Title of Report	Responsible Investment - Carbon Targets discussion and timetable
For Consideration By	Pensions Committee
Meeting Date	19 January 2023
Classification	Public (Exempt Appendix)
Ward(s) Affected	All
Group Director	Ian Williams, Group Director Finance & Corporate Resources

1. Introduction

1.1. This report presents the Pensions Committee with a discussion paper to help inform the Committee's decision making in respect of setting climate targets. The paper, produced by Redington, sets out a summary of the climate challenge, considers potential approaches the Committee might take, and sets out potential next steps once an approach has been decided.

2. Recommendations

2.1. The Pensions Committee is recommended to note the report

3. Related Decisions

3.1. Pensions Committee 22 November 2022 - TCFD Consultation Response

3.2. Pensions Committee 15 June 2022 - Carbon Risk Audit 2022 – Full Results & Presentation (TruCost)

4. Comments of the Group Director of Finance and Corporate Resources.

4.1. The Pensions Committee acts as Scheme Manager for the Pension Fund and is therefore responsible for the management of £1.8 billion worth of assets and for ensuring the effective and efficient running of the Pension Fund. The investment returns that the Fund is able to deliver have significant financial implications, not just for the Fund itself but also on the Fund's employers in terms of the level of contributions they are required to make to meet the Fund's pension promises, which are underwritten by statute.

4.2. The Fund recognises that climate change represents a systemic risk that will have an impact on investment portfolios - including both transition and physical risks, but also opportunities to contribute to the transition to a net zero economy.

4.3. In considering its net zero investment strategy, the Committee will need to remain mindful of its fiduciary duties and how the various components of the proposed strategy (investment objectives, climate risk, carbon emissions and impact on the real economy) will impact its decision making.

4.4. The use of climate targets can help the Fund monitor its climate risk exposure and progress towards net zero. The targets used by the Pension Fund will differ from those of the Council given the Fund's focus on its underlying investment portfolio and hence the wider economy. This is in contrast to the Council's focus on the local area.

4.5. There are no immediate financial implications arising from this report.

5. Comments of the Director of Legal, Democratic and Electoral Services

5.1. In 2014, the Law Commission produced guidance on the fiduciary duties of investment intermediaries, which indicated that investors should have regard to ESG factors where they are financially material. In its guidance to occupational schemes, the Pensions Regulator has given a clear indicator that it believes this to be the case for climate change.

5.2. This report helps to demonstrate that the Committee is actively engaged in shaping the Government's approach to disclosure of climate risks within the LGPS. Improved disclosure will assist the Fund in factoring climate risk into its investment strategy setting process as a material financial risk.

5.3. There are no immediate legal implications arising from this report.

6. Background to the report

6.1. This report presents a discussion paper to assist the Committee in setting climate targets as part of its net zero strategy; the paper has been prepared by Redington, the Fund's investment consultants. The Committee's ambition is for the Fund to achieve net zero by 2040; interim climate targets can be used to help the Fund monitor progress and more fully understand its exposure to climate related risks and opportunities.

6.2. The Fund recognises that climate change represents a systemic risk that will have an impact on investment portfolios. It brings significant risks, including both transition and physical risks, but also opportunities to contribute to the transition to a net zero economy. The inevitable impact of climate change on investment portfolios means that it is vital to integrate it into investment decision making.

6.3. TCFD is the most common framework for embedding climate risks into investment decision making, and the Fund is likely to be required to make use of it from 2023/24. However, the TCFD is designed for evaluating how climate risks and opportunities impact an asset owner's investment strategy, but not the impact investment decisions might have on climate change and hence the real world economy.

6.4. Investors can respond to the objective of reaching net zero by focusing on portfolio decarbonisation, or by targeting real economy decarbonisation. Portfolio decarbonisation is an approach that involves selling higher emitting assets in favour of lower emitting ones. It can help investors to manage their own exposure to carbon risks but does not influence what is occurring within the real economy, and therefore cannot address any of the root causes of the system risk posed to investors.

6.5. The Fund has already achieved significant portfolio decarbonisation, as evidenced by performance against its previous target to reduce exposure to future emissions by 50% over 6 from 2016 to 2022. The Fund achieved a 97% reduction in exposure, a very significant reduction in exposure to carbon reserves.

6.6. Targeting real economy decarbonisation means investing in a way that targets a real-world impact and is aligned with what is occurring in the real economy. Some investors incorporate such real-world impacts into their investment process. Investing in a way that is aligned to the global net zero transition, could increase a portfolio's emissions in the short term, but should lead to portfolio decarbonisation over the longer term.

6.7. This paper asks the Committee to consider its aim in developing a net zero investment strategy and associated interim targets; the Committee should establish the extent to which it is trying to achieve portfolio decarbonisation or real economy decarbonisation. Where the Fund falls on this spectrum will determine the type of interim target that can help achieve the long-term objective of the Fund.

6.8. It will also impact the constraints the chosen target introduces in investment decision-making, the key metrics that will help monitor progress over time and the approaches the Committee can use to help achieve the target.

6.9. It should be remembered that the Fund's approach to net zero strategy setting will differ from that of the Council. The Council's Climate Action Plan is focused on achieving net zero within the local area. In contrast, the Pension Fund needs to focus on its underlying investment portfolio and, by extension, the wider economy.

Appendices

Appendix 1 (EXEMPT) - Consideration for Setting Climate Targets

By Virtue of Paragraph(s) 3 Part 1 of schedule 12A of the Local Government Act 1972 this report and/or appendix is exempt because it contains Information relating to the financial or business affairs of any particular person (including the authority holding the information) and it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Background documents

None

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