worcestershire
countycouncil

PENSIONS BOARD
3 MARCH 2023

INVESTMENT STRATEGY STATEMENT (ISS) AND CLIMATE RISK STRATEGY UPDATE

Recommendation

1. **The Chief Financial Officer recommends that the Board note and comment on:**

   a) **The Fund's 2023 draft Investment Strategy Statement (ISS) set out at Appendix 1;**

   b) **The updated LGPS Central Voting Principles Appendix 2**

   c) **The draft Climate Risk Strategy set out at Appendix 3;**

   d) **The Funds ESG Workshop Review on the 8 February 2023 and the recommended outcomes;**

   e) **The Fund's 3rd Annual Climate Risk Report (Appendix 4); and**

   f) **The draft 'Task Force on Climate related Financial Disclosures' (TCFD) Report (Appendix 5)**

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 Levelling Up, Housing &Communities (DLUHC) outlines guidance on preparing and maintaining an Investment Strategy Statement.

4. The current 2022 ISS was approved by the Committee on 3 March 2022 and a key focus was to continue to 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, the Funds second 2021 Climate Risk report provided by LGPS Central and the first annual ESG review that the Fund conducted on 2 February 2022.

Funds ESG Review 8 February 2023

5. The Fund had an ESG Review workshop with Committee members on the 8 February 2023 which was to review progress against the Pension Committee ESG recommendations in March 2022 and ascertain what further changes may be required when looking ahead. The workshop was led by Karen Shackleton from Pensions for Purpose who has provided valuable support for the Fund in this area since January 2020, and supported by officers and the Funds independent Investment Advisor The objectives of the review were as follows:-

- Refresh – the Fund's investment beliefs, priorities and how you can align to these.
- Review - strategic actions agreed at the last review and progress made.
- Review - Stewardship Code 2020 and TCFD reporting.
- Update on key outcomes of the Funds 3rd Climate risk report and 2nd Climate scenario analysis presented by LGPS Central.
- Consider – ESG progress in private markets (presentations from two Fund managers, Bridgepoint (Corporate Private Debt) and Stonepeak (Infrastructure).
- Explore - case studies of LGPS funds exhibiting best practice.
- Review - key insights from the ESG pensioner members questionnaire.
- Consider - net zero goals – mapping the journey to net zero.
- Discuss – priorities for the next 12 months

6. **The workshop finished with a consideration of the next steps to consider for the next 12 months** with the issues below raised by Pensions for Purpose. General views expressed are shown by each item:

a) **Enhance engagement activity?** *The fund was already doing a lot on engagement activity and the Fund would target its engagement activity in line with the stewardship plan within LGPSC Climate Risk report*;

b) **Further member engagement?** *The current level of proposed engagement was satisfactory and the ESG questionnaire would be rolled out in 2023 to employees contributing to the Fund (around 23,000) and the following year to Deferred pension members (around 23,000);*

c) **More action from investment managers/pool?** *To continue to monitor the Fund managers progress in this area and work with LGPSC to enhance reporting and information on the effectiveness of engagement outcomes over time;*

d) **More climate solutions/more de-risking?** *Agree a decarbonisation goal for the next five years with 2020 as the baseline (an action for the committee to consider);*

e) **Commit to impact-driven investing?** *This may be a way to align to some of the other SDG priorities that the fund has agreed, subject to the opportunities delivering strong market-rate, risk-adjusted financial returns;*

f) **Training on impact investing?** *This was felt to be a good suggestion; and*

g) **Training on Science Based Targets vs Implied Temperature Rise?** *This was felt to be a good suggestion.*

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.

2023 Draft Investment Strategy Statement (Appendix 1) proposed amendments

8. The key amendments are highlighted via tracked changes and shaded areas. These mainly relate to:

a) Updating the cashflow management risks;
b) Updating information around the Funds surplus as at the 2022 Triennial Valuation.
c) Updating the Voting Principles provided by LGPSC.(Appendix 2);
d) The Funds commitment to the enhanced UK Stewardship code;
e) Taking out the compliance with the Myners principles as this has been superseded by compliance to the UK Stewardship Code;
f) Update to the Funds Strategic Allocation Investment Benchmark(SAIB) increase the Funds US Passive equity investment and reducing its UK passive equity investment by 5%; and
g) Noting the allocation within the SAIB to Private Equity by using the flexibility within the strategic asset allocation ranges that are available to build up to the 5% over time and then make this more formal in the next Strategic Asset Allocation review in 2025.

Draft Climate Risk Strategy

9. The Fund has a separate Climate Risk Strategy (Appendix 3) for the Fund which sets out the Funds approach to addressing the risks and opportunities related to climate change. This also reflects the potential material effect of climate change, and the response to climate change, on the assets and liabilities of the Fund.

10. 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 8 February 2023.

Funds 2022 Climate Risk Report

11. The Fund has received its 3rd Climate Risk Report – January 2023 report from LGPSC (Appendix 4) covering the Funds listed equity portfolio. Its purpose is to:

a) assesses the Fund’s exposure to climate-related risks and opportunities;
b) allows the Fund to identify further means to manage its material climate risks;
c) To highlight the report’s key findings; and
d) To provide an overview of the Fund’s progress in managing climate risk.

12. the executive summary key highlights were:-

a) The carbon intensity of the Fund’s Total Equities decreased by 13% between 2020 and 2022;
b) This overall decrease was driven by a 24% decrease in the intensity of Passive Equities, but mitigated by a 22% increase in intensity of Active Equities;
c) The Fund’s carbon intensity has remained consistently lower than the benchmark and is currently 30.1% lower;
d) Four of the Top 5 contributors to the portfolio’s Carbon Footprint are currently in the Climate Stewardship Plan meaning dedicated engagement activities;
e) 7 out of 8 of climate stewardship plan companies have been awarded a management quality of 4 (top mark) by the Transition Pathway initiative; and
f) Seen a marginal increase in its weight in fossil fuels.

13. The key recommendations by LGPSC for the Fund were:-

a) Continue updating the Climate Stewardship Plan following changes to the portfolio;
b) Consider formalising a Net Zero Climate Strategy;
c) Continue to report against the TCFD recommendations
d) Work with fund managers to continue understanding how they identify, monitor, and mitigate climate risk; and
e) Repeat the Carbon Risk Metrics annually and the CSA every 2-3 years.

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 draft TCFD report and is attached as Appendix 5.

Contact Points

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Supporting Information

- Draft Investment Strategy Statement - Appendix 1

- Updated Voting Principles – Appendix 2
- Draft Climate Risk Strategy Appendix 3
- Draft Climate Risk Report January 2023 – Appendix 4
- Draft Task Force on Climate related Financial Disclosures' (TCFD) Appendix 5

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.