



Investment or Divestment *Is Ethical Banking the answer?*

June 2016

EXECUTIVE SUMMARY

Council has sought an initial report on options, analysis and recommendations to be provided on a strategy to move Council's investments away from financial institutions that fund fossil fuel developments. This strategy will be incorporated into current investment policy to maximise benefits for Bass Coast Shire ratepayers and the community.

The Council Resolution specifically requests an options, analysis and recommendations report addressing the following three items:

- Whether only term investments, or additionally operational transaction accounts, should be part of this strategy – Scope of Strategy
- Whether screening of financial institutions is done by simply avoiding those having fossil fuel linked investments or whether we can prioritise those supporting clean renewable energy initiatives,
- Options to advocate to financial institutions to improve their performance both financially and environmentally.

BACKGROUND

At the March 2014 ordinary meeting, Council adopted a position to protect our unique assets that said in part "Council is totally opposed to exploration and mining of coal, and unconventional gas". To support this position as well as Council's commitment to Bass Coast being recognised as a region of environmental significance, Council has requested development of a strategy to divest or to move its investments away from financial institutions that fund fossil fuel developments. This environment driven approach can often conflict sharply with the more traditional economic rationalist approach of seeking the highest return on investment from a financial perspective only. Neither approach considered in isolation is either appropriate or without cost or risk, and the ideal direction seeks to balance the two using an approach more aligned with triple bottom line that also considers social impacts.

REGULATORY REQUIREMENTS

First and foremost, any investment decisions or strategy by Council must comply with the requirements of the *Local Government Act 1989* (the Act). The Act sets out the principles of sound financial management that must be implemented by Council, which have been reflected in the objectives of the current Funds Investment Policy. The Policy provides a prudent framework for management of the investment portfolio with the objectives of preservation of capital (minimising exposure to risk) and maximisation of returns.

SCOPE OF STRATEGY

Transactional Banking

The key considerations in selecting an institution for transactional banking include the ease of use (including the complexity of product offerings), accessibility (branch network) and cost efficiency, to enable delivery of Council's day-to-day banking functions. Including transactional banking in the scope of the strategy would leave Council very few options for institutions, as it would currently exclude most of the major banks. Anecdotal evidence suggests that such an approach would have an adverse impact on the level of service provided to residents and ratepayers (through reduced electronic banking payment options), reduced electronic banking functionality for administration of banking activities by Council staff, and would come at an increased cost to Council for banking services. As Councils change transactional banking arrangements infrequently, at this time little data is available to perform a detailed comparison without testing the market. Banking services are however to go out for tender in 2016 and as part of the tender process consideration of sustainability commitments and investment strategy will be incorporated. As noted above the key consideration in awarding the tender will be functionality and financial performance.

Term Investments

As part of its business operations, Council invests funds with various financial institutions in order to maximise returns for ratepayers and the community, whilst ensuring the capital (or funds) are kept as securely as possible. Under the current Funds Investment Policy Council considers the social impact on the local community as well as prudent financial management by having a mechanism to support investing with the local Community Bank.

It should be noted that Council already invests a portion of funds in non-fossil fuel aligned financial institutions¹ and for example as at 18 December 2015 31% of the term investments held by Council were with institutions with no investment in fossil fuels.

Term investments are most suited to targeting the social and environmental impact of Council investments.

Indirect Investments

The impact of Council's activities is broader than simply the direct investments of Council. Council also makes indirect investments which can lead to support of fossil fuel developments through the significant amount paid for employee superannuation, and also for insurance.

Employees have the right under legislation to choose their superannuation fund, and as such Council cannot influence how employees choose to invest their retirement savings where choice of fund is exercised. The default fund selected by Council is Vision Super, whose Balanced investment option is invested in 24% known fossil free companies, 11% companies that are either part of the fossil fuel industry or provide critical support to the fossil fuel industry, and 65% unknown².

Insurance in the Local Government sector in Victoria is sourced through the Municipal Association of Victoria and JLT Municipal Asset Protection Plan in order to get best value for money and achieve economies of scale.

ETHICAL BANKING APPROACH – A BALANCED APPROACH TO SUSTAINABILITY

Council has a responsibility to consider not just the environmental impacts of its activities, but also the social and financial impacts. Section 136 of the Act stipulates that Council must ensure that decisions are made and actions are taken having regards to their financial effects on future generations. The ethical banking movement is an international movement that focusses on corporate social responsibility and considers an ethical bank as one that is concerned with the social and environmental impacts of its investments and loans. Ethical banks are regulated by the same authorities and abide by the same rules as traditional banks, however follow the principles of transparency, having clear ethics policies that set out what is and isn't supported, for example in respect of renewable energy, fossil fuels, tobacco products, social investment in local communities, human rights and gambling.

A challenge in trying to identify institutions who are considered "ethical", who do not invest in fossil fuels, or who support another objective (for example renewable energy), is to find a credible source of information to support the assessment of the institution. A source commonly used by Local Government is Market Forces, an organisation that believes that the banks, superannuation funds and governments that have custody of money should use it to protect the environment. To this end they have compiled information on over 120 banks, mutual and credit unions and their stance on investment in fossil fuels, however where the detailed financial research conducted by Market Forces did not cover a particular institution, a statement has been provided by the institution that does not undergo an independent review. The currency of the financial research conducted by Market Forces also gives rise to some doubt as to the authoritative nature of the organisation.

¹ Market Forces <http://www.marketforces.org.au/banks/compare> accessed 06/01/2016

Market Forces is an organisation that believes that the banks, superannuation funds and governments that have custody of money should use it to *protect not damage* the environment. To this end they have compiled information on over 120 banks, mutual and credit unions.

² Super Switch <http://superswitch.org.au/>

Another organisation who rates the ethical business practices of major companies internationally is the Ethisphere Institute, who publish an annual list of the World's Most Ethical Companies® Honorees. The scoring system focuses on ethics and compliance, corporate citizenship and responsibility, culture of ethics, governance, and leadership, innovation and reputation. In 2016 National Australia Bank was one of only two Australian banks to make the list (the other being Teachers Mutual Bank), and has made the list each year since 2011.

Although there is some risk or doubt surrounding the authoritative nature of the organisations' analysis, it would be recommended that a balanced approach using both Market Forces and Ethisphere to assess the ethical credibility of financial institutions is taken, in the absence of better sources.

IMPACT OF DIVESTING FROM FOSSIL FUELS

Due to the small size and concentrated business risks of institutions which do not lend to or invest in the fossil fuel industry, they have lower credit ratings than the major banking institutions. As a consequence divestment away from the major institutions would have a potentially higher risk of capital loss than the current portfolio.

Analysis of two scenarios is provided below which compares the impact of:

- Full divestment from institutions that support the fossil fuel industry; and
- Selection from a broader range of institutions than are currently used.

Both scenarios comply with the credit risk and institution limits of the current Funds Investment Policy.

To limit the exposure of Council the Funds Investment Policy sets limits on the proportion of funds that can be invested in a single institution, the proportion of funds that can be invested with institutions of particular credit ratings, and requires consideration of investment in the local community bank where the interest rate is within 0.3% of the best available rate. The limits on funds investment are as follows:

Funds Investment Policy Limits

Long-term Credit Rating (Moody's)	Short-term Credit Rating (Moody's)	Quality of Investment	Maximum % of funds with one institution	Maximum % of total investment	Maximum term
Aaa to Aa3	P1	Superior	60%	100%	120 days
A1 to A2	P1/P2	Good	20%	100%	120 days
A3 to Baa1	P2	Good/Adequate	10%	80%	120 days
Baa2 to Baa3	P3	Adequate	5%	10%	120 days

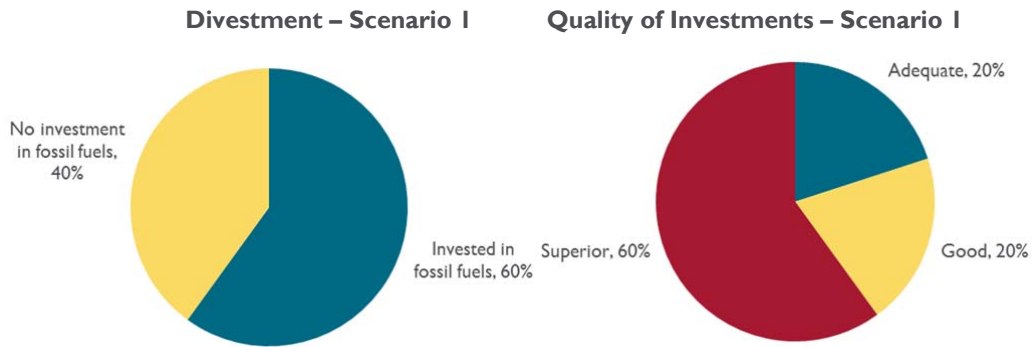
The scenarios below are based on interest rates available at 31 March 2016 for 90 day term deposits, based on a total investment of \$18 million (the monthly average year to date investment to April 2016, rounded to the nearest million dollars). Further detail of the investments for each scenario can be found in Appendix I. It should be noted that adoption of either practice will result in additional staff time being allocated to determine the ethical or fossil fuel investment status of financial institutions.

Scenario I

Scenario I follows Council's current practice to comply with the Funds Investment Policy, however extends the range of institutions considered for investment by using Curve Securities who publish daily term deposit rates for 29 institutions and coordinate the investment process.

Selection of institutions offering the best available rates within the limits of the Funds Investment Policy would result in 40% of Council's term deposits being held with funds that have no investment in fossil fuels. The other 60% would be held with National Australia Bank, who were listed by Ethisphere as one of the World's Most Ethical Companies® Honorees in 2016.

This scenario achieves the objectives of preservation of capital by managing exposure to risk through holding a significant portion of funds in superior quality investments, and also maximises returns.



Scenario 2

Scenario 2 applies the limits set out in the current Funds Investment Policy, however limits the selection of institutions to those who have no investment in fossil fuels.

Scenario 2, while still within the parameters of the Funds Investment Policy, exposes Council to a higher level of risk without a corresponding increase in returns. In fact this Scenario results in a cost to Council of \$41,400 per year in foregone interest.



ADVOCACY

The final focus point of the Council Resolution is to outline options for Council to advocate to financial institutions to improve their performance both financially and environmentally. The scope for Council to force change is limited to our market power (with regard to our investments and our banking activities). Given Council's limited size, our ability to influence is minimal on all financial institutions.

Council could, if it wished, write to the major institutions.

RECOMMENDATION

Scope of Strategy

Officers recommend that only Council's term investments are subject to any strategy to align financial operations with environmental and/or social values. The primary objectives of transactional banking are functionality and cost efficiency, and any restrictions on selection of institutions based on other criteria would be expected to have a reduction in access to electronic banking facilities.

Screening of Institutions

Officers do not recommend that Council fully divest from fossil fuel aligned financial institutions as this would have an adverse impact on Council's risk management focus and investment objectives, including the primary objectives of the preservation of capital and maximisation of returns.

It is recommended that any investment strategy should follow an ethical banking approach that considers the social and environmental impacts of investing with particular institutions. This approach takes a broader view than focussing only on fossil fuel investment, and is consistent with the values of Council to consider the social wellbeing of the community as well as environmental sustainability.

It is proposed that Council seek to prioritise investments in non-fossil fuel aligned financial institutions and ethical institutions if the investment is compliant with Council's Funds Investment Policy and the rate of return is favourable in comparison to other investments available at the time, as outlined in Scenario 1. This approach is also consistent with Council's environmental commitments and with Council's commitment to cap rate increases.

The organisations Market Forces and the Ethisphere Institute can be used to assess the proportion of funds invested with institutions that are considered ethical and do not support fossil fuels, but the activities of Council should not be limited by the assessments of these organisations.

Advocacy

Council's ability to directly force changes in behaviour of major banking institutions is limited. Advocacy options available include writing directly to the major institutions.

APPENDIX I

Scenario 1 - Compliant with Investment Policy, consideration of community banks, extension of range of institutions considered

Institution	Long Term Credit Rating	Short Term Credit Rating	Interest rate at 31/03/2016	Divestment Status	Investment Quality	Institution limit	Credit Rating limit	Portion invested	Amount invested	Annual Yield
National Australia Bank	Aa2	P-1	3.02%	Invested in fossil fuels	Superior	60%	100%	60%	\$ 10,800,000	\$ 326,160
Bank of Queensland Limited	A3	P-2	2.90%	No investment in fossil fuels	Good	10%		10%	\$ 1,800,000	\$ 52,200
Members Equity Bank Limited	A3	P-2	2.85%	No investment in fossil fuels	Good	10%		10%	\$ 1,800,000	\$ 51,300
Beyond Bank	Baa1	P-2	3.05%	No investment in fossil fuels	Adequate	10%	80%	10%	\$ 1,800,000	\$ 54,900
Auswide Bank	Baa2	P-2	2.90%	No investment in fossil fuels	Adequate	5%		5%	\$ 900,000	\$ 26,100
Mystate Bank Ltd	Baa2	P-2	2.90%	No investment in fossil fuels	Adequate	5%	10%	5%	\$ 900,000	\$ 26,100
								100%	\$ 18,000,000	\$ 536,760

Scenario 2 - Compliant with Investment Policy, fully divested from fossil fuels

Institution	Long Term Credit Rating	Short Term Credit Rating	Interest rate at 31/03/2016	Divestment Status	Investment Quality	Institution limit	Credit Rating limit	Portion invested	Amount invested	Annual Yield
Bendigo and Adelaide Bank Limited	A2	P-1	2.60%	No investment in fossil fuels	Good	20%	100%	40%	\$ 7,200,000	\$ 187,200
Bank of Queensland Limited	A3	P-2	2.90%	No investment in fossil fuels	Good	10%		10%	\$ 1,800,000	\$ 52,200
Members Equity Bank Limited	A3	P-2	2.85%	No investment in fossil fuels	Good	10%		10%	\$ 1,800,000	\$ 51,300
Heritage Bank	A3	P-2	2.74%	No investment in fossil fuels	Good	10%		10%	\$ 1,800,000	\$ 49,320
Beyond Bank	Baa1	P-2	3.05%	No investment in fossil fuels	Adequate	10%		10%	\$ 1,800,000	\$ 54,900
People's Choice Credit Union	Baa1	P-2	2.68%	No investment in fossil fuels	Adequate	10%	80%	10%	\$ 1,800,000	\$ 48,240
Auswide Bank	Baa2	P-2	2.90%	No investment in fossil fuels	Adequate	5%		5%	\$ 900,000	\$ 26,100
Mystate Bank Ltd	Baa2	P-2	2.90%	No investment in fossil fuels	Adequate	5%	10%	5%	\$ 900,000	\$ 26,100
								100%	\$ 18,000,000	\$ 495,360

Funds Investment Policy

1. Preamble

As part of its business operations, Council invests funds from time to time in order to maximise benefits for Bass Coast Shire ratepayers and the community. This policy establishes the basis for such investments.

2. Policy objectives

- 2.1 Preservation of capital** - Investments must be placed in a manner that safeguards the investment portfolio. This includes managing interest rate exposure risk within identified thresholds and parameters, by using recognised risk ratings criteria and by complying with legislative requirements.
- 2.2 Maximisation of returns** - Investments should be placed in a manner that maximises the return on funds, taking into account the need to maintain liquidity. This will include taking into account the balance between risk and return and the need to preserve capital.
- 2.3 Social and environmental benefit** – Investments should be placed in a manner that considers the social and environmental impacts of the financial institutions offering the investments. This allows a ‘triple bottom line’ approach to investment decision making and supports ethical banking practices.
- 2.4 Community benefit** - Investments should be placed in a manner that provides Community Banks within the Shire access to Council’s investment business. This may increase Community Banks’ ability to reinvested profits in community projects within the Shire, thereby increasing the potential for community benefit.

3. Policy statement

3.1 Preservation of Capital

The preservation of capital will be achieved by investing with institutions that are legally authorised and secure as indicated by their relative credit rating.

In determining the institutions that Council will invest in, Council will:

- a) Comply with Section 143 of the Local Government Act 1989 which sets out the institutions with which Council can invest (an authorised deposit-taking institution and any financial institution guaranteed by the Government of Victoria).

- b) Only invest with institutions that have the following credit ratings (or equivalent), subject to the limits set out below:

Long-term Credit Rating		Short-term Credit Rating		Maximum % of funds with one institution	Maximum % of total investment	Maximum term
Moody's	Standard & Poors	Moody's	Standard & Poors			
Aaa to Aa3	AAA to AA-	P1	A-1+	60%	100%	120 days
A1 to A2	A+ to A	P1/P2	A-1	20%	100%	120 days
A3 to Baa1	A- to BBB+	P2	A-2	10%	80%	120 days
Baa2 to Baa3	BBB to BBB-	P3	A-2/A-3	5%	10%	120 days

- c) If any of Council's investments are with an institution whose credit rating has been downgraded such that they no longer fall within these ratings, they will be divested at maturity or as soon as practicable.
- d) If a different level of rating is applied by one of the Rating Agencies, the lower of the ratings will be utilised by Council in assessing the rating of that financial institution for investment purposes.

3.2 Maximisation of returns

Returns on investment will be maximised as follows:

- By investing surplus cash not required to meet Council's immediate cash flow needs in term deposits.
- By using a sweep facility to clear surplus cash required to meet immediate cash flow needs from Council's Operating Account into an At Call Account at the end of every business day.
- Term Deposit quotes may be sought from investment intermediaries who source deposit rates from a wide range of banking institutions. As a minimum, three quotes are required before investing or re-investing funds.
- The best possible investment rate must be selected, subject to the limits outlined in this policy at 3.1 b), 3.3 b) and 3.4 b). These limits apply at the time of investment.

3.3 Social and environmental benefit

- The determination as to which financial institutions support sound social, environmental or ethical practices will be made by referring to assessments by various organisations who gather data on the ethical, social or environmental status of financial institutions (such as Market Forces and Ethisphere).
- Preference will be given to investing with such financial institutions where the interest rate quoted is comparable with the best available rate quoted under 3.2 b), subject to the limits set out in 3.1 b).

3.4 Community Benefit

- a) Community Banks play an important role in funding local community projects which result in significant benefit. In order to maximise the pool of available funds for distribution for community projects, Community Banks seek to maximise business activity within the Shire.
- b) Council will, subject to the limits set out in 3.1 b), support local Community Bank branches by investing some of its surplus funds where the quoted rate is within 0.3% of the best available rate quoted under 3.2 b) above.

4. Reference to other documents

Section 136 of the *Local Government Act 1989*
Section 143 of the *Local Government Act 1989*

5. Review process

This policy will be reviewed by Council within two years of it coming into operation.

6. Accountability process

The Manager Finance will provide a quarterly report to Council on investing activities undertaken under this policy.

7. Approval

Approved by Council at its meeting held on	Date
Signed by the Mayor (Name) Cr	
Date	