Supplementary Papers – Public Questions & Responses

Surrey Pension Fund Committee

Date & time	Place	Contact	Chief Executive
Friday, 12 March 2021 at 10.00 am	Remote via Teams	Angela Guest Tel 020 8541 9075 angela.guest@surreycc.gov.uk	Joanna Killian

We're on Twitter: @SCCdemocracy

Elected Members
Mr Tim Evans (Chairman), Mr Ben Carasco (Vice-Chairman), Mr John Beckett (Ewell), Mr David Mansfield, Ms Charlotte Morley and Mrs Hazel Watson

Co-opted Members:
Kelvin Menon (Employees), Borough Councillor Ruth Mitchell (Hersham), District Councillor Tony Elias (Bletchingley and Nutfield) and Philip Walker (Employees)

PART 1
IN PUBLIC

4 QUESTIONS AND PETITIONS (Pages 1 - 8)

Public questions and responses are attached.

Joanna Killian
Chief Executive
Published: Thursday, 11 March 2021

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Surrey Pension Fund Committee – 12 March 2021

Item 4.2 Public Questions

Q1 – submitted by Ian Chappell

In your reply to me on 25th January 2021, you stated:

"*We would like to reiterate the fiduciary duty of the Pension Fund to maximise its financial returns to meet pension obligations. As part of this, The Pension Fund diversifies its investment portfolio to mitigate risks and returns within some sections of its portfolio against others. So only analysing one sector underperformance does not take into account the role of the Pension Fund in diversifying risk of underperformance within its entire portfolio"*

Given that fiduciary duty consists of the dual obligations of loyalty and prudence, I would suggest that every option must be kept on the table - regardless of a council or committee's ideology - to ensure that risk to members' pensions are properly managed. As the Law Commission put it in 2013: *"They must not fetter their discretion; they must consider relevant circumstances; and they must take advice"*

The implications of this seem clear. There is nothing about fiduciary duty which requires you to own every sector of the market. Moreover, excluding a possible course of action which may prevent harm from widely discussed risks, such as stranded assets, seems imprudent and therefore inconsistent with fiduciary duty.

Could you please explain how your policy of retaining investments in fossil fuels is consistent with your fiduciary duty?

Reply:

A Pension Fund Committee's fiduciary duty is to ensure it can continue to meet the long term liabilities of the members of that Pension Fund, and the Fund's funding level as at 31 December 2020 was 105%, demonstrating that there is no suggestion that the Pension Fund Committee is not meeting its fiduciary duty.

Moreover, the UK Pensions Minister was quoted in the Financial Times on 5 March 2021 as stating, "Merely selling your stocks that make you look bad from a fossil fuels standpoint is a reverse greenwashing because it doesn't actually fix the problem."

The Surrey Pension Fund employs fund managers on its behalf who carry out the stock selection within a portfolio. In doing so they diversify the risk within its portfolio across multiple sectors. It therefore does not instruct its fund managers to hold investments in every sector, but holds managers to account if they are not seen to be managing investment risks within its portfolio, or not fulfilling any expectations as per their original Investment Management Agreement.

Active management is based on the belief that the market is regularly inefficient at pricing individual securities or even sectors and countries, and that the opportunity exists to take advantage of any mispricing, leading to outperformance. The ability to maximise financial returns rests upon having the flexibility to invest across all sectors of the market, and benefit from greatest number of mis-pricings. Keeping a broad benchmark effectively maximises this opportunity set, and the return potential.

The flexibility to exploit a given benchmark is influenced by the degree of discretion the client is willing to extend to their manager, typically codified by a risk budget or tracking error range. This risk budget is determined according to the risk appetite of the investor. The lower the risk appetite, the lower the risk budget, the lower the ability of the manager to diverge substantially from the composition of the market as represented by the benchmark. The size of that risk budget thus has a direct impact on whether a manager will have the flexibility to not invest in certain sectors at certain times. The active manager must use the flexibility they have wisely, assessing the economic scale of the opportunities and costs a company faces. This includes the risk of stranded assets in the case of fossil fuel companies and can be incorporated in assessing the value of the company in light of these opportunities and costs, and then comparing that to the market price of the security and investing accordingly. The combination of making informed investment decisions and the flexibility to apply that investment approach across the broadest opportunity set most closely aligns with the fiduciary duty to maximise returns.

The question also appears to be slightly contradictory; if all options should be kept on the table as you had suggested, then this option would also involve continuing to hold those same investments. Identifying those best in class energy companies, who are well placed to lead a low carbon transition with their capital as well as their strategies, would therefore be consistent with the Pension Fund's fiduciary duty to deliver risk adjusted returns to meet pensions obligations. Those companies, if identified correctly, can increase the Fund's shareholder value.

However, the Fund is a supporter of the Taskforce for Climate Related Financial Disclosures (TCFD), so will be aiming to develop its Climate Risk Management reporting to identify the risks you had highlighted with regards to stranded assets. Stranded assets go beyond solely the fossil fuel sector and can impact multiple sectors and economies, who may be disproportionately impacted by a low carbon-transition. We therefore understand the significance of Climate Change as an investment risk to our whole portfolio.

Q2 – submitted by Janice Baker

One of your advisers, Hymans Robertson, made the following observation in their recent Climate Change Report " An increasing awareness and understanding of climate change, together with ever-increasing regulatory change, is forcing companies to adapt and address the impact they have on the environment. Greater adoption of renewable energy, and a strive to rely less on fossil fuels, is giving rise to "stranded assets" as energy companies find themselves unable to economically exploit reserves of oil and coal. This results in companies writing off the value of these assets, with negative impacts on shareholders. Shell and BP wrote off up to $22bn and $17.5bn respectively in mid-2020 from weakened long-term demand for oil and an acceleration towards a lower-carbon economy"

What risk assessments have you made - and are planned to be made - that take stranded assets into account whilst maintaining higher returns throughout the transition period to net-zero carbon emissions and thereafter? Please explain what the time-frame is for shedding these assets, currently held in fossil fuel industries, before they become worthless.

Reply:

The Fund is a supporter of the Taskforce for Climate Related Financial Disclosures (TCFD), so will be aiming to develop its Climate Risk Management reporting to identify the risks you had highlighted with regards to stranded assets. Stranded assets go beyond solely the fossil fuel sector and can impact multiple sectors and economies, who may be disproportionately

impacted by a low carbon-transition. We therefore understand the significance of Climate Change as an investment risk to our whole portfolio.

To further develop our Climate Risk reporting approach, we will begin to produce scenario analyses, emissions-based reporting as well as how we can monitor our performance against it. This is also in line with updated Regulations where more Local Government Pension Schemes will be required to report more closely against TCFD from April 2022. We will therefore take your comments on board when considering stranded asset risk within the context of our Climate Risk reporting.

With regards to your second question on time-frames we have not made any commitments to divest our assets in fossil fuel industries.

Q3 – submitted by Pat Smith

BP recently announced in the national press a £900 million investment in UK offshore wind farm licenses – which I welcome. However, they forgot to mention that they plan to spend £41 billion on new oil exploration in the next decade, including projects in Canadian tar sands, the most damaging of all extraction processes, the Arctic National Wildlife Reserve and the Amazon rainforest. If you care to browse their website www.bp.com, predictably you will note on the very first page much self-praise and backslapping as they enhance their renewable credentials. Looking beyond that, however, to the investment pages and on to major upstream projects you will find detailed accounts of numerous new activities all focused on fossil fuels.

Your policy of engagement with the fossil fuel industry rather than divestment has been well debated over the past few years, so I greeted your statement at the last quarterly meeting, “we will not carry on with people who are not engaging properly”, with some enthusiasm. In further support of your decision, it is my understanding that you received many email messages echoing this, with some possibly fearing that you will renege on your statement.

In light of the information I cover in my first paragraph it is my anticipation that you already have, or will shortly, will be instructing your fund managers to withdraw all pension fund investments in British Petroleum. Or will you renege on your commitment?

Reply:

Thank you for your message. Although addressed to the Chairman of the Pension Fund Committee, you should be aware that the Pension Fund Committee has a jointly agreed position on this issue.

The Fund has not made any commitment to divest from an entire sector, but we do agree that companies who haven’t engaged over a long period of time can potentially present an investment risk to the Fund.

We are therefore happy take your comments on board and challenge our fund managers, if we feel there are companies who pose an investment risk to our portfolio.

Q4 – submitted by Helena Ritter

In December’s SPF committee meeting, you set out the results of the work that has been done on aligning the Surrey Pension Fund investments with the UN Sustainable

Development Goals and celebrated your leadership in being one of the first pension funds to do such an analysis.

The Committee on Climate Change's Sixth Carbon Budget advises local authority pensions to "disclose their approach to assessing and managing climate risk and [to] consider investing in net zero aligned schemes within their legal duties" (see p13 of their report, Local Authorities and the Sixth Carbon Budget).

In the context of the CCC's advice and the work from SPF on aligning with SDGs, what are you doing to show leadership on climate change within the Border to Coast Pension Partnership?

Reply:

Thank you for your comments.

The Fund takes heed of the comments of the Committee on Climate Change, as it does all relevant sources of information. However, they are not an authority on pensions policy decisions, so Surrey Pension Fund does not automatically comply with their recommendations.

We also note the UK Pensions Minister Guy Opperman, quoted in the Financial Times on 5 March 2021, "Merely selling your stocks that make you look bad from a fossil fuels standpoint is a reverse greenwashing because it doesn't actually fix the problem."

In terms of Border to Coast's approach, how external managers consider climate risk is captured and addressed during the appointment and selection process with ongoing monitoring on a quarterly basis, deep dive environmental, social and governance (ESG) sessions and as part of the annual review.

ESG and carbon screens are conducted on a quarterly basis across internally and externally managed mandates. The companies that are the largest contributors to the carbon footprints are identified. External and internal portfolio managers are asked to provide detailed investment rationales for these holdings. Border to Coast map these companies against the Transition Pathway Initiative tool. This shows how company management are addressing climate, how they are improving and the direction of travel. They also map which companies are being engaged through our various engagement streams. This identifies companies for further engagement and also where they may need to escalate with voting and co-filing shareholder resolutions.

Engagement is essential to address climate change and reduce carbon emissions. Divesting at the sector level does not solve climate change. The emissions will still be being produced but will be 'owned' by an investor who may not be engaging with the company. Border to Coast is a member of the largest ever collaborative engagement initiative, Climate Action 100+, which has had some significant achievements with companies committing to net zero and additional detail on implementation plans and putting transition plans to vote at AGMs.

The Fund is and will continue to be open to Climate friendly and sustainable investment opportunities when they arise.

The Fund supports the industry standard Taskforce for Climate Related Financial Disclosures (TCFD) and is aiming to develop its Climate Risk Management reporting to identify the risks you had highlight.

We are further developing our Climate Risk reporting approach, to produce scenario analyses and emissions-based reporting. This is in line with updated Regulations, which will require Local Government Pension Schemes to report more closely against TCFD from April 2022.

Q5 – submitted by Simon Hallett

From Border to Coast's (BtC's) TCFD report for 2019/20 we can infer how seriously BtC takes the management of carbon risk in its directly managed portfolios. Table 1 below shows that in each case the internally managed funds (where stock selection decisions are all made by BtC portfolio managers) show carbon intensity that is actually greater than the benchmark index. In terms of carbon emissions per $ invested the figures are similar to the index. What is also striking is that the third-party managers employed by BtC to manage the performance orientated 'alpha' funds have materially lower carbon intensity and emissions, in the case of the global alpha fund strikingly so. Table 2 shows that the same is the case in terms of holdings of fossil fuel companies. Thus, third party commercial managers accountable for performance have taken significant steps to limit emissions and carbon risk in their portfolios, while BtC, which is accountable directly to SPF and its other partner funds, have done nothing at all!

Finally, the report states:

> We actively engage with companies in relation to carbon risk management; however, the decision, along with Partner Funds, has been made not to introduce carbon reduction targets for portfolios. This will remain under review.

The UK has a legally binding target of net zero emissions by 2050, and increasing numbers of investors (Cambridge University among them) are falling in line with that by setting net zero goals for 2050 or sooner. But unlike forward thinking investors, BtC has decided to do nothing.

What, if any, requirements are SPF placing on BtC to reduce carbon risk, and emissions in your portfolio? What discussions are underway that may lead to a change in policy and when may we expect an outcome?

Table 1

	Weighted average carbon intensity ($t\,CO_2e$ / $m sales)		Carbon intensity ($t\,CO_2e$/$m sales)		Carbon emissions (per $m invested)	
Portfolio	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
Overseas Developed	166	168	237	214	184	178
Emerging Markets	379	319	467	445	378	381
UK Listed Equity	136	126	165	159	180	194
UK Listed Equity Alpha	87	126	122	159	170	194
Global Equity Alpha	76	164	93	136	93	139

4

Table 2

Portfolio	Weight of companies owning fossil fuel reserves	Benchmark weight of companies owning fossil fuel reserves
Overseas Developed	7%	7%
Emerging Markets	11%	9%
UK Listed Equity	14%	15%
UK Equity Alpha	12%	15%
Global Equity Alpha	2%	6%

The percentage of portfolio companies owning fossil fuel reserves are broadly in line or underweight with their respective benchmarks.

Reply:

The Surrey Pension Fund, along with other partner funds, is in regular engagement with Border to Coast to enhance its Climate Risk reporting, for the benefit of all our stakeholders.

During the annual Responsible Investment Policy review, the decision was made to develop a standalone Climate Change Policy. This is in the early stages of development and will be shared with Partner Funds for feedback and input over the next few months.

Border to Coast has an external engagement provider, Robeco, who engage across various environmental, social and governance (ESG) themes which run for three-year terms. New engagement themes are put in place each year to replace themes that are closing. Border to Coast actively participate by feeding into the decision and selection process for new themes. This year there are two additional themes focusing on climate change: Acceleration to Paris Agreement – focusing on high carbon companies that are behind in transition; and Climate Transition of Financials – focusing on the banking and insurance sectors.

These are in addition to the engagements already underway. This include Net Zero - with a focus on steel, cement, utilities and oil and gas sectors, encouraging high carbon-emitting companies to set carbon reduction targets and to achieve alignment with goals of the Paris agreement; and Climate Action – assessing the Governance framework on climate-related issues and climate risk management.

As well as engaging with companies to encourage them to make changes and commit to reducing carbon emissions, we also need to have strong public policy that supports the transition. Border to Coast are members of the Institutional Investor Group on Climate Change and, as such, are involved in public policy advocacy. We have co-signed a number of letters over recent months to the Prime Minister and other Ministers of the UK Government on climate change and net zero.

The Surrey Pension Fund continues to develop and refine its views on all ESG issues, including carbon risk and emissions, and these form the basis for ongoing discussions with Border to Coast. The outcomes of these discussions are illustrated in the form of reports like the one you quote, which help inform future decision making. Our long standing preference for engagement rather than divestment is supported by the UK Pensions Minister Guy Opperman, who was quoted in the Financial Times on 5 March 2021 as stating, “Merely selling your stocks that make you look bad from a fossil fuels standpoint is a reverse greenwashing because it doesn’t actually fix the problem.”

Q 6 – submitted by Jenifer Condit

With this being the last public meeting of the Surrey Pension Fund Committee before the upcoming Local Council election on May 6, this is an excellent opportunity for individual

members of the SPF Committee to state your position on de-carbonising the SPF portfolio, and on divestment of fossil fuel shares. As members of this committee you have the greatest opportunity to influence this question for the next four years and so have the greatest obligation to make your feelings known. For many voters, this may be a crucial matter in their voting decision.

In light of the rapidly escalating urgency of the climate emergency we all face, and indeed the increasing adoption of divestment strategies by institutional investors, would each elected SPF member please state:

1. Whether you consider the decarbonisation of the SPF portfolio to be of a matter of extreme urgency, and

2. Whether you support eliminating oil, gas and coal producers from the portfolio, as being the investment decision which can most rapidly reduce the carbon intensity of the fund?

Reply:

The fund has strong governance policies such that investment policies are subject to rigorous scrutiny, taking into account all relevant factors, before adoption. All members of the committee, whether elected or not, have an equal say and therefore it is appropriate to respond as a full Committee rather than on an individual basis.

In response to your first question, decarbonisation involves tilting the weighting of holdings in companies to those less reliant on carbon, across all sectors, not just specific to fossil fuels. The Fund had already decarbonised its Indexed Funds with Legal and General Investment Management.

In response to your second question, the Surrey Pension Fund commissioned a carbon exposure review in 2017, to gain further insight into the carbon emissions within its portfolio. The Surrey Pension Fund transitioning a portion of it indexed equity holdings into Legal and General's Low Carbon Fund, as part of a strategic change to its asset allocation and also informed by the findings from the report. However, although reviewing the carbon exposure of the Fund is a useful metric in understanding one aspect of climate risk within a portfolio, reducing 'portfolio emissions' has zero impact on actual emissions. Therefore, eliminating oil, gas and coal producers from our investment portfolio, does not have any impact on real world emissions.

This view is also supported by the UK Pensions Minister Guy Opperman, who was quoted in the Financial Times on 5 March 2021 as stating, "Merely selling your stocks that make you look bad from a fossil fuels standpoint is a reverse greenwashing because it doesn't actually fix the problem."

We will continue to challenge our fund managers when we feel some companies within these sectors present a significant investment risk to our returns, to gain assurance on what they are doing to manage this risk.

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