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London Borough of Enfield

PENSION POLICY AND INVESTMENT COMMITTEE

Meeting Date: 17 September 2020

Subject: Draft Responsible Investment Policy and Update on Moving Towards Low Carbon Investments and a Reduced Exposure to Fossil Fuels

Cabinet Member: Cllr Maguire

Executive Director: Fay Hammond

Key Decision: [ ]

Purpose of Report

1. This report sets out Enfield Pension Fund's Proposed Responsible Investment Policy and an Update on Moving Towards Low Carbon Investments and a Reduced Exposure to Fossil Fuels.

2. The report also outlines the recent decisions made by the Committee, allocating the entire 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 a determined 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's 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 objective of influencing a wider move from fossil fuels in the world economy.

Proposal(s)

4. The Pension Policy and Investments Committee are recommended to:
   a) consider and note the content of this report; and
   b) consider and note the content of the Draft Responsible Investment Policy attached as Appendix 1.

Reason for Proposal(s)

5. The Pension Policy and Investments Committee act in the role of quasi trustees for the Pension Fund and are therefore responsible for the management of £1.26 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.

6. 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.

7. 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 in this report are aimed at developing both a greater understanding of the risks and a set of strategies to help mitigate them.

8. 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 as a whole.

Relevance to the Council's Corporate Plan

9. Good homes in well-connected neighbourhoods.

10. Build our Economy to create a thriving place.

11. Sustain Strong and healthy Communities.

Background

12. Responsible Investment (RI) is an approach that takes into account ESG 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.

13. 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.

14. The Enfield Pension Fund has not been immune from this ongoing pressure. The Fund has subscribed to an annual review of carbon footprint of the Fund. However, Members are being asked to consider a number of new ways in which they can better integrate ESG factors into the investment decision making.

15. There are many facets to responsible investments, 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

16. The Responsible Investment Policy is set out in Appendix 1 of this paper. The purpose of this policy document is to set out the Fund's approach to how environmental, social and governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.

17. The long term nature of pension funds means that factors that can impact the investments in many years to come have to be considered. There are a number of ways in which pension funds can opt to demonstrate their commitment to ESG ranging from engagement with companies right the way through to divestment. Below is the Fund's current stance in regard to ESG.

ESG obligations of LGPS administering authorities and Fiduciary Responsibility

18. LGPS regulations issued by DCLG in September 2016, requires Investment Strategies of LGPS funds to outline their policy on how ESG considerations are taken into account within investment decision making. This marked a shift in the LGPS as a whole.

- **Regulation 7(2)(e)** requires funds to follow pertinent advice and act prudently when making investment decisions, *"…a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence".* They must consider any factors that are financially material to the performance of their investments, including **ESG factors** contemplating the time horizon of the liabilities along with their approach to social investments.

- **Regulation 7(2)(f)**, emphasises that *"administering authorities are encouraged to consider the best way to engage with companies to promote their long-term success, either directly, in partnership with other investors or through their investment managers, and explain their **policy on stewardship** with reference to the Stewardship Code. "*

- *Administering authorities are strongly encouraged to either vote their shares directly or ask their fund managers to vote in line with their policy under the Regulation 7(2)(f) and to publish a report of **voting activities** as part of their pension fund annual report under Regulation 57 of the 2013 Regulations.*

19. The role of the Council as administering authority for the LBE is to maintain, administer and invest the funds and to this end powers have been delegated to the to the Pension Policy and Investment Committee (PPIC). The regulations do not impose any legal obligation on the Committee to take ESG considerations into account. The PPIC acting in a quasi-trustee capacity have to act in a fiduciary manner meaning that they have to act in the best financial interest of the und.

20. According to legal advice obtained by the LGPS Scheme Advisory Board (SAB) and summarised on the SAB website, funds can take ESG factors into consideration provided that pension fund members do not suffer significant financial loss.

21. London Borough of Enfield (LBE) Pension Fund (the Pension Fund) is committed to be a responsible investor and a long-term steward of the assets in which it invests. The Fund has a fiduciary duty to act in the best interests of its beneficiaries and this extends to making a positive contribution to the long-term sustainability of the global environment.

22. The Pension Fund recognises that the neglect of corporate social responsibility and poor attention paid to environmental, social and governance (ESG) issues may lead to poor or reduced shareholder returns. This presents a significant responsibility for the Pension Policy & Investments Committee (the Committee). The ESG approach has become integral to the Fund's overall investment strategy.

23. The Fund maintains a policy of non-interference with the day-to-day decision making of the investment managers. The Committee believes that this is the most efficient approach whilst ensuring the implementation of policy by each manager is consistent with current best practice and the appropriate disclosure and reporting of actions.

24. There are a wide range of ESG issues, with none greater currently than climate change and carbon reduction. The Pension Fund recognises climate change as the biggest threat to global sustainability alongside its administering authority employer, Enfield Council, which has committed itself to achieving carbon neutrality by 2030.

25. Members of the Pension Fund place their trust in the Pension Fund Committee who hold a fiduciary duty to act in the members' best interests and ensure that their pension benefits are fully honoured in retirement. For this reason, as well as targeting investment returns that match the pension liabilities, the Committee is committed to managing the investment risks: the risks that pose a substantial threat to LGPS members' long-term future.

Engagements

26. This involves taking an active interest in the companies and tackling poor ESG standards by challenging management decisions deemed not to be in the best interests of the company. Ideally engagement should be robust with planned outcomes. The London Borough of Enfield is a member of the Local Authority Pension Fund Forum (LAPFF), a collaboration of more than 60 LGPS funds. Their collaboration and engagement are important in managing and mitigating risks associated with investments within the LBEPF's invested companies. Members and Officers attend business meetings. LAPFF identify strategic ESG risks for engagements and have engaged with companies across a number of cross cutting themes and have jointly filed resolutions.

27. Some of LAPFF's engagement includes meeting with Rio Tinto to discuss their climate change report in response to a shareholder issued resolutions they were involved in filing. They have also engaged with Shell and welcomed Shell's move to divest oil sands assets and continue to put pressure on Shell and other oil companies to migrate towards the lower carbon future that is fast approaching.

Voting

28. Equity share ownership in the majority of companies gives investors the right to vote and the LBEPF can use their vote to influence company behaviour. LBEPF has delegated voting to asset managers. The managers the Fund has appointed engage with companies on ESG issues and have detailed voting policies which set out how they will vote. The Fund can also override this by issuing voting direction on advice from the LAPFF.

29. Some funds appoint stewardship firms who assist in formulating a voting policy for the Fund and vote the shares on behalf of the Fund in accordance with the policy. These additional services are likely to be a cost to the fund.

Data

30. Reliable ESG data is important to investors if they are to measure risk and reward of best practice in ESG by investee companies. The key to reliable data is that it should be independent, objective and publicly-sourced.

31. The Companies the Fund invested in usually have ESG scores which is an expression of all its ESG stance and other key factors. These scores can then be aggregated to establish a portfolio score. Numerous underlying factors are obtained from a range of data points. Data vendors are able to acquire and validate underlying ESG company data. ESG scores are one of the metrics used by fund managers to assess the sustainability of investee companies.

32. Data Vendors who provide this information for asset managers can also provide information for underlying Investors who want to acquire and ESG score across their whole portfolio. Obtaining an ESG score across all investments from all asset managers can allow investor to better understand their ESG risk by comparing the Fund's portfolio score to standard market ESG benchmarks.

33. Members are asked to consider whether this is a service they wish to subscribe to or explore further by receiving a presentation at a future meeting.

Climate Change and Fossil Fuel Divestment

34. A number of lobby groups have been pressuring LGPS funds including LBEPF to divest or have a plan to divest from fossil fuels on the basis that coal, oil and gas consumption are contributing heavily to climate change and global warming to which some scientists have attributed responsibility for the increase in the incidence of natural disasters such as storms, floods heatwaves in recent times.

35. LGPS funds have continued to come under criticism for investing in controversial stocks such as oil, tobacco, alcohol producers, gambling firms, and payday lenders. Some local authority including Enfield Pension Fund, the London Boroughs of Islington, Haringey, Southwark and the Environment Agency have committed to reducing their exposure to carbon and some have gone on to state when they expect to be fully divested.

36. However some LGPS funds have opted to retain their investments in companies with significant carbon footprints on the basis that being invested enables them to continue to lobby the companies to reduce their CO2 emissions. The LAPFF working with a group of other investors successfully lobbied Shell to concede to a number of demands on climate change by lodging a shareholder resolution. The cost of immediate divestment will be substantial based on the returns on some of the companies alleged to be ESG offenders.

37. 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'

38. Taking all of the above together, the Committee should consider 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.

Update on Moving Towards Low Carbon Investments and a Reduced Exposure Fossil Fuels

39. Members of this Committee began its 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.

40. The recommendations approved 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.*

41. 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.

42. The Fund undertook its first carbon risk audit towards the end of 2019, 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.

43. After careful consideration of how carbon risk could best be reduced within the investment management framework in which LGPS funds operate, an appropriate way forward was deemed to be to set a quantifiable, time-bound target for a reduction in the Fund's exposure to future fossil fuel emissions hence the Committee set the below targets:

    i) the Fund to reduce its total equity portfolio relative exposure to future emissions from fossil fuel reserves (measured in $MtCO_2e$ – million tonnes of CO_2 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)

44. The above targets represent 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.

45. As the target was to be assessed over 5 years, the Committee will need to have an interim audit carried out just after receiving the 2022 formal valuation results to review progress against the target to assist with decision making for the 2023 investment strategy review.

Safeguarding Implications

46. 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.

47. **Public Health Implications**

48. The Enfield Pension Fund indirectly contributes to the delivery of Public Health priorities in the Borough.

Equalities Impact of the Proposal

49. 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

50. Environmental and climate change considerations are all over this report.

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

51. 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

52. 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

53. Spending time developing the responsible investment policy 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.

54. The development of a robust responsible investment policy 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.

Legal Implications

55. 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 taken into account in the selection, non-selection, retention and realisation of investments.

56. 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

Workforce Implications

57. 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

58. None

Other Implications

59. None

Options Considered

60. The Committee could decide not to have this policy in place but as a long-term investor, committed to investing to build a better future through the integration of ESG issues at all stages of the investment decision-making process and also to gain the trust and pride of members in the governance process and the way in which in the Fund is invested on their behalf. It is therefore important for the Pension Fund to be completely transparent and accountable to members and stakeholders.

Conclusions

61. 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.

62. As part of the planned carbon risk audit, the Committee will consider an analysis of its energy exposure against the energy requirements for 2°C and 1.5°C future warming scenarios. This analysis can then be used to consider how the Fund might look to align its exposure to those scenarios.

63. 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.

64. The Pension Fund will continue to assess investment opportunities that have a positive impact on society as whole. These include but are not limited to, investments in fixed income (green bonds), property, low carbon assets, renewables and social impact opportunities.

65. The Pension Fund views engagement with companies as an essential activity and encourages companies to take position action towards reversing climate change. The Enfield Pension Fund is a responsible owner of companies and cannot exert that positive influence if it has completely divested from carbon intensive producing companies. The Pension Fund will continue to encourage positive change whilst officers will continue to engage with the investment managers on an ongoing basis to monitor overall investment performance, including carbon and other ESG considerations.

66. The Fund expects managers to integrate ESG factors into investment analysis and decision making. Monitoring these effectively can assist with resolving issues at early stages through effective engagement with companies and board members. The Fund expects asset managers where possible to engage and collaborate with other institutional investors, as permitted by relevant legal codes to ensure the greatest impact.

67. The measurement of ESG performance is still developing and benefitting from significant improvements. There are several performance benchmarks and disclosure frameworks that exist to measure the different aspects of available ESG data which include carbon emissions and a variety of social impact scores.

68. The Pension Fund carries out a carbon footprint exercise on its separate portfolios annually via a specialist firm. The outcome of this measurement exercise will be instrumental in ensuring that the fund is able to meet its decarbonisation goals through effective asset allocation.

69. The Pension Fund will continue to work closely with its investment managers to measure the carbon impact of its investments. This will involve developing internal metrics and agreed targets which will be reviewed on a regular basis.

70. Increasingly, there is growing interest in the investment community to develop investment strategies that focus on sustainable investments. As well as the wider investment community, the Pension Fund will support and contribute to the work carried out by the London CIV in the development of sustainable investments.

71. LBE’s LGPS members have spent at least part of their careers helping to deliver key services to their community. It is important for them to understand how their Pension Fund is managed and the contribution its investments make in securing a sustainable future. Members are encouraged to take an active interest in the governance processes of their Pension Fund and their views are represented within the work of the Local Pension Board.

72. The Pension Fund will aim to provide members with a variety of information which allows them to easily understand the types of investments within the portfolio.

73. The Pension Fund reports on its overall performance annually through an annual report which is readily accessible to members on the fund's website.

74. Data within the annual report will include investment performance, an assessment of the key performance indicators (KPIs) of the Fund's administrative function and the Fund's assessment of its many risks.

75. The Pension Fund will host an annual general meeting (AGM), following the end of the financial year, which all members and key stakeholders will be invited to attend. Giving them updates on the administration service, investment performance, as well as a market update from an asset manager/investment consultant and a presentation from the Fund actuary.

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Date of report 8th September 2020

Appendices
Appendix 1 – Responsible Investment Policy

Background Papers
None