PUBLIC

MINUTES of a meeting of the **PENSIONS AND INVESTMENT COMMITTEE** held at County Hall, Matlock on 4 March 2020

PRESENT

Councillor J Perkins (in the Chair)

Derbyshire County Council

Councillors R Ashton, N Atkin, J Boult, P Makin, S Marshall-Clarke, B Ridgway and M Wall (substitute Member)

Derby City Council

Councillors M Carr and L Eldret

Derbyshire County Unison

Mr M Wilson

Also in attendance – N Dowey, D Kinley, P Peat and K Riley

N Calvert (Pension Board member)

Apologies for absence were received on behalf of Councillor R Mihaly

11/20 **VARIATION IN ORDER OF BUSINESS** The Chairman informed the Committee that Michael Marshall, the Director of Responsible Investment and Engagement from LGPS Central Ltd would be providing presentations on the climate-related reports. To enable Members to consider the Climate Risk Report, it had been agreed that the confidential section of the meeting would be brought forward. The public could then benefit from the presentation on the Climate-Related Disclosures report.

12/20 **EXCLUSION OF THE PUBLIC** **RESOLVED** that the public be excluded from the meeting during the Committee's consideration of the remaining items on the agenda to avoid the disclosure of the kind of information detailed in the following summary of proceedings:-

SUMMARY OF PROCEEDINGS CONDUCTED AFTER THE PUBLIC HAD BEEN EXCLUDED FROM THE MEETING

1. To receive declarations of interest (if any)

2. To confirm the exempt minutes of the meeting held on 22 January 2020 (contains exempt information)

3. To consider the exempt reports of the Director of Finance and ICT on:-

   (a) Climate Risk Report (contains information relating to the financial or business affairs of any particular person (including the Authority holding that information))
   (b) Stage 2 Appeal under the LGPS Application for Adjudication Disagreement Procedure (contains information relating to any individual)

(Following consideration of the exempt items on the agenda, the Committee returned to the public section of the meeting)

16/20 **MINUTES** **RESOLVED** that the non-exempt minutes of the meeting held on 22 January 2020 be confirmed as a correct record and signed by the Chairman.

17/20 **CLIMATE-RELATED DISCLOSURES** The Derbyshire Pension Fund's Climate-Related Disclosures report, which had been prepared in collaboration with LGPS Central was received by the Committee. Michael Marshall, from LGPS Central Ltd attended the meeting to provide Members with a presentation.

A report outlining the Fund's approach to incorporating the implications of climate change into its investment processes was considered by the Committee in August 2017. Since the report was considered by Committee, climate change had continued to move up the political and financial agenda. The urgency of addressing the issue of climate change had increased as the world has experienced a number of extreme weather events and as five of the warmest years on record have been recorded since 2010.

The overall risk for the Fund was that its assets would be insufficient to meet its liabilities. Underlying the overall risk, the Fund was exposed to demographic risks, regulatory risks, governance risks, administration risks and financial risks including investment risk.

Climate change risk was not currently separated out from the other investment risks on the Fund's Risk Register or included as a potential risk to the liabilities of the Fund. However, the Fund's approach to managing the risks associated with climate change, via the incorporation of Environmental, Social and Governance (ESG) factors into the investment process and Fund stewardship activities, was included in the Investment Strategy Statement approved by Committee in October 2018. It was increasingly best practice for pension funds to develop stand-alone climate strategies given the magnitude of the potential climate-related risks and opportunities.

The Bank of England (the BOE), having established that the financial risks from climate change were significant and would manifest through transition risks and physical risks, expected the organisations that it supervised to develop an enhanced approach to managing the financial risks of climate change covering governance, risk management, scenario analysis and disclosure.

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, in recognition of the risks caused by greenhouse gas emissions to the global economy and the impacts that were 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 were 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 structured its recommendations around four thematic areas that represented core elements of how organisations operated: governance; strategy; risk management; and metrics and targets. The four overarching recommendations were supported by recommended disclosures that build out the framework with information that would help investors/stakeholders understand how reporting organisations assessed climate related risks and opportunities.

In collaboration with LGPSC, the Fund had developed a Climate-Related Disclosures report (the Disclosures report was attached as Appendix 1 to the report) which was aligned with the recommendations of the TCFD. It described the way in which climate-related risks were currently managed by the Fund and included the results of recent climate scenario analysis and carbon risk metrics analysis undertaken on the Fund's assets as part of LGPSC's preparation of a Climate Risk Report for the Pension Fund. The Disclosures report also included information on the Fund's governance of climate risk and on the Fund's climate-related stewardship activities.

The challenges of measuring the potential impact of climate change on investment portfolios were well recognised. The Fund believed that a suite of carbon risk metrics and climate scenario analysis currently provided the most appropriate method of analysing climate risk to provide an evidence base which would support the development of a detailed strategy for integrating climate risk into investment decisions. Climate scenario analysis carried out at the asset class level estimated the effects of different climate scenarios on key financial parameters (e.g. risk and return) over a selection of time periods. The climate scenario analysis had been carried out on the Fund's current asset allocation and on the asset allocation set out in the Fund's Strategic Asset Allocation Benchmark.

Key findings of the climate scenario analysis were:

- A 2°C scenario would have a positive impact on the Fund's returns considering both a timeline to 2030 and to 2050. This positive impact is boosted under the Strategic Asset Allocation reflecting the 3% allocation to Global Sustainable Equities.
- A 3°C scenario (which is in line with the current greenhouse gas trajectory) has a relatively muted impact on the Fund's annual returns.
- A 4°C scenario would reduce the Fund's annual returns, with most asset classes expected to experience negative returns.

Climate stress testing analysis suggested that should a 2°C scenario suddenly be priced in by the market, the Fund could benefit in terms of financial returns, whereas the opposite was true should a 4°C scenario be priced in by the market.

Carbon risk metrics analysis on the Fund's listed equities portfolios considered: portfolio carbon footprint (weighted average); fossil fuel exposure; carbon risk management; and clean technology (portfolio weight in companies whose products and services include clean technology). The measure for clean technology exposure should be treated with some caution as there appeared to be a moderate positive correlation in the dataset between sectors that had a high carbon intensity and those that had a higher weight in clean technology.

Officers were currently digesting the Fund's Climate Risk Report (CRR) which would be utilised to support the development of a Climate Strategy and a Climate Stewardship Plan for the Pension Fund. In addition, high level climate change risk analysis from the Fund's actuary, Hymans Robertson LLP, which considered the potential effect of climate change on the Fund's liabilities as well as on the assets of the Pension Fund, would support the development of the Climate Strategy. Guidance on implementing the TCFD recommendations for asset owners from the TCFD and the Principles for Responsible Investment would also be utilised.

Climate change risk would be added as a separate risk to the Fund's Risk Register. The Fund's climate-related disclosures would develop over time and would be updated after a Climate Strategy and a Climate Stewardship Plan had been developed for the Fund. It was anticipated that climate-related disclosures would be included in the Pension Fund's Annual Report.

Members welcomed this report as a good starting point with a lot of positives and looked forward to the document being developed over the coming months.

RESOLVED that the Committee notes the Climate-Related Disclosures report attached as Appendix 1 to the report.

18/20 **INVESTMENT REPORT** Mr Anthony Fletcher, the external adviser from MJHudson Allenbridge Investment Advisers Limited, attended the meeting and presented his report to the Committee. The report incorporated Mr Fletcher's view on the global economic position, factual information on global market returns, the performance of the Derbyshire Pension Fund, and his latest recommendations on investment strategy and asset allocation. Mr Fletcher also provided details on the potential impact the coronavirus outbreak could have on the markets.

Details were provided of Mr Fletcher's investment recommendations in UK Equities, North American Equities, European Equities, Japan, Asia/Pacific, Infrastructure, Private Equity and Cash, along with those of the Derbyshire Pension Fund In-House Fund Management Team.

The Fund's latest asset allocation, as at 31 January 2020 and the recommendations of the Director of Finance and ICT and the Fund's Independent Adviser in relation to the Pension Fund's new strategic asset allocation benchmark were reported. Relative to the new benchmark, the Fund as at 31 January 2020, was overweight in cash, and underweight in growth assets, income assets and protection assets. Details were also provided of the recommendations of the Director of Finance and ICT, which had been adjusted to reflect the impact of future investment commitments. These commitments largely related to private equity, multi-asset credit, property and infrastructure and totalled around £310m. Whilst the timing of drawdowns would be difficult to predict, the In-house Investment Management Team (IIMT) believed that these were likely to occur over the next 18 to 36 months.

The value of the Fund's investment assets had risen by £86.6m between 31 October 2019 and 31 January 2020 to just over £5.2bn, comprising a non-cash market gain of around £65m and cash inflows from dealing with members and investment income of around £20m. Over the twelve months to 31 January 2020, the value of the Fund's investment assets had risen by £468.6m, comprising a non-cash market gain of around £370m and cash inflows from dealing with members and investment income of around £100m. A copy of the latest portfolio was presented at Appendix 2 to the report.

The new strategic asset allocation benchmark included a 3% allocation to Global Sustainable Equities. The Committee had previously approved the use a non-DCC framework to appoint two or three investment managers to manage the planned allocation on a discretionary basis. The non-DCC framework had now been finalised and the IIMT was currently in the process of selecting the managers to be appointed. The IIMT expected this to be completed by mid-March, with cash deployment as soon as possible thereafter, an update would be provided at the meeting in June 2020. The IIMT had recommended a neutral opening allocation of 3.0%.

Investment in Infrastructure in the three months to January 2020 totalled £2m. The invested weighting fell by 0.2% to 6.2% over the period, resulting from an adverse currency movement. The committed weighting increased to 9.0% at 31 January 2020 reflecting a £50m commitment to a globally diversified renewable energy fund. The IIMT continued to view Infrastructure as an attractive asset class, and favoured a bias towards core infrastructure assets given the market was now increasingly late cycle.

Asset class weightings and recommendations were based on values at the end of January 2020, and were relative to the new strategic asset benchmark which became effective on 1 January 2019. Many global stock markets were still trading close to all-time highs. Details were given on the Fund’s performances over 1, 3, 5 and 10 years to 31 December 2019. The Fund had out-performed the benchmark over all time periods.

RESOLVED that (1) the report of the external adviser, Mr Fletcher, be noted;

(2) the asset allocations, total assets and long term performance analysis in the report of the Director of Finance and ICT be noted; and

(3) the strategy outlined in the report of the Director of Finance and ICT be approved.

19/20 **STEWARDSHIP REPORT** Members were provided with an overview of the stewardship activity carried out by Derbyshire Pension Fund’s external investment managers in the quarter ended 31 December 2019.

The Fund’s directly held UK Equities were transitioned into a Legal and General Investment Management (LGIM) passive pooled product in November 2019. LGIM exercised the voting rights in respect of the equities held within its UK Equity Index Fund. In order to ensure that Members were aware of the engagement activity being carried out by LGIM and by LGPS Central Limited, copies of the following two reports were presented:

- Q4 2019 Legal & General Investment Management (LGIM) ESG Impact Report (Appendix 1 to the report)
- Q3 2019-20 LGPS Central Limited Quarterly Stewardship Report (Appendix 2 to the report)

LGIM currently managed around £1bn of assets on behalf of the Fund through passive products covering: UK Equities; Japanese Equities; and Emerging Market Equities. It was expected that LGPS Central Limited would manage a growing proportion of the Fund's assets going forward as part of the LGPS pooling project.

These two reports provided an overview of the investment managers' current key stewardship themes and voting engagement activity over the last quarter. It was anticipated that stewardship reports from both managers would be presented to the Committee on a quarterly basis. It was agreed that the Stewardship Manager from LGPS Central Limited would be invited to a future meeting of Committee to present one of the quarterly Stewardship Reports.

RESOLVED to note the stewardship activity of LGIM and LGPS Central Limited.

20/20 **<u>FUNDING STRATEGY STATEMENT CONSULTATION</u>** As part of the valuation process, the Fund reviewed the funding strategy to ensure that an appropriate contribution plan and investment strategy was in place. The funding strategy was set out in the Funding Strategy Statement (FSS) which was the Fund's key governance document in relation to the actuarial valuation.

The FSS set out the funding policies adopted, the actuarial assumptions used and the time horizons considered for each category of employer. The draft Funding Strategy Statement was presented to the Committee in December 2019, when it was noted that the Fund intended to consult with the Fund's stakeholders on the FSS. The main changes to the FSS since the previous valuation were:

- Increased likelihoods of reaching the funding target for all employers to allow for the potential impact of the McCloud judgement (court ruling that transitional protections awarded to some members of public service pension scheme when the schemes were reformed were unlawful on the grounds of discrimination)
- A larger increase in the likelihood of reaching the funding target, and a reduction in the assessment of the employer covenant for the sector
- Increased clarity on risk sharing options
- The proposed treatment of exit credits
- Increased clarity on pooling arrangements

The consultation on the FSS had commenced on 6 January 2020 and closed on 2 February 2020. Hymans Robertson LLP, the Fund's actuary had explained the main changes in the FSS to the attendees, representing 70 scheme employers, who had attended the Fund's Employer Valuation Seminar on 13 January 2020. Respondents to the consultation could submit comments either by email or by post. The Fund had received one response to the consultation from the University of Derby and details of these comments were provided.

Members welcomed this informative report. The response to the consultation was considered and the members endorsed the actions of the officers.

RESOLVED that having considered the report to the consultation, the Committee confirms that no changes to the proposed Funding Strategy Statement are required approve the Funding Strategy Statement attached at Appendix 1 to the report.

21/20 **TREASURY MANAGEMENT STRATEGY** Derbyshire Pension Fund traditionally adopted the same Treasury Management Strategy as the County Council. The Treasury Management Strategy, attached at Appendix 1 to the report, had been approved at Full Council on 5 February 2020. In future, an individual Strategy for the Pension Fund would come straight to this Committee for approval, and not Full Council. The Strategy covered both the County Council and the Pension Fund, and references to the County Council also applied to the Pension Fund unless separately identified.

The Fund's current benchmark allocation to cash was 2% (about £100m at current asset values). The Fund generally needed to retain a higher level of instant access funds than the County Council. A major buying opportunity in the market could require immediate access to significant sums of cash for investment. The Fund's actual cash allocation at 31 January 2020 was 6.4%, equating to £334m. Future commitments at 31 January 2020 totalled around £310m.

The recommended Strategy for 2020-21 included the following requirements and comments:

- The Council's objective when investing money was to strike a balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income;
- The Pension Fund used cash for liquidity rather than investment return;
- The maximum amount and duration by counterparty should be as per Table 2b on page 4 of the Strategy. This also noted that the Pension Fund may receive employer contributions in advance, and this could substantially increase the cash balances of the Pension Fund, pending a

suitable investment opportunity. It was, therefore, requested that the limits on Banks were increased from £10m to £30m and on Local Authorities were increased from £20m to £30m with effect from 1 April 2020; and

- Investments should be limited by type in accordance with Table 3b on page 8 of the Strategy.

Borrowings were permitted only in exceptional circumstances and in accordance with the LGPS (Management and Investment of Funds) Regulations 2016. Borrowings were limited to the maximum amount required to meet the Fund’s obligations, and should not exceed 90 days in duration.

RESOLVED that the Treasury Management Strategy attached at Appendix 1 to the report, be approved.