

LONDON BOROUGH OF HAMMERSMITH & FULHAM

Report to: Pension Fund Committee

Date: 26 November 2024

Subject: Defence Company Stocks Discussion Paper

Report author: Siân Cogley, Pension Fund Manager

Responsible Director: Phil Triggs, Tri-Borough Director of Treasury and Pensions

SUMMARY

This report provides an overview of the LBHF Pension Fund's exposure to the weapons sector as at 30 June 2024, following a request from the Chair of the Pension Fund Committee for a discussion paper earlier this year.

RECOMMENDATIONS

1. That the Pension Fund Committee discuss the Fund's exposure to the weapons sector, shown as Appendix 1, and decide whether further action is required.

Wards Affected: None

Our Values	Summary of how this report aligns to the H&F Values
Being ruthlessly financially efficient	Ensuring good governance for the Pension Fund should ultimately lead to better financial performance in the long run for the Council and the council tax payer.

Financial Impact

There are no immediate financial implications arising from this report, although investment performance has an impact on the Council's employer contribution to the Pension Fund and this is a charge to the General Fund

Legal Implications

None.

DETAILED ANALYSIS

1. Background

- 1.1 Following an enquiry made to the Chair of the Pension Fund Committee regarding the Fund's investments in arms companies, the Chair requested that officers prepare a discussion paper to be reviewed at the next appropriate meeting of the committee.
- 1.2 Officers requested information from all investment managers. The information requested covered:
- A list of all current investments made by the pension fund in companies involved in the manufacturing, distribution, or sale of arms and weaponry as at 30 June 2024.
 - Details of any investment policies or guidelines that pertain to investments in the defence sector, particularly those related to arms and weaponry for the products that the LBHF Pension Fund is invested in.

2. Position

- 2.1 At 30 June 2024, the LBHF Pension Fund Value was valued at £1,373,559,710.
- 2.2 The exposure to companies involved in the manufacturing, distribution, or sale of arms and weaponry across the whole portfolio was 3.5%.
- 2.3 The table below shows the types of investment, the company, whether the investment is held within the LCIV pool, the estimated value and the percentage it represents of the overall pension fund value.

Investment Type	Name	Pooled Investment?	Value £000	% of Overall Fund Value
Equity	BAE Systems	Under Pool Management	470	0.034%
Equity	Northrop Grumman	Under Pool Management	256	0.019%
Equity	Rheinmetall	Under Pool Management	342	0.025%
Equity	TransDigm Group	Under Pool Management	385	0.028%
Equity	CAE	Under Pool Management	470	0.034%
Equity	Elbit Systems	Under Pool Management	-	0.000%
Equity	HEICO A	Under Pool Management	43	0.003%

Equity	L3Harris Technologies	Under Pool Management	43	0.003%
Equity	Thales	Under Pool Management	43	0.003%
Equity	Axon Enterprise	Under Pool Management	684	0.050%
Equity	ArcelorMittal	Pooled	296	0.022%
Equity	Bayer	Pooled	696	0.051%
Equity	Vallourec	Pooled	484	0.035%
Equity	Accenture Plc Cl A Usd	Pooled	7,139	0.520%
Equity	Alphabet Inc Class A	Pooled	6,506	0.474%
Equity	Atlas Copco Ab-a Shs	Pooled	2,139	0.156%
Equity	CDW Corp Com	Pooled	2,650	0.193%
Equity	Danaher Corp Com	Pooled	1,110	0.081%
Equity	Microsoft	Pooled	11,837	0.862%
Equity	Texas Instruments	Pooled	4,867	0.354%
Equity	Thermo Fisher Scientific	Pooled	5,816	0.423%
Bonds	AT&T	Pooled	660	0.048%
Bonds	General Motors	Pooled	299	0.022%
Bonds	Thermo Fisher Scientific	Pooled	593	0.043%
Bonds	Walmart	Off Pool	295	0.022%
TOTAL			48,121	3.503%

3. Fiduciary Duty

- 3.1 The LBHF Pension Fund is committed to being a responsible investor and a long-term steward of the assets in which it invests. The Fund has a fiduciary duty to act in the best interests of its beneficiaries and this extends to a wide variety of Environmental, Social and Governance (ESG) considerations, including the infringement of human rights and violations of international law.
- 3.2 When decision makers exercise their LGPS investment responsibilities, the primary purpose must be to achieve the required investment returns in an appropriately risk managed way to pay pensions in full when they

become due, minimising the need for additional funding in the future. LGPS administering authorities are required to invest the Fund in the best interests of scheme members and employers.

- 3.3 The phrase “best interests” in the context of pension scheme investments will typically mean “the best financial interests” of scheme members and this is referred to as the fiduciary duty. Value, risk and yield of investments should therefore drive the administering authority’s decisions and there exists a duty to scheme employers to invest competently so as not to unnecessarily inflate the contributions needed from them in the future.
- 3.4 Arising from these duties, financial factors must always be taken into consideration in the setting of the investment strategy. Under the LGPS Investment Regulations 2016, administering authorities are required to include in their investment strategies a policy on how ESG considerations are taken into account in the selection, non-selection, retention and realisation of investments.
- 3.5 It is not appropriate for investment decisions to be driven directly by the political views of committee members, except as where prescribed in law, e.g., under the Sanctions and Anti-Money Laundering Act 2018. The Supreme Court held, in its judgment on the Palestine Solidarity Campaign case, that it is not appropriate for political preferences, whether local or national, to take precedence over what is required under the fiduciary duty.
- 3.6 This makes pension fund committees different from other local government committees that are dealing with service provision, and which have to make political choices about the prioritisation of scarce public resources.
- 3.7 Thus, pension fund committees are required to focus on ensuring that good investment decisions are made in the best interests of scheme members, taking into account all relevant considerations and excluding irrelevant ones, with committee meetings not used as a forum to set out political positions.
- 3.8 Scheme members and the public have a right to lobby the administering authority and peacefully protest against decisions but, when acting within the fiduciary duty, the administering authority is legally obliged to limit itself to acting in the best interests of scheme members.

4. Further Considerations

- 4.1 The Supreme Court ruling of 29 April 2020 ruled that the administering authority can take into consideration beneficiaries’ ethical and moral concerns into account when devising an investment strategy. However, as per advice from the LGPS Scheme Advisory Board (SAB), it is not appropriate for investment decisions to be driven directly by political views, except as where prescribed in law.

- 4.2 It is important to note that the LBHF Pension Fund has made conscious decisions to transition a significant proportion of its equity holdings into ESG-tilted funds, which emphasises the committee's stance on sustainability and societal impacts of the portfolio. For example, the Morgan Stanley global equity fund seeks to provide a concentrated high-quality global portfolio of companies, excluding tobacco, alcohol, gambling, weapons, fossil fuels, and gas/electrical utilities.
- 4.3 The current Passive Equity Allocation (LGIM MSCI) is an index-tracker multi-investor pooled product and, as such, there is no explicit Arms or Weapons exclusions applied to the fund or index. LGIM does have a fund range, known as the Future World Fund Range, that applies exclusions to certain arms manufacturers.
- 4.4 The LBHF Pension Fund has engaged with asset managers on their approach to human rights, and the implementation of these factors in their investment decision making process. LBHF Pension Fund can confirm that various investment managers implement a specific human rights screening within their investment process, including compliance with the United Nations Global Compact (UNGC). Managers without an official screening process ensure compliance with local laws surrounding human rights, labour laws and anti-bribery/anti-corruption laws.
- 4.5 The Fund takes guidance from the Local Authority Pension Fund Forum (LAPFF), a pressure group of 86 LGPS pension funds, which engages on London Borough of Hammersmith and Fulham Pension Fund's behalf with companies on a range of ESG matters, including human rights and international law.
- 4.6 On 24 October 2024, Nigel Giffin KC, provided an opinion to the LGPS Scheme Advisory Board (SAB). The opinion argues that it would not be unlawful for administering authorities of LGPS funds to invest in entities involved with activities related to Israel's actions concerning Gaza or other Palestinian territories.

Key points:

- 4.7 **Criminal Liability:** The opinion refutes claims that such investments could lead to criminal liability under the International Criminal Court Act (ICCA) 2001 or the Terrorism Act 2000. Ordinary investments in companies do not constitute assistance in those companies' activities or in any alleged crimes by entities receiving goods or services from them. Likewise, investment in Israeli government bonds does not imply liability unless specifically linked to criminal activities.
- 4.8 There is insufficient public evidence to conclusively determine that Israel is committing ICCA offenses, so administering authorities cannot be considered to have the necessary criminal intent.
- 4.9 **Terrorism Act:** Investing in such companies does not constitute an "arrangement" under the Terrorism Act 2000, and actions by a foreign government do not meet the definition of terrorism within the Act.

- 4.10 Public and International Law: Local authorities, as administrators of pension funds, are not bound by international law obligations. The opinion also finds no public law obligation requiring these authorities to consider international law breaches when making investment decisions.
- 4.11 In conclusion, the opinion clarifies that, while international law may be relevant for broader ethical considerations, it does not legally obligate LGPS funds to avoid such investments.
- 4.12 The full opinion is attached as **Appendix 1**.

5. Next Steps and Recommendations

5.1 The Committee is requested to consider the following points in regard to any requests that the Fund divest from specific arms companies and the Israeli state:

- Under the Fund's current policies, decision making regarding the implementation of ESG factors is delegated to the Fund's investment managers. The Fund should maintain a policy of non-interference with the day-to-day decision making of the investment managers, while ensuring the implementation of ESG policy by each manager is consistent with current best practice and the appropriate disclosure and reporting of actions.
- Rather than having an exclusion or divestment policy from companies, the Fund aims to engage with and encourage companies to take positive action regarding ESG issues. The LBHF Fund is a responsible owner of companies and cannot exert positive influence if it has divested from companies. The Fund is also a LAPFF member, the officers of which have experience of engagement with global companies operating in conflict zones, including the Israeli/Palestinian territories.
- The cost of divestment from holdings may attract significant fees and charges, as well as opportunity costs for time out of the market. If the Fund wanted to exclude particular companies from any portfolio, it would need to enter into a segregated mandate, outside of the LCIV sub-funds or index-tracker funds, resulting in significant cost.
- The Fund must consider its fiduciary duty and regulatory requirements before any divestment decisions can be considered. Of particular note is the "Economic Activity of Public Bodies (Overseas Matters) Bill", which was previously working its way through parliament. It is not known for certain if the new government will complete this bill.

- As per the Supreme Court ruling, it is not appropriate for political preferences, whether local or national, to take precedence over what is required under the fiduciary duty.
 - The Fund has not found any evidence of its asset managers breaching any international laws, with due care taken in regard to local laws surrounding human rights.
- 5.2 It is therefore recommended that the Committee should not take any divestment action. The Fund will continue to encourage positive change on all ESG factors, while officers will continue to engage with the investment managers to monitor investment performance, including consideration of human rights, international law and other ESG issues.

LIST OF APPENDICES

Appendix 1: LGPS SAB Legal Opinion drafted by Nigel Giffin KC