worcestershire
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PENSIONS COMMITTEE
20 MARCH 2024

INVESTMENT STRATEGY STATEMENT (ISS) AND CLIMATE CHANGE RISK STRATEGY (CCRS) UPDATE

Recommendation

1. **The Chief Financial Officer recommends that:**

   a) **The Fund's 2024 draft Investment Strategy Statement (ISS) be approved as set out at Appendix 1;**

   b) **The draft Climate Change Risk Strategy (CCRS) be approved as set out at Appendix 2;**

   c) **The Fund’s ESG Workshop Review on the 8 February 2023 and the recommended outcomes be noted;**

   d) **The Fund’s 4th Annual Climate Risk Report (Appendix 3) be noted; and**

   e) **The draft ‘Task Force on Climate related Financial Disclosures’ (TCFD) Report (Appendix 4) be noted.**

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 2023 ISS was approved by the Committee on 22 March 2023 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 and Sustainable Development Goals (SDG) mapping conducted previously.

Fund ESG Review 31 January 2024

5. The Fund held its second annual ESG Review workshop with Committee and Board members on 31 January 2024. In addition to reviewing against recommendations from the previous workshop, members received insight into the concept of impact investing. The workshop was led by Karen Shackleton and David Brown from Pensions for

Purpose who have supported the Fund in this area since January 2020, collaborating with the Fund's independent Investment Advisor.

6. The objectives of the workshop were as follows: -

- Review - strategic actions agreed at the last review and progress made.
- Review – the Fund's fourth Climate Risk Report and TCFD reporting.
- Update on new MSCI metrics presented by LGPS Central.
- Consider – the framework for setting climate targets.
- Consider - net zero goals – mapping the journey to net zero.
- Explore – strategies for investing with impact.
- Review - key insights from the Fund's existing investments with impact featuring case studies from the Fund's investments in Gresham House BSIF I & II, forestry, and private equity funds.
- Discuss – priorities for the next 12-months.

7. Discussion was focussed on four key areas:

ESG successes
It was noted there have been many ESG successes since the February 2023 ESG workshop, such as further investment in forestry, investment in vertical farming and energy from waste. Additionally, the Fund has enhanced its TCFD reporting (now into fourth year on a voluntary basis), enhanced engagement with LGPSC RI&E Team and maintained signatory status with the Stewardship Code 2020. Over the year the Fund has been well supported by LGPS Central including via their reporting on Climate Risk Metrics.

Investment beliefs
The current Sustainable Development Goal's highlighted as priorities remain as Good Health and Well-Being (SDG 3), Affordable and Clean Energy (SDG 7), Industry, Innovation, and Infrastructure (SDG 9), Responsible Consumption and Production (SDG 12) and Climate Action (SDG 13). The Fund is supportive of further impact investments provided they are considered on a finance first approach.

Net zero target
The Fund has previously agreed not to set a net zero target despite having a five-year decarbonisation goal and Fund investments in climate opportunities. This decision was reviewed during the workshop. The following observations were made:

- An internal net zero target could be considered, although it was felt this would not remain internal for long and so was dismissed as an option.
- An explicit net zero objective would significantly restrict the current investment universe available with consequences for the Fund's fiduciary duty obligations.
- With a more limited investment set it was difficult to adequately plan for net zero. Planning issues were compounded by the lack of available emissions data.
- The market is still maturing, and the committee needed more confidence in data quality and approach. The Fund needed to be honest, transparent, and real. There was a preference for the Fund to be "alert and watching".
- The absence of setting a net zero target need not be detrimental to stewardship, collaboration, and member engagement activities.

Therefore the Fund agreed not to set a net zero target at this point but to reflect again on this in a few years' time, as the market matures. More generally, concern was expressed over the plethora of climate metrics. There is a risk of all 8 pension funds in LGPS Central monitoring different things (and the pools themselves measuring different things). Standardisation of the right metrics to measure de-carbonisation was therefore deemed to be important. There was a suggestion that there might be a benefit to engaging with other pool members.

Impact investing
The committee was happy with the way the Fund was developing its impact investment approach. It should focus on highlighting impact achievements more effectively for members, across all the investment managers. For example, Igneo was a good performer, and its investments included an energy waste plant. It was agreed that the committee could consider adding an explicit paragraph in the Investment Strategy Statement which indicated commitment to impact investment in the Fund's own way and time.

8. The workshop finished with the identification of issues to consider over the next 12 months. The issues for the Fund to consider, raised by Pensions for Purpose were:

- Agreement of a timeline and implementation plan for achieving climate targets with a net zero goal.
- Formalise a commitment to impact-driven investing.
- Implement further member training on impact investing.

Investment Strategy Statement Guidance Requirements

9. 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 requirement to invest money in a wide variety of investments;
- The authority's assessment of the suitability of particular investments and types of investments;
- The authority's approach to risk, including the ways in which risks are to be measured and managed;
- The authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
- 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
- The authority's policy on the exercise of rights (including voting rights) attaching to investments.

2024 Draft Investment Strategy Statement

10. Given that the Fund completed its most recent strategic asset allocation review in March 2023, the 2024 draft ISS, included at **Appendix 1**, represents a minor update rather than substantive amendments. A key update has been to include a section regarding investing with impact within the Fund's investment beliefs.

Draft Climate Risk Strategy

11. The Fund has a separate Climate Risk Strategy, included at **Appendix 3**, for the Fund which sets out the Fund's 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.

12. This has been updated to take on board the outcome of the ESG workshop that was conducted informally with the Pensions Board & Committee members on 31 January 2024.

Climate Risk Report 2023

13. The Fund has received its 4th Climate Risk Report – January 2024 report from LGPSC (**Appendix 4**) covering the Fund's listed equity portfolio. Its purpose is to:

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

14. Key highlights are: -

- The Weighted Average Carbon Intensity (WACI) of the Fund's Total Equities has decreased by 31.5% since 2020 and 13.7% since 2022 driven by a reduction in exposure to the energy sector;
- The Fund's WACI remained consistently lower than the benchmark and is currently 40% lower;
- Six of the Top 10 contributors to the portfolio's Carbon Footprint are currently in the Climate Stewardship Plan meaning dedicated engagement activities;
- The Fund is represented in engagement efforts with companies responsible for 71% of its exposure to financed emissions.

15. The key recommendations by LGPSC for the Fund are: -

- **Governance** - continue to review, improve, and enhance climate-related disclosures with an awareness of potential future regulations.
- **Strategy** - continue to commission Climate Scenario Analyses as recommended by DLUHC.
- **Risk Management** - consider further disclosures relating to the frequency and scope of climate-related discussions at the Pensions Committees
- **Metrics & Targets** - consider adopting a Net Zero Climate Strategy, as well as short-, medium-, and long-term interim targets.

Task Force on Climate related Financial Disclosures' (TCFD)

16. 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. Disclosure that aligns with the TCFD recommendations has not yet become compulsory and therefore currently represents best practice.

17. LGPSC have provided the fund with its fourth draft TCFD report which is attached as **Appendix 4**.

Contact Points

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Supporting Information

- Draft Investment Strategy Statement - Appendix 1
- Draft Climate Change Risk Strategy Appendix 2
- Draft Climate Risk Report January 2024 – Appendix 3
- Draft Task Force on Climate related Financial Disclosures (TCFD) 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.