



Report of: Corporate Director of Resources

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	26 November 2018		n/a

Delete as appropriate	Exempt	Non-exempt
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## SUBJECT: DECARBONISATION POLICY AND INVESTMENT STRATEGY STATEMENT(ISS) REVIEW

### 1. Synopsis

- 1.1 This report and draft policy and ISS appendices—provides information on the Fund to review and update its ISS and to enable a better understanding to its exposure to climate risk and opportunities.
- 1.2 It also specifically focuses on developing a policy on decarbonisation across its entire investment assets and demonstrate a consistent approach.
- 1.3 Mercer, our investment advisors have prepared a draft decarbonisation policy document attached as Appendix 1 for discussion and agreement.

### 2. Recommendations

- 2.1 To receive and consider the draft decarbonisation policy document presented by Mercer, our investment advisors- attached as Appendix 1
- 2.2 To agree the draft decarbonisation policy document and approve its integration into the draft Investment Strategy Statement attached as Appendix 2 for information
- 2.3 As part of next steps of implementation to agree to:
  - integrate ESG issues including climate change in investment policy
  - consider positive allocations to sustainable opportunities
  - formulate a regular monitoring and reporting regime on progress
  - extend decarbonisation beyond listed equities over the next 4 years
  - continue to engage and collaborate with relevant parties including the LCIV on responsible investment.

- 2.4 To agree to authorise officers, with Mercer to update the ISS document-Appendix 2 with the agreed changes and publish it.

### **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 now want to extend decarbonisation across its entire investment assets and it is important that they define their beliefs and investment policy, take account of sustainable opportunities, and agree a monitoring regime and progress measurement.

- 3.6 Some of the issue that needs to be considered on implementing their policy include:

- Fiduciary duty to members of the scheme
- Defining carbon exposure and measuring a company’s carbon reserve
- Investment risks of companies with high fossil fuel exposure
- The missed opportunities of total divestment during transitions of companies
- Collaboration and engagement with policy makers, industry initiatives and the LCIV

- 3.7 Members are asked to consider and agree the decarbonisation policy attached as Appendix 1 and authorise officers and Mercer to integrate the agreed policy into the draft ISS document – Appendix 2 and publish it.

### **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 recommendations**

- 5.1 Members are asked to consider and agree the decarbonisation policy prepared by Mercer and agree to authorise officers to integrate the policy into our current ISS and publish the updated version.

#### **Background papers:**

None

Final report clearance:

#### **Signed by:**

Corporate Director of Resources

Date

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