

# CLIMATE CHANGE STATEMENT 2020

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## SUMMARY

The Fund recognises the risks associated with climate change and the potential for these to impact on the long-term value of the Fund investments, but also the opportunity for investment reward, for example in green energy investments, particularly during the period of transition to a lower carbon economy. The Fund is very aware of the scientific evidence around climate change and takes this into account when making investment decisions across all asset classes.

As a long-term institutional investor, a key objective for the Fund is investing to deliver returns to pay pensions. The Fund must balance the risks to potential future returns with the opportunities to benefit as global energy demand continues to increase and more renewable energy sources and techniques emerge.

We note both the benefit that investment in companies whose activity includes the extraction of fossil fuels have brought to the portfolio in the past, through strong returns, and the risks these businesses face in the future with regard to climate change. We acknowledge that company level engagement continues to successfully drive behaviour, an outcome we do not believe divestment would bring to the same effect.

The Fund's approach to managing climate-related risks and opportunities involves both its asset allocation decisions and a robust approach to engagement and voting. The Fund has currently invested £2.5 billion (14.5% as at 31/08/2020) in sustainable equities and low carbon funds, with further investments into sustainable equities being made towards the year end in line with the Fund's *Climate Change Framework and Strategy* that it set out in 2019.

Climate change remains a key engagement theme for the Fund. Along with 'sustainable food systems' (identifying the role that a changing climate has in changing land use, habitat boundaries and food security), the two themes were approved by Pensions Committee in June 2020 as two of the Fund's four engagement themes running until 2023<sup>1</sup>. Collaboration with other institutional investors, monitoring investee companies, and lobbying climate policy-makers will continue as the sector continues to evolve.

## STRATEGY

The Fund has developed an investment strategy underpinned by the belief that effective management of financially material environmental, social and governance risks protect returns over the long term. The Fund takes a holistic and portfolio-wide approach to managing exposure to climate change risk, based on a set of overarching beliefs<sup>2</sup> documented and approved by Pensions Committee in March 2020.

Based on these beliefs, the Fund's four-year *Climate Change Framework and Strategy*<sup>3</sup> was agreed in March 2019. The current strategy has set medium term targets to reduce exposure to pure-play thermal coal producers and investing 15% of the Fund in low carbon and sustainable strategies by 2023. The Fund continues to reflect upon and review this strategy and its implementation on an ongoing basis to ensure it is appropriate to meet the Fund's longer-term strategic objectives.

<sup>1</sup><https://www.wmpfonline.com/CHttpHandler.ashx?id=17655&p=0>

<sup>2</sup><https://www.wmpfonline.com/CHttpHandler.ashx?id=16022&p=0>

<sup>3</sup><https://www.wmpfonline.com/CHttpHandler.ashx?id=17543&p=0>

## LOW CARBON AND SUSTAINABLE HOLDINGS

In October 2019 the Fund made a £1.6 billion allocation to of LGPS Central's All World Equity Climate Multi Factor Fund, which has reduced exposure to carbon intensive companies concurrent with increased exposure to green revenue streams. Rather than divesting from fossil fuel companies, the index includes those that are transitioning their business models, which aligns with the Fund's *Climate Change Strategy*.

Since January 2020 the Fund has re-allocated over £800 million of its global equity portfolio to a sustainable equity mandate, with a further £50 million scheduled to be re-allocated by the year end. The Fund is also investing in improving its property portfolio to be more energy efficient; through a programme of engagement and incentives, tenants are encouraged to embrace changes which improve their individual energy usage. The Fund has subscribed to the gold standard service level provided by its property manager targeting an 18% reduction of carbon emissions, which aids in working towards the objectives of Fund's climate change framework, supporting transition to a lower carbon economy.

These initiatives are likely to result in a further reduction in allocation to assets exposed to the risks associated with fossil fuel energy generation and these are made in conjunction with wider strategic climate risk monitoring and review across the portfolio. Investment decisions will continue to be taken to support long-term risk adjusted returns. The Fund does not seek to make allocations that will have a detrimental financial effect.

## INVESTMENT IN RENEWABLE ENERGY

The Fund has been increasing exposure to renewable energy opportunities over the last 15 years, including wind and solar infrastructure projects. Approximately £200 million has been invested through both direct investments and indirect investments in a portfolio of UK-based wind farms and other forms of renewable energy. The wind farms generate 550MW of power, which is about enough to power all the homes of the Fund's c.300,000 scheme members. The Fund has recently also made investments in battery storage and bio fuel opportunities through a sustainable infrastructure fund. The Fund continues to seek further investments in low carbon and sustainable initiatives where there are opportunities to meet the Fund's return requirements within its risk parameters.

## FUND'S INDUSTRY OUTREACH WORK AND POLICY INFLUENCE

The Fund believes that no individual investor is influential enough to act alone, nor is the investment Industry sufficient to achieve the required rate of change; policy makers, consumers, companies and investors all have a role to play, hence the Fund looks to work collaboratively with others to tackle climate change.

The Fund is a member of Institutional Investor Group on Climate Change's (IIGCC) which influences and builds support for institutional resolutions on climate change. Through its membership, the Fund receives regular briefings on developments in climate policy and takes the opportunity to pressure governments to implement the EU Paris Agreement goals<sup>4</sup>. The Fund has publicly signalled strong support for the Paris Agreement on climate change and, in collaboration with like-minded investors, has pushed for policy makers to increase the levels of ambition from the current Nationally Determined Contributions<sup>5</sup>. WMPF is signatory to the 2018 Global Investor Statement on Climate Change and will continue to actively support both national and global initiatives where these are aligned with the Fund's broader strategic objectives.

Significant engagement progress has been made through participation in the Climate Action 100+ initiative (CA100+)<sup>6</sup>, a collaboration of institutional investors jointly responsible for \$47 trillion of assets under management. The CA100+ initiative has three engagement objectives aimed at target companies: robust governance of climate change; business strategies in line with the Paris goals; and high quality disclosures on climate risks through the Task Force on Climate-Related Financial Disclosures (TCFD). The work of the CA100+ is supported by the Transition Pathway Initiative (TPI), of which the Fund was a founding partner, which appraises companies' preparedness for a low-carbon transition.

<sup>4</sup>[https://ec.europa.eu/clima/policies/international/negotiations/paris\\_en](https://ec.europa.eu/clima/policies/international/negotiations/paris_en)

<sup>5</sup><https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement/nationally-determined-contributions-ndcs>

<sup>6</sup><http://www.climateaction100.org/>

The Fund is an active member of the Local Authority Pension Fund Forum (LAPFF) an active campaigner on ESG (Environmental, Social and Governance) issues but in particular climate change. LAPFF issues progress reports on company engagement including climate change. In 2019 LAPFF engaged with c170 companies on climate changes issues in 2019. Through the LGPS Central investment pool of which the Fund is one of eight Partner Funds, voting and engagement provider EOS at Federated Hermes provides a stewardship service for the Fund. Last year Hermes EOS engaged with 141 companies on the matter of climate change.

In December 2019, together with nine other investors, LAPFF and LGPS Central co-filed a shareholder resolution at Barclays Plc asking the company to disclose targets to phase out the provision of finance to companies, starting with those in the energy and utility sectors, that are not aligned with the Paris climate change goals. The resolution aligns with LAPFF's, LGPS Central's and West Midlands Pension Fund's responsible investment beliefs on climate change as a material financial risk.

We are pleased to see a number of oil and gas companies continue to step up their response to climate change. In February 2020 both Rio Tinto and BP pledged to cut their greenhouse gas emissions to net zero by 2050. The target set by BP is one of the most ambitious yet within the oil and gas industry, and easily outstrips commitments made by competitors at this point and follows on from considerable investor pressure to set targets on climate change.

It is recognised that companies could be doing more to demonstrate their resilience to climate change and we continue to campaign for greater pace and disclosure, at both the demand and supply sides, to inform progress with a view to protecting long term value and investment returns to the Fund.

## COMMENDATION

As an asset owner, the Fund has been a signatory of the Principles for Responsible Investment (PRI) since 2011. This year the Fund took part in the first mandatory reporting and assessment cycle for all PRI signatories. Assessment ensures that signatories can understand, commit to, and demonstrate their alignment with a global industry-standard of responsible investment, and ultimately achieve higher investment returns whilst making a positive contribution to environmental and societal causes. The Fund was therefore delighted to learn that it has achieved an A+ or A for every module of the report. The Fund was one of the first 70 UK asset owners to report for assessment and, along with the Fund's pool company, LGPS Central Ltd, the Fund was one of only 6% of the UK's local government pension schemes to submit. The report's results, in conjunction with the Fund being within the first tranche for submission, demonstrates the Fund's global commitment to responsible investment.

The Fund was highly commended within the Climate-Related Risk Management category by the 'Investments and Pensions Europe' (IPE) at their annual awards in December 2019. The IPE denoted that the Fund was carrying out outstanding climate work within several pillars of activity: TCFD disclosure; climate related fund allocations; engagement; and manager selection. IPE further commented that climate change has been embedded within both the Fund's *Investment Strategy Statement* and *Responsible Investment Framework*. IPE also highlighted that the Fund had extended its underlying investment beliefs in 2018 to explicitly include those around climate change and how these should be addressed within the Fund leading to the launch of the four-year climate change strategy and framework in March 2019.

The Fund was praised by the House of Commons Select Committee Environmental Audit Committee in May 2018 for being "more engaged" in managing the risks of climate change and being a first mover in reporting in line with the recommendations of the Task Force on Climate-Related Financial Disclosure (TCFD).

## CONCLUSIONS

The Fund continues to believe that engagement is more likely to lead to decarbonisation than a divestment approach. There is no evidence that giving up the opportunity to influence investee companies is likely to lead to superior environmental outcomes. The Fund's approach to managing climate-related risks and opportunities involves both its asset allocation decisions and a robust approach to engagement and voting. Collaboration with other institutional investors, monitoring investee companies, and lobbying climate policy-makers will continue as the sector continues to evolve.

The Pensions Committee which includes representatives from the metropolitan district local authorities across the West Midlands are kept up to date with engagement and investment activity through reporting prepared for each quarterly meeting.