

CLWYD PENSION FUND COMMITTEE

Date of Meeting	Wednesday, 10 th November 2021
Report Subject	Responsible Investment Roadmap
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

At the meeting of the Committee in June 2021, it was agreed to adopt a 2050 net zero ambition for the Fund's investment strategy. The Committee also agreed the high level net zero work plan, or roadmap, and that more detailed analysis of the portfolio was necessary to develop a credible implementation plan.

It was agreed that setting a net zero plan was the best way to decarbonise the investment portfolio and manage carbon risks as the world transitions to a low carbon economy. The role of the Wales Pension Partnership (WPP) was also recognised as key to this transition, and the development of an active sustainable global equity portfolio an important part of this.

This report and its attached appendices look to set decarbonisation targets and considers the high level implementation plan to achieve them. The report contains a number of proposals, the key one being that the Fund targets net zero by 2045 (rather than 2050) with a 50% total portfolio carbon reduction by 2030. This report also addresses the roadmap and key milestones that will take place along the way.

The Fund's Investment Strategy Statement (ISS) will need to be updated to reflect these commitments. It is intended that the ISS will be updated after the Committee meeting to reflect the proposals, subject to agreement, and the Fund will then consult with Employers on these changes ahead of the next meeting of the Committee in February 2022.

RECOMMENDATIONS

1.	That the Committee consider the analysis in light of the previously agreed net zero target by 2050.
2.	That the Committee consider and agree each of the proposals in paragraph 1.08 of this report, specifically, targeting net zero by 2045 - a more ambitious timeline.
3.	That the Committee agree that the Investment Strategy Statement is updated to reflect these commitments for consultation with the Fund's Employers.

REPORT DETAILS

1.00	Responsible Investment Roadmap and Net Zero investing
1.01	<p>Background</p> <p>The Clwyd Pension Fund has a fiduciary duty is to act in the best interests of its members and employers. The Fund recognises that ESG issues, including climate change, create risk and opportunity to its financial performance, and will contribute to the risk and return characteristics. The Fund believes, therefore that these factors should be taken into account in its Funding and Investment Strategies and throughout the decision making process.</p> <p>Climate Change</p> <p>The Fund recognises the importance in addressing the financial risks associated with climate change through its investment strategy, and believes that:</p> <ul style="list-style-type: none">• Climate change presents a systemic risk to the overall stability of every economy and country, with the potential to impact on the members, employers and all of the holdings in the Fund's investment portfolio.• Considering the impacts of climate change is not only the legal or fiduciary duty of the Fund, but is also consistent with the long term nature of the Fund. The Fund's investments need to be sustainable to be in the best interests of all key stakeholders.• Engagement is the best approach to enabling the change required to address the Climate Emergency, however selective risk-based disinvestment is appropriate to facilitate the move to a low carbon economy.• As well creating risk, it also presents opportunities to make selective investments that achieve the required returns, whilst at the same time make a positive social and environmental impact, such as environmental infrastructure and clean energy.
1.02	<p>Why investors are adopting a Net Zero Commitment</p> <p>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.</p> <p>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.</p> <p>Markets are recognising climate in pricing already and investors should make sure they are positioning their portfolios manage the risks and opportunities. For example, companies with business models reliant on fossil fuels (such as</p>

	<p>oil and gas majors) may increasingly be viewed and priced differently by the market compared to renewable energy companies.</p> <p>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 investors not only to make these commitments but also develop credible implementation plans to underpin them.</p>
1.03	<p>To build on its commitment to Responsible Investment, in February 2020 the Committee agreed a number of responsible investment strategic priorities for inclusion in the Fund’s Investment Strategy Statement. These included:</p> <ul style="list-style-type: none"> • Evaluating and managing carbon exposure – including measuring and understanding its carbon exposure, and setting carbon reduction targets. <p>As part of this work, at the meeting in June 2021, the Committee agreed to adopt a 2050 net zero ambition for the Fund’s investment strategy, noting this may be revised to target an earlier date following further consideration and analysis.</p> <p>When the Committee agreed the Net Zero commitment, they also agreed a high level work plan, or roadmap, which set out the steps required for a credible implementation plan.</p> <p>A key element of this work plan was to undertake further analysis to set key short, medium and long term targets for carbon reduction.</p> <p>This report considers this analysis and sets out a number of proposals the Committee are recommended to adopt for Clwyd Pension Fund. Explanations of terms used in this report and the appendices are included in the glossary to this report.</p>
1.04	<p>The work plan agreed in June set out the approach that the Fund could take to align portfolios to the agreed net zero outcome by 2050, or potentially earlier. This approach involved four steps:</p> <ol style="list-style-type: none"> 1. Calculate the baseline – this includes current emissions, transition capacity and green exposures. One output is to split the portfolio into three areas: <ul style="list-style-type: none"> • “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.

	<p>2. Analyse portfolio possibilities for implementing a portfolio wide transition by asset class.</p> <p>3. Set measurable targets for reducing emissions and growing transition capacity, tested against different scenario pathways (for example a 2050 net zero target).</p> <p>4. Implement a plan, drawing on outputs from each step.</p>										
1.05	<p>Roadmap At the meeting in June 2021 the Committee also agreed the following high level roadmap:</p> <table border="1" data-bbox="296 562 1362 2107"> <thead> <tr> <th data-bbox="296 562 1157 622"><u>Roadmap Item</u></th> <th data-bbox="1157 562 1362 622"><u>Timeframe</u></th> </tr> </thead> <tbody> <tr> <td data-bbox="296 622 1157 1637"> <p>Listed equity</p> <p>The work would cover four areas:</p> <ol style="list-style-type: none"> 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: <ul style="list-style-type: none"> • 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. Set a detailed implementation plan across three areas: integration, stewardship and green investments. This will incorporate additional, more granular targets across each of these areas. </td> <td data-bbox="1157 622 1362 1637">July - October 2021</td> </tr> <tr> <td data-bbox="296 1637 1157 1776">Present results. Agree 2050 (or earlier) net zero targets and implementation plan at Pension Fund Committee meeting.</td> <td data-bbox="1157 1637 1362 1776">November 2021 PFC meeting</td> </tr> <tr> <td data-bbox="296 1776 1157 1915">Update Investment Strategy Statement for net zero ambition and targets. Communicate approach to key stakeholders.</td> <td data-bbox="1157 1776 1362 1915">November / December 2021</td> </tr> <tr> <td data-bbox="296 1915 1157 2107"> <p>Property, infrastructure, private equity and private debt</p> <p>Commence work on carbon footprinting and setting net zero targets for these additional asset classes.</p> </td> <td data-bbox="1157 1915 1362 2107">H1 2022</td> </tr> </tbody> </table>	<u>Roadmap Item</u>	<u>Timeframe</u>	<p>Listed equity</p> <p>The work would cover four areas:</p> <ol style="list-style-type: none"> 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: <ul style="list-style-type: none"> • 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. Set a detailed implementation plan across three areas: integration, stewardship and green investments. This will incorporate additional, more granular targets across each of these areas. 	July - October 2021	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	<p>Property, infrastructure, private equity and private debt</p> <p>Commence work on carbon footprinting and setting net zero targets for these additional asset classes.</p>	H1 2022
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	<p>Listed equity</p> <p>Monitor progress against targets and update implementation plan.</p>	<p>H2 2022</p>
<p>1.06</p>	<p>Analytics for Climate Transition (ACT)</p> <p>The Appendices to this report set out the detailed analysis of the portfolio. The analysis has been undertaken to assess the potential of the Fund’s investments to transition to a low-carbon economy. There are a number of reasons for focussing on a transition to a low-carbon economy:</p> <ul style="list-style-type: none"> • Risk Management – Climate Change presents a significant risk and opportunity over the short, medium and long term. • Climate Policies and targets are being set by governments, companies, regulators and investors • Technology development in the renewable energy sector is already evident • Markets are recognising climate change and are already pricing in, and investors need to remain ahead of the curve <p>The analysis being considered in this paper recognises risks, opportunities and fiduciary duty, and looks at how investors can achieve the desired outcomes.</p> <p>A low carbon transition plan answers key questions:</p> <ul style="list-style-type: none"> • How to reduce emissions and meet investment objectives? • How to deliver emission reductions without just divesting high intensity companies? • How to set a target that can be implemented and monitored? <p>The analysis is consistent with the work of the Institutional Investors Group on Climate Change (IIGCC) Net Zero Framework and the requirements of the Taskforce for climate related financial disclosures (TCFD) reporting, that the Fund will be looking to comply with in 2022.</p> <p>The results of this analysis reflect the current global position in that there are many companies that are not ready to transition, however we expect that this will change rapidly in coming months.</p>	

1.07 To understand the current position of the listed equity portfolio the analysis considers a number of measures. These measures are then used to assess the transition alignment of the Fund’s listed equity portfolio to understand the which assets are well aligned (“green”), or not well aligned (“grey”), and those that lie in between (“yellow”).

Absolute Emissions, a measure used to understand the Fund’s emissions based on the amount invested in underlying companies, is used as the basis for listed equity target setting. This metric is useful for targeting real world emissions.

The key findings from the analysis are:

Total Fund

- The Fund can credibly adopt a 2045 net zero target.
- The Fund could also set a low carbon and sustainable allocation target of 30% by 2030

Listed Equity portfolio

- The baseline of Scope 1 and 2 absolute emissions for the CPF’s current listed equity portfolio is currently 46,126 tCO₂e, as at 31 March 2021.
- To achieve this **target** the Fund should target 36% reduction by 2025 (i.e. target 29,520 tCO₂e), and 68% reduction by 2030 (i.e. target 14,760 tCO₂e).
- The results of the transition analysis are shown on Page 8 of Appendix 1 and highlights the significant proportion of assets that are currently shown as “in-between”.

1.08 The detailed analysis (Appendix 1) will be presented at the meeting and results in a number of proposals. The proposals have been extracted from the presentation and are detailed below:

Summary of proposals for consideration

	Scope	Main Proposal	Detailed/interim proposal
<u>1</u>	Total Fund	The Fund targets net zero by 2045. Adopt a total Fund target of 50% carbon reduction by 2030.	Communicate decarbonisation targets to WPP and listed equity managers, and consider setting individual manager targets. Review reporting metrics for each of the proposals and prepare a TCFD report for stakeholders.
<u>2</u>	Total Fund	Set total Fund low carbon and sustainable allocation target of 30% by 2030.	Continue to identify and allocate to climate mitigation/ adaptation opportunities within private market mandates, as a priority, followed by understanding what is possible in other asset classes.
<u>3</u>	Total Fund	Expand net zero target setting to incorporate synthetic equity, multi	Develop emissions baseline for the Fund’s asset classes, in order to build total portfolio baseline/targets 2022/23.

		asset credit, TAA, property, private markets and hedge funds over 2022/23	
	4	<u>Listed Equity Portfolio</u> Net zero transition trajectory: consider adopting listed equity portfolio carbon reduction targets of 36% by 2025 and 68% by 2030, versus 2021 baseline position	Achieve c.27.6% of emissions reduction by 2023 (vs 2021 baseline). Incorporate Scope 3 within emissions reduction efforts by 2023.
	5	<u>Listed Equity Portfolio</u> Consider setting equity Fund target of at least 30% green and sustainable assets by 2030	Within the listed equity portfolio, achieve c.12% of the shift to green and sustainable companies by 2023.
	6	<u>Listed Equity Portfolio</u> Fossil Fuel targets: within the equity portfolio the Fund should target a reduction in potential emissions. These should be 70% by 2025 and 90% by 2030 for Oil & Gas. For coal the targets should be 90% reduction by 2025 and 95% by 2030.	Monitor fossil fuel exposures and ensure they are reducing.
	7	<u>Listed Equity Portfolio</u> Stewardship target: • 70% of financed emissions in key sectors* aligned to net zero or subject to engagement by 2025. • 90% of financed emissions in key sectors* aligned to net zero or subject to engagement by 2030.	Conduct annual stewardship monitoring, going forward. Consider an initial focus on the Emerging market mandates, as well as top grey companies identified, for engagement within the listed equity portfolio. Identify the top 10-20 key climate change holdings and work with managers, WPP and Robeco to understand actions and outcomes from engagement.
1.09	Next Steps		
	<p>The Committee will be aware that the Fund has long established approach to sustainable investing, and these targets and proposals look to build on this work and develop a long term approach. There will be a number of specific areas for the Fund to focus on over the coming months and years to deliver these ambitious targets and deliver on the targets:</p> <ul style="list-style-type: none"> • Update the Fund's Investment Strategy Statement to reflect the ambitions and targets, and consult with Employers; • Work with the Wales Pension Partnership to develop a sustainable Global Equity portfolio which will deliver in a number of key areas; • Continue to look for opportunities within the Private Markets portfolio to invest in sustainable and Impact investments; 		

	<ul style="list-style-type: none"> • Expand analysis of Fund to cover all of the Fund's other asset classes; • Develop reporting in line with TCFD requirements which will help the Committee and other key stakeholders to monitor progress; • Continue to develop targets and ambitions in line with national and international developments and initiatives.
2.00	RESOURCE IMPLICATIONS
2.01	The net zero recommendations will lead to increased annual monitoring requirements. The monitoring requirements will need to be supported by the internal team with support from the Fund's advisers. There will also need to be in depth discussion with the WPP to support the Fund's ambitions.
3.00	CONSULTATIONS REQUIRED / CARRIED OUT
3.01	The Fund will consult with Employers on the changes to the Investment Strategy Statement as a result of these ambitions/proposals.
4.00	RISK MANAGEMENT
4.01	Funding and Investment Risk 9 – The Fund's Long term Investment Strategy fails to deliver on its ambition and objectives as a Responsible Investor. – Setting these ambitions and targets and the necessary supporting work will help the Fund manage this risk.
5.00	APPENDICES
5.01	Appendix 1 – Analytics for Climate Transition – presentation Appendix 2 - Analytics for Climate Transition - detailed analysis and methodology Appendix 3– Analytics for Climate Transition – Analysis and methodology (exempt section)
6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	<ul style="list-style-type: none"> • Investment Strategy Statement • Fossil Fuel Investments briefing paper – May 2021 <p>Contact Officer: Philip Latham, Head of Clwyd Pension Fund Telephone: 01352 702264 E-mail: philip.latham@flintshire.gov.uk</p>
7.00	GLOSSARY OF TERMS
7.01	<p>What is Responsible Investment (RI)?</p> <p>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.</p>

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 2°C 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.

What are Absolute Carbon Emissions?

A measure of a portfolio's absolute exposure to greenhouse gas emissions, expressed in tons CO₂e. Formula: Carbon emissions (Metric tons) * (investment value/company enterprise value).

What is Weighted Average Carbon Intensity (WACI)?

A measure of a portfolio's exposure to carbon intensive companies, expressed in tons CO₂e/\$M revenue. Formula: Carbon emissions (Metric tons) / \$ Million sales * portfolio weights.

What are Scope 1, Scope 2 and Scope 3 greenhouse gas emissions?

Greenhouse gas emissions are categorised into three groups or 'Scopes' by the most widely used international accounting tool, the Greenhouse Gas (GHG) Protocol.

Scope 1 covers direct emissions from owned or controlled sources. Scope 2 covers indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed by the reporting company. Scope 3 includes all other indirect emissions that occur in a company's value chain.

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>