

Responsible Investment: Overview and Next Steps

London Borough of Enfield Pension Fund



Prepared for: The Committee

Prepared by: Aon

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Background and objectives

Background

- In 2021 and early 2022, we worked with the Committee to provide training on the rapid developments in the Responsible Investment (RI) space, including regulatory requirements that the pension industry needs to fulfil; and focus specifically on the Fund's climate-related objectives.
- It has been some time since the last discussion on this topic, over which the Committee's composition has changed and there have been wider developments in the market.
- These developments mean that it is an opportune time to re-evaluate the Fund's desired approach and next steps to align with this.

Objective

- This session is intended to:
 - Provide an overview of Responsible Investment
 - Explain why climate change risks and opportunities are important and how it is relevant to the Fund;
 - Reflect on your current approach and consider the next steps necessary to align with the Fund's desire to take its RI approach further;
 - Identify prospective actions following these considerations.



Agenda

1

Introduction to RI
and current
requirements

2

Why is climate
and net zero
important?

3

Recap of 2021
discussions and
future roadmap

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What are other
LGPS doing?

5

Summary

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Appendix



What is responsible investment?

And why is it important?

What is responsible investment?

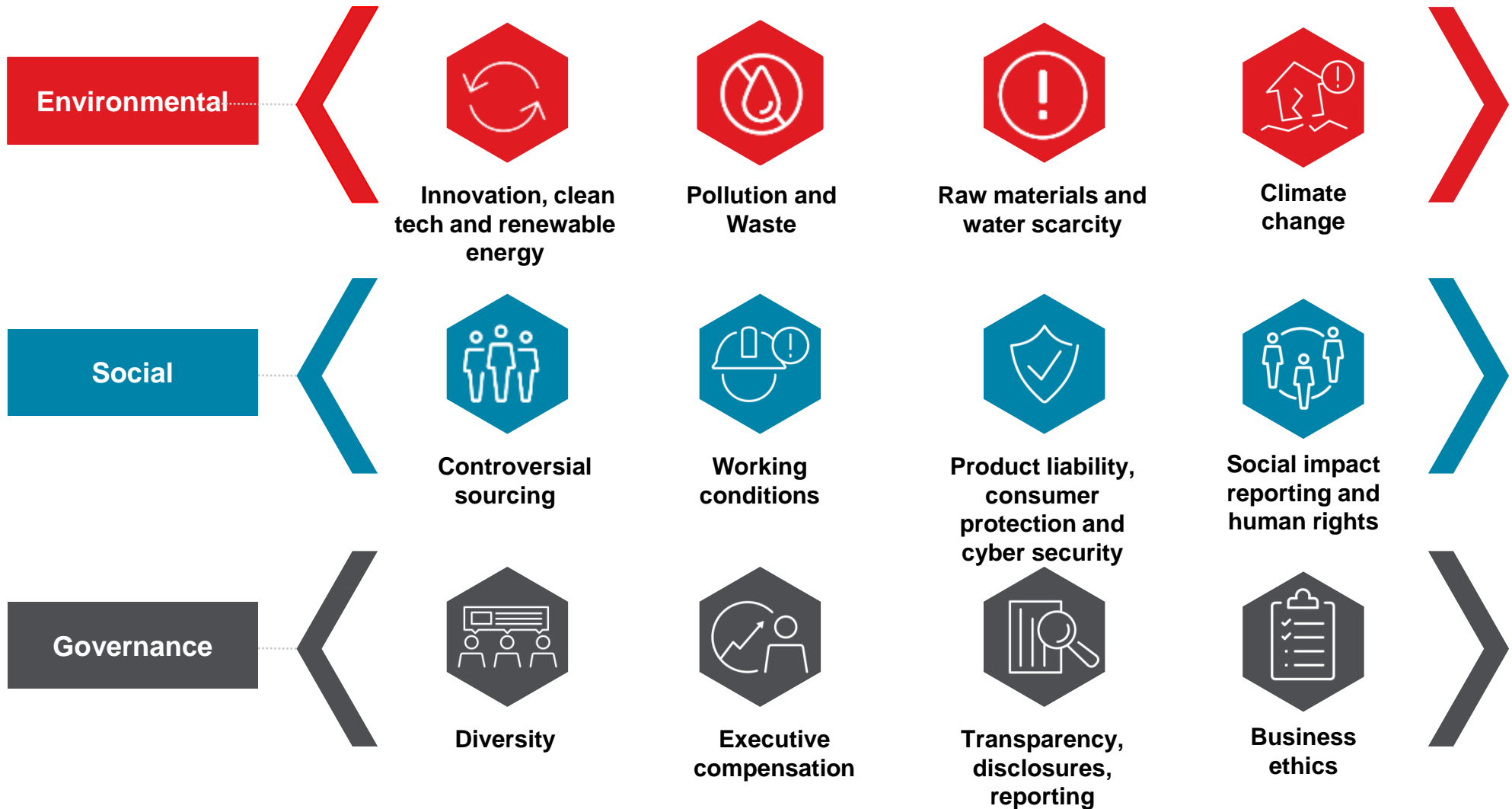
The Principles for Responsible Investment (PRI) is a global organisation which aims to advance responsible investment across institutional investors.

PRI defines responsible investment as *a strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership.*



Examples of ESG issues

There are many and varied Environmental, Social and Governance considerations



Why does it matter?

50%

reduction in carbon emissions needed over the next decade to limit the rise in global temperatures to no more than 1.5 degrees Celsius above pre-industrial levels by the end of the century

Source: IPCC

73%

of pension fund decisionmakers believe that climate change will impact on returns within a timeframe they are concerned about

Source: Aon

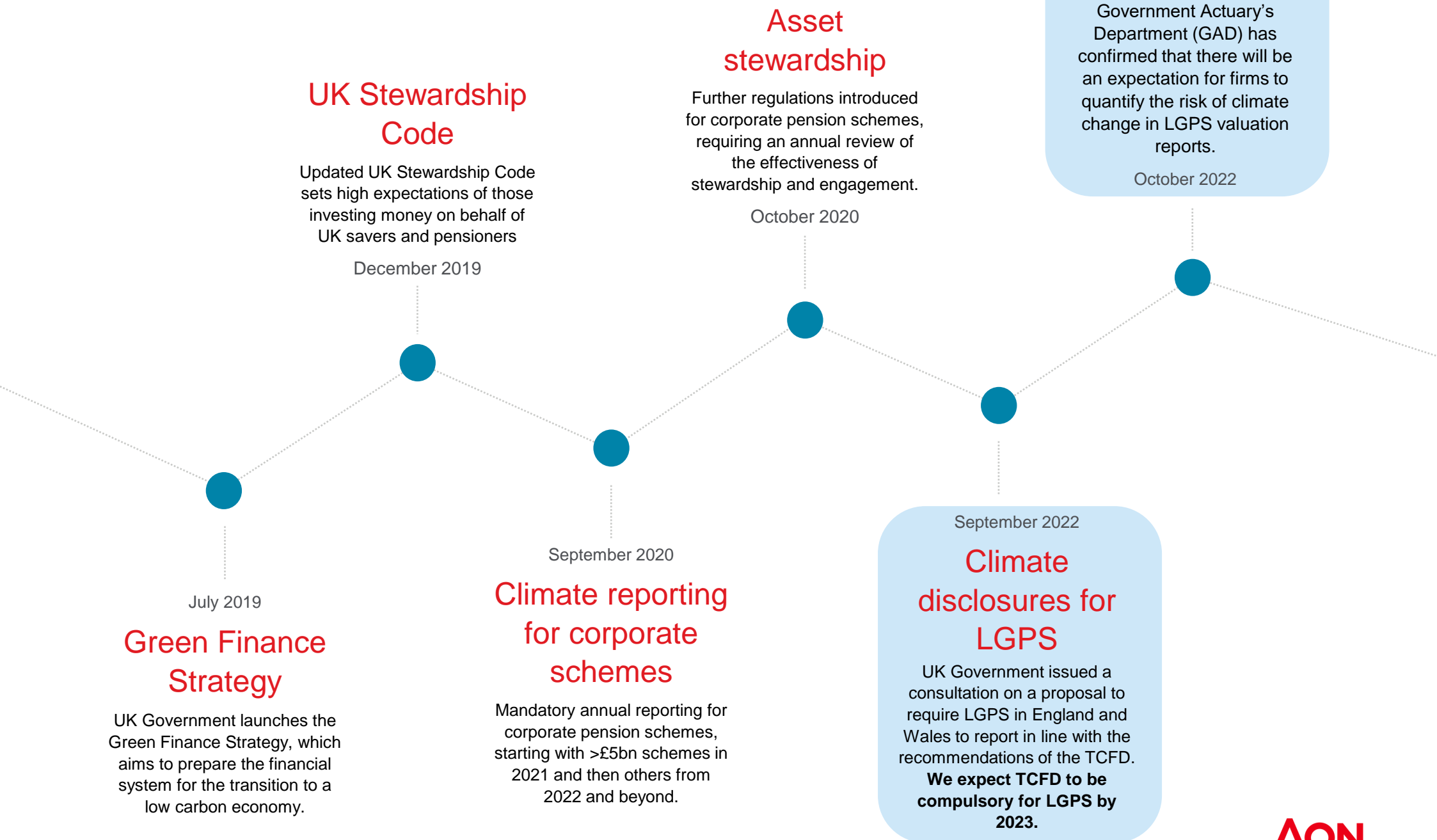
47%

of pension fund decisionmakers believe they have a duty and an ability to help tackle climate change

Source: Aon

Developing requirements

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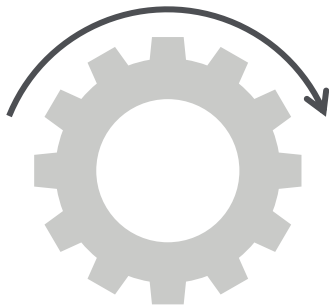
In more detail: TCFD and its purpose

The Task Force on Climate-related Financial Disclosures framework establishes a set of **eleven** clear, comparable and consistent recommended disclosures about the **risks and opportunities** presented by climate change.

The **increased transparency** encouraged through the TCFD recommendations is intended to lead to decision-useful information and therefore **better informed decision-making** on climate-related financial risks.

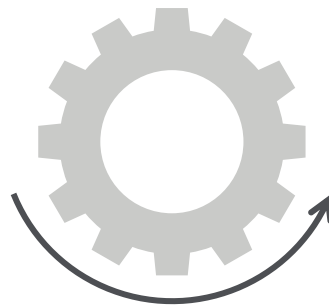
MHCLG has consulted on introducing mandatory TCFD-aligned reporting in the local government pension scheme (LGPS) in 2023. **As part of this, you will be asked to measure certain metrics and set targets for the Fund.**

The TCFD has structured its recommendations around four pillars:



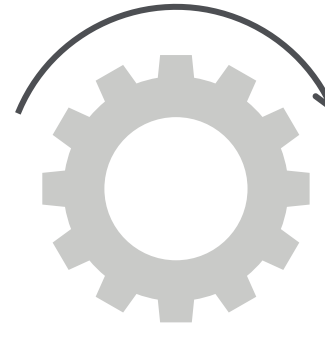
Governance

Disclose the organisation's governance around climate-related risks and opportunities.



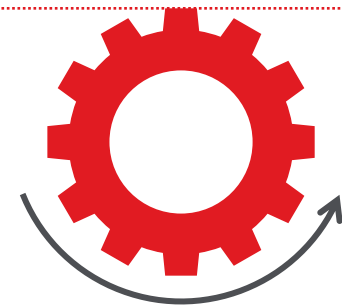
Strategy

Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's business, strategy and financial planning.



Risk Management

Disclose how the organisation identifies, assesses, and manages climate-related risks.



Metrics and Targets

Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities.



Why is climate and net zero important?

Climate change is one of the highest concern risks facing the world over the next 10 years, as identified by the World Economic Forum in each of its last 5 years' risk assessments.

This is even more relevant today...

The world's climate is already 1°C warmer today, on average, than it was relative to pre-industrial levels. We are currently on a 4.1-4.8°C warming path relative to pre-industrial levels by the end of this century, with catastrophic consequences for ecosystems and humanity.

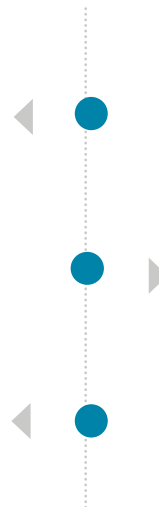
Physical Risks

The risks that occur as a result of physical events, such as extreme weather



Opportunities

Associated with the transition to a green / low-carbon economy



Transition Risks

The risk associated with realignment of our economic system towards low-carbon, climate resilient or carbon-positive solutions, including changes in political policies



Winners and losers will emerge as part of the transition, creating risks but also opportunities

Why is this important to the London Borough of Enfield?

Climate emergency

- The Council declared a climate emergency in Summer 2019

Objective by 2030 and 2040

- The Borough's 2020 Climate Action Plan sets out its objective to "become a carbon neutral organisation by 2030, and a carbon neutral borough by 2040"

What does this mean for the Fund?

The Council listed "*All council funds and investments (relating to pensions) divested of fossil fuels by March 2025*" and "*Develop and agree a Pension Fund Investment Strategy which increases the level of investment in low carbon and fossil free equities and funds whilst still meeting obligations to pension fund members*" as actions within its 2020 Climate Action Plan.

The Committee should expect the Council to consider the fossil fuel exposure and carbon emissions of the Fund.

How big was the pandemic impact on emissions?

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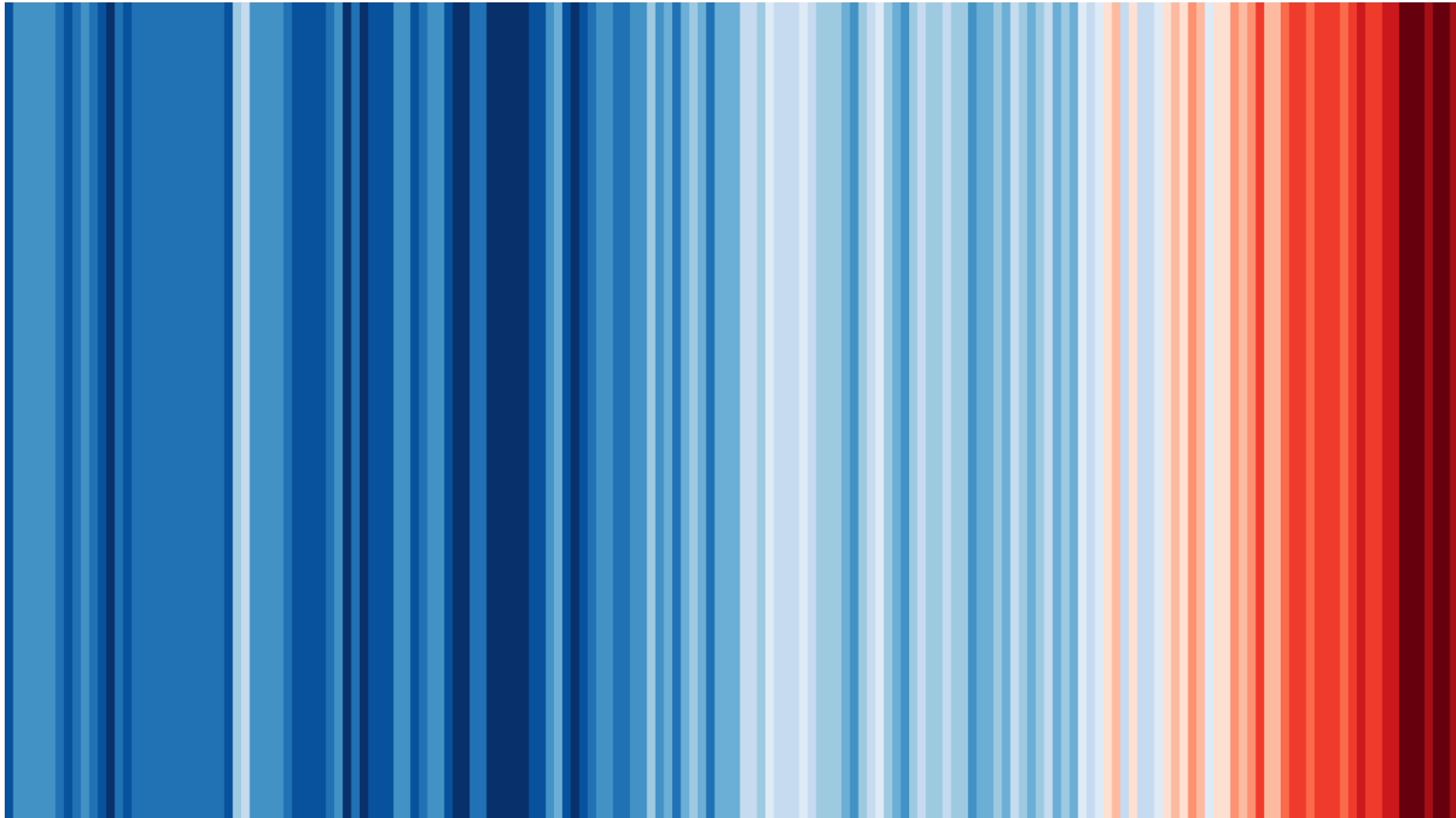
Economic activity
significantly
decreased...

But how much did emissions decrease by?

-?%

Global temperature change (1850 – 2021)

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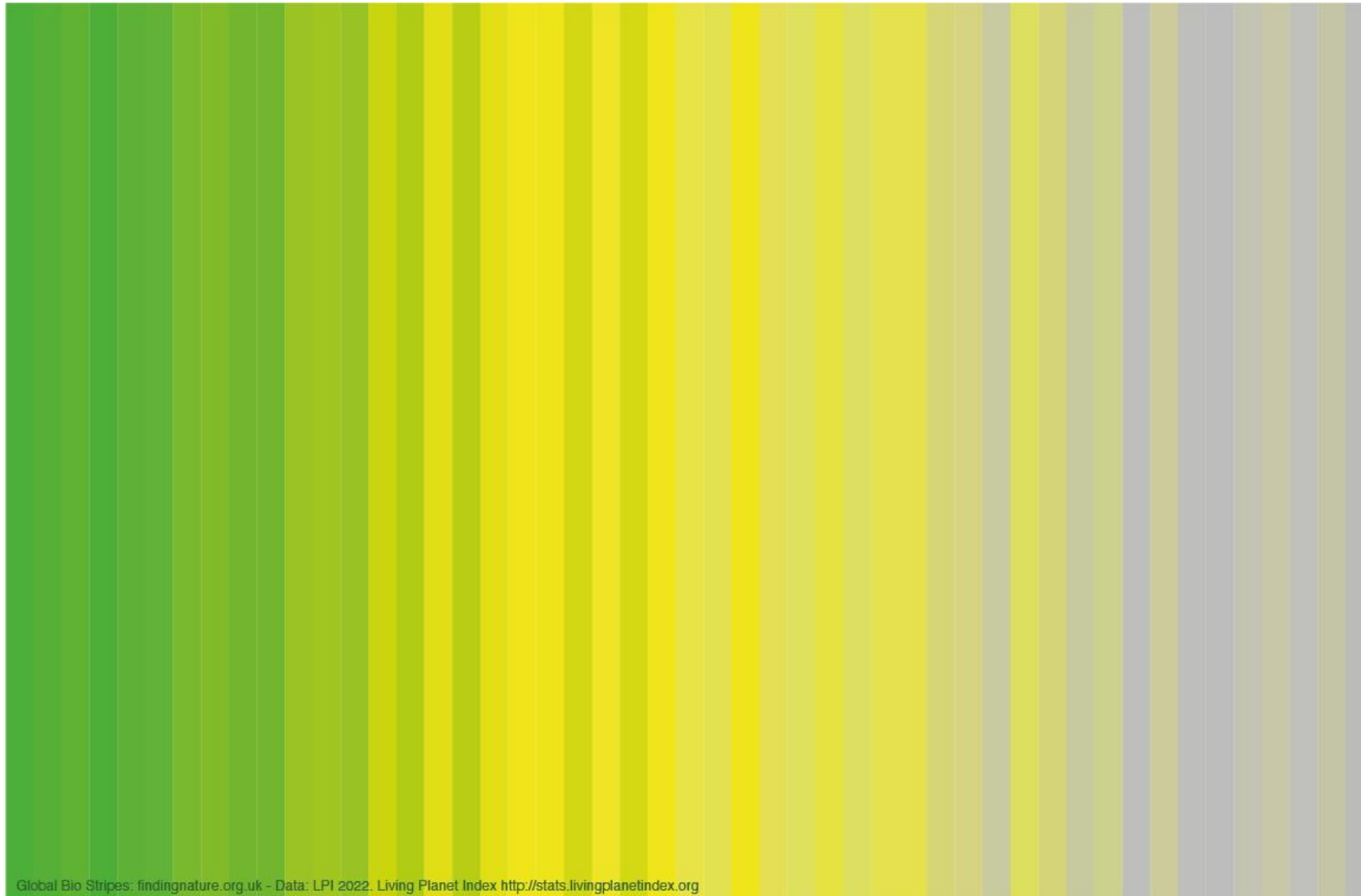
The world is getting hotter

These 'warming stripe' graphics are visual representations of the change in temperature as measured over the past 100+ years. Each stripe or bar represents the temperature in that country averaged over a year.

Source: [Ed Hawkins](https://showyourstripes.info), National Centre for Atmospheric Science, University of Reading (<https://showyourstripes.info>)

Global change in biodiversity (1970 – 2021)

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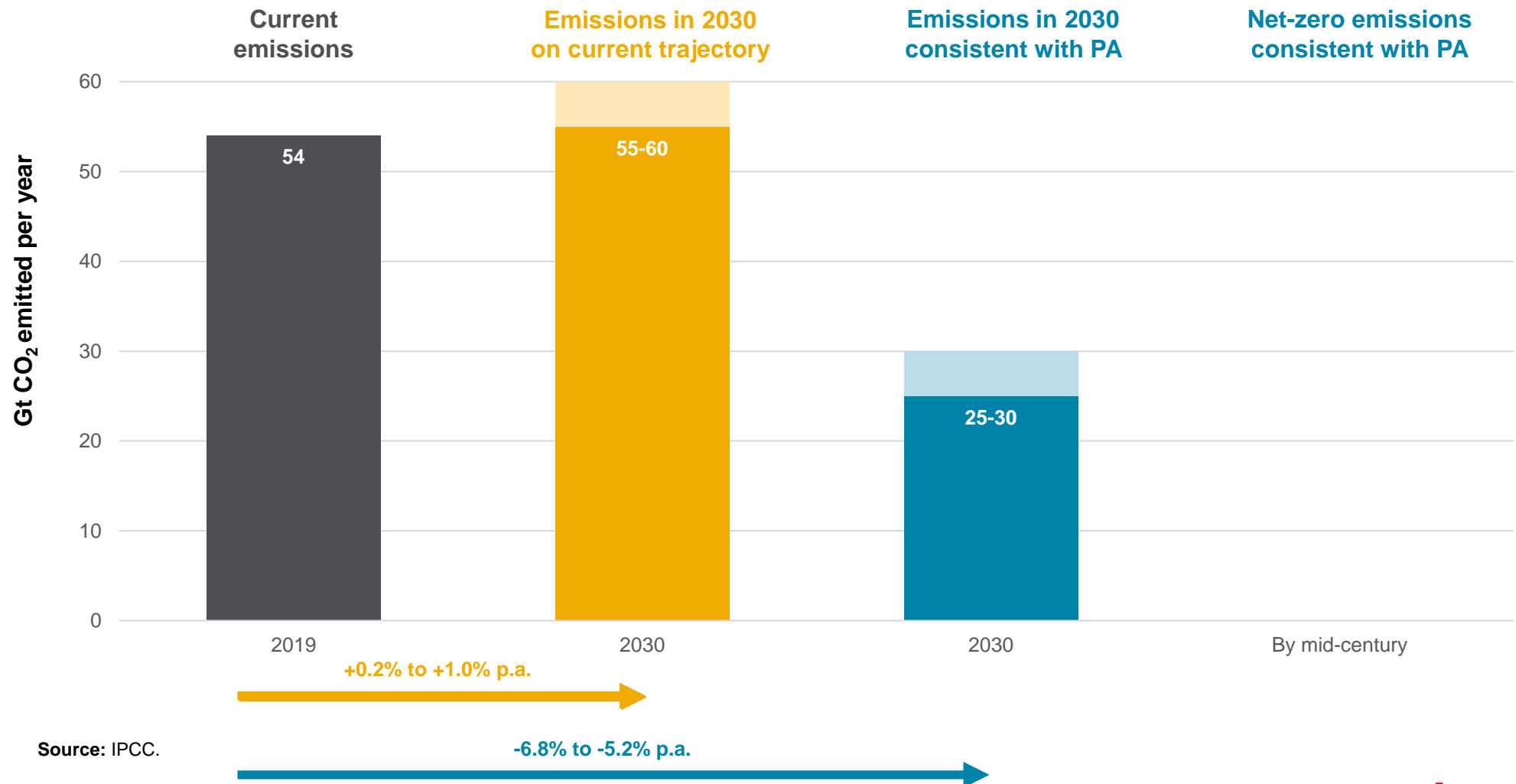
The world is losing biodiversity

These 'loss stripes' are visual representations of the change in levels of biodiversity as measured by the Living Planet Index. the decline of wildlife is a loss of vibrancy and colour, the green becoming grey. The global stripes start green in 1970 and turn grey as we enter the 2000s.

Source: Professor Miles Richardson, University of Derby (<https://findingnature.org.uk>)

What has to happen?

Carbon emissions must go to net-zero by mid-century to limit warming in line with the Paris Agreement



What has to happen?

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Structural changes to the energy system

Oil peaks no later than 2025-2026

Thermal coal production decreases by broadly 80% to 2030

Renewables comprise approximately half the electricity generation mix from 2030



Electrification of transport

Internal combustion engine (ICE) vehicle demand drops to near-zero

Falling costs of electric vehicles drive mass adoption of ultra-low emissions vehicles (ULEVs)

ULEVs comprise broadly 70% of passenger vehicles by 2040



Land use

Deforestation virtually eliminated by 2030; afforestation and reforestation efforts ramp up substantially

Investment opportunities emerge: yield-enhancing technologies, bioenergy production



Recap and roadmap

Actions you can take to reduce climate risk

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Commit

E.G: To a net zero pathway (*note: this was the topic of Committee discussions in 2021, and at that time the Committee was considering an internal (non-public) objective of 2030*)

Be active

Invest, divest, engage, across all asset classes (*note: the 2020 Climate Action Plan produced by the Borough commits the Fund to divestment by 2025*).

Collaborate

With partners to influence and innovate.

Engage

With service providers e.g. London CIV; fund managers; etc. (*note: Aon developed a framework for this in early 2021, which could be reinvigorated*).

Seek to understand

Your climate risks and potential to contribute to solutions (*note: the Fund has previously undertaken carbon data analysis, and we understand this was to be undertaken again in 2022*).

Communicate

Report progress openly and transparently.



Key takeaway

If the Committee reaffirms its desire to set a Net Zero objective and reinvigorate this area, a full project plan will be required.

1



Engagement

Work directly with investment managers to ensure they are aligned. This could mean:

- Regular meetings with managers to understand and challenge investments and stewardship decisions
- Requesting managers to complete net zero scorecards to review progress towards goals
- Setting expectations and escalation processes for when these are not met

2



Allocate

Away from “slow movers”; to “aligned”, low, zero or negative carbon assets, and offsets.

The Fund may wish to consider alternative investments if the current managers’ engagements illustrate progress is not in line with expectations.

3



Collaborate

What can we invest in to aid the real world transition and accelerate our own?

The Fund should collaborate with its investment managers to encourage the provision of data and information.

The Fund may wish to engage with industry initiatives to drive change.



Journey towards net zero is not straightforward

There are many ways to reduce the carbon footprint of investment portfolios, however, it is important to set a framework and milestones, and assess them regularly to monitor your journey towards the end goal.

The spectrum of potential actions

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There are a range of approaches to achieve emissions reduction. A mix of these would be needed to achieve any meaningful interim and long-term target reduction.

Engage

Reallocation and replacement actions could affect the Fund's expected return and level of diversification.

We suggest **first pursuing a process of engagement** with managers (conveying expectations and gathering data).

If manager responses are unsatisfactory then reallocation or replacement should be considered.

Reallocation

Considering the mix and types of investments can be an appropriate starting point.

Liaison with LCIV should be ongoing to determine how they will support Funds in attaining net zero objectives.

Within property and infrastructure, implementation options are becoming more established (e.g. renewable energy infrastructure, timberland).

Replace

Replacing poorly performing managers (or those without credible carbon reduction targets) with lower carbon offerings.

Requires using analysis from monitoring and engagement exercises.

The pace of carbon footprint reduction is slower, but more meaningful to the medium term reduction in planet's carbon footprint, arguably more important from a risk mitigation perspective.

It is possible to markedly and quickly reduce the carbon footprint by reorganising the allocations to the existing managers and/or replacing with new managers.

Suggested next steps

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Monitoring

Carry out a reporting exercise to **gather data on the ESG characteristics and TCFD recommended climate metrics**



Evaluate Targets

Following a review of the data, **consider tangible actions and pathways** to ascertain if a net zero target can / should be committed to



Engagement Plan

Use portfolio data, discussions to date, NZIF, to **develop an engagement plan (targets, criteria, escalation strategies)** to support the Fund's priorities



Asset Allocation

Consider asset allocation decisions to **rebalance or replace existing holdings with low carbon solutions**

Your actions should inform communication...

Your members

...are likely to be interested. Communicating as you progress will help to proactively address questions.

London CIV

...will need to be involved, particularly in light of any mismatch in target setting (e.g. 2040 vs 2030).

Your managers

...should understand your objectives, and provide you with transparency on their own progress. Engagement is fundamental.

The wider public

...are likely to look to the LGPS for action, and public campaigns will scrutinise actions (both taken and not taken).



What are other LGPS
doing?



Other LGPS with net zero targets

Environment Agency
Pension Fund

Set a goal to make its investment portfolios net zero by **2045** and halve emissions by **2030**. They are **5 years** ahead of their target.



South Yorkshire Pensions Authority has set a goal to make its investment portfolios net zero by **2030**.



Net zero target by **2050** across its whole portfolio.



Net zero by **2040**.



Net zero by **2030**.



TOWER HAMLETS

Net Zero target by **2040**.



Net zero by **2030**.



Key takeaway

Over 50% of LGPS have now set Net Zero targets. Focus on this area will increase and it is important that the Fund is equipped to manage this.

What are we supporting others with?

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Defining beliefs

Committee and key stakeholders completing a short survey in order to gather a broad range of views and agree their collective beliefs.

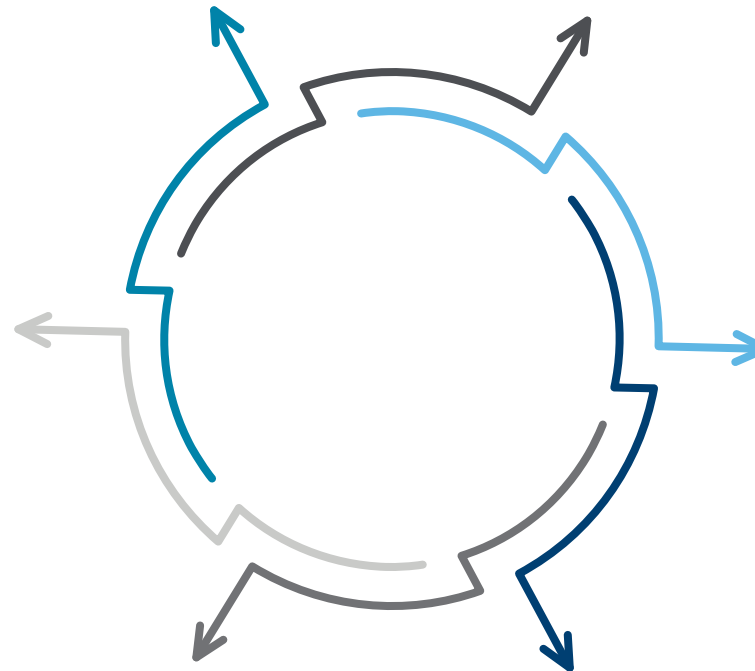
Developing an RI Policy

Drafting a document to sit alongside the SIP which details Committee RI beliefs and policies

Engaging & reporting

Engage with members and other stakeholders, and deciding how to share the Fund's policies and objectives.

Monitoring and reporting on progress regularly.



Review of managers

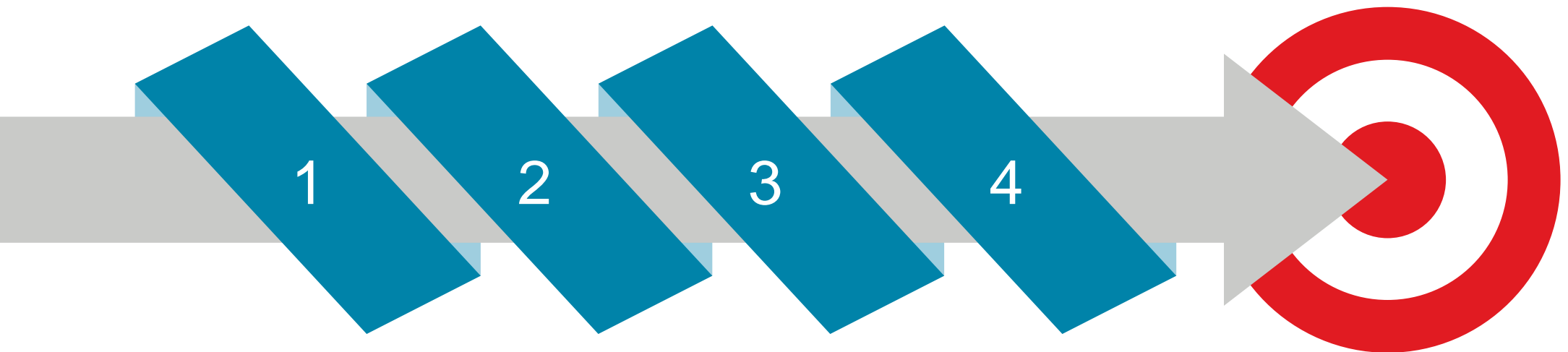
Investigate how effectively fund managers are considering ESG factors using Aon's ESG ratings

Manager selection

Incorporate ESG capabilities into future manager selection exercises.

Modelling climate change

Consider how climate change could impact on funding level through both assets and liabilities using scenario analysis.



Implementing climate strategies

Several Funds are gearing up for TCFD; some Funds report on a voluntary basis already.

Examples:

Fund A – establishing a TCFD Action Plan to prepare over an 18-month timeframe

Fund B – already reports, but seeking to enhance.

Interrogation of stewardship action

The Stewardship Code revisions have prompted Funds to consider how they apply the Code's principles across all asset classes.

Examples:

Fund C – not currently a signatory, but planning to apply in 2022

Fund D – 2012 Code signatory; has reapplied under 2020 Code

Net Zero commitments?

Many funds are grappling with a degree of stakeholder pressure to commit to net zero emissions across their portfolio by a specified date.

Examples:

Fund E – Commitment by 2030

Fund F – Adopting a 'wait and see' approach, depending on peer action

Stakeholder communications

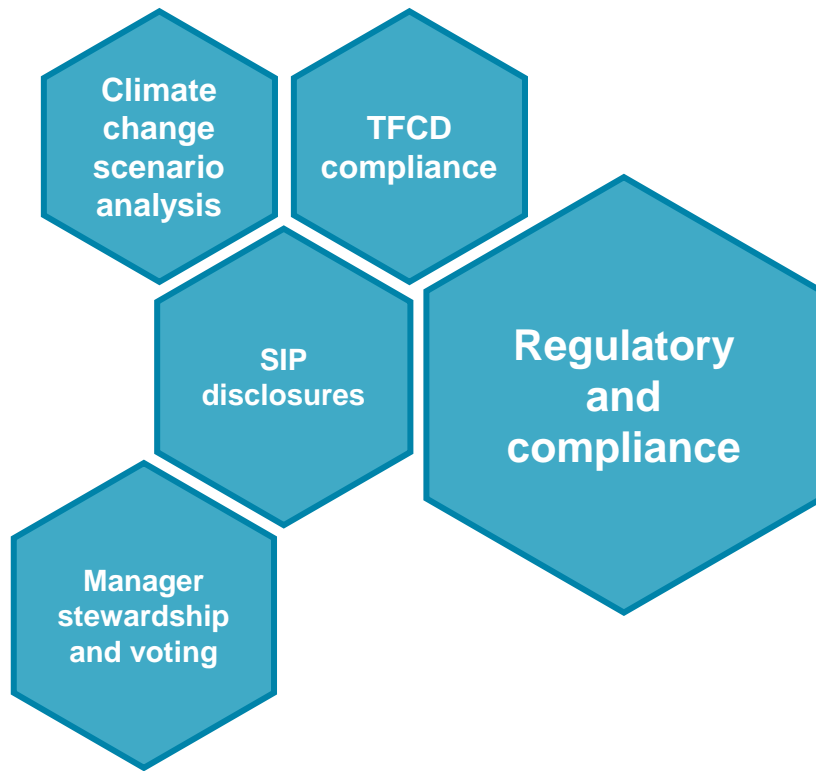
An increasingly prominent area. We are assisting several Funds in how they communicate with members and the public.

Example:

Fund G – targeted by campaign groups over fossil fuel exposure; developed quarterly reporting and proactive strategy

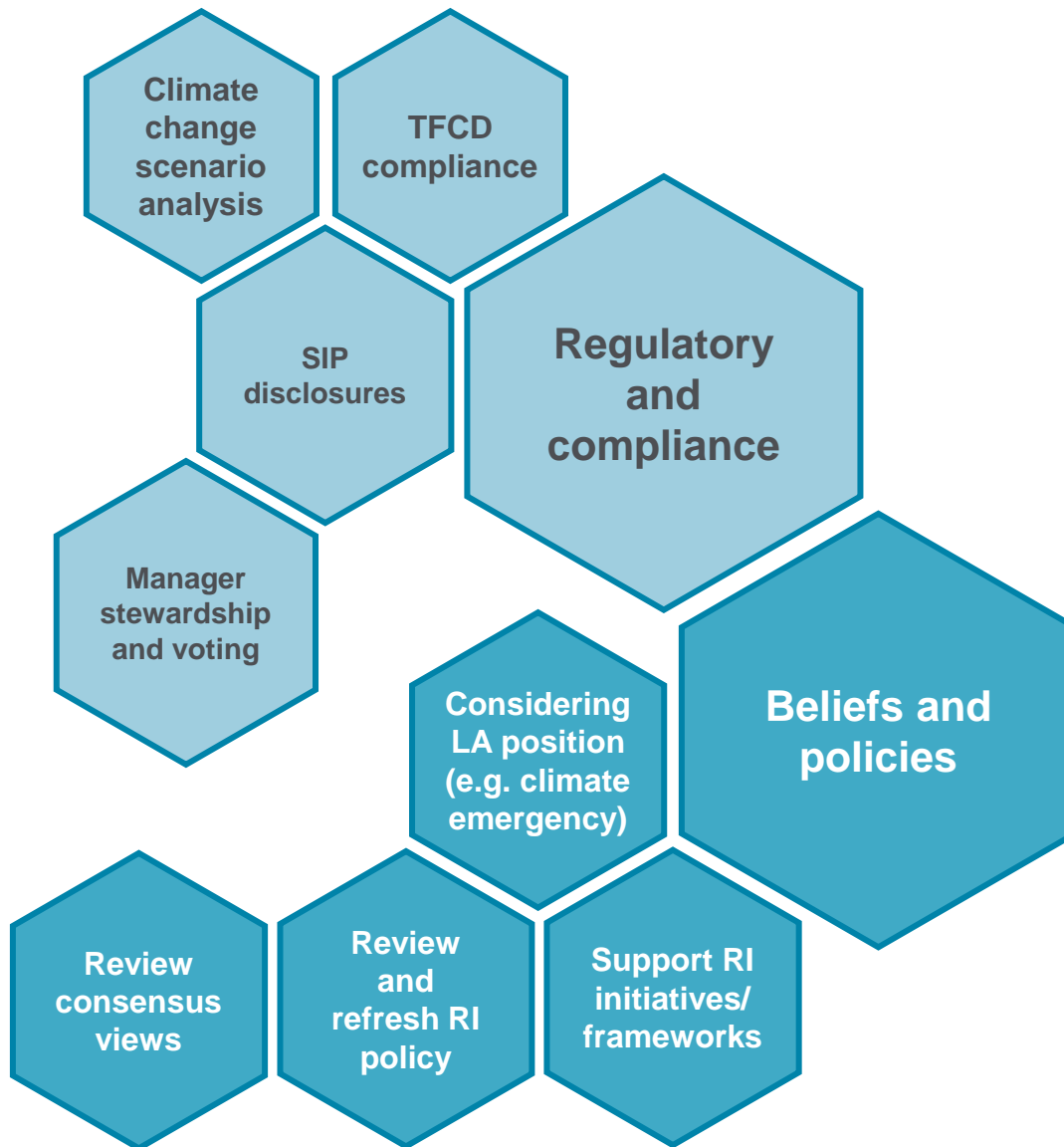
What other Funds are doing

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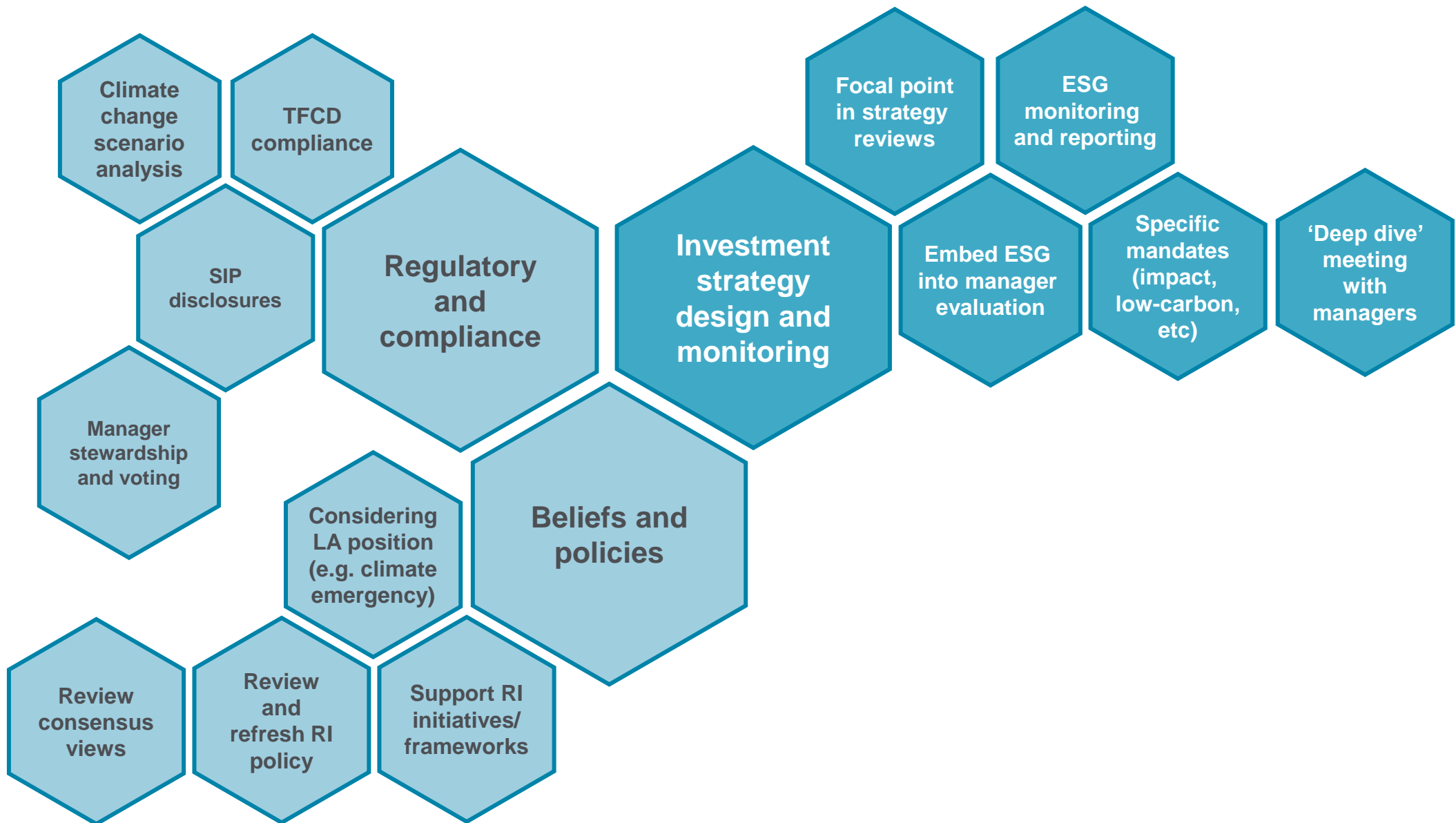
What other Funds are doing

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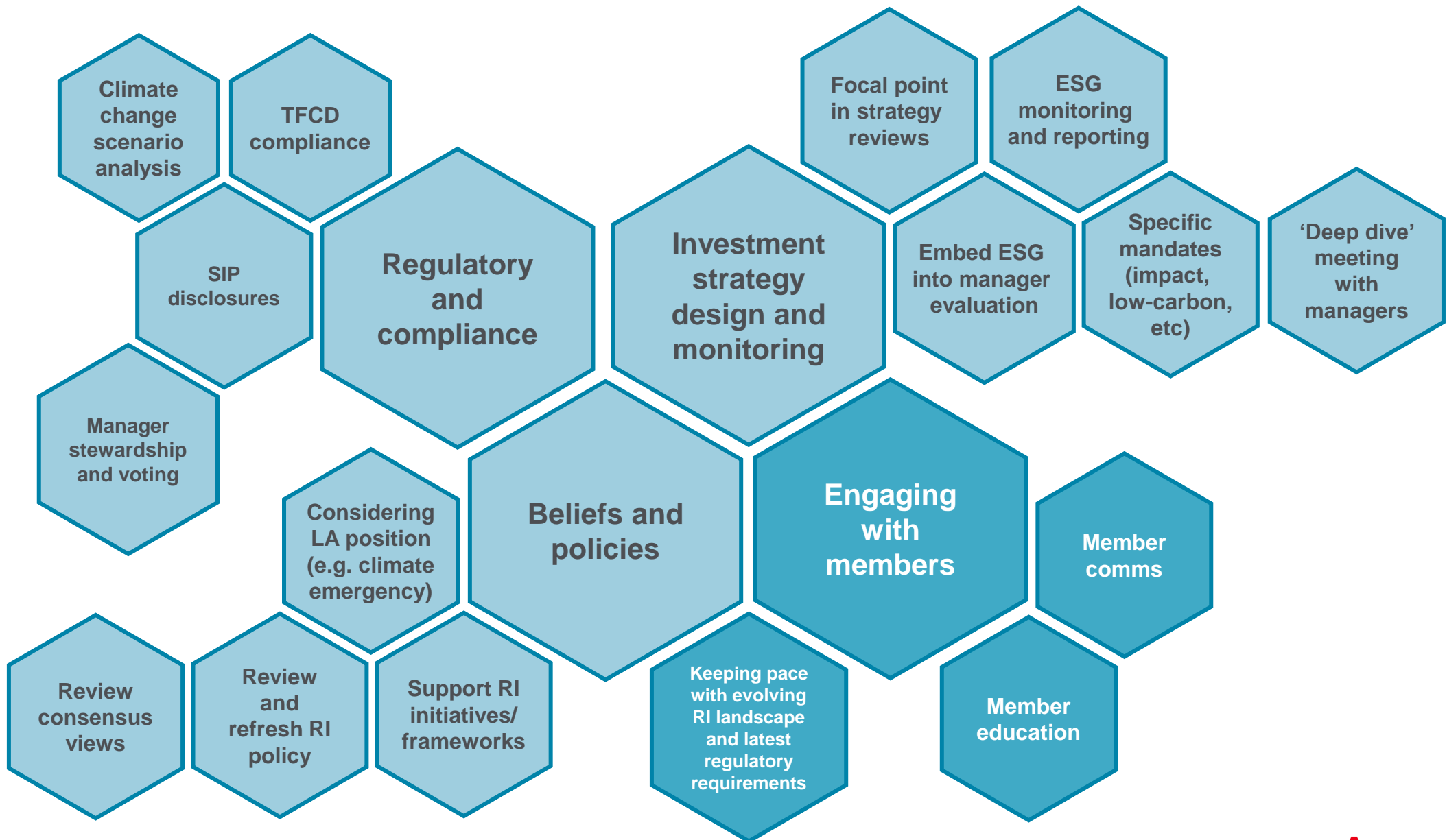
What other Funds are doing

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What other Funds are doing

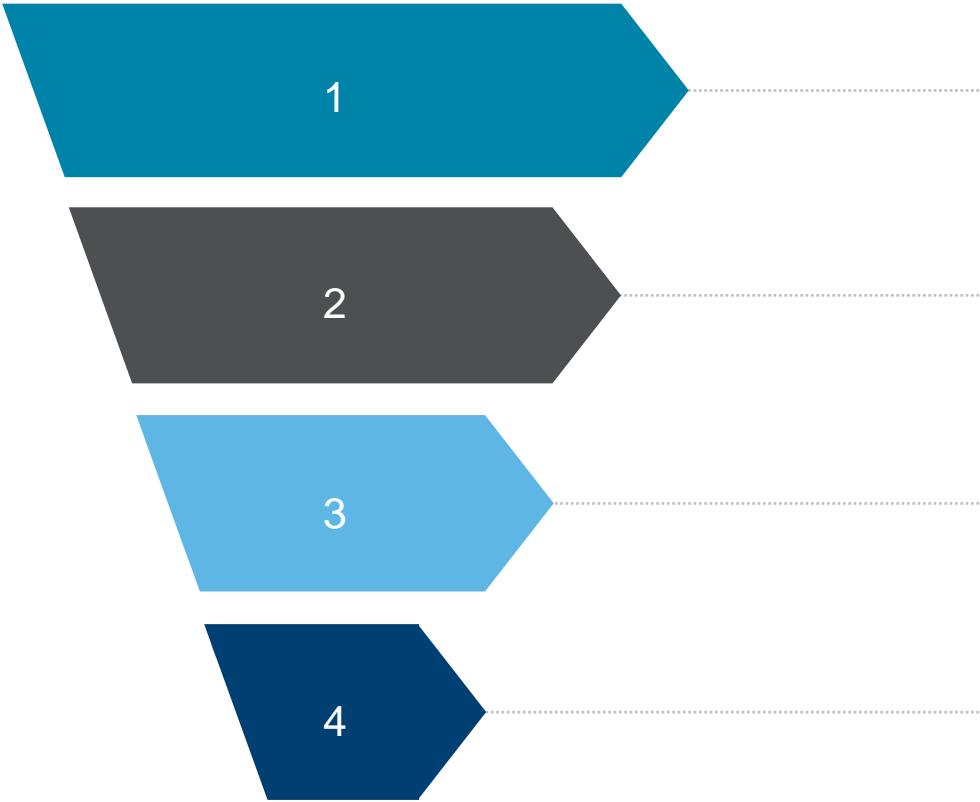
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Summary

Potential Next Steps



Agreeing objectives

Previously, the Committee was highly focused on climate actions and implementing a comprehensive strategy. Reaffirming this is the ***‘first next step’***.

Develop a plan

Having agreed on priorities and objectives, a plan should be developed to support the Fund achieving these outcomes.

Monitoring your profile

Understanding the Fund’s ‘ESG profile’ can provide a valuable insight into, e.g., the climate footprint of your current investments.

Further training and workshops

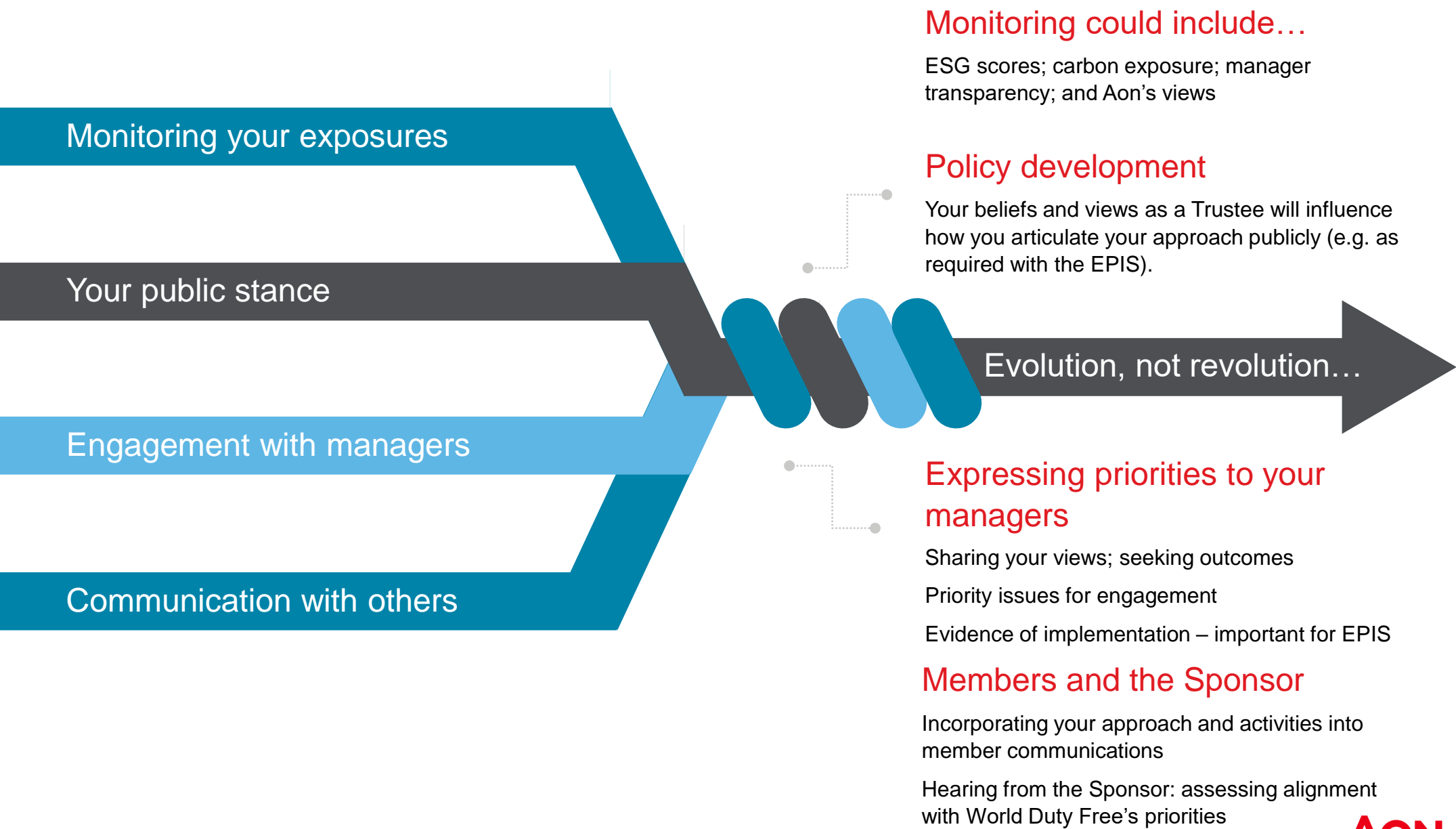
This is a large area and will be under significant regulatory attention in the near term. Exploring this in more depth will help you develop your understanding further.



Key takeaway

To further develop the Fund’s approach, we recommend devoting some time to do so thoughtfully.

Areas to consider...



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