London Borough of Havering Pension Fund

Climate Risk Policy - considerations

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Executive Summary

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 to outline some of the considerations associated with the commitments included in the Fund’s draft climate plan. This paper should be read in conjunction with the draft climate plan.
- This paper the following sections:
  - Net-zero target date – providing some implications associated with different net-zero target dates, and rationale behind suggesting the Fund adopt a 2050 ambition
  - Other climate related targets – giving an overview and providing comment on the other climate related targets included in the policy
  - Further sections – covering the remaining sections in the policy
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Net-zero target date

Example net-zero goals and considerations

Timeframe	2030	2035	2040	2045	2050	2060
Sovereign examples	Barbados, Maldives	Finland	Iceland	Sweden, Germany	US, EU, Japan, UK	China, Russia and India (2070)
Pension examples	South Yorkshire	BT	London Borough of Lambeth	Environment Agency	Scottish Widows, NEST	None
Asset considerations	• Very limited universe of asset classes/stocks • Intensive use of offsetting required		• Increasing investment universe, large number of exclusions • Use of offsetting required • Significant engagement and advocacy required	• Wide investment universe, some exclusions • Promote climate-strategy innovation • Strong engagement and advocacy	• Wide investment universe, limited exclusions • Adoption of climate-driven investment strategies • Proactive engagement	• Unlimited investment universe • Climate-passive investment strategies • "Free riding"
Implications	• Lower financial returns • Reduced diversification, increased risk • Limited contribution to financing the decarbonisation process • Use of scarce offsetting capacity • Offsetting costs		• Returns dependent on rate of low carbon adoption • Reduced diversification, increased risk • Short-term volatility and execution costs likely higher • Limited opportunity to support climate solutions providers	• Potentially enhanced medium term financial returns from evolving markets • May capture higher proportion of climate opportunities • Short-term volatility and execution costs likely higher • Opportunity to support climate solutions providers	• Market aligned financial returns • Balance progressive reduction in carbon emissions with support for climate solutions providers	• Potential for higher short-term and future financial returns from unwanted holdings • Potentially higher risk
Required changes to strategy	• Significant change to all areas of the strategy	• Change to equity and income portfolios to further limit carbon exposure • Increased focus on carbon offsetting investments	• Some changes to equity portfolio likely required • Climate metrics required for illiquid and property assets required to determine changes • Increased focus on carbon offsetting investments	• Limited change in short-term • Carbon offsetting should be considered • Longer-term change dependent on rate of wider low carbon adoption	• Limited change in short-term • Longer-term change dependent on rate of wider low carbon adoption	• No change

Source: ClimateWatch

Suggested 2050 target date

- Committee has previously expressed a desired to set a net zero ambition for the Fund. At this time, we suggested the Fund frame this ambition as being net-zero by 2050
- We view 2050 as an appropriate date for the Fund to target as it strikes a balance between:
  - Positioning the Fund to benefit from opportunities that will arise during the transition to a low carbon economy by creating an expectation of action
  - Reducing exposure to stranded asset risk and other risks associated with the transition by compelling the Fund to consider whether its actions are consistent with its long-term ambition
  - Maintaining a broad investment universe which allows time for corporates to develop and implement climate transition plans
  - Retaining the opportunity to help finance the decarbonisation process and use Fund capital to support climate solutions providers
- The UK, and the majority of other major economies, have a target net-zero date of 2050
- The London Borough of Havering has a 2040 carbon neutral target (though note this target is for operations rather than financed emissions / carbon footprint of investments as is being suggested for the Fund)
- We consider the expected actions required to achieve net-zero by 2050 across the portfolio overleaf

Expected action required to achieve 2050 target

	Current Target	Action required short-term (1-3 years)?	Action required medium-term (3-7 years)?	Comments
Listed equities	40.0%	Yes	Possibly	• Material actions have been taken in recent years which have reduced emissions • Actions over the medium-term will depend on the rate of progress across key regions/sectors the Fund is exposed to • Primary focus of action will be on ensuring effective engagement by LCIV and LGIM to drive change
Multi-asset growth	12.5%	Yes	Likely	• The LCIV Absolute Return Fund has relatively high emissions so action likely over the medium term • Primary focus of action will be on ensuring effective engagement by LCIV to drive change
Property	10.0%	Possibly	Possibly	• Limited monitoring metrics currently available • Carbon footprint of commercial UK property receiving external attention and likely to reduce in the coming years • Need to ensure that managers are addressing climate issues in building management
Infrastructure	12.5%	Unlikely	Possibly	• Limited monitoring metrics currently available and heavy reliance on estimates • Data currently available suggests relatively low emissions • Need to ensure that actions are being taken within infrastructure funds • Potential route for gaining exposure to climate solutions
Private debt	7.5%	No	Yes	• Limited Metrics currently available and heavy reliance on estimates, though this is expected to improve in time • Allocation likely to be reviewed in the medium term to assess the alignment with a net-zero portfolio • Reinvestment of capital can be subject to stronger climate ambition • Likely to see emergence of "impact debt" strategies which should be considered by Committee
Gilts	5.0%	No	Unlikely	• UK ahead of other governments in making plans for achieving net zero. Currently rated 'almost sufficient' • UK achieves its net zero target by 2050, then investments in government debt should at least move closer towards net zero by this time • Potential for broader policy engagement
Multi-asset credit	7.5%	No	Likely	• Current metrics are broadly in line with benchmark • Mandate with more focus on ESG characteristics may be considered in future
Investment Grade Credit	5.0%	No	Possibly	• Expected to be retained for the shorter term, with proceeds to be directed towards private market assets over time.

Other climate related targets

Portfolio level

	Targets	Comments	Actions required
Portfolio emissions	• Ambition to reduce financed emissions to net zero by 2050 at the latest • Interim target to reduce scope 1 and 2 emissions on listed equities by 50% compared to the 2022 baseline level by 2030	• 2050 suggested target as discussed on previous slides • Financed emissions are the greenhouse gas (GHG) emissions linked to the Fund's investment activities. This is essentially the carbon footprint of the Fund's investments • Suggested interim 50% listed equity reduction target broadly aligned with net-zero by 2050 and focused on an asset class with greater data quality and coverage already available	• Combination of capital allocation and engagement. Extent of capital allocation changes will be determined in future years depending on rate of progress / low carbon adoption • Engagement with the London CIV will be a key focus, with the development of compelling decarbonisation solutions a priority • Focus on clear decarbonisation pathways across investments (even where not included as a formal objective)
Climate solutions and opportunities	• 10% asset allocation to climate solutions by 2030, with potential to consider further increasing allocations past 2030 • Positive impact to deforestation, biodiversity loss, social factors and climate adaptation are key factors included in decision-making	• Renewable energy infrastructure is a growing element of the exposure to climate solutions although other avenues can be considered • Local investment also being considered which may result in a positive social impact investment • Timberland/reducing deforestation may also be considered in future	• Consider extending allocation to renewable energy • Consider local investment with positive social impact • Emphasise climate solutions in new allocations to private market assets

Asset level

	Targets	Comments	Actions required
Alignment	• Minimum 50% alignment of listed assets aligned with an appropriate net zero pathway by 2030 • At least 75% of heavy emitting sectors aligned with a net zero pathway by 2030 • 50% of real assets aligned with net-zero by 2030	• Further analysis of portfolios will be needed to understand exposures, but this can be undertaken incrementally • Need to categorise investments into those which are aligned, aligning or not aligned • Heavy emitting sectors require greater rate of change and therefore key to ensure the majority of exposure to these sectors is aligned with a net-zero pathway by 2030	• Focus on engagement with investment managers (including LCIV) initially • Mandate alignment will be considered alongside engagement; in particular any new commitments to unlisted assets
Engagement	• Engage collaboratively, via the investment managers, with the most misaligned companies (at the portfolio level) in the heavy emitting sectors • Deforestation, biodiversity loss, social factors and climate adaptation are key engagement topics • Emissions data available and robust for all asset classes by 2025	• Focus has to be on dialogue with key managers as their actions are critical • Need to be able to assess whether managers are doing their job well, so an evaluation framework is necessary • Data coverage and availability will be crucial in accurately assessing net-zero progress so aiming to have a complete picture by 2025	• Identify key exposures through portfolio monitoring and raise issues with manager • Engage to support improving data availability and quality

Further sections

Data, Asset Class Coverage and Emissions

- This section gives an assessment of the data availability for each asset class within the Fund's strategy. In particular, the current reliance on estimates, or lack of any data, across the portfolio is highlighted
- A comment is also included on the different "scopes" of emissions and significance of scope 3 emissions, despite the difficulties in accurately measure scope 3 emissions at this stage (see appendix for definitions of the different scopes)
- We expect improvements in the quality and coverage of data in the coming years and Committee have their part to play in accelerating this process by continuing to engage with, and put pressure on, managers to make improvements
- The baseline assessment of the portfolio on a range of climate related metrics is also included in this section. This assessment is as at 31 March 2022 (where data at that date was available)

Investment process (1)

- This section is focused on the steps the Committee will take in building strategy and how climate considerations are integrated. Issues to highlight are set out below:
- Framing objectives
  - Recognise that the goal is system change and that the Fund is a participant in the broader system. Fund level decarbonisation is a necessary step
  - Objectives will evolve as more information becomes available and data gets better
  - Objectives should be associated with actions and we have sought to reflect this in having an action oriented plan.
- Journey planning
  - Framing strategy will necessitate ongoing analysis of investment portfolios to ensure that Committee has an appropriate understanding. There are several Net Zero frameworks that can be used to support this analysis.
  - Assessing portfolios individually will build up a portfolio level picture, but can be undertaken incrementally.
  - The consideration of net zero also necessitates the consideration of associated issues, such as deforestation and nature in addition to the idea of a “Just Transition”. This can be incorporated into an evolving approach
- Risk Management
  - Aligned to the expected requirements of TCFD, assessing risk will be an expectation of committee
  - Risk arises from physical and transition sources, and there should be a means of understanding these exposures where possible and managing these risks.
  - Having an appropriate risk management framework in place to assess risk will be an important action

Investment process (2)

- Identifying opportunities
  - The climate transition will inevitably create investment opportunities as the need for decarbonisation gain pace.
  - Understanding where potential winners and losers may arise will be an important consideration and having a clear basis for evaluating opportunities may also be helpful
  - We think it sensible to focus on strategies that encourage decarbonisation (i.e.. Emissions reducers) and those which remove emissions, noting that the latter may be more nature based in the immediate short term
- Active stewardship
  - Stewardship is expected to comprise two elements
  - Engagement with managers/LCIV is directly within the Committees control. There is an expectation that such engagement will take place regularly
  - Engagement with underlying entities is outwith the Committees direct control. Understanding and challenging the actions of others should be the focus of Committees activity
  - Framing clear expectations and desired outcomes at both levels may be sensible
- Measuring and accountability
  - Expect that data will be captured annually and metrics updated and assessed against targets
  - Metrics can be changed as understanding develops
  - The overall plan should be re-evaluated periodically – every three years would seem to be an appropriate frequency
  - A sector level deep dive can be undertaken to inform engagement activity. This approach has proven helpful with other clients

Governance and reporting

- The final section is focused on the key stakeholders and the expectations that Committee should have of them. This includes the responsibilities of the Committee itself
- Key stakeholders also include advisers, officers, investment managers and the London CIV
- Expectations can be set for each party (theses can be changed/refined) with Committee then able to scrutinise whether expectations have been met
- It is anticipated that reporting on governance and having an appropriate climate governance framework will be a key element of the TCFD regulations

Glossary

Green revenue	Revenue generated by economic activities relating to the transition to net zero, which typically meet the requirements of the EU Taxonomy on Sustainable Finance
Scope 1 emissions	All direct greenhouse gas emissions
Scope 2 emissions	Indirect emissions from consumption of electricity or heat
Scope 3 emissions	All other indirect emissions in the value chain of the company, including both upstream and downstream emissions
Material sectors	Companies undertaking activities material to the transition to net zero, specifically Nomenclature of Economic Activities (NACE) code categories A-H and J-L. These categories include sectors such as mining and quarrying, manufacturing and construction.
Paris-aligned benchmarks	Benchmarks such as the Paris Aligned Benchmark or Climate Transition Benchmark in which companies are weighted based on degree of alignment with net zero goals and which aim to deliver a material reduction in emissions intensity vs relevant market cap indices (-50%/-30% respectively) and 7% year-on-year reductions in carbon footprint

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.