

Committee(s): Pensions	Dated: 12 September 2023
Subject: Climate Action Strategy Update	Public
Which outcomes in the City Corporation's Corporate Plan does this proposal aim to impact directly?	All
Does this proposal require extra revenue and/or capital spending?	N/A
If so, how much?	£
What is the source of Funding?	N/A
Has this Funding Source been agreed with the Chamberlain's Department?	N/A
Report of: Director of Innovation & Growth and The Chamberlain	For Information
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Summary

This paper provides information on the history, current status and future plans for the Financial Investments workstream under the Climate Action strategy. This is the first update provided to support Members of the Pensions Committee in any future decision making regarding aligning the Corporation's pension investments with the Climate Action Strategy (CAS). Progress on Climate action will be reported to this Committee 2 to 3 times a year depending on the Committee cycle.

The Year 3 (23-24) plan has 4 sub-workstreams

1. Engagement with Fund managers- progress has been good and we follow an engagement first approach working with managers to challenge them to be more ambitious where needed to incite sustainable change in the asset management sector and then wider market.
2. Taskforce for Climate Related Financial Disclosures is produced on financial investments, split by Fund. The report is expected to be finalised in the autumn and will go to the Policy & Resources Committee for approval
3. Track KPIs - Members will note that there are issues in terms of measuring and accuracy of data around emissions, particularly for government and sovereign bonds and that officers are working to find a solution.
4. Memberships and networks

Recommendations

Members are asked to note the report.

Main report

Background

1. The Climate Action Strategy (the Strategy) was adopted by the Court of Common Council for the City Corporation, both as Trustee of BHE and in delivering its wider functions and activities, on the 8 October 2020. This marked the start of a new and transformative programme of action. It set out three interlinked primary objectives for the City Corporation (including Bridge House Estates (BHE) of which it is a trustee) and the Square Mile
 - to support the achievement of net-zero emissions,
 - to build resilience, and
 - to champion sustainable growth.
2. The Strategy was adopted with action plans across thirteen delivery areas to collectively achieve overall targets of:
 - Net Zero in our own operations by 2027
 - Net Zero in our value chain including our investments and supply chain by 2040.
 - Net Zero in the Square Mile by 2040
 - Climate resilient in our buildings, public spaces and infrastructure
3. Implementation of the Strategy is done under programme management of thirteen workstreams held in six departments reporting to over 10 committees. Policy & Resources Committee serves as the central oversight committee for activities under City Fund and City Cash, and Bridge House Estates (BHE) Investment Committee for activities under BHE funds.
4. Key CAS terminology is set out in Appendix 1.
5. The Financial Investments workstream looks after the alignment of our financial long-term portfolios for all three funds (Pensions, City's Cash and Bridge House Estates). Controlling emissions arising from our investments into underlying assets is Scope 3 and relates to the 2040 goal to reduce the Corporation's value chain emissions. The workstream is a joint endeavour between the CAS Strategic Implementation Team in Innovation & Growth and the Corporate Treasury Team within the Chamberlain's Department in consultation with the Sustainable Finance Policy team in Innovation & Growth. This combined effort ensures alignment with the Climate Action Strategy but also the wider work of the Corporation around the UK as a leader in sustainable finance. This workstream has a primary objective of managing the Corporation's Fund Managers against the responsible investment policy. It has a secondary objective to incite change in the wider market by demonstrating leadership within our portfolios. Decisions on climate are integrated with other factors such as performance, portfolio diversification etc. This integration is aligned and integral to practices across the Climate Action programme.
6. Interim targets have been set for each workstream in aggregate across all Funds. Progress against these targets is reviewed every year in an annual carbon footprinting exercise conducted across the entire value chain and reported in the Climate Action Strategy Annual Report. This report is then presented to internal officer and Member governance, published publicly and used to inform the next

year's business planning under CAS. This ensures that the CAS programme is both consistent to original targets but nimble in approach to achieving them successfully. The 2023 report will be issued in the autumn, following approval from Policy & Resources Committee and BHE Investment Committee. The report also includes any achievements or challenges in meeting those targets.

7. The interim targets for the financial investments are as follows:
 - 24% reduction in absolute emissions by 2025 from the 2019 baseline figure.
 - 55% reduction in absolute emissions by 2030 from the baseline figure.
8. Management and target KPIs are also set across the programme and are reported quarterly on the public dashboard located on the City Corporation website. The KPI set for each workstream has been set from a baseline and new KPIs have been added to the yearly plans and public Dashboard where relevant. The Dashboard can be found [here](#).
9. The plan for each workstream is prepared on an annual basis and presented across the Climate Action Programme in summary form to Members at the Policy & Resources Committee in April of each year. The Year 3 (2023-24) Plan (which covers Pension Fund, City's Cash and Bridge House Estates financial investments) is attached at Appendix 2 on the non-public agenda, for information. The financial investment workstream is in a state of evolution and refinement. As part of the CAS and to assist with the financial investments workstream funding has been provided for a Responsible Investment & Engagement Manager post, which was recruited to in June 2022.
10. These Plans describe the activities for the year, notes risks and opportunities and reports governance plans, staffing and KPIs for the year ahead. The Y3 (2023-24) plan for financial investments covers activities for all three funds (Pensions, City's Cash and Bridge House Estates) under the same workstream. Progress during the year against the full Climate Action Strategy plan is reported to Policy & Resources on a quarterly basis. The progress reports to service committees are different for each workstream. The previous practice with the Financial Investment Board (FIB) was 3 times a year as FIB only conducted 5 meetings a year. Officers recommend that progress should be reported 2 to 3 times per annum depending on the Committee cycle.
11. Every two years, a Taskforce for Climate Related Financial Disclosure (TCFD) is also produced on financial investments, split by Fund. In Year 3 of CAS (2023-2024), the report is expected to be finalised in the autumn and will go to the Policy & Resources Committee for approval.
12. At the time of the adoption of the Climate Action Strategy, the London Collective Investment Vehicle (LCIV) had a net zero target of 2050. Recognising the misalignment with Corporation targets, an early action in the Financial Investments workstream was to work with the LCIV for a more ambitious target. Fortunately, the LCIV was on a similar trajectory and set its 2040 goal in October 2021.
13. During the adoption of the CAS strategy there was operational and Member discussion on whether or not the Corporation could go faster than the original commitment of 66% Paris alignment in the portfolios by 2040 which was the target during when adopted by Court in October 2020. Therefore, as a planned onwards development of the Climate Action Strategy, Aon was commissioned to look at an

accelerated exercise for BHE and City Cash to determine if the target of net zero by 2040 for financial investments could be brought forward.

14. This was presented to Members of the (then current) Financial Investments Board (FIB), the BHE Chair and the Chair and Deputy Chair of the Finance Committee in a series of workshops held in the summer of 2021. It was collectively concluded at the time that an acceleration within the 2040 net zero target was advisable. It was recommended and accepted to extend the 2040 target to 100% of financial investments being included in net zero as compared to the previously determined 66%. This was adopted by the Financial Investments Board and the Policy & Resources Committee in October 2021 for the Corporation as well as the Court. Interim targets were redrawn to take this decision into account.
15. Achieving net zero by 2030 or 2035 was rejected at the workshop stage for all the funds due mainly to the expected short-term devaluation to the portfolio, the lack of suitable investment vehicles and for the Pension Fund, the expectation of specific regulations and Pooling.
16. Following adoption of CAS, it was an early action of the FIB to redraft the Responsible Investment Policy (RI Policy) to align with the new Strategy. The updated and current RI Policy notes that the Corporation is a long-term investor across all three funds and as such takes an engagement first approach as compared to divestment; the RI Policy is attached at Appendix 3. At the time of adoption, the FIB discussed the strength of the leadership position of the Corporation in challenging managers to work with holdings that were not compliant and then evidence around the lack of market changes with a divestment approach. Finally, the Corporation works with its investment advisors, Mercer, in identifying opportunities to join with other investors to engage managers to apply pressure to underlying holdings to manage a successful transition to net zero.
17. This Committee is currently reviewing the asset allocation of the Pension Fund following the 2022 triennial valuation and there is a separate paper on today's agenda. Members will also be aware of the current consultation from DLUHC on *the LGPS: Next Steps on Investments*. Whilst this does not cover climate action, there are potentially other obligations around the pooling agenda and levelling up.
18. The governance for the CAS programme has evolved with the changes made under Lisvane. Previously, a progress report on the Financial Investments workstream practice across the funds has always been in a state of evolution as the CAS matures.

Current Position

19. The Year 3 (23-24) plan has 4 sub-workstreams:

- *Engagement with Fund Managers*: This is the bulk of the volume of activity under the workstream. An engagement plan is designed at the beginning of the year, held operationally and then adjusted quarterly. Fund Managers have a requirement to report figures and progress against net zero quarterly. These are collected and analysed by the internal team who identify points of further engagement for Managers who are reporting information which is not aligned with progress towards interim targets. The policy is again an engagement first approach working with managers to challenge them to be more ambitious where needed as this is what will incite sustainable change in the asset management sector and then wider market. Engagement is more complex with

regards to the LCIV but we have a good and open dialogue with the responsible investment and wider teams there.

- *Produce TCFD report:* refer to paragraph 11 above.
- *Track KPIs:* This is done quarterly for internal governance and to inform future areas of action. It is also used to prepare the Climate Action Strategy Annual Report and assists with the annual carbon footprint exercise,
- *Memberships and networks:* For financial investments, we consider what memberships and networks the Corporation should join. The teams monitor which initiatives are worth the investment of time and money.

Engagement with Managers

20. Over the last 12 months, initial engagement meetings have been undertaken with a number of fund managers to gain insight into their methodology and approach to climate change. Within UK Equity, Global Equity, Multi-Asset and Alternative Credit asset classes, all the managers are signatories to the PRI and produce reports in line with the TCFD recommendations. All fund managers, excluding Harris, also have net-zero commitments in place. Details of engagement meetings are set out in Appendix 4 on the non-public side of the agenda.

21. The challenges of the workstream are as follows:

- Recalculation of emissions associated with the bond portion of the portfolio for multi-asset managers.
- Managing differences in reported emissions between fund managers.
- Lack of national/international standards on data inclusion/measuring.

22. Pension Fund Regulations/Requirements The CAS programme keeps an extensive risk register across all 13 workstreams. The recognised risks of the financial workstream are as follows:

- The timing of strategic asset allocation: failure to implement CAS performance targets due to new or existing asset allocation.
- Degradation of international relationships/ public reputation due to CAS performance. Risking a loss of political support for CAS.
- Slow action on climate risks may have an impact on financial performance – loss in portfolio value.

Carbon Emission Data

23. Whilst undertaking this year's annual carbon footprint exercise, it has come to light that the multi-asset fund managers do not account for the UK Government and Sovereign bond holdings within their portfolio. Instead, the equity portion of their portfolio was scaled up to 100%, thus overstating the level of emissions associated with their portfolio. Following subsequent conversations with these fund managers, the main reason behind this is because carbon data for these types of holdings is still in its infancy and there is an absence of any 'industry standard' for non-corporate bonds.

24. The lack of maturity on carbon data and absence of industry standard for non-corporate bonds is a widely recognised issue within the industry and recognised by the Science-Based Targets Initiative (SBTi – a global initiative that defines and promotes best practice in emissions reductions and net-zero targets in line with

climate science) which states that sovereign bonds are not required to be included in financial investments inventories. Discussions with the Responsible Investment team at the London CIV confirmed that they follow the SBTi approach.

25. Two of the multi-asset managers have a significant portion of their portfolio in Government and Sovereign bonds, and officers are currently in the process of finalising a robust method that will enable the Corporation to more accurately reflect the emissions associated with these investments.
26. Once the carbon foot printing exercise has been completed and the issues around the Government and Sovereign bonds has been resolved, the data will be included in the CAS Annual Report, which once published, will be circulated to Members of this Committee.

Summary

27. This paper provides Members of the Pensions Committee with a history and current status update on the Climate Action Strategy. Members will note that there are issues in terms of measuring and the accuracy of data around emissions (particularly around government and sovereign bonds) and that officers are working to find a solution. In addition, the Pension Fund is subject to various Regulations and there is currently a consultation on pooling and investments (*LGPS: Next Steps on Investments*) and Members are currently reviewing the asset allocation for the Pension Fund, following the triennial valuation.

Appendices

Appendix 1 - Key Terminology

Appendix 2 - Y3 (2023-24) Plan (Non-Public)

Appendix 3 - RI Policy

Appendix 4 - Fund Manager Engagement Meeting Details (Non-Public)

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Key Terminology

Absolute Emissions – absolute emissions are the attributed share of total GHG emissions for a portfolio and is expressed in Tonnes of CO₂.

Carbon Intensity – the emissions rate per £m sales.

Carbon Footprint – the emissions rate per £m invested.

Science Based Targets Initiative (SBTi) - a partnership between CDP, the United Nations Global Compact, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF). SBTi mobilises the private sector to take the lead on climate action. Whilst also showing companies and financial institutions how much and how quickly they need to reduce their greenhouse gas (GHG) emissions to prevent the worst effects of climate change.

Scope 1 Emissions – refer to direct greenhouse gas (GHG) emissions that occur from sources that are controlled or owned by an organisation.

Scope 2 Emissions – are indirect GHG emissions associated with the purchase of electricity, steam, heat, or cooling.

Scope 3 Emissions – all indirect emissions (not included in scope 2) that occur in the value chain.

TCFD – The Financial Stability Board (FSB) created the TCFD to develop recommendations on the types of information that companies should disclose to support investors, lenders, and insurance underwriters in appropriately assessing and pricing a specific set of risks—risks related to climate change.

PRI - The Principles of Responsible Investment works to:

- understand the investment implications of environmental, social and governance (ESG) factors;
- support its international network of investor signatories in incorporating these factors into their investment and ownership decisions

CITY OF LONDON CORPORATION RESPONSIBLE INVESTMENT POLICY

The City of London Corporation (the Corporation) is committed to being a Responsible Investor and the long term steward of the assets in which it invests. It expects this approach to protect and enhance the value of the assets over the long term.

The Corporation recognises it is consistent with its fiduciary duty to manage Environmental, Social and Corporate Governance ('ESG') issues that may be financially material. This policy sets out the Corporation's approach to Responsible Investment (RI) and details the actions the Corporation, and its external providers, take on its and other stakeholders behalf, to protect the Corporation and its assets from ESG and reputational risks.

As a long-term investor, the Corporation recognises that it should manage ESG risks including climate related financial risk that can be both long-term and short-term in nature. In addition, the Corporation seeks to identify investment opportunities and managers aligned with its long-term objectives. The Corporation is a signatory of the Principles for Responsible Investment (PRI). The foundations of the Corporation's approach are its **RI Beliefs**, which are set out below:

The City of London Corporation's Responsible Investment Beliefs

- The Corporation is a long-term investor and seeks to deliver **long-term sustainable returns**. Taking a sustainable investment view is more likely to create and preserve long-term investment capital.
- The identification and management of ESG risks that may be financially material is **consistent with our fiduciary duty**.
- The Corporation seeks to **integrate ESG issues including climate related financial risk at all stages of its investment decision-making process**, from setting investment strategy to monitoring its investment managers.
- **Active ownership** helps the realisation of long-term shareholder value. The Corporation has a **duty to exercise its stewardship and active ownership responsibilities** (voting and engagement) effectively by using its influence as a long-term investor to encourage responsible investment behaviour.
- The Corporation recognises that taking a **collaborative approach** with other investors can help to achieve wider and more effective outcomes.
- The Corporation seeks to identify **sustainable investment opportunities** where aligned with its broader investment objectives.
- It is important that the Corporation be **transparent and accountable** to members and stakeholders with respect to its RI activities.
- **Engagement for change** is our starting position but this will be kept under review as the Corporation reviews progress on delivering against its targets and commitments to responsible investment and managing financial risk.

- The Corporation recognises that climate change presents a systemic and material risk with the potential to impact our holdings throughout the portfolio. The Corporation is **committed to aligning our approach with the objectives of the Paris Agreement (2015)** for a below 2 degrees world. The Corporation works with managers, partners and networks who are seeking to do the same.

Implementation

The Corporation seeks to **integrate RI across its investment decision-making process**. The Corporation adopts a flexible approach to managing the investment strategies and asset allocation of its Funds in order to ensure they are robust from a risk and return perspective.

In setting and implementing its investment strategy, the Corporation takes advice from professional investment advisors. The Corporation **expects its investment advisors to consider proactively and integrate ESG issues including climate related financial risk** when providing investment advice.

The Corporation's assets are managed by third-party investment managers responsible for the day-to-day investment decisions, including undertaking voting and engagement activities on behalf of the Corporation. The Corporation **considers the approach to ESG integration and active ownership when selecting and monitoring investment managers**.

The Corporation will be looking to actively manage a downward trajectory path on the carbon emissions of the portfolio and set interim targets. Progress against reductions, Paris alignment and PRI agreements will be regularly monitored and reported annually.

The Corporation expects its external investment advisors and investment managers, including the London Collective Investment Vehicle (London CIV), to be signatories, and demonstrate commitment, to the PRI and any disclosure requirements in the jurisdictions in which they are regulated. The Corporation expects that UK asset managers are actively preparing for TCFD disclosure ahead of regulation and encourages non-UK based managers to consider the same.

Active Ownership

The Corporation recognises that it has **responsibilities as a shareholder**, as well as rights, and is an **active owner**. The Corporation seeks to exercise its voice through engagement with its investment managers (and consequently portfolio companies) as part of its active ownership, or stewardship, duties to its beneficiaries.

- The Corporation **aims to exercise its voting rights in all markets** and its investment managers are required to vote at all company meetings or give the Corporation notice when is not practical to do so. A record of voting should be made available on request.
- The Corporation supports **the UK Stewardship Code** (Code) and expects its investment managers to comply with the Code. Non UK managers will be expected to sign up to an equivalent Code in their country of origin. The Corporation has outlined its approach to stewardship, including voting and engagement, in its **UK Stewardship Code - Statement of Commitment** It remains a signatory to the UK Stewardship Code 2012 until the first list of signatories to the new Code is

published in 2021. The Corporation fully intends to achieve compliance with the new Code and is aiming to publish its first Annual Stewardship Report in 2022.

- The Corporation delegates voting and engagement to its investment managers and **monitors how its investment managers undertake voting and engagement activities** in comparison to relevant codes of practice. The Corporation expects its investment managers to implement appropriate escalation procedures for its stewardship activities.
- The Corporation expects fund managers to be **engaging with holdings to build credible pathways** to either adapt or actively drive their transition to a low carbon economy and to disclose climate related risks in line with latest best practice guidelines, such as those of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD).

Collaboration

The Corporation recognises that **collaboration with other investors is a powerful tool to influence** the behaviour of companies, policy makers and other industry stakeholders. The Corporation seeks to work with and support the initiatives of other bodies with similar goals, including via its investment managers and investment advisor. For example, the City of London Corporation Pension Fund is an active member of the Local Authority Pension Fund Forum (LAPFF) and the Pension and Lifetime Savings Association (PLSA). As a member fund of the London CIV, the City of London Corporation Pension Fund also collaborates within the pool to influence responsible investments.

Reporting and Stakeholder Engagement

The Corporation recognises that **transparency and disclosure** is an important aspect of being a responsible investor. The Corporation expects transparency and disclosure from its investment managers, including reporting on engagement progress and success on climate related financial risk.

Our Commitment

We acknowledge that the Corporation's approach to RI will need to continually evolve, both due to the changing landscape with respect to responsible investment as well as broader industry developments. We are committed to making ongoing improvements to the Corporation's approach and the processes that underpin the delivery of this policy to ensure it remains relevant.

Approved by the Financial Investment Board on 9 February 2021.

Glossary

ESG - Environmental, social and corporate governance issues

RI - Responsible Investment – This refers to the incorporation of environmental, social and corporate governance considerations into investment processes, as these are absent in much traditional financial analysis. RI was very focused on company level analysis, but climate change and sustainability challenges increasingly require a more strategic, forward looking, portfolio view. There are 4 levers that an investor can use in its responsible investment approach: integration, stewardship, thematic investment and exclusions.

PRI - Principles for Responsible Investment – The PRI was formed by the UK in 2006 and has two main goals; to understand the investment implications of environmental, social and corporate governance (ESG) issues; and to support signatories in integrating these issues into investment and ownership decisions. The PRI believes that an economically efficient, sustainable global financial system is a necessity for long-term value creation. The PRI will work to achieve this sustainable global financial system by: encouraging adoption of the Principles, collaborating on their implementation, fostering good governance, integrity and accountability and addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

Stewardship and Active Ownership – The principle that shareholders should not be passive in their role as providers of capital and should take an active approach to using the voting rights attached to their shares and engaging with the companies they invest in (where appropriate) to encourage best practise and maximise shareholder value. For pooled fund clients, good stewardship and active ownership can be demonstrated through the review and ongoing monitoring of the pooled fund managers' activities in the areas of voting and engagement and the managers demonstrating the potential value of their actions.

UK Stewardship Code – Introduced for institutional investors in 2010, the UK Stewardship Code aims to incentivise investors to seek increased accountability from company boards and encourage them to seek on-going dialogue with their investors. The Stewardship Code has seven Principles and it is a mandatory requirement of the Financial Conduct Authority (FCA) that UK authorised asset managers disclose their compliance with the Code or explain otherwise through a public 'Statement of Commitment'.

Paris Aligned Investments – Investments with a business model that is adequately prepared for and/or actively contributing to the transition to a low carbon economy necessary to meet the goals of the Paris Climate Agreement (2015).