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Paris Alignment Forum

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Asset-owner event – shared experiences - introducing climate action to a pension fund portfolio

September 2021

What are Paris Alignment Forum asset-owner events?

The Paris Alignment Forum runs a series of asset-owner events which are exclusively for pension funds and other asset owners. They provide an opportunity for frank, peer-to-peer discussion around the progress and challenges associated with incorporating climate action into pension fund governance and strategy. Discussions follow "Chatham House" rules, so we report on the proceedings of the meeting, but comments are not attributable. These events begin with a case study of one asset owner's climate action approach, followed by a sharing of experiences.

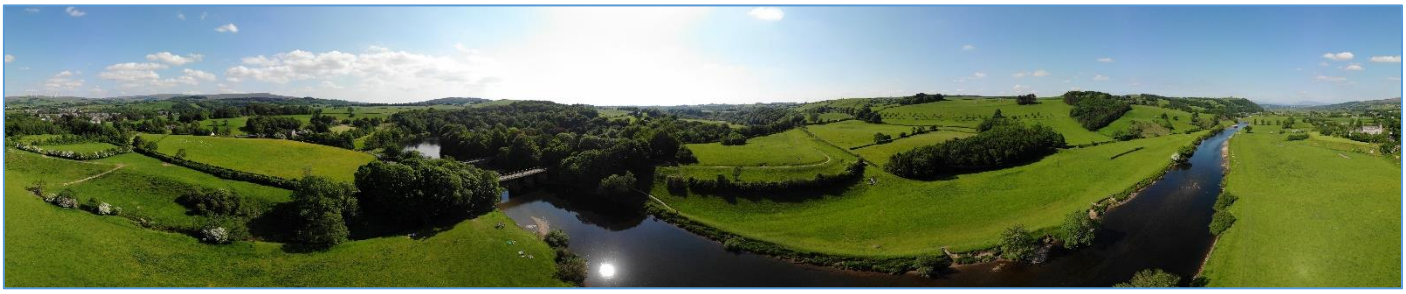
Case Study – London Borough of Islington Pension Fund

We were delighted to have a range of corporate, LGPS, DB and DC pension funds at our September asset owner event and it proved why sharing experiences on a universal issue such as climate change is so valuable. Participants represented a range of pension funds including public and private sector defined benefit funds and defined contribution pension funds and master trusts. Different participants were at different stages of their journey. Themes from the different types of schemes are outlined overleaf.

Karen Shackleton hosted the fireside chat with Joana to understand how, when and what the London Borough of Islington Pension Fund had achieved in considering and then setting climate targets.

Information about the London Borough of Islington Pension Fund's investments:

- £1.7bn in assets
- 45% in global equities (including emerging markets)
- 10% in infrastructure
- 20% in real estate
- 10% in private debt
- 5% in private equity.



The Fireside Chat

When did London Borough of Islington first start thinking about climate action?

"The members of the committee were very specific about their fiduciary duty and that climate change presented a risk. They were prepared to do anything to mitigate that risk. In 2014 we therefore sought advice. We were told that we would need to specify this in our statement of investment principles and in our policies. Once we embedded these considerations in our policies and therefore investment decisions, we then looked at the portfolio to understand where the risks lay. In 2016 we had already agreed to look at our equities and reduce the carbon footprint."

"A climate emergency was also declared by the council and there was some pressure from the campaign group 'Fossil Free Islington'. The calls were for divestment but there were concerns about our fiduciary duty. We decided to embark on training using external advisers, for members of the committee, to understand the impact of the investments on the climate."

How did you set climate targets?

"In 2016 we did an initial carbon footprint exercise. That would then be our baseline from which we would measure improvements over time. We set ourselves a target of a 50% reduction in carbon emissions from our baseline by 2022. These targets are reviewed on an annual basis, and this includes engaging with the fund managers on their ratings and performance. In order to meet our targets, we agreed an allocation to green sustainable and impact opportunities of up to 15% by 2022. We also focused on less carbon-intensive indexes, which made a significant difference. "

Are you on track to meet those targets?

"Yes, we are on track to meet our targets."

What are your new targets on your journey to net zero?

"We had a day of training with the members to ensure we created a realistic target for the fund that didn't require us to sell off significant portions of the portfolio. We ended up setting a net zero target of 2050 but with medium and short-term goals, including a 60% reduction by 2030 (using the 2016 baseline). We will also be extending our investment in green impact opportunities from 15 to 20%."

Will it become more challenging over time to achieve your targets?

"We accept that it is going to be more difficult as we analyse the different asset classes. We have to make sure that we are clear with our fund managers what our targets are and that this is crucial criteria on which they will be measured. The annual review also helps with this."

The questions from pension fund attendees.

You have a high property allocation. What is your strategy to reduce your carbon footprint here?	"We engage with each of the managers in the portfolio to understand how they are moving to or trying to create a more sustainable portfolio."
How did you get members comfortable with a 2050 rather than 2030 net zero target date?	"The training and climate scenario analysis helped us to understand that a 2030 date would be impossible to achieve without selling off significant portions of our portfolio. That would not meet our fiduciary duty. As with all of these things it is a delicate balance."
How do you address emerging markets?	"We do have an active emerging markets manager and we understand that there is a trade-off in terms of the carbon output: that it will be higher for longer, but we also recognise that there is a strong investment case to continue to invest in the transition."

The Shared Experiences

The following experiences were shared by some of the participants present at the event:

DC Master Trust participant: They were setting goals to be net zero by 2050 with a 50% reduction by 2030. They have signed up to the Impact Investing Principles for Pensions and will be adding impact allocations to their portfolio. They will also be looking at which UN SDGs they would like to target. Some of the challenges for a DC fund are around costs, particularly in assets like sustainable infrastructure. They felt they were fortunate with the level of governance they had but many DC funds will struggle with the resource and expertise needed to get on top of this.

DC Master Trust participant: They had a lot of passive exposure and were trying to transition via their managers in their default offering but were changing all of their existing line items so making changes quickly was more challenging.

Corporate DB and DC pension fund: There was a lot to do. They need to begin TCFD reporting this year and were grappling with their baseline. The trustees have set an ambitious 2040 net zero target, so they needed to get to grips with what that means for their interim targets. The challenge was the incomplete data set on which they were setting targets, particularly because they had a significant allocation to private markets.

LGPS fund: They were at the point of setting the baseline. They were adjusting parts of the portfolio and were adding in the managers' measurement of carbon emissions but could not set overall targets until they knew their baseline.

LGPS fund: They have considered Environmental, Social and Governance factors to start to move assets. It was important for them to understand how their fund managers saw this and where they were on their own climate change targets. A lot is changing very quickly. They have commissioned their investment adviser to help understand where they are in relation to best practice in relation to things like the Stewardship Code. They know that they will need to do a carbon footprint analysis. They were also focused on sustainable and impact opportunities to get the benefit of the transition to a sustainable economy.

Corporate DB and DC pension fund: They did not need to report on TCFD until 2022. They have been focused on the relationship between climate change and the covenant with the employer. They haven't had any enquiries from members or the employer about the fund's climate strategy; however, the trustees do ask questions and they anticipate more on this in the coming months. They will be doing more focused ESG training with an external consultant as well.

Conclusion

We were pleased to have such good engagement and interaction from the participants on the challenges and opportunities in setting climate action policies. Sharing what is a universal and significant change from multiple perspectives is one of the best ways to facilitate action and ensure best practice. We look forward to welcoming more pension funds to our next Paris Alignment Forum asset-owner-only event.

Would you like to join future asset owner events?

Asset-owner events are open to Paris Alignment Forum members who are involved the governance of assets e.g. as a Trustee or in-house executive of a pension fund or asset pool. If you would like to receive information about future Paris Alignment Forum events, please e-mail Mike Rogers.

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8th September 2021
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