Derbyshire Pension Fund

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2020 Consultation FAQs:

- **Investment Strategy Statement**
- **Responsible Investment Framework**
- **Climate Strategy**

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Investment Strategy Statement

What is the purpose of the Investment Strategy Statement? (ISS)

The Investment Strategy Statement sets out the long-term investment strategy for Derbyshire Pension Fund (the pension fund/fund) and describes the framework used by the fund when making decisions about whether to buy, hold or sell an investment. It includes descriptions of the type of assets that the fund invests in, including equities (e.g. shares); bonds (e.g. government and corporate debt); property; private equity and infrastructure assets.

What are the key proposed changes in the ISS?

A change in the fund's Strategic Asset Allocation Benchmark (SAAB) is proposed. The SAAB sets out the fund's target mix of investment assets. Following an improvement in the pension fund's funding level (the fund's investment assets compared to its pension liabilities), a 2% reduction in the allocation to equities is proposed, with a corresponding 2% increase in the allocation to infrastructure.

The fund is also proposing to consolidate its North America, Europe and Asia Pacific Ex-Japan regional equity allocations into its Global Sustainable Equities allocation.

What are Global Sustainable Equities?

The Global Sustainable Equities allocation targets investments in global companies that are sustainable in financial, environmental, social and governance terms and, where appropriate, that provide solutions to sustainability challenges (e.g. rising income & wealth inequality, climate change, famine & healthcare inequalities).

Why is the fund moving from regional equity allocations to a more global approach?

Many companies now trade on a global basis and the level of financial and economic integration has increased. A global approach allows the investment manager to select the best investment opportunities, regardless of which stock market companies are listed on.

Continued separate equity allocations to the UK, Japan and Emerging Markets are proposed to provide exposure to the 'home' market, to offer diversification and to ensure that the fund's total equity portfolio is more closely aligned with the global gross domestic product mix.

Why does the proposed ISS include both an Intermediate and Final SAAB?

The proposed changes between the current and final SAAB are significant and will result in some sizeable market transactions. It is, therefore, proposed that the changes are phased to allow the fund to manage the transition risks (e.g. market timing, liquidity risk, product availability).

The Intermediate SAAB represents the mid-point between the current SAAB and the Final SAAB. The Intermediate SAAB is expected to come into effect in the first quarter of 2021, with the Final SAAB expected to come into effect on 1 January 2022 at the latest.

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Responsible Investment Framework

What is the purpose of the Responsible Investment Framework (RI Framework)?

The Responsible Investment Framework sets out the fund's approach to responsible investment which includes the consideration of environmental, social and governance (ESG) factors alongside traditional financial factors when making investment decisions.

It also sets out the fund's approach to the stewardship of its investment assets including voting on shareholder resolutions and engaging with the companies it invests in (investee companies). Engagement is increasingly done in partnership with other investors which increases the effectiveness of discussions between investors and investee companies.

The RI Framework also demonstrates how the fund will report to its stakeholders on its responsible investment activities.

What do ESG factors include?

ESG factors include environmental issues such as climate change and pollution; social issues including working conditions, health and safety and employee relations; and governance issues such as executive pay, board diversity and bribery and corruption.

What is difference between responsible investment and ethical investment?

Responsible investment is an approach to investment that aims to incorporate environmental, social and governance (ESG) considerations into investment decisions, alongside traditional financial considerations to better manage risk and generate sustainable, long term investment returns.

Ethical investment is different to responsible investment as it is an approach to selecting investments based on beliefs about what is morally right and wrong. For a pension fund, it is appropriate to take a responsible investment approach to investment rather than basing investment decisions on subjective moral judgements.

Responsible investment involves the consideration of ESG matters which are likely to affect the sustainability of companies' business activities. It is compatible with the fund's trustee-like responsibility to scheme members, scheme employers and local taxpayers.

Why does the fund favour engagement over divestment?

The fund adopts a strategy of engagement with companies to influence behaviour and enhance value, rather than adopting a strategy of divesting from (selling) certain sectors/industries. Engagement allows the Fund to use its influence as an active investor, with other like-minded investors, to improve ESG practices in investee companies, influence that would be lost through a divestment approach.

Collaboration between like-minded investors has increased significantly over recent years with a particular focus on influencing companies which are adapting their business models to take into account climate change. The fund recognises that change takes time, and as a long-term investor the pension fund takes a long-term approach to its stewardship activities.

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Climate Strategy

Why has the fund developed a Climate Strategy?

Climate change, and the response of policymakers, regulators and companies to climate change, has the potential to materially impact the investment assets and the pension liabilities of the fund. While the external focus has often been on specific sectors/industries, climate change has the potential to affect the whole of the fund's investment portfolio.

The Climate Strategy has been developed to clearly set out for stakeholders the fund's approach to addressing the risks and opportunities related to climate change and to set out clear climate-related targets. The Climate Strategy includes support for the ambitions of the Paris Agreement and the aim to achieve a portfolio of assets with net carbon emissions by 2050.

What is the Paris Agreement?

The Paris Agreement is a global agreement to substantially reduce global greenhouse gas emissions. The aim of this agreement is to limit the increase in the global temperature to well below 2^0C above pre-industrial levels, and to pursue efforts to limit this increase to 1.5^0C. It has been ratified by 189 parties (individual countries and also the European Union).

What are Scope 1, Scope 2 and Scope 3 greenhouse gas emissions?

Greenhouse gases include carbon dioxide, methane and nitrous oxide.

Scope 1 emissions are direct emissions by a company from its owned and controlled resources.

Scope 2 emissions are indirect emissions from the generation of purchased energy (energy purchased by a company from a utility provider).

Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions. In other words, emissions that are linked to the company's operations. Scope 3 emissions can have a material impact on a company's overall level of emissions, but the assessment and reporting of Scope 3 emissions remains an area of development for many companies.

As an illustrative example, Amazon assessed and published its Scope 3 emissions as part of its measurement of the company's 2019 worldwide carbon footprint. Scope 3 emissions accounted for 78% of the company's total emissions. This demonstrates the importance of considering the potential impact of climate change on the whole investment portfolio.

Why can't the fund commit to a faster reduction in the carbon emissions of its investment portfolio?

The target of achieving a portfolio of assets that has net zero emissions by 2050 is considered to be aligned with the aims of the Paris Agreement. Investors, such as pension funds, have an important role to play in the transition to a low carbon economy but they rely heavily on the actions of

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governments, policymakers, consumers and companies. Investors also rely heavily on the quality of climate-related company disclosures and the current tools and techniques for assessing climate-related risks, when making investment decisions, both of which are evolving disciplines.

As the actions of all parties develop and the quality of disclosures and assessment tools evolve, it remains essential for the fund to invest in a diversified portfolio of assets. The targets for carbon footprint reduction and investment in low carbon and sustainable investments by 2025 are achievable. They have been based on a detailed review of:

- the fund's existing investment assets
- the fund's investment beliefs and objectives
- proposed changes to the SAAB included in the revised ISS
- products currently available in the marketplace

The fund expects to see a material increase in both targets in the five year period to 2030, and in each subsequent five year period, on the journey to net zero emissions by 2050, taking into account the contemporary development of carbon-related metrics and the availability of suitable products across all asset classes.

Why does the fund still invest in fossil fuel companies?

The fund adopts a strategy of engagement rather than divestment from certain sectors/industries in order to influence behaviour and enhance value. While fossil fuels are expected to continue to account for a large part of total power generation in the coming decades, fossil fuel companies have a key role to play in the transition to a greener-economy and are investing significantly in renewable energy solutions.

Collaborative engagement with these companies has gained traction in recent years and several of the world's leading publicly owned international oil companies have committed to being carbon neutral by 2050. Environmental analysts are currently working through the details of these recent announcements.

As the transition to a low carbon economy progresses and business models are reshaped, the fund's active investment managers will continue to assess the sustainability of fossil fuel companies' earnings as part of the investment process.

How will the fund report to stakeholders on progress towards the achievement of its climate-related targets?

In order to report to stakeholders on the fund's progress towards the achievement of its climate-related targets, the fund will:

- prepare a report in line with the recommendations of the Taskforce on Climate-related Financial Disclosures every two years
- report on the progression against the fund's carbon footprint and low carbon & sustainable investment targets every two years
- report on a suite of carbon metrics in the fund's annual report
- disclose the stewardship reports of the fund's key investment managers on a quarterly basis
- report on progress against the fund's Responsible Investment Stewardship Plan engagement goals every two years.

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