



Report of: Corporate Director of Resources

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	17 June 2019		n/a

Delete as appropriate	Exempt	Non-exempt

**Appendix 3** is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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 MONITORING PLAN

### 1. Synopsis

- 1.1 This report discusses a proposed monitoring plan to achieve the targets set in the fund's decarbonisation policy.
- 1.2 Mercer, our investment advisors have prepared the following:
  - I) a monitoring plan attached as Appendix1 for discussion and agreement
  - II) shared the document Investing in Time of Climate Change attached as Appendix 2 for information, and
  - III) an update on the fund's portfolio ESG ratings attached as Exempt Appendix 3 for discussion and proposed next steps

### 2. Recommendation

- 2.1 To receive and consider the monitoring plan attached as Appendix1
- 2.2 Note the briefing paper Investing in Time of Climate Change- Appendix 2
- 2.3 Consider the updated ESG ratings of our current portfolio fund managers attached as Exempt Appendix 3 and agree the next steps

### 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 The agreed targets are as follows

3.6.1 **The Fund seeks to achieve the following targets by May 2022 through:**

1) Reducing future emissions by focussing on absolute potential emissions (tons of CO<sub>2</sub>e), 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 [\[1\]](#), 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.

3.6.2 **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 bi-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 2°C to 4°C.

- 3.6.3 Members are asked to consider the proposed monitoring plan and agree any amendments if required and note for information the briefing paper. Members are also asked to note the updated ESG ratings and agree the next steps of engaging with manager who have a lower rating and highlight the better managers best practise.

## **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 briefings monitoring plan and updated ESG ratings of our portfolio managers.

**Background papers:**

None

Final report clearance:

**Signed by:**

<b>Received by:</b>	Corporate Director of Resources	Date
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	Head of Democratic Services	Date
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