

PERTH AND KINROSS COUNCIL

Strategic Policy & Resources Committee

1 October 2014

TAYSIDE PENSION FUND EMPLOYER CONSULTATION – INVESTING IN TOBACCO

Report by the Head of Finance and Head of Legal Services

PURPOSE OF REPORT

The purpose of this report is to determine the response to the consultation received from Tayside Pension Fund. This requests the views of Perth and Kinross Council on whether the Fund should continue investing in tobacco stocks given the legal framework within which investment decisions require to be made.

1. BACKGROUND

- 1.1 The Tayside Pension Investment Sub-Committee of Tayside Pension Fund (the Fund) has been giving consideration as to whether or not to withdraw from investing in tobacco companies.
- 1.2 To this end Perth and Kinross Council, as an employer and contributor to the Fund, has been requested to respond with any views by Friday 26 September 2014. The Council has subsequently obtained an extension to 1 October 2014 to allow the issue to be considered by this Committee in line with the approved committee timetable.
- 1.3 The value of tobacco investments in the main Fund was £28.96m at 31 March 2014 (1.18% of the total Fund value). The return achieved from this investment equated to £32m over the five year period (1.4% of the overall asset value of the Fund as at 30 June 2013).

2. COUNSEL OPINIONS

- 2.1 Tayside Pension Fund has provided the Council with two Counsel Opinions on whether or not it is competent for the Fund to take a decision to actively disinvest in one sector.
- 2.2 In the Opinion by Mr J W McNeill QC (21 January 2013) Tayside Pension Fund has “power to withdraw from investments which it considers are not ethical having regard to its values, ethos and aims”. However, Mr McNeill further explains that “prior to reaching a decision the effect of the proposed policy on investment returns should be evaluated with investment managers. In the event that the advice of investment managers was that there was a significant risk of materially lower returns overall, the Council and Sub-Committee should take that point into account prior to reaching a decision. Such a view would not

preclude a decision to withdraw from the sector but would be a material consideration to be taken into account along with all other material considerations.”

- 2.3 However in the Opinion of Mr N Giffin QC (25 March 2014) Tayside Pension Fund’s “power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must therefore be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the Fund (balancing risk and return in the normal way).” Mr Giffin goes on to say that “so long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the Fund”.
- 2.4 In light of these Opinions, the decision was taken by the Members of the Tayside Pension Investment Sub-Committee that the officers of Tayside Pension Fund should consult with individual portfolio managers as to their professional views on the potential impact of:
- not directly investing in the tobacco sector,
 - whether such decision would dilute returns, and
 - what impact the alternative would have on the risk and volatility of the Fund.
- 2.5 Financial information was requested for returns from tobacco stocks held over the prior five year period compared to the overall portfolio return and volatility.

3. ACTUARIAL OPINION

- 3.1 In order to ascertain the impact on current and future funding levels and the resultant effect on employer contributions, the information received from the portfolio managers was passed to the pension fund actuaries. Their analysis states that the Fund’s returns would have been reduced by approximately 0.3% of the Fund value per year over the last five years and that future investment returns would also be reduced by the same proportion.
- 3.2 The information received showed that the Fund value would have suffered by £32m over the five year period (1.4% of the asset value). The volatility of the portfolio would increase as tobacco stocks are less volatile than a number of others within respective market universes and therefore the removal of these would increase the risk profile of the Fund as a whole.
- 3.3 The impact of the analysis based on not investing in tobacco would have reduced Tayside Pension Fund’s funding level by 1.4%. This, in turn, would have required an employer’s contribution rate increase of 1.8% of payroll.

- 3.4 The actuarial estimations, based on the assumptions that the same reduction in funding which would have resulted in the past five years without tobacco investment is replicated in the next five years, show the funding level would drop an additional 3.7%. This would result in a requirement for contributions to be increased by an additional 3.1% per annum for each employer in order to generate additional contributions of £10.8m.
- 3.5 The full actuarial opinion is set out in Appendix 1.

4. FINANCIAL IMPLICATIONS

- 4.1 The current employer contribution rate is 18% and this is provided for in the Revenue Budget. The letter received from Tayside Pension Fund (see Appendix 2) provides an estimate, based on an actuarial calculation, that a decision to disinvest in tobacco stocks could result in the employer contribution rate increasing by 3.1% to 21.1%. This would equate to an additional employer contribution cost to Perth and Kinross Council of an estimated £2.519m per annum.

5. CONCLUSIONS AND RECOMMENDATIONS

- 5.1 The Counsel Opinions appear to be slightly contradictory. Mr Griffin QC does not appear to share the view that the fund is entitled to take an ethically based decision unless there is an alternative investment available which produces comparable returns. As this is the more restrictive interpretation of the Fund's decision making powers, it is considered the prudent and robust course for the Committee to reflect this Opinion.
- 5.2 Accordingly, should the Committee be minded to request the Tayside Pension Fund to disinvest in tobacco stocks it is considered that it would be incumbent upon it to identify alternative investments of comparable value to the Fund in order to prevent returns being seriously diluted. At this time officers of Tayside Pension Fund are unable to recommend any other investment which would deliver this objective without materially affecting the volatility of risk and return, given the existing investment objectives and constraints.
- 5.3 The information obtained from the actuary indicates that a decision to disinvest from tobacco stocks in the absence of an identified appropriate alternative could result in a significant increase in the Council's employer contribution rate.
- 5.4 It is recommended that the Committee:
- 5.4.1 Advises the Tayside Pension Fund that it would support the Fund disinvesting in tobacco stocks given the effect of tobacco on the health of the citizens of Perth and Kinross only if suitable alternative investments are identified.

- 5.4.2 Requests that the Tayside Pension Fund, through its Fund Managers, keeps the issue of alternative investments to tobacco under review and that if the Fund Managers can identify other investments which would provide satisfactory returns without materially affecting the volatility of risk and return, the Fund should disinvest in tobacco.

Authors

| Name | Designation | Contact Details |
|--------------|------------------|--|
| Scott Walker | Chief Accountant | swwalker@pkc.gov.uk 01738 475515 |
| Geoff Fogg | Legal Manager | GFogg@pkc.gov.uk 01738 475130 |

Approved

| Name | Designation | Date |
|------------|------------------------|------------|
| John Symon | Head of Finance | 24/09/2014 |
| Ian Innes | Head of Legal Services | 24/09/2014 |

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Council Text Phone Number 01738 442573

ANNEX

1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

The undernoted table should be completed for all reports. Where the answer is 'yes', the relevant section(s) should also be completed

| Strategic Implications | Yes / None |
|---|-------------------|
| Community Plan / Single Outcome Agreement | None |
| Corporate Plan | Yes |
| Resource Implications | |
| Financial | Yes |
| Workforce | Yes |
| Asset Management (land, property, IST) | Yes |
| Assessments | |
| Equality Impact Assessment | Yes |
| Strategic Environmental Assessment | Yes |
| Sustainability (community, economic, environmental) | Yes |
| Legal and Governance | None |
| Risk | None |
| Consultation | |
| Internal | Yes |
| External | None |
| Communication | |
| Communications Plan | None |

1. Strategic Implications

1.1. Corporate Plan

1.1.1. The Council's Corporate Plan 2013 – 2018 lays out five outcome focussed strategic objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:

- (i) Giving every child the best start in life;
- (ii) Developing educated, responsible and informed citizens;
- (iii) Promoting a prosperous, inclusive and sustainable economy;
- (iv) Supporting people to lead independent, healthy and active lives; and
- (v) Creating a safe and sustainable place for future generations.

1.1.2 This report relates to objective (iii).

2. Resource Implications

2.1. Financial

2.1.1. The financial implications of this proposal are set out in the main body of this report in Section 4.

2.2. Workforce

2.2.1. There are no direct workforce implications arising from this report other than those reported within the body of the main report.

2.3. Asset Management (land, property, IT)

2.3.1. There are no direct asset management implications arising from this report other than those reported within the body of the main report.

3. Assessments

3.1. Equality Impact Assessment

3.1.1. Under the Equality Act 2010, the Council is required to eliminate discrimination, advance equality of opportunity, and foster good relations between equality groups. Carrying out Equality Impact Assessments for plans and policies allows the Council to demonstrate that it is meeting these duties.

3.1.2. The information contained within this report has been considered under the Corporate Equalities Impact Assessment process (EqIA) and has been assessed as **not relevant** for the purposes of EqIA.

3.2 Strategic Environmental Assessment

3.2.1 The Environmental Assessment (Scotland) Act 2005 places a duty on the Council to identify and assess the environmental consequences of its proposals.

3.2.2 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

3.3 Sustainability

3.3.1 Under the provisions of the Local Government in Scotland Act 2003 the Council has to discharge its duties in a way which contributes to the achievement of sustainable development. In terms of the Climate Change Act, the Council has a general duty to demonstrate its commitment to sustainability and the community, environmental and economic impacts of its actions.

- 3.3.2 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

4. Consultation

4.1 Internal

- 4.1.1 The Chief Executive has been consulted in the preparation of this report.

2. BACKGROUND PAPERS

- 2.1 No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

3. APPENDICES

Appendix 1 – Client Advice Note – Tayside Pension Funds – received from Barnett Waddingham

Appendix 2 – Tayside Pension Fund Employer Consultation – correspondence from Dundee City Council dated 12 June 2014

Client Advice Note

| | |
|-------------|-----------------------|
| Client | Tayside Pension Funds |
| Subject | Tobacco Investments |
| Prepared by | Roisin McGuire FFA |
| Reviewed by | Graeme D Muir FFA |
| Date | 1 April 2014 |

1. Introduction

- 1.1. We have been asked by Tracey Russell to undertake some analysis on the potential impact on the funding position and contribution requirements if the Main Fund was to avoid investing in tobacco stocks.

2. Data

- 2.1. Tracey has provided us with some data supplied by the Fund managers on what the assets values would have been as at 30 June 2013 had they not invested in the tobacco sector in the previous 5 years.
- 2.2. This analysis shows that the assets would have been £32m less had the Fund avoided tobacco stocks over that 5 year period. £32m represents approximately 1.4% of the total assets as at 30 June 2013 which equates to a reduction in return on the Fund of approximately 0.3% per annum over the previous 5 years.

3. Analysis

- 3.1. To assess the impact on funding position we have taken as our starting point the Inter-valuation Monitoring Report prepared by ourselves as at 30 June 2013.
- 3.2. We have then recalculated the results of the intervaluation monitoring assuming
- Assets lower by £32m
 - Future investment returns 0.3% lower than previously assumed

4. Results

4.1. The following table sets out the result of the analysis:

| Smoothed Valuation | | | |
|--|-----------|--------------|--------------------------------|
| June 2013 | Published | Lower Assets | Lower Assets and Lower Returns |
| Assets (£000s) | 2,321,365 | 2,289,282 | 2,289,282 |
| Liabilities (£000s) | 2,212,434 | 2,212,434 | 2,293,409 |
| Surplus/(Deficit) (£000s) | 108,932 | 76,849 | (4,126) |
| Funding Level % | 104.9% | 103.5% | 99.8% |
| Ongoing Cost (% of payroll) | 16.2% | 16.2% | 16.8% |
| Past Service Ctn (% of payroll) | (2.5%) | (1.8%) | 0.0% |
| Total Ctn (% of payroll) | 13.7% | 14.5% | 16.8% |
| Total Payroll (£(000s) at 31 Mar 2013) | 350,000 | 350,000 | 350,000 |
| Total Ctn (£000s) | 48,080 | 50,648 | 58,871 |

A1.1. As we see the funding level would have been 1.4% lower and the total required contribution rate would have been 0.8% of payroll higher if we only allow for the lower asset value. Assuming a total payroll of £350m this would equate to an extra £2.5m or so in extra contributions

A1.2. If we also assume that the reduction in return over the last 5 years is replicated in all future years then the funding level drops by a further 3.7% and results in extra contributions of 3.1% of payroll or an extra £10.8m in contributions.

4.2. We would be pleased to answer any questions arising from this note.



Graeme D Muir FFA



Roisin McGuire FFA



Marjory Stewart - Director of Corporate Services
Floor 4, Dundee House,
50 North Lindsay Street, Dundee, DD1 1NZ

Tel 01382 434000
Fax 01382 433045

Bernadette Malone
Chief Executive
Perth & Kinross Council
2 High Street
Perth
PH1 5PH

If calling please ask for

Marjory M Stewart - 01382 433555
Email: Marjory.stewart@dundeecity.gov.uk

Our Ref MS/at
Your Ref
Date 12 June 2014

Dear Sir/Madam

Tayside Pension Fund Employer Consultation

At the last Pensions Investment Sub-Committee, it was reported that officers would obtain a fund report from Barnett Waddingham, the funds actuary, showing the effect on the fund value and the required employer contribution rate if there had been no investments in the tobacco industry over the last 5 years and what the impact would be on the future 5 years if the fund chose not to invest in the tobacco industry.

The figures received from Barnett Waddingham based on the last 5 years investment demonstrate that the fund value would have been £32m lower and that employers would have had to contribute an additional £2.5m per annum (requiring an additional 0.8% of individual payrolls). Going forward, if the reduction in returns is replicated then there would be a requirement for an additional £10.8m employer contribution (3.1% of individual payrolls). An individual estimate of the impact on your organisations contributions is attached.

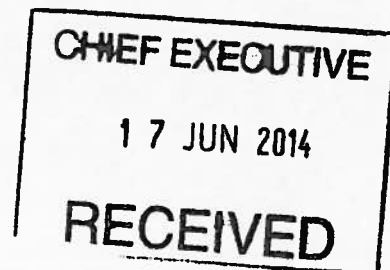
This information is now being submitted to all employers in the fund asking for their views in light of these figures and whether they believe that the fund should seek to withdraw from tobacco investments. I would ask that you respond in writing if you have any views regarding this that you would wish considered by Friday 26th September 2014.

Roger Mennie, our Head of Democratic and Legal Services, has shared the Counsel's Opinions which have been received in Scotland and in England and Wales regarding this issue with Ian Innes and you will no doubt wish to consult with her when replying.

Yours sincerely

Marjory M Stewart

Marjory M Stewart
Tayside Pension Fund



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TAYSIDE PENSION FUND

Employer :- 030 Sch Perth General Fund

| | |
|---|-------------------|
| 2013/2014 Employers Pension Contributions (Actual) | £14,630,484 |
| Future Employers Pension Contributions based on 2013/2014 +3.1% (21.1% contribution rate) | £17,150,178 |
| Estimated Increase of Employers Pension Contributions (1 Year) | <u>£2,519,694</u> |
| Estimated Increase of Employers Pension Contributions (5 Year) | £12,598,472 |