

NORTH YORKSHIRE COUNCIL

PENSION BOARD

6 APRIL 2023

RESPONSIBLE INVESTMENT POLICIES

Report of the Treasurer

1.0 PURPOSE OF REPORT

- 1.1 To present the Responsible Investment Policy and Climate Change Statement of the Fund and the policies of Border to Coast and ask members of the Pension Board for their comments.

2.0 BACKGROUND

- 2.1 North Yorkshire Pension Fund's (the Fund) Responsible Investment Policy describes how environmental, social and governance (ESG) issues are taken into account in the investment strategy and in relation to investment decisions. The Policy is updated each year to take account of changing circumstances and best practice.
- 2.2 The Fund has published a Climate Change Statement which provides additional information intended to clarify the approach to climate change risk. This is only one of many ESG issues but given its increasing importance and profile it was considered appropriate to do this.
- 2.3 The responsibility for stewardship, which includes shareholder voting, rests with the Fund. Some stewardship activity has been delegated to its investment managers for assets under their management, with appropriate monitoring and challenge to ensure that this continues to reflect the Fund's requirements.
- 2.4 The Fund's investment managers have their own suite of responsible investment policies, which are broadly in line with those of the Fund.
- 2.5 North Yorkshire was involved in the creation of Border to Coast's responsible investment policies in 2018 and has contributed to the annual review process since then. This process is aimed at making sure the documents are in line with best practice in a rapidly changing area. The Fund's involvement has also helped to ensure that Border to Coast's policies remain very much in line with its own.
- 2.6 As a consequence of the regulatory requirement to pool investments, over 70% of the Fund's assets are managed by Border to Coast. In time, this is expected to rise to 100%. This adds to the importance of reviewing Border to Coast's policies and taking the opportunity to provide feedback to influence

their continued evolution. Interestingly, four of the eleven partner funds in Border to Coast now adopt the Border to Coast policies, rather than have their own.

3.0 RECENT DEVELOPMENTS

- 3.1 Drafts of the Fund's updated Responsible Investment Policy and Climate Change Statement are attached as **Appendix 1** and **Appendix 2** respectively.
- 3.2 The draft Responsible Investment Policy has received a few minor updates in paragraphs 5.4 to 5.6 which are in the section on climate change. This is to update the document to reflect changing circumstances, for example, the climate change scenario work undertaken in 2022/23. There are no other material changes. The draft Climate Change Statement has been similarly updated, for example now referring to the investment in Border to Coast's Climate opportunities fund.
- 3.3 Border to Coast has a Responsible Investment Policy (**Appendix 3**), Climate Change Policy (**Appendix 4**) and Corporate Governance and Voting Guidelines document (**Appendix 5**). As Border to Coast directly manages investments including engaging with investee companies and voting company shares, these documents are necessarily more detailed than those of North Yorkshire.
- 3.4 The most recent review of Border to Coast's policies was carried out in the second half of 2022, with the documents being published on their website in January 2023. The review included an evaluation by Border to Coast's adviser on responsible investment issues, Robeco, using the International Corporate Governance Network Global Governance Principles, the UK Stewardship Code and the UN Principles of Responsible Investment as benchmarks. They also reviewed the policies against those of asset managers and asset owners seen to be leaders in the area of responsible investment.
- 3.5 The main changes to Border to Coast's Responsible Investment Policy were:
- highlighting expectations of companies with regard to human rights; to support the social engagement theme Border to Coast has joined an initiative on human rights led by the UN PRI (United Nations Principles for Responsible Investment) (5.0, integrating RI into investment decisions)
 - additional requirements for private markets managers to report on RI policies and data against and key performance indicators (5.2, private markets)
 - updated text on the transition to a low carbon economy, and noting just transition issues (5.6, climate change)

- insertion of a new section on exclusions, covering thermal coal, oil sands and cluster munitions (6.2.3 exclusions)
- 3.6 When considering any exclusions, Border to Coast conducts analysis of the associated material financial risk of a company's business operations and whether they have concerns about its long-term viability. This includes considering key financial risks and the likelihood of success through engagement in influencing company strategy and behaviour.
 - 3.7 As part of this year's annual RI policies review process the approach has been revisited. Revenue thresholds for thermal coal and oil sands have been reviewed with analysis conducted across equity and fixed income funds, associated benchmarks and the MSCI Universe to identify potential companies that managers may also invest in off benchmark.
 - 3.8 To demonstrate the commitment to Net Zero and provide a clear signal of long-term intentions to reducing exposure to the most carbon intensive fossil fuels in investment portfolios, the revenue threshold has been decreased to >70% for investments in public markets, with a lower threshold of 25% for private markets to reflect the long-term nature of these investments. This still reflects the risk criteria used to determine the original exclusions in last year's policy.
 - 3.9 Controversial weapons were highlighted as an area to consider for exclusions last year but due to a lack of data and ability to screen portfolios effectively this was deferred. As additional screening tools are now available the analysis of cluster munition companies has been conducted across portfolios, associated benchmarks and the MSCI Universe.
 - 3.10 Following this, the exclusion policy has been extended to cover companies manufacturing cluster munition whole weapons systems and companies that manufacture components that were developed or are significantly modified for exclusive use in cluster munitions.
 - 3.11 As Border to Coast supports a just transition and recognises that not all countries are at the same stage in their decarbonisation journey, they will assess the implications of the thermal coal and oil sand exclusions and may make exceptions if they consider this to be appropriate.
 - 3.12 The engagement themes (section 6.2.1) are areas of focus deemed to be the most material to the investments. They highlight the priority areas for engagement and collaboration. They were established in 2022 and will be reviewed in 2024. They are low carbon transition, waste and water management, social inclusion through labour management and diversity of thought.
 - 3.13 The low carbon transition engagement theme will focus on high emitting sectors where companies will need to adapt or fundamentally change their business models. This will also cover banks identified as key to financing the transition to a low carbon economy.

- 3.14 The waste and water management theme will focus on companies with packaging waste which is a huge environmental issue and is coming under increasing regulation, and those with high exposure to water intensive operations.
- 3.15 The social inclusion through labour management theme will target companies with labour intensive operations and with supply chain labour management risk, which have been put under added pressure by the pandemic.
- 3.16 The diversity of thought theme will focus on companies with boards which could be enhanced by broader perspectives, to improve decision making, resilience and long-term sustainability.
- 3.17 Border to Coast's Climate Change Policy is based on the internationally recognised Net Zero Investment Framework, which provides a set of recommended actions, metrics and methodologies to help organisations become carbon neutral by 2050 or sooner. The main changes to the Climate Change Policy were:
- a new paragraph on just transition has been added (2.2, why climate change is important to us)
 - the addition of a chart showing the reporting and monitoring timeline for implementing the net zero by 2050 or sooner plan (2.4, roadmap)
 - inclusion of information on the Net Zero Framework and Net Zero Asset Manager initiative to demonstrate the commitment to the target (3.1, our ambition – net zero)
 - describing the “three lines of defence” model in relation to climate change risk (4.1, how we identify climate-related risks)
 - noting the use of scenario analysis to understand the potential risks and opportunities in relation to climate change (4.2, how we assess climate-related risks and opportunities)
 - describing the exclusion criteria for certain thermal coal and oil sands companies in the context of a policy of engagement over divestment (5.1, our approach to investing)
 - noting the launch of the Climate Opportunities fund, and the development of net zero targets in relation to the other asset classes currently in scope (5.2, acting within different asset classes)
 - noting the monitoring of carbon metrics against targets for externally managed investments and the work undertaken to understand changes over time; this will for example include having the managers explain the rationale for investing in carbon heavy companies (5.3, working with external managers)

- noting the use of votes in relation to companies in high emitting sectors, where they are considered not to be taking a sufficiently robust approach to addressing climate change risk (6.1, our approach to engagement)

3.18 Border to Coast has published a Net Zero Implementation Plan, which is available [on their website](#).

3.19 The main changes to Border to Coast's Corporate Governance and Voting Guidelines document were:

- insertion of a new section on human rights, setting out the expectations of companies and voting intentions in certain circumstances (page 12)
- revision and expansion of the section on climate change, describing the objective of investee companies being carbon neutral by 2050 or sooner, action to be taken if companies are not addressing climate change risk sufficiently robustly, and acknowledging just transition issues (page 12)

4.0 NEXT STEPS

4.1 The Fund's Responsible Investment Policy and Climate Change Statement will be amongst the governance documents reviewed by the Pension Fund Committee in July. Pension Board members are therefore asked to comment on the draft documents attached to this report so their views can be captured in the review process.

4.2 The next review of Border to Coast's policies will commence in the summer. Pension Board members are therefore asked for their comments, so they can be fed into the review process.

4.0 RECOMMENDATIONS

3.1 Pension Board members to comments on

- the Fund's draft Responsible Investment Policy and draft Climate Change Statement
- Border to Coast's Responsible Investment Policy, Climate Change Policy and Corporate Governance and Voting Guidelines document

GARY FIELDING
Treasurer to North Yorkshire Pension Fund
16 March 2023