Worcestershire Pension Fund

CLIMATE CHANGE RISK STRATEGY

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1. Introduction

This Climate Strategy sets out Worcestershire Pension Fund's (the Fund) approach to addressing the risks and opportunities related to climate change.

The Fund is supportive of the ambitions of the Paris Agreement on Climate Change to hold the increase in the global temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels – ratified by 191 parties.

The Pensions Committee (the Committee) is responsible for reviewing and approving the Fund's policies and strategies, including its Climate Strategy. The Climate Strategy works in tandem with the Fund's Investment Strategy Statement and Funding Strategy Statement.

The development of a separate Climate Strategy reflects the potential material effect of climate change, and the response to climate change, on the assets and liabilities of the Fund. For example, short-term risks include stock price movements resulting from increased regulation to address climate change. Medium-term risks include policy and technology leading to changes in consumer behaviour and therefore purchasing decisions – the uptake in electric vehicles is an example of this. Long-term risks include physical damages to real assets and resource availability. Examples would include increased sea level rise for coastal infrastructure assets or supply chain impacts for companies as a result of severe weather events.

The Committee will review the Climate Strategy at least every two years, or at such time as the Committee determines it is appropriate to review the Fund's approach to addressing the risks and opportunities related to climate change.

Responsibility for the identification and management of climate-related risks, together with the implementation of the Fund's Climate Strategy, resides with the Chief Financial Officer and the Pensions Investment & Treasury Management Manager.

2. Climate Change

Human activities are estimated to have caused approximately 1.0°C of global warming above pre-industrial levels. Most of this warming has occurred in the last 35 years, with the five warmest years on record taking place since 2010. The observed global mean surface temperature has risen from around 1950 onwards. Over 97% of climate scientists (Source: NASA) agree that this trend is the result of greenhouse gas (GHG) emissions which are being trapped in the atmosphere and creating a 'greenhouse effect' – a warming that occurs when the atmosphere blocks heat radiating from Earth towards space. These climate scientists have observed that these climactic changes are primarily the result of human activities including electricity and heat production, agriculture and land use change, industry, and transport.

This is causing more frequent and more extreme weather events and world governments have started to respond. The signatories to the 2015 Paris Agreement committed to keeping the global temperature rise this century to well below 2.0°C compared with pre-industrial levels and to aiming to limit the increase to 1.5°C (Article 2(1)a). The Paris Agreement commits signatories to the establishment of Nationally Determined Contributions (NDCs), which are intended to be individually equitable and collectively sufficient to achieve Article 2(1)a. It is estimated that under current global policies (and assuming successful implementation), the world is heading towards a warming of 3.2°C.

The low-carbon transition is already underway, with a number of governments and institutions around the world intensifying their climate change policies, and corporates responding in turn. Investors are exposed globally to the risks and opportunities presented by climate change adaption and mitigation. The risks might include holding companies whose business will be negatively impacted as the climate transition evolves (e.g. fossil fuel companies). The opportunities might include investing in companies that stand to gain from the transition to a low carbon economy.

Investors have an important role to play in the transition to a low carbon economy, influencing company behaviours and encouraging the development of better climate-related disclosures. However, investors cannot effect material change alone. Governments, policy makers, consumers, companies, and investors all have a role to play in the transition to a low carbon economy.

If policy and corporate action does not progressively transition towards the net zero goal, it will be extremely challenging for investors to achieve a portfolio of assets that has net zero emissions in 2050.

The Fund recognises that:

- Human activities have caused a change in the earth's climate which presents material risks to human and eco-systems and to global economies.
- A global coordinated policy response and a change in consumer behaviour will be required to limit the damaging rise in global temperatures.
- Climate change is a long-term financial material risk for the Fund, across all asset classes, and has the potential to impact the funding level of the Fund through impacts on employer covenant, asset pricing, and longer-term inflation, interest rates and life expectancy.

The Fund believes that:

- The risks and opportunities of climate change should be considered as part of asset allocation decisions, manager selection decisions and individual investment decisions.
- Diversification across asset classes, regions and sectors is an important risk management tool to reduce the unpredictability of climate-related risks such as unexpected events (weather) and expected events (such as melting ice) where the implications of these events aren't fully understood as yet.
- In order to fully integrate climate-related risk into the Fund's investment processes, the consistency, comparability, and quality of climate-related data, including the identification and measurement of companies' Scope 3 emissions will need to improve. **Scope 3 emissions** are the result of activities from assets not owned or controlled by the reporting organisation, but that the organisation indirectly impacts in its value chain. Scope 3 emissions, also referred to as value chain emissions, often represent the majority of an organisation's total Greenhouse Gas (GHG) emissions
- The low-carbon transition is already underway, but the pathway is unclear, and the transition will not occur by focusing only on the suppliers of energy; the demand for energy must also be addressed.
- It is possible for a company to shift its business model in order to thrive in the transition to a low carbon future; such a shift is more likely with the support and stewardship of responsible investors.

3. Climate-related Objectives

The Fund aims to have access to the best possible information available on the risk and opportunities presented by climate change. This includes impacts to the Fund's investment strategy, or its funding strategy, as a result of transition risks, physical risks, and opportunities.

The Fund aims to ensure that its investment portfolio will be as resilient as possible to climate-related risks over the short, medium, and long term. For an effective first line of defence, the Fund aims to integrate climate-related factors into the investment process, including the selection of investment managers.

The Fund intends to reduce the carbon intensity of its portfolio through its selection of investments and investment managers.

4. Collaboration and Transparency

The Fund aims to collaborate with like-minded organisations to support the ambitions of climate-related initiatives and aims to be fully transparent with its stakeholders through regular public disclosure, aligned with best practice.

- The Fund supports the Paris Agreement on Climate Change.
- The Fund will actively participate in selected initiatives that lend support to the Fund's Climate Strategy, including working with other like-minded investors to engage with high-emitting companies.
- The Fund supports the Taskforce on Climate-related Financial Disclosures (TCFD) and adopts its recommendations for the Fund's climate disclosures.
- The Fund will use its membership of the Local Authority Pension Fund Forum (LAPFF) and being a partner to the LGPS Central Limited pool to assist it in pursing engagement activities.

5. Strategic Actions

5.1 Measurement & Observation

The Fund recognises that the tools and techniques for assessing climate-related risks in investment portfolios are an imperfect but evolving discipline. The Fund aims to use the best available information to assess climate-related threats to investment performance.

The Fund will make regular measurements and observations on climate-related risks and opportunities relevant to the Fund. This will include:

- Identification of the most material climate-related risks to the Fund.
- Economic assessment of the Fund's asset allocation against plausible climate-related scenarios.
- A suite of carbon metrics for the Fund's listed equity portfolio to allow the Fund to assess progress in responding to climate-related risks and opportunities, including carbon intensity; weight in companies with fossil fuel reserves; weight in companies with thermal coal reserves; and weight in companies with clean technology. A more complete analysis of all of the Fund's assets classes will be carried out when reliable carbon-related data becomes available for non-listed equity assets.
- Assessment of progression against the Fund's carbon footprint and low carbon & sustainable investment targets.

Methodologies for assessing the impact of future climate-related scenarios, including the possibility of measuring against alignment with the Paris Agreement, remain at an early stage of development, and the Fund will support efforts to develop more reliable and comparable methodologies.

The Fund recognises that there is currently significant variability in the relevance, consistency, comparability, and quality of companies' climate-related disclosures. The Fund supports adoption, and encourages disclosure, in line with the recommendations of the TCFD.

5.2 Asset Allocation & Targets

Where there is a credible evidence base, the Fund will integrate climate-related factors into asset class reviews, subject to the requirements of the Investment Strategy Statement and Funding Strategy Statement. The Fund will aim to:

- Reduce further the carbon footprint (Scope 1 & 2) of the Fund's listed equity portfolio compared to its weighted benchmark in 2022 by the end of 2023; and set a decarbonisation reduction target up to 2025 at which point it will be further reviewed.
- Continue to invest a proportion of the Fund's portfolio in low carbon & sustainable investments by the end of 2023.

5.3 Manager Selection and Monitoring

The Fund will assess material climate-related risk and opportunities using an evidenced based long term investment appraisal to inform decision making, alongside other relevant investment factors, as part of the investment manager selection process.

As a largely externally-managed pension fund, the identification and assessment of climate-related risks is also the responsibility of individual investment managers appointed by the Fund. Existing investment managers are monitored on a regular basis to review the integration of climate-related risks into the portfolio management process, and to understand their engagement activities.

5.4 Stewardship

The Fund's annual Responsible Investment Stewardship report will include a section on climate-related stewardship plans. This will set clear goals of engagement with investee companies and investment managers to manage risks and opportunities within the Fund's investment portfolio, focusing on those risks and opportunities which will have the greatest impact.

The Fund will collaborate with other like-minded investors where possible and the Fund will participate in selected collaborative initiatives where these support the Fund's climate-related objectives. The Fund will make full use of its voting rights and will co-file or support climate-related shareholder resolutions where these support the Fund's climate-related objectives.

6. Transparency & Disclosure

The Fund will:

- Prepare a TCFD Report annually
- Report on the progression against the Fund's carbon footprint and low carbon & sustainable investment targets annually
- Report on a suite of carbon metrics in the Fund's annual report.
- Disclose the stewardship reports of the Fund's key investment managers on a quarterly basis.
- Report on progress against the RI Stewardship Plan engagement goals annually.