

## **Low Carbon Investments by Eight Local Government Pension Funds (June 2020)**

### **Key points**

- The accelerating climate emergency poses dire financial risks to pension funds. In June 2020 BP announced the write-down of up to \$17.5bn of fossil fuel reserves, in response to a slump in demand and expectation of a lower carbon world<sup>1</sup>.
- Nottinghamshire Pension Fund currently has no investments in low carbon or fossil fuel-free funds. The Pension Fund must investigate low carbon and fossil-free options with urgency, and transition its investments into funds which mitigate - not exacerbate - global heating.
- This paper looks at substantial low carbon 'passive' equity investments made by eight Local Government pension funds. It is highly likely that other Local Government pension funds have made similar investments.
- These investments are easily available to Nottinghamshire Pension Fund. They include: investments by Cheshire and West Midlands Pension Funds in a fund which is directly available to Nottinghamshire through pension pooling arrangements<sup>2</sup>; and investments in funds managed by Legal & General Investment Management, one of the Nottinghamshire Fund's main asset managers.
- These funds appear to have significantly lower carbon footprints than funds which are not designed to reduce carbon exposure.
- Although the funds discussed would likely represent a substantial improvement in Nottinghamshire Pension Fund's investments with regard to mitigating climate change, it is unknown whether any of the funds are compliant with a 1.5°C target. It is essential that all investments made by Nottinghamshire are 1.5°C compliant and are assessed by the Pension Fund accordingly.

The low carbon passive equity fund investments made by the eight pension funds are as follows:

- Cheshire Pension Fund: **£453m**
- West Midlands Pension Fund: **£1.615bn**
- Environment Agency Pension Fund: **£240m**
- Wiltshire Pension Fund: **£500m**
- Avon Pension Fund: **£497m**
- Oxfordshire Pension Fund: **£135m**
- Haringey Pension Fund: **£300m**
- Southwark Pension Fund: **£300m**<sup>3</sup>

**Note:** This document does not constitute investment advice or a recommendation of any of the funds discussed. It is for Nottinghamshire Pension Fund to fully assess investment opportunities.

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<sup>1</sup> <https://www.bbc.co.uk/news/business-53047894>

<sup>2</sup> Through the LGPS Central partnership.

<sup>3</sup> Plus further investment of £150m in a fossil fuel-free fund which is likely to be 'actively' rather than 'passively' managed – see p. 7.

## **Introduction**

Despite the accelerating climate emergency, which poses dire financial risks to its members and threatens the well-being of everyone in Nottinghamshire and beyond, Nottinghamshire Pension Fund appears to have no equity investments in low carbon or fossil-free pooled funds designed to be low carbon or fossil fuel-free.

This is not for want of options.

A number of Local Government pension funds have made substantial investments in low carbon passive equity funds. Here we look at investments made by Haringey, Southwark, Avon, Oxfordshire, Wiltshire, Cheshire, West Midlands and the Environment Agency Pension Fund.

A low carbon fund is available to Nottinghamshire via LGPS Central, the Central England pension pooling partnership of which it is a member. Cheshire Pension Fund and West Midlands Pension Fund have made substantial investments in this fund.

Some of the other pension funds looked at have invested in low carbon funds managed by Legal & General Investment Management, one of Nottinghamshire Pension Fund's main asset managers.

It is for Nottinghamshire Pension Fund to fully assess investment opportunities on financial and climate grounds (climate risk being an ecological - and therefore a financial - risk). It is essential that all investments made by Nottinghamshire are 1.5°C compliant and are assessed accordingly.

## **How low carbon are these 'low carbon' funds?**

The investment funds we are looking at are 'passive', meaning that they track a stock market index, and comprise a portfolio of shares identical or very similar to the constituents of that index<sup>4</sup>.

As they are designed to be lower carbon, the investment funds looked at here track two specially-designed indexes, themselves designed to be lower carbon:

- The FTSE All-World Climate Balanced Comprehensive Factor Index (which the LGPS Central low carbon fund tracks)
- The MSCI ACWI Low Carbon Target Indexes (which the other low carbon funds we are looking at track)

So how low carbon are these Indexes?

### **FTSE All-World Climate Balanced Comprehensive Factor Index**

The FTSE All-World Climate Balanced Comprehensive Factor Index is based on the FTSE All-World Index (an 'all-share' index), but applies weightings with the aim of reducing carbon exposure and increasing green revenues relative to the benchmark All-World Index.

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<sup>4</sup> The best known example of a stock market index in the UK is the FTSE100.

Specifically these weightings aim at:

- Reducing the carbon emissions of companies held within the Index
- Reducing exposure to fossil fuel reserves of companies held
- Increasing green revenues earned by companies held

XR Nottingham has seen figures suggesting that these re-weightings do make a substantial improvement in both carbon exposure and green revenues. On average over the last 8 years carbon emissions were reduced by 40%, fossil fuel reserves by 75%, and green revenues increased by 97%.

It is also worth looking at the Oil & Gas industry share of the Index as well as its benchmark Index. As at 29<sup>th</sup> May 2020 the Oil & Gas industry share of the FTSE All-World Climate Balanced Comprehensive Factor Index was 2.15%. This can be viewed against an Oil & Gas sector share in the All-World Index of 3.87%<sup>5</sup>.

The true situation with regard to these industry shares is more complicated than the headline industry figures suggest<sup>6</sup>.

However, putting available information together suggests that investment in the LGPS Central fund based on the FTSE All-World Climate Balanced Comprehensive Factor Index is likely to bring substantial reduction in exposure to fossil fuels and substantial carbon emission and green revenue improvements, bringing a corresponding reduction in climate-related investment risk.

Significantly, and perhaps unsurprisingly, over the last five years the financial returns of the All-World Climate Balanced Comprehensive Factor Index have outperformed those of the All-World Index<sup>7</sup>.

It should be noted that the LGPS Central fund based on this FTSE Index was only launched in October 2019, so its current climate performance - as opposed to the historical performance of the Index which it tracks - needs to be assessed by Nottinghamshire Pension Fund. XR Nottingham is aware that the Pension Fund has been monitoring the LPS Central fund.

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<sup>5</sup> See factsheets for the Indexes at <https://www.ftserussell.com/analytics/factsheets/home/search>.

<sup>6</sup> The Oil & Gas industry classification does – in addition to oil and gas-specific activities – include the Alternative Energy sector, which comprises Renewable Energy Equipment and Alternative Fuels (see Industry classification as used by FTSE according to the Industry Classification Benchmark: [https://research.ftserussell.com/products/downloads/ICBStructure-Eng.pdf?\\_ga=2.212156503.2108512420.1561509060-1968584676.1548988834](https://research.ftserussell.com/products/downloads/ICBStructure-Eng.pdf?_ga=2.212156503.2108512420.1561509060-1968584676.1548988834)). Due to its re-weighting methodology towards green revenues, the proportion of renewable/alternative energy companies within the Oil & Gas industry sector share is probably likely to be higher in the All-World Climate Balanced Comprehensive Factor Index than in the All-World Index. On the other hand, it is noteworthy that Legal & General Investment Management's Future World Fund – which tracks a version the All-World Climate Balanced Comprehensive Factor Index - has previously been criticised for having large holdings in Shell, although these have recently decreased as a result of large falls in Shell's share price. The Future World Fund is distinct from the Legal & General managed funds discussed in this document, though the underlying Index is very similar.

<sup>7</sup> See the graph on page 1 of the factsheet for the FTSE All-World Climate Balanced Comprehensive Factor Index (see footnote 5 for the link to the factsheet).

## MSCI ACWI Low Carbon Target Indexes

The MSCI ACWI Low Carbon Target Indexes are based on the more general MSCI ACWI Indexes of large and medium sized companies<sup>8 9</sup>. They are designed to reduce exposure to carbon emissions and fossil fuel reserves. They do so by overweighting companies with low carbon emissions relative to sales and those with low potential carbon emissions per dollar of market capitalization (the market value of the company). This re-weighting is however constrained to limit the degree to which the make-up of the Low Carbon Target Indexes can differ from their parent Index<sup>10</sup>.

By focusing solely on carbon emissions and not also explicitly on companies earning green revenues, the MSCI Index could be seen as less holistic than its FTSE equivalent with regards to climate change and the environment.

Figures available suggest that the Low Carbon Target Index's carbon footprint is at least 73% lower than that of its parent index<sup>11 12</sup>.

Although the benchmark index it is referring to is unknown, Haringey Pension Fund stated when it recently invested in a fund based on the Emerging Markets version of the MSCI Low Carbon Target Index that by doing so it "aims to reduce exposure to carbon emissions of these investments by an estimated 73% compared to the fund's previous emerging market investments"<sup>13</sup>.

As at May 2020, fossil fuel companies represented 2.33% of the MSCI ACWI Low Carbon Target Index, as opposed to 3.78% of its parent MSCI ACWI Index<sup>14 15</sup>.

It is well worthwhile noting that – looking beyond fossil fuel exposure and directly-measurable carbon emissions – the sustainable investing organisation As You Sow gives a fund based on the Low Carbon Target Index an 'F' grade for investments in "three key deforestation-driving sectors:

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<sup>8</sup> Low Carbon Target Index factsheet <https://www.msci.com/documents/10199/a61f00d8-7f84-4125-ae11-db8776e981b6>  
MSCI is the US equivalent of FTSE as a constructor of stock indexes which are very widely used.

<sup>9</sup> The MSCI Indexes have different regional versions. For example, local government pension funds discussed in this document invest in funds based on the World version on the index and the Emerging Markets version.

<sup>10</sup> See Index methodology

[https://www.msci.com/eqb/methodology/meth\\_docs/MSCI\\_Low\\_Carbon\\_Target\\_Indexes\\_Methodology\\_May2018.pdf](https://www.msci.com/eqb/methodology/meth_docs/MSCI_Low_Carbon_Target_Indexes_Methodology_May2018.pdf)

<sup>11</sup> A 73% figure is calculated by the website fossilfreefunds.org when comparing an investment fund which tracks the Low Carbon Target Index ('This fund' in the graph on the following webpage) and one based on the parent MSCI ACWI Index ('ACWI - iShares MSCI ACWI ETF'). Carbon footprints are 31 tonnes CO2 per \$1m invested, versus 117 tonnes  
<https://fossilfreefunds.org/fund/ishares-msci-acwi-low-carbon-target-etf/CRBN/carbon-footprint/FS0000B65I/F00000UIVU>

<sup>12</sup> A figure of 80% is given here relating to Haringey Pension Fund's investment in a fund based on the MSCI index.

<https://www.ipe.com/news/esg/haringey-pension-fund-moves-one-third-of-equities-into-low-carbon/10011637.article>

<sup>13</sup> <https://www.haringeypensionfund.co.uk/client-area/news/haringey-pension-fund-invests-in-low-carbon-emerging-equity-fund/>

<sup>14</sup> See the Low Carbon Target Index factsheet (footnote 8) and the MSCI ACWI Index factsheet

<https://www.msci.com/documents/10199/a71b65b5-d0ea-4b5c-a709-24b1213bc3c5> The MSCI uses a different industry classification system to FTSE. Under the system it uses, the 'Energy' industry solely comprises fossil fuels and does not include renewable energy [https://en.wikipedia.org/wiki/Global\\_Industry\\_Classification\\_Standard](https://en.wikipedia.org/wiki/Global_Industry_Classification_Standard)

<sup>15</sup> The 'bottom active weights' table in this article shows that a number of the world's largest fossil fuel companies are underweighted in the Low Carbon Target Index as a result of its methodology. <https://www.unpri.org/listed-equity/weighting-vs-exclusion-in-low-carbon-indexes/172.article>

commodity producers, banks and lenders, and major consumer brands”<sup>16</sup>. This highlights the need for investors who are looking seriously at sustainability to consider multiple issues, as well as the fact that many stock exchange-listed companies across multiple industries have ties to environmentally destructive practices.

With regard to financial performance – and similar to the comparative performance of the FTSE low carbon Index discussed above - over the last 10 years the Low Carbon Target Index has generally slightly outperformed its parent index<sup>17</sup>. Given its reduced exposure to climate risk this could be viewed as unsurprising.

## **Investments by Local Government pension funds**

### **Investments in the LGPS Central All World Equity Climate Multi Factor Fund**

The LGPS Central All World Equity Climate Multi Factor Fund tracks the FTSE All-World Climate Balanced Comprehensive Factor Index, discussed above.

This LGPS Central fund was launched in October 2019 and is available to all partner pension funds, including the Nottinghamshire Fund. At its launch Cheshire Pension Fund and West Midlands Pension Fund made substantial investments in it<sup>18</sup>.

**Cheshire Pension Fund** had £453m in the LGPS Central All World Equity Climate Multi Factor Fund in its latest published figures<sup>19</sup>. It is notable that the total size of the Cheshire Pension Fund – at £5.5bn - is similar to the Nottinghamshire Fund. This low carbon investment therefore represents slightly over 8% of the total value of the Pension Fund.

**West Midlands Pension Fund** had £1.615bn in the LGPS Central All World Equity Climate Multi Factor Fund at the time of its latest published figures<sup>20</sup>.

### **Investments by Local Government pension funds based on the MSCI Low Carbon Target Index**

Brunel Pension Partnership, the south-west England equivalent of LGPS Central, offers a MSCI World Low Carbon Index Fund to its member pension funds. This Fund is based on the MSCI ACWI Low Carbon Target Index, discussed above.

The **Environment Agency Pension Fund** has a £240m investment in this Fund through Brunel Pension Partnership<sup>21</sup>.

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<sup>16</sup> See <https://fossilfreefunds.org/fund/ishares-msci-acwi-low-carbon-target-etf/CRBN/investment-profile/FS0000B65I/FO0000UIVU> The fund based on the parent index also has a 'F' for deforestation <https://fossilfreefunds.org/fund/ishares-msci-acwi-etf/ACWI/investment-profile/FSUSA08N99/FOUSA06OEZ>

<sup>17</sup> Low Carbon Target Index factsheet <https://www.msci.com/documents/10199/a61f00d8-7f84-4125-ae11-db8776e981b6> Page 1 shows performance against the parent MSCI ACWI Index.

<sup>18</sup> <https://www.lgpscentral.co.uk/lgps-central-limited-launches-all-world-equity-climate-multi-factor-fund/>

<sup>19</sup> Cheshire Pension Fund investments as at 31.03.2020 <https://www.cheshirepensionfund.org/members/wp-content/uploads/sites/2/2020/06/BGIM-Active-Equities-310320.pdf>

<sup>20</sup> West Midlands Pension Fund investment holdings as at 31.12.2019, from <https://www.wmpfonline.com/QIH> For comparison's sake it is worth remembering that the West Midlands Fund is around three times the size of the Nottinghamshire Fund.

**Wiltshire Pension Fund** in December 2019 transitioned £500m of funds previously held in UK, global and fundamental passive equities into the Brunel Pension Partnership Fund. This £500m represents a little under 20% of the fund's total assets of around £2.7bn.

It is very notable that Wiltshire Pension Fund made this transition following a review of its strategic asset allocation, led by its Pension Committee, which recognised climate change risk as investment risk:

*“The review was undertaken to ensure that the fund is well set to achieve investment returns that meet all future liabilities and pay the pensions of its beneficiaries. As part of this the Pension Committee recognised that as long term investors it needs to take all risks into account and that includes managing climate change risk alongside good governance”<sup>22</sup> (emphasis added)*

**Avon Pension Fund** has an investment of £497m as at the end of March 2020 in an MSCI World Low Carbon Index Fund managed by Legal & General Investment Management<sup>23</sup>. Legal & General Investment Management are one of the Nottinghamshire Pension Fund's main asset managers.

**Oxfordshire Pension Fund** made the decision in March 2020 to immediately transition around £135m into a “low-carbon investment fund”. This represents 5% of the Pension Fund's total assets<sup>24</sup>.

No further information is publically available on this. However, Oxfordshire Pension Fund is a member of Brunel Pension Partnership, so it appears fairly likely that the investment will be made in its MSCI World Low Carbon Index Fund.

The **London Borough of Haringey Pension Fund** has investments in two funds based on different versions of the MSCI Low Carbon Target Indexes. The result is that as at March 2020 around 25.7% of Haringey Pension Fund's total assets were invested in low carbon passive fund investments<sup>25</sup>.

Having committed to it in 2016, Haringey has now allocated half of its developed markets equity portfolio to a passive fund that tracks the MSCI World Low Carbon Target Index, managed by Legal & General Investment Management<sup>26</sup>. This is around £200m<sup>27</sup>.

The second investment was as a seed investor in a MSCI Emerging Markets Low Carbon Target Index Fund, also managed by Legal & General Investment Management. According to information from the Pension Fund this fund “aims to reduce exposure to carbon emissions of these investments by an

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<sup>21</sup> EAPF investment holdings data as at 30.September 2019, from <https://www.eapf.org.uk/investments/investment-holdings-data>

<sup>22</sup> <https://www.wiltshirepensionfund.org.uk/client-area/news/wiltshire-pension-fund-moves-over-500m-of-assets-into-brunel-s-low-carbon-passive-equities-portfolio/>

<sup>23</sup> See p.15 of Avon Pension Fund's holdings data as at 31 March 2020:

<https://www.avonpensionfund.org.uk/sites/default/files/APF-Holdings-Report-20200331.pdf>

Avon is a member of Brunel Pension Partnership. It is unclear from available information whether this investment is in Brunel Pension Partnership's fund or a separate one.

<sup>24</sup> <https://news.oxfordshire.gov.uk/pension-boost-for-low-carbon-economy/>

<sup>25</sup> See p.15 of <https://www.haringeypensionfund.co.uk/media/5251/investment-strategy-statement-from-2320.pdf>

<sup>26</sup> See p.8 of <https://www.haringeypensionfund.co.uk/media/5251/investment-strategy-statement-from-2320.pdf>

<sup>27</sup> <https://www.ipe.com/news/esg/haringey-pension-fund-moves-one-third-of-equities-into-low-carbon/10011637.article>

estimated 73% compared to the fund's previous emerging market investments". It has invested around £100m<sup>28</sup>.

**Southwark Pension Fund** made the decision in late 2017 to begin a process of divestment from fossil fuels and investment in low carbon and fossil fuel-free funds.

Its 2018-19 annual report stated that "£300m of passive equities have been transferred into specific low carbon investment funds, with an agreement made to transfer a further £150m into a new fossil fuel exclusionary equity investment"<sup>29</sup>.

Southwark Pension Fund had net total assets of £1.64bn as at 31 March 2019, meaning that low carbon or fossil free equity investments represent a very substantial share of the Fund's total value.

Of the £300m in passive equities, it is known that in January 2018 the Pension Fund committed £150m into the Blackrock Low Carbon Target Equity Fund, based on the MSCI Index<sup>30</sup>.

Details of the fossil fuel exclusionary equity investment are not publically available, including whether this is a passive or an actively-managed investment.

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<sup>28</sup> <https://www.haringeypensionfund.co.uk/client-area/news/haringey-pension-fund-invests-in-low-carbon-emerging-equity-fund/>

<sup>29</sup> See p.16 of Annual Report 2018-19 available at <https://www.southwark.gov.uk/council-and-democracy/pensions/pension-fund>

<sup>30</sup> <https://www.southwark.gov.uk/news/2018/jan/council-commits-to-low-carbon-investment>