REPORT TO:	**PENSION COMMITTEE** **14 September 2021**
SUBJECT:	**Pension Fund Environmental, Social and Governance Policy.**
LEAD OFFICER:	**Nigel Cook** **Head of Pensions and Treasury**

CORPORATE PRIORITY/POLICY CONTEXT:

This is a matter for the Pension Committee relating to the Pension Fund's environmental, social and governance policy for investments and fund managers.

FINANCIAL SUMMARY:

This report relates to investing the Croydon Pension Fund. In order to meet the overall investment targets for the Fund the funds that the Pension Fund are invested with need to meet a number of criteria; failure to meet return targets many impact on the overall viability of the Fund and increase the impact on the Pension Fund on the authority.

FORWARD PLAN KEY DECISION REFERENCE NO.: N/A

1 RECOMMENDATIONS

1.1 The Committee is asked to agree the recommended policy targets set out below:

1.2 To revise section 6 of the Investment Strategy Statement to read '*The Fund will only invest in investments with a strong environmental, social and governance policy that includes no tobacco investments. Furthermore, where this is consistent with the agreed investment strategy, the Fund will invest in assets that positively address these [same] environmental, social and governance policy issues*.'

1.3 To include a statement to move towards net carbon neutrality into the Fund's investment policy, by incorporating into current investment criteria.

1.4 To incorporate the option to allow London CIV concessions.

1.5 To continue to subscribe to the LAAPF to meet commitments to engage and campaign on social and governance issues.

1.6 To encourage fund managers to report on environment factors.

1.7 That officers survey fund managers to identify best practice that can be included in regular performance reporting.

1.8 That the Committee selects an external provider to measure progress towards net zero carbon and report periodically to the Committee or consider expanding the Pension Fund Investment team to undertake this piece of work.

2 EXECUTIVE SUMMARY

2.1 This report sets out a framework to ensure that the Croydon Pension Fund adopts an Environmental, Social and Corporate Governance policy that is appropriate and a set of goals that are achievable.

3 DETAIL

3.1 This report considers how the Croydon Local Government Pension Scheme Fund (the Fund) should respond to some of the most demanding issues of the day: climate change, the state of the environment including the oceans and rivers but also locally, modern slavery, and corruption and poor governance. The Council's current approach is set out in the Croydon Investment Strategy Statement which was agreed at the Pension Committee 18 September 2018 (Minute A50/18 refers). The section on ESG issues is set out here:

Environmental, Social and Corporate Governance (ESG)
6.1 The Fund is committed to being a long term steward of the assets in which it invests and expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills. In addition the Pensions Committee undertakes training on a regular basis and this will include training and information sessions on matters of social, environmental and corporate governance.

6.2 The Fund requires its investment managers to integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments. It expects its managers to follow good practice and use their influence as major institutional investors and long-term stewards of capital to promote good practice in the investee companies and markets to which the Fund is exposed.

6.3 The Fund will only invest in investments with a strong environmental, social and governance policy that includes no tobacco investments. The Fund will disinvest from existing fossil fuel investments in a prudent and sensible way that reflects the fiduciary responsibility due to stakeholders. Furthermore, where this is consistent with the agreed investment strategy, the Fund will invest in assets that positively address these issues. Examples of this approach include investing in renewable energy projects, screening out regional markets where there might be issues with modern slavery, and looking to explore opportunities to contribute to and invest in the Borough.

6.4 The Fund expects its external investment managers (and specifically the London CIV through which the Fund will increasingly invest) to undertake appropriate monitoring of current investments with regard to their policies and practices on all issues which could present a material financial risk to the long-term performance of the fund such as corporate governance and environmental factors. The Fund expects its fund managers to integrate material ESG factors within its investment analysis and decision making.

6.5 Effective monitoring and identification of these issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the Fund expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

6.6 The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

6.7 The Fund will invest on the basis of financial risk and return having considered a full range of factors contributing to the financial risk including social, environment and governance factors to the extent these directly or indirectly impact on financial risk and return.

6.8 The Fund in preparing and reviewing its Investment Strategy Statement will consult with interested stakeholders including, but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with.

3.2 A great deal has occurred in the three years since this version of the policy was adopted, most recently the publication of the IPCC Climate Change 2021 report. In such a dynamically evolving environment it is important to review the Council's approach to these issues frequently: to ensure the policy reflects current thinking and to incorporate successful practices as well as assessing the global state of thinking. Specifically this policy should reflect the Paris Accord and be flexible enough to incorporate whatever should come from COP26 at Glasgow this autumn. It is important to note that this policy already requires that fund managers integrate ESG into investment decisions. The policy specifies excluding tobacco investments. There is also a reference to disinvesting from existing fossil fuel investments. There is an inherent problem with too many exclusions, and this approach may result in perverse outcomes and unbalancing the portfolio. The policy mentions appropriate monitoring and this report touches on this further below. Similarly talk of collaborating is addressed below when this report discusses the relationship with the London Collective Investment Vehicle (London CIV). The key point the current policy makes, which is given due emphasis by this report, is the necessity to invest on the basis of risk and return.

3.3 The Pension Committee's professional investment consultants, Mercer, have briefed the Committee on the subject of Investing in a Time of Climate Crisis (Minute 63/19 refers). This training session covered the steps that this Committee had taken to date, i.e. excluding tobacco shares, discussing the concept of carbon neutral and investing in infrastructure. The Committee also considered the ethical and financial factors that influenced these decisions, key metrics, and this lead to a discussion about decarbonising towards carbon neutrality. The question of how to implement such a policy was addressed with five recommendations:

3.3.1 Ensure the Committee has a clear direction that enables the Fund to communicate its approach to climate change proactively. Include sustainable investment beliefs and implementation considerations.

3.3.2 Increase exposure to sustainability themed strategies that align with the shift to the low carbon economy. Consider a more transition aligned benchmark.

3.3.3 Include decarbonisation into investment policy, with expectation of portfolio wide action over a reasonable timeframe – set targets. Minimise costs, maximise impacts. Keep risk, return and reputation, as well as practical implications central to execution.

3.3.4 Collaborate to influence London CIV policy on climate change. Consider supporting an engagement initiative.

3.3.5 Strong, candid leadership – perform to targets and report regularly on progress with transparent communications to members and other interested stakeholders. Consider adopting the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.

3.4 It is apparent that these are significant issues and this report will seek to address them. If there is a hierarchy for these issues at the top of the pyramid must be sustainable investment beliefs. The current statement on this is set out in the ISS at paragraph 6.3, reproduced. It may be that a condensed version of this will be adequate to reflect the Committee's beliefs, such as:

The Fund will only invest in investments with a strong environmental, social and governance policy that includes no tobacco investments. Furthermore, where this is consistent with the agreed investment strategy, the Fund will invest in assets that positively address these [same] environmental, social and governance policy issues.

The issue of disinvesting from existing fossil fuel investments is complex. Definition is difficult (apart from the measure of the influence of supply chains and incidental contributors to carbon pollution) and this approach does not distinguish between forward thinking green advocates and notorious polluters. There is also the question of the structure of the portfolio – effectively this ambition applies to listed equity and to continue to disinvest the authority would either have to look for a closely defined passive fund or manage a segregated fund. This approach would be at odds with LCIV's more inclusive compromise which excludes some fossil fuel investments but which allows a proportion in its policy.

3.5 The second recommendation above, which is to Increase exposure to sustainability themed strategies that align with the shift to the low carbon economy is already incorporated in the current alternatives portfolio: the Fund has invested in a number of Infrastructure Funds managed by Access, Temporis, Equitix, MacQuarrie (ex – Green Investment Bank) and I – Squared.

3.6 The third recommendation, to include decarbonisation or indeed a direction of travel towards net carbon neutrality into the Fund's investment policy, can be readily incorporated into current investment criteria. The question of metrics is addressed below.

3.7 The question of collaborating with the regional pool, managed by the London CIV, is also fairly complex. The governance structure of the CIV embraces compromise and thus absolute positions, such as described above, cannot be accommodated easily. The process by which new funds are brought into the CIV relies on groups of administering authorities coming together to agree some sort of compromise and the Committee will have to decide, on a case by case basis, whether they can accept such concessions. This will have to be built into the arrangements set out by the Investment Strategy. At various times the Committee has discussed a number of exclusions from the Fund. These include controversial weapons, nuclear, alcohol, adult entertainment, and gambling. These exclusions have also been considered by the CIV. Note that this group of businesses do not necessarily impact negatively on the environment – these considerations fall within the 'social' bracket. The key is engagement with and monitoring of the London CIV along with other ESG issues.

3.8 So far this report has focussed very much on the environmental part of the ESG policy. This is not unreasonable given the high-profile given to these issues and the urgency of introducing change. But social and governance issues are also critical aspects of stewardship and impact significantly on returns and the reputation of the authority. To date this authority has relied on the work of the Local Authority Pension Fund Forum (LAPFF) for engagement and stewardship in respect of social and governance issues. The Forum comprises 81 Pension Funds and 6 Pools and so can effectively engage and campaign on a number of stewardship issues. Voting, at present, is undertaken by the passive equity fund manager according to their specific voting guidelines.

3.9 As touched on above, there are a number of issues about measuring progress towards the targets suggested above. These fall into two categories. Each of the fund managers that make up the Pension Fund portfolio will publish data on progress towards meeting their targets. This data could be collated and presented to this Committee. This approach would be demanding in terms of resources and there would be issues in terms of timing and lagging. Further comparability between different types of funds and indeed within asset classes would be challenging at best and possible inappropriate. However, for some of the over-arching issues, such as progress towards carbon neutrality, some way may need to be found to measure progress towards this goal. As mentioned above, the Committee may wish to commit to the Task Force on Climate-related Financial Disclosures. Officers will need to engage with fund managers to assess the practicality of this and agree appropriate metrics.

3.10 Given that this is such a rapidly evolving aspect of managing the Pension Fund Officers recommend that fund managers are surveyed as to what information is already generated, whether there are market best practices that should be adopted, and whether these practices should be adopted across the portfolio and a selection criteria for choosing future investments.

3.11 As to the question of achieving net zero carbon emissions, officers recommend that the Committee selects an external provider to manage this data and report periodically to the Committee or consider expanding the Pension Fund Investment team to undertake this piece of work. It would not be appropriate to set a time scale at present before this exercise reports on feasibility and direction of travel.

3.12 The final consideration is to future proof this policy. This would involve periodic reviews of the policy, relevant metrics, targets and timescales. It would also involve revisiting the policy in the light of developments such as those anticipated by COP26.

3.13 In summary here are the recommendations of this report:

3.13.1 To revise section 6 of the Investment Strategy Statement as per the recommendation in paragraph 3.4.

3.13.2 To include an ambition for decarbonisation into the Fund's investment policy, by incorporating into current investment criteria, as set in paragraph 3.6.

3.13.3 To incorporate the option to allow London CIV concessions, as per paragraph 3.7.

3.13.4 To continue to subscribe to the LAAPF to meet commitments to engage and campaign on social and governance issues, as set out in paragraph 3.8.

3.13.5 To encourage fund managers to report on environment factors, as described in paragraph 3.9.

3.13.6 That officers survey fund managers to identify best practice that can be included in regular performance reporting, as per paragraph 3.10.

3.13.7 That the Committee either select an external provider to measure progress towards net zero carbon and report periodically to the Committee or consider expanding the Pension Fund Investment team to undertake this piece of work. (Paragraph 3.11).

4 CONSULTATION

4.1 Officers have fully consulted with the Pension Fund's advisers in preparing this report.

5 FINANCIAL CONSIDERATIONS

5.1 This report deals exclusively with the management of the Council's Pension Fund.

Approved by: Nigel Cook, Head of Pensions and Treasury on behalf of Richard Ennis, Interim Director of Finance, Investment and Risk, S151 Officer

6. LEGAL CONSIDERATIONS

6.1 The Head of Litigation and Corporate Law comments on behalf of the interim Director of Law and Governance that the provisions of Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 place the following requirements on the Administering Authority in relation to the Investment Strategy:

"7.—(1) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State

(2) The authority's investment strategy must include—

(a) a requirement to invest fund money in a wide variety of investments;
(b) the authority's assessment of the suitability of particular investments and types of investments;
(c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;
(d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
(e) the authority's policy on how social, environmental and corporate governance

considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
(f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

(3) The authority's investment strategy must set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment.

(4) The authority's investment strategy may not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007.

(5) The authority must consult such persons as it considers appropriate as to the proposed contents of its investment strategy.

(6) The authority must publish a statement of its investment strategy formulated under paragraph (1) and the first such statement must be published no later than 1st April 2017.

(7) The authority must review and if necessary revise its investment strategy from time to time, and at least every 3 years, and publish a statement of any revisions.

(8) The authority must invest, in accordance with its investment strategy, any fund money that is not needed immediately to make payments from the fund."

Approved by: Sandra Herbert, Head of Litigation and Corporate Law on behalf of the Interim Director of Law and Governance and Deputy Monitoring Officer.

7. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

7.1 This report contains only information that can be publicly disclosed.

8. HUMAN RESOURCES IMPACT

8.1 There are no direct workforce implications arising from the recommendations within this report.

Approved by: Sue Moorman, Director of Human Resources

9. EQUALITIES IMPACT

9.1 There are no equalities impacts arising from this report.

10. ENVIRONMENTAL IMPACT

10.1 There are no environmental impacts arising from this report.

11. CRIME AND DISORDER REDUCTION IMPACT

11.1 There are no crime and disorder impacts arising from this report.

12. DATA PROTECTION IMPLICATIONS

12.1 **WILL THE SUBJECT OF THE REPORT INVOLVE THE PROCESSING OF 'PERSONAL DATA'?**

NO

12.2 The Director of Human Resources comments that this report relates to matters relating to the administration of the LGPS and the Croydon Pension Fund.

Approved by: Sue Moorman, Director of Human Resources

CONTACT OFFICER:

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Resources Department, ext. 62552.

BACKGROUND DOCUMENTS:

Training material presented to the Pensions Committee

Investing in a Time of Climate Crisis, Mercers, 5th November 2019

London Borough of Croydon ESG Policy, Mercers, September 2021

Appendices:

There are no appendices.