Brent	**Pensions Fund Sub-Committee** 16 July 2020
	Report from the Director of Finance

Low Carbon Equity Fund Investment

Wards Affected:	ALL
Key or Non-Key Decision:	Non-Key
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	PART EXEMPT - as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: "Information relating to the financial or business affairs of any particular person (including the authority holding that information)"
No. of Appendices:	Two 1. Brent Low Carbon Equity Fund – Hymans Paper June 2020 (Exempt) 2. Fees Table - June 2020 (Exempt)
Background Papers:	▪ N/A
Contact Officer(s): (Name, Title, Contact Details)	Minesh Patel, Director of Finance Ravinder Jassar, Head of Finance Sawan Shah, Senior Finance Analyst Saagar Raithatha, Finance Analyst

1.0 Purpose of the Report

1.1 As part of the investment strategy review carried out in Q1 2020, the Committee agreed to make an initial investment in a low-carbon equity fund, which will be funded by investing a proportion of the Fund's excess cash holdings. This report presents analysis and results of investment options for the Committee to consider and agree which fund to invest in.

2.0 Recommendation(s)

2.1 The Committee to note the analysis set out in Appendix 1 undertaken by the Fund's investment advisors, Hymans Robertson in relation to an initial investment in a low-carbon equity fund.

2.2 The Committee to approve an initial investment of c£28m in the BlackRock ACS World ESG Tracker Fund.

3.0 London CIV update on Responsible Investment

3.1 Responsible Investment (RI) and environmental, social and governance (ESG) considerations with regards to strategic investment decision making is at the forefront of pension fund investing at present. This has been driven by an increased focus in this area from lobby groups, regulators and from greater public scrutiny.

3.2 ESG is a term that is used to describe a set of factors within responsible investing (RI) that can be a source of financial risk within different assets. The below table shows some examples of ESG factors.

Environmental factors	Social factors	Governance Factors
Climate change	Diversity	Board Structure
Resource Scarcity	Human rights	Executive Remuneration
Water Stress	Health & Safety	Transparency
Pollution	Data Protection	Shareholders Rights
Waste Management	Community Relations	Auditing and Accounts

3.3 Existing ongoing work on ESG can be notably seen through the London CIV, where the majority of the Fund's current investments are held. An update on this was provided by LCIV in a RI and ESG Progress report taken to the LCIV Shareholder Committee meeting on 2 April 2020. It had previously been recommended that in light of the increased focus on ESG and RI, that at least two Responsible Investment positions be appointed within LCIV, starting with the Head of Responsible Investment. In addition to this, five further recommendations were approved in December 2020 as priorities to be taken forward as part of ongoing work on ESG. The below table provides a status update on these recommendations. Although progress to date is welcome, officers will continue to engage with the LCIV team and insist that the recommendations are implemented and embedded.

Priority Areas	Description	Status
1	Specific resource focused on Responsible Investment and ESG matters	Interviews held in March. Head of RI has been appointed.
2	Product offerings	Renewable Infrastructure fund first meet held in April. Sustainable Equities exclusion fund launched on 11 March.
3	Improvements in reporting and communication	New website being mapped out in development.
4	Engagement Services	Presentation by providers received.
5	Investment foot-printing including at least carbon and fossil fuel exposure	Workshop date to be agreed.

6	Culture, leadership and investment beliefs	Appointment of Chris Bilsland as NED Champion

4.0 Low Carbon equity fund

4.1 Low-carbon equity funds offer reduced exposure to carbon-intense companies, sectors and geographical locations. Investing in such funds is one of a number of ways in implementing a more RI focussed investment strategy.

4.2 In February 2020, initial high-level discussions of low-carbon equity funds took place as part of the review of the Fund's investment strategy. As part of this exercise, it was agreed to expand the Fund's investment beliefs to have a more explicit Responsible Investment focus, including incorporating management of "climate change" risk into the strategy via an initial investment into a low-carbon equity fund. The following paragraphs, together with the details set out in Appendix 1, set out the main considerations in understanding the low-carbon options available, such that an informed investment decision can be made.

4.3 With increasing industry focus on climate risk within investments, fund options are evolving rapidly over time. Current options available to the Fund are from the existing array of managers, namely Legal and General Investment Management (LGIM) (the Fund's existing passive equity manager), BlackRock (the Fund's existing passive fixed income manager) and the London CIV (the Fund's pooling vehicle with various existing investments). It is important to note that LGIM and BlackRock are under the umbrella of the LCIV, despite not being direct LCIV funds on their platform, and meet the Government's definition of asset pooling. Being managers already appointed to the London CIV with respect to other mandates, LGIM and BlackRock both offer viable options with each fund having slightly different approaches. Investing with either of these funds would be closely aligned to the intentions of pooling given their status within the London CIV. In addition, the Fund benefits from significantly reduced fees negotiated by LCIV. The below table provides an overview of the options available for investment.

Fund	**Style**	**Exclusions**	**Active Engagement**	**Scope to Divest ***
LGIM Future World	Passive Factor Based	Partial	Yes	Yes
LGIM MSCI ACWI Adaptive Capped ESG	Passive Market Cap	Partial	Yes	No
LGIM Future World Dev ex UK Equity	Passive Market Cap	Partial	Yes	Yes
LGIM Future World Global Equity	Passive Market Cap	Partial	Yes	Yes
LGIM MSCI World Low Carbon Target	Passive Market Cap	Partial	No	No

BlackRock ACS World ESG Equity Tracker (to become Reduced Fossil Fuels)	Passive Market Cap	Full	Yes	Yes
LCIV Sustainability Equity Exclusion Fund	Active	Full	Yes	N/A

*Ability to divest applicable to passive non-exclusionary funds only. Active and exclusionary funds by definition avoid or divest from certain companies versus the index.

4.4 The table shows that LGIM and BlackRock both offer “passive” options, consistent with the Fund’s RI beliefs. The recently launched (March 2020) LCIV Sustainable Equity Exclusion Fund is an actively managed fund. Taking the decision to invest in this fund will be a departure from existing beliefs and require a broader discussion of entering into active equity management funds. The options offered by LCIV will be brought back to the Committee at a future meeting once further details of the fund have been developed.

4.5 The Fund should note that BlackRock’s Reduced Fossil Fuels Fund is an evolution of their existing offering. This transition is planned to take place in November 2020 at which point the Reduced Fossil Fuels Fund will replace the current fund.

4.6 Funds have different levels of exclusions. Some will refrain from investment from any companies within a particular sector whilst others will only seek to exclude those with the highest carbon exposure within a sector, focussing investment on companies who are performing better relative to peers. Of the options available, full exclusion can be found through BlackRock ACS World ESG Equity Tracker (to become Reduced Fossil Fuels) and the LCIV Sustainability Equity Exclusion Fund.

4.7 All investment managers offer a minimum level of engagement with companies. However, some employ an additional layer. For instance, some LGIM funds adhere to their ‘Climate Impact Pledge’ which involves a targeted engagement process with companies they have identified as critical to meeting the aims of the Paris Agreement to limit climate change. Some managers may also permit divestment from companies on top of engagement. The manager may divest from companies that do not meet minimum standards after a period of engagement.

4.8 The above highlights various factors that can be taken into account when constructing a low-carbon portfolio. The level of carbon reduction within the fund will depend on the approach taken across these areas and the below table provides information on the carbon intensity of each fund.

Fund	**Carbon Intensity - Metric Tonnes CO2/$1m Sales**
LGIM Future World	Index = 214 Fund = 185
LGIM MSCI ACWI Adapative Capped ESG	Index = 209 Fund = 161
LGIM Future World Dev ex UK Equity	Index = 188 Fund = 108
LGIM Future World Global Equity	TBC
LGIM MSCI World Low Carbon Target	TBC
BlackRock ACS World ESG Equity Tracker (to become Reduced Fossil Fuels)	Index = 171 Fund = 64 (will be 37)**
LCIV Sustainability Equity Exclusion Fund	Index = 168 Fund = 55.8

** Once the fund evolves into Reduced Fossil Fuels, carbon emissions intensity will drop from 64 to 37.
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4.9 Funds that fully exclude high carbon sectors e.g. fossil fuels, have the most significant reduction in their carbon footprint. These are BlackRock’s soon to be reduced fossil fuels fund and the offering from London CIV. Across the LGIM funds, the varying approaches taken, lead to a carbon footprint reduction of between 15% and 40% based on the information received to date.

4.10 In assessing the options available from a carbon footprint standpoint, the LGIM funds do not fare as well as the BlackRock fund. Through their optimisation approach to stock selection and index construction, the BlackRock ACS World ESG Equity Tracker fund, as it stands, delivers a c63% reduction in carbon emissions versus the index. Once the fund evolves to be ‘exclusionary’, this will fall a further 15-20% relative to the index. Being exclusionary avoids a need to be able to divest from companies such as in the LGIM fund range. There have been previous concerns raised in relation to the success rate of engaging with fossil fuel companies with a belief that divestment from such areas was preferred to avoid a stranded asset risk. The evolution of the BlackRock fund is consistent with this belief and significantly reduces the risk in regards to stranded assets.

4.11 There are various costs associated in moving towards investment in low carbon products. Appendix 2 provides details on the fee structure of each fund based on an initial investment of c£28m and a comparison of these costs against current holdings within the Fund. Passive funds in general have a lower cost compared to actively managed funds. Therefore, given the nature of the LCIV Fund being active, its associated costs are higher when compared to those passive products such as in the LGIM and BlackRock fund range.

4.12 Conclusions drawn from the exercise undertaken by the Fund’s investment advisors, Hymans Robertson indicate that an investment through BlackRock’s ACS World ESG Equity Tracker fund (to become Reduced Fossil Fuels) would fulfil Fund’s belief and objectives. It is a passively managed equity fund, adopts an exclusionary approach to fossil fuels, delivers a significant carbon footprint reduction relative to its index and offers good value for money.

5.0 Financial Implications

5.1 The Fund currently has surplus cash within its allocation. This is to be used for an investment into low-carbon equity fund as approved by the Committee in February 2020. As at 10 June 2020, cash held by the Fund amounted to £58.8m. This includes c£12m set aside for ongoing rebalancing, therefore an available cash balance of c£47m exists for investment.

5.2 In determining the amount to invest, there are a number of factors to note. This includes the Fund's liquidity requirements to meet future private market commitments, any strategic objectives and the current market environment. In addition to this, the Fund's investment advisors have recommend holding a slightly higher cash allocation than normal due to the increased volatility within markets. It is therefore proposed that the Fund maintains an allocation of 2% over the short-medium term in cash to meet these needs with the remaining balance c£28m being used to make this initial low-carbon investment.

5.3 Restricted Appendix 2 provides details on the fee structure of the Fund's current global equity holding and the low-carbon equity funds discussed in this report. There are costs associated with holding more ESG focussed funds because these funds have additional management expenses; the exact cost depends on the mandate entered into. Passively managed funds including those offered by LGIM and Blackrock have a lower cost compared to actively managed funds such as the LCIV Sustainability Equity Exclusion Fund.

6.0 Legal Implications

6.1 The Pension Fund Sub-Committee holds a key fiduciary responsibility to manage the Fund's investments in accordance with its investment strategy and in the best interests of the beneficiary members and the council tax payers, where the primary focus must be on generating an optimum risk adjusted return. It is vital that any investment decision must not negatively impact on this primary responsibility.

6.2 The administering authority has fiduciary duties both to scheme employers and scheme members and the investment strategy must be exercised for investment purposes, and not for any wider purposes. Thus, investment decisions must be spread across a wide variety of investments classes and achieve a balanced risk and return objective.

6.3 The choice of investments can be influenced by RI and ESG considerations, so long as that does not risk material financial detriment to the Fund.

7.0 Equality Implications

7.1 Not applicable.

8.0 Consultation with Ward Members and Stakeholders

8.1 Not applicable.

9.0 Human Resources

9.1 Not applicable.

<u>Report sign off:</u>

Minesh Patel
Director of Finance