

Non-Executive Report of the: Pensions Committee Monday, 5 July 2021	 TOWER HAMLETS
Report of: Corporate Director, Resources	Classification: Open (Unrestricted)
Revised Responsible Investment Policy	

Originating Officer(s)	Miriam Adams
Wards affected	(All Wards);

Executive Summary

This report provides an update on the Responsible Investment Policy for the London Borough of Tower Hamlets Pension Fund.

Recommendations:

The Pensions Committee is recommended to:

1. Note the content of this report and
2. To review, comment and approve the revised LBTH Pension Fund Responsible Investment (RI) Policy 2021 and Corporate Governance & Voting Guidelines 2021.

1. REASONS FOR THE DECISIONS

- 1.1 Both Responsible Investment Policy and Corporate Governance & Voting Guidelines are due to be reviewed annually or whenever revisions are proposed.

2. ALTERNATIVE OPTIONS

- 2.1 There are no alternatives to this report.

3. DETAILS OF THE REPORT

- 3.1 The term 'responsible investment' refers to the integration of financially material environmental, social and corporate governance ("ESG") factors into investment processes. It has relevance both before and after the investment

decision and is a core part of our fiduciary duty. It is distinct from 'ethical investment'.

- 3.2 RI is an essential part of the Fund's approach to investing. This is reflected in the Investment Strategy Statement.

The UK Stewardship Code 2020

- 3.3 The UK Stewardship Code sets out expectations for those responsible for investing money to help them better to exercise their stewardship responsibilities. Compliance with the code is not mandatory for LGPS funds but they have support of the UK Government and Local Authority Pension Fund Forum (LAPFF).
- 3.4 The 2020 Stewardship Code represents a significant increase in level of ambition compared to the 2012 version. In November 2020, the Fund embraced the 12 principles of the Financial Reporting Council's UK Stewardship Code 2020 and is actively considering the most appropriate way to improve stewardship reporting going forward (whilst remaining cognisant of the Fund's wider objectives and the governance constraints on Officers).
- 3.5 In March 2021, the received and approved the 2021/22 Investment Strategy Statement. The Committee agreed to set a date aside for the training and drafting of the Responsible Investment Policy and Climate Change Policy. This took place on 22nd April 2021, the revised draft RI Policy is attached as appendix 1 to this report.
- 3.6 The Committee is asked to approve the revised Responsible Investment Policy.

4. EQUALITIES IMPLICATIONS

- 4.1 There are no direct equalities implications from this report.

5. OTHER STATUTORY IMPLICATIONS

- 5.1 This section of the report is used to highlight further specific statutory implications that are either not covered in the main body of the report or are required to be highlighted to ensure decision makers give them proper consideration. Examples of other implications may be:
- Best Value Implications,
 - Consultations,
 - Environmental (including air quality),
 - Risk Management,
 - Crime Reduction,
 - Safeguarding.
 - Data Protection / Privacy Impact Assessment.

Risk Management Implications

5.2 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 liabilities by creating a reserve from which future liabilities will be met.

6. COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 There are no direct resources issues for the council however changes in the financial performance of the pension fund affects the pension fund deficit reflected in the council's accounts and the level of contributions payable by the Council and other employers.

6.2 Investment management expenses are met directly from the Fund.

7. COMMENTS OF LEGAL SERVICES

7.1 The Constitution delegates to the Pensions Committee the function of setting the overall strategic objectives for the Pension Fund.

7.2 The LGPS (Management and Investment of Funds) regulations 2016 (Regulation 7(7)) requires the Committee to periodically (at least every three years) to review and if necessary, revise the investment strategy.

7.3 When performing its functions as administrator of the LBTH pension fund, 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).

Linked Reports, Appendices and Background Documents

Linked Report

- 25 March 2021 – Investment Strategy Statement
<https://democracy.towerhamlets.gov.uk/ieListDocuments.aspx?CId=392&MId=11917&Ver=4>
- November 2020 – Responsible Investment (RI) and RI Accreditations
<https://democracy.towerhamlets.gov.uk/ieListDocuments.aspx?CId=392&MId=11803&Ver=4>

Appendices

- Revised Responsible Investment Policy - Appendix 1

Local Government Act, 1972 Section 100D (As amended)

List of “Background Papers” used in the preparation of this report

- None

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Responsible Investment and Climate Change Policy

Members of the Pensions Committee (the “Committee”) have a fiduciary duty to act in the best interests of Fund members and other beneficiaries in all financial and non-financial decisions. With respect to the Fund’s investments, to do this effectively there is recognition of the importance of generating sustainable long-term returns. This involves more than an appraisal of financial factors but also takes into account non-financial factors such as Environmental, Social and Corporate Governance (“ESG”) issues, including notably, climate change, which the Committee believes will be financially material to the Fund’s investments. The Committee recognises the growing urgency and continual regulatory developments with regard to long-term sustainability issues and believes that it is imperative that ESG and stewardship (or active ownership) considerations are integrated throughout investment processes and that they are taken into account as part of funding and investment strategy setting.

1. ESG integration

Effective management of ESG issues is a key determinant of long-term shareholder value and good risk management. Their consideration is part of the Fund’s fiduciary duty to beneficiaries. The Fund therefore recognises the importance of its investment managers integrating all material financial and non-financial factors, including ESG considerations, into the decision-making process for fund investments and the ongoing monitoring of these same issues.

The Fund invests via pooled funds and the underlying investment managers therefore ultimately have discretion in assessing and integrating ESG factors. The Committee has directed investment managers to consider the effects of ESG issues on the performance of a fund when considering the acquisition, retention or realisation of investments, however. The LCIV also performs a similar assessment of ESG, stewardship and the consideration of sustainable opportunities before any investment manager is appointed to the Pool.

The Committee will seek assurance via interactions with the LCIV and underlying investment managers held outside the Pool, that they are meeting the Fund’s requirements with regards to ESG integration. In particular, all current investment managers within the equity portfolio (50% of Fund assets) fully integrate ESG (as well as wider RI) considerations into their portfolios and see these issues as fundamental to their investment strategies.

Whilst the progress made in relation to the E in ESG is increasingly in focus and can often be more easily measured (see also the climate change section below), the Committee is similarly committed to developing its policy in relation to Social and Governance considerations.

In respect of social concerns, the Fund’s investment managers are expected to actively engage with underlying companies on all social issues including employee health and safety, demographics and diversity, labour and supply chain management etc. The Committee will also assess the viability of specific social investments on an ongoing basis, such as UK social housing.

The Fund receives periodic reporting on the degree to which the Fund's investment managers integrate ESG within their investment practises. Where managers are lagging behind their peers (or the Committee's expectations) engagement will be undertaken with the respective manager to encourage them to improve. In addition, ongoing ESG developments are monitored through quarterly performance reporting.

2. Stewardship – exercise of voting rights and engagement

Good stewardship can protect and enhance value for companies and markets as a whole. The Fund is committed to being a long-term steward of the assets in which it invests. It believes in the importance of managers acting as active asset owners through proactive voting and engagement with companies. In addition, the Fund believes that acting collectively with other investors is an effective way to engage with companies.

The Committee has delegated the exercise of voting rights to investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long-term shareholder value. For investments held within the LCIV pool, the manager has implemented its own RI policy that covers voting, which it expects all managers on the platform to adopt.

The Fund is also a member of the Local Authority Pension Fund Forum ("LAPFF") which aims to protect the long-term investment interests of beneficiaries by promoting the highest standards of corporate governance and corporate responsibility amongst investee companies. Further details can be found on the [LAPFF website](#).

In collaboration with other like-minded investors, the Fund may engage with public policy makers, regulators, trade bodies, indexes and other players in the financial markets to further support the Fund's fiduciary responsibilities. The Fund considers these initiatives on a case-by-case basis.

The Fund embraces the 12 principles of the Financial Reporting Council's UK Stewardship Code 2020 and is actively considering the most appropriate way to improve stewardship reporting going forward (whilst remaining cognisant of the Fund's wider objectives and the governance constraints on Officers). The Fund provides voting, engagement and stewardship updates to the Committee and has also agreed to take an annual 'deep dive' on its investment managers in this area.

From a Pooling perspective, the LCIV is supportive of the UK stewardship Code. The Pool also encourages investment managers to sign up to the Code and the United Nations supported Principles of Responsible Investment (UNPRI).

3. Human rights

Human rights include civil, political, economic, and social and cultural rights, such as the right to life, the right to freedom of association or the right to health. The ability and commitment to human rights issued reflects the strength of a company's culture and risk management. As a member of LAPFF, the Fund has been supportive of the LAPFF focus on valuing and supporting greater diversity on company boards.

LAPFF stewardship work incorporates a drive for wider-ranging action on equality and inclusion to drive change and increase representation and involvement by all.

4. Climate Change

The Fund believes that climate change presents risks over the short, medium and long-term that the Fund should better understand and mitigate where possible. The Fund recognises these risks as well as the Council's own targets in this regard and the views and aspirations of other employers and members. Climate risk is recorded as a key risk in the Fund's Risk Register.

The Committee have been on a journey to lower the Fund's carbon footprint for several years by annually monitoring fossil fuel exposure and the Fund's wider carbon footprint (measuring carbon intensity and fossil fuel reserve exposure) to better understand opportunities and risks within the Fund's portfolio.

Given the proactive steps taken in this area the Fund's equity portfolio has shown materially lower carbon intensity relative to the benchmark over all periods reviewed. The equity assets are invested in a diversified and innovative way, with dedicated allocations to Low Carbon equities, a Paris-Aligned equity strategy and broad based Sustainable equities. Looking forward, the Committee have discussed setting explicit decarbonisation targets and these will be considered further in due course.

Separately, the Committee is also actively working with advisors regarding the adoption of the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD"), which was established with the objective of creating a consistent climate disclosure framework to be used by companies, asset managers and asset owners, further showcasing the Fund's ongoing commitment to managing climate change. As part of this reporting framework, the Fund plans to build on its existing annual carbon monitoring report by undertaking climate change scenario analysis. This analysis seeks to understand the climate impact on return at the total Fund and asset class level across different warming scenarios and help the Fund to further its decision-making. The Fund is looking to be an early mover and adopt these recommendations over 2021.

5. Thematic sustainable investments opportunities

Long-term sustainability trends, including climate change, present opportunities that require explicit consideration. The Fund actively considers investing in strategies that target long-term ESG themes (e.g. energy, water, demographic trends) on the basis that such opportunities will generate good risk-adjusted investment returns.

The Fund has a representative on the Responsible Investment Reference Group (RIRG) which was set up to progress the RI agenda for London based Pension Funds. The Committee has also worked closely with the LCIV separately to encourage the set-up of specific sustainable investment mandates that the Fund now invests in. In particular, the Fund has worked with the LCIV to introduce;

- A renewable energy infrastructure mandate, in order to invest Fund assets in clean, renewable energy and further contribute to the transition towards to a lower carbon economy.

- An equity sub-fund with a more explicit view on reducing carbon exposure and increasing sustainable equity exposure via alignment with the Paris Agreement.

The Fund will consider further investment initiatives with environmental or low carbon themes or where there is a social benefit in future, providing they also meet the Fund's fiduciary requirements. Work is ongoing to explore the potential introduction of targets and the monitoring of sustainable exposures via annual reporting.

6. Pooling

The Fund is a participating Fund in the LCIV Pool and works collaboratively with LCIV to set clear expectations and help define the strategic requirements of the Fund in respect to Responsible Investment, believing that it is important that LCIV offer funds to investors that integrate ESG considerations into their investment. It is expected that the Fund's ability to implement its own Responsible Investment Policy will be enhanced through the LCIV Pool, due to the inherent benefits of scale and improved governance and stewardship practices that will result from the collaboration.

For the investments that are held within the Pool, LCIV recognises that it has a responsibility to be an active steward and to promote good corporate governance and management of the companies within the sub-funds and has developed a comprehensive Responsible Investment Policy that it expects investment managers to follow. More information can be found here [LCIV-Responsible-Investment-Policy.pdf \(londonciv.org.uk\)](https://www.londonciv.org.uk/LCIV-Responsible-Investment-Policy.pdf).

The Fund is committed to continue working with LCIV and the underlying partner funds to further develop the Responsible Investment approach and the pool level reporting.