Non-Executive Report of the: **Pensions Committee** 19 November 2020	TOWER HAMLETS
Report of Neville Murton, Corporate Director, Resources	**Classification:** This report is Unrestricted Appendix A is restricted

Carbon Foot Print Audit of Listed Equity Portfolio

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

Appendix A to this report is not for publication as it contains exempt information relating to the financial or business affairs of a particular person as defined in and paragraph 3 of Schedule 12A of the Local Government Act 1972 and publication is not in the public interest.

SUMMARY

This report summarises the Fund's carbon footprint analysis and, quantification of the Fund's decarbonisation progress of the listed equity portfolio of the Fund.

Both carbon intensity (measured by Weighted Average Carbon Intensity "WACI" and potential emissions from fossil fuel reserves were measured.

The Fund has made strong decarbonisation progress since 2017 (disinvesting from GMO in 2017 and moving from LGIM Global Equities to LGIM to Low Carbon Equities.

Overall, carbon intensity (WACI) of the listed equity portfolio decreased is 29% since 2017. In 2017 the Fund's Carbon intensity was 137.8 tCo2 e per million sales, in 2020 this was 97.2 tCo2 per million sales.

While the potential emission of the listed equity portfolios are equivalent to 634 thousand tCo2 per billion invested in 2020. This decreased by c76% from 2.7millionin 2019. This means in simple terms that the listed equity portfolio of the Fund is decarbonising through increased allocation and reduced exposure to fossil fuel reserves.

RECOMMENDATIONS

The Pensions Committee is recommended to:

1. Note the contents of this report;
2. Note the reduction in carbon footprint from 2017 to 31 March 2020;
3. Consider and agree to put in place a climate change strategy, inclusive of short term decarbonisation targets to 2025 and 2030, and a commitment to net zero emissions by 2050 to align thinking with the Climate Emergency declared by the Council and the UK Climate Change Act 2008;
4. Consider and agree the adoption of the recommendations of the Task Force on Climate – Related Financial Disclosures (TCFD), to further embed climate led investment thinking. Analysis in will help the Fund to adopt and disclose according to TCFD recommendations (Metrics & Targets);
5. Consider and agree conducting climate change scenario analysis as per the TCFD recommendations to help the Fund to better understand climate change risks and opportunities that arise, both from the transition to a low carbon economy and physical damages; and
6. Consider and agree to expanding the scope in measuring climate chance investment risk across the entire portfolio.

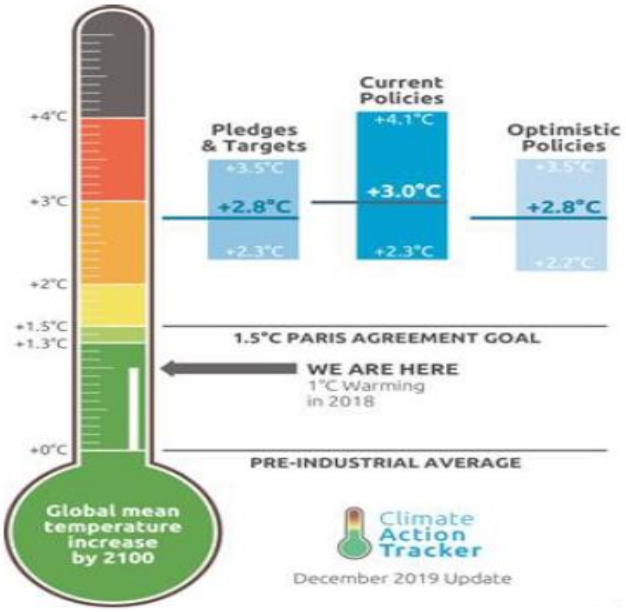
1. REASONS FOR THE DECISION

1.1 Since 2017, the carbon intensity (WACI) of the listed equity portfolio has consistently been lower than the MSCI ACWI benchmark. In 2019, there was a brief rise in the carbon intensity (WACI) trend for all funds, with the expectation of LGIM Passive Global Equity, from which the Fund divested last year.

1.2 Responsible investment (RI) established by United Nations in 2006, is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions to better manage risk and generate sustainable long-term returns.

2. DETAILS OF REPORT

2.1 The world is already experiencing the impacts of climate change, equivalent to and approximated position of ≈ -1°C of warming. Under global policies we are currently on track for approximated estimated position of - **3**°C of warming to the end of the century. More therefore remains to be done by the world as a whole to meet the ambition of the Paris Agreement.



Warming under current policies
Source: https://climateactiontracker.org/

Global and European Regulations

2.2 In 2015, Global governments agreed the Paris Agreement and Sustainable Development Goals.

In 2016, EU IORP II, came in force requiring pension scheme risk assessments should include climate change.

In 2018, EU High Level Expert Group on Sustainable Finance and EU vision to become climate neutral economy was agreed.

In 2019, EU leaders agreed to carbon Shareholders Rights Directive to improve transparency of engagements as shareholders.

In 2019, PRI reached approximately 2,400 signatories with estimated asset under management of around $90 trillion. This includes voluntary ESG and climate change disclosures. While other initiatives also promote voluntary ESG and climate change disclosures.

In addition to the above drivers, the cost of new renewable energy has reached and passed parity with new fossil fuel generation. It is expected that new renewable capacity will soon become more cost effective than existing fossil fuel capacity. Electricity investments have shifted towards renewables networks and flexibility. It is estimated that $100 trillion in investment is required to transform the energy sector towards 2050.

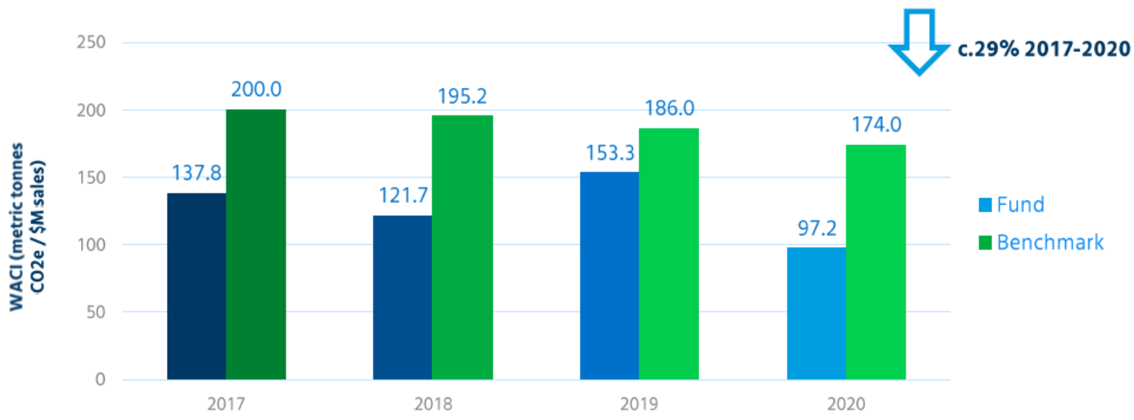
UK Update

2.3 In 2019, the UK Government declared a climate emergency and committed to becoming a carbon -neutral economy by 2050. Underpinning this, the Green Finance Strategy aims to mobilise private finance for clean and resilient growth, mainstream climate factors as a financial strategic imperative and position the UK as a leader in green finance.

As a response to the COVID-19 pandemic, governments across the globe are engaged in an unpreceded macroeconomic stimulus with ambition to contribute to “Green Recovery”.

London Borough of Tower Hamlets Pension Fund the journey so far

2.4 Since March 2017, the Fund has made a number of changes to the equity portfolio. The Fund divested from GMO Global Equities portfolio mandate in 2017 and invested in LGIM Low Carbon Equity in 2018 and 2019 respectively. This means that through out the period the Fund has held predominantly equity strategies that have lower carbon exposure to the benchmark which has helped keep the overall WACI materially lower that the wider equity universe at each point as shown in the table below.



2.5 Not all strategies have contributed in this reduction in carbon intensity. The Fund also implemented Equity protection (and Synthetic Equity) in 2018 and renewed the program in 2020.

2.6 The WACI is not static but expected to fluctuate over time as active managers change stocks often for other reasons other than a carbon perspective as its benchmark changes stocks. The long term trajectory is that emissions will continue to tilt towards lower figures.

Proportion of Portfolio Analysed

2.7 49% of portfolio’s emission analysed in 2020 made up of LGIM, LCVI BG and equity allocations in the LCIV DGF and LCIV Ruffer portfolios.

Synthetic Equities also part of the equity strategic asset allocation given its nature i.e. implemented via derivative contracts and Equity Protection also via derivative contracts have not been included in the analysis.

It is expected that when the Synthetic Equity contract matures in March 2021 and the assets converted to physical equity that the Fund WACI would increase due to an increase in actual physical assets.

2.8 Recommendations contained within this paper requests the Committee to consider and agree to extending future carbon foot printing exercises to include credit allocations within the portfolio assets managed by Goldman Sachs and Insights as well as LCIV MAC fund. This will allow for inclusion of non equity allocations in LCIV Baillie Gifford and LCIV Ruffer diversified growth funds.

2.9 The 2019/20 results also show that the Funds exposure to stranded assets is lower than benchmark. The Committee is asked to include green revenues analysis in next year's review so as to track not only carbon risks but also the opportunities that may arise from the transition to a lower carbon economy.

3. Next Steps

3.1 In order to build up on this progress members are asked to consider and agree a broad strategy of putting in place a climate change strategy inclusive of short term decarbonisation targets to 2025 and 2030 and a commitment to net zero emissions by 2050. This will enable the Fund to align its thinking with the climate emergency declared by the Council and the UK Climate Change Act 2008.

3.2 To enable the Fund achieve these targets, the Committee is asked to consider and agree that the Fund adopt the recommendations of the Task Force on Climate related Financial Disclosures (TCFD). This meeting also includes agenda item on Responsible Investment and RI Accreditations of which the TCFD is one.

3.3 The Committee is asked to consider and agree that the Fund commission climate change scenario analysis as per TCFD recommendations to enable the Fund to better understand climate risks and opportunities that arise, both for the transition to a low carbon economy and physical damages.

3.4 The Committee is asked to consider and agree to expanding its scope in measuring climate change investment risks across the entire portfolio. To enable the inclusion of carbon foot printing measurements beyond listed equities and assessing its exposure to green revenues.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 This report is for information there are no direct costs arising from the recommendations of this report will be met by the Pension Fund.

5. LEGAL COMMENTS

5.1 One of the functions of the Pensions Committee is to meet the Council's duties in respect of responsible investment matters. It is appropriate having regard to these matters, for the Committee to receive information about new guidance to ensure the Fund is being managed in accordance with the Council's statutory obligations. There are no immediate legal implications arising from the report.

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1 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.

7. BEST VALUE (BV) IMPLICATIONS

7.1 This report helps in addressing value for money through planning to have a rigorous and robust monitoring of carbon foot print audit of the Fund.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

8.1 Being a Responsible Investor has direct Sustainable Action for a Greener Environment.

9. RISK MANAGEMENT IMPLICATIONS

9.1 Any form of investment inevitably involves a degree of risk.

9.2 Climate change is a key financial material environmental risk. To minimise risk, the Pensions Committee attempts to achieve a diversified portfolio. Diversification relates to asset classes and management styles.

9.3 Risks associated with climate change action program are captured within the Fund's risk register. Risk FI 5

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

- Responsible Investment and RI Accreditation

Appendices

Appendix A - Carbon Foot Print Report (restricted)

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

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

Officer contact details for documents:
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