

London Borough of Enfield

PENSION POLICY AND INVESTMENT COMMITTEE

Meeting Date: 23 July 2020

Subject: Pension Fund Business Plan and Budget for 2020/21

Cabinet Member: Cllr Maguire

Executive Director: Fay Hammond

Key Decision: []

Purpose of Report

1. This report sets out a revised timetable for the development of the Fund's 2020 Investment Strategy following the 2019 actuarial valuation. It also presents an interim Investment Strategy Statement (ISS), which has been updated to reflect the work done on carbon and environmental footprints of the Fund and to reinforce the investment beliefs and approach of the Committee.
2. The report also outlines the recent decisions made by the committee to allocating all the current passive equities portfolio into Low Carbon and also allocating 10% of the total Fund assets to renewable energy and sustainable funds. This is in an effort to support transition towards a low carbon economy through positive investment in renewable energy, in line with the recent reports that state that a rapid and orderly transition to other energy sources is increasingly urgent, at the same time meeting the Fund strategic investment requirements.
3. The Committee will continue to engage with fossil fuel companies via organisations such as LAPFF in order to influence their future strategies with the aim to influence a wider move from fossil fuels in the world economy.

Proposal(s)

4. Pension Policy and Investments Committee are recommended to:
 - a) note the timetable for development of the 2020 investment strategy attached as Appendix Y;
 - b) consider and approve that the Fund reduce its total equity portfolio relative exposure to future emissions from fossil fuel reserves (measured in MtCO₂e – million tonnes of CO₂ emissions) by 50% in over the next 5 years. (September 2025);
 - c) consider and approve the Fund measure the reduction relative to the Fund's total equity portfolio position as at 30th September 2019 and adjusted for Assets Under Management (£AUM); and

- d) approve the interim Investment Strategy Statement (ISS) attached as Appendix Z of this report.

Reason for Proposal(s)

5. The Investment Strategy Statement has been set out to reflect the funding position of the Fund and the investment beliefs of the Committee.
6. Adherence to the principles set out in the Strategy will enable the Fund to take an ordered and prudent approach to the management of its assets, helping to manage the long term costs associated with the Pension Fund.
7. The full consideration and approval of the ISS ensures that the Committee are fulfilling their responsibilities as quasi Trustees of the Fund and that the Fund's investment objectives and policies are clearly set out in line with the Local Government Pensions Scheme (Management and Investment of Funds) Regulations 2016.
8. The Investment Strategy Statement (ISS) is a statutory document for LGPS funds, as required by Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.
9. There has been a change (amendments to the Social, Environmental or Corporate Governance section to reflect work carried out and investment beliefs of the Committee) to the Fund's investment strategy since the last ISS was approved in March 2019; this report brings back a revised copy of the ISS incorporating these changes.

Relevance to the Council's Corporate Plan

10. Good homes in well-connected neighbourhoods.
11. Build our Economy to create a thriving place.
12. Sustain Strong and healthy Communities.

Background

Investment Strategy Development Timetable

13. Appendix Y to this report presents a timetable for the development of the Fund's investment strategy. The timetable has been updated to take into account the impact of the Coronavirus pandemic and the pausing of concluding the Investment Consultant tendering exercise.
14. The timetable breaks down the topics to be discussed as part of investment strategy development, including investment beliefs and objectives (including around Responsible Investment), asset allocation, rebalancing and cashflow planning. It sets out an indicative timetable for discussion of these issues and the review of necessary policy documents, including the Investment Strategy Statement (ISS) and the Responsible Investment and Voting & Engagement policies.

15. The timetable increases the time needed for discussion of key issues by including 2 planned workshops during September and October. The proposed agendas for the workshops would not include formal decision making, but instead would allow additional discussion of key topics ahead of formal meetings in February 2021.

Interim Investment Strategy Statement

16. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 Regulation 7 requires the Administering Authorities to publish and maintain an Investment Strategy Statement which includes, amongst other items, details of the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.
17. The Enfield Pension Fund's policy, based on guidance from the Law Commission, is to take into account any factors which are financially material and affect the financial sustainability of investments. These may include Environmental, Social and Governance (ESG) factors, such as carbon risk. The Fund does not make investment decisions on the basis of non-financial factors.
18. The Pensions Regulator specifically references climate risk in its Defined Benefit investment guidance, stating that 'Most investments in pension schemes are long term and are therefore exposed to long-term financial risks. These potentially include risks relating to factors such as climate change, unsustainable business practices, and unsound corporate governance. Despite the long-term nature of investments, these risks could be financially significant, both over the short and longer term'
19. Taking all of the above together, the Committee considers it appropriate to take climate risk into account as a material financial risk within its investment strategy. The remainder of the paper sets out actions taken by the Committee to address this risk.

Past Activities on Climate Change Issue

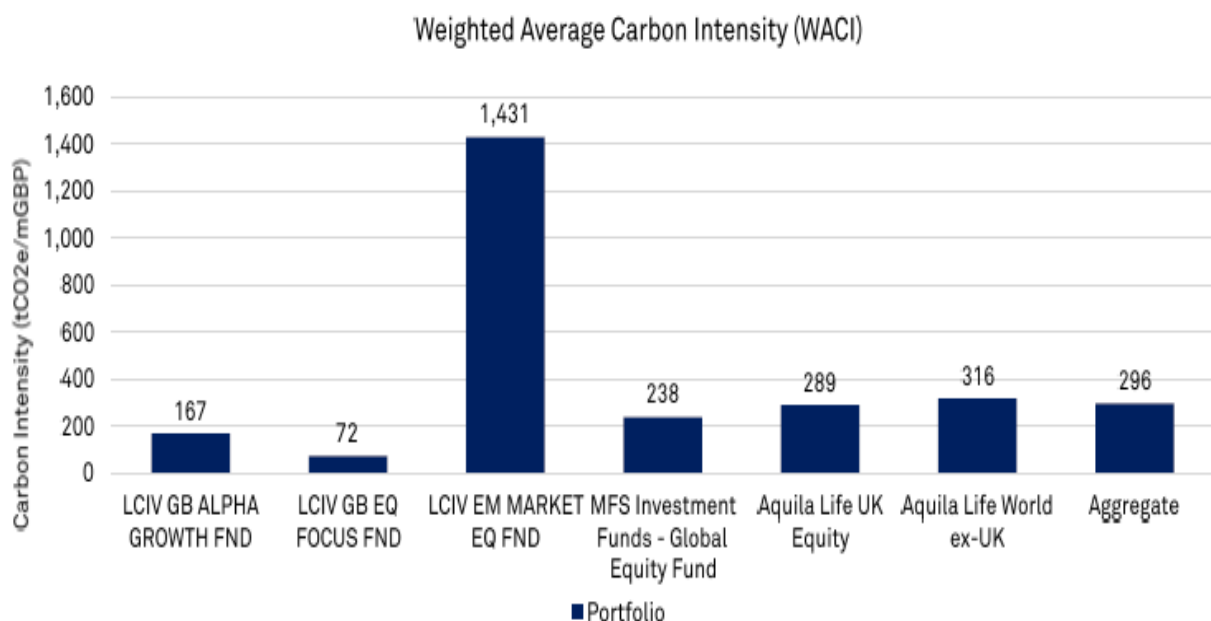
20. Members of this Committee began it's in depth consideration of carbon exposure towards the end of 2019. Between October 2019 and February 2020, the Committee members held several strategy meetings to consider in detail the Fund's approach to investment in fossil fuels and management of the financial risks posed by climate change. At this meeting, the Committee considered and approved a set of recommendations reflecting both its recognition of these risks and a strengthened commitment to factor them into its investment approach
21. The approved recommendations made at its September 2019 and February 2020 meetings are set out below:

- a) *Consider and approve moving all the Fund's passive equity exposure to track a Low Carbon Index Strategy;*
 - b) *Consider options for an initial active investment of approximately 5% of the Fund total assets in a sustainable or fossil fuel free global equity mandate and another 5% of the Fund total assets to be consider for a renewable energy/clean energy fund(s), given the right risk/return profile. Investment in such a fund would demonstrate the Fund's commitment to transition into low carbon economy;*
 - c) *Maintain the Fund's current engagement activities which the Local Authority Pension Fund Forum (LAPFF) carry out on behalf of the Fund;*
 - d) *Consider initiating a programme where the Fund could engage with investee companies (through its managers, the London CIV or possibly directly) on ESG issues;*
 - e) *Following the result of the carbon risk audit carried out by Trucost using the Fund valuation position as at 30th September 2019, to consider setting 2 year and 5 year targets to reduce the carbon footprint of the Fund; and*
 - f) *Agree to monitor carbon risk annually by using a specialist contractor to conduct and assess the progress being made against the Fund's target to reduce the exposure to future CO2 emissions.*
22. The Committee agreed to move the 15% passive equity portfolios into a Morgan Stanley Composite Index (MSCI) Low Carbon index-tracking target strategy which aims to reduce the carbon exposure of the allocation by some 70%, relative to the broad market index, whilst still expecting to perform broadly in line with the wider market over the long term. The work on this was delayed due to market volatility brought about by the current global corona virus pandemic. This work is scheduled to be completed in September 2020.
23. The Fund undertook its first carbon risk audit towards the end of last year, following the recommendation made at the November 2019 meeting to commission a carbon footprint report for the Fund. This analysis was carried out by Trucost, using the end of September 2019 assets data and this audit assessed not only the carbon footprint of the Fund's equity portfolio, but also its exposure to future emissions through fossil fuel reserves.
24. The Fund's view is that exposure to future emissions most accurately represents the risk to the Fund from investing in fossil fuel companies. Assessing exposure to emissions from reserves in this way helps the Fund to take a view on its exposure to potentially stranded assets that may become unusable as a result of the transition to a low carbon economy.
25. The table below summarises the carbon exposure of each portfolio with equity holdings as at 30th September 2019.

Portfolio	Total CO2 Footprint per holding (tCo2e/£m revenue)	Benchmark CO2 Footprint per £m holding (tCo2e/£m revenue)	Variance (- = less than & + = more than BM exposure)	Comment in relation to the benchmark – MSCI ACWI
LCIV GB ALPHA	167	229	-62 or 27%	Efficient
LCIV GB FOCUS	72	229	-157 or 69%	Highly efficient
LCIV EM FUND	1,431	229	+1,202 or -525%	Significantly inefficient
MFS	238	229	+9 or -4%	Inefficient
AQUILA UK	289	229	+60 or -26%	Very inefficient
AQUILA WORLD	316	229	+87 or -38%	Highly inefficient
AGGREGATE	296	229	+67 or -29%	Very inefficient

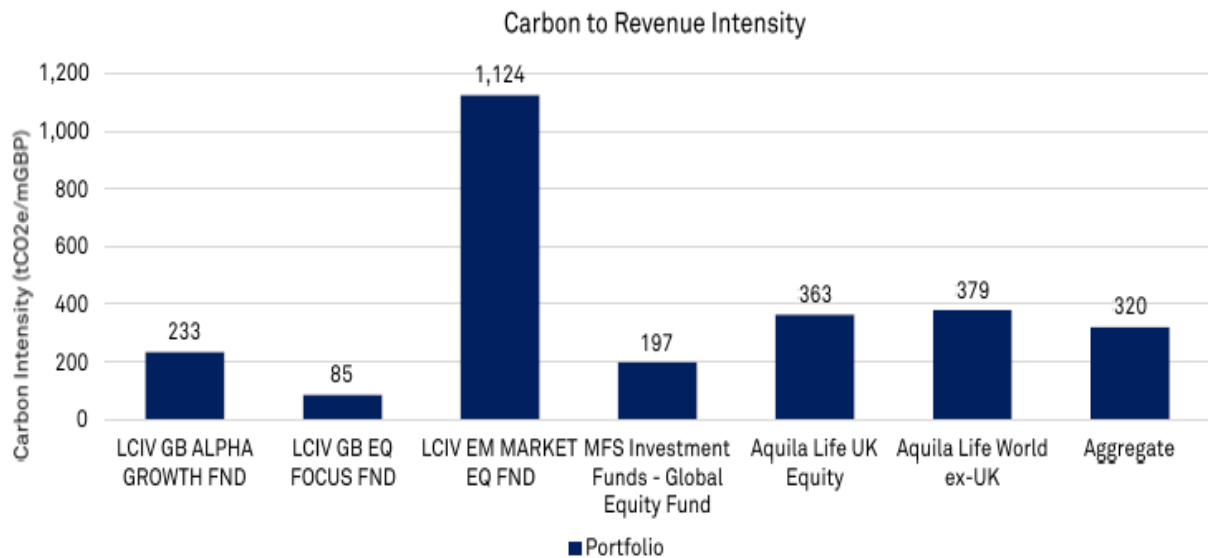
26. The carbon footprint analysis was carried out on the Fund equity holdings with the following portfolios; Blackrock Aquila UK Equity (FTSE), Blackrock Aquila Global Equity (MSCI), MFS (GE) (MSCI), LCIV JPMorgan (EM) (MSCI), LCIV Longview (GE) (MSCI) and LCIV BG (GE) (MSCI). The outcome is shown in the table above and the aggregate portfolio had 296 tCO2e/mGBP of weighted average carbon intensity (WACI). This was the Fund aggregate equity portfolio's exposure to carbon intensive companies as at 30th September 2019.

27. The graphical outcomes produced by Trucost is shown below:



The Weighted Average Carbon Intensity shows a portfolio's exposure to carbon intensive companies.

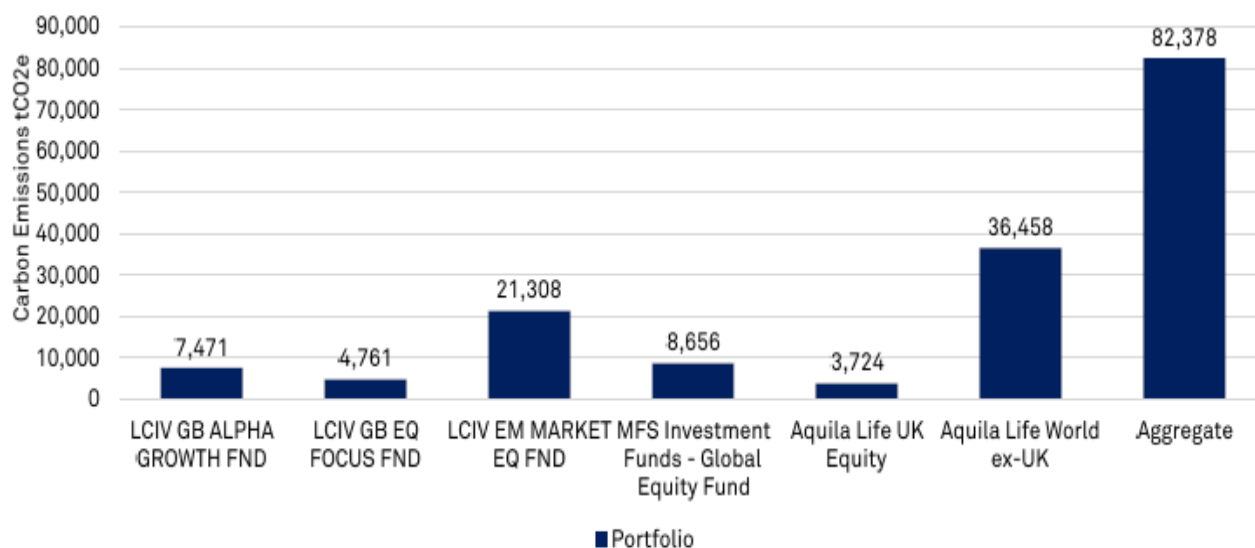
28. And the aggregate portfolio exhibits 320 tCO₂e/mGBP carbon to revenue intensity, this indicates how operationally efficient the companies are in terms of carbon emitted per unit of “output”.



The revenue method indicates how operationally efficient the portfolio companies are in terms of carbon emitted per unit of “output”

29. Trucost has analysed the carbon emissions embedded within the fossil fuel reserves that are disclosed by the underlying companies within the Fund’s equity portfolio. The emissions measured are the potential future amounts of CO₂ that could be released if the fuel reserves disclosed were to be burnt.
30. Although proposition is to measure performance against our target using emissions intensity, Trucost have also measured the absolute exposure to future CO₂ emissions as shown in the below chart. The total exposure within the Fund’s total equity portfolio as at 30th September 2019 was 82,378 tonnes CO₂e.

Absolute Emissions (Direct + First Tier Indirect Emissions)



Total Carbon Emissions allocated to the portfolio in absolute terms.

31. After careful consideration of how carbon risk could best be reduced within the investment management framework in which LGPS funds operate, it seems the way forward is to propose a quantifiable, time-bound target for a reduction in the Fund's exposure to future fossil fuel emissions by asking the Committee to consider the below targets:
 - i) the Fund to reduce its total equity portfolio relative exposure to future emissions from fossil fuel reserves (measured in MtCO₂e – million tonnes of CO₂ emissions) by 50% over 5 years (by 30th September 2025)
 - ii) measure the reduction relative to the Fund's total equity portfolio position as at September 2019 and adjusted for Assets Under Management (£AUM)
32. The proposal represents an initial step in ensuring that the Fund is prepared for transition to a low carbon economy. It clearly set out the timeframe for decarbonisation and defined how it should be measured, making it the most ambitious carbon reduction target amongst the London LGPS funds.
33. As the target was to be assessed over 5 years, the Committee will need to have an interim audit carried out just after receiving 2022 formal valuation results to review progress against the target to assist with decision making for the 2023 investment strategy review.
34. Appendix 2 to this report presents a draft interim Investment Strategy Statement (ISS) for review by the Committee. The statement is based on the Fund's current strategy and investments as at 31st March 2020.
35. The updates made to the statement relate primarily to the Fund's asset allocation, which has changed significantly since the statement was last

approved. Changes have also been made to the section concerning pooling, as the Fund has pooled some of its assets since the previous update.

36. It is intended that the ISS should be reviewed again once the new investment strategy (including any changes to the Fund's Responsible Investment approach) has been finalised.

Safeguarding Implications

37. The report provides clear evidence of sound financial management, efficient use of resources, promotion of income generation and adherence to Best Value and good performance management.

Public Health Implications

39. The Enfield Pension Fund indirectly contributes to the delivery of Public Health priorities in the borough.

Equalities Impact of the Proposal

40. The Council is committed to Fairness for All to apply throughout all work and decisions made. The Council serves the whole borough fairly, tackling inequality through the provision of excellent services for all, targeted to meet the needs of each area. The Council will listen to and understand the needs of all its communities.

Environmental and Climate Change Considerations

41. There are no environmental and climate change considerations arising from this report.

Risks that may arise if the proposed decision and related work is not taken

42. Climate change is a key financially material environmental risk. The Committee believe that, over the expected lifetime of Enfield Pension Fund, climate-related risks and opportunities will be financially material to the performance of the investment portfolio. As such, the Committee will consider climate change issues across Enfield Pension Fund and specifically in areas such as Strategic Asset Allocation, Investment Strategy and Risk Management with the aim of minimising adverse financial impacts and maximising the opportunities for long-term economic returns on Enfield Pension Fund's assets.

Risks that may arise if the proposed decision is taken and actions that will be taken to manage these risks

43. Not approving the report recommendations and not adhering to the overriding legal requirements could impact on meeting the ongoing objectives of the Enfield Pension Fund.

Financial Implications

44. This report sets out a revised timetable for the development of the Fund's 2020 investment and presents a draft interim Investment Strategy Statement for Committee approval. Development of a robust investment strategy helps the Fund to take an ordered and prudent approach to the management of its assets, helping to manage the long term costs associated with the Pension Fund.
45. Spending time developing the investment strategy helps to ensure that the Committee are fulfilling their responsibilities as quasi Trustees of the Fund and that the Fund's investment objectives and policies are clearly set out in line with the Local Government Pensions Scheme (Management and Investment of Funds) Regulations 2016
46. There are no direct financial implications arising from this report.

Legal Implications

47. The Committee has responsibility for the prudent and effective stewardship of the Pension Fund and a clear fiduciary duty in the performance of its functions. Reviewing the Fund's Investment Strategy following the 2019 actuarial valuation helps to ensure that the Strategy remains appropriate given the funding position and assists the Committee in fulfilling this duty.
48. Regulation 7 of the 2016 Regulations requires the Administering Authority to formulate an Investment Strategy Statement (ISS) in line with guidance published by the Secretary of State. Broad powers allow the Government to intervene if an Administering Authority does not publish and maintain an ISS as set out in the guidance. Updating the ISS at this time ensures that the Fund remains compliant with Regulation 7.

Workforce Implications

49. The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will allow the Council to meet this obligation easily and could also make resources available for other corporate priorities.

Property Implications

50. None

Other Implications

51. None

Options Considered

52. The Committee could decide to continue with its existing statement. It is however, considered best practice to publish a revised updated statement which reflects the up to date Fund position and investment beliefs of the Committee.

Conclusions

53. The Committee is planning to use the next investment strategy review to consider how the Fund could align its strategy with the Enfield climate action plan for 2020 which is agreed at the cabinet meeting of 15th July 2020 and also to increase its positive contribution to the transition to a low carbon economy by increasing its investment in renewable energy, whilst meeting its own strategic investment requirements.
54. As part of the planned carbon risk audit, the Committee will consider an analysis of its energy exposure against the energy requirements for 2oC and 1.5oC future warming scenarios. This analysis can then be used to consider how the Fund might look to align its exposure to those scenarios.
55. The ISS has been reviewed and revised by the Council as administering authority due to some material changes that took place during the year. The changes are:
 - i) changes to the investment beliefs setting out ESG themes that will be important areas of focus for the Fund Responsible Investment activities, and our core positions in each area. (section 6.2 of the ISS);
 - ii) changes to the pooling governance (section 12 of the ISS);
 - iii) additional information providing greater clarity about the Fund expectations to both investee businesses and other stakeholder and Fund benchmark for robust monitoring and auditing Fund's carbon exposure (section 13); and
 - iv) changes to the Fund actuarial valuation results (section 7.6 of the ISS).
56. Climate change is a key financially material environmental risk. The Committee believe that, over the expected lifetime of Enfield Pension Fund, climate-related risks and opportunities will be financially material to the performance of the investment portfolio. As such, the Committee will consider climate change issues across Enfield Pension Fund and specifically in areas such as Strategic Asset Allocation, Investment Strategy and Risk Management with the aim of minimising adverse financial impacts and maximising the opportunities for long-term economic returns on Enfield Pension Fund's assets.
57. Taking into account the risks associated with exposure to fossil fuel reserves, the Committee is asked to consider and approve a target set below and for the updated ISS to incorporate the changes set out below, to ensure that the ISS remains current:
 - i) A target to reduce the Fund's total equity portfolio relative exposure to future emissions from fossil fuel reserves (measured in tCO₂e – million tonnes of CO₂ emissions) by 50% over next 5 years up until 30th September 2025; and

- ii) Measure the reduction relative to the Fund's total equity portfolio position as at September 2019 and adjusted for Assets under Management (£AUM).

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Date of report 14th July 2020

Appendices

Appendix 1 – Investment Strategy Review Timetable

Appendix 2 – Interim Investment Strategy Statement, July 2020

Background Papers

Trucost Climate Analytics Results

Investment Strategy Review Timetable

Date	Task	Comments
July – August 2020	<ul style="list-style-type: none"> • Private Debt/Equity training and advice • Short investment strategy training focused on current strategy • Interim Investment Strategy Statement review to update the statement with changes to pooled governance, investment beliefs around ESG considerations and triennial valuation results. 	
September -up to 2 workshops and November PPIC	<ul style="list-style-type: none"> • Review investment beliefs • Consider climate/RI objectives (based on discussions from 26th Nov & “7th February Committee and 15th November & 9th January Workshop) • Long term objectives (link in with valuation, CMA objectives, reporting) • Investment strategy/asset class considerations – current and new asset classes, approach to currency hedging, infrastructure, review of equity structure, fixed income, multi asset, property, private debt and private equity • Investment Strategy Review • Asset liability modelling results (including climate risk scenario modelling) • Implementation timeline • Cashflow planning • Voting and engagement training session 	
February 2021 PPIC	<ul style="list-style-type: none"> • Finalise investment strategy - new mandate training, suitability notes etc • Rebalancing framework (“de-risking”) • Update Investment Strategy Statement with new strategy • Finalise RI policy • Finalise voting & engagement policy 	