	Pension Fund Committee **24 February 2021**
Title	**Responsible Investing & Climate Change**
Report of	Director of Finance
Wards	N/A
Status	Public
Urgent	No
Key	No
Enclosures	Appendix 1 – Revisions to Investment Strategy Statement Appendix 2 – TCFD Framework
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Summary

Two issues are covered in the paper. Firstly documentation of the Committees responsible investment beliefs in the investment strategy statement and secondly to make the Committee aware of the impending requirement to comply with the recommendations of the Taskforce on Climate-related Financial Disclosures.

Officers Recommendations

That the Pension Fund Committee:

1. Approved the revised Responsible Investment section of the Investment Strategy Statements, and
2. Note the work that officers and investment advisors will undertake in preparation for the anticipated requirement to comply with the framework established by the Taskforce on Climate-related Financial Disclosures.

1. WHY THIS REPORT IS NEEDED

Updating of Investment Strategy Statement

1.1 The Pension Fund Committee have considering their approach to responsible investment (RI) and in particular the incorporation of environmental, social & governance (ESG) factors into investment decision making since the summer of 2019, mostly notably via the training on 11 November 2019 and the survey of members' attitudes that followed. The Committee concluded last July that there should be more emphasis on responsible investment (RI) and pooling within the portfolio. Reference to RI was intended to mean all aspects of ESG. Hymans Robertson (investment advisor) have proposed that the Committee prepare a Responsible Investment Policy note that would set out the approach taken by the Committee to RI, it's beliefs and how these would be implemented. This appears sensible as a reference point as the Committee are currently reshaping the investments to enhance both sustainability and pooling. Knowing the Committee's reluctance to generate additional paperwork, officers are proposing that as an alternative the beliefs underlying decision making are reflected in an amended section of the investment strategy statement (ISS). The proposed and current sections of the ISS are attached (appendix 1)

1.2 The beliefs that emerged from the survey as subsequently discussed at Committee have been recorded as:

Well run companies will generate better long-term returns

Incorporating a regard for ESG into investment decision making will help mitigate risk such as climate change.

The Fund should avoid/limit exposure to securities where environmental, social or governance aspects will be financially detrimental to the portfolio.

The change to a low carbon economy offers both opportunities and risks.

Engagement, particularly in collaboration with other investors, is a better approach than disinvestment, although the latter may be appropriate when engagement will not achieve the Committee's goals.

Obtaining the best long-term financial outcomes remains the primary objective of investment policy and ESG is a factor, but not the only factor in choosing investments

1.3 If the Committee is satisfied that these statements reflect their beliefs, they are asked to approve the amendment to the ISS contained within appendix 1.

Taskforce on Climate-related Financial Disclosures

1.4 The Government has previously consulted on requiring private sector pension schemes to manage and report on climate related risk using a framework developed by the Taskforce on Climate Related Financial Disclosures (TCFD). A copy of the framework is attached (appendix 2). It is expected that this requirement will be extended to public sector schemes. The purpose of the Government's proposals is to require pension schemes to put in place appropriate governance arrangements to ensure that climate risks and opportunities are being considered. Also to "allow trustees to demonstrate better how consideration of climate-related risks and opportunities is integrated into their scheme's entire governance and decision-making processes." While application to LGPS has not been confirmed, it does appear likely and is a matter of relevance to the decisions the Committee will be taking at the meeting.

1.5 The framework has four dimensions which are: governance, strategy, scenario analyses and metrics & targets. Regulations may include an additional dimension relating to knowledge and Understanding. Essentially it is a risk-based approach, with a nod to considering the opportunities. Statutory guidance is expected to specify the types of metric that may be employed and how the framework should be used. In particular, it is expected that the use of Weighted Average Carbon Intensity [Emissions per unit sales for each portfolio company, weighted by the size of the allocation to each company in the portfolio] will be included in guidance as the preferred emissions-based metric.

1.6 Based on value of fund, Governance requirements for Barnet Pension Fund will be required from I October 2022, with the first report latest 31 October 2023. The requirements for schemes in excess of £5 billion commence one year earlier therefore it is expected that we will be able to review over the next year the approaches adopted by larger schemes in determining our own approach. We have been assured that corporates, fund managers and other regulated entities (investment advisors) will be subject to the same requirements. The Government have made clear that the proposed private sector regulations do not give it the power to direct schemes or set their investment strategies. However, Government already have such powers for the LGPS introduced to facilitate pooling. In reference to metrics & scenario analysis they will also caveat the requirements with "as far as they are able" i.e. the required data is available and also that immateriality may be a limiting factor and possibly where costs are prohibitive (complex investment structures). It is assumed that the requirements apply to all asset classes.

1.7 The government has also signalled a future intent to consult on "Paris alignment reporting" and the potential obligation for pension schemes to report on the implied warming potential of a portfolio. However, they appear to realise the complexity and imprecision noting that the Paris accord was never written with investors in mind.

<u>Next Steps</u>

1.8 As mentioned above there are good reasons for taking a wait and see approach over the next twelve months:

- The current proposals do not yet apply to the LGPS,
- Statutory guidance will be published, and
- Schemes of the size of Barnet have a year longer than larger pension schemes to implement the proposals thus offering an opportunity to learn and cherry pick approaches most suitable.

1.9 However, it is suggested that the following actions are taken in 2021:

- Update the Committee when LGPS regulations and guidance is issued,

- Engage with investment managers (including LCIV) and advisors to determine how they will meet their responsibilities, particularly in relation to the provision of data,
- Ask managers presenting to the Committee to focus on TCFD compliance and RI integration into investment processes,
- Monitor the approaches taken by larger schemes and ascertain suitability for LB Barnet, and
- Review Committee training needs.

1.10 A further report will be made once draft LGPS regulations are published.

2. REASONS FOR RECOMMENDATIONS

2.1 The LGPS (Management and Investment of Funds) Regulations 2016 (Regulation 7(7)) requires the Committee to periodically (at least every three years) review the investment strategy and publish a statement of any revisions made. The Regulations also require the Scheme's Investment Strategy Statement to the Committee's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 Alternatives will be considered when TCFD regulations and guidance applicable to LGPS are issued.

4. POST DECISION IMPLEMENTATION

4.1 There will be regular feedback to the Committee on actions taken.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 Good management of the Pension Fund will minimise the cost of providing benefits thus enabling funds to be directed to Council priorities.

5.2 Resources (Finance and Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 There are no direct resources issues however changes in the financial performance of the pension fund affects the pension fund deficit reflected in the Authority's accounts and the level of contributions payable by the Council and other employers.

5.3 Social Value

5.3.1 The Public Services (Social Value) Act 2012 came into force on 31 January 2013. It requires people who commission public services to think about how they can also secure wider social, economic and environmental benefits.

5.3.2 Before they start the procurement process, commissioners should think about whether the services they are going to buy, or the way they are going to buy them, could secure these benefits for their area or stakeholders.

5.3.3 The Act is a tool to help commissioners get more value for money out of procurement. It also encourages commissioners to talk to their local provider market or community to design better services, often finding new and innovative solutions to difficult problems.

5.3.4 There are no specific social value issues arising out of this report, however membership of the Pension Fund ensures the long-term financial health of contributing employees on retirement.

5.4 **Legal and Constitutional References**

5.4.1 The LGPS (Management and Investment of Funds) Regulations 2016 (Regulation 7(7)) requires the Committee to periodically (at least every three years) to review the investment strategy and publish a statement of any revisions made.

5.4.2 The Council's Constitution – Article 7 – includes within the responsibilities of the Pension Fund Committee, (1) the approval of the Investment Strategy Statement (ISS) and (2) the appointment of investment managers. This paper considers factors that will influence the asset allocation set out in the ISS.

5.5 **Risk Management**

5.5.1 Risk management is central to the LGPS; which are in themselves risk management tools, managing the risk that future employer income streams will be able to meet future pensions liabilities by creating a reserve from which future liabilities will be met.

5.5.2 Understanding the causes of sources and variabilities of scheme returns informs the management of investment and funding risk.

5.6 **Equalities and Diversity**

5.6.1 Pursuant to the Equality Act 2010, the Council is under an obligation to have due regard to 1) eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; 2) advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and 3) fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation. The Council also has regard to the additional protected characteristic of marriage and civil partnership even though this does not apply to parts 2) and 3) (above) of the public-sector equality duty.

5.7 **Corporate Parenting**

5.7.1 Not applicable in the context of this report.

5.8 **Consultation and Engagement**

5.8.1 Including Local Pension Board members in training and in the beliefs survey will enable the Committee to consider the views of scheme member and employer representatives.

5.9 **Insight**

5.9.1 Not applicable

6. BACKGROUND PAPERS

6.1 Pension Fund Committee 21 November 2019, agenda item 12 – Responsible Investing

https://barnet.moderngov.co.uk/ieListDocuments.aspx?CId=191&MId=9920&Ver=4

Pension Fund Committee 27 July 2020, agenda item 9 – Responsible investing

https://barnet.moderngov.co.uk/ieListDocuments.aspx?CId=191&MId=10149&Ver=4

Appendix 1

Revision to Investment Strategy Statement

<u>Proposed revised RI section</u>

How Responsible Investment (social, environmental and corporate governance considerations and stewardship) are taken into account in the selection, non-selection, retention and realisation of investments

In this section responsible investment (RI) refers to investment practices that integrate the consideration of environmental, social and governance (ESG) factors into investment management processes and ownership practices recognising that these factors can have a material impact on financial performance. Stewardship and governance refer to acting as responsible and active investors/owners, through considered voting of shares, and engaging with investee company management as part of the investment process.

<u>Beliefs</u>

The Pension Fund Committee (The Fund) has reviewed its responsible Investment beliefs with the assistance of a workshop facilitate by its investment advisor and external speakers. This was followed up with a survey of members of both the Pension Fund Committee and Local Pension Board. As a consequence the Committee has expressed the following beliefs with regards to Responsible Investment.

- Well run companies will generate better long-term returns.
- Incorporating a regard for ESG into investment decision making will help mitigate risk such as climate change.
- The change to a low carbon economy offers both opportunities and risks (stranded assets).
- The Fund should avoid/limit exposure to securities where environmental, social or governance aspects will be financially detrimental to the portfolio.
- Engagement, particularly in collaboration with other investors, is a better approach than disinvestment, although the latter may be appropriate when engagement will not achieve the desired outcomes.
- Obtaining the best long-term financial outcomes remains the primary objective of investment policy and ESG is a factor, but not the only factor in choosing investments

These beliefs will be reviewed annually and will be taken into consideration when making investment decisions both in relation to setting and implementing investment strategy.

The Fund is committed to be a long-term steward of the assets in which it invests and expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills. In addition training is taken on a regular basis and this will include matters of social, environmental and corporate governance.

<u>Implementation of Beliefs</u>

The Fund has agreed that investment sustainability and pooling should be enhanced. In doing so the following actions will be / have been taken:

1. The majority of passive quoted equities are currently invested in line with either market capitalisation or a value based index. Consideration will be given to changing the indices to one's that incorporate ESG factors into the selection of investment particularly with the aim of reducing exposure to climate changing emissions and preferring companies with good social and governance practices.
2. Consideration of moving assets from passive equities to pooled active equities that have a strong sustainability approach to the selection of investments.
3. Consideration of investing into other products offered by the London CIV that focus on opportunities with sustainability characteristics e.g. renewables.
4. Monitor through regular dialogue and reporting that appointed investment managers, including the London CIV (1) integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments, and (2) use their influence, including through collaboration where appropriate, to promote good practice in the investee companies and markets to which the Fund is exposed.
5. Periodic qualitative and quantitative reviews of the ESG risks within the portfolio and consideration of alternatives.

<u>Social Investment</u>

The Fund is consistent in the application of risk and returns requirements when evaluating all investment opportunities, including those that address societal challenges. The Fund would invest in opportunities that address societal challenges but generate competitive financial returns. Seeking such opportunities is generally delegated to our external fund managers but will be a factor in selecting managers and investee funds.

<u>Reporting of Responsible Investment Outcomes</u>

It is expected that the Fund will be required to manage and monitor its exposure to climate change using the framework developed by the Taskforce on Climate-related Financial Disclosures. The Fund will develop its approach to compliance with the framework during 2021 & 2022. Where possible, reporting will also incorporate the social and governance aspects to RI. In doing so, the Fund will take a long-term view on RI, including the direction of travel as well as the current implementation.

The exercise of rights (including voting rights) attaching to investments

Voting rights

The Committee has delegated the exercise of voting rights to the investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the Fund's managers have produced written guidelines of their process and practice in this regard. The managers are strongly encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2)(f). The Committee monitor the voting decisions made by all its investment managers on a regular basis.

Stewardship

The Fund fully endorses the principles embedded in the Stewardship Code. The Fund will be reviewing this position during 2021-22 and will consider becoming a signatory to the Code as part of this review.

In addition, the Fund expects its investment managers to work collaboratively with others if this will lead to greater influence and deliver improved outcomes for shareholders and more broadly.

The Fund through its participation in the London CIV will work closely with other LGPS Funds in London to enhance the level of engagement both with external managers and the underlying companies in which it invests.

The Committee expects both the London CIV and all directly appointed fund managers to also comply with the Stewardship Code and this will be monitored on an annual basis.

The Fund is a member of the Local Authority Pension Fund Forum and Pension and Lifetime Savings Association and in this way joins with other investors to magnify its voice and maximise the influence of investors as asset owners.

END

Existing ESG & Stewardship section

How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments

It is recognised that ESG factors can influence long term investment performance and the ability to achieve long term sustainable returns. The Committee consider the Fund's approach to responsible investment in two key areas:

• **Sustainable investment / ESG factors** – considering the financial impact of environmental, social and governance (ESG) factors on its investments.

• **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.

The Fund is committed to be a long-term steward of the assets in which it invests and expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills. In addition the Panel undertakes training on a regular basis and this will include training and information sessions on matters of social, environmental and corporate governance.

The Fund requires its investment managers to integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments. It expects its managers to follow good 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.

The Fund expects its external investment managers (and specifically the London CIV through which the Fund will increasingly invest) 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. The Fund expects its fund managers to integrate material ESG factors within its investment analysis and decision making.

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, the Fund expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

The Fund will invest on the basis of financial risk and return having considered a full range of factors contributing to the financial risk including social, environment and governance factors to the extent these directly or indirectly impact on financial risk and return.

The Fund in preparing and reviewing its Investment Strategy Statement will consult with interested stakeholders including, but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with.

The exercise of rights (including voting rights) attaching to investments

Voting rights

The Committee has delegated the exercise of voting rights to the investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the Fund's managers have produced written guidelines of their process and practice in this regard. The managers are strongly encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2)(f). The Committee monitor the voting decisions made by all its investment managers on a regular basis.

Stewardship

The Fund has not issued a separate Statement of Compliance with the Stewardship Code, but fully endorses the principles embedded in the 7 Principles of the Stewardship Code. The Fund will be reviewing this position in 2017-18 with a view to formally adopting the Code.

In addition, the Fund expects its investment managers to work collaboratively with others if this will lead to greater influence and deliver improved outcomes for shareholders and more broadly.

The Fund through its participation in the London CIV will work closely with other LGPS Funds in London to enhance the level of engagement both with external managers and the underlying companies in which it invests.

The Committee expects both the London CIV and any directly appointed fund managers to also comply with the Stewardship Code and this will be monitored on an annual basis.

The Fund is a member of the Pension and Lifetime Savings Association and in this way joins with other investors to magnify its voice and maximise the influence of investors as asset owners.

End

Requirements for Investment Strategy Statement

In formulating and maintaining their policy on social, environmental and corporate governance factors, an administering authority:-

- **Must take proper advice**
- **Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors**
- **Must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments**
- **Should explain their approach to social investments**

In formulating their policy on the exercise of rights, administering authorities:-

- **Must give reasons in their Investment Strategy Statement for not adopting a policy of exercising rights, including voting rights, attaching to investments**
- **Should, where appropriate, explain their policy on stewardship with reference to the Stewardship Code**
- **Should strongly encourage their fund managers, if any, to vote their company shares in line with their policy under Regulation 7(2)(f)**
- **May wish to appoint an independent proxy voting agent to exercise their proxy voting and monitor the voting activity of the managers, if any, and for reports on voting activity to be submitted annually to the administering authority**
- **Should publish a report of voting activity as part of their pension fund annual report under Regulation 57 of the 2013 Regulations**

Appendix 2

Taskforce on Climate-related Financial Disclosures – Framework

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TCFD Area	Requirement	Suggested LB Barnet Actions (draft)
Governance	• Establish and maintain oversight of climate related risks and opportunities • Establish and maintain processes that allow the trustees to satisfy themselves that those managing the scheme are assessing and managing climate related risks and opportunities	Annual Report on risks within portfolio v benchmark and review of opportunities as part of strategy update Annual report on the climate related risk and opportunities in relation to each portfolio in the fund.
Strategy	• Identify climate related risks and opportunities that will impact the investment and, for DB schemes, funding strategy of the scheme over different time horizons • Assess the impact of identified risks and opportunities on the scheme's investment and, for DB schemes, funding strategy	tbc tbc
Scenario analysis	• At least annually, assess the resilience of the scheme's assets, liabilities and investment and, for DB schemes, funding strategy to climate related risks in at least two scenarios (including one scenario that reflects an annual temperature rise of 1.5 to 2 degrees.	tbc
Risk management	• Adopt and maintain processes for identifying, assessing and managing climate-related risks • Ensure the integration of climate-related risks into overall risk management	tbc Amend the risk register to incorporate the risk identified above.
Metrics	• Select at least one GHG emissions and one non-emissions metrics against which to assess scheme assets against climate related risks and opportunities • At least quarterly, obtain the Scope 1/2/3 emissions of the portfolio and calculate the selected emissions metric • At least quarterly, obtain the necessary data and calculate the non-emissions metrics	Metrics to be selected. Discuss with investment adviser & managers the processes for undertaking the measurement of the selected emissions metric. Discuss with investment adviser & managers the processes for undertaking the measurement of the selected non-emissions metric.
Targets	• At least annually, set one target to manage climate relate risk with respect to the chosen metrics and measure performance against this target at least quarterly.	Once metric has been selected (above) are target. NB targets are not legally binding and can be altered.

Additional Area to be reflected in Private Sector Regulations

Knowledge & Undertaking	K&U requirements to include (1) the principles relating to the identification, assessment and management of risks arising to occupational pension schemes from the effects of climate change, including steps taken because of climate change (whether by governments or otherwise); and (2) the principles relating to the identification, assessment and management of opportunities relating to climate change for such schemes.	To be incorporated into training plans.