

Appendix 1

London Borough of Enfield Pension Fund Draft Responsible Investment Policy September 2020

The London Borough of Enfield is the Administering Authority of the London Borough of Enfield Pension Fund and administers the Local Government Pension Scheme on behalf of participating employers

RESPONSIBLE INVESTMENT POLICY

1. Introduction

- 1.1 Responsible Investment is defined by the United Nation's 'Principles for Responsible Investment' document as an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and to generate sustainable, long term returns. The Pension Fund's approach to responsible investment is aligned with the Fund's investment beliefs and recognises ESG factors as central themes in measuring the sustainability and impact of its investments.
- 1.2 Failure to appropriately manage ESG factors is considered to be a key risk for the Pension Fund as this can have an adverse impact on the Fund's overall investment performance, which ultimately affects the scheme members, employers and local council taxpayers.
- 1.3 The United Nations has established 17 Sustainable Development Goals (SDGs) as a blueprint to achieving a better and more sustainable future for all. These goals aim to address the challenges of tackling climate change, supporting industry, innovation and infrastructure, and investing in companies that are focused on playing a key role in building that sustainable future.
- 1.4 The Pension Fund acknowledges that these goals form a vital part of acting as a responsible investor alongside its administering authority, Enfield Council, with the Council having recently committed itself to achieving carbon neutrality by the year 2030.
- 1.5 The Pension Fund maintains a policy of engagement with all its stakeholders, including those operating in the investment industry. It is broadly recognised that, in the foreseeable future, the global economy will transition from its reliance on fossil fuels to the widespread adoption of renewable energy as its main source. The impact of this transition on the sustainability of investment returns will be continually assessed by officers, advisors and investment managers.
- 1.6 The Pension Policy & Investments Committee is committed to playing an active role in the transition to a sustainable economic and societal environment. To that extent, the Pension Fund will continue to seek investments that match its pensions liability profile, whilst having a positive impact on overall society. Greater impact can be achieved through active ownership and lobbying for global companies to change and utilise their resources sustainably.
- 1.7 With these noble objectives at the forefront, it is important to note that the Pension Policy & Investments Committee has a vital, fiduciary duty to act in the best interests of the LGPS beneficiaries to ensure that their pension benefits are honoured in retirement.

Policy Implementation: Selection Process

- 1.8 The Pension Policy & Investments Committee delegates the individual investment selection decisions to its investment managers. To that extent, the Pension Fund maintains a policy of non-interference with the day-to-day decision-making processes of the investment managers. However, as part of its investment manager appointment process, the Pension Policy & Investments Committee assesses the investment managers' abilities to integrate ESG factors into their investment selection processes.
- 1.9 This includes, but is not limited to:
- a. evidence of the existence of a Responsible Investment policy;
 - b. evidence of ESG integration in the investment process;
 - c. evidence of sign-up to the relevant responsible investment frameworks such as the United Nations Principles for Responsible Investment (PRI);
 - d. evidence of compliance with the Stewardship Code as published by the Financial Reporting Council (FRC);
 - e. a track record of actively engaging with global companies and stakeholders to influence best practice;
 - f. an ability to appropriately disclose, measure and report on the overall impact of ESG decisions made.
- 1.10 As part of its investment selection process, the Pension Policy & Investments Committee will obtain proper advice from the Fund's internal and external advisors with the requisite knowledge and skills. The investment advisor will assess ESG considerations as part of its due diligence process and assess investment managers against the following criteria:
- a. for active managers, the advisor will assess how ESG issues are integrated into investment selection, divestment and retention decisions;
 - b. for passive managers, the investment advisor is aware of the nature of the index construction in the investment selection process places and the proximity of ESG issues in comparison with an active portfolio, but still hold ESG issues in its responsible investment policy as the passive manager actively engages with global companies and stakeholders where appropriate;
 - c. consideration of whether managers are making most effective use of voting rights and if votes are exercised in a manner consistent with ESG considerations specified by the manager;
 - d. how significantly managers value ESG issues and whether any specialist teams and resources are dedicated to this area; and

- e. how ESG risk assessment is integrated into the portfolio investment selection process and the value and effectiveness of these assessments.
- 1.11 Investment managers are expected to follow best practice and use their influence as major institutional investors and long-term stewards of capital to promote best practice in the companies/projects in which they invest. Investee companies will be expected to comply with all applicable laws and regulations in their respective markets as a minimum.

Policy Implementation: Ongoing Engagement and Voting

- 1.12 Whilst it is still quite difficult to quantify the impact of the less tangible non-financial factors on the economic performance of an organisation, this is an area that continues to see significant improvement in the measurement of benchmarking and organisational progress. Several benchmarks and disclosure frameworks exist to measure the different aspects of available ESG data which include carbon emissions, diversity on company boards and social impact. It is apparent that poor scoring on these ESG factors can have an adverse impact on an organisation's financial performance. It is therefore important for the appointed investment managers to effectively assess the impact such factors may have on the underlying investment performance.
- 1.13 The Pension Fund views active engagement as an essential activity in ensuring long-term value and encourages investment managers to consider assessing a range of factors, such as the company's historical financial performance, governance structures, risk management approach, the degree to which strategic objectives have been met and environmental, governance and social issues.
- 1.14 Pension Fund officers will continue to engage with the investment managers on an ongoing basis to monitor overall investment performance, including ESG considerations. This can be implemented in several forms which include, but are not limited to:
- a. Regular meetings with investment managers to assess investment performance and the progress made towards achieving ESG targets;
 - b. reviewing reports issued by investment managers and challenging performance where appropriate;
 - c. working with investment managers to establish appropriate ESG reporting and disclosures in line with the Pension Fund's objectives;
 - d. contributing to various working groups that seek to positively influence the reporting of industry standards on ESG metrics;
 - e. actively contributing to the efforts of engagement groups such as the Local Authority Pension Fund Forum (LAPFF), of which the fund is a member (currently 83 LGPS member funds).

- 1.15 The Pension Fund holds units in pooled equity funds, where our asset managers will have the opportunity to vote at company meetings on our behalf. Engagement with companies can have a direct impact on voting choices and fund manager voting and engagement reports are reviewed on a regular basis.
- 1.16 The Fund will continue to collaborate with the London CIV on maintaining a shared voting policy for the equity managers on the London CIV platform and actively seek to align these policies with manager insights. Lobbying with other London CIV clients will give the Pension Fund greater control and impact over our voting choices and a centralised process will ensure our voting remains consistent and has the greatest impact.
- 1.17 The Pension Fund's officers will work closely with the London CIV pool, through which the Pension Fund will increasingly invest, in developing and monitoring its internal frameworks and policies on all ESG issues which could present a material financial risk to the long-term performance of the fund. This will include the London CIV's ESG frameworks and policies for investment analysis, decision making and responsible investment.
- 1.18 In preparing and reviewing its Investment Strategy Statement, the Pension Fund will consult with interested stakeholders including, but not limited to:
- a. Pension Fund employers;
 - b. Local Pension Board;
 - c. advisors/consultants to the fund;
 - d. investment managers.

Policy Implementation: Training

- 1.19 The Pension Policy & Investments Committee and the Fund's officers will receive regular training on ESG issues and responsible investment. A review of training requirements and needs will be carried out at least once on annual basis. Training is intended to cover the latest updates in legislation and regulations, as well as best practice with regards to ESG integration into the pension fund's investment process.

FOSSIL FUEL DIVESTMENT PRINCIPLES

- 1.20 This section will specifically address the Fund's principles for the divestment over time of fossil fuel investments: The four key principles for divestment are set out below:
- Fossil fuel risk will be incorporated into the overall asset allocation strategy
 - The commitment to reduction in fossil fuel investment is more than a long term risk mitigation strategy.
 - Divestment is not risk free.

- Engagement and LCIV

Principle 1: Incorporation into asset allocation strategy

- 1.21 The primary purpose of the Fund is to meet the pension benefits for the members of the Fund. Every three years the Fund undergoes an actuarial valuation, which estimates the value of pensions due to be paid to members. The result of which allows the Fund to review the asset and investment strategy in order to establish the most appropriate mix of assets to best achieve the required level of net of fees investment return on an appropriate risk adjusted basis, whilst ensuring diversity of assets, sufficient liquidity and appropriate governance of the investments.
- 1.22 The Fund will seek to fully integrate fossil fuel risk into the investment strategy review process, from overarching asset allocation to individual investment choices. All investments will be considered through the lens of fossil fuel risk, but that any investment cannot be separated from the overall investment objectives for the Fund and must be subject to a full business case in consideration of the overall portfolio as well as fees and transition costs.

Principle 2: More than a long-term risk mitigation strategy

- 1.23 The Fund has a fiduciary duty to all the employers within the Fund and for the scheme members and as such must manage the investments assets effectively with an investment time horizon in line with the liabilities for the Fund and have due regard to the investment risk inherent within the portfolio
- 1.24 The Fund recognises the risk that fossil fuel investment places upon the Fund for future investment and as such, this document largely involves the desire to mitigate risk.
- 1.25 However, purely focussing upon those investments that are negatively exposed to the decline in profitability and viability of fossil fuel extraction and usage excludes a key consideration for the Fund; identifying those investments that are positioned to gain from such a transition.
- 1.26 The Fund therefore will proactively seek to identify suitable investments that fit within the overall asset allocation strategy and will be the beneficiaries from a low carbon regulatory and investment environment. The Fund will target both a downside risk mitigation strategy and a desire to invest in positive 'green' focussed assets.

Principle 3: Divestment is not risk free – Potential for negative implications

- 1.27 The Fund has sought to operate an uncomplicated and stable investment structure, resisting short term investment decision making. This approach has proved successful for the Fund with strong investment performance over the previous long term. The implementation of a fossil fuel risk mitigation commitment has the potential to complicate investment decision making.

- 1.28 It is therefore imperative that, as set out in Principle 2, the Fund must seek to incorporate fossil fuel implications into the overarching investment strategy rather than seeking to separately implement fossil fuel risk mitigation approaches.
- 1.29 The Fund has long held a large portion of equity investments as passive (investments that are held in the same proportion as that of the market as a whole) with a current target allocation of 40%. This approach acknowledges the challenges and typically higher costs involved in seeking to predict future investment winners and losers. The inclusion of a fossil fuel risk mitigation strategy within this leads to a risk that in the short term the Fund may be negatively exposed to overall market returns if fossil fuel based investments outperform the wider market. Global usage of fossil fuels is still predicted to comprise a significant portion of global energy usage in years to come and as such the Fund must be cognisant of the potential investment returns forgone should fossil fuel usage decline at a rate slower than the market has priced in.
- 1.30 There are likely to be additional management expenses within equity investment mandates that have some element of fossil fuel exclusion. As such the Fund must be confident that the additional risk from holding a portion of the Fund that is exposed to fossil fuels must be considered to be greater than the additional burden of higher management fees and any associated costs of transitioning assets from one mandate to another. It is therefore important for the Fund to collaborate with other local authority partners to work to reduce the costs for such reduced fossil fuel investments.
- 1.31 The measurement and assessment of which investments are most exposed to fossil fuels is not straightforward. Some companies may hold fossil fuel reserves or operations which are more damaging to the environment as a result of greater CO₂ output but that might be paradoxically less exposed to changing regulatory environment due to lower extraction costs. Companies not directly involved in the production or extraction of fossil fuel may derive significant portions of their revenue from fossil fuel companies. The Fund must ensure that any assessment of exposure to fossil fuels risk is sophisticated and investments are not distorted by inaccurate data.

Principle 4: Engagement and Local Authority partnerships – LCIV

- 1.32 There is growing appreciation of the growing risks and opportunities that Pension Funds face from the transition away from traditional fossil fuel usage, including among Local Government Pension Funds. It is important that the Fund works with other Local Authority partners to share knowledge and best practice as well as utilising collective assets to push for the most effective and efficient implementation of reduced fossil fuel strategies.
- 1.33 The Fund will work with local authority partners, such as the London Borough of Hackney, Islington, Haringey as well as the LCIV, the pooled investment vehicle of which the Fund is a shareholder and active supporter, in the application of this commitment. The Fund will also seek to be an active voice in the investment community for the advancement of investment outside of fossil fuels.

- 1.34 The carbon footprint assessment of a portfolio is most commonly applied to listed equities as significant numbers of listed companies publicly report their estimated greenhouse gas emissions using the greenhouse gas protocol standard template for measurement. This allows for greater consistency in comparison between companies and sectors and allows an investor to better understand which elements of the portfolio are the most exposed to fossil fuel risk.
- 1.35 A key element for this document is to not just focus upon the risk to the Fund from fossil fuels but also to invest in assets that are best positioned to benefit from a low fossil fuel environment. Two companies involved in electricity generation may have a very similar current carbon output; but one has focussed capital spend and research on renewable energy and other 'green' activities. As part of a portfolio assessment, a data provider can analyse the extent to which income for the portfolio is derived from low fossil fuel sources.
- 1.36 This assessment is easier to perform for listed equities, due to the wider availability of company specific data, but can be extended to analyse other assets classes within the portfolio. The Fund commissioned a full assessment of the greenhouse gas exposure within the Fund equity portfolios on a current output and potential output basis. The results of which will allow the Fund to monitor progress in the reduction of exposure as well as to set meaningful targets for this reduction.

Timeline:

- 1.37 The Fund's implementation period for fossil fuel reduction is split into three main time horizons, encompassing short medium and long-term objectives.
- The short term: one-five years (2020-2024)
 - The medium term: five-ten years (2024–2030)
 - The long term: beyond ten years (2030+)
- 1.38 Given the difficulty in predicting the global investment and technological environment in addition to Fund specific liability and investment requirements, longer term periods will likely be subject to significant variability and uncertainty.

Short Term – From 2020 to 2024**Triennial Actuarial Valuation and Investment Strategy Review**

- 1.39 The Fund published the most recent actuarial valuation in March 2020, the results will be the foundation for the next asset strategy review, to be completed by December 2020. The asset allocation review aims to ensure that the current investment allocation is appropriate to meet the required investment return to fund future pensions within a suitable risk profile. Where investment underperformance is identified or risk profile changes, either

across an asset class or manager specific, any subsequent reallocation will be considered with regard to overall fossil fuel exposure.

Local Authority Collaboration and Pooling

- 1.40 It is important that the Fund works together with other likeminded local authority partners, e.g. London Borough of Hackney, in order to develop suitable fossil fuel reduction opportunities. Collaboration will also seek to mitigate some of the fee and transition cost implications of changing investment allocation.
- 1.41 The Fund will engage with the LCIV through representation by officers and members on key LCIV governance panels to push for the availability of reduced fossil fuel investment mandates within the LCIV.

Fund Managers

- 1.42 Continue work with Blackrock to agree the transition of circa £190m, or circa 15% of the whole fund, to a specific low carbon equity index. This index re-weights investment exposure to those companies with low carbon emissions and low future carbon emissions, whilst minimising divergence from overall market returns. This is estimated to reduce carbon emissions by 70% from existing equity assets.
- 1.43 The Fund will continue dialogue with MFS Investment Management to ensure that fossil fuel risk is considered as part of stock decision making and that those with significant CO2 output be treated with caution.
- 1.44 The Fund will use this period to investigate the implications and opportunities in different low carbon equity investments as well as the possibility of deploying 10% of total assets in long-term investments in sustainable technology and alternative energy sources.

General

- 1.45 The Fund commissioned a carbon footprint assessment for the equity portfolios to analyse the overall exposure across each asset classes to identify the most effective methods to reduce the risk from fossil fuels. This analysis demonstrated the proportion of the Fund, which is positively exposed to low carbon or 'green' revenue. Quantifying exposure will allow the Fund to develop meaningful targets for the reduction in fossil fuel exposure over the long term, whilst also identifying the areas of greatest risk within the portfolio.
- 1.46 The Fund will continue to support the work of the Local Authority Pension Fund Forum (LAPFF) as representing 90 local authority pension funds in their engagement with companies to promote best practice climate aware business activities
- 1.47 Any changes to investment allocations will need to be communicated with key advisors, such as the Fund actuary, as well as the Fund's external auditors.

Medium Term – From 2024 to 2030

Triennial Actuarial Valuation and Investment Strategy Review

- 1.48 The medium term will incorporate the results of the triennial valuation in 2025 and 2028 and will constitute key points for major review of assets and investments to ensure that these are best placed to meet the payment of benefits to members of the scheme. Fossil fuel risks and opportunities incorporated in the consideration for any amendments to the asset allocation strategy.
- 1.49 The carbon footprint and risk analysis will be re-calculated at each triennial asset allocation review and incorporated into the overall portfolio risk assessment.

Local Authority Collaboration and Pooling

- 1.50 The Fund is committed to working with the LCIV and will seek to comply with the Government requirements for pooled investments. Over the course of this period the proportion of assets under the control of the LCIV will increase significantly, which may limit the availability of reduced fossil fuel investment mandates. Therefore, the Fund will continue to seek to exert influence over the strategic direction of the available investments within the LCIV, alongside other local authority partners, to ensure that these are appropriate for the sustainable strategy that the Fund wishes to implement. The opportunity for reduced fossil fuel or sustainable investment in multi asset mandates will likely develop as part of continued engagement between the Fund and other likeminded members of the LCIV.

Fund Managers

- 1.51 Continued engagement with fund managers to ensure that fossil fuel risks and opportunities are consistently and appropriately taken into consideration throughout the decision making process.

General

- 1.52 The Fund will continue a policy of engaging with companies through membership of the LAPFF and the LCIV to encourage companies to adopt the highest of standards with regard to fossil fuels and energy efficiency.
- 1.53 The Fund will be able to measure progress made against targets for the proportion of investments exposed to low carbon or green revenues and the overall carbon exposure of the Fund. In the event that elements of the portfolio should be changed then subject to business case and appropriate due diligence, any change in portfolio must be considered in light of the overall investment strategy with regard to fossil fuels.

Long Term: 2030 onwards

Triennial Actuarial Valuation and Investment Strategy Review

- 1.54 The Fund will continue to assess the overall investment strategy as required to meet the pension benefits for members based upon the calculations within

the triennial actuarial valuations. As and when asset and manager allocations require amending, the risk of fossil fuel exposure will be incorporated into any due diligence regarding risk and reward decision making.

Local Authority Collaboration and Pooling

- 1.55 In the long term, the vast majority of assets will be invested through the LCIV so ensuring the availability of suitable opportunities within the LCIV will be key for the continued reduction in fossil fuel investments as well as positioning the Fund to benefit from clean technology and low carbon industries. This will allow the Fund to invest across a variety of disparate asset classes without compromising the ambition to be a long-term sustainable investor.

Fund Managers

- 1.56 Most of this engagement will be exercised through the LCIV pooled investment vehicle.

General

- 1.57 The Fund will fully incorporate fossil fuel risk, through regular and sophisticated monitoring and portfolio analysis into the investment decision making process. Carbon reduction targets as part of the overall portfolio will play a key role in the increasing percentage of investment assets within sustainable or low carbon income sources.