Towards a Charter for Responsible Investment
at
Highland Council Pension Fund

A report by Highland - Palestine

Highlight – Palestine

Highland – Palestine is a network of people across the Highlands who support the Palestinian people's struggle for equal rights and self-determination: highland.palestine@gmail.com

Highland Council Pension Fund: why we need to take action now

With well over £300 billion worth of assets, UK Local Authority Pension Funds wield significant financial power; they could be, and ought to be, a positive force for the public good, particularly in the areas of human rights, sustainable development and environmental protection.

Yet, all too often, they limit their ambition, invest for the short-term and ignore the consequences. Rather than playing their part in promoting a sustainable future, they continue to fund the forces of destruction. To give just a couple of examples, UK Local Authority Pension Funds currently hold more than £16 billion in the fossil fuel industry and almost £600 million in arms companies linked to the war in Yemen.

Over the past three years Highland - Palestine has been campaigning to persuade Highland Council Pension Fund to divest its £6.8 million shares in US arms company, General Dynamics. In a series of reports, we have demonstrated conclusively that General Dynamics manufactures and supplies weapons that have killed thousands of civilians in Gaza and Yemen, implicating them in the commission of war crimes. Highland Council Pension Fund's response has been to buy even more shares in General Dynamics!

Our experience, similar as it is to that of other local campaign groups, has shown us that the councillors responsible are unresponsive, unaccountable and disinclined to act, hemmed in, as they are, by a restrictive interpretation of their responsibilities. Despite Highland councillors' claims to 'take ethical, social and environmental issues seriously', there is clear evidence that Highland Council Pension Fund's 'policies, procedures and governance structure' in this area are weak, inadequate and ineffective.

It is our view that the current practices of Highland Council Pension Fund fail to meet the standards which their scheme members and other stakeholders are entitled to expect.

In March 2021 the Highland Council Pension Fund Committee will meet to approve a revised *Statement of Investment Principles* in which it will be required to identify its approach to investment ethics. We believe this is an opportunity for Highland Council Pension Fund to institute a transparent and accountable framework for responsible investment.

To this end, we have produced this report, setting out the case for change, and highlighting recent local, national and international developments in the following areas:

1. The Scottish Local Government Pension Scheme (SLGPS)
2. Ethical Investment
3. Fiduciary Duty and the Statement of Investment Principles
4. Highland Council Pension Fund (HCPF)

First, we look at the legislative framework in which Scottish Local Government Pension Schemes operate; then we examine the growth and development of ethical investment policies and practices, and highlight the emerging role of Scotland as a centre of ethical finance; third, we discuss the evolution of the concept of 'fiduciary duty' and how this emerging understanding should be reflected in the *Statement of Investment Principles*; finally, we focus on the deficiencies in Highland Council Pension Fund's approach to ethical, social and environmental issues and propose a number of practical suggestions to remedy them, in the form of a *Charter for Responsible Investment*.

A transparent and accountable investment policy

We invite all organisations across the Highlands who represent local residents and have an interest in the responsible management of this significant financial resource to support our call for Highland Council Pension Fund to adopt four key recommendations:

- it should incorporate an explicit ethical policy into its Statement of Investment Principles;
- it should identify explicit Environmental, Social and Governance criteria against which it can monitor the performance of investment fund managers;
- it should adopt screening procedures to identify the type of shares that should not be acquired and those that should be favoured
- it should take steps to consult with its scheme membership over these policies.

Moreoever, HCPF should establish a forum at which local residents can raise their concerns. These policies are not something that can be dealt with once and for all. There needs to be a continuous process of monitoring and adjustment. To this end, we believe that there should be a body within the fund that is responsible for ensuring that the policy is implemented. We recommend that the Highland Council Pension Fund Board establish a *Responsible Investment Advisory Body* under the terms of a *Charter for Responsible Investment*.

Highland Council Pension Fund: a Charter for Responsible Investment

We the undersigned, have agreed the following recommendations as the foundation of a Highland Council Pension Fund *Charter for Responsible Investment*:

Highland Council Pension Fund should establish *a Responsible Investment Advisory Body* that would

- be responsible to the Highland Council Pension Fund Board;
- formulate and keep under review *a Responsible Investment Policy* that would form part of Highland Council Pension Fund's *Statement of Investment Principles*;
- identify and publish *a list of exclusions and inclusions* i.e. the type of shares that should not be acquired and those that should be favoured;
- maintain *a public register of Responsible Investment Criteria* against which the activities of fund managers could be monitored and evaluated;
- *consult* members of the Highland Council Pension scheme with regard to its *Responsible Investment Policy*;
- *act as a forum* for receiving, hearing and responding to the concerns of other stakeholders in the Highland Council Pension Fund.

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Contents:

1. The Scottish Local Government Pension Scheme (SLGPS)

(a) The Scottish Local Government Pension Scheme (SLGPS) comprises 11 main funds which cover 32 councils and some 500 other employers. Between them they manage assets worth £47.7 billion.

(b) Local Government Pension Schemes in Scotland are governed by three principal pieces of legislation: *The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010* [LGPS(S) 10], *The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015* [LGPS(S) 15] and *The Local Government Pension Scheme (Scotland) Regulations 2018* [LGPS(S) 18].

(c) Each fund has a Pension Committee which takes the overarching decisions on investment. In addition, *LGPS(S) 15* created a requirement for each fund to set up a Pension Board, comprising 'an equal number of representatives appointed by scheme employers and relevant trade unions' (LGPS(S) 15:6). The Pension Committee and the Pension Board meet at the same time to consider the same agenda, but the Pension Board may also 'meet separately from the Pension Committee with the agreement of the Pension Committee' (LGPS(S) 15:6).

(d) The SLGPS is regulated by the Scottish Public Pensions Agency (SPPA), which describes itself as being 'responsible for developing the regulations for Scotland's Local Government Pension Scheme'. This responsibility overlaps to some extent with that of the Scottish Local Government Pension Scheme Advisory Board (SLGPSAB) which was established by the LGPS(S) 15 'to provide advice to the Scottish Ministers, at the Scottish Ministers' request, on the desirability of changes to the Scheme' (LGPS(S) 15:2).

> 'The SAB is a bipartite Board comprising equal representation from employers and employee representatives. It meets four times a year and considers Scotland-wide issues relating to the governance of the scheme.
>
> In the past, these have included Fiduciary Duty, 'pensions choice', scheme governance, reviews of pension regulations, Guaranteed Minimum Pensions, and the Audit Scotland review of funds.'
>
> \- SLGPSAB (2019)

(e) A Local Government Pension Fund in Scotland is required by law to publish 'a written statement setting out its funding strategy', a 'Funding Strategy Statement' (LGPS(S) 18:56). In doing so, it is required to 'have regard to' the requirement to publish a 'Statement of Investment Principles' (LGPS(S) 10:12). This statement 'must cover its policy on … the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments' (LGPS(S) 10:12). Pension Boards are empowered by statute to 'consider any matter concerning pensions it deems relevant', including the scheme's 'funding strategy' (LGPS(S) 15:8).

2. Ethical Investment

(a) Over the years, a number of organisations, motivated by a range of different concerns, have demanded that financial institutions, and particularly pension funds, adopt ethical principles as a guide to their investment decisions. Often these campaigns have called for the exclusion of certain types of investment ('negative screening'), notably stocks in the so-called 'sextet of sin': alcohol, gambling, tobacco, armaments, pornography and nuclear power.

Over time, the concept of ethical investment has been supplemented, and to some extent displaced, by terms such as 'responsible investment' and 'sustainable investment', which encompass a broader range of issues including adherence to employment standards, regard for human rights, the promotion of sustainable development and concern for the environmental impact of business activities. It is now common for such issues to be referred to as Environmental, Social and Governance considerations, often abbreviated to ESG issues.

The role of religious organisations, particularly the Quakers and the Methodist Church, 'in pioneering ethical investments in the UK is well established', and religious groups have also played an important role in recent initiatives. The Church of England has published a *Statement of Ethical Investment Policy* and established an *Ethical Investment Advisory Group* (Church of England 2018). In March 2016, the Church of Scotland and the Islamic Finance Council UK signed a partnership agreement known as *The Edinburgh Finance Declaration* 'to co-develop an ethical finance solution open to all society, regardless of race, religion or ethnic background and based on the shared values between the faith traditions' (GEFI 2018).

Data from global research agency *Morningstar* indicates that environmentally focused investing is becoming mainstream, and, moreover, that environmentally sustainable funds are outperforming traditional funds. This shift was reflected in a speech by the then Chief Executive of the Financial Conduct Authority, Andrew Bailey, in 2018, in which he drew attention to research that 'indicated that 54% of respondents believed ethical investment is important' (FCA 2018).

(b) The 'UN Principles for Responsible Investment' are a significant reference point in any current discussion of ethical investment. The UN PRI process, a form of ethical kite-marking, was launched in 2006, and requires its 3,000 signatories to commit to its six principles. The PRI defines 'responsible investment' as 'an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns' (UN PRI n.d). As they point out, 'There are many terms - such as sustainable investing, ethical investing, and impact investing - associated with the plethora of investment approaches that consider ESG issues. Most lack formal definitions, and they are often used interchangeably.' This PRI list of 'ESG factors' identifies a number of areas that may be of concern but doesn't provide criteria on which to form a judgement as to whether a fund manager is being 'responsible' or not.

Examples of environmental, social and governance (ESG) factors are numerous and ever-shifting. They include:

Environmental	**Social**	**Governance**
▪ Climate change	▪ Human rights	▪ Bribery and corruption
▪ Resource depletion	▪ Modern slavery	▪ Executive pay
▪ Waste	▪ Child labour	▪ Board diversity and structure
▪ Pollution	▪ Working conditions	▪ Political lobbying and donations
▪ Deforestation	▪ Employee relations	▪ Tax strategy

(c) In recent years, Scotland has acquired a reputation as 'a global centre of expertise in ethical and green finance'. Since 2018, the Edinburgh-based Ethical Finance Hub (EFH), supported by the Scottish Government, has hosted the annual Ethical Finance Conference, on behalf of the Global Ethical Finance Initiative (GEFI). At the 2018 conference 'the Scottish Government and the United Nations Development Programme (UNDP) announced a 2-year programme of collaboration aimed at mobilising private capital for the UN Sustainable Development Goals (SDGs)' (UNDP 2018).

According to a recent report by EFH, 'Scotland has a highly active and engaged responsible investing sector.' However, as seems to be common across the financial sector, the terms 'ethical' or 'responsible' investment often lack specificity, with asset managers seeming to prefer ambiguity and imprecision as a means to keeping their investment options open:

> In the absence of a clear, consistent and standardised taxonomy Scottish asset managers have taken varying approaches to interpreting and communicating their responsible investment strategies. To reconcile the ambiguity and inconsistency that pervades the wider industry each responsible asset manager, with some leaning heavily on PRI, has developed a proprietary position. .... Reviewing the Scottish responsible investing taxonomy has highlighted the inconsistencies across, and in some cases within, asset managers. ESG, as expected, is the most common term and some provide more detail than others as to how they define it and how it integrates into existing processes. The analysis also identified contrasting approaches to responsible investing which range from those who employ positive screens to those who avoid using negative screens to ensure their investment universe is maximised.
>
> \- EFH 2020

(d) This complexity and lack of clear definition has been explored in a recent paper by an organisation called 'Ethical Screening', which includes a diagram illustrating the range of terms currently in use and their position in relation to various approaches to 'responsible investment'.

As the report by Ethical Screening points out this can give rise to seriously anomalous ratings of company performance.

> Take the example of an oil company: it can have a very high ESG score because, due to the inherent risks connected to its operations, its management systems are usually very well developed. However, the company's operations cannot be considered sustainable in the sense of the Brundtland report. To follow this example through, Royal Dutch Shell's inclusion in the Dow Jones Sustainability Index is, we argue, an

example of confusion in terminology - it may be a reasonably well managed oil company that scores well on an ESG assessment, but is in no-way an example of a truly sustainable company. Does its inclusion meet a client's expectation of a sustainable investment? Similarly, British American Tobacco tends to score highly on ESG ratings assessments, but its inclusion in a 'sustainable' fund would raise eyebrows amongst the majority of our clients.

- Ethical Screening 2019

(e) In response to this lack of definition, the European Union has produced a Taxonomy that specifies in detail 'performance thresholds (referred to as 'technical screening criteria') for economic activities which make a substantive contribution to one of six environmental objectives' as well as other sustainability goals. This is linked to a set of regulations, known as Taxonomy Regulations (TR), 'on sustainability-related disclosures in the financial services sector'. This was 'agreed at the political level in December 2019, [and] creates a legal basis for the EU Taxonomy. The TR sets out the framework and environmental objectives for the Taxonomy, as well as new legal obligations for financial market participants, large companies, the EU and Member States' (EU 2020).

(f) The *Norwegian Government Global Pension Fund* is the world's largest sovereign wealth fund. It was established in 1990 to invest surplus revenues from the Norwegian oil sector, and it currently holds over US$1 trillion in assets, including 1.4% of all global stocks and shares. The fund's investments are overseen by an *Advisory Council on Ethics* which was established under regulations issued by the Norwegian Ministry of Finance in November 2004. The Norwegian pension fund cannot invest in companies that directly or indirectly contribute to killing, torture, deprivation of freedom or other violations of human rights in conflict situations or wars. To support the ethical screening process, the *Council on Ethics* works with *RepRisk ESG Business Intelligence*, a global research firm and provider of environmental, social and governance (ESG) risk data. *RepRisk* monitors the companies in the *Norwegian Pension Fund*'s portfolio for issues such as severe human rights violations, particularly regarding child labor, forced labour, and violations of individual rights in conflict areas, as well as gross environmental degradation and corruption.

3. Fiduciary Duty and the Statement of Investment Principles

(a) A 'fiduciary' is someone who, having accepted a position of trust, binds themselves 'to protect and/or to advance the interests of another.' The fiduciary's 'duty of loyalty' requires them to pursue the best interests of the 'beneficiary', and, if necessary, to place them above their own interests.

> 'The classic definition of fiduciary duty in Scots Law is one under which as a matter of law a party (the fiduciary) is bound to prefer to his own interests those of another (the principal or beneficiary), for whose benefit he is exercising particular powers or undertaking particular transactions. This is in contrast to normal transactions, in which each party considers their own interests.'
>
> \- Unison 2015

(b) The concept of 'fiduciary duty' in relation to Local Government Pension Schemes has been the subject of reports by, among others, the Law Commission (2014, 2017), Nigel Giffin QC on behalf of the Local Government Association (2014), and Pinsent Masons on behalf of the Scottish Local Government Pension Scheme Advisory Board (2016). According to Unison (2015):

> The precise nature of fiduciary duty in relation to the Scottish LGPS has become a topical issue in recent years. Primarily in relation to investment decisions and the degree to which fiduciary duty acts as a constraint on certain investments (e.g. infrastructure and local investments), and more broadly when considering Environmental, Social and Governance issues (ESG).
>
> -Unison 2015

(c) The requirement on pension committees to perform their fiduciary duty is sometimes cited as a barrier to their consideration of broader ethical or social investment purposes. The 2012 Kay Review identified widespread concern that 'their fiduciary duties required [fund managers] to maximise returns over a short-time scale, precluding consideration of long-term factors which might impact on company performance' (Law Commission 2014).

(d) This narrow definition of the concept of fiduciary duty is apparent in the submission by the SPPA to the 2015 Local Government and Regeneration Committee (LGRC) of the Scottish Parliament.

> The sole purpose of the LGPS is to meet pension liabilities when they fall due. Thus, the pension committees have a legal and fiduciary duty to treat the interests of scheme members as paramount. To comply, investments made on behalf of scheme members are geared towards securing the best rate of return subject to any investment restrictions agreed for the scheme (e.g. ethical, social or environmental reasons.) … The fiduciary duty' placed on LGPS to act in the interests of the beneficiaries of the funds is the underlying principle of their investment strategy and governs their investment decisions.
>
> \- Scottish Parliament 2015

In its report the LGRC refers to the 'cautious approach to risk' inhibiting pension fund committees from 'investing members' funds more locally and building in elements of public good.' Faced with the requirement to take ESG issues into consideration, this 'narrowness of meeting the fiduciary duty can cause a dichotomy for some funds depending on their interpretation' (Scottish Parliament LGRC 2015).

(e) The Law Commission report, 'Fiduciary Duties of Investment Intermediaries', concluded that:

> 'Where trustees think ethical or environmental, social or governance (ESG) issues are financially material they should take them into account.
>
> …. while the pursuit of a financial return should be the predominant concern of pension trustees, the law is sufficiently flexible to allow other, subordinate, concerns to be taken into account. We conclude that the law permits trustees to make investment decisions that are based on non-financial factors, provided that:
>
> - they have good reason to think that scheme members share the concern; and
> - there is no risk of significant financial detriment to the fund'
>
> \- Law Commission 2014

In a further report in 2017, *Pension Funds and Social Investment*, the Law Commission said it had found that the barriers to a more flexible approach 'were mostly structural and behavioural rather than legal or regulatory' (Law Commission 2017).

(f) Given that the debate over 'fiduciary duty' centres on the definition of 'best interests', it is increasingly apparent that consultation with pension scheme members is essential. There is a growing perception that the narrow focus on the short-term maximisation of returns is no longer sufficient. The challenges posed by, among other things, climate change and the need for environmentally sustainable development compel pension funds to give more consideration to the longer term interests of members.

> UNISON believes that modern fiduciary duty requires that pension fund investments are made in the interests of scheme members, that the financial obligation is not to maximize returns but to ensure there is enough resources to meet the pension benefit obligation. Therefore councillors and officers, who make, develop and influence these investment decisions should consult scheme members when drawing up policies on such issues as, climate change, executive pay or labour rights issues in the supply chain.
>
> \- Unison 2019

(g) This is a perspective echoed in the report by the UN PRI and the UN Environment Programme Finance Initiative [UNEP FI] entitled 'Fiduciary Duty in the 21st century':

> Today, the fiduciary duties of investors require them to:
>
> - Incorporate environmental, social and governance (ESG) issues into investment analysis and decision-making processes, consistent with their investment time horizons.
> - Encourage high standards of ESG performance in the companies or other entities in which they invest.
> - Understand and incorporate beneficiaries' and savers' sustainability-related preferences.
> - Report on how they have implemented these commitments.
>
> \- UNEP FI and PRI 2019

(h) In response to these various reports on 'fiduciary duty', and particularly those of the Law Commission, in 2018 the UK Government recommended that pension fund trustees be required to 'update their Statement of Investment Principles (SIP) to set out:

- how they take account of financially material considerations, including (but not limited to) those arising from ESG considerations, including climate change;
- their policies in relation to the stewardship of the investments, including engagement with investee firms and the exercise of the voting rights associated with the investment;
- a separate statement on how they will take account of members' views (including, but not limited to, views on ethical, social impact, and present and future quality of life matters) in relation to the matters covered in the SIP.'

- DCMS / DWP 2018

4. Highland Council Pension Fund (HCPF)

(a) As of March 2019 Highland Council Pension Fund (HCPF) held assets worth £1,999m, i.e. very close to two billion pounds. As part of the Scottish Local Government Pension Scheme (SLGPS) the fund exists 'to provide retirement and death benefits to employees and dependents within the scheme.' The Highland scheme has approximately 31,600 members, including current and former employees of Highland Council, Comhairle Nan Eilean Siar, The University of the Highlands and Islands, Highlands of Scotland Tourist Board, Highlands and Islands Enterprise, Scottish Fire and Rescue, and more than twenty other organisations that, together, account for around one tenth of all employment in the Highland region.

In addition to its investment income, the fund is financed through employee contributions (17.8%) and employer contributions (20.2%), which ultimately derive from either local government or national government taxation. The Highland Community, then, has a considerable stake in the HCPF, either directly, through employment, or indirectly, through the payment of taxes.

(b) The Highland Council as an 'Administering Authority' delegates governance of the fund to a Pensions Committee and Pensions Board who, in turn, appoint and monitor investment fund managers. There are currently seven fund managers whose supervision is further delegated to the Pensions Investment Sub Committee (ISC).

Highland Council Pension Fund's current 'Statement of Investment Principles' (Report No. PC/03/18) was approved at an HCPF Committee meeting on the 8th February 2018. Beforehand, the ISC commissioned a report on ESG issues by the Fund's Investment Advisors, Aon Hewitt, which 'concluded that the approach that the Fund takes to integrating ESG into its decision making is in line with other LGPS.' This approach is described as involving 'some integration' of ESG factors, achieved primarily by encouraging 'their fund managers to engage on ESG issues with the companies they invest in, recognising that they may have an impact on long term performance' (Aon Hewitt 2017). The fact that HCPF's approach to 'Social, Environmental and Ethical Considerations' is broadly similar to that of other Scottish funds should not be regarded as a source of reassurance but, rather, as an indication of a 'cut and paste' response to a legal requirement. As a report by Unison says:

> Many of these funds have introduced short 'template like' policies, possibly indicating a lack of proper ownership of their approach to responsible investment, particularly climate change.
>
> \- Unison 2019

(c) The minutes of the February 2018 meeting of the Pension Committee show that two Conservative members of the committee tried to strike out the section in the 'Statement of Investment Principles' that dealt with Environmental, Social and Governance considerations, even though its inclusion is a legal requirement. 'A view was expressed that the Fund should achieve the best possible investment returns and ESG factors chosen for moral reasons should not be included in investment policy. … Time and money could be saved by not having a formal ESG policy.' In the event, the committee did adopt the statement in full, but the section on Social, Environmental and Ethical issues is weak, and was relegated to item 16 in the document.

> 16.4 Whilst recognising its over-riding fiduciary duties the Fund will continue to encourage its managers to engage on issues with companies in which it holds investments as the Fund believes that environmental, social and corporate governance (ESG) issues will have a significant effect on the performance of investment portfolios through time.

16.5 Engagement in this context is to involve the Investment Managers in:

- Meeting and corresponding with Companies on relevant issues;
- Working with the representatives of other shareholders, where appropriate;
- Voting against adverse proposals at Company AGM/EGMs;
- Reporting regularly on actions taken in this regard.

- Highland Council Pension Fund 2018

(d) While the Statement of Investment Principles does refer to environmental, social and corporate governance (ESG) issues, it makes no attempt to define in specific terms what these issues are. Further, the Chair of the ISC has stated that, 'The investments made by the Pension Fund are selected by independent investment managers, not by Councillors.'

In other words, the HCPF claims not to exercise any direct control over specific investments or, indeed, over the range of investments it finances. The current policy makes no attempt at either negative or positive screening and confines itself to a restricted form of investment 'stewardship', under which the ISC encourages the seven investment fund managers to engage on ESG issues with companies in which they invest. It seems, then, that the main role of the ISC in relation to ESG is to monitor the performance of fund managers in engaging with companies, but without any clearly-stated criteria for evaluating their performance. Responsibility for ethical investment practices is, in effect, sub-contracted to the fund managers.

As the Local Authority Pension Fund Forum argues:

> Delegating shareholder engagement does not mean that trustees should simply let their fund managers take over shareholder activism. Delegation still requires responsible stewardship by trustees of their managers' delegated responsibilities, in line with the UK Stewardship Code.
>
> - LAPFF 2020

(e) This overall approach contrasts, for example, with the position adopted by the Church of England pension fund. *The Statement of Ethical Investment Policy* published by the *Church of England Ethical Investment Advisory Group* states that they 'expect companies in which they invest to manifest sustainable environmental practice, fair treatment of customers and suppliers, responsible employment practices, conscientiousness with regard to human rights, sensitivity towards the communities in which they operate and best corporate governance practice' (Church of England 2018). Moreover, the C of E has identified a range of 'investment exclusions' i.e. types of investments that will not be permitted, and which are specified in policy statements such as their *Defence Investment Policy*.

(e) Despite their claims to 'take ethical, social and environmental issues seriously', there is clear evidence that HCPF's 'policies, procedures and governance structure' in this area are weak, inadequate and ineffective.

HCPF currently holds at least £136 million of shares in companies of questionable provenance. These include some £72 million shares in classic 'sin shares': gambling - £1.2 million (Sands China); alcohol - £23 million (Pernod, Diageo, Mitchells and Butlers); tobacco - £32.3 million (Japan Tobacco, British American Tobacco, Philip Morris, Altria Group); armaments - £13.5 million (Axon Enterprise, Meggitt, General Dynamics); nuclear - £1.9 million (Rolls Royce). They also hold £39.8

million in mining and mining-related companies, many of them based in Australia, and £24.4 million in oil and oil-related companies. Furthermore, they own very significant holdings in insurance and financial services companies whose investments are potentially open to question. For example, HCPF owns £8.5 million in AIA who are the target of the 'Kick Out Coal Campaign' because of their stake in at least $3 billion of coal projects.

(f) Highland - Palestine's experience over three years of campaigning to persuade the HCPF to divest from US arms company General Dynamics has exposed the many flaws and deficiencies in HCPF's approach to the ethical management of investment. HCPF currently holds £6.8 million of shares in General Dynamics through its investment in fund manager, Pyrford International. This is despite Highland - Palestine having demonstrated conclusively that General Dynamics manufactures and supplies weapons that have killed thousands of civilians in Gaza and Yemen, implicating them in the commission of war crimes.

Our experience is that the HCPF is unresponsive and wants to avoid being either accountable or transparent. The HCPF Committee Chair and the Chair of the ISC have consistently failed to engage with our concerns. In our view, the ISC has failed in its duty to monitor the investment activities of Pyrford International on behalf of HCPF. Despite at one point giving us an assurance that they had held 'robust discussions' with the managers of Pyrford International, the ISC has allowed Pyrford to increase its holding in General Dynamics over the past three years by 20,350 shares, an increase of some 57%, and this at time when the value of the shares has been falling.

The ISC has failed to hold Pyrford International to account regarding responsible investment even though, on its own behalf, Pyrford International is keen to parade its 'responsible' credentials. The company has been a signatory to the UN PRI since May 2014. Its parent company BMO Global Asset Management was a founding signatory to the UN PRI and has 'achieved the maximum rating of A+ for [its] overall Strategy and Governance'. In 2019 BMO published a marketing brochure entitled 'Responsible Investment Strategies' in which it claimed to apply 'ethical and environmental, social and governance (ESG) principles to the selection of investments, having a robust approach to portfolio construction and management.' This 'robust approach', it says, is based on three pillars:

> **Avoid** investments in companies with activities that harm society or the environment;
>
> **Invest** in companies that demonstrate responsible business practices, and support those whose activities make a positive contribution to society and the environment;
>
> **Improve:** use our influence as an investor to encourage companies in their efforts to improve their management of ethical and ESG issues through engagement and voting.
>
> \- BMO Global Asset Management 2019

Among the 'product-based exclusions' the document identifies are: alcohol, fossil fuels, gambling, nuclear energy, tobacco and weapons. In the case of 'weapons', this would entail excluding companies that 'Derive any turnover from the manufacture or sale of weapons, weapons systems or platforms, including products or services specific to such systems.' Had their monitoring been more rigorous, it would have been easy for the ISC to challenge Pyrford over the inconsistencies and contradictions in its position. We are surely entitled to ask why they failed to do so?

(g) We are not suggesting that HCPF Committee and Board members act in bad faith. We are, however, arguing that their policies, practices and procedures are deficient and require substantial updating and reform. In particular, they need to move away from an approach that relies solely on a weak form of stewardship and, in effect, delegates responsibility for its ethical practice to the fund managers; they should institute a clear set of principles and criteria, through consultation, that can help steer the fund towards a more acceptable, responsible and sustainable future.

We believe that HCPF needs to become both transparent and accountable. As a minimum, it should accept the following four recommendations:

- it should incorporate an explicit ethical policy into its Statement of Investment Principles;
- it should identify explicit ESG criteria against which it can monitor the performance of investment fund managers;
- it should adopt both negative and positive screening procedures;
- it should take steps to consult with its scheme membership over these policies.

Moreoever, HCPF should establish a forum to which local residents can bring their concerns. These policies are not something that can be dealt with once and for all. There needs to be a continuous process of monitoring and adjustment. To this end, we believe that there should be a body within the fund that is responsible for ensuring that the policy is implemented. We recommend that the Highland Council Pension Fund Board establish a *Responsible Investment Advisory Body* under the terms of a *Charter for Responsible Investment*.

Highland Council Pension Fund: a Charter for Responsible Investment

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