HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Pension Fund Panel and Board
Date:	25 March 2022
Title:	Updates to the Responsible Investment (RI) policy
Report From:	*Director of Corporate Operations*

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Purpose of this Report

1. The purpose of this paper is to introduce proposed amendments to the Pension Fund's Responsible Investment (RI) policy recommended to the Panel and Board for consultation with LGPS stakeholders and which are summarised in the Fund's draft annual RI update for scheme members. These proposed changes to the Fund's RI policy have been agreed and are recommended to the Panel and Board by its RI sub-committee (RISC).

Recommendations

2. That the Pension Fund Panel and Board approves:
   - the proposed updates to the Responsible Investment policy for consultation with scheme members and employers;
   - that the annual Responsible Investment update is published;
   - that a further tranche of work from the Responsible Investment consultants, MJ Hudson Spring, is commissioned to again review the Pension Fund's investment portfolios and produce a plan for meeting the 2050 net-zero aim.

Background

3. The Pension Fund's RI policy forms part of its Investment Strategy Statement and is a requirement of the LGPS Investment Regulations 2016.

4. The Pension Fund's RI policy was substantially rewritten in 2019 following Members' review through the RI working group and the advice of Dr Rupert

Younger who had chaired Oxford University's Socially Responsible Investment Review.

5. Following the revisions to the RI policy the Fund consulted with scheme members and employers including:

    - launching a new section on the Fund's website for RI,
    - inclusion in the employers' newsletter,
    - an email to a sample of 500 deferred scheme members, and
    - inclusion in the newsletter that accompanies the pensioners' annual payslip.

Updates to the RI policy

6. The RI policy includes proposed updates which have been discussed and approved by the RISC, based on feedback received from the RI consultants Minerva and key areas that have been brought out in Members' discussions and representations from scheme members. The draft policy is attached in Annex 1 with proposed changes highlighted.

7. Minerva have been commissioned by the ACCESS pool to review the pool's RI policy. In so doing they have reviewed each of the 11 ACCESS authorities' RI policies and provided feedback. Updates to the policy are proposed where Minerva have suggested that further clarification would be beneficial. In particular a section on the Fund's RI beliefs that form the basis of the policy have been included. Of these, the most significant areas that the Pension Fund has not previously documented are:

    - the Pension Fund 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, and
    - to address Climate Change there needs to be a transition to a low carbon economy, but that must be an orderly transition that is inclusive and does not leave anyone behind – this is referred to as a *Just Transition.*

<u>Net-zero 2050</u>

8. The proposed policy includes a statement that the Pension Fund 'commits to the aim for its investments to have net-zero greenhouse gas emissions by 2050'. This aim reflects the advice of Minerva that setting a strategic goal will assist the Pension Fund in focusing its activities and also reflects the views that the Pension Fund has heard from scheme members, including a number of deputations. This aim is consistent with the Pension Fund's activities since the last revision of the RI policy, in particular the Fund's adoption of the recommendations of the Taskforce of Climate Related Financial Disclosure

(TCFD), the publication of carbon footprint data and the focus on working with investment managers to set targets and limits for the carbon output of the Fund's investments.

9. This proposed aim for the Pension Fund is consistent with the UK Government's net-zero strategy targeting 2050, which was published in October 2021, and reflects that the Pension Fund investment strategy contains a significant allocation to UK index-linked gilts.

10. It is recognised that in setting a net-zero aim the Pension Fund will need a plan to achieve this. This plan will build on the progress to date in agreeing amendments to five of the Fund's existing portfolios to move to lower carbon strategies or agree a limit to the carbon output of the portfolios. It is therefore proposed that in addition to agreeing the commitment to the aim for its investments to have net-zero greenhouse gas emissions by 2050, the Pension Fund commissions a further tranche of work from the RI consultants, MJ Hudson Spring, to again review its investment portfolios and produce a plan for meeting the 2050 aim.

Fossil fuels

11. The committee will be aware that it has been reported that the Pension Fund had £136m of investments in fossil fuel companies. This figure is taken from Friends of the Earth research across the LGPS published in February 2021. The figures quote Hampshire's total value of £7bn from March 2020, and the percentage in fossil fuel companies of 1.95%, compared with the LGPS average of 2.99%. Importantly the research is based on the Carbon Underground 200 index, which only includes companies owning reserves of fossil fuels, and not in wider supply chain for example in processing or selling fossil fuels.

12. The Pension Fund has reviewed with its investment managers the exposure to fossil fuels and renewable energy based on a fuller definition[1]. As at 31 December 2021 when the Pension Fund was valued at £9.9bn, £323m (3.3%) was invested in renewable energy[2] and £214m (2.2%) was invested in fossil fuel companies.

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[1] +10% revenue from extraction, mining and production of fossil fuels, or +50% revenue from fossil fuel services (distribution, retail, equipment, services, petrochemicals, pipelines/transportation, refining, trading or power generation)

[2] Based on the total of all revenues derived from any of; alternative energy, energy efficiency, green building, pollution prevention, sustainable water, or sustainable agriculture

13. The Pension Fund has previously stated that it believes in engagement over divestment as the means to promote RI beliefs. This has been repeated specifically in relation to fossil fuel companies where these are held because active investment managers believe they will help to meet the Fund's investment objectives, or they are in the passive indices that the Pension Fund tracks. The updated RI policy contains proposed amendments as follows, to explain why the Pension Fund believes this is important in relation to fossil fuel companies, which it is hoped will improve dialogue with scheme members:

    - If the Pension Fund's shares in fossil fuel companies are sold, it will lose its ability as a Responsible Investor to engage with those companies, to hold them to account and to influence and support them in their move towards a lower-carbon economy. The investors that would buy these shares from us may not do this.
    - The necessary transition to a lower carbon economy needs to be managed carefully to ensure that it is a Just Transition – this means that the benefits of a low carbon economy transition are shared widely, ensuring that the areas of society who lose economically from the transition are supported. Simply disinvesting from fossil fuels will not achieve this.
    - Some fossil fuel companies are playing an important role in the transition to a lower carbon economy, for example in developing and investing in renewable energy. These companies need support from investors as they develop these new carbon efficient alternative fuel sources.

14. The Pension Fund recognises the economy still relies on many carbon-intensive industries for example manufacturing, mining, chemicals, cement and transport. Many companies in these sectors still rely on fossil fuels. It is known too that many people in their day to day lives consume products that are derived from fossil fuels for example plastic containers, synthetic clothes, medicines, shampoo – the list goes on. In the short to medium term, there remains a reliance on fossil fuels to support our daily lives and the transition to a low carbon economy, such as producing the steel to build wind turbines. However, by investing in and engaging with these companies we can support and quicken their transition to lower carbon alternatives to enable the required transition to a lower carbon economy.

15. This also reflects the Government's policy to 'encourage stewardship rather than disinvestment'. Government continues to believe this [disinvestment] would be the wrong approach – engagement with high carbon companies, when done effectively, can reduce the climate risk to which the scheme is exposed. At the same time, stewarding these firms to set a plan for the transition can have a greater impact on climate change than simply selling assets to others who might not hold investee firms to account'.

<u>Thermal coal</u>

16. The Fund's analysis of fossil fuel investments with its investment managers also included a breakdown of the types of fossil fuel investments. This showed that the Fund had the following exposure to thermal coal.

Table 1 – Exposure to thermal coal 31 December 2021

	£m	%
Passive	0.9	0.01%
Active	0.8	0.01%
Total	1.7	0.02%

17. Although the exposure is very small, thermal coal is the greatest challenge for the Fund's RI policy and the proposed aim for net-zero by 2050 due to the very high carbon emissions and lack of possible transition to lower carbon alternatives. This is consistent with the agreements reached at the recent global COP26 summit. The Fund's draft RI policy therefore includes working with the Fund's investment managers to remove thermal coal from the Fund's portfolios.

RI Standards and initiatives

18. Following the revisions to the 2019 RI Policy the Pension Fund signed the UN Principles for Responsible Investments (PRI), the UK Stewardship Code, and subsequently adopted the recommendations of TCFD. These have been important in framing the Pension Fund's approach to implementing its RI policy and showing the standards that the Pension Fund and its investment managers expect to work at. At the time that these standards were agreed it was signposted that further standards could be appropriate and the following are now proposed as part of the updates to the RI policy:

    - Just Transition – was a joint project of the London School of Economics and Grantham Research Institute on Climate Change and the Environment. It produced evidence that showed the shift to a resilient, low carbon economy will boost prosperity and be a net driver of job creation. But there will be challenges for workers, communities and countries as this shift takes place. To address this, investor strategies to tackle the growing threat of climate change need to incorporate the full range of environmental, social and governance (ESG) dimensions of responsible investment. There is no cost to declaring support for the Just Transition initiative.
    - Institutional Investors Group on Climate Change (IIGCC) - is the leading European membership body enabling the investment community to drive significant and real progress by 2030 towards a net zero and resilient future. There are 360 members representing €50 trillion of assets under management (including six of Hampshire's investment managers and two other ACCESS authorities). There are three clear areas of focus: policy, investor practices and corporate engagement reflecting the key investor levers for change. There would be an annual fee (currently £8,620) for joining this group.

- Transition Pathway Initiative (TPI) – is a global initiative led by asset owners and supported by investors globally. It assesses companies' (currently 479) preparedness for transition to a low-carbon economy and would be an additional tool to supplement stewardship and monitoring of the Fund's investment managers. There would be no cost to support TPI.

Scheme member communication and consultation

19. Given it is 3 years since the Pension Fund consulted on its RI policy and that the policy forms part of the Investment Strategy Statement, which carries with it the statutory requirement 'to consult such persons as it [the authority] considers appropriate', it is recommended that the Pension Fund consults with its stakeholders on what they consider should be the Fund's priorities when considering RI. It is proposed that the consultation would run from 1 April to 31 May 2022 and the results will be reported to the Pension Fund Panel and Board on 28 July 2022 with a recommendation on finalising the RI policy at that point.

20. On the basis that the proposed amendments to the policy are approved for consultation by the Pension Fund Panel and Board, a draft annual RI update has been prepared for scheme members, which is attached in Annex 2. This will be the Fund's third published annual update for scheme members and will be published on the Fund's website, highlighting the consultation, and will also be published on the scheme member Portal coinciding with when pensioners' payslips will be available and included with the pensioners' payslips that are still printed.

Climate Change Impact Assessments

21. 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.

22. 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 environmental, social and governance (ESG) factors including the impact of climate change can materially reduce long-term returns.

23. 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. The key document for the Pension Fund in this respect is the Responsible Investment (RI) policy which is the subject of this paper.

REQUIRED CORPORATE AND LEGAL INFORMATION:

Links to the Strategic Plan

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

<u>Document</u>	<u>Location</u>
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