	Pension Fund Committee **11 July 2022**
Title	**Developing the Fund's Responsible Investment strategy**
Report of	Executive Director of Resources (S151 officer)
Wards	N/A
Status	Public, with exempt appendix.
Urgent	No
Key	No
Enclosures	Appendix A – tCO2 emissions from the Pension Fund's listed equity investments Appendix B – Hymans paper around emissions and ESG performance **(exempt)** **Exempt enclosures - Not for publication by virtue of paragraphs 3 of Part 1 of Schedule 12A of the Local Government Act 1972 as amended (information relating to the financial or business affairs of any particular person (including the authority holding that information).**
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Summary

This report provides the Pension Fund Committee with an update on matters relating to Responsible Investing ("RI") with a view to further progressing the Fund's strategy in this area.

Specifically, this report covers:

- A high-level background of actions taken to date in relation to RI
- The wider Regulatory environment and action taken by other LGPS Funds
- An initial summary of the Carbon Baseline of the Fund and general ESG performance
- Suggested Next Steps to facilitate the development of the Fund's RI policies generally and, in particular, to set a pathway to Net Zero

Officer Recommendations
The Pension Fund Committee is requested to agree (1) a dedicated training session and workshop to be held in the autumn with the purpose of establishing a Net Zero strategy, and (2) to review the RAFI fund against possible low emission alternatives.

WHY THIS REPORT IS NEEDED

1.1 Setting metrics and targets around climate change has gained momentum within the LGPS community with around a quarter of funds now declaring a Net Zero target (as of March 2022).

1.2 In addition, the Council has recently declared a "Climate Emergency" and has brought forward its aspirational target date to make Barnet "Net Zero" as a place (from 2050 to 2042).

1.3 The Council has done substantial work to understand its Carbon Footprint at an operational level and is developing its strategy to reduce its Carbon Footprint over time.

1.4 To support the development of the Pension Fund Committee's sustainability strategy this paper summarises:

- the steps the Pension Fund Committee has taken to date around Responsible Investment ("RI");
- sets out the regulatory framework and what other LGPS funds are doing;
- provides an estimate of the Fund's total Carbon emissions in metric tonnes (referred to as units of tCO2) for its listed investments; and
- sets out possible next steps to develop its RI strategy, including setting a target for the Fund to reach Net Zero.

Summary of steps taken to develop a Responsible Investment strategy

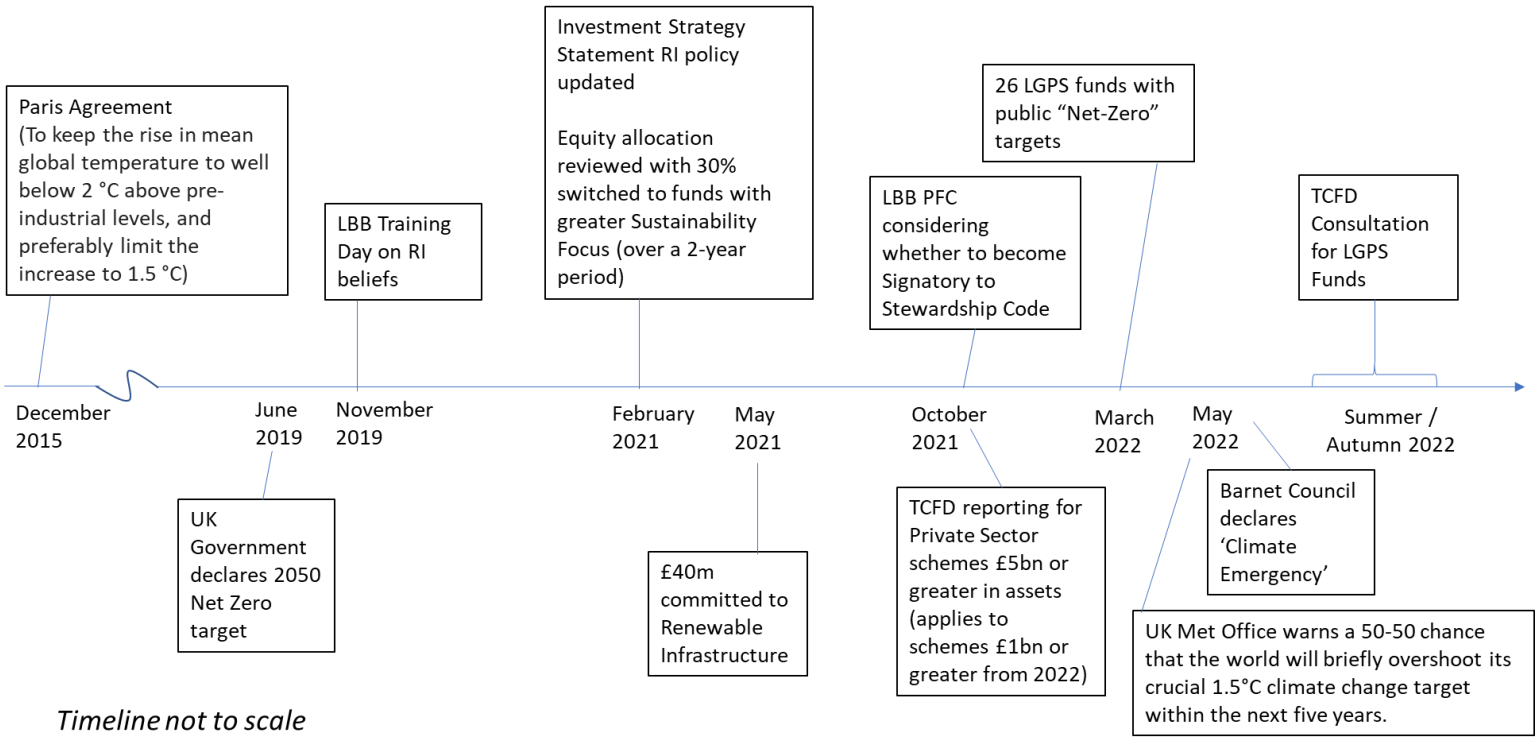
1.5 The Pension Fund Committee started to develop its RI strategy in earnest in November 2019 following a full day's training on sustainability issues. The key milestones met since that session were to:

1.5.1 Make more explicit reference towards RI within the Fund's Investment Strategy Statement (finalised in October 2021)
1.5.2 To rework the Fund's listed equity allocation to have a higher focus on sustainability (February 2021)
1.5.3 To commit £40m to a dedicated LCIV Sustainable Infrastructure Fund (May 2021)

1.6 This work has been against a background of increased focus on sustainability of investment capital in general and of targeting a 'Net Zero' position specifically. The timeline below illustrates some of the key milestones for the Barnet Pension Fund. Of note is an expected requirement for LGPS funds to

report extensively on its CO2 emissions and climate risk through Task-force for Climate related Financial Disclosure ("TCFD") reporting.

High-level timeline of actions taken towards developing a Responsible Investment strategy:

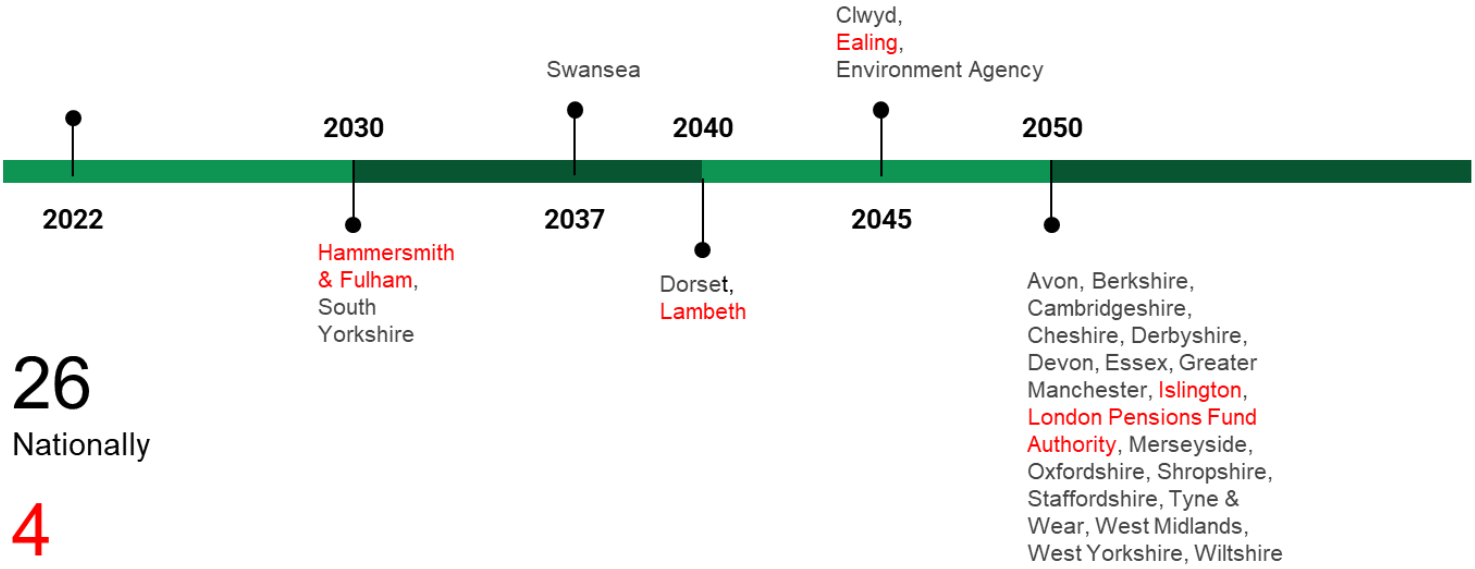


Timeline not to scale

1.7 In March 2022 the LGPSplus.com reported on LGPS Funds that had declared an aspirational Net Zero target. The findings of this report are illustrated below (26 Funds nationally, with four based in London)

1.8 In addition, the London Collective Investment Vehicle (London CIV) has a target for its funds to be Net Zero by 2040.

LGPS Funds with Net Zero targets



26
Nationally

4
London Boroughs

Source: LGPSplus.com

The Pension Fund's Carbon Baseline

1.6 To support the Pension Fund Committee with the development of its RI strategy, the Pensions Team commissioned Hymans Robertson to collate the Fund's emissions from its listed investments holdings. The Pension Team have restricted this exercise to listed investments as the availability of data from non-listed investments is limited.

1.7 A key observation from the Hymans report is that the Fund's listed equity RAFI allocation contributes significantly to the overall emissions generated by the Fund - RAFI has an ultimate target of around 22% of the Fund's listed equity allocation, but is projected to contribute towards around 70% of the Fund's listed equity tCO2 emissions – i.e. RAFI contributes around 3x the level of Carbon emissions relative to its allocation.

1.8 The Pension Fund Committee are already aware that RAFI is likely to produce relatively high Carbon Emissions as this was a key driver to reduce the RAFI allocation from 20% of Fund assets to 10% of Fund assets.

1.9 It should also be noted that the RAFI fund provides important diversification benefits and has performed relatively well over the 12-moths to 31 March 2022 (11.6% p.a. relative to an overall Fund return of 7.4% p.a.) – this is likely to be, in some part, due to its higher relative weighting to value based stocks, which have performed well over recent months.

1.10 If the Pension Fund Committee has an objective of reducing the carbon emissions from its investments, then reviewing the RAFI allocation would be a relatively straightforward first step.

How does the Pension Fund emissions relate to the Council's emissions?

1.11 On a Scope 1 and Scope 2 measure, and as an order of magnitude as the data is very limited, the Pension Fund investments are likely to generate around 5x – 10x the emissions that are generated directly by the Council. However, it should be noted that reducing the Council's carbon footprint has a real world impact, but reducing the Pension Fund's emissions through divestment arguably does not have a real world impact on carbon emissions.

1.12 Appendix C provides a summary of the key statistics of Carbon emissions from the Fund's listed investments collated from the Hymans report. Hymans' report is included as Appendix D.

Broader considerations in setting a Net Zero target

1.13 The market in "climate friendly" funds has expanded significantly in recent years and, in theory, it could be possible for the Fund to switch to a Net Zero target over a relatively short time frame (say 2 to 3 years). However, there are many considerations that need to be borne in mind which means a longer time frame is likely to be needed in practice.

1.14 The table below summarises some of the key considerations that the Pensions Fund Committee will need to take before setting its Net Zero strategy:

Consideration	Comment
Fiduciary Responsibility	As the body responsible for the investment of Pension Fund money, the Pension Fund Committee has a Fiduciary Responsibility to act with due care. The primary objective of the Committee is to ensure that sufficient return is generated from the investments given an acceptable degree of risk. Any strategy around sustainability needs to bear this in mind and carefully consider the impact on return and risk from any decisions made. Carefully considering climate change impacts may help reduce overall investment risk. An issue at present is that the market for 'climate friendly' funds is relatively narrow meaning that important diversification benefits can be lost if the focus on sustainability is too high. If the Pension Fund assets underperform there could be a knock-on impact due to increases in contribution rates

Consideration	Comment
	on the ability of the Council to deliver essential services and meet its own goals around sustainability.
Pace of change	Whilst a high proportion of the Fund's investments are very liquid (i.e. can be sold quickly and easily without impacting the realisable value), a relatively high proportion of assets are not liquid. This places a natural restriction on how quickly the portfolio can be changed. Understanding the maturity profile of the current portfolio will be a key part of any transition to a low carbon portfolio. We currently estimate that around 20% - 40% of the Fund's assets have a maturity profile of 3 years or longer. We are working with Hymans to establish a more refined picture of when assets can realistically be liquidated. In addition, the market for 'sustainable' options in certain asset classes is limited and ignoring those asset classes could mean important diversification benefits are lost.
Engagement vs. divestment	Some investors have taken a policy of divesting from certain sectors (e.g. Fossil Fuel or Tobacco industries). Notwithstanding any Fiduciary considerations, a factor here is whether diverting capital from companies actually does incentivise particular behaviours. This is because the ultimate pool of capital is incredibly deep and so action from a relatively small number of investors does not necessarily influence asset prices significantly. By divesting an investor may simply transfers assets to other owners who may not have the same objectives around sustainability. In addition, companies that appear to deliver high emissions today may be developing technologies that will help society to reduce emissions in the future, therefore any divestment policy needs to be carefully considered against a clear set of objectives, including the potential impact of divesting and what steps could be taken to increase engagement and encourage good behaviours.
Physical Risk	Climate change creates potential physical risks to invested assets in terms of the impact of severe or changed weather on the services or product development

Consideration	Comment
	that a particular company delivers. This might be at a sector level or a geographical level. Understanding how a portfolio is potentially impacted by physical risks is a key part to any sustainability strategy.
Climate Solutions	Supporting ventures or companies that are seeking to develop climate solutions could deliver wider benefits to Society broader than the return on capital invested. Having an explicit allocation to climate solution funds is a positive way a pension fund can contribute to managing climate change, however, the investment risks from such investments would need to be understood.
Pooling	The London CIV has an objective to become Net Zero by 2040. Any policy developed by the Pension Fund Committee needs to consider what LCIV is seeking to achieve and able to deliver.
Macro picture	Investment markets have experienced a substantial period of low inflation, supportive Monetary Policy towards maintaining capital values, e.g. through Quantitative Easing, and a high degree of global connectively. This environment around investment markets may be changing, which may trigger a broader review of investment strategy and may also increase overall investment risk. In addition, the liability profile of the Pension Fund is maturing, with the possibility that the Fund becomes cash flow negative over the next few years, which may further cause a refresh of the underlying strategic allocation. These factors need to be borne in mind when considering and developing the Fund's Responsible Investment strategy.

Consideration	Comment
Engagement	Any policies in relation to the Pension Fund impacts a number of stakeholders. The three key groups of stakeholders (other than the Local Authority) are: 1) Other Pension Fund employers (e.g. Middlesex University and Barnet & Southgate College) 2) Barnet Council Tax payers (who ultimately underwrite the Pension Scheme) 3) Pension Fund members Given the importance of the subject and its increasing high profile with the General Public, the Pension Fund Committee should consider how it engages with stakeholder groups.
Disclosure	The DLUHC is expected to launch a consultation on Disclosure Requirements relating to climate change for LGPS funds later this year (TCFD reporting). Whilst this consultation will be focused on disclosure requirements rather than actions, having a formulated policy around climate change will help support any disclosures made.
Nature Positive vs. Net Zero and wider ESG considerations	Whilst there is a large focus on achieving a Net Zero position from an emissions perspective, the Pension Fund Committee may also wish to consider how its investments impact the world in a broader way – i.e. the impact on other aspects of natural capital and / or the social impact of any investments made.

Training requirements

1.10 Given the complexity of setting a Net Zero strategy the Pensions Fund Committee will need extensive training on the issues. In addition, whilst aspirations can easily be set, implementing any strategy is likely to be a major undertaking that will need to evolve over time.

1.11 Because establishing a strategy may take time to work through, we recommend that the Pension Fund Committee devotes a day towards training and workshops with the objective of developing its key principles and objectives. This will help expediate the process for developing and implementing any strategy.

Indicative timeframe

1.12 At a high level we believe operating to the following timeframe is likely to be achievable – note that this timeline will need to evolve and be developed:

Period	Action
July – December 2022	- Review listed equity portfolio (RAFI) - Review listed credit portfolio - Training session / workshops with objective of formulating views and setting priorities and principles - Develop aspirational strategy to reach Net Zero - Further develop and refine Stewardship strategy
January – June 2023	- Document principles around Responsible Investment and reporting - Consider approach to non-liquid investments - Wider review of investment strategy (e.g. strategic allocation to asset classes) - Develop implementation plan around transition to Net Zero

Wider Environment, Sustainability and Governance considerations (ESG)

1.13 Hymans' have also considered the Fund's listed investments from a wider ESG perspective – see page 3 of Appendix [X].

1.14 In summary, the Fund's listed investments perform marginally better than the Composite Benchmark. The Pension Fund Committee may wish to discuss with Hymans whether the improvement in ESG scores is significant relative to the increased cost of investing with ESG focused funds and what further steps could be taken to improve the Fund's ESG ratings.

2. REASONS FOR RECOMMENDATIONS

2.2.1 The Council has ambitious plans to meet it responsibilities around sustainability generally and climate change specifically. The Pension Fund is a significant contributor to overall emissions. The recommendations will accelerate the development of the Pension Fund's RI strategy and therefore support the Council in meeting its overall objectives around sustainability and climate change.

3.2.1 In addition, further regulation is expected which will require the Pension Fund to report on certain aspects of climate change and the actions recommended will support the Pensions Committee with complying with those regulations.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1.1 Not applicable.

4. POST DECISION IMPLEMENTATION

4.1.1 Not applicable

5. IMPLICATIONS OF DECISION

5.1.1 Corporate Priorities and Performance

5.1.2 Good management of the Pension Fund, including developing governance around climate change and ESG, 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.

5.6.2 The rules governing admission to and participation in the Pension Fund are in keeping with the public-sector equality duty. The Public Sector Equality Duty requires public authorities in carrying out their functions, to have due regard to the need to achieve the objectives set out under s149 of the Equality Act 2010.

Good governance arrangements will benefit everyone who contributes to the fund.

5.7 Corporate Parenting

5.7.1 Not applicable in the context of this report.

5.8 Consultation and Engagement

5.8.1 Not required, although consultation may ultimately be needed before formalising any specific targets around Net Zero.

5.9 Insight

5.9.1 Not applicable

6. ENVIRONMENTAL IMPACT

6.1 None

7. BACKGROUND PAPERS

7.1 None