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ISLINGTON

PENSIONS SUB-COMMITTEE

23 November 2021

SECOND DESPATCH

Please find enclosed the following items:

Enquiries to	:	Mary Green
Tel	:	Telephone: 0207 527 3005
Email	:	democracy@islington.gov.uk
Date	:	18 November 2021

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Agenda Item B5

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	23rd November 2021		n/a

Delete as appropriate	Exempt	Non-exempt

Appendix 1 is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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: THIRD GENERATION CLIMATE INDICES SERVICE PROVIDER SELECTION

1. Synopsis

1.1 This is an update report to implement the pathway to transition to Net Zero Carbon emissions target by 2050.

1.2 A briefing has been prepared by Mercer (our investment consultants) and is attached as Exempt Appendix 1 to discuss the results of the fact finding on 15th October 2021 in relation to selecting a third generation climate transition index provider.

2. Recommendations

2.1 To receive the exempt Mercer briefing

2.2 To discuss the options in the briefing and agree the option that best aligns with the Fund's agreed objective to transition to Net Zero Carbon and achieve its short to medium term targets.

2.3 Subject to 2.2 agree the next steps for implementation

2.4 To agree to receive a progress report on the implementation.

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. At the September meeting, Mercer presented a briefing setting out information in relation to Third Generation Climate Indices ("3G Indices"). These indices are explicitly designed to measure initial and ongoing decarbonisation, consistent with the Intergovernmental Panel on Climate Change's 1.5 degrees Celsius warming scenario. This is a key component to enable the Fund to achieve its net zero carbon emission target set to 2050.

3.2 **Progress to date**

3.2.1 Members agreed a decarbonisation policy as part of its Investment strategy statement and set 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 set were to be achieved by May 2022.

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. For 69% of scheme assets, our emissions is 66,096 tCO_2e. It was also identified that the in-house UK equity and RAFI Emerging Market equity allocations (c12% of total assets) were the largest contributors to the overall carbon footprint of the Fund and changing some of our current low carbon indices to third generation climate indices will enable the achievement of our short to medium targets.

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 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 affordability for employers.

3.3.1 Members agreed at the June 2021 meeting to adopt new decarbonisation targets for the short to medium term and a net zero carbon emission for the whole Fund by 2050.

The new targets are :

i) Net zero emission target at 2050 including aligning with the 1.5 degree Celsius scenario

ii) Investing at least 20% of the fund in sustainability themed investments (such as low carbon technology or green infrastructure) by the end of April 2026

iii) Reduce carbon emissions of all listed portfolios i.e. equities and credit by 49% by 2026, and 60% by 2030 against a baseline in 2016.

3.3.2 At the September meeting, Members delegated authority to officers and our investment advisors to explore further details with two preferred index providers to identify options available that are best aligned to Islington's objective to transition to Net Zero carbon emissions target.

3.3.3 On 15th October, the two preferred index providers presented their climate transition indices covering index construction and methodologies to Mercer and head of treasury and pensions. Mercer have prepared a briefing of the results and made some recommendations and next steps for implementation.

3.3.4 Members are asked to receive the Mercer presentation and consider the options recommended and agree to implement the option that best aligns with the Fund's climate transition objective.

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).

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

The sub- committee must

(i) reasonably believe that the recommended index provider'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.

4.3 In considering the recommendations in this report, members must take into account the information contained in the Exempt Appendix 1 to this report.

4.4 **Resident Impact Assessment**

4.4.1 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

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 recommendations

5.1 Members are asked to receive the presentation from Mercer (attached as Exempt Appendix 1) and consider the options and agree the option that is best aligned to the funds agreed climate transition pathway objective.

Background papers:
None

Final report clearance:

Signed by:

Corporate Director of Resources Date 18 November 2021

Report Author: Joana Marfoh
Tel: (020) 7527 2382
Email: Joana.marfoh@islington.gov.uk

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Agenda Item E2

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