Pension Fund Committee
11 January 2024

Title	Responsible Investment Update
Date of meeting	11 January 2024
Report of	Executive Director of Strategy & Resources (S151 Officer)
Wards	N/A
Status	Public
Urgent	No
Appendices	None
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Summary

This report provides an update on the actions we have taken to further progress the Fund's NetZero strategy, specifically, we have investigated what a "Paris Aligned" Fund means in practice and the options for us to pursue this type of Fund for our equity holdings and we have started to explore Nature Based Assets in partnership with the London CIV and other Investment Managers.

Recommendations

The Committee is asked to note the contents of this report and the progress made towards NetZero.

1. Why This Report is Needed

Context

1.1 To help Barnet Council achieve its ambitious climate change goals, the Barnet Pension Fund has devised a strategic plan known as the 'BarNetZero 2030 Model Portfolio'. This plan outlines how the pension fund could, in theory, align its investments with climate-friendly objectives and work towards achieving a nearly zero carbon footprint by the year 2030.

1.2 Details of this model were set out within our Responsible Investment paper shared at the 2 November 2023 Pension Fund Committee meeting.

1.3 Our Model Portfolio has informed two workstreams:

- First, seek to reduce the carbon footprint in our core investments (i.e. our equities, bonds and property), aligning them with the goals set by the 2015 Paris Agreement. We believe this can be achieved without taking on excessive risks.
- It then subsequently sets an approach where we would allocate a portion of our investments to 'offsetting' assets to neutralize any remaining carbon emissions generated by our portfolio.

Paris Alignment

1.4 The 2015 COP21 Paris Climate Summit aimed to generate momentum towards tackling climate change, and as a result the idea that companies and organisations should take responsibility to cut emissions was developed. This has led to a framework for companies/organisations to cut emissions in a practical way.

1.5 The framework also set our three actions that companies/organisations must do in order to align themselves with the agreement:

- Stabilising Greenhouse gases at a level which will increase global temperature below 2°c by 2050.
- Increasing the ability of countries to adapt to climate change.
- Ensuring finance flows to support climate-resilience and low-carbon development.

What is a Paris Aligned Fund

1.6 A Paris Aligned Equity Fund would set its allocation against a “Paris Aligned” Benchmark, which is defined by the EU as “where the underlying assets are selected in such a manner that the resulting benchmark portfolios greenhouse gas emissions are aligned with the long-term global warming target of the Paris Agreement and is also constructed in accordance with the minimum standards laid down in the delegated acts.”

1.7 These funds will invest in equities of companies that either, have a low or reducing carbon intensity or are delivering solutions to tackle the challenge of climate change.

1.8 In general, Sectors such as the Financial Sector and / or Technology Sectors tend to score well against these measures. As these Sectors have a “growth” tilt, Paris Aligned Funds also tend to have a “growth” tilt – i.e. companies that are more bias towards growing beyond their fundamental value. For this reason, it can be challenging to develop a Paris Aligned Fund that has a “Value” tilt, i.e. companies where there is a tangible nature to their value, either through the strength of their balance sheets or due to the capabilities around production, although the RAFI proposal covered in 1.12 to 1.14 is an attempt to offer a “value” Paris Aligned fund.

Real World Impact and Investment case for investing within a Paris Aligned Fund

1.9 Whilst investing in Paris Aligned funds would help reduce the Fund's Carbon Emissions, the Committee should also seek to understand the investment case for switching investments in this way and what the Real World impact is from making the change is.

How do our equity Funds currently comply with Paris Alignment

1.10 The table below summarises are current allocation to equities, their general style, whether they are Paris Aligned and whether there is an alternative we could explore:

Fund	AUM 30/09/2023	Style	Paris Aligned?	Possible Alternative?
Future Worlds	£196.7m	Growth tilt	No	LCIV PEPPA (see 1.10 and 1.11 below)
RAFI	£93.5m	Value tilt	No	RAFI Global Low Carbon Transition Index (see 1.12 to 1.14 below)
Sustainable Exclusion	£39.6m	Growth tilt	No *ESG focused fund*	N/A given ESG focus?
Emerging Markets	£65.5m	Growth tilt	No	EM Paris Aligned Funds are less developed

Spotlight on LCIV Passive Equity Progressive Paris Aligned (PEPPA) Fund

1.11 LCIV launched the PEPPA fund in late 2021, with the aim of tracking the S&P Developed Ex-Korea Large MidCap Net-Zero 2050 Paris Aligned ESG Index (GBP). The benchmark/index is based on the S&P Developed Ex-Korea LargeMidCap Index, weighted to be collectively compatible with a 1.5°c global warming climate scenario, and aims to meet the requirements of the EU Paris Aligned Benchmark standard.

1.12 The benchmark brings about a 7% CO2 reduction year-on-year, with exclusions on fuels and fossil-fuels and limits on how companies produce their energy. LCIV consider the benchmark to be more ambitious than other Paris Aligned indices, not only as it aims for the 1.5°c increase but as it also brings in an element of green revenues (funding transition of companies from brown to green energy). LCIV also feel the benchmark provides good quality data from TruCost, which captures data in a robust and meaningful way and they also note the stewardship aspect of the PEPPA fund, where individual investors can vote on the holdings of the fund.

Spotlight on potential RAFI index

1.13 The RAFI Fundamental Low Carbon Transition Index strategy provides the benefits of RAFI's Fundamental Index approach, while offering investors a pathway to net neutral emissions through an immediate 30% reduction in carbon-intensity level relative to the market and additional 7% reduction each year. Security weights are determined by using fundamental measures of company size (adjusted sales, adjusted cash flow, dividends + buybacks, and book value + intangibles) rather than price (market cap).

1.14 RAFI achieves this by taking the underlying RAFI Fundamental Index and adapting it to achieve Carbon reduction objectives. These objectives are to exclude coal related companies and those who produce controversial weapons. In addition, we started with a carbon intensity 30% below the market and this self decarbonizes by 7% each year going forward.

1.15 The adjustment uses an algorithm to adjusts all the companies weights up or down depending on their carbon intensity score. More efficient companies within a region and sector get an uplift at the expense of those that are less carbon efficient. This algorithm runs multiple times until carbon intensity is reduced in line with the target.

Focus on Natural Capital

1.16 Since the last Pension Fund Committee meeting Officers and the Chair have had several meetings with third parties to build understanding and explore whether Natural Capital is an investable area for the Fund. Recall that our Model Portfolio suggests an allocation of 10% towards Nature Based solution.

A summary of specific actively is set out below:

1.17 **7 November** – London CIV hosted an excellent Natural Capital workshop delivered by Redington. The output from this workshop is accessible on the London CIV's portal as a seven-part MP4 downloadable video and we would encourage all Committee members to consider building into their wider professional development programme.

The parts covered are:

Part 1 - What is Natural Capital

Part 2 - Demystifying Carbon Credits

Part 3 - Deep Dive into Natural Based Solutions

Part 4 - How Forestry Investment works

Part 5 - Sustainable Agriculture

Part 6 - Nature Based Credits

Part 7 - The Blue Economy

The sessions can be accessed via the London CIV portal at www.londonCIV.org.uk. This workshop was a precursor to a Fund that London CIV are looking to develop around Natural Capital and Barnet are an active participation in terms of initial discussions on this Fund.

1.18 **8 November** – Room151 Investment Forum. David Spreckley amongst a Panel of four discussing Natural Capital. Room151 article including quotes from David Spreckley can be accessed here.

1.19 **14 November** – David Spreckley meeting with Stafford Timberland. Discussions centred on Stafford's approach, but also considered how Timberland sequestration could generate yield from the Carbon Credits and the opportunities and risks that potentially arise from this.

1.20 **21 November** – London CIV initial seed investor group meeting for forthcoming Natural Capital Fund. Cllr Radford and David Spreckley attended. Positive discussions on shape of future fund but acknowledgement that much training and work required before the Fund could be investable.

1.21 **23 November** – David Spreckley meeting with Federated Hermes. Discussions around Federated Hermes approach to Timberland investment, but also considered wider Carbon Credit market and risks and opportunity around this.

1.22 **6 December** – Head of Pensions and Treasury and Cllr Radford meeting with Gresham House. Discussions on GH approach to Timberland and considering investment opportunity (demand / supply drivers) and regulatory drivers around Carbon Credit market.

1.23 This will be an area we will continue to focus on during early 2024 and we encourage all Committee members to start reading widely around this new and emerging asset class.

Model Portfolio

1.24 For reference a summary of our Current and NetZero Model Portfolio is provided in the table below.

	Current	Model
Equity	25%	25% *Paris Aligned*
Private Equity	5%	5% *Paris Aligned*
Fixed Income	30%	40% *Paris Aligned*
Property	6%	10% *Paris Aligned*
Infrastructure	8%	0%
Asset Backed Securities	23%	0%
Renewable Infrastructure	3%	10%
Natural Capital	0%	10%
Expected Return (20 years relative to cash)	3.7% p.a.	3.7% p.a.
Variance (1 year)	12.1%	12.8%
Emissions (2030)	225 KtCO2	0 (NetZero)
Emissions (2050)	100 KtCO2	-33 KtCO2

2. Alternative Options Considered and Not Recommended

2.1 Not applicable in the context of this report.

3. Post Decision Implementation

3.1 Not applicable in the context of this report.

4. Corporate Priorities, Performance and Other Considerations

Corporate Plan

4.1 The Pension Fund Committee supports the delivery of the Council’s strategic objectives and priorities as expressed through the Corporate Plan, by careful monitoring of the Pension Fund activities with a view to ensuring the overall sustainability of the Pension Fund.

4.2 Sustainability of the Pension Fund is a crucial pillar in allowing the council to fulfil its wider objectives.

4.3 The Pension Fund is also developing its NetZero and Stewardship policies which feed into the wider objectives around Planet, Places and People.

Corporate Performance / Outcome Measures

4.4 Not applicable in the context of this report.

Sustainability

4.5 Not applicable in the context of this report.

Corporate Parenting

4.6 Not applicable in the context of this report.

Risk Management

4.7 Risk management is central to the LGPS. LGPS pension funds 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. Good governance is essential to managing the risks of the pension fund.

Insight

4.8 Not applicable in the context of this report.

Social Value

4.9 Not applicable in the context of this report.

5. Resource Implications (Finance and Value for Money, Procurement, Staffing, IT and Property)

5.1 Risks that are not mitigated or managed can have a financial penalty to the Fund.

6. Legal Implications and Constitution References

The Council's Constitution – Part 2B section 15.1 includes within the responsibilities of the Pension Fund Committee. The terms of reference for the committee includes: To have responsibility for all aspects of the governance, investment and administration of the LB Barnet Pension fund, including, but not limited to the following: To ensure compliance with all Local Government Pension Scheme statutes, regulations and best practice."

7. Consultation

7.1 Not applicable in the context of this report.

8. Equalities and Diversity

8.1 Pursuant to the Equalities Act 2010, the Council is under an obligation to have due regard to eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and 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, marriage and civil partnership.

8.2 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.

9. Background Papers

9.1 Further discussion on the Fund’s Responsible Investment approach can be accessed from the following links:

January 2023

Developing the Funds Responsible Investment strategy - update.pdf (moderngov.co.uk)

July 2023

230704 Responsible Investment Update - Cleared.pdf (moderngov.co.uk)