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ISLINGTON

PENSIONS SUB-COMMITTEE

21 June 2021

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18 June 2021

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ISLINGTON

Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: Corporate Director of Resources

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	21st June 2021		n/a

Delete as appropriate	Non-exempt	

Appendices 1 and 2 attached are exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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: PRIVATE DEBT PROCUREMENT OPTIONS

1. Synopsis

1.1 This is a further update report on outcome of the due diligence of three managers included in the LCIV private debt offering and Project Monument-a collaboration of LA procurement of private debt.

1.2 MJ Hudson were commissioned to conduct an investment and operations due diligence on the three managers and the summary opinions and recommendations are attached as Exempt Appendix 1 and 2 for consideration.

2. Recommendations

2.1 To consider and note the due diligence summary report of Key terms and performance comparison attached as exempt Appendix 1

2.2 To consider the consolidated summary opinions report attached as Exempt Appendix 2.

2.3 To agree with the report's recommendation of the preferred two managers (one European and one US private debt manager) that best delivers value for money, meet the fund's mandate specification and will deliver returns to keep contributions sustainable.

2.4 To agree to allocate 50% of the fund's total allocation of 10% in this first tranche of appointments to give diversification

2.5 To agree to delegate to the Corporate Director of Resources, in consultation with the Acting Director of Law and Governance , authority to negotiate and agree terms and conditions of the fund management agreement(s) with the recommended and agreed manager(s).

3. Background

Introduction

3.1 The 2019 actuarial valuation was completed in March 2020 and as part of the process, preparatory work was undertaken to determine the funding position and an investment strategy review that could support sustainable contributions from employers. The agreed target investment return of CPI+3.2% was re-evaluated in the light of Covid-19 impact on markets. The risk and return target options were discussed and a new target investment return of CPI +2.8% was proposed with asset allocation changes that would support the short to medium term net negative cashflow position of the Fund and also achieve our decarbonisation and governance goals.

3.2 Private Debt asset class is privately negotiated debt typically used when public loans are not available to the borrower, and usually used to finance privately owned companies. Some of the characteristics include direct loan contracts with strong covenants secured by the firm assets if your loan is a senior debt. The main risks include defaults and illiquidity.

3.3 Members agreed an Islington Private Debt mandate specification at their December meeting. Three processes of procurement were explored at the March meeting; a fiduciary manager, LCIV and existing Project Monument (a private debt offering secured through the collaboration of five local authorities in 2018). Members agreed to proceed with LCIV and Project Monument. Officers were instructed to conduct a due diligence on the managers covered under the LCIV private debt offering and Project Monument.

3.4 Three managers had to be scrutinised because one US manager is common to both offerings and the European Managers are different. MJ Hudson were commissioned to conduct the due diligence and have provided a summary report on the key terms and conditions of all three managers attached as Exempt Appendix 1 and a consolidated summary of opinions on the three managers also attached as Exempt Appendix 2.

3.5 The Key terms and conditions report-Exempt Appendix 1 covers summarised investment objectives, fees and key fund terms and track record. A snapshot of commonalities concludes that all three managers have the same target return, two of the managers target Europe and one targets US. The record of accomplishment between the 2 European managers show there is no material differences in performance even though one has a longer track record. There are however, differences on the baseline fees quoted as shown in table 2.

3.6 Exempt Appendix 2 – Consolidated summary of opinions gives more details of each of the managers' firm structure, overall assessment that covers operations, ESG and points to consider.

3.7 **Summary**

- The LCIV has a Private debt offering of a US and European manager. It is a fund of fund model and all investments require an equal split to both managers on the platform. The LCIV will charge a second layer of fees for management of 0.075% and, have not reached scale for better fee structure discount. Total commitment for LCIV is currently £290m equally split between the two managers.

- The Project Monument's private debt also offers a US and European manager. Existing LA commitments means fees negotiated are as competitive and both managers are willing to allow Islington to group their investments with other London Monument investors for fee discount purposes. Current commitment is US manager £250m, European £350m.

- Since both proposals have the same US manager and base fees fairly the same, the decision to be made is between the two European managers. The due diligence report makes a recommendation and members are asked to consider the summary opinions and agree to allocate to the preferred European manager.

3.5 Members also need to take into consideration the following issues;
- that Private debt can take 3 to 5 years to reach full allocation
- a plan needs to be in place on how soon we want to reach full strategic allocation of 10%
- cash flow matching of these commitments
- manager vintages for diversification
- availability of managers because investments are generally in closed funds.

4. Implications

4.1 **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.

4.2 **Legal Implications**

The Council, as the administering authority for the pension fund may appoint investment managers to manage and invest in a private debt portfolio on its behalf (Regulation 8(1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

A competitive tendering exercise has been undertaken for the appointment of a private debt manager in accordance with the requirements of the Public Contracts Regulations 2015 and the council's Procurement Rules. The council has conducted an independent due diligence to ascertain its own assurance of the appointed managers. The sub-committee may appoint the highest evaluated manager as recommended in Exempt Appendix 1, provided that it is satisfied that their offers represents value for money and is satisfied as to the matters set out in paragraph 4.2.2.

The sub- committee must

(i) reasonably believe that the recommended investment manager's ability in and practical experience of financial matters makes them suitably qualified to make investment decisions for the Council

(ii) have proper regard to the advice of the Corporate Director of Resources and its external advisers, in relation to the proposed appointment.

4.2.2 In considering the recommendations in this report, members must take into account the information contained in the Exempt Appendices 1and 2 to this report.

4.3 **Environmental Implications and contribution to achieving a net zero carbon Islington by 2030:**
Environmental implications will be included in each report to the Pensions-sub committee as necessary. The current agreed investment strategy statement for pensions outlines the policies and targets set to April 2022 to reduce the current and future carbon exposure by 50% and 75% respectively compared to when it was measured in 2016 and also invest 15% of the fund in green opportunities. The link to the full document is https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonboroughofislingtonpensionfundinvestmentstrategystatement.pdf

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 consider the options of procurement and consider the recommendations in Exempt Appendix 1 and 2 and if in agreement then powers should be delegated to the Corporate Director of Resources, in consultation with the Acting Director of Law and Governance, authority to negotiate and agree terms and conditions of the fund management agreement with the two managers.

Background papers:
None

Final report clearance:

Signed by:

Corporate Director of Resources Date 18 June 2021

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Finance Department
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Report of: **Corporate Director of Resources**

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SUBJECT: DECARBONISATION POLICY –UPDATE NET ZERO CARBON TRANSITION

1. Synopsis

1.1 This is a report on progress made on the current decarbonisation targets by 2022 and discusses proposal and actions for post 2022 to continue on the pathway to transition to Net Zero Carbon by 2050.

1.2 Mercer will make a presentation to discuss the current carbon foot printing result as at 31 March 2021 for both equities and corporate credit (69% of the fund); alternative decarbonisation pathways based on absolute carbon emissions and set out evidenced recommendation to commit to 2050 net zero target with short- term emission reduction targets for 2025-26 and 2030.

2. Recommendations

2.1 To receive the exempt Mercer presentation (to follow)

2.2 To note that the fund carbon foot printing results as at 31 March 2021 shows the baseline of emissions for the listed portfolio (listed equity and corporate credit) is 66,096 tCO_2e and the listed equity portfolio has decarbonised by 32.8% (absolute emission) between 2016 and 2021.

2.3 To consider and agree the next post 2022 decarbonisation targets for the fund in both short and medium term; 2025-26, 2030 and net zero carbon by 2050.

2.4 To agree to receive a further report in September to consider action plan and fund changes required to achieve the agreed future targets.

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 **Progress to date**

3.2.1 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 the Committee's beliefs and takes account of sustainable opportunities, and agrees a monitoring regime and progress measurement.

The agreed targets are as follows:

The Fund seeks to achieve the following targets by May 2022 through:
1) Reducing future emissions by focussing on absolute potential emissions (tons of CO2e), a reserves based measure that focusses on emissions that could be generated if the proven and probable fossil fuel reserves owned by the companies in the portfolio were burned, in the public equity allocation by more than three quarters compared to the exposure at June 2016, the date of the Fund's latest carbon foot-printing exercise.

2) Reducing "exposure to carbon intensive companies" as measured by Weighted Average Carbon Intensity, an indicator of current climate-related risks facilitating comparison across asset classes and across industry sectors in the public equity allocation by more than half compared to the exposure at June 2016, the date of the Fund's latest carbon foot printing exercise.

3) Investing at least 15% per cent of the Fund in sustainability-themed investment - for example in climate change mitigation, low carbon technology, social housing, sustainable infrastructure, energy efficiency and other opportunities.

Measures agreed to monitor and guide decarbonisation and allocation to sustainability include:
1) The Fund adopting TCFD supplemental guidance for asset owners where applicable.

2) The Fund reviewing targets annually.

3) The Fund forming a view on decarbonisation of all asset classes beyond public equities by 2022 and will develop mechanisms to evaluate the progress.

4) The Fund monitoring 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 ranging from 2ºC to 4ºC.

ESG ratings

3.2.2 Mercer conducted a review of ESG ratings for the Fund's 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. The average rating for the whole Fund has improved from 2.3 to 2.1.

Measuring carbon footprint of equities portfolio annually

3.2.3 The Fund's latest carbon foot printing exercise on the equity and corporate credit holdings as at 31st March 2021 showed that since 2016 the fund has achieved in its equities a reduction of 32.6% in absolute emissions, whilst for 69% of scheme assets our emissions is 66,096 tCO2e.

3.3 **Transition to net zero carbon for pension investments**

The decarbonisation policy is a living document and Members have targeted decarbonisation across all asset classes of its pension investment where the funds' risk and return objectives are optimised. Any transition should still achieve the primary objective of paying benefits to pensioners and still affordable for employers.

3.3.1 Members agreed at the March meeting after their training session in February to adopt and agree new decarbonisation targets for the short to medium term and a net zero carbon emission for the whole Fund by 2050. Mercer our investment advisors have prepared a presentation to discuss these future targets and the transition pathway. The fund's carbon foot printing results for equities and corporate credit as at 31 March 2021 will also be discussed.

3.3.2 Members are asked to receive the presentation and consider proposal and recommendations for future short to medium targets and agree the transition pathway to net zero carbon by 2050. Members should also consider and agree an action plan for implementation and monitoring.

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, Regulation7 (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 and contribution to achieving a net zero carbon Islington by 2030:**

Environmental implications will be included in each report to the Pensions-sub committee as necessary. The current agreed investment strategy statement for pensions outlines the policies and targets set to April 2022 to reduce the current and future carbon exposure by 50% and 75% respectively compared to when it was measured in 2016 and also invest 15% of the fund in green opportunities. The link to the full document is https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonboroughofislingtonpensionfundinvestmentstrategystatement.pdf

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

4.4.1 An equalities impact assessment has not been conducted because this report is seeking opinions on an existing policy document and therefore no specific equality implications arising from this report.

5. Conclusion and reasons for recommendation

5.1 Members are asked to receive the presentation from Mercer and agree the next short to medium decarbonisation targets on the transition pathway to a net zero carbon by 2050.

Background papers:
None

Final report clearance:

Signed by:

Corporate Director of Resources Date 18 June 2021

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