

Email: 28 May 2020

Dear Ms Owen and Ms Hopkinson

Thank you for your email of 24 May 2020 regarding Derbyshire Pension Fund's investments in companies with exposure to fossil fuels.

The Pensions and Investments Committee recognises that material climate change risks and opportunities could be experienced across the whole of the Fund's investment portfolio and that climate change is also likely to impact the Fund's liabilities. The Committee must consider these risks alongside all the other risks to which the Fund is exposed, including: demographic risks, regulatory risks, governance risks, administration risks, and financial risks.

The current coronavirus pandemic has added further risks for Committee to consider, including the risk of lower longer term trend growth and the associated risk of lower longer term equity returns together with increased uncertainty about the future path of inflation. All of these risks need to be taken into consideration in the course of ensuring that sufficient assets are available to meet benefit payments for our members.

As your email notes, the Fund recently commissioned a Climate Risk Report; this report assessed the financially material climate-related risks within the Pension Fund's investment portfolio, highlighted climate-related opportunities and provided an evidence base to support the development of a Climate Strategy and a Climate Stewardship Plan for the Pension Fund.

It was necessary for the Climate Risk Report to consider a range of climate scenarios, including the scenario of extreme global warming, recognising that the Fund cannot predict with any degree of certainty which scenario will ensue. The analysis demonstrated that the asset allocation required to capture returns under one scenario may have a negative impact under an alternative scenario. For example, annual returns under a 2°C scenario benefit from higher allocations to sustainable equities and sustainable infrastructure, whereas these allocations are likely to have a negative impact under a 4°C scenario because the assets would be subject to increased physical risk.

The Fund's current investments in the oil and gas sector amount to approximately £125m, with a further £74m invested in the mining sector which has some exposure to fossil fuels; together these sectors account for around 4% of the Fund's investment portfolio. This exposure has been reduced from a weighting of almost 8% in April in 2015, largely due to a reduction in the allocation to the UK equity market which has a heavy weighting in fossil fuel companies.

Given its contribution to global greenhouse gas emissions, the energy sector is expected to play a significant role in the long-term decarbonisation of the global economy, albeit fossil fuels are expected to continue to provide a large proportion of the global energy mix for many years to come. However, the potential climate-related

issues faced by diversified investors, such as Derbyshire Pension Fund, are not limited to the oil and gas and power generation sectors. Investors focussing exclusively on primary energy suppliers are likely to fail to identify material climate risks in other sectors.

There is considerable uncertainty in the crystallisation pathway for climate risk and considerable difficulties in estimating the exact timing and severity of the physical effects of climate change. The suite of carbon risk metrics and climate scenario analysis contained in the Fund's Climate Risk Report enable the Pension Fund to consider climate risks in relation to the whole portfolio.

Stewardship activities will remain a fundamental aspect of the Fund's approach to managing climate risk. Large asset owners have an important role in influencing the organisations in which they invest to provide better climate-related financial disclosures.

In March this year, the Fund published its Climate-Related Disclosures report using the framework recommended by the Task Force on Climate-Related Financial Disclosures to describe and communicate the steps that the Fund is taking to manage climate-related risks and incorporate climate risk management into investment processes.

It is anticipated that the Climate Strategy and the Climate Stewardship Plan highlighted in the climate-related disclosures, will be considered by Committee in September; the Fund's stakeholders will be consulted on the Climate Strategy prior to its approval by Committee, as they are consulted on any material change to the Fund's Investment Strategy Statement (ISS).

With respect to the 3% allocation to global sustainable equities in the Fund's Strategic Asset Allocation Benchmark, it is good practice when investing in a new asset class, to start off with a relatively small allocation and build it up as the Investment Team's knowledge and experience of the asset class grows. This allocation will be reviewed during the next review of the ISS. It is also worth noting, that the Fund currently has around £100m invested in renewable energy companies with a further two such potential investments, which would account for a further £50m, subject to ongoing due diligence.

In order to improve the Fund's engagement with its members, the Fund plans to set up a Members' Forum as part of the implementation of a member self service portal; the implementation of this portal is due to begin in October. Members will need to provide the Fund with their email addresses in order to sign up to the self service portal which will enable the Fund to communicate directly with a wide cross-section of the Fund's membership.

The Climate Risk Report was procured to provide a solid evidence base to support the development of a Climate Strategy for the Pension Fund. The Fund subsequently developed its climate-related disclosures in order to transparently report the steps being taken by the Fund to manage climate-related risk. Derbyshire Pension Fund is one of only a handful of LGPS funds to have published such disclosures, and remains committed to developing them further in order to keep all stakeholders up to

date with the Fund's progress on addressing the risks and opportunities related to climate change.

I think this answers all of the concerns you have raised in your email.

Regards

**Councillor Jim Perkins**

**County Councillor for the Chapel and Hope Valley Division**

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