



PENSIONS SUB COMMITTEE

25 March 2019

SECOND DESPATCH

Please find enclosed the following items:

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|----------------|---|--------|
| Item B6 | UK equity portfolio decarbonisation (to follow) | 1 - 4 |
| Item E3 | UK equity portfolio decarbonisation - exempt appendix (to follow) | 5 - 16 |

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Date : 19 March 2019



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Report of: Corporate Director of Resources

| Meeting of: | Date | Agenda item | Ward(s) |
|------------------------|---------------|-------------|---------|
| Pensions Sub-Committee | 25 March 2019 | | n/a |

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| Delete as appropriate | | Non-exempt |
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Appendix 1 is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information relating to the financial or business affairs of any particular person (including the authority holding that information)

SUBJECT: DECARBONISATION POLICY IMPLEMENTATION

1. Synopsis

- 1.1 This report discusses further proposals to achieve the targets set in the fund's decarbonisation policy.
- 1.2 Mercer, our investment advisors have prepared a presentation document attached as Exempt Appendix 1 for discussion and agreement.

2. Recommendation

- 2.1 To receive and consider decarbonisation proposal presentation presented by Mercer, our investment advisors- attached as Exempt Appendix 1

3. Background

- 3.1 The Committee believes that Environmental, Social and Governance ("ESG") risks should be taken into account on an ongoing basis and are an integral part of the Fund's strategy and objective of being a long-term investor.

3.2 Action to date

Members agreed at November 2016 pension sub- committee meeting that the carbon footprint level of equities in the In-House UK Passive Fund be reduced with immediate effect, with 50% of assets allocated to Legal and General Investment Management's MSCI World Low Carbon Target Index Fund and the remaining 50% of assets managed in house to track the FTSE UK

Low Carbon Optimised index and that officers investigate how a low carbon approach could be realised for the rest of the Fund, which does not comprise equities.

- 3.3 Officers implemented the low carbon indices for passive global and UK by May 2017, covering 25% of the whole fund. The existing active global equities managed by Newton and Allianz on the LCIV platform had a low carbon footprint and did not require amendments
- 3.4 Mercer has completed analysis to identify ways in which the Fund can reduce ESG risk and has conducted a review of ESG ratings for the Fund's underlying investment managers. Mercer's ESG ratings provide an assessment of the integration of ESG issues into the investment process and provides an overall rating – ESG 1 is the highest possible rating and ESG 4 is the lowest possible rating. As such, Mercer has provided the ESG ratings the Fund's 9 strategies across equities, fixed income, DGFs, property and private equity.
- 3.5 Members agreed a decarbonisation policy as part of its Investment strategy statement and sets targets to achieve further decarbonisation across its entire investment assets. The policy defines their beliefs and take account of sustainable opportunities, and agree a monitoring regime and progress measurement.
- 3.6 Mercer have looked at alternative low carbon indices to the current In House Passive equity benchmark and indicated a preference. Their analysis is based on emissions reduction. Transaction cost, equity protection realignment, and non- investment factors like cashflow alternatives, human resources and custody arrangements will also have to be evaluated before any implementation.

4. Implications

4.1 Financial implications

- 4.1.1 The cost of providing independent investment advice and transition cost is part of fund management and administration fees charged to the pension fund.

4.2 Legal Implications

The LGPS (Management and Investment of Funds) Regulation 2016, Regulation 7 (1) requires an administering authority to formulate an investment strategy which must be in accordance with the guidance issued by the Secretary of State. The ISS must include: The authority's policy on how social environmental or corporate governance considerations are taken into account in the selection, non- selection, retention and realisation of investments

The Sub-Committee holds a key fiduciary responsibility to manage the Fund's investments in the best interests of the beneficiary members and the council taxpayers, where the primary focus must be on generating an optimum risk adjusted return. It is vital that any investment decisions or strategies developed, such as a carbon strategy, must not negatively influence this primary responsibility.

The precise choice of investments can be influenced by ethical and environmental, social and governance (ESG) considerations, so long as that does not risk material financial detriment to the fund. Whilst deliberating on such issues, Queen's Counsel (Nigel Giffin) advice, commissioned by the LGPS Scheme Advisory Board and published in 2014, states that the administering authority may not prefer its own specific interests to those of other scheme employers, and should not seek to impose its particular views where those views would not

be widely shared by scheme employers and members (nor may other scheme employers impose their views upon the administering authority).

4.3 **Environmental Implications**

None applicable to this report. Environmental implications will be included in each report to the Pensions Sub-Committee as necessary.

4.4 **Resident Impact Assessment**

None applicable to this report. 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.

5. **Conclusion and reasons for recommendation**

- 5.1 Members are asked to consider the Mercer presentation and agree an implementation that will take account of decarbonisation, cost and non-investment factors.

Background papers:

None

Final report clearance:

Signed by:

Corporate Director of Resources

Date

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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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