Brent	**Pensions Fund Sub-Committee** 02 October 2019
	Report from the Director of Finance

Brent Pension Fund's approach to Responsible Investment and Environmental, Social and Governance issues

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)	Open
No. of Appendices:	Appendix A – LCIV Responsible Investment Policy
Background Papers:	▪ N/A
Contact Officer(s): (Name, Title, Contact Details)	Minesh Patel, Director of Finance Ravinder Jassar, Head of Finance

1.0 Purpose of the Report

1.1 This report sets out the Fund's proposed approach to further integrating Environmental, Social and Governance (ESG) considerations into its strategic decision making, in particular it sets out a new package of measures, subject to committee approval, the Fund intends to take in the short and medium term to manage the risk of climate change.

2.0 Recommendation(s)

That the committee:

2.1 Note the overall report with regards to position on responsible investment and climate change;

2.2 Note the further work proposed with regards to scenario analysis, carbon footprint analysis and consideration of alternative index-tracking funds;

2.3 Express their view on membership of the Local Authority Pension Fund Forum.

3.0 Background

3.1 This report is intended to help guide the Fund's approach to current and future investment risks and opportunities that result from the impacts of climate change and subsequently develop the investment strategy to accommodate climate change considerations. In beginning to develop this framework consideration has been given to the requirements placed on Administering Authorities by LGPS Investment Regulations and MHCLG Guidance on the content and coverage of Investment Strategy Statements which shape the regulatory context for funds in relation to their stewardship and responsible investment activities. It is also worth noting the Scheme Advisory Board is shortly due to issue guidance in relation to this subject. The impact of this guidance on the proposals set out in this report will be reflected on when it is published.

3.2 LGPS funds face increasing pressure, from various oversight bodies, to explain how they are responding to climate change risk. The forthcoming guidance on responsible investment is likely to require LGPS funds to explain how they are managing climate change risk. Divestment campaigners continue to subject funds to scrutiny whilst Fund actuaries must take account of professional guidance to consider climate risk in the development of advice on long-term funding strategies.

3.3 The Brent Pension Fund Committee takes Responsible Investment ("RI") seriously. The Committee recognise that Environmental, Social and Governance ("ESG") factors can influence the Fund's ability to achieve long term sustainable returns. This RI commitment is reflected in the Fund's Investment Strategy Statement, which includes the following stated 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.*

3.4 The Fund also has the following funding principles:

- Ensure that sufficient resources are available to meet all benefit as they fall due for payment;
- Recover any shortfall in assets, relative to the value of accrued liabilities, over broadly the future working lifetime of current employees;
- Enable employer contributions to be kept as stable as possible and at reasonable cost; and
- Maximise the returns from investments within reasonable risk parameters.

3.5 The ESG criteria of its existing investments are assessed on an ongoing basis, including regular interaction and challenge of the Fund's investment managers (including the Fund's asset pool, London CIV). ESG is also a key consideration when assessing the relative merits of any potential new Fund investments. The Committee has an ongoing education programme in place to increase overall knowledge, including on RI matters and latest industry regulation and guidance.

3.6 The Fund has been a strong advocate of responsible investment for many years. This has led to improvements in the understanding how ESG forms part of the Fund's strategic decision making, interaction and challenge of fund managers on their reporting of ESG issues, rather than just purely reporting on financial performance. In recent years this has involved working with the London CIV to develop an overarching Responsible Investment policy, which the Committee endorsed and agreed to adopt in November 2018. This is re-attached as Appendix A for reference.

3.7 The London CIV's commitment to responsible investment is particularly important given that just under 90% of the Fund's investments are within the London CIV and in the next 12 – 18 months this is expected to rise to over 95%. In addition, at the Committee meeting of February 2019, strong representations were made to the London CIV to have a senior lead on responsible investment. The Committee welcomes the news that the recent appointment of the Chief Investment Officer, Mark Thompson, will be leading on responsible investment. The London CIV's Responsible Investment Policy is considered to be a good starting point, providing an effective influencing and engagement framework. In particular, it provides a framework for oversight of investment managers. The London CIV has begun to implement the policy which will be the subject of ongoing review and update reports to the Committee and the Board in the light of regulatory and other developments in Responsible Investment.

3.8 Despite a clear commitment to responsible investment the Fund is regularly challenged about its approach to responsible investment. The challenges are usually made by individuals or groups that object, often on ethical grounds, to the Fund owning shares in companies operating in certain industries or in certain geographies on the basis that they are too risky to own. Examples include companies operating in the defence industry, the extraction and sale of fossil fuels (coal, oil and gas), the sale of tobacco and/or alcohol, and companies operating in controversial areas of the world.

3.9 The issues raised by lobby groups often involve complex social, legal and moral issues. Whilst the Fund is sympathetic to some of the issues raised, its paramount consideration is its own social obligations, which is to pay promised benefits to pensioners.

3.10 The Fund's policy on responsible investment is informed by its fiduciary duty to its members and employers, rather than by purely ethical considerations. Accordingly, the Fund does not disinvest from companies for purely non-financial reasons, not least because this could lead to legal challenge. The Fund does, however, believe that environmental, social and governance (ESG) issues can affect the financial performance of the companies in which it invests. Consequently, it takes these issues seriously and integrates them into the decision-making processes.

3.11 The Fund has a policy of engagement with its fund managers rather than a policy of exclusion or divestment. By engaging with the fund managers in this way it aims to improve the sustainability of corporate strategy to the benefit of shareholders, and to the benefit of wider society. In contrast, it can be argued that a policy of divestment passes shares to less responsible share owners, who are less likely to hold management to account.

4.0 Climate Change

4.1 It is recognised that one of the most challenging issues of the day is climate change and its effect on the planet and the Fund's investments. The Paris Agreement aimed at keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels. In terms of the impact of this on LGPS funds, at this stage it is only possible to make broad assumptions about what may happen. Policies focused on adaptation in the short-term may give rise to more immediate costs although benefits may be realised in the longer term as there is a lower need for mitigation. Delayed action may increase the likelihood of more extreme climate outcomes and consequently financial loss from physical impacts. There remains considerable uncertainty around the pace and scale of both the policy and market response to climate change.

4.2 The important question for the Brent Pension Fund, and thus the Committee is, "how do we achieve long-term sustainable returns and how could climate change risk impact our ability to achieve these returns". This is likely to require a review of the Committee's investment beliefs, and other investment areas (some of which are set out below).

Oversight and governance

4.3 There are various governance aspects to consider. One is to encourage the Fund's managers to improve their disclosures and reporting on ESG issues. This strategy has been successful, where over the last year our fund managers have significantly improved their reporting on ESG matters. The quarterly reports from our LCIV fund managers provide a detailed breakdown of ESG activities, including new policies and procedures, voting records and holdings within the investment portfolio in industries which may be considered relevant for ESG considerations. Specifically, these industries are:

4.4

- Aerospace and defence
- Alcohol
- Gambling
- Oil & Gas
- Tobacco

4.4 Going forwards these disclosures will be reported as part of the usual quarterly monitoring of Fund activity. Managers will be encouraged to ensure that active portfolios include positions that maximise the investment benefits, and minimise the risks, from climate change. All Investment Managers will be monitored on their approach to climate change as part of the regular review of the funds.

Scenario Analysis

4.3 Another way of understanding the impact of climate change on LGPS funds is to employ different climate related scenarios. Hymans, the Fund's actuary and investment advisors, are able to model various scenarios to help funds explore these challenging questions. Briefly these are:

- **Green Revolution**: Rapid policy response from government creates the absolute necessity for change which is matched by the deployment of green technologies and ongoing investment in adaptation;
- **Challenging times**: Challenging times reflects delayed policy action. Change is likely to be intermittent at first but is assumed to become more severe in response to growing environmental feedbacks;
- **Head in the Sand**: Policy responses do not prioritise environmental change with corporates largely continuing business as usual type approaches.

4.4 Although different methods can be employed, taking the three scenarios outlined above, it is possible to filter out those funding level projections that fit the economic parameters for each climate scenario. This allows the Fund to illustrate the potential impact on funding level outcomes. By modelling possible outcomes, funds can begin to have more meaningful conversations on climate risk as well as reflecting this in funding strategies and investment arrangements.

5.0 **Carbon exposure- awareness, risk and disclosure**

5.1 Climate change has the potential to impact all asset classes over the Fund's lifetime. As a result, many assets may be re-priced but the timing of this is uncertain and the impact will vary by asset class depending on factors such as geography and liquidity. There is also uncertainty over the direction and speed of policy changes in this area. To that end, it is proposed to undertake a carbon footprint exercise for the Fund in order to improve its understanding of the Fund's holdings. The exercise will use the latest data on greenhouse gas emissions attributable to global companies. The data collated will be used by officers to direct research and engagement activity with a view to assessing the opportunities and risks related to the shares.

5.2 Officers will work with our investment advisors, Hymans, to scope out this project further and report back to the committee. Following this, recommendations on the measurement of and actions related to carbon emissions will be then presented to the committee for approval. That said, and for the avoidance of doubt, the legal and fiduciary duty of the pension fund committee is to ensure its assets are invested so that the pensions that its members are entitled to can be paid. The final decision over the Fund's investment arrangements, including whether to invest in some low carbon/sustainable funds, will depend upon a number of factors including the

Fund's: investment regulations, objectives, funding principles, ability to achieve economies of scale, and governance arrangements. Any agreed changes will be reflected in the Fund's investment strategy statement.

5.3 As described above the Fund does not divest automatically from companies in a certain industry. A number of campaigners who argue for divestment prefer investments to be directed to renewable energy rather than fossil fuels. The Fund is highly aware of the fact that renewable energy will grow its share of the world's energy needs in the future. The Fund has investments in the renewables sector, but only where it sees a good risk-adjusted return that will help to pay pensions. As at 31 March 2019, the Fund had investments of £15m in the renewable energy sector, including onshore and offshore wind, solar and hydro assets, through its private market infrastructure manager. This excludes such investments which may be held in our listed equities and diversified growth funds, as further work is required to analyse each of the underlying investments held with each of our fund managers. This will be done as part of the carbon footprint project described in section 5.1.

5.4 As part of the implementation of the Fund's investment strategy, a commitment has been made to invest in the London CIV's Infrastructure fund, expected to take place in November 2019. As part of the design of the portfolio, a minimum of 25% of the Fund's allocation will be invested in renewable projects.

5.5 Approximately half of the Fund is invested in passive or tracker funds which holds shares in all of the companies in the relevant index, for example, the FTSE All Share, a practice encouraged by government due to the low fees paid to investment managers. A feature of this tracker fund is that we cannot pick and choose which assets are held. As part of the Fund's 2019/20 responsible investment workplan the Committee will consider other forms of indexation e.g. low carbon strategies.

6.0 Collaboration

6.1 Collaboration with other investors has the potential to help influence and improve market best practice standards, as well as strengthening the voice of pension funds. Individual funds engaging with companies on their own are thought to be unlikely to have as much of an impact. Working collaboratively, therefore, funds can maximise their influence on major companies on topics such as climate change, labour rights and other ESG issues. There are a number of collaboration groups in this space, including the Local Authority Pension Fund Forum (LAPFF).

6.2 Members received a presentation on the benefits of joining LAPFF at the last committee meeting. Members requested further information on more recent examples of their achievements. These have been provided directly to members and the decision to join the forum has been brought back to the committee.

6.3 LAPFF represents the interests of 80 public sector pension fund members, including 6 LGPS Pools, with combined assets of over £230 billion. The Forum has long been concerned about climate and carbon-related risks to the underlying investment portfolios of member funds.

6.4 Should the policies and procedures of LAPFF differ from that of the Fund, the Fund is able to cease membership at any point.

7.0 Financial Implications

7.1 If the committee agrees to become a member of the Forum the annual cost will be £9,500 and will be funded by the Pension Fund.

7.2 If the committee approves the further analysis proposed by way of this report (scenario analysis and carbon footprint analysis), additional fees will be incurred to deliver the work. These costs, as well as a full project plan, will be presented to the committee for approval at the next meeting once members confirm the objectives and scope of the projects.

8.0 Legal Implications

8.1 Regulation 7(2) (e) of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 requires an administering authority to include in its Investment Strategy the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.

9.0 Equality Implications

9.1 Not applicable.

10.0 Consultation with Ward Members and Stakeholders

10.1 Not applicable.

11.0 Human Resources

11.1 Not applicable.

<u>Report sign off:</u>

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