

Oxfordshire Local Government Pension Fund Consultation Document on the Investment Strategy Statement

Introduction

1. Under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, the Oxfordshire Local Government Pension Fund (the Fund) must review its Investment Strategy Statement at least once every three years. The Fund chooses to do that in line with the tri-ennial Valuation and a fundamental review of the Strategic Asset Allocation.
2. The Regulations also require that the Fund consults all interested parties on the content of the revised Statement. This document sets out the basis for that statutory consultation and invites comments to be submitted back to the Fund before the Statement is finalised in June.
3. This document sets out the key changes to the Investment Strategy Statement proposed at this time and sets out the key issues discussed by the Pension Fund Committee at its meeting on 6 March 2020 when it agreed the draft as the basis for consultation.
4. Any comments arising from this consultation should be submitted to Sean Collins, the Service Manager responsible for the Pension Fund. Responses can be either submitted by email to sean.collins@oxfordshire.gov.uk or by post to Oxfordshire County Council, County Hall, New Road, Oxford OX1 1ND. Responses must be received by Friday 15 May 2020 to enable these to be included in the report to the meeting of the Pension Fund Committee on Friday 5 June 2020. Please ensure you provide your name and in what capacity you are responding e.g. scheme member, scheme employer, Oxfordshire tax-payer etc.

Main Revisions to the Investment Strategy Statement

5. There are two main areas of change to the latest draft of the Investment Strategy Statement. These are changes to reflect the transition of assets to the Brunel Company as part of the Government's pooling arrangements, and the introduction of a new Annex to set out the Fund's Climate Change Policy. The Statement has also been revised to reflect the decisions made at the March 2020 Committee meeting in respect of the strategic asset allocation.
6. In respect of the developing arrangements with Brunel, the Statement has been revised to make it clear that all future investments should be through Brunel wherever possible, with requests made to Brunel under the agreed policies to set up new portfolios where the existing ones do not meet the requirements of the Fund.

7. The Statement also covers the switch for the Committee from the responsibility for the direct review of Fund Managers to the responsibility for obtaining assurance that Brunel is undertaking the appropriate review of the appointed Fund Managers. The Statement makes it clear that the focus of this review should be on net investment performance rather than simply cost, and that all Fund Managers are investing in line with the Policies agreed by Brunel with the support of the 10 founding Funds.
8. Similarly, the Statement has been updated to reflect the role of Brunel in managing the engagement with the underlying companies and in exercising the voting rights in respect of our investments. Again, the role of the Committee has switched to monitoring the performance of Brunel rather than direct involvement in engagement and exercise of voting rights.
9. In terms of the asset allocations, the strategic asset allocation has been updated to reflect the decisions made at the March 2020 Committee to switch 5% of the investments in UK equities to global equities and the decision to reduce the overall allocation to equities by introducing a 3% allocation to private debt. These decisions were made to provide greater diversification and in response of the concentration in the UK markets to oil and gas companies. The allocation was also updated to reflect the split previously agreed between allocations to developed and emerging markets.
10. The introduction of a Climate Change Policy reflects the Committee's belief that climate change risk presents the single most important factor in determining the long-term investment performance of its assets. As such, the decision is seen as entirely consistent with the over-arching fiduciary duty of the Fund to the scheme members.
11. The Policy has been developed following an initial workshop arranged with the support of Fossil Free Oxfordshire and attended by the members of the Pension Fund Committee, the Local Pension Board and several climate change experts. The outcomes of the Workshop were further considered by a Working Group consisting of the Chairman, Vice Chairman and Opposition Spokesperson on the Committee, the Independent Financial Adviser to the Pension Fund and representatives of scheme members and Fossil Free Oxfordshire.
12. The Policy takes the Paris Agreement on Climate Change as its guiding principle and aims to ensure that over time all investments are consistent with the aims of the Paris Agreement. As a high-level target, the Policy makes a commitment to have transitioned to net zero greenhouse gas emissions by 2050, in line with a maximum temperature increase of 1.5°C.
13. The Policy aims initially to reach this target without the need for blanket divestment decisions, but to follow a policy of engagement and select divestment where companies are clearly not on a path to be aligned with the

Paris Agreement. The Policy supports the Just Transition, seeking to manage the societal and economic impacts of the transition to a low carbon economy.

14. The Policy identifies the need to manage the exposure of investment assets to risks associated with climate change, including flooding. It also seeks to increase the investments in climate change mitigation e.g. renewable infrastructure.
15. The Policy also states the Fund's support for wider advocacy of Governments etc to bring in policy change consistent with the aims of the Paris Agreement including the mandating of the Task-Force on Climate-Related Financial Disclosures Template and the removal of fossil fuel subsidies.
16. The Policy recognises the shortfall on current industry-wide metrics to assess the compliance of the investments with the policy objectives. The Policy therefore includes support for the development of a basket of such metrics to enable targets to be set and progress to be measured. The Policy includes a commitment to have a fundamental review of the Policy in 2022 to ensure that it is sufficiently ambitious to meet the objectives of the Paris Agreement (or any subsequent internationally agreed revisions).

Key Issues Discussed by the Committee

17. The Committee noted that the purpose of the Climate Change Policy was to set a strategic direction of travel, and as such did not include detailed statements around the allocation to specific portfolios. It was agreed that the implementation of the Policy would be included in a separate Implementation Plan to be initially presented to the June 2020 meeting of the Committee.
18. The implementation plan would include clear timescales around the development of suitable metrics against which to assess performance against the Policy. This would include criteria and timescales to be used in assessing the success of the engagement with the underlying investment companies, and metrics to determine the extent to which investment portfolios were aligned with the Paris Agreement.
19. In the short term, the Committee agreed a switch of 5% of the Fund from the UK passive portfolio to the Low Carbon Portfolio. Although this was seen as a positive first step to reduce the carbon intensity of the Fund and to send a clear message about the direction of travel, it was recognised that the Low Carbon Portfolio itself had a number of flaws, particularly to the extent that it did not measure scope 3 emissions. As such, the portfolio included several companies which whilst they themselves had low scope 1 and 2 emissions, were part of a supply chain for the oil and gas industries and responsible for significant levels of scope 3 emissions.

20. As such the Committee agreed that further switches to assets should await the development of new portfolios through Brunel that better reflected the objectives of the Climate Change Policy, so avoiding the need to incur double transition costs. It was noted that further switches from existing portfolios to new portfolios better aligned to the Paris Agreement could take place at any time within the agreed asset allocation and was not dependent on either a further asset allocation review or indeed the 2022 review of the Climate Change Policy itself.
21. Finally, the Committee noted that whilst climate change risks are the greatest risk to long term investment performance, they were not the only risk, and care needed to be taken to ensure that future portfolios were developed with full consideration of these wider risks and indeed of the remaining United Nations Sustainable Development Goals. A properly diversified portfolio appropriately balancing the various risks was in the best long-term interests of the scheme members and therefore consistent with the Committee's fiduciary duty.
22. The Committee therefore decided not to increase the current allocation to the infrastructure portfolio managed by Brunel, despite the fact that this portfolio is heavily weighted to investments in renewable infrastructure. This was based on advice about the need to ensure that the overall liquidity in the Fund was not further reduced to ensure there was always sufficient cash to pay the pension benefits as they fall due and to meet the already significant commitments agreed to the private markets.

Consultation Responses

23. The Committee would welcome any general comments on the content of the Investment Strategy Statement including the introduction of the separate annex to cover their Climate Change Policy. Specific issues that respondents may wish to consider include:
 - The use of the Paris Agreement to act as the guiding principle for the Climate Change Policy. Are there alternative strategic drivers better suited?
 - The decision not to include any blanket divestment statements within the Policy but to focus on a practice of engagement and selective divestment across all asset classes and sectors where sufficient evidence of compliance with the Paris Agreement is not forthcoming.
 - Whether the focus on climate change risks relative to the other risks facing the pension fund is appropriate, and whether there should be greater emphasis on any of the other UN Sustainable Development Goals or risks.
 - Potential metrics to be included in any future iterations of the Investment Strategy Statement and Climate Change Policy against which compliance can be assessed