London Borough of Havering Pension Fund

Climate risk plan

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Introduction

- This paper is addressed to the Pensions Committee ("the Committee") of the London Borough of Havering Pension Fund ("the Fund").
- The purpose of this paper is to develop the Fund's plan for addressing climate risk. This paper follows on from the climate risk workshop the Committee held in November 2021.
- This paper should not be released or otherwise disclosed to any third party except as required by law or regulatory obligation without our prior written consent. We accept no liability where this note is used by, or released or otherwise disclosed to, a third party unless we have expressly accepted such liability in writing. Where this is permitted, the note may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

Committee belief

"Climate change and the expected transition to a low carbon economy represents a long-term financial risk to Fund outcomes and should be considered as part of the Committee's fiduciary duty."

Climate risk plan

Build knowledge and understanding

November 2021 climate risk workshop

Baseline position for change

Focus of today's discussion

Create focus areas and frame objectives/targets

Build and implement a plan

Monitor, evolve and report

Be prepared to learn from others

- Set minimum expectations
- Clearly defined goals
- Willing to advocate for change
- Prepared to work with others
- Accepting that tools and data will evolve
- Transparent in activity
- Investing in solutions

TCFD update

TCFD and the LGPS

- DLUHC to issue consultation on TCFD reporting requirements – initially expected summer 2021, but now expected later in 2022. Consultation likely to cover the following areas:
  - **Scope and timing -** will require all funds to comply regardless of size
  - **Governance –** requirement to establish and maintain oversight and management of climate related risks and opportunities (roles and responsibilities/processes)
  - **Strategy –** identify short, medium and long term risks and opportunities, assess impact of climate related risks and opportunities including use of scenario analysis
  - **Risk –** clear process for identifying and assessing climate related risks – concise information on risk tools used and how risks have been identified and managed, both transition and physical
  - **Metrics and targets –** minimum of one absolute emissions metric, one emissions intensity metric or one additional climate change metric. One metric must be used as a target and reported annually
  - **Knowledge and understanding –** guidance and best practice on knowledge, requirement to take proper advice
  - **Disclosure –** annual report to be published and accessible through public website, potentially free standing. SAB will also publish a scheme wide report annually

Requirements structured around four themes…

TCFD | TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

TCFD recommendations are structured around **four thematic areas** that represent core elements of how organisations operate**:**

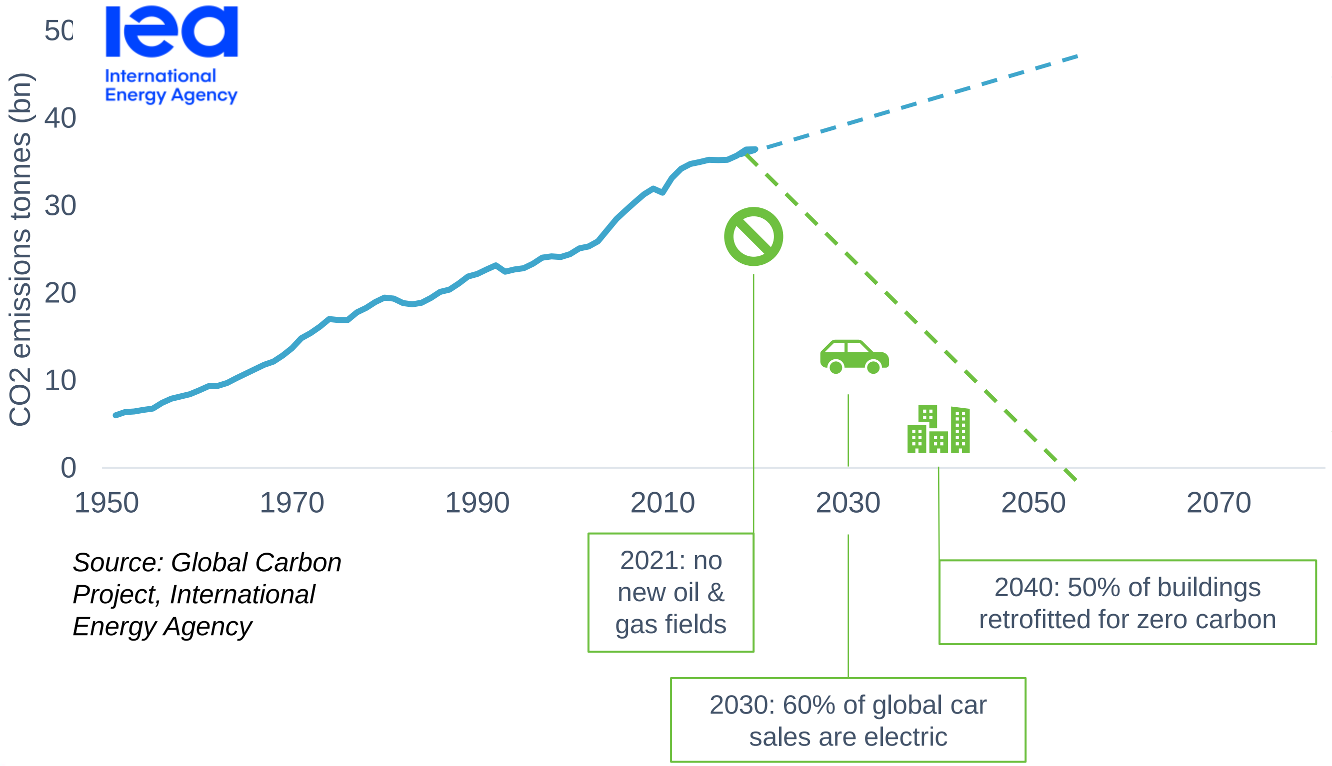
- **Governance:** Disclose the Fund's governance around climate-related risks and opportunities
- **Strategy:** Disclose the actual and potential impacts of climate-related risks and opportunities on the Fund where such information is material
- **Risk management:** Disclose how the Fund identifies, assesses, and manages climate-related risks
- **Metrics and targets:** Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material

Taking next steps on climate change

What is "net zero"?

“Net zero” means reaching a state of the world where there is a balance between the greenhouse gases human activity discharges into the atmosphere and the emissions that can be safely absorbed by natural processes or which are otherwise removed. Policy pathways towards net zero will determine the nature of the climate risks faced by asset owners.

As shown in the chart below, carbon emissions have rapidly increased in the last 70 years and the change required to achieve net zero is huge, and is therefore likely to be a key driver of risk and return in future.



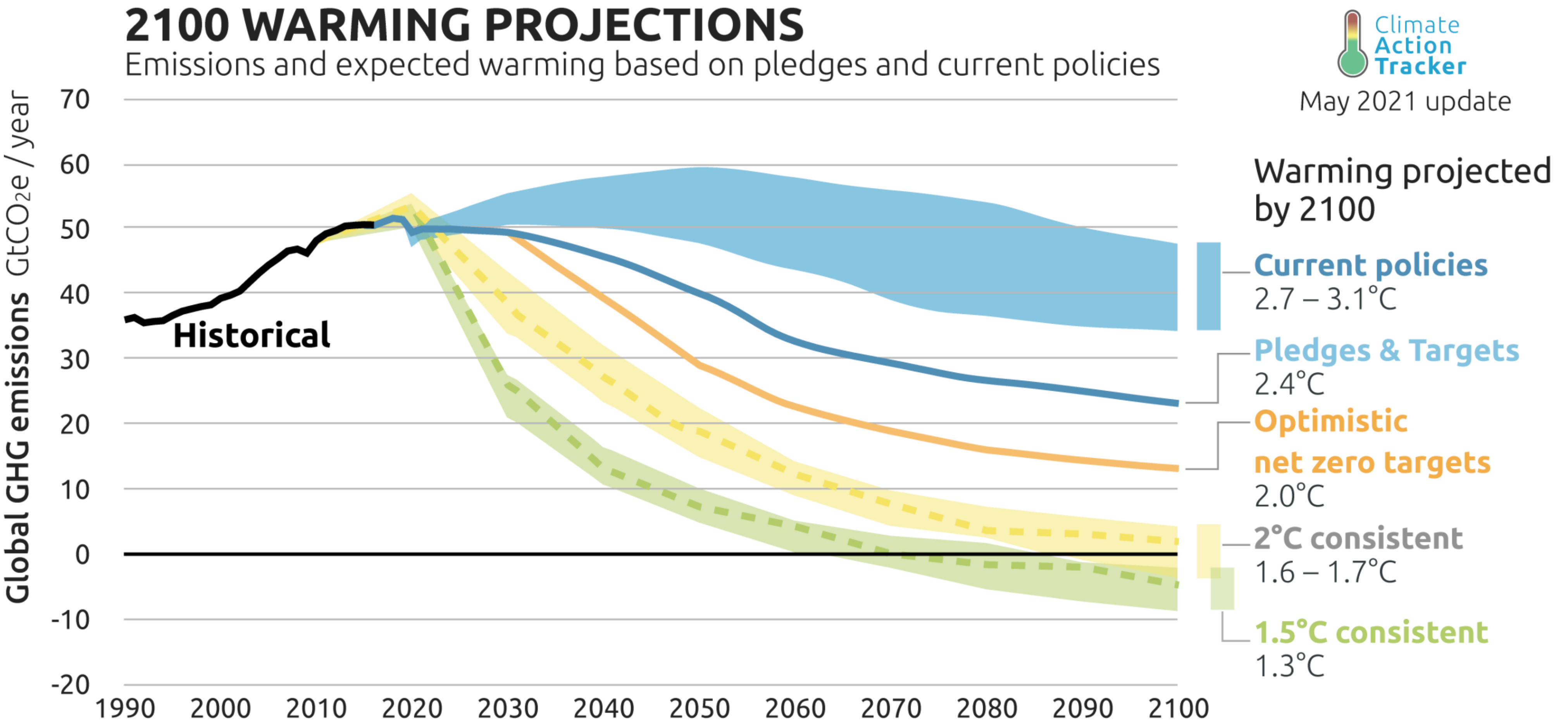
Source: Global Carbon Project, International Energy Agency

Limited policy action
>2 degree warming by 2100
Significant **physical** risks

Strong policy action:
<2 degree warming by 2100
Significant **transition** risks

Pathways create stranded assets

Global warming- the need for Net Zero targets



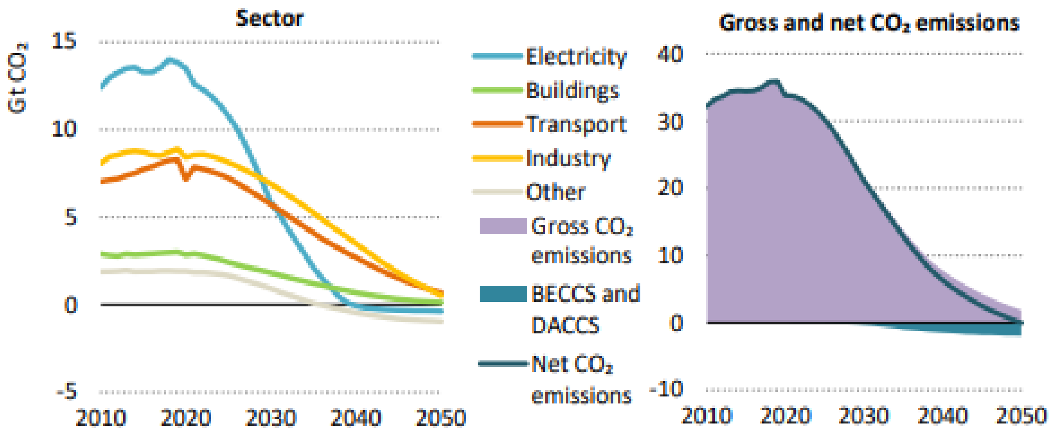
Source: Climate Action Tracker (May 2021 briefing)

Global carbon budget

The **IPCC** estimate that the world can emit:

- 400 GtCO2e for a 67% chance of staying below 1.5°
- 500 GtCO2e for a 50% chance of staying below 1.5°
- 1,150 GtCO2e for a 67% chance of staying below 2°

Global net-CO2 emissions by sector and CO2 emissions for Net Zero pathway



Source: UN Emissions Gap Report

The **MSCI Net-Zero Tracker** report estimates that:

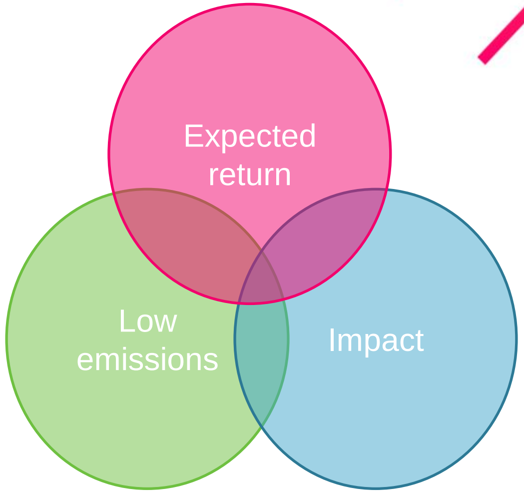
- Remaining carbon budget for publicly listed companies is c58 GtCO2e (scope 1 only)
- The estimated direct (scope 1) emissions of listed companies are currently 11 GtCO2e per annum
- At the current rate, listed companies will burn through their share of the global carbon budget for keeping temperature rise below 1.5°C by Nov 2026

Alignment with goal of limiting temperature increases

Source: MSCI Net-Zero Tracker Report

Some key decarbonisation challenges

- The Committee must not lose sight of its primary obligation to pay benefits to the members of the Fund, including consideration of any associated risks
- Decarbonising a portfolio which is invested globally, across many sectors, is more challenging than decarbonising individual, carbon-light organisations
- Decarbonising whole economies without causing grave damage to individuals prosperity and standard of living will take many years; a balanced approach (a just transition) is required
- Switching to a low carbon portfolio over the short term will not necessarily support the global transition to net zero
- Measuring climate risk effectively remains challenging particularly in private markets
- Effective management of climate change will involve capturing opportunities as well as mitigating risks
- Effective engagement is harder than divestment, but more constructive
- Robust investment solutions are only now becoming available



Achieving a good balance is key

Sustainable investment can be about more than limiting climate change

Local government pension scheme net zero targets

- Funds with stated targets are split as follows:
  - 2030 – 3 Funds
  - 2037 – 1 Fund
  - 2040 – 2 Funds
  - 2045 – 3 Funds
  - 2050 (or “2050 or earlier”) – 18 Funds

- 33 Funds have not set a net-zero target date
  - Of these, 8 have stated they expect to set a target date with the next 12 months
  - 3 have stated they are waiting for the government’s consultation on climate reporting (expected this summer) before deciding to set a target

Source: Local Government Chronicle – publication date 10 March 2022

Net zero framework overlaps with TCFD

Governance and strategy	❑ Commit to goal of net zero emissions by 2050 or sooner ❑ Define beliefs and set strategy/objectives for managers & others ❑ Undertake risk assessment in line with TCFD ❑ Publish clear action plan and disclose information in relation to net zero goal
Targets & Objectives	❑ Set medium term emissions reduction (<10 years) ❑ Set medium term climate solutions targets (<10 years) and define measurement basis ❑ Set asset class targets for % AUM in material sectors achieving or aligned to net zero ❑ Set engagement goal for % financed emissions in material sectors subject to stewardship
Implementation	❑ Use appropriate portfolio construction approaches to build climate aligned strategy ❑ Clear climate aligned engagement/voting plan with escalation ❑ Use of selective divestment based on cliamte related financial risks
Strategic Asset Allocation	❑ Update capital markets assumptions based on scenario analysis ❑ Use broader range of climate metrics to set objectives and strategy ❑ Set asset class mix with climate variants ❑ Review constraints to increasing alignment
Advocacy & Engagement	❑ Advocate for net zero policy, regulation, disclosure and shareholder rights ❑ Engagement with asset managers ❑ Engagement with other market actors

TCFD and Net Zero metrics

Emissions metrics

- TCFD for absolute and intensity metrics
- Net zero – reduction targets covering equity, corporate debt and real estate
- Evidence of how the targets are determined

Alignment metrics

- TCFD expectation around measuring alignment with Net Zero/Paris trajectory
- Measure at an individual mandate level and determine allocations that are aligned/misaligned to net zero trajectory
- Identify individual holdings that are misaligned and engage with managers. Set target for engagement

Climate solutions

- No TCFD expectation around solutions, although could be an additional metric
- Need to define climate solutions and what is encompassed by this
- Net zero framework suggests a target for allocating to climate solutions. Consider as a potential ambition?

Key question to address: Should the Fund set a Net Zero ambition?

Summary and next steps

We suggest the next steps for Committee are as follows:

- Include basic TCFD reporting in the report & accounts for 2021/22, reflecting actions taken over the last year
- Continue to include climate considerations as part of investment decision making – in particular as part of the emerging market equity review later this year
- Assess the Fund’s current position against a series of standard metrics as at 31 March 2022 – this will address ongoing reporting requirements and allow a baseline position to be set
- Consider whether a net zero goal should be set, and if so, what date should be adopted
- Subject to the consultation requirements and Committee decisions, plan what additional actions need to be taken to meet Fund requirements

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Appendix: Current manager position

Current position: Equity/Multi-Asset

Mandate	Mandate integrates climate considerations	Manager a NZAMI signatory	Manager supports Climate Action 100+	Action needed
LGIM Global Equity	No	Yes	Yes	Yes. 5% remaining allocation should be revisited in future.
LGIM Emerging Markets	No	Yes	Yes	Yes. Review of Emerging Market allocation to take place in H2 2022 – climate considerations should be factored into review.
LGIM Future World Fund	Yes	Yes	Yes	No
LCIV Global Alpha Paris Aligned Fund	Yes	No (LCIV) Yes (Baillie Gifford)	Yes (LCIV) No (Baillie Gifford)	No
LCIV PEPPA Fund	Yes	No (LCIV) Yes (State Street)	Yes (LCIV) Yes (State Street)	No
LCIV Absolute Return Fund	Not explicitly	No (LCIV) No (Ruffer)	Yes (LCIV) Yes (Ruffer)	Not immediately. Fund has higher carbon and fossil fuel exposure than benchmark – this may need to be explored further in future
LCIV Diversified Growth Fund	Not explicitly	No (LCIV) Yes (Baillie Gifford)	Yes (LCIV) No (Baillie Gifford)	

Current position: Real Assets

Mandate	Mandate integrates climate considerations	Manager a NZAMI signatory	Manager supports Climate Action 100+	Action needed
UBS Triton Property	No	Yes	Yes	No. Has been ranked highest in its peer group in the Global Real Estate Sustainability Benchmark for the 5th consecutive year.
CBRE Global Property	No	No	No	Not immediately. Still meets the Fund's needs and performs in line with expectation.
JP Morgan Infrastructure	Not explicitly	Yes	Yes	Not immediately. C.25% of the portfolio is invested in renewable energy infrastructure.
Stafford Infrastructure	Not explicitly	Yes	No	No
LCIV Renewable Energy Infrastructure	Yes	No (LCIV) Yes (BlackRock) Yes (Stonepeak) No (Foresight) Yes (Quinbrook)	Yes (LCIV) Yes (BlackRock) No (Stonepeak) No (Foresight) No (Quinbrook)	No

Current position: Credit Assets and Currency Overlay

Mandate	Mandate integrates climate considerations	Manager a NZAMI signatory	Manager supports Climate Action 100+	Action needed
Royal London Credit	No	Yes	Yes	Yes. Multi-asset credit funds with an ESG focus should be explored.
Churchill Private Debt	Not explicitly	No	Yes (parent company Nuveen)	No
Permira Private Debt	Not explicitly	No	No	No
Russell Currency Overlay	n/a	Yes	Yes	No

Risk warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.