WIRRAL COUNCIL

PENSIONS COMMITTEE

16 NOVEMBER 2015

SUBJECT:	**RESPONSIBLE INVESTMENT & CLIMATE RISK**
WARD/S AFFECTED:	**NONE**
REPORT OF:	**STRATEGIC DIRECTOR TRANSFORMATION & RESOURCES**
KEY DECISION?	**NO**

1.0 EXECUTIVE SUMMARY

1.1 Climate change has significant investment implications, which Merseyside Pension Fund addresses through its responsible investment strategy.

1.2 Members are asked to reaffirm the commitment to responsible investment and to approve further investigation of alternative investment approaches to climate risk mitigation and adaptation.

2.0 BACKGROUND AND KEY ISSUES

2.1 At its meeting of 28th September 2015, Pensions Committee discussed concerns relating to the risks to the investments of Merseyside Pension Fund presented by climate change. In particular, such risks as they related to the Fund's fossil fuel-related investments. Members noted the Fund's activities in this area, carried out in accordance with its commitment to Responsible Investment, and requested a further update on the issues.

2.2 In December 2015 the latest round of UN climate change negotiations (COP21) will take place in Paris, which aims to make progress on reducing global carbon emissions to a level that is compatible with a scenario of restricting global warming to within two degrees of pre-industrial levels by 2100. The scientific consensus is that the world needs to halve emissions between 2010 and 2050 to achieve this goal; a global temperature increase above two degrees will greatly exacerbate the risk of climate disturbance and make adaptation costlier. Whatever the outcomes of COP21, there is a clear direction of travel in public policy and strong likelihood of further government actions to restrict the use of fossil fuels. Among the financial implications of this is likely to be a significant increase in the cost structure of carbon emissions.

2.3 Widely regarded studies have pointed to a risk to investors exposed to 'stranded assets', whereby interactions of external factors lead certain assets to suffer pre-mature or unanticipated valuation write-downs or conversion to liabilities. Companies in fossil fuel-intensive industries hold very sizeable oil, gas and coal reserves, of which 50-80% could not be commercialised by 2050 if the two degree target to restrict global warming is to be met. Financial markets, it is argued, are failing to adequately price this risk. The Governor of the Bank of England, Mark Carney, addressed the risk to financial stability in a recent speech, "A wholesale reassessment of prospects, especially if it were to occur suddenly [*carbon pricing*], could potentially destabilize markets, spark a pro-cyclical crystallization of losses and a persistent tightening of financial conditions. The speed at which such re-pricing occurs is uncertain and could be decisive for financial stability."

2.4 A number of groups have run increasingly prominent campaigns (predominantly focusing on university endowments and public pensions in the US, but attention now turning to European investors), calling on institutional investors to sell their shareholdings (divestment) in companies deemed to contribute significantly to global warming on account of their contribution to carbon emissions. Fossil Free UK has launched a divestment campaign targeted at the LGPS, calling on all Funds in the Scheme to commit to divesting from fossil fuel-related companies within five years. The campaign has created an online database that gives details of fossil fuel holdings of each Fund and has attracted national media interest. Fossil Free UK make the ethical and environmental arguments for divestment, alongside the financial one (the risk of substantial loss of capital value owing to exposure to stranded assets). However, alongside the challenges of implementation, there is a counter-argument that holds that divestment is a sub-optimal strategy to address climate risk for an institutional investor with a long time horizon.

2.5 As a responsible investor, the Fund seeks to integrate environmental considerations into its investment processes and ownership actions, in a manner that is consistent with its investment objectives and fiduciary obligations. This includes ongoing evaluation of the risks and opportunities arising from climate change and engagements with companies, regulators and policy-makers that seek to align strategies to climate change mitigation and adaptation scenarios. As an active member of LAPFF (see Appendices), the Fund has been engaging with companies in the oil & gas and mining industries to urge the identifying and tackling of carbon risks in their business models. The Fund was a co-filer of the strategic carbon resilience shareholder resolutions put to BP and Shell's 2015 AGMs. The Fund is a signatory to the Global Investor Statement on Climate Change (see Appendices), which has been signed by investors representing in excess of US $24 trillion in assets and "sets out the contribution that we as investors can make to increasing low carbon and climate resilient investments." The Fund pursues this strand of engagement through its membership of the IIGCC.

2.6 A divestment strategy would bring such engagement to an end and remove the Fund's ability to positively influence climate-resilient policies and business strategies. Divestment would bring its own, difficult to quantify, risks and costs. It would require the Fund to sell assets (although there is no definitive list of fossil fuel investments) in volatile market conditions; at a time when the exact nature and timing of regulatory change is uncertain and commodity prices are highly variable (particularly oil). Over the medium term, fossil fuels will continue to be widely used in the economy (and not just as part of the energy mix) and it would prove challenging to re-invest at scale the proceeds of divestment into low carbon alternatives.

2.7 The Fund is directly investing in the low carbon economy through its allocations to infrastructure, private equity and property. This includes investment in renewable energy, clean technology and sustainable buildings; with in excess of £200 million presently committed and set to increase as opportunities with a suitable risk/return profile continue to be evaluated by the Fund's internal team.

2.8 While full divestment of all fossil fuel-related investments within five years may be viewed as incompatible with the Fund's strategic objectives and fiduciary obligations, further climate risk strategies could be explored within the parameters of the current strategic asset allocation and manager mix. Members are asked to authorise Officers to further explore the following options (with particular regard to the costs and practicalities of implementation):

- Enhanced disclosure in line with the UN Montreal Pledge (portfolio carbon foot-printing)
- Explore options to de-carbonise passive equities
- Sign up to the Portfolio Decarbonisation Coalition; setting explicit reduction targets

By signing up to the Montreal Carbon Pledge, the Fund would commit to measure and publicly disclose the carbon footprint of its investments on an annual basis. This would initially apply to some or all of the Fund's equity portfolios, but could in time be extended to other asset classes such as private equity and infrastructure. The aim of the Pledge is to gather commitments on investments totalling US$ 3 trillion in time for COP21 in December 2015. On the basis that what is measured can be managed, the use of carbon foot-printing would enable the Fund to better quantify its climate risks and disclosure would improve communication with stake-holders of actions being taken to address climate change (as well as enhancing the Fund's capability to meet its reporting and transparency obligations as a PRI signatory). Improved reporting could also include making public more information about the Fund's low carbon investments in areas such as renewable energy and sustainable property.

Within the present strategic benchmark allocation to public equities, one quarter of this is managed in passive strategies (where the aim is to track the performance of the benchmark indices, achieving exposure to the broad market). The indices used by the Fund (FTSE All Share & FTSE North America) are comprised of stocks weighted in the index by their market capitalisation and feature significant concentrations of climate risk (such as oil & gas companies with large fossil fuel reserves). Arguably, this represents a large unrewarded risk of permanent loss of capital. There are now viable strategies for adapting passive equity portfolios to reduce their climate risk exposure (de-carbonisation) while maintaining the required broad market exposure. There is evidence to suggest that significant carbon footprint reduction can be achieved for a slight (but tolerable) increase in tracking error.

The Portfolio Decarbonisation Coalition (PDC) is an action-oriented investor initiative whose members have made an explicit commitment to both thorough carbon foot-printing and specific portfolio de-carbonisation targets. With current commitments representing US$60 billion of assets under management, the aim is to reach by the time of COP21 a target of US$100 billion committed to be de-carbonised. Asset owners in the UK already signed on include Environment Agency Pension Fund. The Fund may defer committing to an explicit carbon reduction target at the outset, pending analysis of a carbon foot-printing exercise.

3.0 RELEVANT RISKS

3.1 Climate change is a systemic risk to the ecological, societal and financial stability of every economy and country on the planet. Global business and policy leaders take climate change seriously and renewed policy actions will seek to restrict warming to the two degrees target by 2100. This will have significant investment implications that must be prudently addressed (Merseyside Pension Fund has liabilities that extend past 2100).

3.2 Campaign groups are raising public awareness of the investment risks of climate change. The Fund has a strong track record of activity to address this issue, but there is a reputational risk in not effectively communicating this to all stakeholders.

4.0 OTHER OPTIONS CONSIDERED

4.1 No other options have been considered.

5.0 CONSULTATION

5.1 There has been no consultation undertaken or proposed for this report. There are no implications for partner organisations arising from this report.

6.0 OUTSTANDING PREVIOUSLY APPROVED ACTIONS

6.1 There are no previously approved actions outstanding.

7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

7.1 There are none arising from this report.

8.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

8.1 There are none arising directly from this report. The initiatives set out will have a financial cost should they be implemented.

9.0 LEGAL IMPLICATIONS

9.1 There are none arising from this report.

10.0 EQUALITIES IMPLICATIONS

10.1 Has the potential impact of your proposal(s) been reviewed with regard to equality?

(b) No because there is no relevance to equality.

11.0 CARBON REDUCTION AND ENVIRONMENTAL IMPLICATIONS

11.1 There are no carbon usage implications in reference to Wirral Council's own carbon reduction plans.

12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

12.1 There are none arising from this report.

13.0 RECOMMENDATION/S

13.1 Members are asked to reaffirm the commitment to responsible investment and to approve further investigation of alternative investment approaches to climate risk mitigation and adaptation.

13.2 That a further report is brought to this Committee providing more information on the implications of alternative investment approaches to climate risk mitigation and adaptation.

14.0 REASON/S FOR RECOMMENDATION/S

14.1

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APPENDICES

Local Authority Pension Fund Forum (LAPFF), 'Pension Fund Investments in Fossil Fuels', 2015

Institutional Investors Group on Climate Change (IIGCC), 'Global Investor Statement on Climate Change', September 2014

BACKGROUND PAPERS/REFERENCE MATERIAL

None

BRIEFING NOTES HISTORY

Briefing Note	Date

SUBJECT HISTORY (last 3 years)

Council Meeting	Date
Pensions Committee	**28/09/2015**