

Report of: Corporate Director of Resources

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	14 th September 2021		n/a

Delete as appropriate	Exempt	Non-exempt

The appendix to this report is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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 REVIEW-PASSIVE EQUITIES

1. Synopsis

- 1.1 This is a report to discuss the pathway to transition to Net Zero Carbon by 2050.
- 1.2 Mercer (our investment advisors) will make a presentation setting out information in relation to Third Generation Climate Indices ("3G Indices") that are explicitly designed to provide initial and ongoing decarbonisation, consistent with the Intergovernmental Panel on Climate Change's 1.5oC warming scenario. This a key component to enable the Fund to achieve its net zero carbon emission target set to 2050

2. Recommendations

- 2.1 To receive the exempt Mercer presentation.
- 2.2 To agree to update the Fund's Responsible Policy, to reflect the new Net Zero commitment and its carbon emission reduction target of 49% by 2026 and 60% by 2030.
- 2.2 To note the 31st March 2021 carbon foot printing exercise, identified the in-house UK equity and RAFI Emerging Market equity allocations (c12% of total assets) as the largest contributors to the overall carbon footprint of the Fund,

- 2.3 To agree delegated authority to officers and investment advisors to explore with the recommended two service providers their offerings in more detail to agree the preferred indices and provider(s)
- 2.4 To agree to receive a progress report on the preferred indices and provider(s) and an implementation plan.

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 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 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 2°C to 4°C.

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 footprinting 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 June meeting to adopt and 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 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 The 31 March 2021 carbon footprinting exercise identified the in-house UK equity and RAFI Emerging Market equity allocations (c12% of total assets) as the largest contributors to the overall carbon footprint of the Fund. As part of the transition pathway to 2050 net zero emissions target, changing some of our current low carbon indices to third generation climate indices will enable us to achieve our short to medium targets. Members are asked to receive the presentation from Mercer (attached as Exempt Appendix 1 to consider the information on these new indices.

- 3.3.3 Members are asked to agree to delegate authority to officers and our investment advisors to explore further details with two providers. A progress report will be brought to the next meeting to agree the preferred indices and provider(s).

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 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 (attached as Exempt Appendix 1) and agree to delegate authority to officers and our investment advisors to explore further third generation indices and report our findings to the next meeting.

Background papers:

None

Final report clearance:

Signed by:



Corporate Director of Resources

Date 07 September 2021

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