

<b>Committee(s):</b> Investment	<b>Dated:</b> 22 September 2023
<b>Subject:</b> Climate Action Strategy Update	<b>Public</b>
<b>Which outcomes in the City Corporation's Corporate Plan does this proposal aim to impact directly?</b>	<b>All</b>
<b>Does this proposal require extra revenue and/or capital spending?</b>	<b>N/A</b>
<b>If so, how much?</b>	<b>£</b>
<b>What is the source of Funding?</b>	<b>N/A</b>
<b>Has this Funding Source been agreed with the Chamberlain's Department?</b>	<b>N/A</b>
<b>Report of:</b> Director of Innovation & Growth and The Chamberlain	<b>For Information</b>
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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 Investment 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. 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.
13. 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.

14. 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.
15. 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.
16. 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**

17. 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**

18. 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.
19. 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.
20. 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**

21. 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.
22. 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.
23. 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.
24. 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**

25. This paper provides Members of the Investment 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. .

## **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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