ISLINGTON

For a more equal future

Resources Department
222 Upper Street
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Report of: Corporate Director of Resources

Meeting of: Pensions Committee

Date: 3 December 2024

Ward(s): N/A

SUBJECT: Passive Equity Portfolio Restructuring Update

1. Synopsis

1.1 This provides an update on restructuring the Pension Fund's passive equity portfolio. Committee members have previously stated a desire to merge the MSCI Low Carbon and Paris Aligned World Equity index funds.

1.2 This report considers the cost, investment implications and legal advice for the fund to do so.

2. Recommendations

2.1 The Committee is recommended:

(a) to agree to the transfer of the MSCI Low Carbon target index fund assets into the Paris Aligned World Equity Index. This will not be a pooled fund of one but simply combining the two portfolios;

(b) to update the Investment Strategy Statement (ISS) as stated in 3.3.6 of this report; and

(c) to agree that the decisions recommended in this report supersede the decisions made by this Committee on 26th September 2024.

3. Background

3.1 The Pension Fund pools passive equity investments with other investors in two large passive equity pooled funds which are managed by Legal & General Investment

Management Ltd (LGIM). These pooled funds track the MSCI low carbon target index and the Paris Aligned World equity index. The Fee structures and investment values for these Funds are currently:

- MSCI Low Carbon: 6.76 basis Points (149k pa), £220m invested.
- Paris Aligned World Equity Index: 8 basis points, (146k pa) £183m invested.

3.1.1 These pooled funds track two separate indices, weighting stocks in the portfolio according to their relevant size in their respective index.

3.1.2 Currently Islington Pension Fund has no say in the composition of these indices and can ask for no amendments or exclusions. The only way to adjust holdings would be to sell assets and move out of the Fund and to track a new customised index.

3.1.3 The Pension Fund Committee had expressed a desire to explore the exclusion from the Fund's investments of companies on the UN's list of businesses involved in activities in the Occupied Palestinian Territory and deemed complicit in human rights abuses.

3.1.4 The Fund's investment manager, LGIM, had recommended that the simplest and cheapest way of doing this would be to create a single pooled fund of one investor that combines both portfolios into one. This would enable the Fund to customise its benchmark.

3.1.5 Creating a pooled fund of one would give the Fund the flexibility to make other custom alterations in the future should it be considered desirable to do so (but subject to legislative changes which seem likely, at some point in the future, to require the Council to pool its funds more widely).

3.1.6 This could be done for a total ongoing fee of 8 basis points per annum on the total portfolio. Based on the values listed above, this would be an increase in fees from £295k per annum to £322k per annum, an increase of £27k pa. This would result in both funds tracking a custom version of the Paris Aligned World Equity Index.

3.1.7 There would be one off transition costs for this process which would amount to an estimated £105k.

3.1.8 Members agreed at the meeting of 24th July 2024 this was the preferred course of action but noted that officers would need to carry out additional compliance tasks before this decision could be taken.

3.1.9 At the meeting of 26th September 2024, following advice from Mercer, the Committee decided that they wished to transfer the MSCI Low Carbon index into the Paris aligned Fund and into a separate pooled fund regardless of whether or not it was subsequently decided to divest from any particular companies. This is because the Paris Aligned Fund better meets the Committee's overall investment objectives in terms of increasing allocations to growth and technology assets and reducing carbon heavy investments such as energy and mining, which the Committee expects to underperform in the long run.

3.1.10 Since the 26th September meeting, Members have further reviewed financial and legal considerations and change of circumstances and concluded that the costs and technical complexities of the novel single fund may be disproportionate and vulnerable to legal challenge.

Paris Aligned vs MSCI Low Carbon

3.2.1 The Paris Aligned and Low Carbon index trackers both have the investment objectives of tracking the broader benchmark MSCI world index return, but to achieve this in a more environmentally sustainable manner. The MSCI world index simply invests capital in companies according to their size, IE investing more in the world's biggest companies. The MSCI Low Carbon and Paris Aligned funds start with this base, but change the weightings of these companies based on different factors, such as carbon emissions. As such they make significant deviations from the broad MSCI world index, most notably in energy as their exposure to fossil fuels is very low, and zero in the case of the Paris Aligned Fund.

3.2.2 The Paris Aligned index goes further than the low carbon index and has a significant number of exclusions and changes in company index weights based on a variety of environmental, social and governance factors. This also includes excluding Tobacco stocks for example, which could be considered a shrinking industry. This aligns to the Committee's belief that companies that have better Environmental, Social and Governance practices will outperform in the long run and have reduced investment risks.

3.2.3 The Paris Aligned index invests capital differently from the benchmark MSCI World Index therefore the investment return compared to the benchmark is expected to be 2% higher or lower. This is opposed to the MSCI Low carbon index which aims to keep within 0.5% of the MSCI World Index due to a more subtle approach to sector and stock deviations.

3.2.4 Since inception in 2021, the Paris Aligned index has outperformed its equivalent benchmark, the MSCI world index, by 2.12%. The Low Carbon index has also outperformed it by a smaller 0.5%. Both the risk adjusted returns of the two funds are almost identical with Sharpe Ratios of 0.84 and 0.85 respectively. In practice this means that the funds are generating additional investment returns for taking a small amount of additional risk. On a £400m investment, 2.12% outperformance represents an increased return of £8.5m over the period since inception. This positive investment performance satisfies the Administering Authority's fiduciary duties in respect of a decision to move holdings from the MSCI Low Carbon Index into the Paris Aligned Index.

3.2.5 The increased returns are mainly due to the increased amount of the fund invested in information technology which has performed strongly in the last few years and avoiding energy stocks which have lagged the market. The Paris Aligned Fund's exclusions and weightings have therefore been beneficial, but it is important to note this will not always necessarily be the case. An oil price shock or commodities boom would ensure the Paris Aligned Fund underperforms in the short term.

3.2.6 The Paris Aligned index's responsible investment exclusions and weightings are more aligned to the Committee's investment objectives set out in the investment strategy statement, which is the benefit of transferring all passive equity assets into this one fund.

3.2.7 LGIM have confirmed that transferring the MSCI World fund into the Paris Aligned fund would have a number of benefits:

- It would be approximately £25,000 cheaper in terms of transition costs.
- It could be enacted much quicker, around 2-3 months faster.
- This would align with Central Government's pensions policies on pooling of investments.
- It would reduce governance risk for officers managing a separate pooled vehicle

3.2.8 As a result of this index change, the Fund will significantly reduce exposure in a number of industries such as arms manufacturing, energy and mining, whilst increasing allocations to technology and healthcare companies. However, that is not the purpose of the proposed index change.

Divestment Considerations

3.3.1 Counsel has provided advice on divestment of companies on the UN list involved in activities in the Occupied Palestinian Territory deemed complicit in human rights abuses.

3.3.2 Further to previous advice, Counsel advised that a decision taken not for financial/investment reasons would potentially be contrary to the Law Commission advice on trustee duties, particularly where the decision was taken for reasons which may be controversial amongst the Fund's members. As such, the Council would be highly likely to face a judicial review challenge. This poses a considerable financial and reputational risk to the Pension Fund and the Council.

3.3.3 Prior to taking such a decision, the Pension Fund would also need to undertake considerable expense to consult the Pension Fund membership for their views, with the membership likely to have strong views on both sides.

3.3.4 Furthermore, the Government has proposed significant changes to local government pension funds and, through consultation released on November 17th, has indicated that all equity assets should be pooled by March 31st 2025, (and all other assets pooled by March 31st 2026) which would remove the Fund's ability to set up a new pooled vehicle just for Islington's investments.

3.3.5 Islington Pension Fund will continue to ensure that its investment managers are held to account for their actions through the Fund's engagement partner, the Local Authority Pension Fund Forum (LAPFF), and exercising voting rights as shareholders. Officers will also request regular updates from both our investment manager (LGIM) and our investment asset pool (the London CIV) on the matter.

3.3.6 A revised investment strategy statement (ISS) that strengthens the fund's responsible investment policy to include a specific section concerning human rights. The extract is shown below:

"As a responsible institutional investor, the Fund will use its influence to encourage the promotion and protection of human rights around the world. The Fund will regularly review its exposure to companies which raise human rights concerns."

4. Implications

Financial implications

4.1.1 The cost of providing independent investment advice is part of fund management and administration fees charged to the pension fund. Officers have been advised that the one off transition costs for the change of structure would be £80k. The ongoing costs of the change from the MSCI low carbon to the Paris Aligned world equity fund would be approximately £27k per annum.

4.2 Legal Implications

4.2.1 The local government pension scheme ("LGPS") is a statutory occupational pension scheme established by regulations made under s.7 of the Superannuation Act 1972, and has effect as if made under the Public Services Pensions Act 2013 ("PSPA 2013"). The Council has a formal statutory role to administer the Pension Fund on behalf of its' members and does so through this Committee.

4.2.2 The primary duty of the Committee in relation to the Pension Fund is to be able to pay, from the fund, the pensions of those employees of the Council and other relevant bodies who participate in the Pension. The Council is required to invest in accordance with the ISS. The relevant statutory powers are in reg. 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (SI 2016/946, "the 2016 Regulations") which requires the Council to formulate an investment strategy statement (reg. 7(1)) and then "invest, in accordance with its investment strategy, any fund money that is not needed immediately to make payments from the fund" (reg. 7(8)). It is therefore prudent to review the ISS regularly to ensure it is being kept up to date.

4.2.3 The Council has sought legal advice on the recommendations set out in this report. The advice confirms that it would be prudent to consider the decision to restructure the two existing LGIM passive equity funds afresh as circumstances have since changed regarding possible divestment.

4.2.4 Counsel has advised that the Committee must consider afresh the advantages and disadvantages of moving the MSCI low carbon to the Paris Aligned world equity fund, in circumstances where the Council will not be pursuing any decision to divest from companies on account of their links with the Occupied Palestinian Territories. The Committee should be mindful of the Government's recent announcement that it would be enacting legislation to require pooling of assets into "mega-funds" including within the LGPS. It is therefore likely that the Council will be required to change the configuration of its funds in the relatively near future.

4.3 **Environmental Implications and contribution to achieving a net zero carbon Islington by 2030:**

Nonapplicable to this report. Environmental implications will be included in each report to the Pension Board Committee as necessary. The current agreed investment strategy statement for pensions outlines the policies and targets set to April 2026 and 2030 to reduce the current and future absolute emissions by 49% and 60% respectively compared to when it was measured in 2016 and also invest 20% of the fund in green opportunities. The link to the full document is Islington Pension Fund Investment Strategy Statement

4.4 **Equalities Impact Assessment**

The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding

An equalities impact assessment has not been conducted because as there are no specific equality implications arising from this report.

5. Conclusion and reasons for recommendation

5.1 The Paris Aligned index represents a market leading passive equity index in terms of providing a market return whilst also closely aligning with the Pensions Committee's investment objectives, especially around climate change. As such it is recommended the Committee transfers all investment assets from the Low Carbon Fund into the Paris aligned Fund.

Appendices
Appendix A Revised Investment Strategy Statement
Appendix B Paris aligned vs MSCI Low Carbon index comparison

Background papers:
None

Final report clearance:

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INVESTMENT STRATEGY STATEMENT -DRAFT
LONDON BOROUGH OF ISLINGTON PENSION FUND – ~~SEPTEMBER 2023~~NOVEMBER 2024

1. Introduction

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require administering authorities to formulate and to publish a statement of its investment strategy, in accordance with guidance issued from time-to-time by the Secretary of State.

This Investment Strategy Statement ("ISS") has been designed to be a living document and is an important governance tool for the Fund. This document sets out the investment strategy of the Fund, provides transparency in relation to how the Fund investments are managed, acts as a risk register, and has been designed to be informative but reader focused. This document replaces the Fund's Statement of Investment Principles.

This statement will be reviewed by the Pensions Committee ('the Committee') at least triennially or more frequently should any significant change occur.

The Fund, in preparing and reviewing its ISS, will consult with interested stakeholders including, but not limited to, Fund employers, investment managers, advisers to the Fund and other parties that it deems appropriate to consult with.

Myners Principles

Although not specifically referenced in the Regulations, the Committee feels that assessment of compliance with the Myners Principles is a valuable governance tool. A copy of the Fund's Myners Compliance Statement can be found in the Annual Report and Accounts and is attached as Appendix A.

2. Investment Beliefs and Objectives

The Committee has adopted policies with the primary objective being to pay members benefits as they fall due and the secondary objective being to achieve the maximum growth of pension fund investments to reduce the burden of employer contributions. The target for real investment returns above CPI is set out in the Fund's Funding Strategy Statement**.**

The Fund has the following investment beliefs which help to inform the investment strategy derived from the decision making process.

- Funding, investment strategy and contribution rates are linked.
- The strategic asset allocation is the key factor in determining the risk and return profile of the Fund's investments.
- Investing over the long term provides opportunities to improve returns.
- Diversification across asset classes can help to mitigate the impact of adverse market conditions and assist the Fund to produce a smoother return profile due to returns coming from a range of different sources.

- Managing risk is a multi-dimensional and complex task.
- Risk mitigation will be prioritised according to size of potential impact and risks will only be taken where they are expected to be rewarded.

"Environmental Social and Governance ("ESG") factors increasingly have an impact on investment risk and return outcomes; and a responsible investment policy can lead to new opportunities and to better reputational and financial risk management.

Long term environmental sustainability is an important investment consideration as the world economy adjusts to the 2015 Paris Agreement; this presents long-term risks and opportunities to which the Fund's strategy will respond."

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3. Investment strategy and the process for ensuring suitability of investments.

As noted above, the Fund's objective is to pay benefits as they fall due and this requires the build-up of sufficient reserves in advance. The Fund is currently assessed to have a deficit in terms of the reserves needed and so the asset strategy is focused on achieving returns in excess of CPI inflation, without taking undue risk.

The asset strategy, along with an overview of the role each asset plays in achieving the Fund's objectives is set out in the table below:

Asset Category	Asset class	Allocation %	Role(s) within the strategy
Equity	Equity (developed and emerging)	45.0	-Long term growth in excess of inflation expected -Significant integration of ESG/sustainability factors
Diversified Alternatives	Infrastructure(including natural capital	14~~2~~.5	-Diversification from equity markets -Generates investment income -Returns expected to be inflation-sensitive -Exposure to Illiquidity premium
	Private Debt	10.0	-Access to 'credit risk premium' and Illiquidity premium -Generates cashflows through income and principal payments
	Impact Investments	3~~5~~.0	-Access broad range of impact opportunities across asset classes -Increase integration of sustainable investments into strategy
Property	Property	20.0	-Diversification from equity markets -Generates investment income -Returns expected to be inflation-sensitive -Exposure to Illiquidity premium
Defensive Fixed Income	Multi Asset Credit	7.5	-Diversification across credit markets -Income-focused return providing lower volatility than equities

	Total	**100.0**	

The Committee is responsible for the Fund's asset allocation which is primarily determined via a triennial strategy review as part of the valuation process but is kept under constant review; noting that strategic changes are an evolutionary process.

The triennial review looks at both qualitative and quantitative analysis, covering:

- The required level of return that will mean the Fund can meet its future benefit obligations as they fall due.
- The level of risk that the Fund can tolerate in absolute terms, and in relation to its funding level and deficit.
- An analysis of the scale of the various risks facing the Fund so that a priority order for mitigation can be determined.
- The need for diversification across asset class, region, sector, and type of security.

4. Risk measurement and management

The Committee assesses risks both qualitatively and quantitatively, with the starting point being the triennial strategy review. Risks are considered, understood and then prioritised accordingly – the Committee evaluates the Fund's risk attribution analysis as part of the investment strategy review following the actuarial valuation, and considers whether this remains appropriate.

a) Investment Risks

Equities – The largest risk that the Fund is running is in relation to its equity holdings. Should equity market conditions deteriorate significantly this will have a negative impact on the funding level. The Fund holds equities in order to provide the necessary returns to ensure that the contributions payable to the Fund remain affordable. The Committee believes that the extra returns that are expected to be generated by equities compensates the level of risk equities bring to the Fund, but it does believe in diversification and looks to mitigate equity risk by allocating to a range of equity strategies and also investing in other diversifying assets. The Committee has also considered and implemented equity options where appropriate.

Inflation –The Fund's liabilities are impacted by inflation, both explicitly and implicitly, and the required return on assets is expressed in terms of inflation plus a premium. The Fund will seek to invest in a range of assets that provide returns in excess of inflation, and in some cases provide an inflation-linked income/capital values that are positively correlated with inflation, subject to a tolerable level of volatility.

Diversification – The Fund's portfolio is well diversified across asset classes, geographies and asset managers. As different asset classes have varying correlations with other asset classes, the Fund, by investing in a range of different investments, can reduce the overall level of risk it is exposed to.

The Fund has a significant proportion of assets allocated to a range of non-equity diversifying assets, with allocations to property, multi-asset credit, infrastructure, private debt and a plan to build an allocation to 'impact investments' across asset classes. The risks that these investments bring at an individual level are not insignificant but the Committee believes that over the long term these assets will provide returns that compensate for the risks being run. Additionally the level of diversification the assets provide helps to reduce the Fund's reliance on returns from equities. Illiquid assets such as property are also a valuable source of income, which will become increasingly important as the Fund matures and cashflow requirements increase.

Active Management – Investment Managers are appointed to manage the Fund's investments on its behalf, a number of which are actively managed (as opposed to passively managed). Extensive due diligence is undertaken before managers are selected, with several different managers employed in some asset classes to prevent manager concentration risk. The investment managers are also monitored regularly by the Committee and by the Fund's Advisors.

b) Demographic Risks

The Fund is subject to a range of demographic risks but, with particular reference to investment strategy, the Committee is aware of the expectation the Fund will mature over time as the pensioner liability increases. A mature pension fund is likely to take less investment risk over time and this is considered at each strategy review. The more mature a pension fund, the more likely it is that disinvestments will need to be made to pay benefits (which will require management to ensure disinvestments are not made at inopportune times or at inopportune moments). This situation is monitored regularly as part of the actuarial valuation and strategy review process.

c) Cashflow Management Risks

The Fund is expected to be 'cashflow negative' in future, meaning that all else equal disinvestments may be required to meet regular cash outgo. The long-term aim is that a portfolio of income generating mandates is built-up such that any negative cashflow can be met automatically from asset income, and this has been an important component of recent strategy reviews.

d) Governance Risks

The Committee believes that there is a benefit to the Fund to be gained from good governance structures in the management of the Pension Fund. Poor governance can lead to opportunities and risks to be missed, which could have a detrimental effect on the funding level and deficit.

Details of the Fund's governance structure can be found in the Governance Compliance Statement in the Annual Report found via https://www.islington.gov.uk/jobs-and-careers/council-pension-scheme/about-the-fund useful documents. The Committee members receive training on a regular basis as a group and attend individual training courses and seminars. Each member must attend the three Day Trustee Training organised by the Local Government Association.

e) Environmental, Social and Corporate Governance ("ESG") Risks

The Committee believes that ESG (including climate change) risks should be taken into account on an ongoing basis. ESG considerations are an integral part of the Fund's strategy and objective of being a long term investor. The Committee expects its investment managers to include information on how carbon risk is being managed within their respective portfolios as part of regular reporting for the Fund.

The Fund encourages its underlying investment managers to comply with the UK Stewardship Code and will monitor progress in this regard, and will also monitor the ESG ratings of its Fund managers by way of an annual report from its Investment Consultant. The Committee accepts that engagement is key in relation to strong corporate governance, which in turn will reduce ESG risks.

The Fund has committed to reduce climate change risk by decarbonising the Fund's portfolio. The Committee expects to continuously review further opportunities, across all asset classes, to reduce the Fund's reliance on carbon sensitive assets by considering the potential financial impacts of both the transition to a low-carbon economy and the physical impacts of different climate outcomes.

The Fund will monitor ESG (including climate change) risks annually and set targets to mitigate these risks. Monitoring will include annual analysis of the carbon footprint of the Fund's portfolio, as well as conducting a periodic scenario analysis based on multiple climate change scenarios.

Notably, the Fund has set a target of 'Net Zero' carbon emissions by 2050; further information is set out in Section 6.

5. Approach to asset pooling

The Fund has formally joined the London Collective Investment Vehicle ("CIV") as part of the Government's pooling agenda. The London CIV has been operational since 2015 and has opened a range of sub-funds covering liquid asset classes and is in the process of building out a fund range covering less liquid asset classes.

The Fund already invests assets with the London CIV (c. £490m as at 31 March 2023 in active sub funds and £397m in passive funds) and will look to transition further liquid assets as and when there are suitable investment strategies available on the platform that meet the needs of the Fund.

The Fund holds a proportion of its assets in life funds and intends to retain these outside of the London CIV in accordance with government guidance on the retention of life funds outside pools for the time being. The Fund agrees for the London CIV to monitor the passive funds as part of the broader pool. These assets are included in the figure for 'passive' funds stated above.

A proportion of the Fund is held in illiquid assets and these may remain outside of the London CIV pool where there is a strong business case. The cost of exiting these strategies early would have a negative financial impact on the Fund. These will be held as legacy assets until such time as they mature. Proceeds may be re-invested through the pool assuming it has appropriate strategies available, or the Fund may change asset allocation and make a decision not to reinvest.

The Fund will actively engage and seeks to work collaboratively with like-minded Funds and the London CIV on climate change and ESG topics, including the provision of fund alternatives that will help London CIV members to decarbonise, reduce ESG risks and invest in sustainably themed opportunities in their investment portfolios.

6. Social, environmental and corporate governance policy and policy of the exercise of rights (including voting rights) attaching to investments

The Committee believes that ESG risks can have material financial impacts and should be taken into account on an ongoing basis, and that the Committee should also consider return opportunities associated with ESG and sustainable investment. ESG considerations are an integral part of the Fund's strategy and objective of being a long term investor, and are considered as part of each investment strategy review and implementation decision.

The Committee believes that the Fund has been a leader within the LGPS in terms of the consideration and management of ESG-related risks and opportunities; this has included setting a 2050 'Net Zero' objective, as part of a broader decarbonisation journey that started in 2016. The Fund also has a formal target to increase exposure to sustainable investments over time, targeting a 20% minimum allocation by 2026. This has so far been achieved through allocations to sustainable equity and renewable energy, and is expected to develop through the implementation of a new 'impact' allocation (5% of total Fund assets).

With regard to responsible investment the Committee is mindful of the following legal principles, which are based on recent decisions in the courts and which apply to all pension schemes:

a. Administering authorities are free to adopt a policy of responsible investment, provided that they treat the financial interests of all classes of scheme members as paramount and their investment policies are consistent with the standards of care and prudence required by law.

b. Administering authorities are free to avoid certain kinds of investment, which they consider scheme members would regard as objectionable as long as they make equally financial advantageous and prudent investments elsewhere. They may also make "ethical" investments provided these are otherwise justifiable on investment grounds.

c. Administering authorities are not entitled to subordinate the interests of members to ethical or social concerns. The financial performance of the Fund consistent with proper diversification and prudence is paramount.

d. ***"As a responsible institutional investor, the Fund will use its influence to encourage the promotion and protection of human rights around the world. The Fund will regularly review its exposure to companies which raise human rights concerns."***

It is proposed to monitor action by fund managers on a quarterly basis and further develop this policy on an annual basis on the basis of experience.

The Fund has joined the Local Authority Pension Fund Forum ("LAPFF") to promote best practice on corporate governance and SRI issues amongst the companies in which it invests, through cooperative action with other local authority funds. The Forum exists to promote the investment interests of local authority pension funds and to maximise their influence as shareholders in promoting corporate social responsibility and high standards of corporate governance amongst companies in which they invest.

With more than half of all local authority funds as members, the Forum can negotiate with companies with a single authoritative voice, impossible for smaller funds acting alone. The Forum is developing policy and carrying out research and engagement with companies on many issues, including environmental issues such as the climate change impact of the transport sector, and the impact of oil extraction from tar sands. Other initiatives include engagement with fund managers to try to improve transparency of proxy voting policies by the managers, and on corporate governance issues.

The Committee is a member of the Institutional Investors Group on Climate Change (IIGCC). The IIGCC seeks to promote better understanding of the implications of climate change amongst its members and other institutional investors. It also aims to promote a lower carbon economy by encouraging the companies and markets in which IIGCC members invest to address their approach to climate change issues.

As mentioned earlier, the Fund has made a commitment to reduce its exposure to carbon intensive companies and assets, as well as tilt the portfolio towards sustainable investment opportunities over time. The Fund previously set targets to reduce absolute potential emissions and carbon intensity (as measured by Weighted Average Carbon Intensity or "WACI"), which covered the period from 2016 to 2022.

The following revised targets were formally adopted by the Committee as a result of analysis completed in 2021:

1. Long Term Target: 'Net Zero' absolute emissions by 2050 for the whole investment portfolio

2. Interim absolute emission reduction targets: -49% by 2026 and -60% by 2030 for the listed equity and corporate bond portfolios, using the Fund's 2016 baseline.

3. Sustainable investment target: 20% of total Fund assets by 2026. This may include investments in sustainable infrastructure, climate change mitigation, low carbon technology, energy efficiency and other opportunities.

In order to monitor and guide decarbonisation and the allocation to sustainable investments, the Fund expects to adopt TCFD supplemental guidance for asset owners where applicable.

The Fund will review targets annually. The Fund will form a view on decarbonisation of all asset classes beyond public equities and corporate bonds over time, and will develop mechanisms to evaluate the progress. The Fund will also incorporate analysis of scope 3 emissions as and when data availability improves to the extent this information is considered reliable.

7. Policy of the exercise of rights (including voting rights) attaching to investments and stewardship

Voting:

The Committee takes its responsibilities as a company shareholder seriously and exercises its votes at company AGMs/EGMs wherever practically possible. The Committee uses the Corporate Governance Service provided by Pension Investments Research Consultants (PIRC), and casts votes at all UK, European and North American company AGMs in line with PIRC recommendations unless the Council decides otherwise.

The Fund's investments through the London CIV are covered by the voting policy of the CIV which has been agreed by the Pensions Sectoral Joint Committee. Voting is delegated to the external managers and monitored on a quarterly basis. The CIV will arrange for managers to vote in accordance with voting alerts issued by the LAPFF as far as practically possible to do so and will hold managers to account where they have not voted in accordance with the LAPFF directions.

Voting records are published in the year end annual reports and quarterly reports of voting actions are posted on the Fund's website https://www.islington.gov.uk/jobs-and-careers/council-pension-scheme/about-the-fund useful documents. The Fund has not issued a separate Statement of Compliance with the Stewardship Code, but fully endorses the principles embedded in the seven Principles of the Stewardship Code.

The Committee will provide an annual report on how the Fund satisfies its UK Stewardship Code obligations requirements.

Stewardship:

The Fund wishes to promote a policy of dialogue on responsible investment issues, through the Fund Managers, with company management. In the first instance, the Committee would like environmental issues, human rights, employment standards and modern day slavery to be raised with company management. Environmental issues could include issues such as reducing carbon emissions, conserving energy, promoting alternative energy sources, recycling, avoiding pollution and using environmentally friendly and sustainable resources. Human rights could involve child labour issues in foreign subsidiaries of UK companies or operations in countries with oppressive regimes. Employment standards could relate to equal opportunities, health and safety, trade union recognition and employee participation.

The Fund invests via pooled funds and is therefore prepared to subscribe to the policies of the individual fund managers. When monitoring investment managers, the Pensions Sub- Committee considers whether managers' actions and engagement activities have been appropriate and in keeping with London Borough of Islington Pension Fund policy.

8. Advice Taken

In creating this statement, the Committee has taken advice from its Investment Consultant, Mercer, and an independent Investment Advisor. Also, in relation to each of the constituent parts, such as the asset allocation and risk mitigation, the Fund has taken advice from its Investment Consultant and the Scheme Actuary (also Mercer). In providing investment advice, Mercer is regulated by the Financial Conduct Authority.

APPENDIX A
Myners Investment Principles - Compliance Statement

In accordance with regulation 9A(3A) of the LGPS (Management and Investment of Funds) Regulations 1998, as amended the Council is required to state the extent to which the administering authority comply with the ten principles of investment practice set out in the document published in April 2002 by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom (Guidance note issue No. 5)"; and give the reasons for not complying where they do not do so. This CIPFA publication is based on ten principles proposed by the Myners review of Institutional Investment in the United Kingdom, and adopted by the Government as a model for best practice in 2001.

The Myners Principles were reviewed by the NAPF during 2008 and a revised set of six principles were issued in October 2008. CIPFA expect to issue a new publication based on the revised six principles in the near future.

Principle 1 - Effective decision-making

- Trustees should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation.
- Trustees should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Comment

The Fund is generally compliant with the requirements of this Principle. The Pensions Committee requires new members serving on the Sub-Committee to source appropriate training within six months of joining the Sub-Committee. The three-day course run by the Local Government Pensions Committee of the Local Government Association is recognised as particularly relevant training for new Members, but other routes and courses, and requisite experience are also recognised as appropriate. Where several new Members are appointed together, tailor-made training will be considered.

Principle 2 - Clear Objectives

- Trustees should set out an overall investment objective(s) for the Fund that takes account of the scheme’s liabilities, the strength of the sponsor covenant and the attitude to risk of both the trustees and the sponsor, and clearly communicate these to advisers and investment managers.

Comment

The Council seeks to undertake regular reviews of investment strategy, most recently in 2023, which took into account the scheme’s liabilities, the strength of the employer covenant and the attitude to risk of both the trustees and the sponsor.

Principle 3 - Risk and Liabilities

- In setting and reviewing their investment strategy, trustees should take account of the form and structure of liabilities.
- These include the strength of the sponsor covenant, the risk of sponsor default and longevity risk.

Comment

In setting the investment strategy, the Trustees have considered the form and structure of liabilities, along with the strength of the sponsor covenant, risk of sponsor default and longevity risk, taking advice from independent professional advisors where appropriate.

Principle 4 - Performance Assessment

- Trustees should arrange for the formal measurement of the performance of the investments, investment managers and advisers.
- Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

Comment

Overall Fund performance and detailed portfolio performance is measured quarterly, annually and over longer periods by external independent measurement specialists BNY Mellon. Performance is also monitored against the local authority peer group of pension funds, also based on old State Street Company data but from 1April 2016 run by PIRC (for the local authority universe), although in line with the Myners Principles the peer group is no longer considered the benchmark for overall fund performance. The overall benchmark is specific and customised to the Fund's objectives based on the outcome of the successive asset/liability studies.

Performance of the Fund is also subject to annual review by external auditors and by internal audit through regular audits programmed into the Audit Plan.

Pension benefits administration performance is reported regularly to Pensions Board

Principle 5 - Responsible Ownership

- Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.
- A statement of the scheme's policy on responsible ownership should be included in the Investment Strategy Statement Trustees should report periodically to members on the discharge of such responsibilities.

Comment

The Sub-Committee uses the Corporate Governance Service provided by Pension Investments Research Consultants (PIRC), and casts votes at all UK, European and North American company AGMs in line with PIRC recommendations unless the Council decides otherwise.

The Fund encourages each active investment manager to take account of social, environmental and ethical considerations insofar as the manager believes such considerations will benefit performance and/or reduce risk.

For those assets of the Scheme managed in pooled funds, the Trustees accept that the assets are subject to the investment manager's own policy on socially responsible investment. The Trustees are satisfied that this corresponds with its responsibilities to the beneficiaries.

The Fund's attitude to and policies regarding responsible ownership are set out within the body of its Investment Strategy Statement.

The Trustees issue member newsletters in which this discharge of responsibilities is noted.

Mercer has adopted the Institutional Shareholders' Committee Statement of Practice relating to investment consultants.

Principle 6 - Transparency and Reporting

- Trustees should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives.
- Trustees should provide regular communication to members in the form they consider most appropriate.

Comment

The Council's SIP (and its replacement the Investment Strategy Statement from 1 April 2017) is currently published and available to scheme members on the Council website. Summaries of performance and monitoring of managers are reported in the Pension Fund Annual Report and available to all pensioners and employees each year. Further performance reporting is provided to contributors and pensioners at the AGM. The full Pension Fund Report and Accounts are published as part of the Council's overall Annual Report and Accounts and available to all members of the public.

Mercer

welcome to brighter

Equity Index Comparison

London Borough of Islington Pension Fund

Tony English
Alex Goddard

November 2024

A business of Marsh McLennan

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Introduction

The Fund currently targets a 40% allocation to global developed market equities, split across four mandates (shown below as at 31 March 2024). LGIM manage two of the four mandate on a passive basis, and these portfolios represent c23% of Fund assets as at 31 March (broadly half of the actual allocation to developed market equities).

Officers have asked us to set out our view of the investment implications of switching the LGIM Low Carbon Index strategy into the LGIM Global ESG Paris Aligned Fund, effectively consolidating the passive portion of the Funds' developed market equity exposure into the Paris Aligned strategy.

Proposal is to switch the Low Carbon holding into the Paris Aligned Fund

Mandate	Actual Allocation (£m)	Actual Allocation (%)	Target Allocation (%)
LCIV Global (Newton)	298.4	15.4	40.0
LCIV Sustainable (RBC)	192.8	10.0	
LGIM Global ESG Paris Aligned	202.1	10.4	
LGIM MSCI World Low Carbon	241.7	12.5	
Total	**934.9**	**48.3**	

Source: BNY Mellon as at 31 March 2024

In summary we are comfortable with the proposed change from an investment perspective, and note the Paris Aligned strategy is better aligned with the Fund's RI/climate objectives given the explicit 'net zero' objective and decarbonisation pathway. We wouldn't anticipate the key characteristics of the Fund's equity portfolio to change materially if the Committee moves forward with this switch. We estimate fees will increase by c£30k p.a. as a result of the switch, which is reasonable given the enhanced characteristics of the Paris Aligned strategy.

The remainder of this presentation sets out the key differences between the two strategies, as well as the impact at the total portfolio level.

Key Considerations

‘Pure’ Investment

Consideration	MSCI World Low Carbon	ESG Paris Aligned Equity	Comments
Tracking Error	Expected tracking error of < 0.5% p.a. relative to the MSCI World Index	Expected tracking error of c. 2% p.a. relative to the MSCI World Index	• Both strategies are passive, tracking different ESG/climate indices • A key consideration is the level of tracking error as an indicator of the risk being taken relative to a pure passive (market cap) approach • The ESG Paris-Aligned Equity strategy has a higher relative tracking error, implying greater potential for deviation from the broad market performance (either positively or negatively)
Diversification	Sector weights and top 10 holdings are broadly in line with the MSCI World Index	Greater deviation in holdings, for example there is a c4% underweight to the energy sector and a c3% overweight to the technology sector as at 30 June 2024	• The MSCI World Low Carbon strategy mirrors key characteristics of the broad market (by design) • The ESG Paris Aligned Equity has greater deviations from the parent index as a result of the exclusions in place (see next slide)

Key Considerations

Responsible Investment

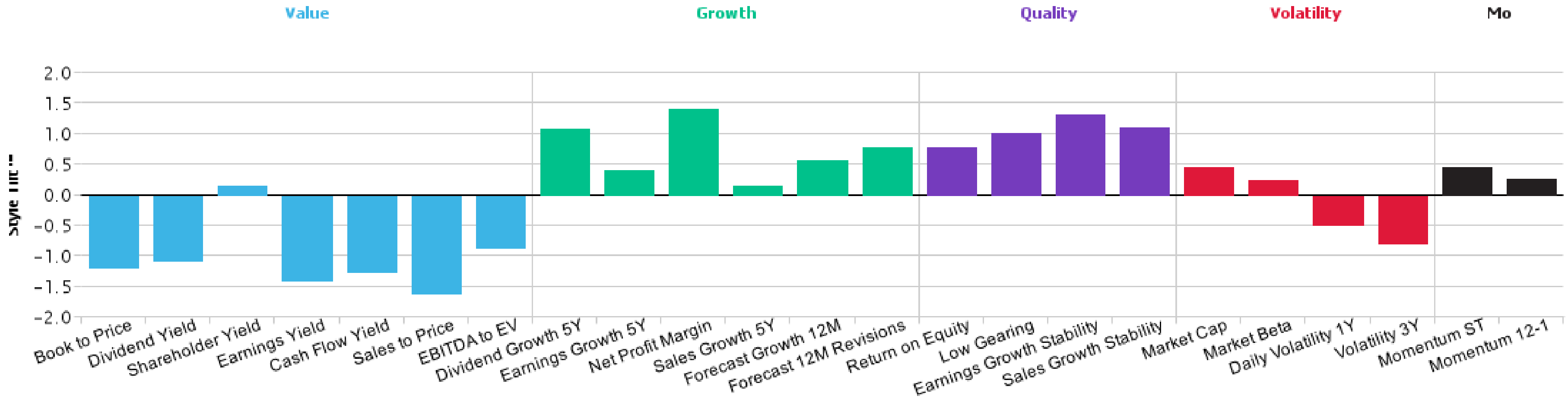
Consideration	MSCI World Low Carbon	ESG Paris Aligned Equity	Comments
Climate Integration	Seeks to mitigate transition-related climate risk by overweighting/underweighting companies with low/high emissions, whilst broadly maintaining the characteristics of the MSCI World Index No ‘Net Zero’ target or decarbonisation pathway in place, and the strategy is not covered by LGIM’s Climate Impact Pledge	Adheres to European Union Paris Aligned Benchmark (“PAB”) requirements 2050 ‘Net Zero’ target and 7% p.a. year-on-year decarbonisation Activity-based exclusions result in c22% of the universe being excluded, c12% of which are in relation to fossil fuel activities Covered by LGIM’s Climate Impact Pledge	• Carbon emissions are a key focus of both strategies. Based on the 2024 decarbonisation analysis, the funds have a comparable carbon footprint (over 60% lower than the MSCI World) and the same Implied Temperature Rise (2ºc, compared to the MSCI World figure of 2.5ºc) • The Paris Aligned strategy has a well-defined decarbonisation pathway, whereas the Low Carbon strategy simply seeks to reduce emissions as much as possible relative to the MSCI World within the agreed tracking error constraint • Overall, the Paris Aligned strategy performs slightly better in terms of climate metrics at present (see overleaf), and is more robust from a forward-looking perspective given the need to adhere to the EU PAB requirements
Broader ESG integration	Not material (although some baseline screens including ESG controversies)	Companies excluded for severe SDG misalignment or for breaching Do No Significant Harm principles Other screens (including Tobacco) also in place LGIM’s ESG scores are used to determine portfolio construction weights, with 34 metrics across the full range of ESG factors	• ESG Paris Aligned Equity strategy provides broader ESG integration, in addition to climate-related considerations • This is a key driver of the higher tracking error relative to the broad market; however, it may be something the Committee are comfortable with given the Fund’s focus on ESG/sustainability considerations

Overall, there would be no concerns from an RI/climate perspective around consolidating the two holdings into the Paris Aligned fund
Indeed, there are areas where we would view this as providing enhancements to the overall equity portfolio

Key Considerations

Impact on Developed Market Equity Portfolio – Style Tilts

Current Portfolio



Consolidated Portfolio

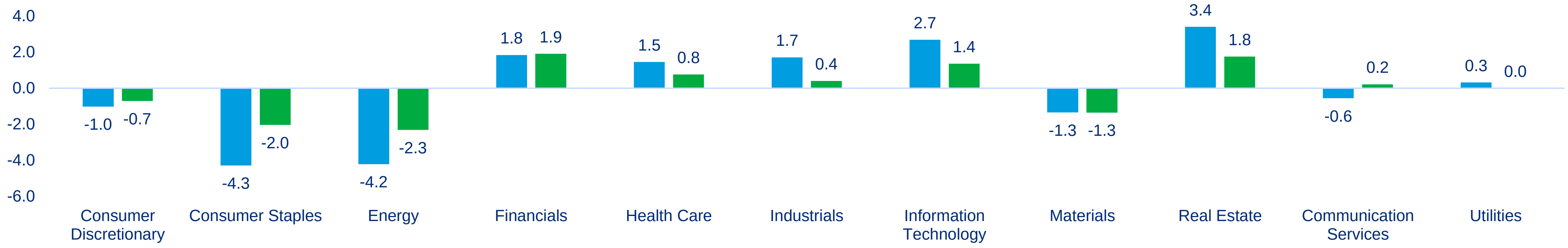
We have modelled the style exposure of the developed market equity portfolio relative to the MSCI World
As expected, the portfolio has a tilt towards ‘growth’ and ‘quality’ factors and away from value factors given the focus on sustainability
There is no meaningful change to the style profile as a result of consolidating the existing LGIM holdings into the Paris Aligned strategy

Key Considerations

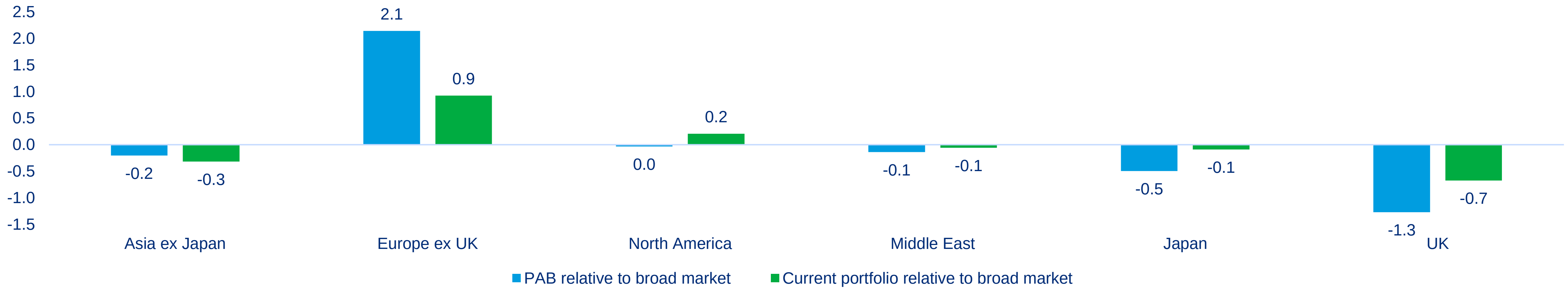
Active risk positioning

- The charts below show the 'active risk' positions relative to the broad market for the LGIM Paris Aligned strategy (in **blue**) and the Fund's current blended LGIM portfolio (in **green**).

Sector Allocations



Regional Allocations

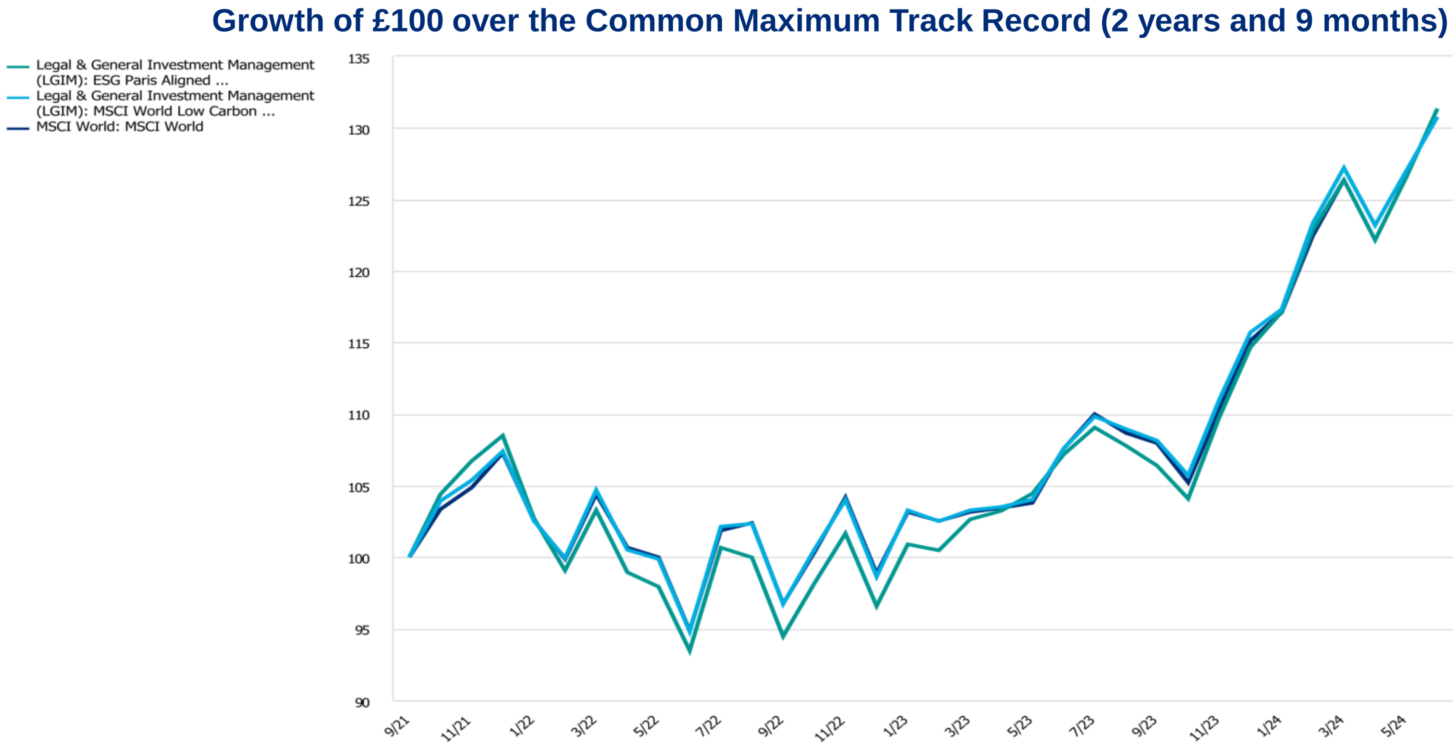


- As expected, the LGIM Paris Aligned strategy has larger sector and country deviations, largely due to the activity-based exclusions. These sector and regional differences are driving the increase in 'tracking error'. A higher tracking error means a higher likelihood of both underperformance and outperformance relative to the broad market.

Source: Refinitiv. Data as at 30 June 2024.

Key Considerations

Performance



Product Name	Beta (MSCI World-GD)	Tracking Error (MSCI World-GD)	Reward to Risk Ratio (MSCI World-GD)
ESG Paris Aligned Global Developed Equity	1.03	2.12	0.84
MSCI World Low Carbon Target Index Fund	1.01	0.50	0.85

- Performance comparisons are not particularly meaningful given the limited time period since the launch of the LGIM Paris Aligned Fund.
- However, as expected the Paris Aligned Fund has experienced a higher tracking error relative to the MSCI World compared to the Low Carbon Fund over this period.
- The Paris Aligned Fund underperformed in 2022 given the underweight to traditional oil & gas companies; however, the strategy has outperformed during the market recovery since the beginning of 2023, and over the whole period performance has been broadly in line with both the MSCI World and the Low Carbon Fund.
- The 'beta' for both strategies is close to 1, suggesting there should be no meaningful increase in structural equity risk as a result of making the change.

Conclusion and Next Steps

- **We are comfortable with the proposal to consolidate the LGIM passive assets into the Paris Aligned strategy. Our view is that implementing this change is consistent with the Fund's objectives.**
- Implementing the change is not expected to have a significant impact on the overall structure of the equity portfolio or the level of diversification, while there are some **potential benefits in terms of alignment with the Fund's Responsible Investment beliefs and climate targets**.
- We view the key next steps as follows:
  - Pensions Committee to agree whether to move forward with switching the LGIM Low Carbon Fund into the LGIM Paris Aligned Fund.
  - If agreement is reached, Officers to work with LGIM to implement the transition of assets (including consideration of transaction costs and managing out of market risk); and
  - Investment Strategy Statement ("ISS") to be updated to reflect the change

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