Brent	**Pension Board** 25 March 2020
	Report from the Director of Finance

Update on Responsible Investment, Climate Change Risk and Environmental, Social and Governance (ESG) 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)	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:	Three 1. Carbon footprinting scopes 2. Climate Change Funding Analysis 3. ESG-oriented Equity funds (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

1.0 Purpose of the Report

1.1 This report provides an update on Environmental, Social and Governance (ESG) considerations with regards to strategic investment decisions, in particular how the fund is continuing to manage the risks of climate change.

2.0 Recommendation(s)

That the committee:

2.1 Note the overall report with regards to the position on Responsible Investment and Environmental, Social and Governance matters (ESG).

2.2 Note the work carried out in relation to scenario analysis of the impact of climate change and agree the actions arising.

2.3 Note the research carried out on low carbon (or ESG orientated) index tracking funds and delegate authority to the Director of Finance to put into effect this investment as part of the wider investment strategy review.

2.4 Agree to conduct a carbon footprint of the Fund at an estimated cost of between £10k and £20k and to delegate authority to the Director of Finance to finalise the terms of the exercise as set out in section 5.9 of this report.

2.5 Note the collaborative work being undertaken by London Boroughs and the London CIV to bring forward new ESG orientated investments.

3.0 Background

3.1 LGPS funds face increasing pressure from various stakeholders to ensure that Environmental, Social and Governance (ESG) issues are considered in the course of managing the fund and in its investment decision making. This has been driven by an increased focus in this area from lobby groups and regulators, and from greater public scrutiny.

3.2 Environmental, Social and Governance (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 LGPS Guidance on Preparing and Maintaining an Investment Strategy Statement requires that responsible investment and ESG issues are considered in investment decisions:

3.4 When making investment decisions, administering authorities must take proper advice and act prudently. In the context of the local government pension scheme, a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence. This approach is the standard that those responsible for making investment decisions must operate.

3.5 Although administering authorities are not subject to trust law, those responsible for making investment decisions must comply with general legal principles governing the administration of scheme investments. They must also act in accordance with ordinary public law principles, in particular, the ordinary public law of reasonableness. They risk challenge if a decision they make is so unreasonable that no person acting reasonably could have made it.

3.6 The law is generally clear that schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors, and over the long term, dependent on the time horizon over which their liabilities arise.

3.7 Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.

4.0 Scenario Analysis

4.1 The Brent Fund Pension Fund has engaged with its actuary to model the impact of three climate change scenarios. 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.

4.2 This analysis isolates different market outcomes which are associated with these three climate scenarios and examines the long term funding impacts on the fund. The modelling combines the impact of markets (which generally affects asset values) and the longevity impact (which affects the Fund's liabilities). The full report is available in Appendix 2.

4.3 The results of this analysis show that, both, the head in the sand and the challenging times scenarios are likely to give poorer funding outcomes than the current funding plan anticipates. Under both of these scenarios, the reduction in longevity lead to a reduction in liabilities. All other things being equal, this would improve the funding position. Therefore, the poorer funding outcome can be attributed to reduction in GDP growth and equity returns.

4.4 The Green Revolution scenario provides the most optimistic outcomes in the medium to long term. These are similar funding outcomes to those that are anticipated in the current funding plan. However, even some of the projections in this most optimistic scenario provide negative funding outcomes in the short term.

4.5 The Fund's current investment strategy reflects that the Brent Pension is poorly funded compared to other LGPS pension funds and strikes an appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund's liabilities.

4.6 Nevertheless, the report proposes a set of next steps including:

- A review of investment beliefs and asset allocation,
- A review of carbon exposure of existing investments,
- Engagement programmes with fund managers and
- Improved reporting and disclosures on ESG using industry best practice guidance.

The Fund has considered many of these actions in this report.

5.0 Fund Manager Research and Measuring Climate Risk

5.1 Within ESG issues, it is clear that climate change and its effect on the planet is a key challenge. To minimise the consequences, world leaders agreed to limit global temperature rise this century to below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius in the Paris agreement. Furthermore, the UK government has committed to bring all greenhouse gas emissions to net zero by 2050. It is clear that that Climate Change poses a significant risk to long-term investors such as the Brent Pension Fund however there remains considerable uncertainty as to what the exact impact will be.

5.2 With an increasing focus on climate risk, investment managers are also adapting to investors' concerns. Therefore, it is important to understand the Fund's current position, both, in terms of engagement and activity already carried out by investment managers, and to understand the Fund's exposure to climate change.

5.3 Officers have asked each active fund manager for further information on the extent to which they are taking account of climate risk within their portfolios and how they are managing this risk. They have also been asked on engagement activity they have conducted on assets owned.

5.4 It is also 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.

5.5 An initial carbon footprinting exercise on the Fund's assets would:

- Provide base data to better understand the impact of the Fund's current investments on emissions and climate risks.
- Allow the committee to assess the impact of future investment decisions on environmental factors and to monitor progress over time.

5.6 Carbon footprinting is a measure of carbon emissions that can be attributed to the Fund's investment portfolio. This is based on the total carbon emissions data of the individual company and then calculating the ownership of the organisation by the Fund. The Fund would then receive a carbon intensity score measured in tonnes/$m invested. This is then typically compared to the footprint of the benchmark (e.g. the portfolio benchmark or FTSE All-world)

5.7 It is important to note that there are several limitations of carbon footprinting and therefore carbon footprinting can only be seen as a tool to aid analysis. However, these limitations are expected to improve over time. In summary:

5.7.1 There are caveats around data quality. The main source of information is through publically available information such as annual reports. Furthermore, the data can sometimes be quite old.

5.7.2 In many countries, carbon reporting is voluntary and is not always audited. Where data is not available carbon footprinting uses estimation techniques to fill gaps.

5.7.3 Assumptions are made as to whether emissions fall into scopes 1, 2 or 3. Carbon footprinting tools focus on scopes 1 and 2, data for scope 3 is not widely reported. Further information on scopes is available in appendix 1.

5.7.4 Data is generally not available for private equity and other private markets.

5.8 Other methods of analysis in this area include: carbon risk ratings which score companies on how susceptible they are to climate change, % portfolio invested in fossil fuel production companies and % of portfolio invested in green transport and renewable energy.

5.9 Officers will work with our investment advisors, Hymans to agree the exact terms of the exercise and to appoint a contactor to conduct a carbon footprint of the Fund. This is estimated to cost between £10k and £20k and the exact cost will depend on the fund's holdings at the measurement date. The results of this exercise will be reported to the committee later this year.

6.0 Investment Strategy

6.1 The Fund's Investment Strategy Statement (ISS) describes its overarching approach to dealing with environmental, social and governance (ESG) issues, these are reflected in its investment beliefs which were formally agreed in November 2018:

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.*

6.2 Following the 2019 valuation and agreed at the last committee meeting, the Fund commissioned an investment strategy review, which is to be considered as a separate report on this agenda. This report recommends that the committee's current investment beliefs are fit for purpose but expands on its Responsible Investment beliefs in light of the increased focus on, and importance of, this area.

6.3 The Fund holds a large proportion of its equity investments in passive tracker funds, these are funds that seek to replicate the performance of a market index. This is a practice encouraged by government due to the low fees paid to investment managers. The government has also encouraged Funds to pool their assets to further benefit from fee savings.

6.4 As at 31 December 2019, 54% of the Fund's total assets were invested in listed equities with 50% of the Fund's assets in passive tracker funds. The Fund has conducted research into ESG-oriented equity tracker funds that are available for investment by the pension fund. This is shown in appendix 3.

6.5 It is important to recognise that there are costs to moving from the Fund's current passive tracker funds to more ESG focussed funds from additional management expenses. The exact cost will depend on which mandate is sold and the new investment entered into. Where the Fund achieves a lower rate of return of return due to increased investment management expenses, this will have a negative impact on the overall funding level of the Brent Pension Fund (which is already low in comparison to other funds) as well increase the employer contribution rate for the Council and other employers in the Fund.

6.6 The investment strategy review has recommended that a global low carbon mandate forms part of the Fund's equity allocation, which is to be funded by selling some of the Fund's existing equity holdings and using cash available. The size of the holding and next steps will be discussed further at the committee meeting.

6.7 The Fund's pool, London CIV (LCIV), currently does not offer sufficient products with an ESG focus however, the Fund is aware that there is now an increased focus in this area from the LCIV. It is therefore important for the Fund to collaborate with other local authorities to work to reduce the costs for investments in this area.

6.8 At the February 2019 committee meeting, the sub-committee agreed to commit £50m to the London CIV's infrastructure fund. The Fund had a successful first close of £399m in total on 31st October 2019. At least 25% of the Fund's investment will be invested in renewable projects. The initial infrastructure investment has been made into the "Macquarie GIG Renewable Energy Fund 2". This fund will be 100% focussed on renewable energy with the majority of investments being in wind and solar assets.

6.9 London CIV are also currently working on a 100% renewable infrastructure fund and an active exclusion equity fund due to demand from a number of London Boroughs. Brent will conduct the necessary due diligence on these products as further details are revealed during the year and provided they fit within the scope of the investment strategy will be brought forward to the committee for consideration.

7.0 Financial Implications

7.1 These are discussed throughout the report.

8.0 Legal Implications

8.1 Not applicable.

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.

Report sign off:

Minesh Patel
Director of Finance
.

Appendix 1 - Carbon footprinting scopes

DEFINING THE SCOPE: DIRECT VS INDIRECT EMISSIONS

MSCI's carbon footprint calculations are based on Scope 1 + Scope 2 carbon emissions:

- **Scope 1:** All direct GHG emissions from sources owned or controlled by the company. Some examples include emissions from fossil fuels burned on site, emissions from entity-owned or leased vehicles.

  As of 21 Sept 2015, Scope 1 emissions comprised 81% of total emissions of the MSCI ACWI Index.

- **Scope 2:** Indirect GHG emissions from consumption of purchased electricity, heat, or steam, and the transmission and distribution (T&D) losses associated with some purchased utilities.

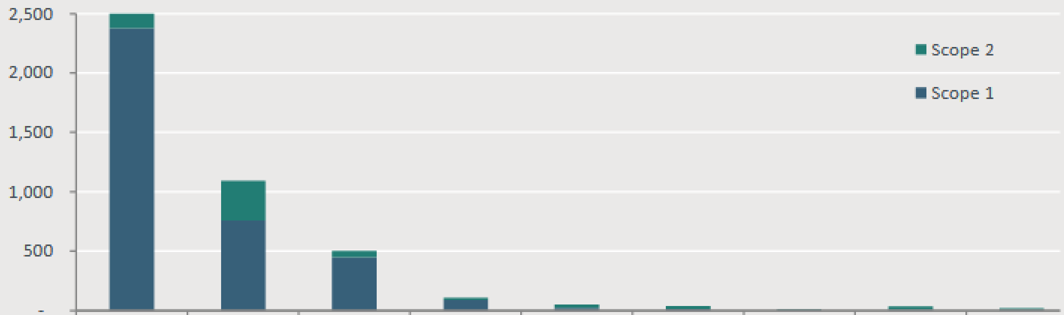
  As of 21 Sept 2015, Scope 2 emissions comprised 19% of total emissions of the MSCI ACWI Index.

- **Scope3:** Other indirect emissions that occur from sources not owned or controlled by the company. Some examples of scope 3 activities are extraction and production of purchased materials; transportation of purchased fuels; and use of sold products and services.

  Since Scope 3 emissions occur from sources not owned or controlled by the company, and the boundaries to measure scope 3 emissions are not well-defined, it is not consistently calculated or disclosed by companies.

  The inconsistency of scope 3 emissions data makes it difficult to perform any meaningful comparative analysis across companies or industries. Further, due to lack of control of the emission sources and boundaries, it is difficult to estimate such emissions comprehensively.

Figure 8 – Scope 1 vs. Scope 2 Emissions by Sector



	Utilities	Materials	Energy	Industrials	Consumer Staples	Consumer Discretionary	Financials	Telecommunication Services	Informatio Technolog
Scope 2	124	332	53	20	26	24	9	33	15
Scope 1	2,377	758	451	90	25	15	5	5	5

Source of definitions: GHG Protocol

Source: MSCI – Carbon Footprinting 101