CLWYD PENSION FUND COMMITTEE

Date of Meeting	Wednesday, 9 June 2021
Report Subject	Responsible Investment Roadmap
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

Much of the recent focus by LGPS on climate change and investments has been driven by the UK government's 2050 net zero commitment, as well as upcoming climate change regulation that is expected to come into force next year. In light of these developments and the Fund's commitment to ESG best practice, the Fund should continue to evolve its approach to climate change.

It is the belief of the Fund's investment adviser that setting a comprehensive net zero plan is the best way to decarbonise the investment portfolio and manage carbon risks as we transition to a low carbon economy. Further, going forward a new allocation to sustainable global equity, provided through the Wales Pension Partnership on an active basis, can play an important role in the Fund's listed equity portfolio.

The matters covered by the report are:

- What is driving investors' policy decisions to adopt a Net Zero commitment (e.g. being Net Zero by 2050)?
- How the Fund could adopt net zero targets and implement a decarbonisation plan to manage the risks and opportunities from climate change.
- A high level introduction to active sustainable global equity.

RECOMMENDATIONS	
1.	That the Committee agree to adopt a 2050 Net Zero ambition for the Fund's investment strategy, noting this may be updated to an earlier date following further consideration and analysis.
2.	That the Committee agree the high level net zero work plan or roadmap as detailed in 1.07. This roadmap lays out the next steps required to set net zero target(s) underpinned by a credible implementation plan.
3.	That the Committee agree to formally request that the Wales Pension Partnership offer an Active Sustainable Global Equity Sub-Fund and that the necessary project to construct this Sub-Fund commences as soon as possible.

REPORT DETAILS

1.00	Net Zero Investing and Sustainable Global Equity
1.01	**Introduction** In February 2020 the Committee agreed a number of responsible investment strategic priorities for inclusion in the Fund's Investment Strategy Statement. These included: • Evaluating and managing carbon exposure – including measuring and understanding its carbon exposure, and setting carbon reduction targets. • Identifying sustainable investment opportunities. This report provides the next steps (i.e. road map) in meeting these priorities and builds on the information shared at the following recent sessions: • 12th May: Briefing on Fossil Fuels – this briefing considered the FCC question around whether any of the Fund's investments involve fossil fuel industries and action that can be taken in relation to them. The full question and answer are included in Appendix 1, and the Committee are asked to remind themselves of the response to that question when considering this report. • 26th May: Training on responsible investment considerations – this training focussed on the three key aspects of this report. The slides from that training are included in Appendix 2 so the Committee may remind themselves of some of the detail in relation to the aspects considered in this report. This report includes a number of responsible investment related terms which are explained in the glossary at the back of the report (Section 7).
1.02	**Why investors should adopt a Net Zero Commitment** Globally we must reduce greenhouse gas emissions by 45% by 2030 (on 2010 levels) to achieve net zero by 2050, according to the Intergovernmental Panel on Climate Change (IPCC). This will create the greatest probability to limit warming to below 2°C, ideally no more than 1.5°C, compared to pre-industrial temperatures.
1.03	There are a number of key elements coming together for a transition to a low carbon economy. For example technology developments and price disruption in the energy sector is already evident through the falling cost of renewable energy generation and storage. Markets are recognising climate in pricing already and investors should make sure they are positioning their portfolios to be ahead of the curve. For example, companies with business models reliant on fossil fuels (such as oil and gas majors) may increasingly be viewed and priced differently by the market compared to renewable energy companies.
1.04	Momentum is growing with respect to a low carbon transition and investors are on the move. Investors who have been early to adopt best practice climate change disclosure frameworks, such as the Task Force on

	Climate-related Financial Disclosures, are increasingly now moving their focus to also incorporate net zero commitments. Investors are not alone as countries, local governments, cities, universities and companies are also adopting net zero targets. The framework, tools and methodologies are now available for the first time for the Clwyd Pension Fund not only to make these commitments but also develop credible implementation plans to underpin them.
1.05	The Fund's investment adviser supports the increasing investor focus to target a below 2^{o}C scenario as a priority because in this scenario: • Risks are more likely in the short term - divergence in sectors (e.g. energy and utilities) and asset classes (e.g. equities and infrastructure), means investors should be monitoring for disruption to reduce portfolio risk where possible. • Opportunities are more likely in the next decade - targeted allocations to companies delivering the solutions to building transition capacity and adapting to physical damages is expected to provide additional diversification benefits and new return opportunities. • A low carbon transition scenario is more likely than not - investors need to navigate the pace of possible transition between a 3^{o}C and 1.5^{o}C scenario and build resilient portfolios accordingly. It is unlikely that there will not be a transition of some magnitude. • It is in investors' best interests over the long term - setting targets and aligning action to influence a below 2^{o}C scenario, where possible, is consistent with fiduciary duty as this is expected to be most beneficial scenario for long term investors (like pension funds), particularly for those with beneficiary timeframes over multiple decades such as the Fund. Further information is contained in the training slides in Appendix 2.
1.06	**Setting credible Net Zero targets and implementation plans for Clwyd Pension Fund** Initially it is recommended that the Committee agree a target to achieve net zero by 2050, with a view to this being reconsidered at a later date to see whether a potentially earlier date could be appropriate. An initial target year of 2050 is consistent with the UK government's legally binding target and is consistent with the Institutional Investors Group on Climate Change (IIGCC) 'Net Zero Investment Framework'. The Fund can then take a step-by-step approach to align portfolios to that net zero outcome by 2050 or potentially earlier. This would involve four steps: 1. **Calculate the baseline** – this includes current emissions, transition capacity and green exposures. One output is to split the portfolio into three areas: • "Grey" – these are the stocks with high carbon intensity and low transition capacity (this is expected to include fossil fuel companies).

	• "Green" – these are the stocks that have low carbon intensity and high transition capacity. • "In between" – these are stocks that have varying carbon intensity and transition prospects. 2. **Analyse portfolio possibilities** for implementing a portfolio wide transition by asset class. 3. **Set measurable targets** for reducing emissions and growing transition capacity, tested against different scenario pathways (for example a 2050 net zero target). 4. **Implement a plan**, drawing on outputs from each step.
1.07	Outputs from this will allow the Fund to develop and implement a comprehensive decarbonisation plan. This plan will include recommendations in relation to goals across different areas: • Decarbonisation targets. This will include how to manage exposures to "grey" stocks and may extend to selective divestment or screening of stocks that have significant carbon exposures, with no prospects of transition. • The use of stewardship to increase companies' transition capacity. • Green allocation targets. Below we provide a high level roadmap for the delivery of this work. The Committee is being asked to agree this roadmap.

Roadmap Item	**Timeframe**
Listed equity The work would cover four areas: 1. Baseline emissions intensity assessment – this analysis would highlight what is driving the Fund's carbon exposure across mandates, geographies and sectors. 2. Net Zero 2050 (or earlier) target setting with interim targets to 2025 and 2030: • Analyse potential 2050 (or earlier) net zero targets. • Analyse interim targets to 2025 and 2030 consistent with a net zero pathway to 2050 (or earlier) using carbon emissions pathway curves. 3. Grey/transition/green transition analysis (see 1.06 for more detail) – analyse the portfolio's transition capacity, including stocks most at risk of climate change and those accessing green opportunities. 4. Develop a detailed implementation plan across three areas: integration, stewardship and green investments. This will incorporate additional, more	July - October 2021

	granular targets across each of these areas (see slide 12 of Appendix 2 for an example implementation plan).	
	Present results. Agree 2050 (or earlier) net zero targets and implementation plan at Pension Fund Committee meeting.	November 2021 PFC meeting
	Update Investment Strategy Statement for net zero ambition and targets. Communicate approach to key stakeholders.	November / December 2021
	Property, infrastructure, private equity and private debt Commence work on carbon footprinting and setting net zero targets for these additional asset classes.	January to June 2022
	Listed equity Monitor progress against targets and update implementation plan.	July to December 2022
	Further information is contained in Appendix 2.	
1.08	**Sustainable Global Equity**	

Based on the current investment opportunities and long-term sustainable themes, the Fund's investment adviser believes sustainable global equities should form a material part of the Fund's equity portfolio. Sustainable global equity mandates typically have a number of characteristics:

- A portfolio of companies focused on sustainable business management and global trends.
- Often based around selecting companies aligned with sustainability themes, such as health, energy efficiency, education, labour rights, etc.
- Generally long-term time horizon and lower expected turnover.
- Can be concentrated and typically quality / growth oriented.
- Strategies are increasingly considering sustainable impact reporting and alignment with the Sustainable Development Goals (SDGs).
- Typically well placed to capture positive investment opportunities associated with the shift to a low carbon economy.

In respect of the link to the Fund's investment strategy, it is the view of the Fund's investment adviser that an allocation to this area of the global equity market is currently (and will remain) a compelling proposition. It is also the view of the investment adviser that this allocation should be managed on an active basis.

Currently there is no sustainable global equities sub-fund available through the Wales Pension Partnership (WPP). The time lag between the request to WPP to construct a sub-fund and the actual date for a launch and feasible transition could be between 12 and 24 months. Hence if this is agreed to be of interest to the Committee, it is necessary for this request to

	be made now. In particular, should the sub-fund be available for investment in the anticipated timescale then the Committee will have the opportunity to integrate decisions regarding an allocation to this area within the 2022 Actuarial and Investment Strategy cycle. Further information is contained in Appendix 2.

2.00	**RESOURCE IMPLICATIONS**
2.01	Taking forward the recommendations in this report will result in some additional work for the Fund's officers and Mercer including: • The net zero recommendations will lead to increased annual monitoring requirements. If the Wales Pension Partnership accepts the Fund's request for a Sustainable Global Equity Fund, the responsibility for designing and launching the offering will sit with the pool. However, the Fund would want to collaborate with the pool on the specifications and be kept informed of progress with the launch.

3.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
3.01	The LGPS Investment Regulations state that the Administering Authority must consult such persons as it considers appropriate as to the proposed contents of its Investment Strategy. It is therefore likely that any changes to the Investment Strategy Statement, including introducing net zero targets into it, will be consulted on with Fund stakeholders, such as employers.

4.00	**RISK MANAGEMENT**
4.01	Any net zero targets would be underpinned by credible implementation plans. This would ensure that the Fund can meet its risk adjusted return objectives and climate change objectives at the same time. An allocation to a new Sustainable Global Equity Fund will be subject to the usual analysis and scrutiny as other new appointments. The Fund's investment adviser will provide suitability advice on the Wales Pension Partnership offering.

5.00	**APPENDICES**
5.01	Appendix 1 – FCC Question and Response on Local Authority Pension Funds and Investments in Fossil Fuels Appendix 2 – Responsible Investment Training: Net Zero and Sustainable Equity

6.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
6.01	1. Current Investment Strategy Statement 2. Fossil Fuel Investments Briefing Paper May 2021 **Contact Officer:** Philip Latham, Head of Clwyd Pension Fund **Telephone:** 01352 702264 **E-mail:** philip.latham@flintshire.gov.uk

7.00	GLOSSARY OF TERMS
7.01	**What is Responsible Investment (RI)?** This is an investment approach that incorporates environmental, social and corporate governance (ESG) factors and broader systemic issues — for example, climate change and sustainable development — along with active ownership (stewardship). These considerations can have a material impact on financial performance, and their inclusion is more likely to lead to sustainable investment outcomes. **What is an Investment Strategy Statement?** All LGPS funds are required to produce an Investment Strategy Statement (ISS). This contains the investment policy approach of the Fund. The Clwyd Pension Fund's latest ISS includes the Fund's Responsible Investment Policy and can be found here: https://mss.clwydpensionfund.org.uk/home/investments-and-governance/strategies-policies/ **What are the main approaches to Responsible Investment?** Mercer views Responsible Investment as having four main approaches: 1. ***Integration:*** Incorporating ESG factors into the investment process for risk/return reasons. 2. ***Stewardship:*** Voting and engagement with underlying companies and/or investment managers and engagement with policymakers for risk/return reasons. 3. ***Investment:*** Themed investing — funds that focus on the risk and return opportunities in ESG / sustainability themes, typically related to sustainability solution trends. Impact investments – seek to balance financial return with a positive impact on society and/or the environment. 4. ***Screening/divestment*** Excluding investments in companies that are perceived to have a negative impact on society, where investors do not want to profit from the product or activity for reputational or ethical reasons. **What is Fiduciary Duty?** The obligation on those that look after or manage other people's money, to act in the best interest of beneficiaries, rather than serving their own interests. This duty extends to Committee members of the Fund. There is now widespread recognition that adopting a Responsible Investment approach is consistent with fiduciary duty. **What are key Climate Change investment risks?** Anthropogenic climate change refers to change in climate caused by human activity. Investors increasingly recognise that climate change poses a systemic risk given the low carbon transition (see definition below) and physical impacts of different climate outcomes (for example reduced

	resource availability and increased severity of natural catastrophes such as wildfires, droughts and hurricanes). **What do we mean by decarbonisation?** Described as the process under which countries, individuals or other entities aim to achieve reduced or zero carbon emissions, or businesses and investors aim to achieve reduced or zero carbon emissions in their operations and investments. It is often most closely linked to a reduction of the carbon emissions associated with the energy/electricity, industry and transport sectors. **What is a Low Carbon Transition?** The decarbonisation of the global economy, and in particular, the decarbonisation of the global energy and transport sectors. A successful transition would see an economy based on low carbon power sources that therefore have a minimal output of carbon emissions into the atmosphere. The Paris Agreement, which aims to limit warming to 2ºC or below, is consistent with a low carbon transition. Policy and technology developments are expected to play an important role in a low carbon transition. **What do we mean by Net Zero?** Net zero refers to achieving net zero carbon dioxide emissions by balancing carbon emissions with carbon removal (often through carbon offsetting) or eliminating carbon emissions altogether. The UK government has set itself a legally 2050 binding net zero target and leading asset owners are starting to set their own net zero targets. **What are Stranded Assets (Fossil Fuels)?** These are assets that turn out to be worth less than expected as a result of changes associated with the low carbon energy transition. This could include assets that have suffered from unanticipated or premature write-down or devaluations. For example, investment in fossil fuel-based assets that as a result of changes brought about by climate change policy (or competing technology) do not recover all or part of their investment during the time they are operational. **Scheme Advisory Board – A-Z of Responsible Investment** To support members of LGPS funds, the Scheme Advisory Board has also put together an A-Z of Responsible Investment, which can be found here: ***https://ri.lgpsboard.org/items***