

Agenda Item No. 4 (c)

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

9 September 2020

Report of the Director of Finance & ICT

RESPONSIBLE INVESTMENT FRAMEWORK AND CLIMATE STRATEGY

1 Purpose of the Report

To seek approval for Derbyshire Pension Fund's (the Fund) proposed Responsible Investment Framework and Climate Strategy.

2 Information and Analysis

Responsible Investment

In accordance with the LGPS (Management and Investment of Funds) Regulations 2016, the Fund's Investment Strategy Statement (ISS) must set out the administering authority's policy on how environmental, social and corporate governance (ESG) considerations are taken into account in the selection, non-selection, retention and realisation of investments. The Investment Strategy Statement must also cover the authority's policy on the exercise of rights (including voting rights) attached to its investments.

Previously, the Fund's approach to the integration of ESG factors into investment decisions and the Fund's approach to voting, was included in the Fund's ISS, supported by a standalone Voting Policy. A Responsible Investment Framework (RI Framework) has now been developed to set out the Fund's approach to Responsible Investment which includes the integration of ESG considerations into the investment process and Fund stewardship (engagement and voting) and governance activities.

Climate Change

A report outlining the Fund's approach to incorporating the implications of climate change into the Fund's investment process was presented to Committee in August 2017. In 2019, the Fund commissioned a Climate Risk Report from LGPS Central Limited which was received in February 2020 and was structured around the Taskforce for Climate-related Disclosures (TCFD) four thematic areas of: governance; strategy; risk management and metric targets.

The Climate Risk Report also included: an assessment of financially material climate-related risks and opportunities within the Fund's investment portfolio; climate scenario analysis; and carbon risk metrics. The Climate Risk Report was presented to Committee in March 2020, together with a copy of the Fund's first TCFD report, which has subsequently been uploaded to the Fund's website.

In recognition of the potential material effect of climate change, and the response to climate change, on the assets and liabilities of the Fund, a separate Climate Strategy has been developed for the Fund.

The Fund's revised ISS, which is being considered separately by this Committee, contains links to the proposed RI Framework and Climate Strategy.

Training

Members of this Committee and of Derbyshire Pension Board have taken part in training sessions covering the ISS, and the proposed RI Framework and Climate Strategy as part of the process of formulating these strategies.

The responsible investment training covered:

- the definition of RI
- LGPS RI regulations
- a three pillar approach to RI
- the spectrum of capital (investment approaches ranging from traditional investment to philanthropy)
- the West Midlands Pension Fund Global Sustainable Framework
- LGPS Central Pool beliefs
- LGPS Central Ltd stewardship
- Engagement versus divestment
- the Local Authority Pension Fund Forum

The climate change training covered:

- what is climate change
- fossil fuel consumption and carbon dioxide emissions
- energy sources and usage
- climate change risks and opportunities
- the Paris Agreement
- the Fund's carbon metrics
- regional benchmark carbon metrics
- the quality of carbon emissions scores & the significance of Scope 3 emissions (indirect emissions that occur in the value chain of the reporting company, including both upstream and downstream emissions)
- the impact of carbon emissions scores on investment decisions

- the Institutional Investors Group of Climate Change draft Net Zero Framework
- net zero implications
- other LGPS pension funds' climate strategies
- key climate strategy questions & the Fund's proposed strategy

RI Framework

The Fund believes that responsible investment can enhance long-term performance. Effective management of financially material ESG risks should support the requirement to protect investment returns over the long term and companies with strong ESG business practices have the potential to create additional value for shareholders.

Responsible investment has relevance both before (i.e. investment selection) and after an investment decision (i.e. on-going stewardship through engagement and voting activity) and is a core part of the Fund's fiduciary duty. It is distinct from 'ethical investment', which is an approach to selecting investments on the basis of ethical beliefs (beliefs about what is morally right and wrong).

The Committee recognises its responsibility to act in the best interest of the Fund's employers and scheme members, whilst seeking to protect local tax payers and employers from unsustainable pension costs.

The RI Framework is consistent with LGPS Central Limited's Responsible Investment & Engagement Framework, which was developed in collaboration with the eight LGPS funds (Partner Funds) within the LGPS Central Pool. In order for the Partner Funds to invest together via the LGPS Central Pool, the agreement of a common approach to responsible investment is important.

The Fund's RI Framework is based on three core pillars: manager selection; stewardship (engagement and voting); and transparent disclosure. A copy of the Fund's proposed Responsible Investment Framework is set out at Appendix 1.

Climate Strategy

The Fund's Climate Risk Report, high level climate change risk analysis from the Fund's actuary, Hymans Robertson, guidance on implementing the TCFD recommendations for assets owners from the TCFD, together with additional internal research into climate risk metrics and the output of the recent member training sessions, have been utilized to develop the proposed Climate Strategy which is attached as Appendix 2.

The Climate Strategy sets out the Fund's approach to addressing the risks and opportunities related to climate change. It includes the introduction of targets to reduce the carbon emissions of the Fund's investment portfolio and to increase investment in low carbon and sustainable investments. The

targets will be reviewed at least every five years. A material increase in the targets in the five year period to 2030, and in each subsequent five year period, is expected, in line with the stated ambition of achieving a portfolio of assets with net zero carbon emissions by 2050. Progress against the targets will be reported every two years.

Consultation

The Fund will consult with its stakeholders, including scheme employers, the local pension board and members of the pension fund, on the proposed RI Framework and Climate Strategy. The results of the consultation will be reported to Committee in December 2020.

Approval is sought for the Director of Finance & ICT, in conjunction with the Chair of the Committee, to consider the results of the consultation in the meantime, and to determine if any revisions to the proposed RI Framework and Climate Strategy are necessary following the consultation.

3 Other Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal and human rights, human resources, equality and diversity, health, environmental, transport, property and prevention of crime and disorder.

4 Background Papers

Files held by the Investment Section.

5 Officer's Recommendations

That the Committee:

- I. Approves the proposed Responsible Investment Framework and Climate Strategy, subject to the outcome of the consultation with the Fund's stakeholders.
- II. Delegates the consideration of the results of the consultation, and the determination of whether any revisions to the proposed RI Framework and Climate Strategy are necessary following the consultation, to the Director of Finance & ICT in conjunction with the Chair.

Peter Handford

Director of Finance & ICT