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MEETING TITLE AND DATE:
Pension Investment & Policy Committee
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REPORT OF:
Director of Finance

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Agenda – Part:	**Item: 8**
Subject: ESG & Fiduciary Duties	
Wards:	
Key Decision No:	

Cabinet Member consulted:

1. EXECUTIVE SUMMARY

1.1. The Pension Fund has a fiduciary duty to act on behalf of members of the Pension Fund and an overriding duty to achieve an appropriate risk-adjusted return. However, it may also take into consideration Ethical, Social and Governance (ESG) issues in determining its investment strategy and decisions over individual mandates.

1.2. There is a growing consensus around the impact of climate change requiring faster action than was previously contemplated. It is widely recognised that investment decisions should take this into account. Even the Bank of England has referred to such concerns.

1.3. This paper details the complexities of the fiduciary duties, the options available to members and the financial risks attached to the various options, including divestment, engagement, removing allocations to certain types of investment.

1.4. The paper also reminds Committee members that the Pension Fund makes decisions over the long-term that are in the best interest of the Pension Fund. At the Triennial Review, the Pension Fund has the ability to gradually reshape its investment allocation but it must still seek a prudent approach to achieving its underlying objectives.

1.5. The Council has asked the Committee to review its investment portfolio in light of what it describes as a 'climate emergency'. This paper recommends key changes that would allow the Pension Fund understand its investments better and strengthen its influence.

1.6. There is a separate paper that details a potential approach to support Committee decision-making on investment decisions that takes into account ESG concerns. However, the paper does note that its passive mandate could be adjusted to a less carbon-intensive version with little tracking error.

1.7. The paper asks that the Fund commissions a professional survey of its members on ESG issues, to support the Triennial Review Process

2. RECOMMENDATIONS

2.1. The Pension Policy & investment Committee is recommended to:

i) Commit to the UK Stewardship Code;

ii) Develop a policy statement regarding the London Borough of Enfield's approach to carbon intensive investment with a view to inclusion as a section within the Fund's Investment Strategy Statement (ISS);

iii) Note options for switching some or all the passive equity mandates into a low carbon target index funds;

iv) Monitor carbon risk within the London Borough of Enfield Pension Fund and to appoint a specialist contractor to conduct a carbon footprint review of the Fund at an estimated cost of between of £5k to £20k.

v) Maintain the current engagement activities which the Local Authority Pension Fund Forum (LAPFF) carry out on behalf of the Fund;

vi) Continue engagement activities with the Fund's and new investment managers/London CIV on their approach to managing transition to low carbon economy and their contribution in dealing with climate change issues when making investment decisions;

vii) Maintain an active approach to climate change issues with investee companies/London CIV and look for further opportunities to work with others on issues of ESG importance.

3. BACKGROUND

3.1 There is increasing pressure being placed on Pension Funds by stakeholders to ensure that ESG factors are considered when making investment decisions. This pressure is coming from lobby groups, other stakeholders, the Bank of England and even the Pensions Regulator has warned that savers face long-term financial risks because trustees are failing to take climate change, responsible business practices and corporate governance into account when making investments.

3.2 There are many facets to responsible investing and they cannot all be covered within the scope this report. The most common term that is used when referring to responsible investment is Environmental, Social and Governance (ESG) Issues. This term is used to describe a group of risks that are explicitly acknowledged and incorporated into the investment research and decision-making process. The below list is some example of factors falling within each category.

Environmental	Social	Governance
Climate Change	Human Rights	Board Structure

Waste & Recycling	Diversity Issues	Employee Relations
Energy Usage/Conservation	Employee Relations	Executive Compensation
Sustainability	Consumer protection	Shareholder rights
Carbon Emissions	Community relations	Vision and Strategy
Supply Chain Management	Animal Welfare	Voting procedures

3.3 For the Committee to make an appropriate legal decision, the new Local Government Pension Scheme Guidance on Preparing and Maintaining an Investment Strategy Statement states in Regulation 7(2)(e) - How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.

3.4 When making investment decisions, administering authorities must take proper advice and act prudently. In the context of the local government pension scheme, a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence. This approach is the standard that those responsible for making investment decisions must operate.

3.5 Although administering authorities are not subject to trust law, those responsible for making investment decisions must comply with general legal principles governing the administration of scheme investments. They must also act in accordance with ordinary public law principles, in particular, the ordinary public law of reasonableness. They risk challenge if a decision they make is so unreasonable that no person acting reasonably could have made it.

3.6 The Council (London Borough of Enfield) is the Administering Body of the Pension Fund but the Pension Fund Assets are separate to assets of the Authority. Members of the Council and officers are duty bound to ensure that the actions on behalf of the Pension Fund are not driven by the self-interest of the members and officers or in Council objectives. This does not prevent members from taking into account wider concerns but members and officers need to recognise that they cannot override their fiduciary duties.

3.7 It is also helpful to remember that while the largest employer within the Pension Fund is the Council, it is not the only one. If the other employers felt the Council was not administering the Pension Fund in the best interest of the members, it could be open to legal challenge. The current contribution rate is £26.1m per year, whereas other employers contribute £8.9m per year. Any loss in performance only increases the contribution rate on the Council (and indirectly the savings target). If it could be argued that the poor performance led to higher liabilities and hence larger contribution rates (including on the Council), the Council could face legal challenge.

3.8 The law is generally clear that schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors, and over the long term, dependent on the time horizon over which their liabilities arise.

3.9 However, the Government has made clear that using pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

3.10 Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision. This is the legal risk referred to in paragraphs 3.7 through 3.8.

3.11 Investments that deliver social impact as well as a financial return are often described as “social investments”. In some cases, the social impact is simply in addition to the financial return; for these investments the positive social impact will always be compatible with a prudent approach to investing. In other cases, some part of the financial return may be forgone in order to generate the social impact. These investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund.

3.12 The extent of investors’ fiduciary duty with regards to ESG factors has been the subject of considerable debate in recent years. The Law Commission published a report, ‘Fiduciary Duties of Investment Intermediaries’, which offered guidance to investors on the circumstances under which they might have a fiduciary duty to consider ESG factors. A recent update to the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018, although not directly applicable to the LGPS, provided a further steer on the Government’s view of the duties of trustees. It is therefore clear that investors are expected to take account of ESG factors where these are financially material and that such a stance should be assumed to be part of any compliant approach to this subject.

Climate change and fossil fuel investments

3.13 The scientific consensus is now ‘unequivocal’ in their opinion that greenhouse gases emitted as a result of human activities are causing global warming. The global temperature increase we will experience in the coming decades will profoundly impact people’s lives and, therefore, our economies. In order to minimise the most damaging consequences, global leaders have agreed to limit the temperature increase to 1.5 – 2°c above the pre-industrial levels. It is an ambitious but achievable target if we can meaningfully shift our methods of generating and consuming energy globally.

3.14 Climate change, and its direct and indirect impact, pose a significant systemic risk for long-term investors. Due to the unpredictable and inconsistent nature of weather patterns, it is difficult to assess the exact level of its impact. The magnitude and likelihood of risks and the scope and scale for solutions are also highly dependent on the policy support for mitigating excess emission levels and adapting to more extreme and changing weather patterns.

3.15 It is widely acknowledged that the "The Stern Review on The Economics of Climate Change", published in 2006, commissioned by the Chancellor as a contribution to assessing evidence and building understanding, was one of the earliest, most extensive and discussed pieces of research into the impact of climate change on the global economy. The full document runs to 700 pages. Stern concluded that, depending on the range of risks taken into account, climate change could cost the global economy between 5 to 20% of GDP in perpetuity unless action is taken to mitigate global warming.

3.16 In brief some of the key points were:

- Climate change is global in its causes and consequences
- Ignoring climate change will eventually damage economic growth
- All countries will be affected by climate change, but the poorest countries will suffer earliest and most
- Average temperatures could rise by 5°C from pre-industrial levels if climate change goes unchecked and could lead to untold consequences for people in terms of access to water, food and health
- Emissions have been and continue to be driven by economic growth but stabilisation of greenhouse gas is feasible if actions are taking to mitigate without significantly damaging economic growth
- Significant new opportunities could arise across a wide range of industries and services and markets for low carbon energy products are likely to be worth at least $500bn per annum by 2050.
- Collective action could lead to an effective response to climate change, this could include carbon pricing, technology policy, innovation and financing and improvements to energy efficiency. "There is still time to avoid the worst impacts of climate change if strong collective action starts now".
- "No-one can predict the consequence of climate change with complete certainty, but we now know enough to understand the risks."

Carbon Tracker Research

3.17 Carbon Tracker is a not for profit financial think tank aimed at enabling a climate secure global energy market by aligning capital market actions with climate reality. Climate tracker has published a number of research pieces, which can be found on their website: http://www.carbontracker.org/

Global Investor Coalition on Climate Change

3.18 Global Investor looked at the issues from the perspective of investors and it is relevant in any discussion on this subject to include a report provided by this group titled: Climate Change Investment Solutions: A Guide for Asset Owners which is included as an appendix to this report.

3.19 The guide is presented in 4 sections each of which sets out a range of suggested actions that asset owners can take.

i) Section 1: Strategic review – Presents actions to integrate climate change into investment beliefs and investment policies that are actionable and transparent.

ii) Section 2: Strategic asset allocation – Discusses actions for measuring and managing the risks and opportunities of climate change, both within the existing asset allocation structure and through evolving the asset mix over time.
iii) Section 3: Mitigation investment actions – Presents actions for reducing the carbon intensity of existing assets, along with opportunities to invest in low carbon, clean energy and energy efficient assets.
iv) Section 4: Adaptation investment actions – Discusses actions to reduce the vulnerability of existing assets to the physical impacts of climate change, as well as building exposure to adaptation opportunities.

3.20 **Investment consultancy firm, Mercer**, has undertaken two studies with a number of partners, including asset owners. These two studies focused on the investment implications for climate change and consider ways that investors should address these issues. The two reports are:

i) Climate Change Scenarios – Implications for Strategic Asset Allocation (2011)

ii) Investing in a Time of Climate Change (2015)

3.21 The most recent study, which is the second study completed in 2015 (*Investing in a Time of Climate Change)* – This study looks to address a number of questions having modelled a number of scenarios and how these might play out in the investment returns that are achieved in various sectors:

a) How big a risk/return impact could climate change have on a portfolio and when might that happen?

i) Climate change, under the scenarios modelled, will inevitably have an impact on investment returns, so investors need to view it as a new return variable.

ii) Industry sector impacts will be the most meaningful. For example, depending on the climate scenario which plays out, the average annual returns from the coal sub-sector could fall by anywhere between 18% and 74% over the next 35 years, with effects more pronounced over the coming decade (eroding between 26% and 138% of average annual returns). Conversely, the renewables subsector could see average annual returns increase by between 6% and 54% over a 35-year time horizon (or between 4% and 97% over a 10-year periods).

iii) Asset class return impacts could also be material – varying widely by climate change scenario. For example, a 2°C scenario could see return benefits for emerging market equities, infrastructure, real estate, timber and agriculture. A 4°C scenario could negatively impact emerging market equities, real estate, timber and agriculture. Growth assets are more sensitive to climate risks than defensive assets.

iv) A 2°C scenario does not have negative return implications for long-term diversified investors at a total portfolio level over the period modelled (to 2050) and is expected to better protect long-term returns beyond this timeframe.

b) What are the key downside risks and upside opportunities and how do we manage these considerations within the current investment process?

i) Key downside risks come either from structural change during the transition to a low-carbon economy, where investors are unprepared for change, or from higher physical damages. In the first instance, under a 2°C, or Transformation scenario, investors could see a negative impact on returns from developed market equity and private equity, especially in the most affected sectors. On the flip side, this scenario would be likely to lead to gains in infrastructure, emerging market equity, and low-carbon industry sectors.

ii) Under a 4°C, or Fragmentation (Higher Damages) scenario, chronic weather patterns (long-term changes in temperature and precipitation) pose risks to the performance of asset classes such as agriculture, timberland, real estate, and emerging market equities. In the case of real asset investments, these risks can be mitigated through geographic risk assessments undertaken at the portfolio level. To embed these considerations in the investment process, the first step is to develop climate-related investment beliefs alongside other investment beliefs.

iii) These can then be reflected in a policy statement, with related investment processes evolved accordingly. The next step is portfolio-oriented activity, including risk assessments, new investment selection/weights and, finally, enhanced investment management and monitoring.

c) What plan of action can ensure an investor is best positioned for resilience to climate change?

i) Investors have two key levers in their portfolio decisions — investment and engagement. From an investment perspective, resilience begins with an understanding that climate change risk can have an impact at the level of asset classes, of industry sectors and of sub-sectors.

Stranded Assets

3.22 Stranded assets are those which suffer unanticipated or premature write-offs, downward valuations, or are converted to liabilities. Assets may become stranded by one-off transformational shifts in valuation, or over time, as a result of appropriate risks not being analysed and priced into the future anticipated value of the assets.

3.23 This stranded asset issue has raised the profile in challenging its managers to take these factors into consideration when investing on behalf of the Fund and to includes questions on manager approaches to ESG when considering new investment mandates.

3.24 It is important to remember that the ‘stranded asset’ factor may already be taken into account within the pricing of the underlying assets. There is equally the possibility that other costs, such as de-commissioning of those same assets has not been. Therefore, it is important that the Pension Fund needs to assure itself that the investment manager has done appropriate due diligence.

Investment Manager Research and Index Providers

3.25 With the increasing emphasis that investors are placing on the risks around climate change, investment managers and index providers themselves are starting to address investor concerns to varying degrees. Some managers have undoubtedly been participating earlier in the debate than others and for some climate change falls under the broad remit of environmental, social and governance (ESG) research.

3.26 The Fund recently asked the fund managers to supply information on their engagement in reducing carbon foot prints of the fund. The intent is that this information will be made available on a quarterly or yearly basis at the Pension Policy and Investment Committee meetings.

3.27 The Fund, through its participation with Local Authority Pension Fund Forum (LAPFF), has supported progress towards an orderly transition to a low carbon economy. This is by actively working with other asset owners, fund managers, companies, academia, policy makers and others in investment industry.

3.28 Officers meet with a wide range of managers on a regular basis to gather intelligence and to explore investment ideas. Some of the managers have assisted officers in building their understanding of the facts, figures and risks around climate change and carbon intensive investments.

3.29 One of the key challenges faced comes from the fact that the Government has mandated Pension Funds to pool their assets to reduce management fees. The London CIV, which is the pool in which the Enfield Pension Fund participates, does not offer sufficient low-carbon products and has not focussed on this area as a priority. However, there are passive equity tracker funds, with a low-tracking error, that are available to the Pension Fund.

3.30 London Borough of Enfield and other London boroughs have already madetheir opinions known to the London CIV on an informal basis. Ultimately, more sub-funds can be created for to achieve such a purpose within the London CIV. For example, the pool's infrastructure sub-fund currently has a 25% target allocation to renewable energy, but this is not good enough for some pension funds that have previously invested in broad infrastructure. Hence LCIV is looking into creating or introducing a dedicated renewable energy sub-fund on their platform. This is because about seven pension funds are seeking to invest independently of the pool into renewable energy funds.

3.31 **Listed below is what other funds are doing:**

i) In June 2015, the Environment Agency Pension Fund committed £280m into the MSCI World Low Carbon Target Index Fund

ii) In July 2015, the London Assembly recommended that the London Pensions Fund Authority (LPFA) change fossil fuel investments to more responsible positions.

iii) In January 2016, Haringey Local Government Pension Fund announced it would shift one-third of its equity funds – equating to about £200m – into the MSCI World Low Carbon Target Index Fund, run by LGIM.

iv) September 2016, Waltham Forest Local Government Pension Fund announced it would "exclude fossil fuels from its strategy over the next five years".

v) In December 2016, the London Borough of Southwark Pension Fund announced its commitment to sell off its investments in fossil fuels.

vi) In 2017, the London Borough of Islington Pension Fund embarked on a drive to reduce their Fund's exposure to carbon, by setting goals to reach by the end of April 2022.

3.32 To date none of the above-mentioned Funds are fully divested out of fossil fuels as they realised, divestment is not an available or arguably legally appropriate route to deal with the climate change issue. The committees have shifted their emphasis to go beyond simply divestment from fossil fuels towards thorough decarbonisation of the Fund. This is because decarbonisation goes further, considering the carbon footprint of all the fund's investments.

3.33 All the above-mentioned Funds had chosen to steadily decarbonise their existing mandates across their Funds and also allocating assets to impact investments such as renewable energy and some other carbon reduction strategy.

3.34 A key distinction should be made between socially responsible investments (SRI) and responsible investment (RI). RI is an approach that considers ESG (Ethical, Social and Governance) factors and considers how the risks posed by the non-sustainability of companies invested in can impact the financial wellbeing of the Fund. Therefore, responsible investment is driven more by how sustainable factors can have financial consequences rather than ethical or moral implications which can be very subjective.

3.35 Currently 40% of the Fund total assets is invested in equity and approximately 15% are held as a passive equity mandates with performance target of tracking the FTSE All Share index. The passive mandates do have c.5% weightings (£9m) in Oil, Gas and consumable fuels as at 30th June 2019.

3.36 The manager, Blackrock, managing Enfield Pension Fund's passive mandates do have some low carbon products that we can switch into and this would be at a cost. Legal and General Investment Management (LGIM) also have low carbon products. London CIV do have a relationship with these two managers and in the past had negotiated lower fees for Funds with passive mandates with the managers.

Conclusion

3.37 Officers are recommending that the committee should consider an approach of reducing the carbon intensity of the Fund portfolios over time, and this is known as "**portfolio decarbonisation**". The benefits of this approach include:

i) A portfolio that is less susceptible to increasing carbon pricing, stranded assets and/or related regulation.

ii) Supports the flow of capital to a resilient low-carbon economy and may help to address the market mispricing of carbon.

iii) Produces a market signal that incentivises companies to develop and invest in low carbon and clean technologies, influences policymakers and helps to catalyse a new standard for other institutional investors.

3.38 The alternative to reducing carbon exposure is an exclusionary approach (i.e. fossil fuel free), however:

i) This approach removes the potential to positively influence companies and help them transition to a lower carbon footprint.

ii) The actual reduction in carbon footprint can be lower, as relatively few companies are excluded (typically the big oil and mining companies), whilst companies that make heavy use of these commodities remain in the portfolio.

3.39 The Pension Policy and Investment Committee’s foremost concern should always be their fiduciary duty to deliver the best risk-adjusted returns for the members of the pension scheme over the long term. The concern over the potential financial risk posed by carbon-intensive investments would therefore be a key driver of the fund’s carbon exposure management agenda.

3.40 At present, the UK and wider global economies remain heavily based on fossil fuels; as we transition to a lower carbon economy, new opportunities will continue to open up. At present, fully restricting fossil fuels from the Fund investment strategy would excessively restrict the Committee investment options in the short-term, leaving it open to legal challenge; fossil fuel divestment is not cost or risk free and the Fund needs to balance the potential long-term benefits of reduction with the risks of increased investment management costs and short to medium term losses. However, as the prevalence of fossil fuels within the wider economy reduces and as the London CIV investment options improve, these risks should also reduce, permitting further reductions in fossil fuel exposure.

3.41 Therefore, to aid with the decision of disinvestment from certain asset class or sectors it is worth looking at returns and risk profile of certain indices and asset class. Hence officers are recommending the Committee should embark on an investment strategy review for the Fund, following the outcome of its latest triennial valuation. This review will incorporate the climate goals when considering changes to the current portfolio asset allocation. The investment strategy review will also consider how the Fund could increase its positive contribution to the transition to a low carbon economy by allocating assets to renewable energy, whilst meeting its own strategic investment requirements.

3.42 Members could consider deploying some allocation or all the current allocation to passive equity investment to a low carbon index or other ESG/quality factor constructed index. This is because an allocation to a Low Carbon Index Target passive global equity fund is expected to reduce the carbon exposure of our Pension Fund compares to a standard global equity benchmark (MSCI ACWI), in some cases to as much as 70% reduction. A separate paper will consider this recommendation.

3.43 Officers are also proposing to include a report in the quarterly monitoring pack which specifically would cover the engagement activities undertaken by LAPFF and the Fund's managers' responses to issues raised. Managers have been challenged and will continue to be challenged on their voting policies and the extent to which they are factoring in ESG in the company selections and increasing their approach to climate change issues.

3.44 In light of these changes, the Investment Strategy Statement (ISS) must be reviewed and revised by the Council as administering authority when any material changes take place such as changes to the investment beliefs; changes to the types of investment held; or the balance between the types of investments in the Fund.

Conclusions

3.45 Set below are plans and indicative timescales for future work on recommendations set in this report as the Fund's approach to management of carbon intensity investments including fossil fuel investment and management of the financial risks posed by climate change.

i) Commit to UK Stewardship Code – For the Committee to agree to become a signatory of the Stewardship Code. The principal aim of the Code is to encourage institutional investors, who manage other people's money, to be active owners and engage with their investee companies to encourage them to act in the interests of their beneficiaries. In the UK context these are primarily shareholders, but UK company law extends corporate responsibilities to wider stakeholders. The Code was revised and updated in September 2016. The seven principles of the Code are that Institutional investors should:

   a) Publicly disclose their policy on how they will discharge their stewardship responsibilities.

   b) Have a robust policy on managing conflicts of interest in relation to stewardship with this policy being publicly disclosed.

   c) Monitor their investee companies.

   d) Establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

   e) Be willing to act collectively with other investors where appropriate.

   f) Have a clear policy on voting and disclosure of voting activity.

   g) Report periodically on their stewardship and voting activities.

ii) Develop a policy statement regarding the London Borough of Enfield's approach to carbon intensive companies/investments with a view to inclusion as a section within the Fund's Investment Strategy Statement (ISS), this will both demonstrate a commitment to managing carbon risk and set targets that are both quantifiable and measurable where this is appropriate.

iii) Review the option of switching the Pension Fund's passive equity mandates and the Fund's passive equity mandates are standard market capitalisation weighted index, currently managed by BlackRock which tracks the FTSE All share.

iv) Monitor carbon risk within the London Borough of Enfield Pension Fund and to appoint a specialist contractor to conduct a carbon footprint of the Fund at an estimated cost of between of £5k to £20k. Measuring emissions and climate risks in the portfolio will allow the Fund to establish a base of data from which to examine its investment assumptions and test investment processes. It will also enable the Fund to make an assessment on an ongoing basis as to how its exposure to climate change risks progresses over time. This work can start September 2019 and the initial results could be presented at a future Committee.

v) Continue engagement activities with the Fund's investment managers on their approach to fossil fuel and to promote consideration of climate change issues with managers when making investment decisions. This is an area in which further work will be undertaken over the coming months. Officers have been in contact with some of the Fund's asset managers to request more detailed reporting on environmental issues and will be looking at this in more detail in the near future.

vi) Maintain an active approach to climate change issues with investee companies and look for further opportunities to work with others on issues of ESG importance. The Fund continues to monitor ESG issues through the alerts issued by the LAPFF, a collection of Local Authority funds who, by acting collectively, can apply pressure to the management of companies. LAPFF has previously been involved with voting climate-change related resolutions and has invited its members to co-file. We will co-file these resolutions as part of LAPFF. Where Enfield's holdings in a company are through a pooled fund, a public expression of support will be made.

vii) Commissioning a professional survey of the membership will allow the Pension Fund to understand members' perspectives and will allow for a much more meaningful consultation on ESG matters.

3.46 Officers strongly believe that engagement with fossil fuel companies via organisations such as LAPFF to influence their future strategies should continue alongside the reductions in stock holdings in such companies. Simply selling stocks, whilst reducing the fund's exposure, does not in itself achieve the impact of an overall reduction in the use of fossil fuels. Others will buy the stocks released and they may not wish to engage with the companies in order to influence the move from fossil fuel.

4. ALTERNATIVE OPTIONS CONSIDERED

No alternative

5. REASONS FOR RECOMMENDATIONS

a) The Pension Policy & investment Committee act in the role of quasi trustees for the Pension Fund and are therefore responsible for the management of £1.16 billion worth of assets and for ensuring the effective and efficient running of the Pension Fund. The management of the Fund's investment portfolio and the investment returns that the Fund is able to deliver have significant financial implications, not just for the Fund itself but also on the Fund's employers in terms of the level of contributions they are required to make to meet the Fund's statutory pension obligations.

b) The Fund recognises that investment in fossil fuels and the associated exposure to potential 'stranded assets' scenarios may pose material financial risks. These risks apply not only to the Fund's investment portfolio but also long term global economic growth.

c) In recognising the risks that climate change and stranded assets scenarios could pose to the Fund, the Committee needs to understand where these risks might apply and how they can best be mitigated within the LGPS investment management framework. The recommendations provided on this report are aimed at developing both a greater understanding of the risks and a set of strategies to help mitigate them.

d) The costs involved will very much depend on future investment strategy decisions. Climate change risk will be integrated into the forthcoming new Investment Strategy Statement to ensure that it is considered as part of the Committee's asset allocation decisions, rather than in isolation. Potential costs that could be incurred through development of the recommendations above include additional fees from using low carbon indices; however, any such costs would need to be considered against the potential for risk mitigation and the performance of the mandate.

6. COMMENTS FROM OTHER DEPARTMENTS

6.1 Financial Implications

a) The current Investment Strategy been implemented to maximise returns of Fund's assets within acceptable risk parameters and to facilitate a reduction in the burden of deficit funding that employers in the Fund are liable for.

b) The performance of the Fund's Strategy is monitored through a quarterly report that is presented to the Committee. Recent performance has been good and generally either in line with or exceeded target.

c) A carbon risk audit would highlight the operational carbon footprint and exposure to fossil fuel reserves of the Fund's equity portfolio, setting out where the Fund is most exposed in terms of assets at risk of stranding. This would enable the committee to set a target in line with the revised investment strategy and review this target periodically to ensure that it remained consistent with the risks associated with investment in carbon assets and with the Committee's fiduciary duties.

6.2 Legal Implications

a) The Committee has legal responsibilities for the prudent and effective stewardship of the Pension Fund and a clear fiduciary duty in the performance of its functions. The LGPS (Management and Investment of Funds) Regulations 2016 require Administering Authorities to state the extent to which they comply with the Guidance given by the Secretary of State. In accordance with regulation 7(2)(e) the authority must set out in its Investment Strategy Statement, its policy on how social, environmental and corporate governance considerations are considered in the selection, non-selection, retention and realisation of investments.

b) Updated Statutory Guidance on preparing and maintaining an investment strategy statement was published on the 15th September 2016. Having a policy in place covering the authority's approach to ethical, social and governance issues will enable to authority to meet its statutory duties in this regard. The recommendations discussed in this report are in line with both the Committee's terms of reference and legal responsibilities.

7. KEY RISKS

a) The Fund recognises that investment in fossil fuels and the associated exposure to potential 'stranded assets' scenarios may pose material financial risks. These risks apply not only to the Fund's investment portfolio but also, when considered on a wider scale, to long term global economic growth.

b) In recognising the risks that climate change and stranded assets scenarios could pose to the Fund, the Committee needs to understand where these risks might apply and how they can best be mitigated within the investment management framework within which LGPS funds operate.

c) It is important that members do not let ESG policy objectives do not cloud the legal requirement for focussing on risk-adjusted returns or the Fund (and the Council) might be legally sued.

d) The recommendations provided on this report are aimed at developing both a greater understanding of the risks and a set of strategies to help mitigate them.

Background Papers

(To be email on request)

i) LAPFF Guidance on Fossil Fuel and Stranded Assets

ii) Blackrock – The Price of Climate Change, Global Warming's Impact on Portfolios (October 2015)

iii) Schroders: Global Climate Change Investment Themes

iv) Schroders - Responding to Climate Change Risk in Portfolio Management (February 2015)

v) Schroders - Understanding portfolio carbon foot printing an introduction (October 2015)

vi) MSCI - Beyond Divestment Using Low Carbon Indices (March 2015)

vii) Global Investor Coalition on Climate Change - Climate Change Investment Solutions: A Guide for Asset Owners

viii) Carbon Tracker - How the energy sector is missing potential demand destruction

ix) LGIM climate change policy

x) LGIM - Corporate Governance & Responsible Investment Policy – UK