Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: Corporate Director of Resources

Meeting of: Pensions Sub-Committee

Date: 28th June 2022

Ward(s): n/a

Appendix 1and 2 attached is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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- ESG Ratings and Carbon Foootprint Results

1. Synopsis

1.1 This report discusses progress to date on the agreed monitoring plan on our decarbonisation policy and to note ESG ratings of our portfolios and carbon footprint of our equity and credit holdings.

1.2 Mercer have prepared a presentation discussing their ESG ratings results of our portfolios and this is attached as Exempt Appendix 1.

1.3 Mercer have undertaken a carbon foot printing measure of our equities and credit holdings and presented the results in a briefing attached as Exempt Appendix 2 (to follow).

2. Recommendation

2.1 To note the ESG ratings of individual portfolios and average rating of 1.8 (previous rating 2.1) for the whole Fund.

2.2 To note the carbon footprint of our public equities and credit

2.3 To note the fund has reduced its exposure to carbon intensive companies since 2016 and absolute emissions as set out in Exempt Appendix 2 (to follow).

2.4 To continue to engage with our portfolio managers to improve ESG ratings and achieve the targets set in 2022 and 2025 for the whole fund.

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 last 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 tCO2e. 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.

Progress to date

3.2.1 **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.

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 in 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.

3.2.2 **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 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 2ºC to 4ºC.

ESG ratings

3.2.2 Mercer 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 of the Fund's 13 strategies across equities, fixed income, DGFs, property, private debt, infrastructure and private equity.

3.2.3 Members are asked to consider the presentation, -Exempt Appendix 1 on the ESG ratings of our 11 managers and focus on integration: having regular follow up discussions with managers as an important element of communicating expectations on ESG and climate integration and a strategic approach to climate risk. The average rating has improved from 2.1 to 1.8.

3.2.4 **Measuring carbon footprint of equities portfolio annually**

The carbon footprint measure comprises of two elements; future emissions that is reserve based, and exposure to carbon intensive companies. The valuation of assets as 31March 2022 was used for the exercise across our public equities and credit mandates.

3.2.5 Mercer have conducted the exercise to capture the equity holdings of the fund and results are presented in Exempt Appendix 2 (to follow). Members are asked to consider the individual portfolios and the total level of emissions and reserves for the fund.

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, Regulation7 (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 t fund in green opportunities. The link to the full document is https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonborough ngtonpensionfundinvestmentstrategystatement.pdf

4.4 **Equality 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.

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5. Conclusion and reasons for recommendation

5.1 Members are asked to note the ESG ratings and carbon footprint results to March 2022 and continue to engage with our fund managers on climate risk.

Appendices: Exempt Appendix1- Mercer presentation ESG ratings results
Exempt Appendix 2- Mercer presentation Carbon footprint results

Background papers:
None

Final report clearance:

Signed by:

Corporate Director of Resources Date

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