradually improve the day-to-day performance of their buildings.

CCLA sets an explicit target to reduce the footprint of the largest assets within the portfolio. This has required targeted interventions and detailed dialogue with occupiers.

CCLA once again wrote to all 78 Local Authorities within which it owned buildings expressing desire to work collaboratively to improve the ESG performance of buildings and to reduce CCLA's negative footprint in the local community.

Ninety One (previously Investec)

General approach

Ninety One has adopted an integrated approach to economic and social challenges and operates within a financial system that is orientated towards long-term outcomes.

The broad thrust is to invest responsibly for a more sustainable future, focus engagement to shape sustainable development, taking direct responsibility for Ninety One's environmental and social impact ("work starts at home") with the aim of preserving and growing the real purchasing power of the assets entrusted to the firm by clients over the long term.

Ninety One supports a long-term investment perspective by integrating, engaging, escalating and monitoring material ESG issues, address internal governance of effective stewardship, and exercise its ownership rights responsibly including engagement and voting rights, act alongside other investors and disclose through publicly available policies and reporting how it discharges its stewardship duties.

Policy on controversial weapons: Ninety One has an exclusion policy for manufacturers of cluster munitions, anti-personnel mines, chemical and biological weapons.

Ninety One's norms-based screening is guided by the UN Global Compact Principles (a voluntary initiative based on CEO commitments to implement universal sustainability principles and to undertake partnerships in support of UN goals).

Active Ownership (Stewardship)

Active ownership is not outsourced to service providers.

Climate change is a focus area within their engagement activities. Escalation strategies for engagement include filing/submitting a shareholder resolution, collaborating with other investors and voting against the board of directors or the annual financial report.

Engagement during the 2019-20 reporting period on E, S or G issues include**:** Acacia Mining, Anglogold Ashanti Ltd, BHP Billiton PLC, China National Petroleum Corp, First Solar Inc, Osisko Mining Corp, Taiwan Semiconductor Manufacturing, Tullow Oil, Valero Energy Corp.

For the upcoming year, Ninety One will lead engagement with 40 companies and act as co-signatories for a further 80 companies.

Objectives also focus on improving disclosure so that Ninety One can better understand the inherent risks and opportunities. Ninety One requires investee companies, which are part of industries that generate high emissions, to participate in the Carbon Disclosure Project (CDP), alongside encouraging them to make use of the Task Force on Climate-Related Financial Disclosures (TCFD) framework. This helps Ninety One to better understand how their strategy, governance, risk management and measurement systems are positioned to respond to the risks and opportunities of climate change.

As investor members of Carbon Disclosure Project since 2010, they share the goal to make environmental reporting and risk management a business norm, and to drive disclosure, insight and action towards a sustainable economy.

Participation in Investor Initiatives

Ninety One is also a supporter of a number of climate related advocacy groups including the Climate Action 100+ and the Institutional Investors Group on Climate Change (IIGCC). Ninety One state they have led on a number of Climate Action 100+ engagements.

They have joined the Transition Pathway Initiative, signed the Just Transition Statement and are a founding supporter of the Impact Investing Institute in the UK.

Integrating ESG into fixed income

Sovereigns: there is an evaluation of several factors:

- Environmental (policy on climate action, resource strategy, land and water management),
- Social policy (build environment, human capital, inclusive growth),
- Governance (institutional capacity, economic policy)

which feed into an ESG impact score which is complemented by a political risk score that captures near-term governance shifts which can potentially impact longer-term ESG trends.

Corporates: Fundamental analysis of corporate debt is undertaken in which the credit which will be scored, resulting in a note that will consist of a credit profile, key drivers, strengths and weaknesses (and here ESG factors are highlighted), any covenant issues, as well as a peer comparison and construction of a financial model:

- Environment: structural shifts in supply and demand; impact on cost/competition and changes in regulation/taxes in response to climate change, impact on the natural environment or pollution and waste;
- Social: business disruption and increased costs with regard to human capital/stakeholder opposition or product liability;
- Governance: the risk of poor oversight/management and corruption.

The ESG risk factors affecting the credit, the potential credit impact and time sensitivity of the impact are discussed in a corporate debt roundtable comprised of the credit team where the credit is deemed investable or not.

If an ESG factor is financially material this is included in the outlook on the company's financial profile such as leverage/growth/margins, but cognisant that cyclicality can often mitigate or exacerbate such ESG drivers.

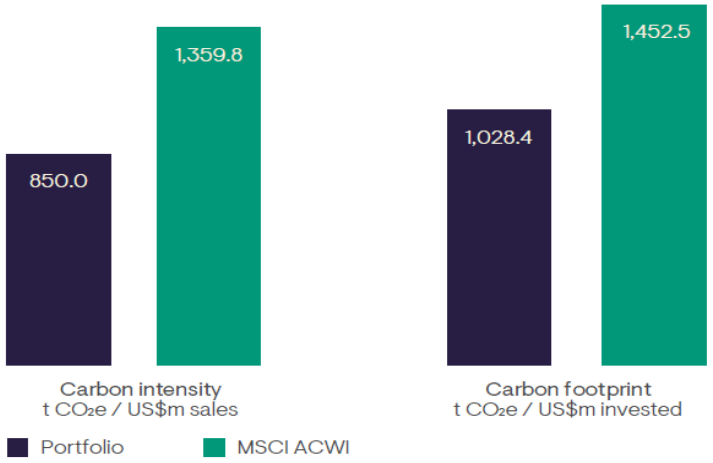
Ninety One Diversified Income Fund

Specifically, for the Ninety One Diversified Income Fund in which the Council is invested, the company has provided a Portfolio Carbon Profile Analysis:

Methodology: The analysis below is based on all assessable corporate securities (both equity and credit) held directly within the portfolio. This relates to c.64% of the portfolio as at 31 October 2020 but for the purposes of this analysis has been reweighted to 100%. The remaining 36% of the portfolio is invested in assets covering certain, predominantly sovereign, fixed income securities, cash and derivatives (including active currency positions and equity index hedging positions). The Morgan Stanley Capital International (MSCI) All Country (AC) World index has been used for comparison purposes only.

The estimated carbon footprint for the Income portfolio as at 31 October 2020 is 1,028 t CO_2e/US$m. This is c.70% of the estimated carbon footprint of the MSCI ACWI, which is 1,453 t CO_2e/US$m.

Figure 3: Scope 1, 2 and 3 carbon profile of Income portfolio and MSCI ACWI



Source: Ninety One Climate Risk Tool, as at 31 October 2020.

Source: Ninety One Diversified Income ESG Report, January 2021

Carbon intensity: measures carbon emissions of a given entity per US$ million of products or services sold (revenue). At the portfolio or index level the figures take the weighted average carbon intensity of each accessible security in the portfolio/index to determine an overall carbon intensity.

Carbon footprint: derived by taking the sum of the 'financed emissions' based on the percentage held of each assessable security's enterprise value. This is normalised by dividing by the total amount of dollars invested in the securities to give a comparable footprint.

The contributions of Scope 1, 2 and 3 emissions are 10%, 3% and 87% respectively.

- Scope 1 emissions are direct emissions from sources that are owned or controlled by the institution,
- Scope 2 emissions are indirect emissions generated in the production of electricity consumed by the institution and includes energy purchased from a utility provider.
- Scope 3 emissions are all the other indirect emissions that are "a consequence of the activities of the entity which occur from sources not owned or controlled by the institution, such as commuting; waste disposal, production, and transportation of purchased goods; outsourced activities; contractor-owned vehicles. It includes emissions from vendors and suppliers in the entity's supply chain.

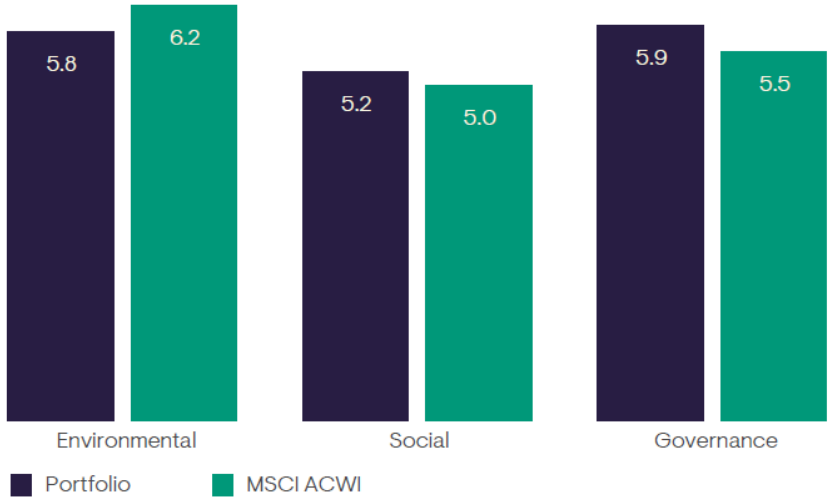
Much of the data for Scope 3 needs to be estimated. Over time, Ninety One expects disclosures to increase and are engaging with corporates to encourage them to do so. (*see glossary for definitions of Scope 1, 2 and 3 emissions*).

In this ESG report for the fund, Ninety One has also provided the following:

MSCI ESG rating

Source: Ninety One, MSCI as at 31 October 2020.

ESG Pillar Scores



Source: Ninety One, MSCI as at 31 October 2020.

Commenting on MSCI ESG ratings, Ninety One states: "*The MSCI ESG ratings are derived on a sector relative basis; they are intentionally designed to be relative to the standards and performance of a given company's industry peers. The sector relative nature of MSCI ratings means that, in isolation, the ratings have limitations for benchmark agnostic equity strategies such as the Income strategy's equity portfolio.*

In our view, ESG ratings should not be used to make investment decisions and instead, the underlying research should be used to inform and prioritise fundamental research. Scores and data are just the beginning, offering an efficient means by which we can identify potential issues and prioritise analyst time. The Multi-Asset equity analysts supplement their own research with the external assessment provided by MSCI, but with a deliberate focus on the underlying drivers of the score rather than the headline scores themselves.

For these reasons, we would not screen out stocks based on a low ESG score nor justify their inclusion based on a high score."

Schroders

General approach

Schroders has been incorporating ESG considerations into its equity fundamental research and stock selection process for more than 20 years with four principal dimensions (i) responsible ownership seeking to manage, protect and enhance the value of through active engagement and voting (ii) understanding companies' long term competitive strengths and the risks that they face (iii) identifying structural shifts that will drive growth in new markets, technologies and assets; and (iv) investment solutions aligned with clients' values and beliefs.

Analysing a company's exposure to, and management of, ESG factors, in addition to traditional financial analysis, is integral to understanding of a company's fair value and ability to deliver sustainable returns over the long-term. The integration approach spans ownership, engagement, voting and reporting.

Policy on controversial weapons: Schroders supports the international conventions on cluster munitions and anti-personnel mines and will not knowingly hold any security that derives revenue from or provides funding for cluster munitions or anti-personnel mines. Schroders will apply this policy to all Schroders funds that are directly managed.

Schroders' norms-based screening is guided by

− UN Global Compact Principles

− The UN Guiding Principles on Business and Human Rights

− International Labour Organization Conventions

− United Nations Convention Against Corruption

− OECD Guidelines for Multinational Enterprises

− US Global Sanctions List.

Encouraging TCFD disclosures

Schroders has publicly supported the TCFD recommendations. They have also signed up to a Global Investor Statement on Climate Change (post-Paris climate agreement) along with more than 600 global investors, committing to take a series of steps to contribute to a low carbon and climate resilient investments. One of these steps is to work with the companies in which they invest to ensure they are minimising and disclosing climate risks and opportunities. In their climate-related engagement, Schroders specifically asked companies to report in line with TCFD recommendations.

Active Ownership

Active ownership is not outsourced to service providers. Individual and collaborative engagements are undertaken to influence corporate practice (or identify the need to influence) on ESG issues, encourage improved/increased ESG disclosure and gain understanding of investee companies' ESG strategy and/or management.

Engagement activities are prioritised based on exposure to the individual companies, either by the total size of assets invested on behalf of clients or by the percentage of shares held and the materiality of the issue identified.

Equity, fixed income, ESG and data teams work together to identify areas that warrant discussion with companies. This may happen pre or post the decision to invest and will feed into the investment decision. Tracking its engagement activity, Schroders data shows that

on average it takes two years to effect change and have historically had a high level of success; the company also reports publicly on its engagement activity.

Schroders has been voting on climate change resolutions since 2000 and have recorded engagements on the topic since 2002 and has joined investor initiative such as the Carbon Disclosure Project (CDP), a global disclosure project for environmental impacts, Carbon Action Initiative and Climate Action 100+ where they are a founding signatory.

- In their 'Aiming for A' investor coalition, Schroders has co-filed a climate change resolutions at Anglo American, Glencore and Exxon and has supported the climate change resolutions filed at Shell and Rio Tinto.
- In 2019, they had more than 230 climate change-related engagements with over 200 companies identified in their research as being materially exposed to climate risk. They were involved in collaborative engagements, such as the Climate Action 100+ initiative, and led the engagement with Chinese cement company, Conch.
- In 2020 engagement with energy companies on environmental issues included: Arch Coal, Alliance Resource, China Coal Energy, Coal India, Equinor, Gazprom, Geo Energy Resources, Lukoil PJSC, NexGen Energy, Petrofac, Rosneft, Schlumberger, Shanxi Luan Environmental Energy, Shanxi Xishan Coal and Electricity Power, Whitehaven Coal and Woodside Petroleum.
- In the resources sector, engagement in 2020 included: Anglo American, Anhui Conch Cement, Arcelor Mittal, BHP Billiton, DS Smith, Glencore (on social issues), Hindalco, India Cements, Jindal Steel and Power, Kumba Iron Ore, Norsk Hydro, Philips Lighting, Rio Tinto, Vale.

Please note the companies listed above are not an exhaustive list. For a full list see the Annual Sustainability Report.

Schroders also voted on 39 climate-related shareholder resolutions and co-filed one shareholder resolution at BP's AGM through Climate Action 100+. The resolution received overwhelming support from shareholders and BP.

Schroders have also exerted influence through voting in support of resolutions asking for greater transparency around companies' scenario planning. They typically support resolutions asking companies to disclose the impacts of a climate transition on their business and their planning for that transition (scenario analysis and transparency are key elements of the TCFD recommendations.)

UBS

General approach

UBS believes that Sustainable and Impact Investing ('SI') can protect and enhance the value of clients' investments by adding value to portfolios within the same risk /return profile. Sustainable investing is grounded in the broader use of material, ESG information in the investment analysis process and the belief that such information will lead to better informed investment decisions. By identifying long-term investment opportunities, anticipating and managing financially material risks, engaging with corporate management and creating products and services that take into account ESG factors, UBS believes companies will be more successful and investments will positively impact society and the environment.

Policy on controversial weapons: UBS has implemented a process to prevent investments in companies involved in the development, production or purchase of cluster munitions and antipersonnel mines also for its passively managed Swiss pooled fund range.

UBS' norms-based screening is guided by the UN Global Compact Principles

Encouraging TCFD disclosures

UBS has been actively engaging with approximately 50 companies in the oil and gas and utility sectors to encourage uptake of TCFD recommendations. UBS has aligned a number of these engagements with the Climate Action 100+ collaborative engagement and is (co-) leading several coalitions under this initiative.

Active Ownership

Active ownership is not outsourced to service providers.

UBS-AM has been actively engaging with 50 companies that pose great risks from a climate perspective. While UBS-AM has interests across a wide range of industries, they have identified the energy and utilities sectors as particularly exposed to the climate change transition.

To ensure a systematic approach to their engagement with companies, UBS developed a scorecard analysis based on the TCFD that reveals interesting insights on the current practice on climate change by the companies and the gaps UBS needs to address. They score companies on eight factors: responsiveness, governance, risk management, strategy, performance, targets, lobbying and disclosure.

Engagements with company management are undertaken, many engagements continue for several years as part of an on-going review process. A comprehensive database is maintained of meetings with companies, review progress over time and follow-up on issues identified.

UBS has aligned a number of these engagements with the Climate Action 100+ collaborative engagement and is currently directly involved in 29 coalitions of investors and lead seven of the company dialogues across regions.

In addition, UBS is also a supporter/signatory of:

- Institutional Investors Group on Climate Change (IIGCC)
- Transition Pathway Initiative (TPI)
- Taskforce on Climate Related Financial Disclosure (TCFD)
- Global ESG Benchmark for Real Assets (GRESB)

2020 engagements:

To create the most effective dialogue within their thematic engagement program on climate change, UBS has developed a climate materiality assessment framework to facilitate research and climate engagement dialogue across nine impacted sectors, including the two in focus, oil & gas and utilities. It focuses on:

- Governance of climate change
- Risk management
- Strategy and policy
- Metrics and performance
- Targets
- Lobbying activities
- Overall level of disclosure

The table below summarises UBS' measure of progress in the engagement focus list

Progress	Number of companies	Percentage
Excellent (76–100% of objectives met)	8	18
Good (51–75% of objectives met)	18	40
Partial (26–50% of objectives met)	16	35
Limited (0–25%of objectives met)	3	7
Total	**45**	**100**

UBS voted against the board chair or board director at four companies: Exxon Mobil Corporation, Marathon Oil Corporation, Korea Electric Power Corp and Power Asset Holdings Limited due to a lack of progress against the objectives for UBS' climate related engagement programme.

Some specific examples of engagement:

BP [on Capital management, environmental management and climate change, remuneration strategy and business model]

Summary of engagement: UBS-AM has been engaging with the company within Climate Action 100+ as a participating investor since 2018. Dialogue with management has taken place both at, board and sustainability department level with the involvement of their SI, fixed income and equity analysts. Dialogue has focused on the content of the shareholder resolution that UBS co-filed in 2019 requesting a decarbonisation strategy, GHG emissions reduction, capital allocation and remuneration in alignment with the goals of the Paris Agreement.

Outcomes and next steps: A newly appointed CEO and chair are both open to dialogue with shareholders. At the beginning of 2020, the company announced a net zero emissions target by 2050 including scope 1, 2 and 3 emissions and completed a global review of lobbying activities on climate change. In August 2020, the company furthered its climate response framework by adding five targets for 2030:

1. Reduction of Scope 1 and 2 carbon emissions by 30%–35% and Scope 3 emissions by 35%–40%

2. A 30% reduction in refinery throughput

3. 10x increase in low-carbon investments

4. Increase renewable generating capacity

5. Reduction in oil and gas production by 40% compared to 2019 levels

The company has also improved disclosure on the assessment of its capital expenditure against different low carbon scenarios. Future dialogue will focus on the application of the new capital expenditure framework to future projects, the coverage of the long-term carbon intensity ambition, engagement with customers, emissions linked to trading, and the Just Transition.

ConocoPhilips – [on environmental management and climate change]

Summary of engagement: ConocoPhillips is a corporate credit issuer included in UBS-AM's climate engagement programme. During 2020 UBS participated in a Climate Action 100+ coalition call with the company's sustainability and climate change specialists to provide feedback on a potential revision of its 5%–15% GHG Scope 1 and 2 emissions target in 2017–30 and the company's climate risk strategy.

Outcomes and next steps: The discussion was followed by the announcement of a revised ambition of 35%-45% reduction in Scope 1 and 2 carbon intensity in 2017-2030, and net zero by 2050. UBS also had a direct engagement with the company involving the credit analyst, where they discussed the company's strategy for meeting these targets, how a recently announced acquisition fits into its climate strategy, the credit implications for the company's exposure to land regulation, and its board governance.

Fortum (a Finnish company) – Utilities

Summary of engagement: UBS-AM has engaged with the company within Climate Action 100+ as a lead investor together with another investment manager since 2018. Dialogue with management has taken place both at CEO, CFO and chair level, both by the SI and fixed income analysts. The engagement objectives have focused on the company's climate change strategy. More specifically, UBS requested full alignment of the company's disclosure with the TCFD recommendations, more ambitious and long term greehouse gas emissions reduction targets, clear timelines for a coal phase out in Europe and Russia, the inclusion of climate metrics in executive compensation and a global analysis of both direct and indirect lobbying activities. In 2020, UBS submitted an AGM statement to reiterate expectations to management.

Outcomes and next steps: The company announced an overall net zero emissions target by 2050 for global operations and by 2035 for the European assets. The company has set more goals in terms of capital allocation to renewables and increased capacity of clean energy. In addition, the most recent sustainability disclosure has been more aligned with TCFD recommendations and Uniper (a company owned by Fortnum) has committed to follow suit in 2021.

Future dialogue will focus on setting a short- and mid-term roadmap to achieve long-term ambitions, and better clarifying the company's decarbonization strategy in Eastern Europe and Russia to investors. Coal phase out in Germany will also remain a priority.

Vale (Brazil) – [on environmental management and climate change]

Summary of engagement: Engagement with Vale has been necessary as a consequence of the catastrophic Brumadinho tailings dam failure in January 2019, which followed the earlier failure in 2015 of a tailings dam at Samarco, where Vale is a joint venture partner. Alongside the scale of social and environmental impacts arising from these events, the combination of both incidents suggested systemic failings within Vale in its management of tailings risks. In the aftermath of Brumadinho, UBS-AM engaged directly with the company

and joined a collaborative engagement coordinated by the Principles for Responsible Investment (PRI).

Outcomes and next steps: The engagement objectives have been to see Vale put a robust remediation plan in place that includes the consultation of all affected stakeholders, changes to procedures to prevent occurrence at its other sites, and better disclosure and life-cycle management of the company's tailings storage facilities. A number of these changes have taken place and the focus is now on the effective implementation of these measures. The PRI coordinated engagement closed in November 2020 and UBS will continue to engage directly with the company going forward.

CHUBU (Italian ulility)- [on environmental management and climate change, strategy and business model, capital management, transparency and disclosure]

Summary of engagement: The company has been selected for engagement based on UBS' proprietary methodology which measures how companies are transitioning to a low-carbon economy within a below 2°C scenario. UBS' dialogue with management started in 2019 and focused on conducting a scenario analysis, reviewing GHG emissions targets, increasing exposure to renewables, linking executive pay to climate metrics and aligning disclosure with the TCFD recommendations. (UBS' dialogue has been with the head of the corporate management division and it has taken place in Japanese through simultaneous translation)

Outcomes and next steps: The company decided to split the business in Transmission and Distribution, Sales and Power Generation (through the 50% joint venture (Jera) with Japanese KEPCO which acquired all Chubu's thermal generation). It has taken previous feedback into consideration and started disclosing according to the TCFD framework. It now conducts scenario analysis linked to a 2°C scenario. Jera has also committed to an additional 5GW of renewables by 2025, higher carbon intensity reductions than the industry average in the country, and net zero emissions by 2050. Going forward, UBS is looking for new commitments on renewables and a more ambitious coal phase-out plan, currently only focusing on low efficiency plants (3.3% of total). Additionally, the company is still in the process of defining new 2030 climate reduction targets.

A bank (name not disclosed) [on environmental management and climate change, strategy and business model]

Summary of engagement: The company has been under intense pressure from NGOs and shareholders to phase out the provision of financial services to the energy sector. This ultimately led to a shareholder resolution at the 2020 AGM. UBS engaged with management and the board on their climate strategy and decided to support the management resolution which commits the bank to becoming net zero by 2050. While the bank has admittedly lagged behind in implementing an action plan owing to other priorities, namely conduct and culture, which have formed part of UBS' engagement programme in the past, UBS believes they will be in a position to become a market leader on climate finance. UBS encouraged management to stay on track regarding the communication of its intermediary targets and methodology to avoid being subject to further action at the 2021 AGM.

Outcomes and next steps: The bank met their commitment to communicate its net zero plans to the market and UBS engaged with management to further understand the strategy, governance and methodology. They also communicated intermediate reduction targets in energy and utilities by 2025.

UBS will seek to engage regularly to monitor progress, particularly on how changes in strategy lead to changes in its relationships with clients and new product development.

Integrating ESG into fixed income for all fixed income assets

Implementation of ESG integration across the UBS fixed income platform is grounded on the collaboration between credit analysts and the Sustainable and Impact Investing team. UBS has established protocols which guide how it addresses issuers covered, how to make use of external ESG ratings information, and how to address gaps in coverage. Credit analysts are responsible for the ESG analysis of issuers within their coverage, supported by UBS AM's sustainability investment research team. Questions about the materiality of an issue are addressed, the quality of an issuer's management of its risks, and how to balance different levels of materiality or the timing of how ESG issues are expected to develop.

Credit analyst recommendations are centrally stored and shared with portfolio managers globally, and analyst credit recommendations are discussed in regularly scheduled credit committee meetings, in which individual cases are discussed in a centralised manner with portfolio managers globally. ESG recommendations are included as part of the credit analysts' credit research and are also subject to the considerations of and discussions with Sustainable and Impact Investing team representatives. By providing integrated recommendations that consider ESG risks and opportunities, UBS avoids portfolio managers being forced to choose between the sustainability and the financial attractiveness of companies when making their stock selections, given that ESG considerations are taken into account in the research recommendations.

Applying ESG in fixed income is relatively new compared to the ESG approaches which have been developing in equities for some time. Some of the challenges that arise are: greater variability in the type of issuer; ESG data availability and quality (corporate data is incomplete especially in emerging markets and high yield, sovereign ESG rating schemes tend toward high coverage but with tenuous connection to credit issues); the nature of fixed income instruments (different role of fixed income instruments in capital structures; issues of duration and maturity of fixed income instruments, bondholders rights compared to shareholders rights).