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LONDON BOROUGH OF ISLINGTON PENSION FUND

DEVELOPING A DECARBONISATION STRATEGY FOR THE FUND - DRAFT

INTRODUCTION

In 2017, the London Borough of Islington Pension Fund (the "Fund") started the decarbonisation of its asset portfolio as part of its Environmental, Social and Governance ("ESG") integration activities. Specifically, the Fund transitioned its passive equity assets to lower carbon alternatives such that the passive UK and global equity portfolios now track the FTSE All Share Low Carbon Optimised index and the MSCI World Low Carbon Target index respectively.

Following discussion at the September 2018 Pensions Sub-Committee (the "Committee") meeting, it was agreed that in addition to the way in which the Fund already incorporates responsible investment considerations throughout its investment strategy, it wants to give specific focus to decarbonisation across all its investment assets, to demonstrate a consistent approach, and develop a policy to reflect this. In a press release "Islington Council's Pension Fund is coming out of carbon" dated Wednesday 12 September the Fund made a public commitment to:

"… remain in the vanguard of the worldwide decarbonisation movement. By continuing to reduce its investment in fossil fuels and its overall carbon intensity, the Fund will contribute to global efforts to keep the earth's temperature from rising by more than 2°C."

In light of this, we would propose that the Committee adopts the below objective (which is consistent with the current regulatory position laid out in the Department for Communities and Local Government guidance (July 2017)).

Objective: To develop and progressively implement a decarbonisation strategy that takes account of the risks and opportunities arising from climate change across all asset classes.

Definition of decarbonisation: A reduction or removal of exposure to carbon dioxide from fossil fuel energy sources and other greenhouse gases within the Fund's investment portfolio. This may mean reduction of carbon intensity (for example, as measured by the emissions per unit of sales or per unit of electricity generated) and/or reduction or removal of potential future emissions (for example, reducing exposure to proven and probable fossil fuel reserves). Decarbonisation also captures opportunities presented by the transition to a low carbon economy that enable the reduction or removal of carbon, either directly or indirectly.

As previously discussed with the Committee in 2016, decarbonisation can be achieved by a number of different approaches including “ESG integration” and “sustainability-themed investments”. We would recommend that the Fund achieves decarbonisation via both of these approaches.

- **ESG Integration** focuses on identifying, mitigating or avoiding financially material risks arising from ESG issues (including climate change) at the portfolio level, by capturing these issues within existing investment frameworks and all investment decision making processes (e.g. the idea generation and portfolio construction process for an individual strategy).[1] This can include the use of low carbon indices.
- **Sustainability-themed investments** focus on identifying growth opportunities in sectors and markets that are addressing global sustainable development challenges either via thematic investments (e.g. renewable energy, resource efficiency, clean water, health, education etc.) or via sustainability-themed core investments such as sustainable equity or fixed income funds.

This document that is for consideration by the Committee at the November 2018 meeting, presents the Fund with Mercer’s recommendation for policies that should be considered to be adopted (if not already in place) by the Committee and integrated within the Fund’s Investment Strategy Statement (“ISS”) to achieve the proposed decarbonisation objective. The ISS as “a living document” is a natural place to express a Fund-wide ESG and decarbonisation framework and to consider how these issues impact the Fund’s wider strategy and we believe this will be more effective than having a stand-alone policy. Updating the ISS is a crucial first step in achieving the decarbonisation of assets beyond listed equity. The proposed updated ISS is appended to this document.

[1] This idea can be illustrated with the following examples: A portfolio manager (PM) is evaluating two similar stocks, one with poor corporate governance and another with good / better governance, but comparable in all other ways. The PM may pick the stock with better governance as, all else equal, it represents a higher quality long-term investment. Alternatively, a PM may buy the stock with worse governance if they believe (a) they can influence the company to improve its governance processes and practices and (b) that these improvements will be recognised by the market. Both approaches fall within ‘ESG integration’.

MERCER'S RECOMMENDED POLICIES

Mercer's recommended policies ensure that the Fund's high level of historic commitment to responsible investment continue, which includes the management and monitoring of ESG risk as well as engagement, are outlined below**.** For completeness we have included an exhaustive list but note that in practice some of these are already adopted by the Committee (these have been highlighted). The Committee has a fiduciary duty in respect of ESG issues - including climate change.

Recommended policies:

- The Committee will set specific targets for decarbonisation and sustainability-themed investments.

- The Committee will annually review these targets.

  The Fund seeks to achieve the following targets by 2022:

  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 XX per cent compared to the exposure June 2016 , the date of the Fund's latest carbon footprinting exercise.

  2) Reducing "exposure to carbon intensive companies" as measured by Weighted Average Carbon Intensity [2], an indicator of current climate-related risks facilitating comparison across asset classes and across industry sectors,in the public equity allocation by 40% percent compared to the exposure June 2016, the date of the Fund's latest carbon footprinting exercise.

  3) Will invest 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.

- The Committee is committed to extend decarbonisation of the Fund beyond listed equity within a set time period (we have used 2020 in the ISS) and develop a mechanism to measure progress.

- The Committee will consider financially material ESG factors on an on-going basis as this is an integral to the Fund's approach to investment as a long-term investor. *This has already been adopted and is incorporated within the ISS.*

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[2] Weighted Average Carbon Intensity (tons CO2e / $M sales). Calculated based on Scope 1 and 2 emissions. Does not relate to the Fund's ownership share and hence serves as an indicator of potential climate-related risks. Importantly facilitates comparison with non-equity assets. FSB Taskforce for Climate-related Disclosures (TCFD) recommended metric for asset owners indicating portfolios exposure to carbon-intensive companies.

- The Committee will ensure that the Fund's investment managers incorporate ESG risk considerations. *This has already been adopted and is incorporated within the ISS.*

- The Fund's investment managers should comply with UK Stewardship code. *This has already been adopted and is incorporated within the ISS.*

- The Committee will monitor manager ESG ratings (as provided by their Investment Consultant) at each Pensions Sub-Committee meeting. *This has already been adopted and is incorporated within the ISS.*

- The Committee will monitor ESG risks including managing climate change / carbon risks within its portfolio (for example bi-annual analysis of the Fund's carbon footprint and periodic climate change scenario analysis to support TCFD reporting (see the next below).

- The Committee will adopt the Task Force on Climate-related Financial Disclosures ("TCFD") guidance in reporting (where appropriate).

- The Committee believes that stewardship is important for the sustainability of investments in the long-run. *This has already been adopted and is incorporated within the ISS.*

- The Fund will engage and collaborate with relevant parties such as policymakers or industry initiatives on ESG matters such as the London CIV, likeminded Funds, the Local Authority Pension Fund Forum ("LAPFF"), the Institutional Investors Group on Climate Change (IIGCC). *This has already been adopted and is incorporated within the ISS.*

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Mercer
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