

Responsible Investment policy

Addressee

This paper is addressed to Officers and the Pension Fund Sub-Committee of the London Borough of Brent Pension Fund (“the Fund”). The purpose of this paper is to formalise the Fund’s Responsible Investment beliefs and principles, and the approach the Fund is taking to fulfilling its commitments in a policy document.

Beginning of Responsible Investment policy

Introduction

The London Borough of Brent is the Administering Authority for the London Borough of Brent Pension Fund. Within its Constitution, The London Borough of Brent Pension Fund has delegated responsibility for the administration of the LGPS to a Sub-Committee of elected councillors. The Brent Pension Fund Sub-Committee (“the Sub-Committee”) is the decision-making body for the Fund.

Our fiduciary duty is to act in the best financial interests of members of the Fund and ensure that the Fund’s objective, as set out in the Investment Strategy Statement, is met. Our aim when setting the investment strategy is to strike an appropriate balance between generating satisfactory long-term returns whilst taking account of market volatility and risk and the nature of the Fund’s liabilities.

Responsible Investment

We define Responsible Investment (“RI”) as the integration and consideration of environmental, social and governance (“ESG”) issues into investment processes and stewardship activities.

The Sub-Committee consider the Fund’s approach to responsible investment in two key areas:

- **Capital allocation** – considering the financial impact of environmental, social and governance (ESG) factors (including climate change) when making investment decisions.
- **Stewardship and governance** – acting as responsible and active investors/owners, through considered voting of shares and engaging with investee company management as part of the investment process.

We recognise that ESG issues represent a material financial risk, which could have a negative impact on the value of the Fund’s investments particularly if the risks are not understood or evaluated properly. We should therefore seek to understand and manage the ESG issues to which the Fund is exposed.

The Fund has previously developed a set of Investment beliefs, including a number of ESG-related beliefs. This policy further develops the Fund’s ESG-related beliefs and sets out the actions we are taking to understand and manage ESG issues for the benefit of Fund members and other stakeholders. The aim is to protect the value of the Fund’s investments from ESG-related risks and to also capitalise on the investment opportunities that ESG issues, such as climate change, may provide.

Our RI beliefs and principles

We have agreed the following ESG-related beliefs and principles as the basis for our RI policy:

- **ESG issues can have a material impact on the long term performance of its investments** – we believe that ESG issues can have a material impact on the long-term risks and returns from the Fund’s investments, and there is an opportunity to positively impact investment returns by taking decisions with a long-term outlook and recognising the significance of ESG-related risks. We will engage with the London CIV, and our investment managers and advisers to understand the nature of these risks and identify investment opportunities which may also arise.

- **Climate change and the expected transition to a low carbon economy is a financial risk over the Fund's investment time horizon** – the Sub-Committee recognises that environmental issues can impact the Fund's returns. The Committee aims to be aware of, and monitor, financially material environmental-related risks and issues through the Fund's investment managers and advisers.
- **Ongoing engagement is preferable to divestment** – the Sub-Committee believes that, in relation to ESG risks, ongoing engagement with investee companies is preferable to divestment. This engagement may be via our managers or alongside other investors (e.g. LAPFF and through the London CIV). Where, over a considered period however, there is no evidence of a company making visible progress towards carbon reduction, we believe that divestment should be actively considered.
- **We must act as responsible owners** – as asset owners in the 21st Century, we believe it is our responsibility to support the transition to a low carbon global economy, consistent with the aims of the Paris 2016 Climate Change agreement to limit temperature increases by 2050 to a maximum of 2°C degrees. We will encourage our investment managers to exercise stewardship and active ownership responsibilities effectively, through voting and engagement activities. This includes using our influence as asset owners to encourage positive behaviour from the managers, working in conjunction with the London CIV where appropriate.
- **The Fund's investment managers and the London CIV should embed the consideration of ESG factors into their investment process and decision-making** – investment managers are responsible for implementing the Fund's strategy. In this role, the managers should reflect the Fund's desire for achieving long-term sustainable returns and improve corporate behaviour.
- **It is important for the Sub-Committee to integrate ESG issues when identifying investment opportunities** – we will consider opportunities to make investments with a positive social or environmental impact subject to the risk and return characteristics being acceptable. Investments expected to have a "positive impact" can be considered if they are consistent with the overall objectives of the Fund's investment strategy.
- **We will generally avoid investing in the most harmful companies and sectors** – we believe we have a duty to consider the wider environmental and social impacts of investments. We believe that we should generally avoid investing in the most harmful companies and sectors.
- **The choice of benchmark index matters** – whilst active managers are expected to take ESG issues in their individual stock selection decisions, it is acknowledged that index-tracking managers will invest in line with the index set out in their mandate. The Committee recognises that, for each asset class where an index-tracking approach is adopted, there is a range of benchmark indices that could be used. As a result, the Committee focus on the benchmark's underlying characteristics and consider how they may be appropriate for the Fund.
- **Disclosure is important** – we will encourage companies and investment managers to improve disclosure of their activity in relation to ESG issues. This will be addressed directly with managers, through involvement in the London CIV and also through membership of the LAPFF. We will also disclose the actions we are taking, including publishing this policy and incorporating our RI policies and approach into the way that we communicate with members.

These are incorporated with the Fund's broader Investment beliefs set out in the appendix to this paper.

Our approach

We take the following steps to ensure the investment strategy is aligned with our RI beliefs and principles.

Integrating ESG issues into the investment decision-making process

We aim to integrate consideration of ESG issues throughout our investment decision-making process, including setting the investment strategy, and the selection and monitoring of the Fund's investment managers. We are supported in these aims through regular and ongoing input from, and engagement with, our investment advisers and the London CIV.

We will consider the use of active management over index-tracking approaches where an active manager can be expected to provide materially improved ESG characteristics, for example when investing in certain geographical regions characterised by their concentration in a smaller number of industry sectors.

When looking to appoint a new investment manager or allocate money to a new fund, we will review the manager's RI policy with input from our investment advisers. This review will consider the manager's overall approach to RI, including how they integrate ESG issues into their own investment decision-making process, and their approach to stewardship.

We will consider opportunities to make investments with a positive social or environmental impact subject to the risk and return characteristics being acceptable. Investments expected to have a "positive impact" can be considered if they are consistent with the overall objectives of the Fund's investment strategy.

We undertake training on a regular basis and this includes training and information sessions on ESG issues, including climate change, and how these could impact the Fund's assets and liabilities.

ESG risk monitoring and assessment

Our processes to monitor and assess ESG-related risks and opportunities include the following:

- Our investment advisers monitor the Fund's managers on an ongoing basis from an ESG perspective. Where available, this includes assigning an 'RI rating' which reflects the commitment of the manager to ESG integration and the practices they apply. We monitor these RI ratings on a quarterly basis.
- These RI ratings are also a key consideration when the Sub-Committee is appointing a new investment manager or allocating money to a new fund.
- We ask our investment advisers to highlight opportunities to invest in responsible investment strategies and will give due consideration to any proposals.
- The Fund will analyse the carbon intensity of the assets at least annually and consider climate change scenario analysis at least triennially to review potential risks to the funding and investment strategy and consider whether any action is required to mitigate these risks.
- We expect our asset managers to understand our RI beliefs and requirements. We provide our policy to our investment managers and to the London CIV.
- In the event that any investment manager does not meet any of the expectations listed in this policy, Officers will engage with the respective stakeholders to encourage improvements in processes, transparency or activity as required.

Expectations and monitoring of investment managers, including the London CIV

We require our investment managers to integrate all material financial factors, including ESG issues, into their investment decision-making processes.

We expect our managers to follow best industry practice and use their influence as major institutional investors and long-term stewards of capital to promote good practice in the investee companies and markets to which the Fund is exposed.

We expect our investment managers to undertake appropriate monitoring of current investments with regard to their policies and practices on all issues which could present a material financial risk to the long-term performance of the Fund such as corporate governance and environmental factors.

Effective monitoring and identification of these issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, we expect our investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

We expect investment managers and the London CIV to comply with the UK Stewardship Code Principles and expect them to be a signatory to the 2020 UK Stewardship Code and to the Principles for Responsible Investment (PRI).

Our investment managers have provided copies of their RI policies. The managers are asked on an annual basis to provide an update on any changes to their policies. The managers are expected to report on their engagement activity with companies as part of their regular quarterly reporting. The consideration of ESG factors, along with discussion on current examples, is also an item on the agenda at all meetings between the investment managers and the Sub-Committee/Officers.

We monitor this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

The London CIV has developed its own RI policy. We will continue reviewing this policy and engaging with the London CIV to ensure that its strategies and beliefs are still aligned with ours. We will also require the London CIV to monitor the investment managers appointed for their fund range and provide reporting on the engagement activities of those investment managers. As an important strategic partner, the London CIV will be invited at least annually to provide an update to the Sub-Committee on their ongoing RI actions and latest RI policy.

Stewardship – voting and engagement

We recognise the importance of our role as stewards of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which our investments reside. This ultimately protects the financial interests of the Fund and its beneficiaries.

We have a commitment to actively exercising ownership rights attached to our investments, reflecting a conviction that responsible asset owners should maintain oversight of the companies they invest in, recognising that the companies' activities impact upon not only their customers and clients but more widely upon their employees and other stakeholders and wider society.

We have delegated the exercise of voting rights to the investment managers on the basis they will exercise this power with the objective of preserving and enhancing long-term shareholder value.

The investment managers have provided copies of their voting policies and these have been reviewed by Officers. The managers are asked on an annual basis to provide an update on any changes to their policies. The managers are also required to report on their voting activity. We publish a report of voting activity as part of the Fund's annual report.

We expect the London CIV to take an active approach to voting and engagement and we will monitor its activity in these areas.

We review the stewardship activities on an annual basis with input from the Fund's investment adviser and will engage with managers and the London CIV as required.

We expect the investment managers to provide suitable context when reporting on their voting and engagement activities, to explain the rationale for the actions they have taken, the relevance to the Fund, and outcome of engagement activity.

We believe in collective engagement and the Fund is a member of the Local Authority Pension Fund Forum (LAPFF), through which it collectively exercises a voice across a range of corporate governance issues.

Climate change

We consider that significant exposure to high carbon emitting companies and projects within portfolio could pose a material financial risk to the value of the Fund's investments.

At present, we have not formalised a net zero target date for the Fund. While we have an ambition for the Fund to be net zero by 2030, we recognise the ability to realise this ambition is dependent on a number of factors including the availability of suitable investment opportunities and reliance on the London CIV. We note that the London CIV has set a net zero target of 2040 for the portfolio of assets it oversees. We are developing a net zero plan as part of the Fund's net zero roadmap, which will identify the priority actions that need to be taken over the short to medium term to move the Fund towards a net zero position.

We have committed to undertaking a carbon footprint exercise for the Fund to quantify the Fund's current carbon emissions. We will then develop a plan to reduce the Fund's carbon emissions. The plan will be periodically reviewed to ensure that it remains consistent with the risks associated with investment in carbon assets and with the Sub-Committee's fiduciary duties.

A key consideration in developing this plan, including the setting of any intermediate targets, will be the London CIV's own plans to reduce the carbon exposure of the funds it oversees. Currently, c35% of the Fund's assets sit directly within the London CIV and this percentage is expected to grow over time.

The Sub-Committee considers exposure to carbon risk in the context of its role in asset allocation and investment strategy setting. Consideration has therefore been given in setting the Fund's Investment Strategy to how this objective can be achieved within a pooled investment structure and the Sub-Committee, having taken professional advice, will work with the London CIV to ensure that suitable strategies are made available.

Plus appendix

End of Responsible Investment policy

I look forward to discussing this paper with Officers and the Sub-Committee on 5 October.

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For and on behalf of Hymans Robertson LLP

20 September 2022

Appendix – Investment Beliefs

Core investment beliefs

Clear and well-defined objectives are essential to achieve future success - the Committee is aware that there is a need to generate a sufficient level of return from the Fund's assets, while at the same time having a clear understanding of the potential risks and ensuring there is sufficient liquidity available to pay members' benefits as they fall due.

Strategic asset allocation is a key determinant of risk and return, and thus is typically more important than manager or stock selection - the Committee understands that having the appropriate strategy in place is a key driver of the Fund's future success. As a result, priority is given to more strategic investment matters. The Committee is aware that there is need to take investment risk in order to generate a sufficient level of return.

Return and risk should be considered relative to the Fund's liabilities, funding position and contribution strategy – the Committee believes that as the funding position of the Fund improves, the level of risk taken by the Fund should reduce as appropriate i.e. only take as much risk as necessary. The Committee believes that there exists a relationship between the level of investment risk taken and the rate of expected investment return. In reducing risk, the Fund's expected return would typically also reduce.

Long term investing provides opportunities for enhancing returns - As a long-term investor it is important that the Fund acts as an asset owner. As a long-term investor, the Fund may choose to gain additional compensation by investing in assets that are illiquid or may be subject to higher levels of volatility (a premium return is required for any such investments).

Equities are expected to generate superior long-term returns - the Committee believes that, over the longer term, equities are expected to outperform other liquid assets, in particular government bonds. However, the Committee also recognise that equities can be highly volatile over the short-term.

Diversification reduces the overall volatility of the Fund's asset returns - the Committee believes that diversification across asset classes can help reduce the volatility of the Fund's overall asset value and improve its risk-return characteristics. However, the Committee also recognise that there is scope to over diversify and that any desire to diversify needs to be aligned to the Fund's governance arrangements.

Passive management has a role to play in the Fund's structure - The Committee recognises that passive management allows the Fund to access certain asset classes (e.g. equities) on a low cost basis and when combined with active management can help reduce the relative volatility of the Fund's performance. There is a belief that passive management is most suitable for markets that are deemed as being more efficient such as developed market equities.

Active management can add value but is not guaranteed – the Committee recognises that certain asset classes can only be accessed via active management. The Committee also recognises that active managers may be able to generate higher returns for the Fund (net of fees), or similar returns but at lower volatility, than equivalent passive exposure. There is a belief that active management is most suitable for markets that are deemed as being less efficient e.g. emerging market equities, specialist markets e.g. infrastructure or where views on the relative value of different asset classes are a targeted source of value e.g. DGF mandates.

Private markets can offer opportunities - Private markets can offer opportunities and give higher return due to higher illiquidity premia. However it is recognised that private markets can be more expensive, less transparent (e.g. fees and drivers of return), increase the Fund's governance burden and require ongoing maintenance to achieve target exposure. Such factors must be taken into account when considering such an allocation.

The choice of benchmark index matters – whilst active managers are expected to take ESG issues in their individual stock selection decisions, it is acknowledged that index-tracking managers will invest in line with the index set out in their mandate. The Committee recognises that, for each asset class, there is a range of benchmark indices that they could use. As a result, the Committee focus on the benchmark’s underlying characteristics and consider how they may be appropriate for the Fund.

Rebalancing policies are important – the Committee recognises that rebalancing the Fund’s assets towards the strategic asset allocation is important in achieving the Fund’s longer term objectives, in particular following a period of strong or weak market performance.

Fees and transaction costs matter - The Committee considers the fees and costs of its investment arrangements to ensure the Fund is getting value for money and to minimise, as far as possible, any cost leakages from its investment process. It also does not seek to move in and out of investments regularly due to the cost drag. The Committee also seek to have transparency on the fees that it is paying to its providers.

Governance “budget” matters – The Committee recognises that the resources (and time) involved in deciding upon (and implementing) an investment strategy and structure play a part in any investment decisions made. A low governance approach to accessing markets is likely to be preferred if it can offer similar risk adjusted returns to alternative approaches.

The London CIV is the Fund’s preferred approach to implementation – the Committee recognises the potential benefits of LGPS pooling. Their preferred route is to implement their investment strategy via the London CIV, subject to carrying out suitable due diligence on the CIV’s investment offering.

ESG-specific beliefs

Environmental, social and corporate governance (‘ESG’) issues can have a material impact on the long term performance of its investments - the Committee recognises that ESG issues can impact the Fund’s returns. The Committee commits to an ongoing development of its ESG policy to ensure it reflects latest industry developments and regulations and ESG is integrated into strategic considerations.

Climate change and the expected transition to a low carbon economy is a long term financial risk to Fund outcomes - the Committee recognises that environmental issues can impact the Fund’s returns. The Committee aims to be aware of, and monitor, financially material environmental-related risks and issues through the Fund’s investment managers and advisors.

Ongoing engagement is preferable to divestment – The Committee believes that, in relation to ESG risks, ongoing engagement with investee companies is preferable to divestment. This engagement may be via our managers or alongside other investors (e.g. LAPFF). Where, over a considered period however, there is no evidence of a company making visible progress towards carbon reduction, we believe that divestment should be actively considered.

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