

# **WIRRAL COUNCIL**

## **PENSIONS COMMITTEE**

**26 MARCH 2018**

<b>SUBJECT:</b>	<b>CLIMATE RISK MANAGEMENT</b>
<b>WARD/S AFFECTED:</b>	<b>ALL</b>
<b>REPORT OF:</b>	<b>DIRECTOR OF PENSIONS</b>
<b>KEY DECISION?</b>	<b>NO</b>

### **1. EXECUTIVE SUMMARY**

- 1.1 The purpose of this report is to update Members on the progress being made toward implementing the decarbonisation goals set as part of the climate risk management policy for Merseyside Pension Fund.

### **2.0 BACKGROUND AND KEY ISSUES**

- 2.1 In January 2018, Members approved a proposal to allocate one-third of MPF's passive equities portfolio to a low carbon strategy. This would meet the Fund's decarbonisation goal in respect of listed equities: to effect a measurable reduction of exposure to climate risk factors in the public equity portfolio and to better align this with the transition to a low carbon economy as defined by the Paris Agreement. The passive low carbon strategy should exhibit a lower carbon risk profile with a return profile in line with or better than the benchmark.

- 2.2 The first stage of a carbon footprint analysis of the Fund's listed equity investments has been undertaken and provides a partial quantification of the climate risk present in the portfolio. The first draft was presented to the Investment Monitoring Working Party on 8 March 2018. The initial findings from the analysis indicate:

- the portfolio has a carbon emissions intensity of 206.48 tonnes per million versus 204.31 tonnes per mn for the benchmark (carbon intensity measures tonnes of Scope 1 + 2 GHG emissions generated per year per US\$ million of revenues);
- overall the portfolio is 1.1% less carbon efficient than the benchmark; having a portfolio carbon emissions intensity that is 2.17 tonnes per million of revenues more than the benchmark;
- UK equities make the largest regional contribution to the footprint, owing to their weighting in the portfolio and the prominence of carbon intensive sectors (inc. Energy, Utilities and Basic Materials).

- Passive mandates contribute the most to the Fund's 'ownership share' of fossil fuel reserves (or financed future emissions).

The carbon footprint analysis will be used to help set decarbonisation goals and to measure the progress of their implementation. A measurement to be taken as at 31st March 2018 will determine the baseline for carbon reduction targets and form part of the Fund's annual public reporting.

- 2.3 In order to improve the Fund's carbon efficiency relative to the strategic benchmark, significant reductions in emissions and reserves metrics should be targeted in the decarbonised passive equities strategy, but subject to an appropriate risk management constraint. It will be necessary to increase the tolerance of tracking error sufficient to achieve carbon reduction goals, but restrained so as to avoid large relative under-performance of the benchmark indices.
- 2.4 Officers (in collaboration with the Fund's independent advisers) are carrying out an options review that encompasses these goals and is considerate of the most cost-effective means of implementing the strategy. It is likely that the Fund's decarbonisation goals will be met through setting portfolio-level objectives to underweight companies with fossil fuel reserves; to re-weight companies (under or over) according to their carbon emissions; and to over-weight companies demonstrating strong positive alignment to the transition to a low carbon economy. The task at hand is to determine an optimal combination of these objectives.

### **3.0 RELEVANT RISKS**

- 3.1 There is an increased risk of the Fund not achieving the returns targeted from the passive equities allocation. It is considered likely that this offset by the risk mitigation benefits likely to be realised over the long-term by reducing the investment strategy's exposure to climate risk.
- 3.2 Implementation of a low carbon strategy will almost certainly involve an increase in investment management costs.

### **4.0 OTHER OPTIONS CONSIDERED**

- 4.1 Not relevant for this report.

### **5.0 CONSULTATION**

- 5.1 Not relevant for this report.

### **6.0 OUTSTANDING PREVIOUSLY APPROVED ACTIONS**

- 6.1 Pensions Committee has previously approved the planning of a reduction in the climate risk exposure of the passive equities portfolio of MPF.

## **7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS**

7.1 There are no implications arising directly from this report.

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

8.1 There may be an increase in investment management costs for the Merseyside Pension Fund arising directly from this report.

## **9.0 LEGAL IMPLICATIONS**

9.1 There are no implications arising directly 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 The proposal will reduce the investment portfolio carbon foot-print of Merseyside Pension Fund.

## **12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS**

12.1 There are no planning or community safety implications arising from this report.

## **13.0 RECOMMENDATION/S**

13.1 That Members note the progress made toward implementing their decision to allocate one-third of MPF's passive equities to a low carbon index.

## **14.0 REASON/S FOR RECOMMENDATION/S**

14.1 The recommendation will progress the implementation of a decarbonisation plan that is in line with agreed policies on addressing climate risk with respect to the Merseyside Pension Fund.

**REPORT AUTHOR:** **Owen Thorne**

Portfolio Manager (Monitoring & Responsible Investment)

telephone (0151) 242 1301

email [owenthorne@wirral.gov.uk](mailto:owenthorne@wirral.gov.uk)

## **APPENDICES**

## **BACKGROUND PAPERS/REFERENCE MATERIAL**

MPF's Climate Risk Strategy Statement:

<https://mpfmembers.org.uk/content/climate-change>

### **SUBJECT HISTORY (last 3 years)**

	<b>Date</b>
Pensions Committee: Climate Risk Management	January 2018
Pensions Committee: Climate Risk Options	March 2016
Pensions Committee: Climate Risk	November 2015