Derbyshire Pension Fund

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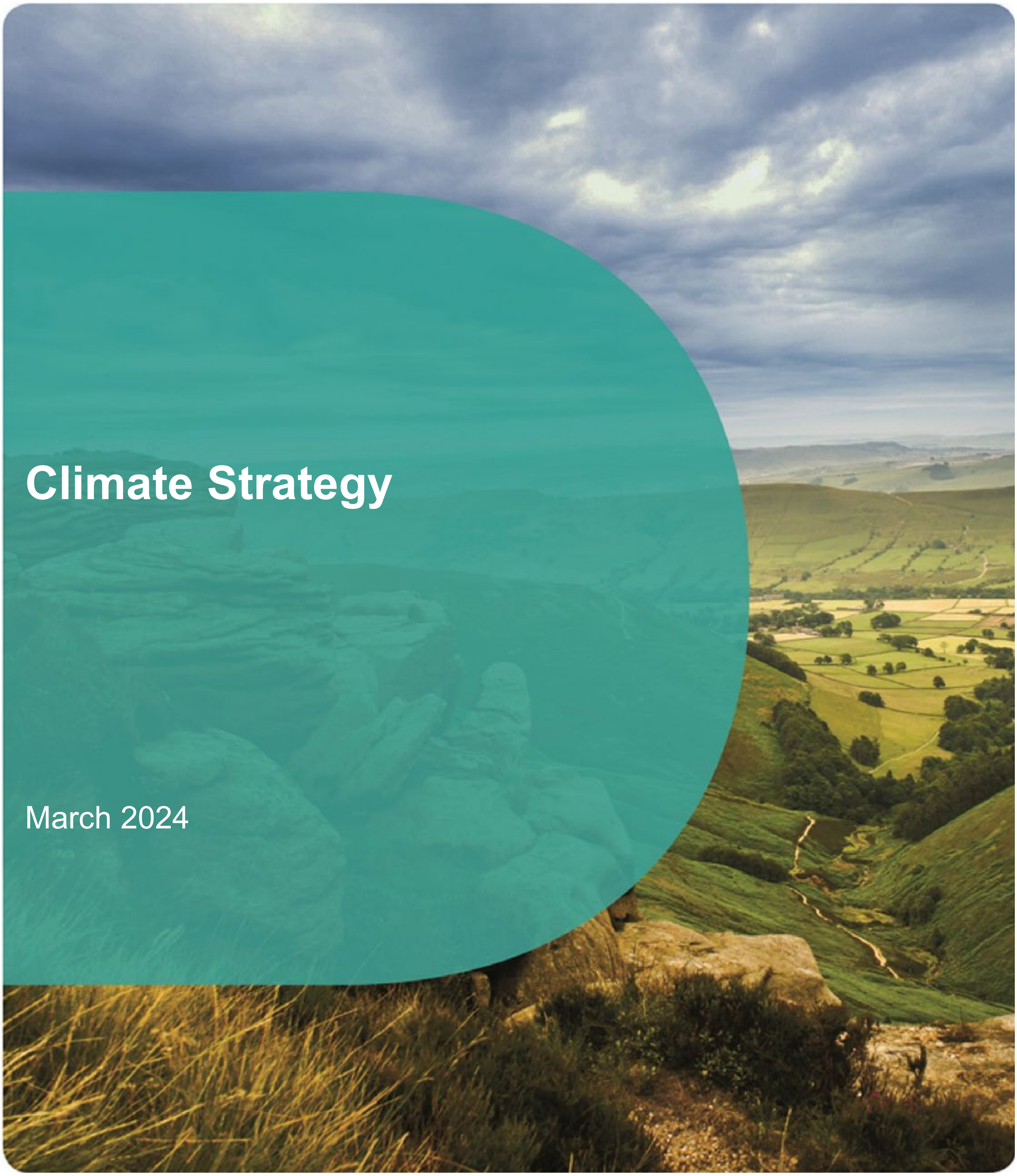

Climate Strategy

March 2024

Local Government Pension Scheme

Contents

1. Introduction

This Climate Strategy sets out Derbyshire Pension Fund's (the Fund) approach to addressing the risks and opportunities related to climate change.

The Fund supports the ambitions of the Paris Agreement[1] and aims to achieve a portfolio of assets with net zero carbon emissions by 2050.

The Pensions and Investments Committee (the Committee) is responsible for reviewing and approving the Fund's policies and strategies, including the Climate Strategy. The Climate Strategy works in tandem with the Fund's Responsible Investment Framework, Investment Strategy Statement and Funding Strategy Statement.

The development of a separate Climate Strategy reflects the potential material effect of climate change, and the response to climate change, on the assets and liabilities of the Fund.

The Committee will review the Climate Strategy at least every three years, or at such time as the Committee determines it is appropriate to review the Fund's approach to addressing the risks and opportunities related to climate change.

Responsibility for the identification and management of climate-related risks, together with the implementation of the Fund's Climate Strategy, resides with the Head of Pension Fund and the Investments Manager.

2. Climate Change

The Intergovernmental Panel of Climate Change notes in its sixth annual assessment report (AR6 Synthesis Report: Climate Change 2023) that human activities have unequivocally caused global warming, principally through emissions of greenhouse gases, with global surface temperature reaching 1.1°C above 1850-1900 in 2011-2020. Greenhouse gas (GHG) emissions are trapped in the atmosphere and create a 'greenhouse effect' – a warming that occurs when the atmosphere blocks heat radiating from Earth towards space. Climate scientists have observed that these climatic changes are primarily the result of human activities related to electricity and heat production, agriculture and land use change, industry and transport. Climate change is causing more frequent and more extreme weather events which is leading to widespread adverse impacts.

World governments have started to respond, with the signatories to the 2015 Paris Agreement committed to keeping the global temperature rise this century to well below 2.0°C compared with pre-industrial levels and to aiming to limit the increase to 1.5 °C (Article 2(1)a). The Paris Agreement committed signatories to the establishment of Nationally Determined Contributions (NDCs), which set out a country's climate action plan for cutting emissions and adapting to climate impacts and which must be updated every five years. The NDCs are intended to be individually equitable and collectively sufficient to achieve Article 2 (1) a.

The latest UN Emissions Gap Report estimates that policies currently in place with no additional action are projected to result in global warming of 2.8 °C over the twenty-first century. Implementation of unconditional and conditional NDC scenarios are estimated to reduce this to 2.6 °C and 2.4 °C respectively. The low-carbon transition is already underway, with a number of governments and institutions around the world intensifying their climate change policies, and corporates responding in turn.

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[1] Paris Agreement – To hold the increase in the global temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels – ratified by 189 parties.

Investors are exposed globally to the risks and opportunities presented by climate change adaption and mitigation. Investors have an important role to play in the transition to a low carbon economy, influencing company behaviours and encouraging the development of better climate-related disclosures. However, investors cannot effect material change alone. Governments, policy makers, consumers, companies and investors all have a role to play in the transition to a low carbon economy.

If policy and corporate action does not progressively transition towards the net zero goal, it will be extremely challenging for investors to achieve a portfolio of assets that has net zero emissions in 2050.

The Fund recognises that:

- Human activities have caused a change in the earth's climate which presents material risks to human and eco-systems and to global economies
- A global coordinated policy response and a change in consumer behaviour will be required to limit the damaging rise in global temperatures
- Climate change is a long term financial material risk for the Fund, across all asset classes, and has the potential to impact the funding level of the Fund through impacts on employer covenant, asset pricing, and longer-term inflation, interest rates and life expectancy

The Fund believes that:

- The risks and opportunities of climate change should be considered as part of asset allocation decisions, manager selection decisions and individual investment decisions
- Diversification across asset classes, regions and sectors is an important risk management tool to reduce climate-related risks
- In order to fully integrate climate-related risk into the Fund's investment processes, the consistency, comparability and quality of climate-related data, including the identification and measurement of companies' Scope 3 emissions will need to improve
- The low-carbon transition is already underway, but the pathway is unclear, and the transition will not occur by focusing only on the suppliers of energy; the demand for energy must also be addressed
- It is possible for a company to shift its business model in order to thrive in the transition to a low carbon future; such a shift is more likely with the support and stewardship of responsible investors

3. Climate-related Objectives

The Fund aims to have access to the best possible information available on the risk and opportunities presented by climate change. This includes impacts to the Fund's investment strategy, or funding strategy, as a result of transition risks, physical risks and opportunities.

The Fund aims to ensure that its investment portfolio will be as resilient as possible to climate-related risks over the short, medium and long term. For an effective first line of defence, the Fund aims to integrate climate-related factors into the investment process, including the selection of investment managers.

The Fund intends to decarbonise its portfolio through its selection of investments and investment managers, with the aim of being carbon neutral by 2050.

4. Collaboration and Transparency

The Fund aims to collaborate with like-minded organisations to support the ambitions of climate-related initiatives and aims to be fully transparent with its stakeholders through regular public disclosure, aligned with best practice.

- The Fund supports the Paris Agreement on Climate Change
- The Fund will actively participate in selected initiatives that lend support to the Fund's Climate Strategy, including working with other like-minded investors to engage with high-emitting companies
- The Fund supports the Taskforce on Climate-related Financial Disclosures (TCFD) and adopts its recommendations for the Fund's climate disclosures
- The Fund is a member of Institutional Investors Group on Climate Change (IIGCC)
- The Fund is a signatory to the Financial Reporting Council's UK Stewardship Code 2020

5. Strategic Actions

5.1 Measurement & Observation

The Fund recognises that the tools and techniques for assessing climate-related risks in investment portfolios are an imperfect but evolving discipline. The Fund aims to use the best available information to assess climate-related threats to investment performance.

The Fund will make regular measurements and observations on climate-related risks and opportunities relevant to the Fund. This will include:

- Identification of the most material climate-related risks to the Fund
- Economic assessment of the Fund's asset allocation against plausible climate-related scenarios
- A suite of carbon metrics for the Fund's listed equity and investment grade bond assets (with a coverage target of at least **90%**) to allow the Fund to assess progress in responding to climate-related risks and opportunities, including: weighted average carbon intensity; absolute financed emissions, weight in companies with fossil fuel reserves; weight in companies with thermal coal reserves; and weight in companies with clean technology
- In respect of the Fund's other assets (Other Assets), including private equity, infrastructure, multi-asset credit, property, sovereign bonds and cash, the availability of consistent and reliable carbon-related data is currently limited. The Fund will aim to assess/estimate the carbon footprint (weighted average carbon intensity and/or absolute financed emissions) of **70%** (Scope 1 and 2) of the Fund's other assets, excluding sovereign bonds, by assets under management (AUM) by the end of 2030
- Assessment of progress against the Fund's carbon footprint (weighted average carbon intensity and absolute financed emissions) and low carbon & sustainable investment targets

Methodologies for assessing the impact of future climate-related scenarios, including the possibility of measuring against alignment with the Paris Agreement, remain at an early stage of development, and the Fund will support efforts to develop more reliable and comparable methodologies.

The Fund recognises that there is currently significant variability in the relevance, consistency, comparability and quality of companies' climate-related disclosures. The Fund supports adoption, and encourages disclosure, in line with the recommendations of the TCFD.

5.2 Asset Allocation & Targets

Where there is a credible evidence base, the Fund will integrate climate-related factors into asset class reviews, subject to the requirements of the Investment Strategy Statement and Funding Strategy Statement.

The Fund believes that portfolio-wide 'top down' targets are an important means to set direction and appropriate ambition for an investment strategy towards net zero, and to monitor whether that strategy is achieving expected outcomes. However, a focus on just a single top down portfolio emissions reduction target can incentivise a shift of assets within a portfolio from high to already lower carbon assets and sectors, rather than driving additional 'real world' emissions reductions from increasing investments in climate solutions that contribute to the achievement of the net zero goal. As a result, the Fund set two initial carbon reduction targets in November 2020. Progress against the initial carbon reduction targets at 31 March 2023 is as follows:

Target	Target by end of 2025	Actual on 31 March 2023
1. Reduce the carbon footprint (Scope 1 & 2) of the Fund's listed equity portfolio by at least 30% relative to the weighted benchmark in 2020 by the end of 2025	(30%)	(47%)
2. Invest at least 30% of the Fund portfolio in low carbon & sustainable investments by the end of 2025	30%	Invested: 29% Committed: 30%

Given the progress made by the Fund against the initial carbon reduction targets, and the Fund's overall aim of achieving a portfolio of assets which has net zero emissions by 2050, the Fund will now aim to:

Listed Equities and Investment Grade Bonds

- Reduce the weighted average carbon footprint (Scope 1 & 2) of the Fund's listed equity and investment grade bond portfolios by at least **60%** relative to the weighted benchmark in 2020[2] by the end of 2030; and
- Reduce the absolute financed emissions (Scope 1 & 2) of the Fund's listed equity and investment grade bond portfolios by at least **60%** relative to the weighted benchmark in 2020 by end of 2030.

The Fund will review the weighted average carbon footprint, financed emissions and low carbon & sustainable investment targets on, at least, a three-year basis. The Fund expects the targets to increase at each review, with an increase broadly in line with the Intergovernmental Panel on Climate Change's (IPCC) Mid-point Net Zero Emissions Pathway Forecast. By setting targets, the Fund will set a pathway to track the decarbonisation of the Fund's investment assets towards net zero.

Other Assets

The Fund will aim to assess/estimate the carbon footprint (weighted average carbon intensity and/or absolute financed emissions) (Scope 1 & 2) of at least **70%** of the Fund's other assets, excluding sovereign bonds and cash, by AUM by the end of 2030. The aim is to build-up the scope, accuracy and comparability of the Fund's other assets' carbon metrics, allowing the Fund to meaningfully engage and monitor investment managers, and track progression towards net zero by 2050.

Low Carbon and Sustainable Investments

[2] For products launched after 2020, the Fund's 2020 weighted benchmark for those products will be based on the first available carbon metrics for that product

The Fund will aim to invest at least **45%** of the Fund's total investment portfolio in low carbon & sustainable investments by the end of 2030.

Scope 3 Financed Emissions
The availability of reported Scope 3 financed emissions (indirect emissions other than from indirect emissions from the generation of purchased energy) is limited and is highly reliant on estimates using a variety of estimation methodologies. This makes it difficult to capture a true picture of the Scope 3 financed emissions of investee companies. However, as Scope 3 financed emissions can be an indicator of the potential risks to an investee company, the Fund will track the reported Scope 3 financed emissions of the Fund's combined top 10 listed equity and investment grade bond portfolio companies by Scope 3 financed emissions as part of the Fund's TCFD report.

5.3 Manager Selection and Monitoring

The Fund will assess material climate-related risk and opportunities, alongside other relevant investment factors, as part of the investment manager selection process.

As a largely externally managed pension fund, the identification and assessment of climate-related risks is also the responsibility of individual investment managers appointed by the Fund. Existing investment managers are monitored on a regular basis to review the integration of climate-related risks into the portfolio management, and to understand their engagement activities.

5.4 Engagement & Stewardship

The Fund will engage with investee companies and investment managers to manage climate change related risks and opportunities within the Fund's investment portfolio, focusing on those risks and opportunities which will have the greatest impact.

The Fund will aim to:

- Listed Assets Engagement Target: engage with investee companies covering at least **90%** of financed emissions in material sectors[3] by the end of 2030. Investee company engagement classified as either net zero aligned or aligning (Transition Pathway Initiative Rating and/or other recognised measure used by the Fund's climate metric data provider) or subject to direct or indirect engagement
- Listed Asset Coverage Targets: at least **50%** of financed emissions in material sectors classified as either net zero aligned or aligning (Transition Pathway Initiative Rating and/or other recognised measure used by the Fund's climate metric data provider) by the end of 2030
- Other Assets Engagement Target: engage with at least **70%** of the Fund's other assets investment managers, excluding sovereign bonds and cash, either directly or indirectly, on carbon metrics and net zero by 2050 targets by the end of 2030

The Fund will collaborate with other like-minded investors where possible and the Fund will participate in selected collaborative initiatives where these support the Fund's climate-related objectives.

The Fund will make full use of its voting rights and will co-file or support climate-related shareholder resolutions where these support the Fund's climate-related objectives.

[3] Material sectors comprise: Agriculture, Forestry & Fishing; Mining & Quarrying; Manufacturing; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage, Waste Management and Remediation Activities; Construction; Wholesale and Retail Trade; Repair of Motor Vehicles & Motorcycles; and Transportation and Storage

6. Derbyshire Pension Fund Corporate Emissions

The Fund is administered by Derbyshire County Council (the County Council). The County Council's approach to managing its journey to net zero is set out in the County Council's Climate Change Strategy: Achieving Net Zero. The Climate Change Strategy sets out the County Council's ambition to be a net zero organisation by 2032 or sooner.

7. Transparency & Disclosure

The Fund will:

- prepare an annual TCFD Report
- report on the progression against the Fund's carbon footprint and low carbon & sustainable investment targets on an annual basis
- 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