HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Pension Fund Responsible Investment Sub-Committee
Date:	30 November 2022
Title:	RI consultancy review
Report From:	Director of Corporate Operations

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Purpose of this Report

1. The purpose of this report is to present the first part of analysis that has been commissioned by the Pension Fund from the RI consultants MJ Hudson.

Recommendations

2. That the RI sub-committee note the advice from MJ Hudson for the Hampshire Pension Fund in achieving its aim for net-zero green-house gas emissions from investments by 2050 at the latest contained in this report and the next steps including:

   - MJ Hudson providing a briefing for members, that includes their advice on the Fund's current position in terms of approaches to carbon reduction and specific ESG issues in the portfolio.

   - The Director of Corporate Operations writing to Dodge & Cox (copying to the other ACCESS investors) to encouraging them that strategic commitment to tackling climate change is required Further reductions in the Scope 1 and 2 carbon intensity of the Pension Fund's equity investment and the first assessment of Scope 3 emissions.

   - That the Pension Fund engages with its investment managers to ask for their assessment of the forecast carbon emissions of their portfolios by 2030, based on the current investment process, and what (if any) further changes could reduce forecast emissions further.

Executive Summary

3. The Pension Fund first commissioned RI advice from MJ Hudson in 2020, to assess the effectiveness of the Fund’s investment managers in managing environmental, social and governance (ESG) issues and specific ESG issues in each of the investment managers’ portfolios. In agreeing revisions to the RI policy for consultation in March 2022, which included the aim for net-zero green-house gas emissions (Scope 1, 2 and 3 emissions) from investments by 2050 at the latest, the Panel and Board also agreed to re-engage MJ Hudson to update their analysis of specific ESG issues in each of the investment managers’ portfolios and provide advice on how the 2050 target is implemented with regard to an interim 2030 target.

4. MJ Hudson have completed the first half of their brief. They have conducted an independent assessment of the Fund’s listed equities carbon footprint, including for the first time the Scope 3 emissions. MJ Hudson held a workshop with the Fund’s officers to share their analysis and high-level comparison of the Fund’s own approach to carbon reduction with a sample of peers, and the approaches of its investment managers.

5. MJ Hudson will move onto the second part of their brief to update their analysis of specific ESG issues in each of the investment managers’ portfolios. This will supplement the Pension Fund’s stewardship activities and monitoring of its investment managers, building on advice from MJ Hudson on how the Funds further formalises its approach in this area.

6. As part of their Panel and Board’s 2022/23 Training Plan, MJ Hudson will provide a briefing for members on 28 November 2022, that includes their advice on the Fund’s current position in terms of approaches to carbon reduction and specific ESG issues in the portfolio.

Overall assessment

7. As an initial assessment, MJ Hudson have considered Hampshire’s high-level approach to managing the risk of climate change in comparison to some LGPS and non-LGSP pension funds (including two ACCESS members Cambridgeshire and Hertfordshire).

	Nest	Railpen	Cambridgeshire County Council	Hertfordshire	South Yorkshire Pensions Authority	Hampshire Pension Fund
			Local Government Pension Schemes (LGPS)			
Net Zero Target 2050	✓	✓	✓	✓	✓	✓
Interim 2030 target	30% absolute carbon emission reduction in public equities and fixed income by 2025	Railpen aims for a 50% reduction in greenhouse gas emissions by 2030	23% emissions decrease by 2024, 57% by 2030 (2021 baseline)	✗	Net Zero 2030 target	✗
Active Manager engagement	✓	✓	✓	✗	✓	✓
Climate considerations in voting policy	✓	✓	Environmental considerations in the ACCESS voting policy	Environmental considerations in the ACCESS voting policy	The Border to Coast consider net zero in line with TPI	Environmental considerations in the ACCESS voting policy
Low carbon index/ benchmark for passive investments	✓[1]	✓[1]	✗	✓[1]	✗	✓[1]
UK Stewardship Code 2020	✓	✓	✗[3]	✗	✓[2]	✓
View on Climate	"At Nest we accept the scientific evidence that climate change presents one of the biggest financial, environmental and societal challenges of our time."	"The climate crisis is a huge challenge for humanity, and we must all work together on it – we actively lead and collaborate to drive meaningful change where we can have the most impact."	"[Our RI policy] shows our support for the Paris Agreement, for a 'just transition' (one that is fair to individuals and communities)"	"Climate change is a systemic risk that will impact investments at the asset class, sector and company level and will require increasing consideration."	"SYPA has recognised for some time that Climate change represents the biggest long-term risk to the value of its investments"	"[HCC] supports the objectives of the Paris Agreement and believes that keeping a global temperature rise this century to well below 2ºC relative to pre-industrial levels is entirely consistent with securing strong financial returns."

[1] Investing into climate aware index funds, there is room for more ambitious benchmarking for passive investments. [2] The Border to Coast pensions partnership is a signatory to the UK Stewardship code
[3] Cambridgeshire County Council supports the principles of the UK Stewardship Code and is looking to assess the impact of the 'apply and explain' Principles of the revised 2020 UK Stewardship Code.

8. This shows Hampshire compares positively with a variety of other Pension Fund's that have taken a strong approach to managing climate change, in setting a 2050 net zero target. Hampshire's obvious gap is a lack of a 2030 interim target, which is being addressed through MJ Hudson's advice.

9. MJ Hudson have also made a high-level assessment of Hampshire's equity investment managers and their approach and commitment to managing climate change, which is shown in the following table.

	Acadian	Baillie Gifford	Dodge & Cox	UBS
Stated commitments	Committing to net zero emissions by 2050 via Net Zero Asset Manager's Initiative (NZAMI)	Committing to net zero emissions by 2050 via NZAMI	The manager does not appear to have climate commitments in place	Committing to net zero emissions by 2050 across scope 1,2 and 3
Alignment with initiatives	• Signatory to the NZAMI • ClimateAction100 • PRI signatory	• Signatory to the NZAMI • ClimateAction100 • PRI Signatory	• PRI Signatory	• Signatory to the NZAMI • ClimateAction100 • PRI Signatory
Portfolio carbon reduction	Carbon emissions limited to 50% of the MSCI World benchmark	Global Alpha Paris Aligned – implementation of a screening process to ensure alignment with the Paris Climate Agreement	The manager does not have a stated carbon reduction objectives	Climate Aware and Low Carbon Factor Mix portfolios both with lower carbon emissions than the equivalent standard passive indices
Additional content	Focus on 3 conviction topics in the investment process: Energy Transition, Employee Well-Being, and Management Long-Termism.	Commit to increasing number of companies with carbon reduction targets, expecting 90% to have robust targets by 2030.	If we believe an ESG factor could impact our investment thesis, we'll consider its risks and opportunities.	Operational emissions net zero by 2025. Reduce emissions intensity from select real estate and energy financing activities

10. Since to MJ Hudson's initial analysis Dodge & Cox have joined Baillie Gifford and UBS in signing the UK Stewardship Code, and have shared with officers their updated tools for measuring companies' alignment to limiting global temperature rises and for prioritising company engagement. However as highlighted in the table above Dodge & Cox are yet to make any strategic commitment to managing climate change, which would be supportive of implementing a carbon reduction process for the portfolio.

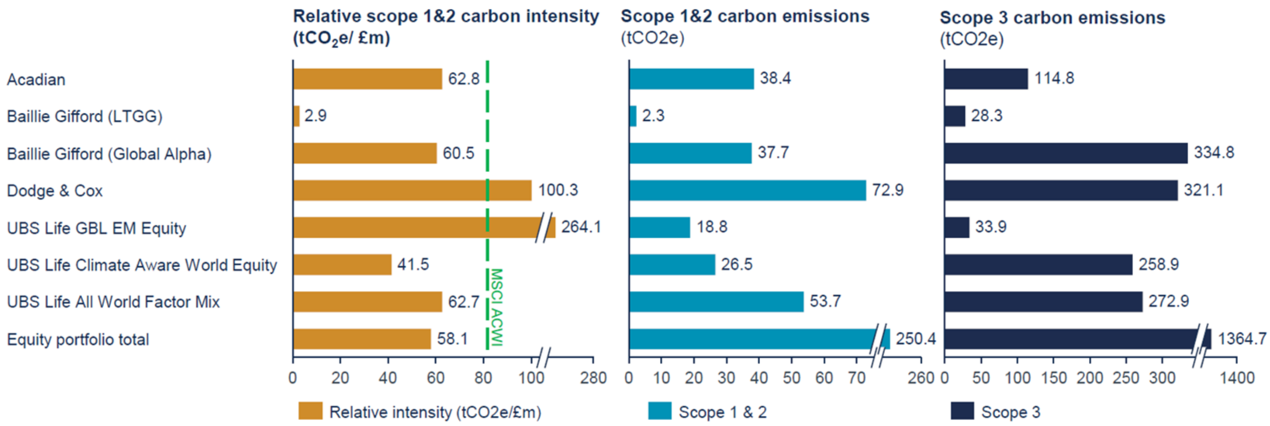
11. As a follow-up action, this will be escalated by the Director of Corporate Operations writing to Dodge & Cox (copying to the other ACCESS investors) recognising the progress they have made in the last 6 months in their responsible investment activities and encouraging them that strategic commitment to tackling climate change is required. The letter should stress that if Hampshire does not see this strategic alignment similar to its other investment managers followed by a process for reducing the portfolio's carbon emissions by set deadlines, Hampshire will be forced to consider if it can achieve similar investment performance with better management of carbon emissions from another investment manager.

Carbon footprint

12. MJ Hudson have used the latest 2021 values from the Sustainalytics database for Scope 1, 2 and 3 emissions for the Pension Fund's active and passive listed equity holdings (46% of the Pension Fund's total investments, which reflects the difficulty of obtaining this data for asset classes other than listed equities). For companies that were not included in Sustainalytics data, MJ Hudson estimated figures based on the company's industry and geography and average carbon footprint intensity. Scope 1, 2 and 3 emissions are defined as:

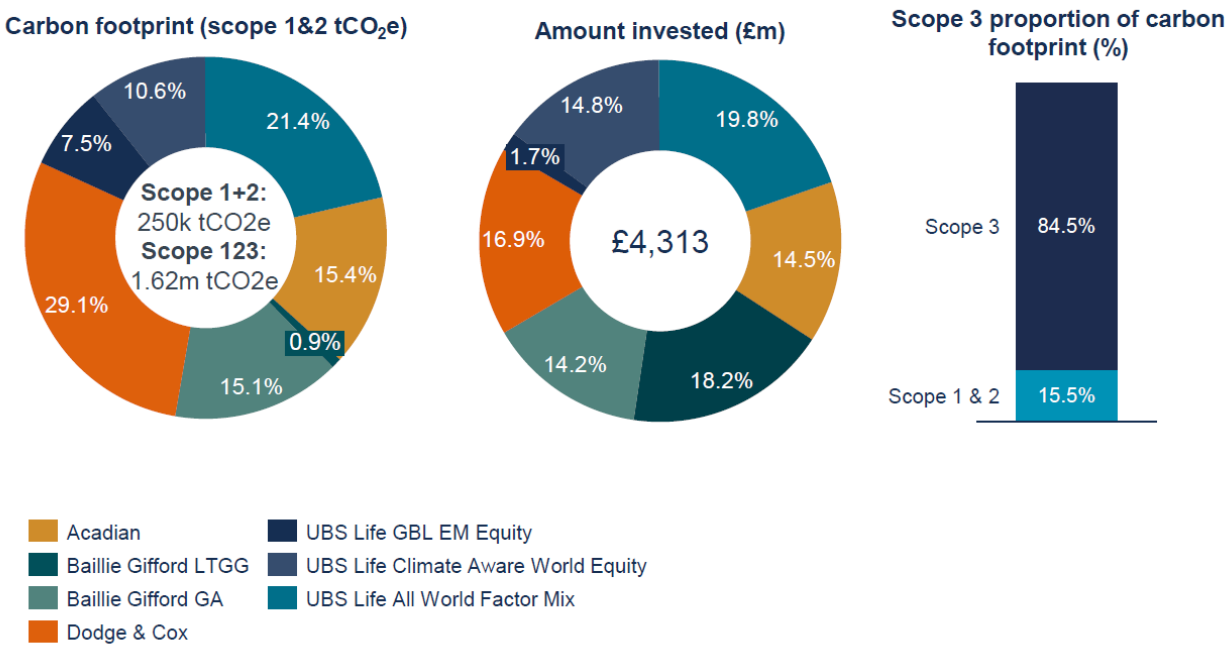
    - Scope 1 - direct emissions from owned or controlled sources
    - Scope 2 – indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed by the reporting company
    - Scope 3 - includes all other indirect emissions that occur in a company's value chain, such as purchased goods and services, business travel, employee commuting, waste disposal, use of sold products and transportation and distribution (up and downstream)

13. The following charts show the carbon emissions from each of the Fund's equity portfolios and in total.



14. The Pension Fund has previously reported the carbon data reported by its investment managers at 31 December in 2019, 2020 and 2021. This is the first time that the Fund has had independently produced carbon data and Scope 3 data. MJ Hudson's data is in line with the data that the Pension Fund has previously published. It shows a further reduction in the carbon intensity of equity investments – down from 109 tCO2e/£m at 31 December 2021 to 58 tCO2e/£m. MJ Hudson have cautioned that the combined effect of the economic contraction resulting from Covid-19 combined with increasing asset value in 2021 will have had a downward movement in carbon intensity figures that may be reversed in the following reporting periods.

15. The following charts show the Fund's equity portfolio's carbon emissions in proportion to the size of each portfolio.



16. These figures and those in the previous charts highlight the following relationships, which will serve as the Pension Fund priorities in its next phase of RI activities:

- The disproportionate emissions from the Dodge & Cox, and UBS passive Emerging Markets portfolios, which remain those that the Fund has to implement carbon reduction approaches for.

- The lack of correlation between portfolios with relatively low Scope 1 and 2 emissions and their Scope 3 emissions, such as the Baillie Gifford Global Alpha portfolio, which is significant given Scope 3 emissions make up the vast majority of total emissions. This will be addressed with investment managers through the ongoing engagement and monitoring by Pension Fund officers and the Panel and Board.

Approaches to an interim 2030 carbon reduction target

17. MJ Hudson have provided advice on approaches to carbon reduction and the setting of an interim target. Their key points are:

    - That the Pension Fund engages with its investment managers to ask for their assessment of the forecast carbon emissions of their portfolios by 2030, based on current investment process, and what (if any) further changes could reduce forecast emissions further.

    - That the investment managers are asked for their assessment of their portfolio's exposure to climate risk – this is a repeat of the Task Force on Climate-Related Financial Disclosures (TCFD) scenario analysis that the Pension Fund undertook in 2021 and plans to update and repeat in 2023.

    - That the Pension Fund considers further changes to its equity portfolios, in particular its use of passive indices, that build in a commitment to year-on-year carbon reduction, or 'glide-path', as the Pension Fund has already done with the move to Baillie Gifford Global Alpha *Paris Aligned* portfolio.

    - That further work is done with the Fund's investment managers to improve the monitoring of company engagement in particular the setting and monitoring of targets/actions for company management, and discussing when disinvestment would be appropriate if these are not met.

    - Further advice from MJ Hudson on industry examples of realistic and stretching interim 2030 carbon reduction targets.

Climate Change Impact Assessments

18. Hampshire County Council utilises two decision-making tools to assess the carbon emissions and resilience of its projects and decisions. These tools provide a clear, robust, and transparent way of assessing how projects, policies and initiatives contribute towards the County Council's climate change targets of being carbon neutral and resilient to the impacts of a 2℃ temperature rise by 2050. This process ensures that climate change considerations are built into everything the Authority does.

19. The Pension Fund itself has a negligible carbon footprint, but it recognises that the companies and other organisations that it invests in will have their own carbon footprint and a significant role to play in the transition to a lower carbon economy. Therefore the Pension Fund recognises the risk that ESG factors, including the impact of climate change, can materially reduce long-term returns. The Pension Fund has a role to play as an investor, in ensuring that its investment managers are suitably considering the impact and contribution to climate change in their investment decisions and acting as a good steward to encourage these companies to play their part in reducing climate change. This is explained further in the Pension Fund's RI policy Responsible Investment | Hampshire County Council (hants.gov.uk). The implementation of this policy is the subject of this report.

REQUIRED CORPORATE AND LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	yes/no
People in Hampshire live safe, healthy and independent lives:	yes/no
People in Hampshire enjoy a rich and diverse environment:	yes/no
People in Hampshire enjoy being part of strong, inclusive communities:	yes/no
OR	
This proposal does not link to the Strategic Plan but, nevertheless, requires a report because of the ongoing management of the Hampshire Pension Fund.	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document	Location
None	

EQUALITIES IMPACT ASSESSMENT:

1. Equality Duty

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionally low.

2. Equalities Impact Assessment:

Equality objectives are not considered to be adversely affected by the proposals in this report as the proposals do not directly affect scheme members.