Non-Executive Report of the: **PENSIONS COMMITTEE** **24 September 2019**	TOWER HAMLETS
Report of: Neville Murton - Corporate Director of Resources	**Classification:** Unrestricted
Increased Allocation to Low Carbon Equities	

Originating Officer(s)	Miriam Adams, Pensions and Investments Manager
Wards affected	All

Summary

It is important for the Committee to understand the approach taken to date as well as what is a decarbonisation investment strategy in comparison to a disinvestment strategy.

A decarbonisation approach allocates to companies that are lower carbon emitting, whereas disinvestment is completely excluding certain 'carbon heavy' sectors from the investable universe (e.g. energy and mining stocks). The approach of the LGIM Global Low Carbon Equity fund is a decarbonisation strategy; it does not seek to fully divest from fossil fuel companies. The decarbonisation approach is more effective at reducing exposure to carbon intensity as it covers the full range of stocks and sectors. Divesting from fossil fuels does nothing to address this.

At the November 2018 meeting of the Pensions Committee, officers presented the results of a carbon footprint analysis of the Fund's listed equity assets.
The results highlighted that the Fund's equity assets were in aggregate approximately 38% less carbon intensive than the Fund benchmark.
A further deduction in the Fund's carbon exposure could be achieved given the Committee's interest in reducing the Fund's carbon exposure.

Recommendations:

The Pensions Committee is recommended to:

i) Consider the options (1and 2) for increasing the allocation to Low Carbon equities set out in the detailed paper prepared by Mercer the Fund actuary (Appendix A);

ii) Consider the cost and currency hedging implications of switching all existing passive global market-cap equities into Global Low Carbon equities (option1);

iii) Agree option 1 - the switching of all existing passive global market-cap equities into Global Low Carbon equities.

1. REASONS FOR THE DECISIONS

1.1 The Pensions Committee act in the role of quasi trustees for the Pension Fund and are therefore responsible for the management of £1.6billion 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, its members but also on the Fund's employers in terms of the level of contributions they are required to make to meet the Fund's statutory pension obligations.

1.2 The costs involved with the implementation of option 1 is estimated as follows

- Estimated direct transition costs £185k
- Estimated increase in passive investment management fees £60k p.a. from current estimates of £310k p.a. depending on asset market values.

1.3 A low carbon investment approach will help to mitigate the risks of climate change that could potentially negatively impact the share prices and generation of dividends from companies that have a high carbon footprint.

2. ALTERNATIVE OPTIONS

2.1 Not to change strategy.

3. DETAILS OF REPORT

3.1 The Committee decided in 2017 to make an allocation to passive Global Low Carbon Equity. An initial allocation of 15% of Fund assets was made. More recently, the Committee has decided to increase the Fund's strategic asset allocation to passive Global low Carbon equities further from 15% to 20%. It is estimated that this would reduce the Fund's equity carbon foot print by around 10% relative to the current position.

3.2 There is increasing pressure being placed on Pension Funds by stakeholders to ensure that ESG factors are considered when making investment decisions. This pressure is coming from lobby groups, other stakeholders, the Bank of England and even the Pensions Regulator has warned that savers face long term financial risks because trustees are failing to take climate change, responsible business practices and corporate governance into account when making investments.

Decarbonisation and disinvestment (fossil fuel free) investing

3.12 A number of lobby groups have been pressuring LGPS funds including LBTHPF to divest or have a plan to divest from fossil fuels on the basis that coal, oil and gas consumption are contributing heavily to climate change and global warming to which some scientists have attributed responsibility for the increase in the incidence of natural disasters such as storms, floods heatwaves in recent times.

3.13 LGPS funds have continued to come under criticism for investing in controversial stocks such as oil, tobacco, alcohol producers, gambling firms,

and payday lenders. Some local authorities, including Tower Hamlets Pension Fund, the London Boroughs of Islington, Haringey, Southwark and the Environment Agency, have committed to reducing their exposure to carbon and some have gone on to state when they expect to be fully divested.

3.14 **Tower Hamlets Decarbonisation Approach versus Fossil Fuel Issues**
Tower Hamlets approach is to reduce the carbon intensity of the Fund over time as an exclusionary approach removes the potential to positively influence companies and the Fund Investment consultant prefers a decarbonisation approach.

3.31 The benefits of the decarbonisation approach include:

a) The portfolio will be less susceptible to increasing carbon pricing, stranded assets and/or related regulation.
b) It supports the flow of capital to a resilient low-carbon economy and may help to address the market mispricing of carbon.
c) Produces a market signal that incentivises companies to develop and invest in low carbon and clean technologies, influences policymakers and also helps to catalyse a new standard for other institutional investors.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 The performance of the Fund affects the level of contribution to the Fund required for the employer's contribution (i.e. the Council's contribution towards employees' pensions).

4.2 The returns achieved by the Fund for the three years beginning 1 April 2019 will impact on the next valuation as at 31 March 2022. It is important to ensure that further investments in the low carbon investment strategy do not have a financial impact on the Fund.

5. LEGAL COMMENTS

5.1 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.

5.2 The Administering Authority through its Investment Strategy Statement must provide details of its policy on how social environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.

5.3 When carrying out its functions, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty).

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1 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 undertakings, which are underwritten by statute.

6.2 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.

6.3 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

7. BEST VALUE (BV) IMPLICATIONS

7.1 The move towards further low carbon strategies is a step towards further reduction in carbon emissions.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

8.1 The Fund through its participation with Local Authority Pension Fund Forum (LAPFF) supported progress towards an orderly transition to a low carbon economy. This is by actively working with other asset owners, fund managers, companies, academia, policy makers and others in investment industry.

9. RISK MANAGEMENT IMPLICATIONS

9.1 The recommendations provided on this report are aimed at developing both a greater understanding of the risks and a set of strategies to help mitigate them.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

10.1 There are no crime and disorder reduction implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report - None

Appendices – Appendix 1: Mercer Report on Increased Asset Allocation to Low Carbon Equities.

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report

- As listed above as appendices

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