Finance Department
7 Newington Barrow Way
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Report of: **Corporate Director of Resources**

Meeting of:	**Date**	**Agenda item**	**Ward(s)**
Pensions Sub-Committee	14th March 2022		n/a

Delete as appropriate	Exempt	Non-exempt

Appendices 1 and 2 are exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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 IMPLEMENTATION OPTIONS

1. Synopsis

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

1.2 Further information has been provided on current Paris Aligned Benchmark (PAB) Indices with comparative data attached as Exempt Appendix 1.

1.3 A summary report has been prepared by Mercer (our investment consultants) and is attached as Exempt Appendix 2 to discuss the results of the due diligence on the preferred third generation climate transition index provider and index.

2. Recommendation

2.1 To discuss and reconsider the Fund's current belief and future objectives to transition to Net Zero Carbon by 2050 and how to achieve the short to medium term targets.

2.2 To consider the comparative data on PAB indices and the LCIV PEPPA fund in Exempt Appendix1.

2.3 To consider the summary report prepared by Mercer on the preferred third generation climate transition index provider and index attached as exempt Appendix2.

2.4 Subject to 2.1-2.3, agree the pathway to achieving the short to medium term targets of transition to Net Zero Carbon by 2050

2.5 To agree the Paris Aligned Benchmark Index

2.6 To agree to receive a progress report on implementation at the June 2022 meeting

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. 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.

3.2 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. 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.

3.3 **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.

3.4 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.

3.5 Members agreed that Mercer and officers meet some preferred index providers to enable the Fund to select indices best aligned with their objectives and the outcome report was discussed at the December 2021 meeting. The decision was to take further due diligence on a Paris Aligned Index to determine its rating and suitability.

3.6 **Factors to Consider**
As part of the decision making process it is important that a consideration is taken of the following factors:

i) Does this index fit with our current stated beliefs in our investment strategy statement (ISS)?
ii) What are the implications of the any changes required in our ISS?
iii) Does the LCIV have a product that meets our objectives and provide value for money?
iv) Will the chosen index deliver our short to medium term targets of decarbornisation?

3.7 **The current ESG paragraph of our ISS states**
"The Committee has a fiduciary duty to invest Fund assets in members' best interests and so must ensure that assets are invested in an appropriate manner; as a result all material ESG considerations, including climate change, must be taken in light of expected risk and return implications.

The Fund seeks to fully incorporate ESG (including climate change) risks and opportunities into its investment strategy and investment implementation, with a view to further reduce or remove exposures to carbon dioxide from fossil fuel energy sources and other greenhouse gases and reduce ESG risks of the portfolio in line with stated objectives. In particular the Fund will seek to allocate investment to sustainability-themed investments, as well as uphold high standards of ESG incorporation the Fund".

3.8 The exempt Appendix 1 has a comparative schedule of some of the specific details of existing and PAB indices like carbon emissions, exclusions, ESG and fees of the alternative indices. The London CIV has now launched its PAB Fund called PEPPA (details were not available last year during our selection period). The PEPPA fund fact sheets are also attached as exempt Appendix 1. Members are asked to consider these high-level details taking account of the factors listed in paragraph 3.6

3.9 Members are asked to consider exempt Appendix 2, PAB index due diligence summary report prepared by Mercer as requested at the December 2021 meeting. The rating given is now been confirmed by the Mercer ratings review committee.

3.10 Members are also asked to consider all the options and factors and reconfirm their investments beliefs on ESG, and then 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 and 2 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 recommendation

5.1 Members are asked to take into consideration the factors in paragraph 3.6 together with indices details within exempt Appendix 1 and 2 and then agree the option that is best aligned to the funds agreed climate transition pathway objective. A progress report on implementation to the next meeting is agreed.

Background papers:
None

Final report clearance:

Signed by: David Hodgkinson

Corporate Director of Resources Date: 9/03/22

Received by:

Head of Democratic Services Date

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