

CITY OF  
WOLVERHAMPTON  
COUNCIL

# Pensions Committee

Wednesday 9 December 2020

Dear Councillor,

## **PENSIONS COMMITTEE – WEDNESDAY 9 DECEMBER 2020**

I am now able to enclose, for consideration at next Wednesday 9 December 2020 meeting of the Pensions Committee, the following appendix that were unavailable when the agenda was printed.

<b>Agenda No</b>	<b>Item</b>
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7	<b><u>Responsible Investment</u> (Pages 3 - 20)</b>
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[To receive an update on the work undertaken in relation to responsible investment activities since the last Pensions Committee meeting.]

If you have any queries about this meeting, please contact the Democratic Services team:

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West Midlands Pension Fund

# CLIMATE RELATED DISCLOSURE 2020

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Report prepared in alignment with the recommendations of the Taskforce on Climate-related Financial Disclosures

*Report prepared in collaboration with LGPS Central Limited*

DECEMBER 2020

Agenda Item No: 7

Cover photo by Nik Shuliahin on Unsplash

# INTRODUCTION AND OVERVIEW

The West Midlands Pension Fund (“the Fund/WMPF”) is one of the largest funds within the Local Government Pension Scheme in the UK. An open defined benefit pension scheme, the Fund has assets under management in excess of £17 billion and invests for the long-term across a wide range of asset classes to deliver returns to pay pensions to over 330,000 Fund members within the West Midlands.

This stand-alone report marks the third year in which the Fund has prepared and disclosed action and approach to assessing and managing the risks associated with climate change. The Fund’s response to climate change is embedded within the Investment Strategy and Investment Strategy Statement and is supported by our Climate Change Framework and Strategy (2019-2023) and wider Responsible Investment Framework.

Our climate-related disclosure report is based on the recommendations set by the Task Force on Climate-related Financial Disclosures (TCFD) and provides an overview of the governance, strategy, risk management tools and metrics employed by the Fund to inform and continue to develop our response to climate change.

As is demonstrated within the metrics reported, the Fund has made progress in reducing exposure to climate change risks and has developed its investment in global equities to reduce carbon intensity by 1/3<sup>rd</sup> relative to the benchmark. The Fund has also increased its weight in clean technology.

## Introduction

- Governance
- Strategy
- Risk Management
- Metrics & Targets

INVESTMENT STRATEGY  
STATEMENT



CLIMATE CHANGE  
FRAMEWORK AND  
STRATEGY (2019-2023)



# OUR APPROACH TO CLIMATE-RELATED DISCLOSURE

Climate change, and the risks and opportunities it presents to us as long-term investors form part of our critical thinking not just in the way we approach investment, but in the Fund's wider objectives and delivery themes which aim for global influence alongside delivering for local people. The Fund recognises the need for action to address climate change on a global scale and that it has a role to play in ensuring transition to a net zero carbon economy, but also that it will take action on the part of governments, companies, investors and individuals to ensure the long-term sustainability of our planet. We believe that the Fund by its actions and in collaboration with others, can and will contribute to change, at the same time as meeting its primary aim of managing the financial risk inherent in investments, to support in meeting the funding objectives and pension promises made to Fund members. The Fund acknowledges that this remains a fast evolving space and believes it appropriate to set shorter-term objectives in its Climate Framework & Strategy as well as more progressive longer-term ambitions.

Openness and transparency are important ways in which we demonstrate the actions we are taking

to address climate change. This is a fast-evolving space, with increased pace of global engagement and policy change – this is why we established our framework in 2019, based around shorter-term targets over four years, ensuring our policy actions were set in context of progressive ambition. The information and data available at this time has evolved considerably since our assessment in 2017/18, however we acknowledge that measurement and risk measurement continue to have some limitations at present. As the Fund moves forward with its climate change response, we remain keen to ensure that any targets set are achievable and measurable, with progress tracked and demonstrated.

As a supporter of the TCFD recommendations, since they were first published in 2017, the Fund has published climate-related financial disclosure against the TCFD recommendations in its Annual Report & Accounts:

Annual Report and Accounts (2020) 

For the first time the Fund is publishing a separate stand-alone TCFD report to further enhance transparency and disclosure around our approach to climate risk management.

Action on climate change requires commitment by all parties on a worldwide scale. As a global investor the Fund believes it has a crucial role to play in leading that change through a proactive and collaborative approach. The Fund recognises that climate-related risks are financially material and that the due consideration of climate risk falls within the scope of the Fund's fiduciary duty and aligns with the Fund's wider beliefs as set out in the Fund's Investment Strategy Statement. Given the Fund's long-dated liabilities and the timeframe in which climate risks could materialise, a holistic approach to risk management covering all sectors and all relevant asset classes is warranted.

## Introduction

Governance

Strategy

Risk Management

Metrics & Targets

This Climate-related Disclosures Report describes the way in which climate-related risks are managed currently. In the interests of being transparent with the Fund's beneficiaries and broader stakeholder base, this report discloses the results of Carbon Risk Metrics Analysis and Climate Scenario Analysis undertaken in 2020 in order to assess the resilience of the Fund's assets.

The TCFD recommendations are based on the financial materiality of climate change and are structured according to the TCFD's four thematic areas of governance, strategy, risk management and metrics and targets [Figure 1].

Our report covers our actions and alignment against each of the core elements in turn.

Figure 1: Core Elements of Recommended Climate-Related Financial Disclosures

**Governance**

The organisation's governance around climate-related risks and opportunities

**Strategy**

The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning

**Risk Management**

The processes used by the organisation to identify, assess, and manage climate-related risks

**Metrics & Targets**

The metrics and targets used to assess and manage relevant climate-related risks and opportunities

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**Introduction**

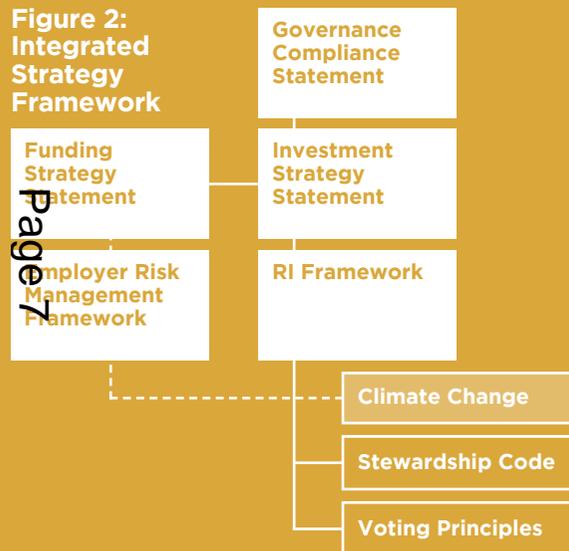
- Governance
- Strategy
- Risk Management
- Metrics & Targets

### TCFD Recommended Disclosure

Describe the board's oversight of climate-related risks and opportunities

**Figure 2: Integrated Strategy Framework**

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## GOVERNANCE

Roles and responsibilities at the Fund are set out clearly in the Fund's Governance Compliance Statement.

Governance Compliance Statement



Overall responsibility for managing the Fund lies with the Administering Authority, the City of Wolverhampton Council, who have delegated the management and administration of the Fund to the West Midlands Pension Fund Committee.

The Pension Fund Committee is responsible for setting the Fund's Investment Strategy Statement (ISS), Responsible Investment Framework (RI Framework) and Climate Change Framework and Strategy (CCFS). These are part of an integrated strategy framework (shown in Figure 2) and inform the development and implementation of policy for the day-to-day management of climate change risk by Officers of the Fund, led by the Director of Pensions.

The ISS recognises climate change risk as one of the Fund's mainstream asset risks. The Climate Change Framework and Strategy is premised on 12 foundational evidence-based beliefs about climate risk, considering the economics of climate

change, the energy transition, and purposeful climate stewardship. Both the Responsible Investment Framework and Climate Change Framework and Strategy are reviewed by the Pensions Committee on an annual basis.

The Pensions Committee oversees the implementation of policy frameworks and strategic actions as part of its quarterly Pensions Committee meetings. To inform and supplement discussion and debate by the Pensions Committee, members receive training, at least annually, on the Fund's climate change strategy, information on the Fund's approach to climate change is shared with wider stakeholders including Fund members and employers through newsletters, briefings, and at routine Fund-wide information events

The Local Pensions Board, formed since 2015 and incorporating broad employee and employer representation, plays a role in supporting the Pensions Committee to ensure the effective and efficient governance and administration of the Fund, including securing compliance with the LGPS Regulations and any other legislation relating to the governance and administration of the Scheme. The Board reviews documents within the strategy framework as these change and develop.

RESPONSIBLE INVESTMENT FRAMEWORK



### Governance

Strategy  
Risk Management  
Metrics & Targets

**FD Recommended Disclosure**

Describe management's role in assessing and managing climate-related risks and opportunities

The Fund's Investment Advisory Panel and independent advisers appointed to this oversee implementation and advise the Director of Pensions and the Fund's Internal Committees on the consideration and response to climate change. A specific focus is placed upon minimising adverse financial impacts and maximising the opportunities for long-term economic returns on our assets.

The Fund's Climate Change Framework and Strategy is holistic in that it incorporates climate change and risk considerations across the investment and funding strategy to consider those posed by changing economic and demographic risks as well as employer covenant.

Day-to-day management of the Fund's climate change strategy is delegated to the Director of Pensions and in turn to Senior Officers (Management Team) and the internal committees they lead (collectively "Fund Officers").

Fund Officers have sourced and work with specialist advisers and providers to collate data and analysis to test and inform climate-related risks, both from a "top-down" and "bottom-up" perspective. This aids the identification, quantitative and qualitative assessment of risk and informs actions aligned to the context of the Climate Change Framework and Strategy. These assessments form part of decision making on funding, investment and employer covenant.

Specifically, in relation to investment, the assessments aid consideration of investment strategy, investment mandates and individual investment decisions within the selection process. They also play a key role in stewardship and ongoing monitoring of strategy and implementation through an integrated monitoring framework and active engagement and stewardship programme.

The Fund supports and utilises a variety of strategic partnerships to continue to inform and develop its approach to the consideration of climate-related risks and opportunities, including:

- The Principles for Responsible Investment (PRI)
- Institutional Investors Group on Climate Change (IIGCC)
- Climate Action 100+ (CA100+)
- Local Authority Pension Fund Forum (LAPFF)
- The Transition Pathway Initiative (TPI)

Action on climate-related risks is informed and supported by robust engagement and voting practices. The Fund has a programme of climate change stewardship which is proactive to uphold its commitment to responsible investment.

In line with the Fund's Climate Change Framework and Strategy, Fund officers give due consideration and assessment of climate-related risks and opportunities when discussing both existing investments and any new investments.

# STRATEGY

The Fund as a large asset owner with long-term liabilities considers climate-related risks and opportunities across multiple timeframes and across a diversified asset-base and employer-base, as well as broader potential impacts across the Fund. A subset of risk and opportunity factors considered is outlined in the table below:

	Short & Medium-Term	Long-Term
<b>Risks</b>	<ul style="list-style-type: none"> <li>Carbon prices</li> <li>Technological change</li> <li>Regulatory &amp; Policy tightening</li> <li>Consumer preferences</li> <li>Asset valuations under range of climate scenarios</li> <li>Biodiversity</li> </ul>	<ul style="list-style-type: none"> <li>Resource scarcity</li> <li>Extreme weather events</li> <li>Sea level rise</li> <li>Fund employers</li> <li>Asset valuations under range of climate scenarios</li> <li>Just Transition &amp; employment</li> </ul>
<b>Opportunities</b>	<ul style="list-style-type: none"> <li>Engagement to support transition</li> <li>Ability to influence</li> <li>Resource efficiency</li> <li>Technological change</li> </ul>	<ul style="list-style-type: none"> <li>Engagement to support transition</li> <li>Improvements to long-term health</li> <li>Resource efficiency</li> <li>Training &amp; upskilling</li> </ul>
<b>Asset Class</b>	<ul style="list-style-type: none"> <li>Listed equities</li> <li>Growth assets</li> <li>Energy-intensive industry</li> <li>Oil-dependent sovereign issuers</li> <li>Carbon-intensive corporate issues</li> <li>Currencies</li> </ul>	<ul style="list-style-type: none"> <li>Infrastructure</li> <li>Property</li> <li>Agriculture</li> <li>Commodities</li> <li>Insurance</li> <li>Private Assets</li> </ul>

## TCFD Recommended Disclosure

Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long-term

### FD Recommended Disclosure

Describe the impact of climate-related risks and opportunities on the organisation's business, strategy and financial planning

We identify short-term risk as stock market movements, medium-term risk as changes in consumer behaviour, driven by policy and technological change (e.g. uptake in electric vehicles), and long-term risk as physical damages to real assets and resource availability (e.g. sea level rise and severe weather events).

The Fund identifies climate-related issues through research and collaboration (notably with the PRI, IIGCC, LAPFF, TPI and Climate Action 100+). The Fund has made use of the TPI Toolkit to observe climate risk management in large listed equity stocks.

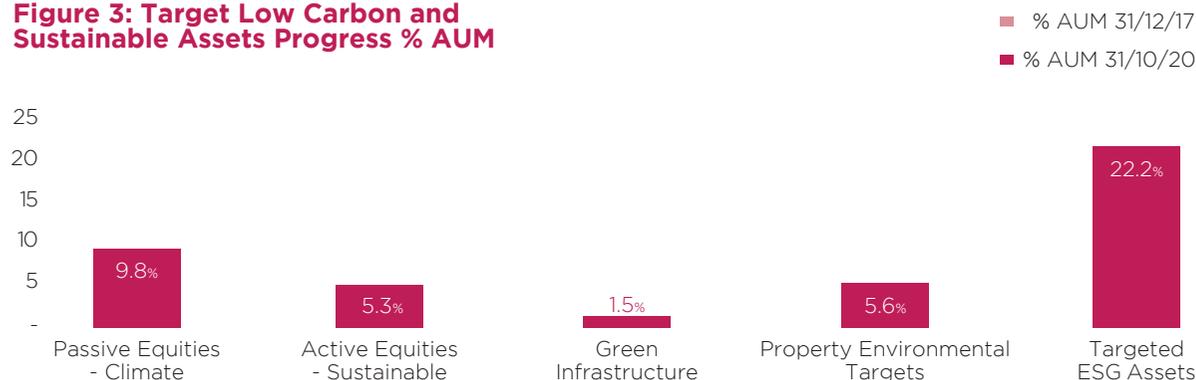
The Fund manages climate risk in different ways according to the nature, duration, magnitude and time horizon of the risk itself. As set out in the Fund's Climate Change Framework and Strategy, the main management techniques within investment strategy are:

- asset allocation;
- selection and due diligence; and
- purposeful stewardship.

The Fund's responsible investment considerations, including climate change, are incorporated into the mandates of external Fund Managers via their respective Investment Management Agreements and ongoing monitoring.

The Fund aims to invest in opportunities where positive environmental outcomes are expected to correlate with positive financial performance. This has included focused investments in a Global Equity low carbon factor fund, Sustainable Global Equity mandates, renewable infrastructure and applying green standards on its direct property investments. Together and alongside the ongoing portfolio-wide selection and stewardship activity, these asset allocations and new strategies have significantly increased exposure to lower carbon and sustainable strategies since 2017 as shown in figure 3 below (with allocations in 2017 being de-minimis):

**Figure 3: Target Low Carbon and Sustainable Assets Progress % AUM**



The Fund takes a holistic approach to climate change and has taken steps since 2019 to better understand the climate change risks and exposure within the employer covenant and underlying employer-base who are required to pay contributions to the Fund towards meeting the cost of Fund benefits.

An initial assessment of the Fund's exposure to climate-related risks was carried out in 2017 by an external provider to understand the extent to which the Fund was exposed to risks under a range of climate scenarios and led to the development of the Fund's Climate Change Framework and Strategy.

In 2020 the Fund again engaged an external expert to assess progress against the 2017 assessment, also reflecting on the agreed changes to the Fund's strategic asset allocation approved in March 2020 by the Pensions Committee. All asset classes were reviewed within 2°C, 3°C, and 4°C scenarios as per the table below. The analysis will be used as an input to our future approach to climate risk.

The table below shows that the new strategic asset allocation further enhances the Fund's position under a 2°C scenario.

It is recognised that the Paris Agreement, which the Fund strongly supports, aims to limit global warming well below 2°C, pursuing efforts to limit it to 1.5 degree. The scenario analysis has developed since 2017 and the Fund will continue to evolve this risk analysis as the investment strategy and assessment tools and underlying data continue to be refined.

#### Annualised Climate Change impact on portfolio returns – to 2030 and 2050<sup>1</sup>

Based on the 2019 asset allocation and the updated approved strategic asset allocation being implemented following Pensions Committee approval post April 2020

Scenario	Timeline	2019 Asset Allocation	2020 Strategic Asset Allocation
2°C	2030	0.20%	0.34%
	2050	0.01%	0.09%
3°C	2030	-0.01%	-0.01%
	2050	-0.07%	-0.07%
4°C	2030	-0.07%	-0.08%
	2050	-0.14%	-0.15%

<sup>1</sup> Extract above from Mercer Limited's (Mercer) report "Climate Change Scenario Analysis" dated 26 June 2020 prepared for and issued to LGPS Central Limited for the sole purpose of undertaking climate change scenario analysis for West Midlands Pension Fund.

### TCFD Recommended Disclosure

Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario

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CLIMATE CHANGE  
FRAMEWORK AND  
STRATEGY (2019-2023)



## RISK MANAGEMENT

The Fund seeks to identify and assesses top-down and bottom-up climate-related risks at the total Fund level, asset class and at the individual asset level. On risk modelling, we have benefitted from our collaboration with our investment pooling company LGPS Central Ltd to access Climate Risk Monitoring, which serves as the primary means through which the Fund identifies and assesses climate risks.

As far as possible climate risks are assessed in units of investment return, in order to compare with other investment risk factors. At this time, tools for assessing climate metrics have some limitations but it is pleasing to see that this is a rapidly developing area and we look forward to seeing improvements to reporting tools. Our preferred metrics to date have been evidenced based returns impact, given various climate scenarios, and a heat map showing the asset classes with the greatest exposures to this risk factor.

The identification and assessment of climate-related risks is also the responsibility of individual fund managers appointed by the Fund. Existing fund managers are monitored on a regular basis through the Fund's stewardship programme.

Engagement activity is conducted with investee companies through selected stewardship partners including:

- LGPS Central Ltd
- EOS at Federated Hermes
- Local Authority Pension Fund Forum (LAPFF)

The Fund is developing its Stewardship Plan in order to focus engagement resources on the investments most relevant to the Fund and risks identified. In addition to the ongoing collaborative engagement this aims to further target engagement at investee companies of particular significance to the Fund's portfolio.

### FD Recommended Disclosure

Describe the organisation's process for identifying and assessing climate-related risks

## TCFD Recommended Disclosure

Describe the organisation's process for managing climate-related risks

The Fund manages climate risk in different ways according to the nature, duration, magnitude and time-horizon of the risk itself. The main management techniques used in relation to the Fund's investment and funding risk are:

- asset allocation;
- selection and due diligence;
- purposeful stewardship; and
- employer covenant assessments

Engagement and shareholder voting are an integral aspect of the Fund's approach to managing climate risk and the Fund believes that climate risk management can be meaningfully improved through focussed stewardship activities by investors.

The Fund supports the engagement objectives of the Climate Action 100+ (CA100+) initiative – that companies adopt appropriate governance structures to effectively manage climate risk, decarbonise in line with the Paris Agreement and disclose using TCFD recommendations.

The Fund's Voting Principles reflect the Fund's strategy to engage with its investee companies and other key stakeholders through partnerships and on its own. The Fund aims to protect and increase shareholder value by engaging on a range of financially material ESG investment factors. The Fund supports the LGPS Central voting principles which have been developed in consultation with the Fund and through which the majority of the Fund's votes are now transacted. LGPS Central will, in cases where escalation of an engagement is deemed appropriate, consider co-filing shareholder resolutions that relate to climate change. The Fund reports quarterly to Pensions Committee on its voting and engagement activities through its Responsible Investment report.

LGPS Central  
Voting Principles



WMPF Voting  
Principles



# THE FUND'S COLLABORATIVE AND ENGAGEMENT PARTNERSHIPS



LGPS Central Ltd is the Fund's investment pooling partner to deliver the benefits of investment pooling, which includes benefits of scale in responsible investment & engagement and analysis of climate change risks.

Climate change is one of LGPS Central's stewardship themes, with quarterly progress reporting available on the website. The Responsible Investment Team at LGPS Central engages companies on WMPF's behalf.



Institutional Investors Group on Climate Change

The Fund is a member of the Institutional Investors Group on Climate Change (IIGCC) which is a leading global investor membership body and the largest one focusing specifically on climate change.

IIGCC help define the investment practices, policies and corporate behaviours required to address climate change.



EOS at Federated Hermes is engaged by LGPS Central to expand the scope of the engagement programme, especially to reach non-UK companies.

In 2019, EOS conducted engagements on 238 climate change issues across its company universe.



Global Investors Driving Business Transition

WMPF is member of Climate Action 100+ an investor initiative launched in 2017 to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. More than 500 investors with over \$47 trillion in assets collectively under management are engaging companies to: Curb emissions; improve governance; and Strengthen climate-related financial disclosures.



WMPF is a founding member of the Local Authority Pension Fund Forum (LAPFF). LAPFF conducts engagements with companies on behalf of local authority pension funds.

In 2019 LAPFF conducted over 150 engagements on climate change.



The Transition Pathway Initiative (TPI) is a global, asset-owner led initiative which assesses companies' preparedness for the transition to a low carbon economy. Rapidly becoming the go-to corporate climate action benchmark.

WMPF supports the TPI, created for the global investor community and which collectively has \$22.8trn AUM.



The Fund is a signatory of the UN Principles for Responsible Investment (PRI) which seeks to set out investment principle and actions that investors can take across a range of responsible investment activities including climate change.

In the 2020 assessment the Fund achieved A+/A across all metrics.

## TFRD Recommended Disclosure

Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management

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Climate change is recognised in the Fund's mainstream asset risks within the Investment Strategy Statement, Responsible Investment Framework and expanded upon in the Climate Change Framework & Strategy. These documents are reviewed at least annually and formally approved by the Pensions Committee.

Climate risk is integrated in the Fund's risk register and has been incorporated into the LGPS Central Investment Pool risk register.

The Fund's Responsible Investment Framework has identified four key themes for engagement recognising that all four themes pose risks but offer significant opportunities for engagement. Climate change has been a key engagement theme for the Fund for a number of years and is included in the most recent framework for engagement.

Annual training includes focused sessions on climate change to ensure those charged with governance are provided with the knowledge and skills with which to assess climate risks and to ensure they are integrated into the Fund's overall risk management.

The Fund's responsible investment stewardship plan, incorporating Climate Change, is being developed to ensure that climate change is being embedded throughout the Fund's risk management activity.

## METRICS AND TARGETS

Carbon risk analysis has been undertaken on all of the Fund's listed equities portfolios along with some analysis on corporate bond portfolios. This analysis along with a range of other inputs is being used to inform review of the Fund's Climate Change Framework and Strategy. The poor availability of data in asset classes other than listed equities prevents a more complete analysis at this time.

Carbon risk metrics aid the Fund in assessing the potential climate-related risks to which the Fund is exposed, and in identifying areas for further risk management, including company engagement and fund manager monitoring. The Fund additionally monitors stewardship data as noted above.

In considering its carbon risk metrics, the Fund remains aware of the limitations of the available metrics and the underlying datasets, but is pleased to note that this is a fast-evolving area and believes that greater transparency and disclosure will only serve to enhance the ability of organisations to assess and monitor their exposure to climate-related risks and opportunities to build into strategy and risk management process.

We have assessed our total equities portfolio as having a weighted average carbon intensity of 149.24 (tCO<sub>2</sub>e/ \$M revenue) as at 31 December 2019. This compares to 223.51 (tCO<sub>2</sub>e/ \$M revenue) of the total equities blended benchmark at the same date. The Fund's holdings have carbon intensity which is 1/3<sup>rd</sup> lower than its benchmark.

### TCFD Recommended Disclosure

Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process

### TCFD Recommended Disclosure

a) Disclose Scope 1, Scope 2, and if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.

- b) Disclose Scope 1, Scope 2, and if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks. TCFD Guidance<sup>2</sup>

*2. Asset owners should provide the weighted average carbon intensity, where data are available or can be reasonably estimated, for each fund or investment strategy*

Reviewing progress over the last year the Fund is able to demonstrate that carbon risk metrics have improved compared to benchmark as set out in the charts<sup>3</sup> to the right in relation to the Fund's equity portfolios:

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The Fund has reduced its carbon footprint, increased investment in clean technology and reduced exposure to fossil fuel reserves and expects to update its carbon risk metrics data on an annual basis.

Figure 4: Portfolio carbon footprint, Total Equities portfolio, December 2018 vs December 2019

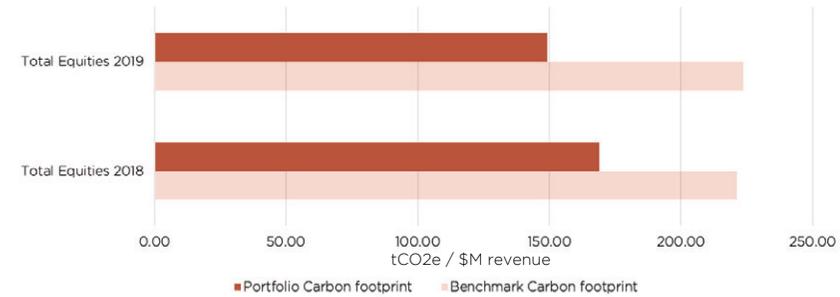


Figure 5: Weight in companies with clean technology, Total Equities portfolio, December 2018 vs December 2019

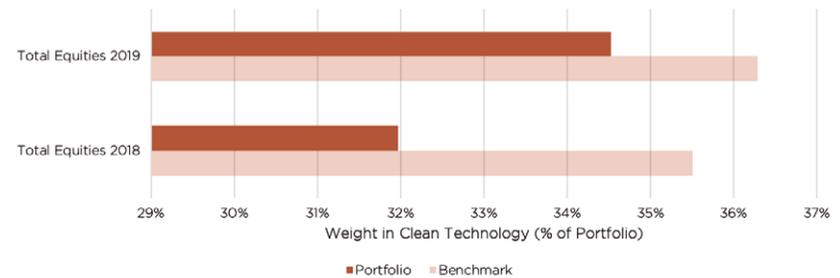
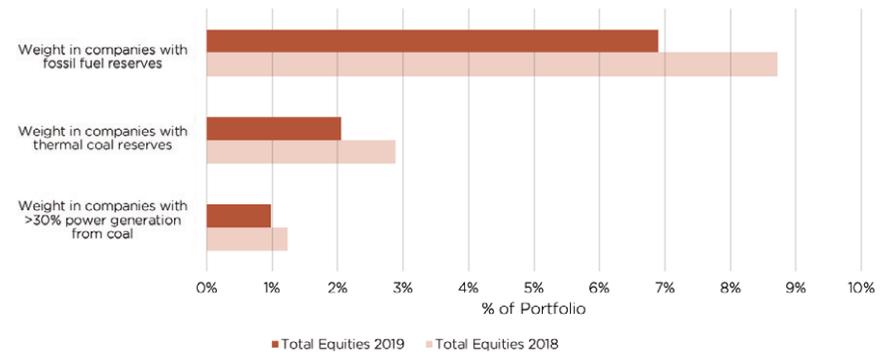


Figure 6: Exposure to fossil fuel reserves, Total Equities portfolio, December 2018 vs December 2019



3. Certain information ©2020 MSCI ESG Research LLC. Reproduced by permission..

## TCFD Recommended Disclosure

b) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets

c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets

The Fund has reviewed the use of targets. As per the Climate Change Framework & Strategy 2019-2023, the Fund articulated a number of strategic actions which included a target of 10-15% of the Fund's investments in low carbon and sustainable assets and investments in thermal coal producers to be less than 1% of the Fund.

Through actions taken, the Fund has already achieved the 2023 targets set in the Climate Change Framework & Strategy.

Climate Change Framework  
and Strategy (2019-2023)



The scope for further target-setting, recognising the paucity of credible methodologies and data currently available, will be considered upon next review.



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