FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 5 JUNE 2024

Report of the Director of Finance

Climate Related Disclosures

1. Purpose

To present Derbyshire Pension Fund's (the Pension Fund/Fund) fourth Climate-Related Disclosures Report (Disclosure Report), attached as Appendix 2, to the Pensions and Investments Committee.

2. Information and Analysis

2.1 Background

The Fund published its first disclsoures report in March 2020, followed by a second report in November 2021, and a third report in January 2023. This report covers the Fund's fourth Disclosures Report and describes the way in which climate-related risks are currently managed by the Fund. It includes the results of climate scenario analysis and carbon risk metrics analysis undertaken on the Fund's assets as part of LGPSC's preparation of an annual Climate Risk Management Report for the Pension Fund.

The Taskforce on Climate-related Financial Disclosures (The Task Force/TCFD) was commissioned in 2015 by Mark Carney in his remit as Chair of the Financial Stability Board (FSB), in recognition of the risks caused by greenhouse gas emissions to the global economy and the impacts that are likely to be experienced across many economic sectors. The Task Force was asked to develop voluntary, consistent climate-related financial disclosures that would be useful to investors, lenders and insurance underwriters in understanding material climate-related risks.

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. Guidance was also released to support all organisations in developing disclosures consistent with the recommendations, with supplemental guidance released for specific sectors and industries, including asset owners.

The Task Force divided climate-related risks into two major categories: risks related to the transition to a lower-carbon economy; and risks related to the physical impacts of climate change. The TCFD report noted that climate-related risks and the expected transition to a lower carbon economy affect most economic sectors and industries, however, opportunities will also be created for organisations focused on climate change mitigation and adaptation solutions. The report also highlighted the difficulty in estimating the exact timing and severity of the physical effects of climate change.

The Task Force structured its recommendations around four thematic areas that represent core elements of how organisations operate: governance; strategy; risk management; and metrics and targets. The four overarching recommendations are supported by recommended disclosures that build out the framework with information that will help investors/stakeholders understand how reporting organisations assess climate related risks and opportunities.

The Fund notes that the FSB concluded in October 2023 that the remit of the Taskforce has been fulfilled and it was disbanded. The FSB asked the IFRS Foundation to take over the monitoring of progress of companies' climate related disclosures.

Moving forward, it is expected that the reporting of LGPS governance of climate change risks will be covered by guidance issued by the Department for Levelling Up, Housing & Communities (DLUHC). DLUHC launched a consultation on 'Local Government Pension Scheme (England & Wales): Governance and Reporting of Climate

Change Risks' on 1 September 2022. The Fund responded to the consultation in November 2023. DLUHC has yet to respond to the consultation responses and issue final guidance. Once published in final form, the Fund plans to comply with the DLUHC guidance to the extent possible.

2.2 Climate-related Disclosures

The Disclosures Report is aligned with the recommendations of the TCFD. It describes the way in which climate-related risks are currently managed by the Fund and includes information on the Fund's governance of climate risk and on the climate-related stewardship activities of the Pension Fund which are an important part of the Fund's approach to managing climate risk. It also includes the results of climate scenario analysis and carbon risk metrics analysis undertaken on the Fund's assets as part of LGPSC's preparation of an annual Climate Risk Management Report.

2.3 Climate Scenario Analysis

The Disclosures Report includes climate scenario analysis prepared by Mercer LLC in 2022. The scenario analysis was carried out at the asset class level and estimates the effects of different climate scenarios on key financial parameters (e.g. risk and return) over a selection of time periods. The climate scenarios forecast are: 1.5°C Rapid Transition; 1.6°C Orderly Transition; and 4°C Failed Transition.

The climate scenario analysis forecasts the following:

- A 1.5°C Rapid Transition is forecast to have a negative impact on returns, particularly on a five-year basis, reflecting an assumption that the hastiness and uncoordinated response to a rapid transition leads to a short-term decline in asset prices. Thereafter, the forecast impact on long-term returns stabilises, albeit remaining marginally negative.
- The impact of a 1.6°C Orderly Transition is forecast to be broadly return neutral across all time horizons.
- A 4°C scenario would have a significant negative impact on long-term returns, reflecting the market wide impact of physical risks.

The absolute basis points forecasts should be viewed with caution given the level of uncertainty and the forecast time horizons (up to 40 years) but provide a directional indicator.

2.4 Carbon Risk Metrics

The Disclosure Report includes carbon risk metrics analysis on the Fund's listed equities and investment grade bond portfolios on 31 March 2023 as reported in LGPSC's fourth Climate Management Risk Report, published in Janaury 2024. These two asset classes accouted for around 57% of the Fund's total investment assets on 31 March 2023.

The carbon risk metrics include: portfolio carbon footprint (weighted average carbon intensity); financed emissions (absolute & normalised emissions); fossil fuel exposure; thermal coal exposure; and clean technology (portfolio weight in companies whose products and services include clean technology), together with metrics designed to assess Paris Agreement alignment, including: Low Carbon Transition; Implied Temperature Rise; Science Based Targets; and Paris Ageement Alignment.

The carbon risk metrics analysis reports the current exposure to the above metrics and demonstrates the progress made since the Fund's first Disclosures Report.

Whilst it is not currently possible to quantify, and present, comparable carbon metrics in respect of the Fund's other asset classes (e.g. private equity, infrastructure, property, sovereign bonds, etc), the Disclosure Report sets out an overview of the Fund's approach to managing the climate related risks and opportunities in respect of these assets.

2.5 Climate Strategy Targets

Committee approved the Fund's first standalone Climate Strategy in November 2020, and the Disclosures Report sets out the progress to 31 March 2023 in respect of the carbon strategy targets set out in the first standalone Climate Strategy.

The Fund believes that portfolio-wide 'top down' targets are an important means to set direction and appropriate ambition for an investment strategy towards net zero, and to monitor whether that strategy is achieving expected outcomes. However, a focus on just a single top-down portfolio emissions reduction target can incentivise a shift of assets within a portfolio from high to already lower carbon assets and sectors, rather than driving additional ‘real world’ emissions reductions from increasing investments in climate solutions that contribute to the achievement of the net zero goal. As a result, the Fund’s first standalone Climate Strategy included targets aiming to:

- Reduce the carbon footprint (Scope 1 & 2) of the Fund’s listed equity portfolio by at least 30% relative to the weighted 2020 base benchmark by the end of 2025; and
- Invest at least 30% of the Fund portfolio in low carbon & sustainable investments by the end of 2025.

The table below is included in the Disclosures Report to show the progress on 31 March 2023 in respect of the two targets:

Target	Target by end of 2025	Actual on 31 March 2023
(1) Reduce the carbon footprint (Scope 1 & 2) of the Fund’s listed equity portfolio by at least 30% relative to the weighted benchmark in 2020 by the end of 2025	(30%)	(50%)
(2) Invest at least 30% of the Fund portfolio in low carbon & sustainable investments by the end of 2025	30%	Invested: 29% Committed: 30%

Committee approved an updated Climate Strategy in March 2024, including updated/new targets. The Fund plans to report progress relative to the updated/new targets from the 31 March 2024 period end onwards.

2.6 Publication

The Disclosure Report will be published on the Fund’s website once noted by Committee.

3. Implications

3.1 Appendix 1 sets out the relevant implications considered in the preparation of the report.

4. Background Papers

4.1 Papers held by the Pension Fund team.

5. Appendices

5.1 Appendix 1 – Implications
5.2 Appendix 2 – Climate-Related Disclosure Report

6. Recommendation(s)

That Committee:

a) notes the Climate-Related Disclosures Report attached as Appendix 2.

7. Reasons for Recommendation(s)

7.1 The Committee oversees the Fund's management of climate-related risks and opportunities.

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Appendix 1

Implications

Financial

1.1 None

Legal

2.1 None

Human Resources

3.1 None

Information Technology

4.1 None

Equalities Impact

5.1 None

Corporate objectives and priorities for change

6.1 None

Other (for example, Health and Safety, Environmental, Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None