Report for: Pensions Committee and Board 20th July 2017

Item number:

Title: Low Carbon Investments Review and Environmental Social and Governance (ESG) and Sustainability Indices Review

Report authorised by: Tracie Evans, Deputy Chief Executive (CFO and S151 Officer)

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Ward(s) affected: N/A

Report for Key/ Non Key Decision: Non Key decision

1. Describe the issue under consideration

1.1. At the 27 March Pensions Committee and Board meeting, the committee agreed to commission a review of the pension fund's low carbon investment strategy for developed market equities, which would be conducted by the fund's Investment Consultant: Mercer.

1.2. At the 27 March Pensions Committee and Board meeting, the committee also agreed to commission a review of Environmental, Social and Governance (ESG) and sustainability indices, which could potentially be utilised for the pension fund's passively managed equity portfolio. This review has been conducted by the fund's Investment Consultant: Mercer.

1.3. This report brings back 2 reports from Mercer (attached in the exempt part of this report Appendices 1 and 2). The low carbon review report highlights possible changes to the fund's investment strategy, which committee members are encouraged to debate and consider in the committee meeting. The ESG report details the wide variety of approaches that leading index providers take to the construction of ESG indices, along with key issues for the Committee and Board members to consider further in the meeting.

2. Cabinet Member Introduction

2.1. Not applicable.

3. Recommendations

3.1. That the Committee consider the report and recommendations outlined by Mercer in Confidential Appendices 1 and 2.

Low Carbon Investments Review

3.2. That the Committee considers the options set out in recommendation 3.3 below and decide whether they wish to increase further the allocation of the Fund's passive developed market equity portfolio from the current 33.3% invested in a low carbon indexed fund. This discussion must be taken in context with the other discussion around ESG indices items at the committee meeting around the fund's investment strategy.

ESG indices Review

3.3. That the Committee and Board note the dispersion in approaches taken by providers who construct ESG indices, as well as the potential volatility that such an index may display compared to the standard market benchmark. The Committee and Board should also note the additional fees that an ESG indexed fund is likely to generate.

Options for Consideration:

3.4. Broadly, the options that the Committee and Board may consider are:

- Option 1: to take no action and make no changes to the investment strategy: maintaining the current allocation of 33.3% of developed market equity in a low carbon indexed fund, and deciding not to pursue ESG indices any further at this stage.
- Option 2: to increase the allocation of developed market equity to a low carbon strategy from 33.3% to 50.0%, and to decide not to pursue ESG indices any further at this stage.
- Option 3: the Committee could also increase the allocation to a low carbon strategy to a larger percentage than 50.0% of developed market equity, if they feel that they do not wish to pursue ESG indices any further at this stage.
- Option 4: if the Committee and Board feel that the argument for the inclusion of an ESG index tracking fund is one which is compelling, then they could agree to meet with some of the leading index providers to further the Committee and Board's knowledge base in this area, prior to making any changes to the fund's investment strategy. This could be done in conjunction with either an increase of the allocation to the low carbon mandate to 50.0%, or by keeping this at the same level 33.3%.

4. Reason for Decision

4.1. The fund has a commitment to investing in a manner which not only secures sufficient returns to meet the fund's strategy to increase the overall funding level, but which also takes serious consideration of ESG factors. Mercer has produced a review of the fund's current low carbon strategy, including historic performance data in order to provide an evidence base for the Committee and Board to consider when making this decision. Mercer has also produced a review of ESG and sustainability indices which currently exist and which could be utilised for the fund's passively invested equity portfolio.

5. Other options considered

5.1. None

6. Background information

6.1. The most important investment role for the Committee and Board is the setting of an asset allocation strategy. This is the desired allocation to the various asset classed e.g. equities, bonds, property, cash etc. Different assets allocations will have different expected outcomes in terms of future returns and also the predictability of returns.

6.2. In setting the current strategy that has a high allocation to equities, whose values have a strong correlation with economic growth, the Committee and Board is focused on funding the promised benefits primarily from investments returns while seeking to minimise / stabilise employer contributions. The Committee and Board is required to keep the strategy under review considering the impact of funding levels and market conditions.

6.3. The Fund has previously allocated a third of its developed market equity portfolio to a low carbon index tracking fund: thereby maintaining the exposure to equities as a growth asset class, whilst also investing in a responsible and sustainable manner. Mercer's report gives a review of the low carbon approach and highlights the current strategy utilised along with other approaches such as alternate low carbon indices.

6.4. The ESG Indices report from Mercer investigates the possibility of undertaking a similar approach to investing in an index which is focussed on wider ESG or sustainability issues. The low carbon mandate is primarily focussed on 'E' or environmental issues, whereas investing via a passively managed ESG fund would address both 'S' (social) and 'G' (governance) issues in addition to this.

6.5. Mercer's report gives a review of some of the ESG indices available. The report highlights the disparity in approaches taken by different index providers, as well as the increased volatility that these indices can display compared to the overall market which they track. In addition, the report highlights the additional fees that would be generated through the use of an ESG index.

7. Contribution to Strategic Outcomes

7.1. None.

8. Statutory Officers comments (Chief Finance Officer (including procurement), Assistant Director of Corporate Governance, Equalities)

Finance and Procurement

8.1. The Fund has enjoyed strong returns in recent years primarily from rising equity valuations. The Pension Committee and Board's responsibility is to look to the long term when setting an investment strategy, ensuring an appropriate degree of diversification.

8.2. The report from Mercer highlights that the low carbon approach has secured returns that are very closely correlated to overall market performance (and in fact are slightly higher in the medium term): therefore altering the current investment strategy by increasing the allocation to low carbon, should not adversely affect the Fund's investments.

8.3. Whilst commitment to ESG issues is clearly a key consideration for Haringey Pension Fund, the overriding aim of the fund's investment strategy must be to improve the funding position with the aim of reaching fully funded status, whilst maintaining stability of employer contributions. Any future changes to the Fund's investment strategy must be consistent with these principles.

8.4. Before any new fund managers or asset classes are introduced to the pension fund, proper due diligence will be undertaken, and sound professional advice will be sought. Officers will ensure that the Pensions Committee and Board receive adequate and appropriate training on any new investment techniques or asset classes prior to these being undertaken by the pension fund.

8.5. The report from Mercer highlights the increased volatility that could be experienced via the inclusion of an ESG tracking indexed fund within the fund's portfolio. Whilst equity is an inherently volatile asset class which has been selected due to the growth potential for the fund, there is a risk that investing in an ESG index tracking fund would result in overall lower returns for the fund over the long term. Whilst the Committee and Board will not be making a decision to change the fund's asset allocation in this meeting, this volatility is something that will require due consideration should the Committee and Board wish to pursue ESG indices further.

8.6. As part of the regular triennial valuation process, it is best practice to review the Fund's investment strategy: this is part of this process.

Legal

8.7 The Council as administering authority for the Haringey Pension Fund has the power to invest fund monies as set out in Local Government Pension Scheme (Management & Investment Funds) Regulations 2016.

8.8 Any changes to the allocations must comply with the Pension Fund Investment Strategy Statement. There are no legal implications in respect of the recommendation.

Equalities

8.5 There are no equalities issues arising from this report

9. Use of Appendices

9.1. Confidential Appendix 1 – Low Carbon Investments Review
9.2. Confidential Appendix 2 – ESG and Sustainability Indices Review

10. Local Government (Access to Information) Act 1985

10.1. Not applicable.