CLWYD PENSION FUND COMMITTEE

Date of Meeting	Wednesday, 15 February 2023
Report Subject	Climate Change Analysis Update
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

The purpose of this report is to provide the Committee with the following documents which relate to climate change analysis of Clwyd Pension Fund's assets:

- The initial draft of the Fund's first Task Force on Climate-Related Financial Disclosures ("TCFD") report
- The latest Analytics for Climate Transition ("ACT") analysis carried out for the Fund.

These documents both cover the periods ending 31 March 2022, and are attached as appendices to this report.

The report and the appendices include key findings in relation to the Fund's decarbonisation and actions for the future.

A useful glossary of terms is available at the end of this report.

RECOMMENDATIONS	
1	That the Committee consider, discuss and note the reports on TCFD and ACT over periods to the end of March 2022.

REPORT DETAILS

1.00	**Climate change analysis of Clwyd Pension Fund Assets**
1.01	The Committee recognise climate change as a risk that could impact the assets of the Fund if it is not properly measured and managed. Within the Fund's Investment Strategy Statement (ISS), the Fund has already documented its beliefs in relation to managing climate risk, and agreed targets to measure progress made towards decarbonisation. Along with all large pension funds there will be a requirement in the future for LGPS funds to report on how they are managing climate risk. This is known as Task Force on Climate-Related Financial Disclosures ("TCFD"). Although this is not a requirement for LGPS funds yet, it was decided in the Fund's business plan for 2022/23 that the Fund would report this information on a voluntary basis, given that the targets and monitoring of carbon emissions is already being carried out. Officers believe there is more work required in relation to the language included and how the TCFD report is positioned. Given the version as at 31 March 2023 will be provided to the September Committee meeting, work will focus on improving the language and positioning of that TCFD report, rather than the attached one.
1.02	**Task Force On Climate-Related Financial Disclosures (TCFD) report** The introduction of TCFD reporting will provide greater transparency and understanding in relation to how this risk is being managed for the Clwyd Pension Fund. The initial draft of the Fund's first TCFD report is included in Appendix 1. Section 3 of the attached TCFD report provides more background on the requirements and framework. The report covers the following key areas: • Governance • Strategy • Risk Management • Metrics and targets
1.03	*Governance* The Fund already has strong governance through the Committee, the Pension Board, the Advisory Panel, a Scheme of Delegation as well as expert advisers including in relation to regulated investment advice. This proven governance structure is being applied in relation to how the Fund manages climate risk. As some of the Fund's assets are invested through the Wales Pension Partnership (WPP), it is important that we work with WPP to deliver the climate beliefs of Clwyd Pension Fund.
1.04	*Strategy* The Committee has previously considered the impact of climate change on the investment performance of the Fund (based on the Investment Strategy at that time).

	Analysis showed that in most scenarios, climate change would have a negative impact on the Fund's investment performance unless the implementation of the strategy continues to evolve as the world decarbonises. The Committee previously approved a number of climate beliefs within the Investment Strategy which are: • Climate change presents a systemic risk to the overall stability of every economy and country, with the potential to impact on the members, employers and all of the holdings in the Fund's investment portfolio. • Considering the impacts of climate change is not only the legal or fiduciary duty of the Fund, but is also consistent with the long term nature of the Fund. The Fund's investments need to be sustainable to be in the best interests of all key stakeholders. • Engagement is the best approach to enabling the change required to address the Climate Emergency, however selective risk-based disinvestment is appropriate to facilitate the move to a low carbon economy. • As well as creating risk, climate change also presents opportunities to make selective investments that achieve the required returns, whilst at the same time make a positive social and environmental impact, such as environmental infrastructure and clean energy. Analysis carried out as at March 2022 also supported the initiatives that the Fund had previously agreed including: • A 5% strategic allocation to sustainable equity • Engagement with managers on matters pertaining to ESG within private markets • Supporting investments with strong sustainability / impact focus • Looking into investment alignments with United Nations' Sustainable Development Goals (UNSDG) • Allocating 4% of the total portfolio to local / impact focused investments within private markets • Endeavouring to make impact-focused allocations within other private market asset classes (Private Equity, Private Debt, Infrastructure and Real Estate) where possible. The separate Committee report on the proposed changes to the Fund's Investment Strategy includes further actions to assist with meeting the Fund's climate beliefs.
1.05	*Risk management* The Fund already has a Risk Management Strategy in place which is being applied to managing climate risk in the same way as it is used to manage all other investment risks.
1.06	*Metrics and targets* The Committee has previously agreed a target for the investments in the Clwyd Pension Fund, as a whole, to have net zero carbon emissions by 2045, with an interim target of carbon reduction of 50% by 2030. Underlying this headline commitment, the plan also has a number of other key targets as outlined below: a) for the Fund as a whole: • to have at least 30% of the Fund's assets allocated to sustainable investments by 2030

- to expand the measurement of the carbon emissions of the Fund’s investments to include all assets by the end of 2023.

b) within the Listed Equity portfolio:

- to achieve a reduction in carbon emissions of 36% by 2025 and 68% by 2030
- to target at least 30% of the Listed Equity portfolio to be invested in sustainable assets by 2030
- to reduce fossil fuel exposure relating to oil and gas by 70% by 2025 and 90% by 2030
- to reduce fossil fuel exposure relating to coal by 90% by 2025 and 95% by 2030
- to engage with the biggest polluters within the Fund’s Listed Equity portfolio as part of an overarching stewardship and engagement strategy, to achieve:
  - by 2025, at least 70% of organisations in carbon-intensive sectors have clearly articulated and credible strategies to attain net zero or are subject to engagement to achieve this objective.
  - by 2030, at least 90% of organisations in carbon-intensive sectors have clearly articulated and credible strategies to attain net zero or are subject to engagement to achieve this objective.

A summary of the Fund’s performance against these targets is included in the ACT report in Appendix 2.

In order to be able to measure whether the Fund is achieving these targets, the following climate-related metrics are being used:

- Absolute emissions metric
- Emissions intensity metric: Carbon Footprint
- Emissions intensity metric: Weighted Average Carbon Intensity (WACI)
- Portfolio alignment metric: Implied Temperature Rise (ITR)
- Portfolio alignment metric: Science Based Targets Initiative (SBTi).

1.07 **Analytics For Climate Transition (ACT)**

The ACT report is included in Appendix 2. It provides the more detailed analysis and information on the Fund’s climate transition plan.

Purpose of analysis

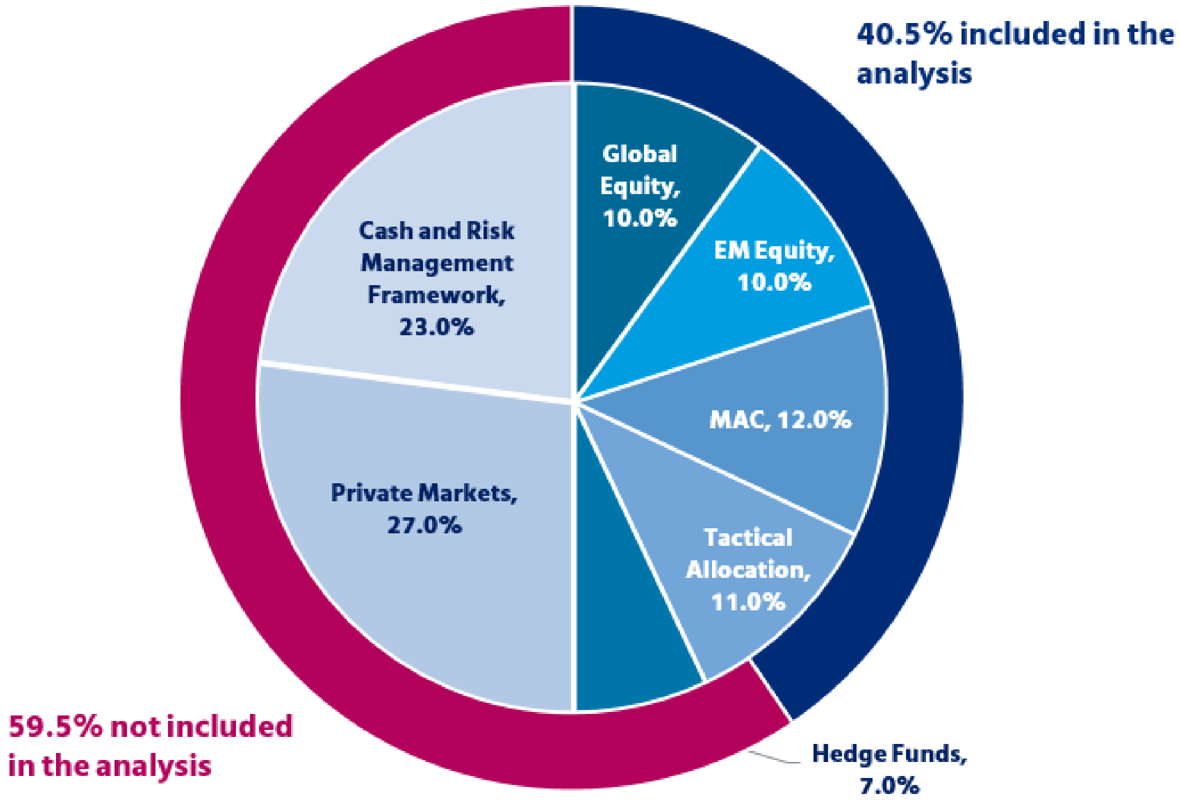
The ACT analysis provides an updated understanding of the Fund’s climate transition progress and potential (“transition capacity”) as at 31 March 2022 using the Mercer Analytics for Climate Transition (ACT) tool. It is the second year of this analysis.

The analysis within the report was carried out on the Fund’s listed equities (Global and Emerging Markets (EM) Equity), synthetic equity and multi-asset credit (MAC) portfolios, as well as on part of the Best Ideas Tactical Asset Allocation (TAA) portfolio. This results in c.40.5% of the total Fund being analysed.

The aim of the analysis is to:

- Monitor progress against the Fund’s listed equity targets across decarbonisation, exposure to fossil fuels (oil, gas, coal) and explore the proportion of emissions within high impact sector that are currently under engagement or aligned with a low carbon future.
- Understand the transition capacity of the Fund’s listed equity, MAC and TAA

	portfolios. • Present an updated high level implementation plan for listed equities that incorporates further asset classes over time. To date, the recommended targets have been set on scope 1 and 2 emissions, and when the level of corporate reporting of scope 3 emissions improves, we recommend including scope 3 emissions within the Fund's emissions baseline and target setting framework. Carbon footprint is now being used as the primary metric for monitoring the decarbonisation progress. Progress is also monitored against absolute emissions and weighted average carbon intensity (WACI). Last year targets were set on an absolute emissions basis.
1.08	*Holdings analysed* Carbon metrics have been provided on 40.5% of the Fund's Strategic Asset Allocation. Consistent with the previous year's analysis, the baseline consists of the Fund's global and emerging market equity mandates. As the Best Ideas Tactical Asset Allocation portion of the Strategic Asset Allocation is tactical and short term by its very nature, this portion of the portfolio was excluded from the initial baseline analysis and assessment of progress versus listed equity portfolio targets. In relation to this analysis (as at 31 March 2022), whilst the majority of the TAA portfolio was analysed from a metrics perspective, the Commodity and the Sterling Liquidity Funds were not able to be analysed owing to data availability in the case of the former. Also some of the TAA portfolio can be cash, and therefore is excluded from the analysis. In relation to other areas of the Fund's assets, there is an active ongoing exercise to gather carbon metrics data on the property holdings. Over time as consensus around methodology for less conventional asset classes grows, this analysis will cover a greater proportion of the Fund.

	 Notes: The data analysed excludes, for example, cash and derivative allocations within the funds analysed. Where there is partial coverage of a portfolio the absolute emissions is scaled up to estimate coverage for 100% of the mandate. Within the Cash and Risk Management Framework there is exposure to synthetic global developed equity and this is included in the analysis. Detailed analysis on each of the asset classes analysed is shown within appendix 2.
1.09	*Key findings and areas for focus* Slides 7 and 8 in appendix 2 provide the overview of the Fund's progress against its targets. Key findings from the ACT analysis are summarised below: • Decarbonisation progress over the period: the listed equity portfolio, on a carbon footprint basis, has increased by 9.7% and is behind target. This was driven by the transition of the legacy Emerging Market mandates to WPP's Emerging Market Equity Fund (i.e. as a result of the move to pooling) which transpired to be more intensive at 31 March 2022. Please refer to slides 15 to 21 in appendix 2 for more detail. • On a more positive note, weighted average carbon intensity (WACI) decreased over the same period by 6.3%. This indicates that at the most granular level, the companies that the Fund ultimately invests in are less carbon intensive now than they were a year ago. As a result, collectively these companies are less susceptible to transition risk than they were 12 months ago. (Note that Mercer's transition capacity methodology has been updated over the year so the figures are not directly comparable year on year). • Fossil fuel exposure has fallen meaningfully across oil, gas and coal. • The proportion of the listed equity portfolio's financed emissions within the most material sectors that have a strategy that is currently aligned with net-

	zero or are under active engagement is on track at 67%.

1.10	Recommended key areas of focus for the next 12 to18 months are summarised below:
	
	• Setting more granular targets across:
	    ○ Sustainable / climate solutions
	    ○ Transition alignment (SBTi – transition to net zero)
	    ○ Engagement and Stewardship
	• Expand the net zero approach beyond the listed equity portfolio to property, infrastructure, private equity and multi-asset credit (data permitting)
	• Integrate climate risk into the Best Ideas Tactical Asset Allocation guidelines
	• Consider connections to biodiversity / natural capital.
	
	Overall, the insights and areas of focus should be used to help shape discussions with WPP and support climate change reporting (TCFD).

2.00	**RESOURCE IMPLICATIONS**
2.01	None directly as a result of this report.

3.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
3.01	None directly as a result of this report.

4.00	**RISK MANAGEMENT**
4.01	This report addresses some of the risks identified in the Fund's Risk Register. Specifically, this covers the following (either in whole or in part): • Governance risk: G2 • Funding and Investment risks: F8, I1, I2

5.00	**APPENDICES**
5.01	Appendix 1 – Task Force on Climate-Related Financial Disclosures (TCFD) – 31 March 2022 Appendix 2 – Analytics for Climate Transition (ACT) – 31 March 2022

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	Analytics for Climate Transition (ACT) period ending 31 March 2021 **Contact Officer:** Philip Latham, Head of Clwyd Pension Fund **Telephone:** 01352 702264 **E-mail:** philip.latham@flintshire.gov.uk

7.00	GLOSSARY OF TERMS
7.01	A list of commonly used terms are as follows: a) **Carbon footprint:** The amount of carbon dioxide (or other greenhouse gasses) released into the atmosphere as a result of the activities of a particular individual, organization or community. Carbon footprint is calculated for each company as (Scope 1 and 2 carbon emissions / $m investments). See also Scope 1, 2, 3 emissions and Weighted Average Carbon Intensity (WACI). b) **Carbon intensity:** The amount of emissions of carbon dioxide (or other greenhouse gasses) released per unit of another variable such as revenue, gross domestic product (GDP), per $1million invested etc. See also Weighted Average Carbon Intensity (WACI). c) **Carbon price:** The price for avoided or released carbon dioxide (CO2) or CO2-equivalent emissions. This may refer to the rate of a carbon tax, or the price of emission permits. In many models that are used to assess the economic costs of mitigation, carbon prices are used as a proxy to represent the level of effort in mitigation policies. d) **Carbon neutrality:** Achieved by offsetting emissions by paying for credits (usually certified via new forestry equivalents that provide carbon removal). Carbon neutrality is similar to net zero targeting – the latter requires actual emissions reductions to meet targets though (rather than purchasing offsets). See also Net Zero CO2 emissions. e) **Decarbonisation:** The process by which countries, individuals or other entities aim to achieve zero fossil carbon existence. Typically refers to a reduction of the carbon emissions associated with electricity, industry and transport. f) **Global warming:** The estimated increase in global mean surface temperature expressed relative to pre-industrial levels unless otherwise specified. See also Pre-industrial. g) **Greenhouse gases:** Gases in the planet's atmosphere which trap heat. They let sunlight pass through the atmosphere but prevent heat from leaving the atmosphere. Greenhouse gases include: Carbon Dioxide (CO2), Methane (CH4), Nitrous Oxide (N2O), Hydrofluorocarbons (HFCs), Perfluorocarbons (PFCs), Sulphur Hexafluoride (SF6), Nitrogen Trifluoride

	(NF3). h) **Inevitable policy response:** A scenario that expects an acceleration of climate-related policy announcements in 2023−2025, which has been supported by the Principles for Responsible Investment (PRI). i) **Mitigation (of climate change):** A human intervention to reduce emissions or enhance the sinks of greenhouse gases. j) **Mitigation strategies:** In climate policy, mitigation strategies are technologies, processes or practices that contribute to mitigation, for example, renewable energy (RE) technologies, waste minimization processes and public transport commuting practices. k) **Net zero CO2 emissions:** Net zero carbon dioxide (CO2) emissions are achieved when CO2 emissions are balanced globally by CO2 removals over a specified period. The term "net zero" is also typically associated with the 2050 date or earlier, as this is aligned with the scientific recommendations to achieve a 1.5°C scenario. See also Carbon neutrality (which differs slightly). l) **Paris Agreement:** The Paris Agreement under the United Nations Framework Convention on Climate Change (UNFCCC) was adopted on December 2015 in Paris, at the 21st session of the Conference of the Parties (COP) to the UNFCCC. The agreement, adopted by 196 Parties to the UNFCCC, entered into force on 4 November 2016 and as of May 2018 had 195 Signatories and was ratified by 177 Parties. One of the goals of the Paris Agreement is "Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels", recognising that this would significantly reduce the risks and impacts of climate change. Additionally, the Agreement aims to strengthen the ability of countries to deal with the impacts of climate change. m) **Physical risks:** Dangers or perils related to the physical or natural environment that pose a threat to physical assets e.g. buildings, equipment and people. Mercer's scenario analysis grouped these into the impact of natural catastrophes (for instance sea level rise, flooding, wildfires, and hurricanes) and resource availability (particularly water). See also Transition risks. n) **Pre-industrial:** The multi-century period prior to the onset of large-scale industrial activity around 1750. The reference period 1850–1900 is used to approximate pre-industrial global mean surface temperature. o) **Principles for Responsible Investment (PRI):** Non-profit organisation which encourages investors to use responsible investment to enhance returns and better manage risks. It engages with global policymakers and is supported by, not but part of, the United Nations. It has six Principles for Responsible Investment that offer a menu of possible actions for incorporating ESG issues into investment practice. p) **Resilience:** The capacity of social, economic and environmental systems to cope with a hazardous event or trend or disturbance, responding or

reorganising in ways that maintain their essential function, identity and structure while also maintaining the capacity for adaptation, learning and transformation.

q) **Scope 1, 2, 3 emissions:** Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions are indirect emissions from the generation of purchased energy. Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

r) **Stranded assets:** Assets exposed to devaluations or conversion to "liabilities" because of unanticipated changes in their initially expected revenues due to innovations and/or evolutions of the business context, including changes in public regulations at the domestic and international levels.

s) **Task Force on Climate-related Financial Disclosures (TCFD):** framework designed to improve and increase reporting of climate-related financial information

t) **Taskforce on Nature-Related Financial Disclosures (TNFD):** market-led, science-based TNFD framework enabling companies and financial institutions to integrate nature into decision making

u) **Transition alignment:** the process of moving away from high-carbon intensive processes towards business models and assets aligned with a low carbon future and the Paris agreement. Different sectors will have different pathways to net zero.

v) **Transition risks:** Risks from policy changes, reputational impacts and shifts in market preferences, norms and technology as the economy moves to a low carbon approach. See also Physical risks.

w) **Weighted average carbon intensity (WACI):** The carbon intensity of a portfolio, weighted by the proportion of each constituent in the portfolio. Carbon intensity is calculated for each company as (Scope 1 and 2 carbon emissions / $m revenue). See also Carbon footprint.