worcestershire
countycouncil

# PENSIONS BOARD
# 7 MARCH 2022

# INVESTMENT STRATEGY STATEMENT (ISS) AND CLIMATE RISK STRATEGY UPDATE

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**Recommendation**

1. **The Chief Financial Officer recommends that the Board notes and comments on:**

   **a) The Fund's 2022 Investment Strategy Statement (ISS) set out at Appendix 1;**

   **b) The Climate Risk Strategy set out at Appendix 2;**

   **c) Note the Fund's ESG Workshop Review on the 2 February 2022 and recommended outcomes:**
   - **Add SDG 12 Responsible consumption & Production to the Funds existing investment beliefs within the ISS**
   - **Look to engage more with the wider members of the pension fund to get their views on Environmental, Social & Governance.**
   - **Explore and agree an internal climate target for the pension fund during 2022.**
   - **Explore further social impact investments as to whether they can deliver market-rate, risk-adjusted returns.**

   **d) Note the Funds 2nd Annual Climate Risk Report; and**

   **e) The 'Task Force on Climate related Financial Disclosures' (TCFD) Report be commented on. (Appendix 3)**

**Background**

2. The LGPS Investment Regulations that came into effect from 1 November 2016 required all funds to publish a new ISS by 1 April 2017. The Fund's 2017 ISS was designed in collaboration with the seven other funds within LGPS Central to ensure a consistent approach to investment beliefs and responsible investment beliefs.

3. Under Regulation 7(6) and (7); the ISS must then be kept under review and revised from time to time and at least every three years. The Department for Communities and Local Government (DCLG) at the time, now known as the Department for Levelling Up, Housing &Communities (DLUHC) also previously outlined guidance on preparing and maintaining an Investment Strategy Statement.

4. The current 2021 ISS was approved by the Pensions Committee on the 16 March 2021 to particularly enhance and strengthen the 'Stewardship and Responsible Investment (RI) areas. This was after taking into account the Funds Environmental, Social & Governance (ESG) Audit, Sustainable Development Goals (SDG) mapping and the Funds first 2020 Climate Risk report provided by LGPS Central.

Funds ESG Review 2 February 2022

5. The Fund had an ESG Review workshop with Committee members on the 2 February 2022 which was to review progress against the Pension Committee ESG recommendations in March 2021 and ascertain what further changes may be required when looking ahead. Discussions and debate focussed on:-

a) Emphasis for targeting SDG's should remain focussed on the financial risk / return and if there is any desire to add any new goals to the existing beliefs. SDG 12 Responsible consumption & Production stood out as an SDG that met these criteria and it was agreed to extend the beliefs to include this, in the belief that this will lead to better returns for the fund over the long term;

b) Stewardship Code 2020 review and it was highlighted that in 2022 more effort would be made to engage with the wider members of the pension fund to get their views on E, S & G, recognising that this is a challenge with so many members;

c) Climate targets: The general feeling was that in 2022 it would be good to explore and agree an internal climate target for the pension fund, and speak to managers about how they would align to this target. This could then be rolled out publicly at a later date. Science based targets on the whole fund with broad interim deadlines, would be preferred, so as to avoid the pension fund becoming a hostage to fortune on individual parts of the portfolio.

   A first step might be to consider targets that other LGPS funds are setting, and to seek their views on how easy these have been to adhere to

d) Spectrum of Capital and the S in ESG: There was more caution about proceeding further along the spectrum of capital at this stage although this seemed because of a concern over the investment thesis: could social impact investments really deliver market-rate, risk-adjusted returns? The committee seemed willing in principle to consider this and further exploration of this will be taken forward.

6. The ESG workshop also received a number of presentations from our Equity Fund managers responding to how they were progressing with a number of climate related questions.

**Investment Strategy Statement Guidance Requirements**

7. Regulation 7(1) requires an Administering Authority to formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State. The ISS must include:

a) A requirement to invest money in a wide variety of investments;
b) The authority's assessment of the suitability of particular investments and types of investments;
c) The authority's approach to risk, including the ways in which risks are to be measured and managed;

d) The authority's approach to pooling investments, including the use of collective investment vehicles and shared services.
e) The authority's policy on how social, environmental, or corporate governance considerations are taken into account in the selection, non-selection, retention, and realisation of investments; and
f) The authority's policy on the exercise of rights (including voting rights) attaching to investments.

**2022 Investment Strategy Statement proposed amendments**
8. The key amendments are highlighted via tracked changes and are mainly the changes to the recommended inclusion of the additional SDG 12 within the report if approved.

**Investment Strategy Target Allocation**
9. Appendix A of the attached proposed 2022 ISS, takes on board the Pension Committee decision on the 8 December 2021 to a 6% decrease in the strategic asset allocation to Market Capitalisation Passive indices and the increase of 6% to the Actively Managed Equities to take on board the investment in Sustainable active equities as per the table below.

| **Passively Managed Equities – Market Capitalisation Indices** | **35.0%** | | **Passively Managed Equities – Market Capitalisation Indices** | **29.0%** |
|---|---|---|---|---|
| United Kingdom | 20.5% | | United Kingdom | 17.0% |
| North America | 8.0% | | North America | 6.5% |
| Europe ex UK | 6.5% | | Europe ex UK | 5.5% |
| **Actively Managed Equities** | **20.0%** | | **Actively Managed Equities** | **26.0%** |
| **Total** | **55.0%** | | **Actively Managed Equities** | **55.0%** |

**Climate Risk Strategy**
10. One of the recommendations of the ESG Audit presented to the Pensions Committee in March 2021 was to have a separate Climate Risk Strategy for the Fund. This Climate Risk Strategy was agreed and set out Worcestershire Pension Fund's (the Fund) approach to addressing the risks and opportunities related to climate change.

11. The development of a separate Climate Risk Strategy reflects the potential material effect of climate change, and the response to climate change, on the assets and liabilities of the Fund.

12. This has been updated to take on board the outcome of the ESG workshop that was conducted informally with the Pensions Committee members on the 2 February 2022.

**Funds 2021 Climate Risk Report**
13. The Fund has received its 2nd Climate Risk Report January 2022 report from LGPSC and our Investment Advisor has provided a brief synopsis on its contents as follows:

> *"Beyond reading this recently published report, I have gone back to the first report published back in October 2020. That report was very much focused on*

*the then current "health" of the Fund's listed markets investments in comparison to carbon benchmarking. We came out as relatively "clean" in that exercise, but with some clear messages about how as a Fund we could make some changes to our portfolios to improve matters further and in a sense to provide some future proofing to the rising tide of concerns amongst at least some of our stakeholders.*

*This report is much more refined, dare I say it; glossier! Quite rightly they do highlight the enormous amount of work that the Fund has done in taking the information provided in their last report and the work undertaken by Minerva from the "talk about it" stage towards the implementation of considered changes to the management of Fund assets. In practical terms this has entailed changes to some of the listed markets mandates, as well as a greater focus on ESG and climate issues within our private markets investments.*

*While the report was again focused on carbon exposure/risk within the listed markets portfolios, reference is made to the likely climate related issues within private markets, although these are general comments rather than focused on the specifics of our investments. Ultimately it would be good to see these reports encompass all of the Fund's investments, so that we have a complete picture to consider and work with.*

*The main focus of our attention can be on listed equities, and it seems to split neatly into consideration of the passive mandates on one hand and active on the other. Starting with the passive mandates, our initial focus has been on the "Factor" based portfolios, with a transition of the greatest carbon "sinner", Low Volatility, into the LGPS Central Climate Multi Factor Fund. The Value portfolio was consolidated into the Quality portfolio, which has a lower carbon footprint. That remains with LGIM.*

*These actions provided the main reason for the Fund's carbon footprint reducing further from the already relatively low level recorded in the October 2020 report. Within the traditional regional passive mandates, the UK element has the highest exposure to fossil fuel companies. As part of the rebalancing process late last year £120m was switched from North America to the UK, so that will have had a small detrimental impact on our overall position. You will be aware that there will be a partial transfer into the newly established LGPS Central Active Sustainable Investment Fund with H1 2022, which will carry a lower carbon footprint. One further point to consider in general terms is that during 2021 non-renewable energy stocks saw a period of considerable outperformance as global energy prices soared from the low levels seen in mid-2020. As such they will have formed a greater percentage of traditional benchmark indices.*

*To some degree this point will also have had some impact in the active equity mandates managed by Nomura and LGPS Central. Both still have a much lower carbon exposure than their respective benchmarks, but both have seen an increase in their carbon exposure since the last review, but again less than the benchmarks. In the case of LGPS Central Emerging Markets this was as a result of UBS investing in two cement companies, that have high carbon footprints.*

*The one item of Work in Progress that was flagged relates to communication strategy in relation to climate risk. My understanding is that this needed to be* *managed in order to ensure that Pensions Committee took appropriate decisions ahead of such communication on a wider basis and does form part of the continuing process.*

*In conclusion, the report as a whole is very encouraging in terms of what the Fund has done and continues to do in response to the challenges presented by climate change. However, it does highlight the difficulties of trying to have your cake and eat it when a balance has to be maintained between investing appropriately to produce financial returns against the laudable aim of investing more sustainably.*

*Ultimately it is appropriate for the Fund to be part of the transition away from reliance on fossil fuels, but with an acknowledgement that this is not something that will be either quick or easy. In the meantime, the Fund's carbon exposure as measured on a relative market capitalisation basis will fluctuate with market movements and will to some extent be subject to investment decisions taken by our investment managers within their terms of reference."*

**Task Force on Climate related Financial Disclosures' (TCFD)**

14. The Taskforce on Climate-related Financial Disclosures (TCFD) was commissioned in 2015 by Mark Carney in his remit as Chair of the Financial Stability Board. In 2017 the TCFD released its recommendations for improved transparency by companies, asset managers, asset owners, banks, and insurance companies with respect to how climate-related risks and opportunities are being managed. Official supporters of the TCFD total 930 organisations representing a market capitalisation of over $11 trillion. Disclosure that aligns with the TCFD recommendations currently represents best practice.

2. LGPSC have provided the fund with an updated TCFD report and is attached as Appendix 3.

**Contact Points**

Specific Contact Points for this report
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**Supporting Information**

- Investment Strategy Statement - Appendix 1
- Climate Risk Strategy - Appendix 2
- Task Force on Climate related Financial Disclosures' (TCFD) - Appendix 3
- Climate Risk Report January 2022 – Appendix 4

**Background Papers**

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.