Climate Risk Plan – Baseline

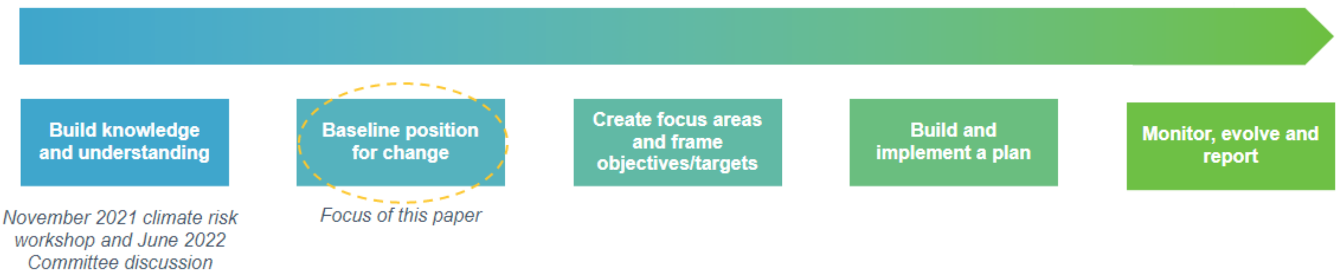
Introduction

This paper is addressed to the Committee of the London Borough of Havering Pension Fund ("the Fund"). This paper gives an indication of the Fund's current positioning on a number of climate related metrics and is designed to help give reference to future net-zero related objectives which may be set. We accept no liability where the paper 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 paper may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

Background

The Committee have a belief that: "*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*."

To help manage this risk, the Committee are developing a climate risk management plan with the desire to link this to a broader net-zero goal. To help frame any objectives which may subsequently be set, this paper begins to establish a baseline for the Fund's current level of carbon exposure across the various investments and considers other climate related metrics that can also be considered. Establishing the baseline in the context of developing the wider climate risk plan is illustrated below.



In the context of a broader net-zero goal, it is appropriate to consider a range of climate related metrics, recognising that climate risk and opportunities cannot be described by a single measure. In particular, when framing such metrics, reference can be made to both the expected requirements of TCFD (which are yet to be published for the LGPS) and the broader, more comprehensive, Net Zero Investment Framework.

The objective of adopting a net-zero goal is to ensure that the Fund's assets both reflect and support the longer-term transition to a low carbon economy. Consequently, the baseline to be set should reflect a number of attributes including:

- **Current carbon emissions**: Given the goal is to reduce carbon emissions to net-zero, so this will reflect a key measure to be considered. Weighted Average Carbon Intensity and Carbon Footprint are key metrics to be considered here.
- **Potential pace of change in future carbon emissions**: To the extent that the Fund is invested in higher-emitting assets, what steps are being taken by managers and companies to reduce emissions. Forward looking, alignment type metrics are key here alongside measures of exposure to materially affected sectors.
- **Engagement goals**. Where there are investments in sectors with higher emissions, the extent to which the companies held are being challenged to do more is key. This reflects the exercise of stewardship by the Fund and its managers to ensure that efforts are being aligned. There are various ways this can be assessed, looking at manager commitments through to the individual companies being engaged.

- **Investment in solutions**. Whilst there is a need to decarbonise existing investments, capital can be committed to assets that facilitate the process of change (solutions). Exposure to such solutions can be monitored although the Fund should be clear on what constitutes a solution.

Data considerations

The baseline and objectives set by the Fund will reflect a number of these metrics. The starting point is to consider the extent to which these factors can be measured and to assess this, we have first considered the data that is already available to the Fund, rather than through undertaking any bespoke analysis. This data is set out in the table overleaf although we make the following observations:

- Reporting on climate related matters is in its early stages and there is still significant variation in the style and content of reporting produced by different managers and across different asset classes. This can be seen by the various gaps highlighted in the table below. Over time we expect there to be improvements in data being reported, particularly driven by regulatory requirements to report on specified metrics.

- Assets that are publicly listed are generally a lot easier to measure as the amount of available data on the underlying holdings is better reported and more transparent. This is part of the reason why there are more metrics shown below for the equity, multi-asset and RLAM bond mandates than for some of the private market mandates.

- As noted above, different metrics have different purposes. Building on the points set out above, we have sought to identify available data on four different data points. A formal definition of each is included in the appendix but at a higher level, the following

    - **Weighted Average Carbon Intensity** (“WACI”) gives an indication of where each portfolio is today and current positioning from a carbon exposure perspective. The lower the number, the less exposed to carbon, and therefore better positioned for the transition to a low carbon economy.

    - **% Portfolio with ties to Fossil Fuels** gives an indication of the current reliance of each portfolio on revenues related to fossil fuels and gives an initial assessment of exposure to materially affected sectors.

    - **Implied Temperature Rise** shows the projected temperature rise implied by the underlying assets held in each portfolio. A metric of 2°c suggests that the portfolio companies’ current emissions and management strategies are aligned with a 2°c climate change scenario. Over time we expect to see this score reduce as wider action is take across the industry to work towards the 1.5°c target included in the Paris Agreement.

    - **Exposure to Green Revenues / Climate Solutions** provides a measure of where mandates are investing in solutions type assets, with the higher the number indicating a greater proportion of the investment is related to the transition to a low carbon economy. As an example, the two Stafford infrastructure mandates have high scores on this metric given they have significant allocations to renewable energy infrastructure.

- We have sourced the data in the following table from investment managers. The methodology for calculating certain metrics may therefore differ slightly although we do not believe this to be a concern at this time.

- We have also included an indicator on whether each manager has made a formal “net zero” commitment in relation to their invested assets, measured as to whether they are a signatory to the Net Zero Asset Managers Initiative (NZAMI).

Baseline metrics

Mandate	Climate related metric				
	WACI (tCO2e / £m)	% of Portfolio with Fossil Fuel Ties	Implied Temperature Rise	Exposure to Green Revenues / Climate Solutions	NZAMI Signatory
MSCI ACWI	163	12%	3.4°c	5%	n/a
Equity					
LGIM All World	177	-	3.0°c	4%	Yes
LGIM Emerging Markets	380	-	3.4°c	7%	Yes
LGIM Future World	146	-	2.7°c	5%	Yes
LCIV BG GAPA	107	0%	-	-	Yes*
LCIV PEPPA	120	1%	-	-	Yes*
Multi-Asset					
LCIV Ruffer	266	15%	-	-	Yes*
LCIV BG DGF	441	14%	-	-	Yes*
Real Assets					
UBS	41	0%	-	-	Yes
CBRE	-	0%	-	-	Yes
JP Morgan	-	22%	-	-	Yes
Stafford II	-	21%	-	35%	Yes
Stafford IV	-	12%	-	32%	Yes
LCIV Renewable Infra	-	-	-	-	Yes*
Bonds					
RLAM MAC	127	2%	3.6°c	6%	Yes
RLAM Corporate Bonds	145	14%	2.7°c	20%	Yes
Churchill II	-	0%	-	-	No
Churchill V	-	0%	-	-	No
Permira	9	0%	-	-	No

**LCIV is not a signatory but each underlying manager is. Source: Investment managers.*

Comments

We make the following comments and observations regarding the above data:

- All managers are signatories to the Net Zero Asset Managers Initiative (see appendix for more detail) with the exception of Churchill, Permira and LCIV. However all underlying managers appointed to manage the LCIV funds (Baillie Gifford, Ruffer, State Street, BlackRock, Foresight, Stonepeak and Quinbrook) are signatories. LCIV has a commitment to become net-zero by 2040 and have an established plan to work towards this goal.
- The emerging markets equity allocation fund has a relatively high WACI. Emerging market countries are generally behind developed market countries with regard to climate policies and adopted practices, and therefore a high WACI is to be expected. However, a high WACI for this fund does provide more opportunity to influence change and reduce the WACI going forward than may be the case for developed market equities.
- The LCIV Global Alpha Growth Paris Aligned fund, LCIV PEPPA fund and LGIM Future World Fund all incorporate explicit climate considerations in their management and hence we expect to see lower reported carbon emissions. Further, the two LCIV equity funds seek greater alignment with the Paris Agreement and have explicit management interventions that will ensure that companies held are more clearly aligned with a net zero goal.

- The LCIV Diversified Growth Fund ("DGF") has a very high WACI. This is primarily down to the fund having a high allocation to renewable energy infrastructure. Although building renewable energy infrastructure is a fundamentally important part of transitioning away from fossil fuels, the physical process of building the infrastructure requires a lot of carbon intensive materials such as cement and steel and therefore reflects badly from a backward looking WACI perspective. Although not reported by the manager (and therefore not show in this table) we would expect this fund to have a higher contribution to climate solutions.
- The implied temperate rise of the portfolio where it has been calculated by managers is significantly above the 1.5°c level implied by the Paris Agreement for all funds measured. This highlights the rate of change the global economy will have to undertake over the coming years to achieve the target.
- Data in respect of bonds and real asset mandates is less complete with only RLAM and UBS having disclosed information on carbon emissions. Our broader research suggests that the collection and reporting on climate data within private markets mandates is less well developed and that asset owners should set clear expectations of asset managers in this regard ahead of framing more clearly defined net zero goals.

Next steps

The first aim for the Committee is to consider its objectives with particular regard to a net-zero ambition. As illustrated in the table, data is most comprehensive within equity and multi-asset mandates suggesting it will be easier to define goals for these asset classes first. As a starting point, for these asset classes, we suggest the Committee seeks to:

- Broaden the data available in respect of equity and multi-asset mandates through direct engagement with LCIV and LGIM to ensure consistency and completeness.
- Consider the potential implications of framing emissions reduction targets of 25-50% over the next 5-10 years and how this could be achieved.
- Consider the extent to which the engagement goals of both LCIV and LGIM are aligned with the Committee's climate aspirations and what each managers' priorities are.
- Drawing on this information, determine an initial net-zero aspiration.

As noted, data in respect of bond and real asset mandates is less complete and further information is necessary to be able to frame an appropriate baseline. The key action that Committee can take is to set out its expectations from managers on reporting. We recommend that Committee write to their managers in this regard as an initial stewardship action.

We look forward to discussing this with Pensions Committee at their forthcoming meeting.

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For and on behalf of Hymans Robertson LLP

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Appendix

Weighted Average Carbon Intensity ("WACI")

A measure of a portfolio's exposure to carbon-intense companies. This is expressed in terms of tons of CO2 equivalent emitted per million dollars of revenue, weighted by the size of the allocation to each company. Is measured using scope 1 + scope 2 emissions. Scope 1 emissions are those from sources owned or controlled by the company, typically direct combustion of fuel as in a furnace or vehicle. Scope 2 emissions are those caused by the generation of electricity purchased by the company.

% Of Portfolio With Ties to Fossil Fuels

The percentage of the portfolio invested in companies with an industry tie to fossil fuels (thermal coal, oil and gas), in particular reserve ownership, related revenues and power generation. It does not flag companies providing evidence of owning metallurgical coal reserves.

Implied Temperature Rise

The security's alignment temperature when referencing a combined approach which takes into account Scopes 1, 2, 3 and "cooling" potential (including emission reduction targets set by the firm). An ITR of 2°c suggested that the company's current emission and management strategies are aligned with a 2°c climate change scenario.

Exposure to Green Revenues / Climate Solutions

The weighted average % of revenue for portfolio companies derived from revenue generated by economic activities relating to the transition to net zero, which typically meet the requirements of the EU Taxonomy on Sustainable Finance.

Net Zero Asset Managers Initiative (NZAMI)

The Net Zero Asset Managers initiative is an international group of asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with net zero emissions by 2050 or sooner.

Paris Agreement

The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at COP 21 in Paris, on 12 December 2015. Its goal is to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels.