Hackney

Title of Report	Responsible Investment - Next Steps
For Consideration By	Pensions Committee
Meeting Date	15th June 2022
Classification	Open
Ward(s) Affected	All
Group Director	Ian Williams, Group Director Finance & Corporate Resources

1. Introduction

1.1. This report sets out the next steps in the Fund's Responsible Investment work programme. Following on from an initial report at the March 2022 Pensions Committee, it provides a progress update on the development of the Fund's TCFD (Taskforce on Climate-related Financial Disclosures) reporting. It sets out the aim to stay at the forefront of driving the environmental, social and governance agenda through taking a leading in role in a London-wide forum enabling the Fund to have greater influence on Government proposals. It also sets out proposals for the Fund's Responsible Investment Working Group (RIWG) for the Committee's approval.

2. Recommendations

2.1. **The Committee is recommended to:**

- **Note the timeline for the development of TCFD reporting and note the Fund's involvement in setting up a London-wide working group**
- **Note the suggestion to introduce a new carbon reporting target once the first assessment of the Fund's portfolio under TCFD reporting is complete**
- **Approve the proposals for the constitution of the Responsible Investment Working Group.**

3. **Related Decisions**

3.1. Pensions Committee 15th June 2022 - Carbon Risk Audit 2022 - Full Results

3.2. Pensions Committee 10th March 2022 - Responsible Investment Policy & Carbon Risk Audit

4. **Comments of the Group Director of Finance and Corporate Resources.**

4.1. The Pensions Committee acts as Scheme Manager for the Pension Fund and is therefore responsible for the management of £1.8 billion worth of assets and for ensuring the effective and efficient running of the Pension Fund. 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 environmental, social and governance factors can present financially material risks and opportunities for the Fund;s investments. The Fund aims to deliver stronger investment returns over the long term by recognising these risks and opportunities wherever possible and by contributing to a more sustainable financial system.

4.3. Climate change presents a systemic risk to ecological, societal and financial stability across the globe. To mitigate this risk, temperature rises need to be kept to well below 2°C compared to preindustrial levels. Financial assets will be significantly impacted through changes in climate policies, new technologies and growing physical risks; the Fund must therefore consider its capital allocation decisions in light of these changes.

4.4. A key risk of these changes is that present valuations do not adequately factor in climate-related risks because of insufficient information. Investors need adequate information on how companies are preparing for a lower-carbon economy; the recommendations from the Taskforce on Climate-related Financial Disclosures (TCFD) are intended to help ensure that companies provide that information.

4.5. Adopting the TCFD recommendations will help the Fund to further assess the key risks posed by climate change and ensure its portfolio is as sustainable and resilient as possible.

5. **Comments of the Director of Legal, Democratic and Electoral Services**

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

- To formulate and publish an Investment Strategy Statement
- 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

5.2. Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 requires the Administering Authority to formulate an Investment Strategy Statement (ISS) in line with guidance published by the Secretary of State. The guidance requires the Fund to include a section on its approach to Environmental, Social and Governance (ESG) factors within its ISS.

5.3. In 2014, the Law Commission produced guidance on the fiduciary duties of investment intermediaries, which indicated that investors should have regard to ESG factors where they are financially material. In its guidance to occupational schemes, the Pensions Regulator has given a clear indicator that it believes this to be the case for climate change.

5.4. This report helps to demonstrate that the Committee is factoring climate risk into its investment strategy setting process as a material financial risk and will make clear disclosures with regards to its approach in the ISS as required by the LGPS (Management and Investment of Funds) Regulations 2016. It also helps demonstrate that the Fund is preparing for the likely introduction of new regulations on climate change governance and reporting for the Local Government Pension Scheme (LGPS).

5.5. The report also sets out proposals concerning the Fund's Responsible Investment Working Group (RIWG). The RIWG is a working group rather than a Committee of the Council; as such the provisions of SEction 102 of the Local Government Act 1972 do not apply.

6. Taskforce on Climate-related Financial Disclosures (TCFD)

6.1. One of the key functions of financial markets is to price risk to support informed decisions about capital allocation; to do this, markets need accurate information from companies. In recent years, it has become apparent that information on the risks posed by climate change to businesses has not always been available - and that markets have not consistently priced those risks.

6.2. The Financial Stability Board (FBS) therefore created the Taskforce on Climate-related Financial Disclosures (TCFD) to develop recommendations on the type of information that companies should disclose to support investors. Published in 2017, the TCFD's recommendations establish a set of 11 clear, comparable and consistent disclosures through which exposure to climate-related financial risks and opportunities can be identified, assessed, managed and disclosed.

6.3. Although the TCFD recommendations focus on disclosures by organisations, the framework is a useful tool for pension trustees in assessing the risks of climate change within their portfolio and managing the consequences. The recommendations can be considered across 4 areas with 11 specific recommendations, as follows:

- Governance - Disclose the organisation's governance around climate-related risks and opportunities.
  - Describe the [Committee's] oversight of climate-related risks and opportunities.
  - Describe management's role in assessing and managing climate-related risks and opportunities.
- Strategy - Disclose the actual and potential impacts of climate-related risks and opportunities on the organisations' strategy where that information is material
  - Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.
  - Describe the impact of climate-related risks and opportunities on the organisation's business, strategy, and financial planning.
  - Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including disclosure under a 2°C or lower scenario.
- Risk Management - Disclose how the organisation identifies, assesses, and manages climate-related risks.
  - Describe the organisation's processes for identifying and assessing climate-related risks.
  - Describe the organisation's processes for managing climate-related risks.
  - Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.
- Metrics and Targets - Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
  - Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.
  - Disclose Scope 1, Scope 2, and if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
  - Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

6.4. The Department for Levelling Up, Housing and Communities (DLUHC) is expected to launch a consultation on TCFD requirements for the LGPS during 2022. Larger private sector occupational pension schemes are already required by law (The Climate Change Governance and Reporting Regulations 2021) to report annually in relation to the TCFD recommendations, and these requirements will be extended to smaller schemes in stages.

6.5. It is anticipated that the requirements for the LGPS will be similar to those for occupational schemes in many ways, albeit with some key differences. Requirements on governance, strategy and risk management are anticipated to be much the same. The scenario analysis recommendation in the 'strategy' element is likely to include a requirement for at least 2 climate change scenarios; one aligned with the Paris Agreement and the other of funds' own choosing.

6.6. It is expected that at least 3 metrics will be required in the 'Metrics and Targets' element, with funds required to set a target based on one of the metrics chosen. DLUHC have suggested that more ambitious funds might consider reporting on, and potentially setting a target based on a fourth metric of their choice.

6.7. DLUHC have also confirmed that asset pools are expected to play a substantial role in delivering the new obligations, to help minimise duplication and ensure that the LGPS is using its scale and market power effectively to drive improvements in the climate data produced by investee companies.

6.8. In setting a clear and measurable carbon reduction target in 2016, the Hackney Fund has been at the forefront of carbon reporting amongst the London LGPS funds. The Fund wishes to maintain this leading role and it is therefore essential that it puts robust plans in place to meet and exceed the expected requirements from the DLUHC consultation.

6.9. Whilst the Fund had initially targeted early adoption of the reporting framework and a new target set at the June meeting of the Pensions Committee, it is increasingly clear that close co-operation between London funds is likely to deliver the best outcomes. It is proposed that a working group of funds with experience of carbon reporting be set up; the Hackney Fund has been proposed as a member.

6.10. Involvement in a collaborative effort is likely to produce better long term outcomes for the Fund. Involvement in a working group to establish the best approach for London gives the Fund considerable say over the preferred approach and helps to ensure value for money in the provision of carbon reporting data. It is also more likely that a collaborative response to the forthcoming DLUHC consultation will influence government proposals. The Fund has a long history of successful collaboration with other LGPS funds and wishes to use its experience in this area to drive a robust approach to TCFD across London.

6.11. It is also suggested that the Committee introduce new carbon reporting targets once the Fund has completed its first portfolio analysis using the new TCFD metrics. Monitoring progress against a clear and measurable target remains a vital strand of the Fund's approach to carbon risk; setting interim targets will be key to helping the Fund achieve its ambition to reach net zero emissions by 2040.

6.12. The Fund's approach to target setting has focused on making commitments based on a full understanding of the dataset. The TCFD reporting project will introduce new metrics not previously covered in the Fund's portfolio analysis - it is therefore suggested that the Committee look to introduce a new target once the first analysis using the new metrics is complete. This will ensure the Committee has a full understanding of the Fund's starting point and is able to set an ambitious target that helps deliver net zero by 2040.

7. Responsible Investment Working Group

7.1. In March 2022 the Committee approved the Fund's Responsible Investment Policy (Appendix 1), which set out the role of the Responsible Investment Working Group (RIWG). The RIWG will have a membership made up of both Councillors and officers and will be responsible for setting the Fund's stewardship priorities and engaging on these with managers and other relevant stakeholders.

7.2. It is recommended that the membership of the RIWG should be as follows:

- Pensions Committee Chair
- Up to 2 other Committee members, to be chosen by the Chair
- 2 Officers - Head of Pensions & Responsible Investment Officer
- Investment consultant

7.3. The RIWG will meet quarterly. As this is a working group rather than a Committee of the Council, it will not require a minimum number of members attending to be quorate; meetings may proceed with only officers in attendance if necessary. It is proposed that any Committee member may attend meetings of the RIWG as an observer if they wish to do so.

7.4. The Committee is recommended to approve the proposals above for the constitution of the RIWG.

Appendices

None

Background documents

None

Report Author	Name: Rachel Cowburn Title: Head of Pensions Email: rachel.cowburn@hackney.gov.uk Tel: 020 8356 2630
Comments for the Group Director of Finance and Corporate Resources prepared by	Name: Jackie Moylan Title: Director, Financial Management Email:jackie.moylan@hackney.gov.uk Tel:0208356 3032
Comments for the Director of Legal, Democratic and Electoral Services prepared by	Name: Georgia lazari Title: Team Leader (Places) Email: georgia.lazari@Hackney.gov.uk Tel: 0208 356 1369