LB Lewisham Pension Fund - Climate Transition & Net Zero Policy - DRAFT

Executive Summary

The Pensions Investment Committee (the ‘PIC’) of the LB Lewisham Pension Fund has developed a Climate Transition and Net Zero policy. This policy will be revised on an ongoing basis as the Fund’s action plan to achieve these objectives is developed and will be supported by ongoing quantitative analysis. This policy sets out the targets set by the PIC as well as the detail on the approaches that will be taken to achieve the net zero ambition. There are 4 core elements to this plan, split between portfolio level and asset level targets and actions. The key targets and actions within each element are summarised on the following page.

Portfolio level

1. Portfolio Emissions

Targets

- Reduce financed scope 1 and 2 emissions to net zero by 2040 at the latest, with an ambition to achieve this by 2030.
- Interim target to reduce scope 1 and 2 emissions on listed equities by at least 80% compared to the 2019 level by 2023, 90% by 2030.
- Measure Scope 1, 2, and 3 emissions across all asset classes by 2028.

Actions

This will be achieved through a combination of capital allocation and engagement, the following boxes setting out the main actions. Engagement with the London CIV will be a key focus, with the development of compelling decarbonisation solutions a priority.

2. Climate solutions and opportunities

Targets

- 10% asset allocation by 2030, with interim targets of 5% by 2025, 7.5% by 2028; further increasing allocations past 2030 – these investments aim to support the Fund's emission targets through either negative or avoided emissions.
- Positive impact to deforestation, biodiversity loss, social factors and climate adaptation are key factors included in decision-making

Actions

- Consider building allocations to natural capital and renewable energy, if these demonstrate impact and also help achieve Net Zero (portfolio level)

Asset level

3. Alignment

Targets

- Maintain alignment of all listed assets (excluding government bonds) to 1.5 degrees sector specific decarbonisation pathway
- 75% of property assets aligned with CRREM or 1.5 ºC fair share by 2030, with interim targets of 50% by 2025, 65% by 2028.
- By 2025, 70% of emissions in material sectors* are either assessed as net zero, aligned with a net zero pathway, or the subject of direct or collective engagement and stewardship actions. By 2030, this will be 90%.

Actions

- Focus on engagement with investment managers (including LCIV) initially. Mandate alignment will be considered alongside this; in particular any new commitments to unlisted assets.
- The Fund commits to reporting progress all targets within this NZ policy on a regular basis, and will use its TCFD reporting as the primary mechanism for achieving this.

4. Engagement

- Engage with the relevant investment managers with regards the top 10 most misaligned companies (at portfolio level) in heavy emitting sectors*
- Deforestation, biodiversity loss, social factors and climate adaptation are key engagement topics; raise these with investment managers and consider collective action where appropriate (e.g. through membership of a climate change advocacy group such as IIGCC, LAPFF).
- Engage to support improving data availability and quality – emissions data available and robust for all asset classes by 2028; firm requirement for any new manager to fully meet all data requirements at the time of appointment.
- Engage annually with LCIV regarding existing investments and be a part of all seed investor groups for relevant sustainability mandates.

*As defined by the Paris-aligned Investment Initiative ("PAII")

Introduction

The Pensions Investment Committee (the 'PIC') of the LB Lewisham Pension Fund considers that climate change represents a material financial risk with the potential to disrupt economic, financial and social systems. As well as climate change presenting a significant risk to the Fund's investment strategy, the PIC believes that long-term asset owners such as the Fund can play a significant role in decarbonising modern economies through the capital allocation decisions they make and the stewardship of the companies they finance.

As a responsible asset owner, the PIC recognises the need to address the systemic risk posed by climate change, including the risks it poses to the Fund's investments and its beneficiaries, thereby impacting the PIC's fiduciary duties. The Fund therefore has an ambition to achieve net zero by 2030, with a commitment to reach net zero financed emissions by 2040. This recognises that future improvements in the availability and quality of climate data (particularly for unlisted investments), and in the availability of available sustainable investment options, are factors in achieving progress. This commitment is made in the expectation that governments will follow through on their own commitments to ensure the objectives of the Paris Agreement are met.

The definition of 'net zero' may include negative or avoided emissions achieved through climate solutions. The Net Zero Asset Owners Alliance (NZAOA) defines climate solution investments as "investments in economic activities considered to contribute to climate change mitigation (including transition enabling) and adaptation, in alignment with existing climate related sustainability taxonomies and other generally acknowledged climate related frameworks".

To support the ambition, the PIC has developed this document as a framework for achieving net zero financed emissions (i.e. emissions produced by the investments held in the Fund). This framework is designed to guide as well as communicate the PIC's investment decisions enabling the Fund to align with the goals of the Paris Agreement and contribute to real economy change. A key objective is achieving positive real-world change and a significant reduction in emissions over time, whilst also maintaining a balance with the Fund's wider risk / return objectives and its fiduciary duty to pay all member benefits.

The PIC recognises the challenges of achieving net zero emissions by 2040, and fully aligning with it over the short term is a considerable undertaking. Therefore, flexibility will be a key aspect of any credible net zero strategy developed today given that the science, suggested pathways and data continue to develop and evolve. However, this should not prevent the Fund from planning and starting its net zero journey but instead should demonstrate proactivity within the wider climate transition and it should be recognised that there will be a need for an evolution of strategy and a dynamic approach towards how the plan is implemented in the future.

This document is therefore designed to be dynamic and evolve as best practice changes. The Fund's transition plan may be adjusted over time as new information emerges and circumstances change. By remaining open to new ideas and approaches, the Fund can strengthen its ability to reach its net zero goals.

The Journey

In recognition that it is cumulative emissions through time that matter, the PIC has set a high-level target to align its investments with a global carbon budget consistent with limiting warming to 1.5˚C (by 2100) with a 67% likelihood (as identified in the IPCC's AR6 report, 2021) and has determined a decarbonisation pathway that aligns with this.

The PIC use a bottom-up approach of assessing the Fund's carbon position, based on the Fund's asset, sector, and regional allocations. This is then built up to a portfolio level position. This approach is in line with the IIGCC's Supplementary Guidance on Target Setting for a Net Zero Investment Framework, which recommends science-based net zero journeys at the portfolio level using a sectoral and regional approach.

Finally, the PIC recognises the importance of interlinked issues such as biodiversity loss and the social implications of transitioning to a low carbon economy. Considering this and building a nature positive investment strategy will be developed alongside the focus on reducing financed emissions.

Data, Asset Class Coverage and Emissions

The Fund's ambition is to be net zero by 2030, with a commitment to be net zero across the **entire** investment portfolio by 2040. However, existing limitations on data mean that approximately 70% of the strategy can be assessed quantitatively. The asset classes held by the Fund for which adequate data is available today are:

Mandate	Allocation	Data coverage (Reported and estimated)
Listed equities	50%	Close to 100%
Private equities	3%	c. 10%
Listed corporate bonds and Gilts	19%	33%
Property	10%	c. 50%
Renewable infrastructure	6%	c. 50%
Infrastructure	6%	c. 50%
Private debt	6%	c. 50%

Emissions

For the asset classes listed above there is a reasonable quality of data on scope 1 and 2 emissions and so the current targets and assessment of alignment will concentrate on these. However, given the significance of scope 3 emissions, particularly in the most material sectors (e.g. agricultural commodities, financial services) these are included in the net zero target and in forward-looking alignment work. Estimations may be made on the level of scope 3 emissions to include today in this forward-looking analysis. While lack of data on other asset classes is an issue, it does not stop the PIC pursuing engagement activity and considering capital allocation into climate opportunities or solutions. Engaging with investment managers to develop good quality data is a primary goal for the PIC.

The "How" – capital allocation and engagement

As an asset owner, there are two primary levers to move the investment portfolio towards a net zero emissions position - capital allocation and engagement. The PIC believes that a combination of both is likely to give the best chance of meeting their net zero goals.

Capital allocation

The PIC considers two aspects to improving the current net zero pathway through capital allocation:

- Reduce emissions - Improve the current mandates by allocating to more efficient companies within sectors and engagement relative to sector laggards. This includes recycling the proceeds of existing private assets into future products with better climate credentials
- Remove emissions - Increase allocations to assets that remove or avoid emissions

The table below provides some examples of how emissions reductions and removal can be achieved.

Emission reduction and removal examples

Emissions reducers		Emissions removers	
Actors: Companies that currently have high emissions that are taking active steps to reduce their emissions over time	**Facilitators:** Companies that are developing technologies that support others in the reduction of their emissions	**Actors:** Companies that are developing assets that serve to actively remove emissions from the atmosphere	**Facilitators:** Companies that are developing technologies that support others in emissions removal
Example: Steel companies that are migrating to electric arc furnaces, investing in low carbon steel or dematerialisation of product	**Example:** Companies that are developing insulation technologies that reduce energy demand	**Example:** Afforestation	**Example:** Companies developing direct from air CO2 capture

The PIC will consider implementing these options in all aspects of the investment strategy process:

- Strategic asset allocation – consider moving assets to asset classes focussed on climate solutions and emissions removal.
- Mandate selection - consider moving assets to more aligned products.
- Adjust allocations within current mandates – for example a focus on best-in-class companies within sectors.

The PIC will take an incremental approach to capital allocation changes as the data and opportunities evolves, balancing their fiduciary duties at all times.

Engagement

The PIC believe that they have a significant influence on the decarbonisation actions of the organisations they finance through engagement and will consider developing a standalone full engagement policy separately and using its influence to encourage LCIV in their engagement activities. The Fund also intends to use its influence to encourage LCIV to create compelling investment products that support decarbonisation and biodiversity objectives. Specifically, the PIC believe that they can encourage portfolio companies to align to the decarbonisation pathways for the sectors in which they operate and set an appropriate strategy to align with these pathways. The goal being that cumulative emissions remain within the carbon budgets established for sectors and companies. Stewardship is critical for investors to manage portfolio risk and real-world impact, especially in asset classes that are traded via secondary markets, e.g. equities. Voting and engagement with companies enable investors to have significant influence on company strategy, operations, long-term sustainability and viability. The PIC believes that engagement is preferable to divestment, although the option to divest when engagement is unlikely to be effective or has failed should be considered as well. The PIC will also consider becoming a member of an institutional investor climate action group in future.

Measuring and accountability

A key part of the action needed to fulfil this plan is to measure, assess and report on the progress made against the targets set. The PIC has established the baseline and alignment by assessing the current investment strategy against a 1.5 degree carbon budget pathway and other metrics. This has enabled the PIC to set portfolio level targets and asset class priorities. The pathway analysis has also helped to define engagement priorities. The committee will undertake an annual recalibration of the net zero journey plan and reassess priorities using annual climate metrics reporting (commenced in 2023, with a view to meeting future TCFD obligations).