Hackney

| REPORT OF THE GROUP DIRECTOR OF FINANCE AND CORPORATE RESOURCES | | |
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| **UPDATE ON CLIMATE CHANGE RECOMMENDATIONS AND PRESENTATION OF CARBON FOOTPRINTING RESULTS**<br><br>**Pensions Committee**<br>**19th September 2016** | **Classification**<br>**PUBLIC**<br>**Ward(s) affected**<br>**ALL** | **Enclosures**<br>**None** |

## 1. INTRODUCTION

1.1 The purpose of this report is to provide an update on the recommendations approved at the January 2016 Strategy meeting in relation to the Pension Fund's approach to investment in fossil fuels. It also provides information on the work undertaken to date on each recommendation as well as setting out indicative timescales for further work.

## 2. RECOMMENDATIONS

**2.1 The Pensions Committee is recommended to note the report and the outcome of the carbon footprinting analysis as presented at the meeting**

## 3. RELATED DECISIONS

- Pensions Committee Strategy Meeting (28th January 2016) – Future workstreams- climate change

## 4. COMMENTS OF THE GROUP DIRECTOR OF FINANCE & CORPORATE RESOURCES

4.1 The Pensions Committee act in the role of quasi trustees for the Pension Fund and are therefore responsible for the management of £1.17 billion worth of assets and for ensuring the effective and efficient running of the Pension Fund. The management of the Fund's investment portfolio and the investment returns that the Fund is able to deliver have significant financial implications, not just for the Fund itself but also on the Fund's employers in terms of the level of contributions they are required to make to meet the Fund's pension promises, which are underwritten by statute.

4.2 The Fund recognises that investment in fossil fuels and the associated exposure to potential 'stranded assets' scenarios may pose material financial risks. These risks apply not only to the Fund's investment portfolio but also, when considered on a wider scale, to long term global economic growth.

4.3 In recognising the risks that climate change and stranded assets scenarios could pose to the Fund, the Committee needs to understand where these risks might apply and how they can best be mitigated within the investment management framework within which LGPS funds operate. The recommendations agreed at the

January Strategy meeting are aimed at developing both a greater understanding of the risks and a set of strategies to help mitigate them.

4.4 The costs involved will very much depend on future decisions made around investment strategy. Climate change risk will be integrated into the forthcoming new Investment Strategy Statement to ensure that it is considered as part of the Committee's asset allocation decisions, rather than in isolation. Potential costs that could be incurred through development of the recommendations below include additional fees for use of low carbon indices; however, any such costs would need to be considered against the potential for risk mitigation and the performance of the mandate as a whole.

## 5. COMMENTS OF THE DIRECTOR, LEGAL

5.1 The Pensions Committee has delegated responsibility for managing all aspects of the Pension including the following from the Committee's Terms of Reference:

- To make arrangements for the appointment of and to appoint suitably qualified pension fund administrators, advisers, investment managers and custodians and periodically to review those arrangements.
- To formulate and publish a Statement of Investment Principles.
- To set the overall strategic objectives for the Pension Fund, having taken appropriate expert advice, and develop a medium term plan to deliver the objectives.
- To determine the strategic asset allocation policy, the mandates to be given to the investment managers and the performance measures to be set for them.
- To monitor the performance and effectiveness of the investment managers and their compliance with the Statement of Investment Principles.

5.2 The Committee has legal responsibilities for the prudent and effective stewardship of the Pension Fund and a clear fiduciary duty in the performance of its functions. The LGPS (Management and Investment of Funds) Regulations 2009 require Administering Authorities to state the extent to which they comply with the Guidance given by the Secretary of State. Statutory Guidance was issued in 2010 covering the 6 updated Myners Principles which include the requirements for those charged with governance to set out how they comply with Effective Decision Making; Clear Objectives; Risk and Liabilities; Performance Assessment; Responsible Ownership; Transparency and Reporting. The recommendations discussed in this report are in line with both the Committee's terms of reference and legal responsibilities.

5.3 There are no immediate legal implications arising from this report.

## 6. BACKGROUND/TEXT OF THE REPORT

6.1 On 28th January 2016 the Pensions Committee held a strategy meeting to consider in detail the Fund's approach to investment in fossil fuels and management of the financial risks posed by climate change. At that meeting, the Committee considered and approved a set of recommendations reflecting both its recognition of these risks and a strengthened commitment to factor them into its investment approach.

6.2 An update on progress to date is given for each of the recommendations, along with plans and indicative timescales for future work.

6.2.1 **Develop a policy statement regarding the London Borough of Hackney's approach to fossil fuel investment with a view to inclusion as a section within the new Investment Strategy Statement (ISS), which will replace the current Statement of Investment Principles.** It is intended that the development of such a statement for inclusion within the ISS will both demonstrate a commitment to managing carbon risk and set targets that are both quantifiable and measurable where this is appropriate. The timetable for development of the policy statement is linked to both the Fund's triennial valuation and a planned update to the LGPS (Management and Investment of Funds) Regulations, as this will set out the required format and content for new ISS. It was originally anticipated that the updated regulations would be released no later than summer 2016; however, this timetable has been substantially revised as, as at the time of writing this report, the planned update to the Regulations is still awaited. Given ths delay, we now anticipate that the new ISS will be in place in early 2017; however this is dependent on the update to the Regulations being published by Government during 2016.

6.2.2 **Agree to monitor carbon risk within the London Borough of Hackney Pension Fund and to appoint a specialist contractor to conduct a carbon footprint of the Fund at an estimated cost of between of £5k to £20k.** Measuring emissions and climate risks in the portfolio will allow the Fund to establish a base of data from which to examine its investment assumptions and test investment processes. It will also enable the Fund to make an assessment on an ongoing basis as to how its exposure to climate change risks progresses over time. This work is currently underway and the initial results will be presented at the Committee on 19th September 2016. The results of the assessment will then be used as described above and to inform work on the other workstreams currently underway.

6.2.3 **Review options for the Pension Fund's passive UK equity mandate.** The Fund's passive UK equity mandate is a standard market capitalisation weighted index, currently managed by UBS, which tracks the FTSE All-share. This is an area currently being reviewed as part of delivering the Government's pooling agenda, and the work being undertaken by the London CIV on delivering passive equity mandates. Low carbon passive strategies are being made available with fee arrangements negotiated through the London CIV and we will be working with the CIV over the coming months to identify suitable strategies for the Fund that will allow us to take this recommendation forward in an efficient cost effective manner Given the requirement to use the pooling vehicles going forward, it would be costly and inefficient to take this work forward outside of the London CIV arrangements, simply requiring us to later move assets again into the pooled fund.

6.2.4 **Continue engagement activities with the Fund's investment managers on their approach to fossil fuel and to promote**

**consideration of climate change issues with managers when making investment decisions.** This is an area in which further work will be undertaken over the coming months. We have been in contact with a number of our managers to request more detailed reporting on environmental issues, and will be looking at this in more detail in the near future.

6.2.5 **Maintain an active approach to climate change issues with investee companies and look for further opportunities to work with others on issues of ESG importance.** The Fund continues to monitor ESG issues through the alerts issued by the LAPFF, a collection of Local Authority funds who, by acting collectively, are able to apply pressure to the management of companies. LAPFF has previously been involved with voting climate-change related resolutions, and has invited its members to co-file. So far, these engagements have not affected companies we hold directly; however, where we are able (i.e. we have direct holdings in the company concerned), we will co-file these resolutions as part of LAPFF. Where our holdings in a company are through a pooled fund, we will make a public expression of support.

6.2.6 **Consider options for an initial active investment of approximately 5% of the Fund in a sustainability/low carbon or clean energy fund(s). Given the right risk/return profile, investment in such a fund would demonstrate the Fund's commitment to invest in clean and sustainable companies.** Again, this is an area in which work is taking place alongside the London CIV, to ensure that any strategy decision is made in line with the move to asset pooling. During August, the CIV commenced a search for active global equity managers – one element of the search is concerned with Global Sustainable Equity. The Hackney Fund is playing an active role in this procurement through representation on the Global Equity Working Group. This group is part of the wider Investment Advisory Committee (on which the Fund is also represented) and is supporting the CIV in the procurement exercise through reviewing submissions and attending manager interviews. Once the procurement is complete, we aim to identify a suitable strategy through the Global Sustainable Equity lot. As set out in 6.2.3 above, to make changes to our asset allocation outside of the London CIV pooling arrangements at this time would be costly and inefficient.

6.2.7 **Review options for switching some of the existing property mandate into a low carbon property fund.** Work on this recommendation is already well underway, with £10m being moved in June 2016 from the Fund's existing mandate to Threadneedle's 'Low Carbon Workplace' fund. Low Carbon Workplace is a partnership between Columbia Threadneedle Investments, the Carbon Trust and property developer Stanhope. Through the fund, the partnership acquires commercial office buildings and refurbishes them, turning them into energy efficient workplaces. Once occupied, the buildings' energy and carbon performance are monitored against standards set by the Carbon Trust, who also provide support to occupiers to help reduce their energy usage. Further investments in the

Low Carbon Workplace fund will be made as and when projects are available for investment, up to a total of £25m.

6.2.8 **In recognition of the financial risks posed by climate change, resolve to amend the Fund's risk register to reflect this as a risk.** Climate change, and the financial risks it could pose in terms of stranded assets is included as an item on the Fund's risk register. This is due for detailed review by the Pensions Committee at its January 2017 meeting.

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**Background Papers**
None