

REPORT OF SERVICE DIRECTOR – FINANCE, INFRASTRUCTURE & IMPROVEMENT**FINANCIAL RISKS OF CLIMATE CHANGE****Purpose of the Report**

1. To inform members of the Pension Fund's developing approach to assessing and responding to the financial risks of climate change.

Information

2. Members of the Pension Fund Committee will be aware of the current high profile of climate change issues. Members will also be aware that this is not a new risk, nor is it the only risk affecting the Pension Fund.
3. The issue for the Pension Fund is not about climate change itself. Members will be aware that the transfer of ownership of equity shares will not affect an investee company in any way, except if they are transferred to a less engaged owner who may put less pressure on companies to ensure sufficient plans are made for a sustainable future could reduce actions taken to increase sustainability. Moreover although social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments, the Pension Fund is not permitted to consider non-financial factors unless it can be demonstrated they are not significantly detrimental to the investment return and the Committee is satisfied that members share their concerns.
4. The issue is about the financial risk to the Pension Fund arising from climate change. Like all financially material risk factors, this is a very valid concern. Fossil fuel companies are exposed to changes in the price of oil. Oil is a valuable commodity and can be used to produce many synthetic products and there is likely to be a long term demand. However demand for oil as a fuel, its main use, is likely to reduce over the long term as travel and energy generation become more efficient and increasingly powered from renewable sources. It seems increasingly likely that some identified oil reserves may never be extracted, becoming valueless (known as stranded reserves).
5. Oil and gas companies make up a significant share of global market capitalisation. Through its investment in passive funds the Pension Fund has automatic exposure to this sector in addition to any positions held in our active equity mandates. The Pension Fund's investments in passive funds align with the Pension Fund's Investment Beliefs, particularly in relation to

the use of diversification (i.e. across all sectors) as a key technique for reducing risk, and in relation to minimising investment management fees. It should be noted that the Oil & Gas Industry sector also includes renewable energy equipment and alternative fuels. Oil and Gas Industry weights in our main passive funds as at 31 December 2019 were as follows:

FTSE All-Share Index	11.8%
FTSE North America Index	5.0%
FTSE Developed Europe Ex UK Index	4.5%
FTSE Japan Index	0.8%
FTSE Developed Asia Pacific Ex Japan index	3.2%

These figures are reported to us by Legal and General Investment Management on a quarterly basis.

6. It is important that the Pension Fund understands the financial risks of its exposure to fossil fuels, potentially stranded reserves and climate change which will impact on many industry sectors, especially transport, energy generation, high energy industries, farming, tourism and businesses in parts of the world directly affected by changes in weather or sea level rises. It should be noted that the financial risks of climate change are not confined to the Oil and Gas sector alone.
7. Consequently LGPS Central has been commissioned to produce some climate risk analysis to enable the Pension Fund to identify its exposure, understand its financial risk and to formulate and publish a Climate Strategy.
8. Members need to be aware of the challenge in obtaining reliable data for these calculations and the complexity of modelling these issues. Data is improving, partly due to pressure from engaged shareholders such as ourselves, but the sensitivity to assumptions needs to be appreciated in interpreting the results of this work.
9. The provisional timeline for this piece of work is as follows:-

Immediately	Provision of data to LGPS Central as at 31 March 2019. This date was selected as it represents a starting point just after we set our current strategic asset allocation. This will provide a baseline against which progress can be measured.
April	Data will be processed by LGPS Central's service providers.
June	Working party with Members attended by LGPS Central to understand the process and discuss the results
July	Report to Pension Fund Committee
Further work	Formulation of a climate risk strategy

A refresh of data as at 31 March 2020 to enable early progress to be evaluated

Exact timing will be dependent on resources both within the Pension Fund and LGPS Central.

10. While this work is ongoing the Pension Fund will continue to implement its long term Strategic Asset allocation. This includes an increasing allocation to infrastructure investments, a significant proportion of which are in clean energy, and a gradual reduction in equity investments. Within our equity investments we are looking at a number of low carbon and sustainable funds. Over time our exposure to fossil fuels will reduce as a result of these asset allocation and diversification decisions.
11. The Pension Fund will continue to monitor and manage all financially material risks to which it is exposed.

Other Options Considered

12. There are other providers of similar services, but using LGPS Central provides economies of scale, additional support and is consistent with the principle of pooling.

Reason/s for Recommendation/s

13. Members and officers need to better understand the climate related financial risks in the Pension Fund investments.

Statutory and Policy Implications

14. This report has been compiled after consideration of implications in respect of crime and disorder, data protection and information governance finance, human resources, human rights, the NHS Constitution (public health services), the public sector equality duty, safeguarding of children and adults at risk, service users, smarter working, sustainability and the environment and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

Financial Implications

15. The cost for LGPS Central to undertake climate risk analysis is covered in the LGPS Central annual budget to which the Pension Fund contributes through the pool's cost-sharing model.

RECOMMENDATION/S

That Pension Fund Committee members consider whether there are any actions they require in relation to the issues contained within the report.

Nigel Stevenson

Service Director for Finance, Infrastructure & Improvement and Section 151 Officer

For any enquiries about this report please contact: Tamsin Rabbitts

Constitutional Comments (KK 04/02/2020)

16. The proposal in this report is within the remit of the Nottinghamshire Pension Fund Committee.

Financial Comments (TMR 31/01/2020)

17. The financial implications are set out in paragraph 15.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

- None

Electoral Division(s) and Member(s) Affected

- All