Supplementary Agenda

Surrey Pension Fund Committee

Date & time of meeting	Publication of supplementary agenda:	Chief Executive
Friday, 23 September 2022 at 10.00 am	Monday, 26 September 2022	Joanna Killian We're on Twitter: @SCCdemocracy

Following discussion at the meeting, the Chairman agreed to consider and publish the following reports within Part 1 of the meeting.

15 ASSET CLASS FOCUS - REAL ESTATE (Pages 1 - 10)

As part of good governance, the Committee periodically reviews the performance of the Fund's investments.

16 RESPONSIBLE INVESTMENT POLICY UPDATE (Pages 11 - 18)

This paper provides details of the progress made in developing the Surrey Pension Fund's (the Fund's) standalone Responsible Investment (RI) Policy.

17 TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TCFD) REPORT (Pages 19 - 40)

The Surrey Pension Fund Committee has committed to publishing a Task Force on Climate-related Financial Disclosures (TCFD) report annually.

20 NET ZERO CONSIDERATIONS (Pages 41 - 62)

This paper provides an update on analysis by Mercer in consideration of the Surrey Pension Fund's desired date for achieving net-zero.

Joanna Killian
Chief Executive
Published: 26 September 2022

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SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **23 SEPTEMBER 2022**

LEAD OFFICER: **ANNA D'ALESSANDRO, DIRECTOR CORPORATE FINANCIAL & COMMERCIAL**

SUBJECT: **ASSET CLASS FOCUS – REAL ESTATE**

SUMMARY OF ISSUE:

As part of good governance, the Committee periodically reviews the performance of the Fund's investments. There is a further focused review of different asset classes. This paper concentrates on Real Estate.

RECOMMENDATIONS:

It is recommended that:

The Committee note the Fund's Real Estate holdings, respective funds' investment performance and review from the Fund's independent investment adviser.

REASON FOR RECOMMENDATIONS:

A solid framework of review is required to benefit from this long-term asset category. This is consistent with Fund's strategic investment objectives.

DETAILS:

Background

1. The Fund's Real Estate exposure is derived through investment in a fund-of-funds with CBRE. As at 30 June 2022 the weighting to Real Estate in the Fund was 7.2%. The target weight within the current investment strategy asset allocation is 7.6%

2. The mandate commenced April 2004 and is invested in UK and Global property funds. Currency exposure is unhedged and performance is measured in sterling.

3. As at 30 June 2022, the asset split between UK and Global property funds was 75% UK and cash and 25% Global. The expectation is to move to a 50% weight in Global but progress has been delayed whilst Real Estate product developments take place at BCPP.

4. The performance objective at the mandate level is to outperform the MSCI/AREF UK QPFI All Balanced Property Fund Index by at least 0.5% p.a. gross of cash and fees over three-year rolling periods. For the UK Real Estate exposure the benchmark is also the MSCI/AREF UK QPFI All Balanced Property Fund Index, whilst the performance objective for the Global Alpha Fund is to deliver returns of 9-11%.

5. For the year to 30 June 2022, the total mandate returned 22.4% in sterling, compared to the objective return of 23.8%. The 3-year return was 8.3% p.a. in sterling compared to 9.7% for the objective.

6. The report by the Independent Advisor can be found in Annexe 1. This covers performance and positioning of the current Real Estate exposure. It also reviews the progress made by BCPP in developing their own investment offerings for Global and UK. The global fund will be a similar approach to CBRE but the UK fund will be predominately made up of direct property investments.

CONSULTATION:

7. The Chair of the Pension Fund has been consulted on the report.

RISK MANAGEMENT AND IMPLICATIONS:

8. Risk related issues are contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

9. Financial and value for money implications are contained within the report.

DIRECTOR OF CORPORATE FINANCE & COMMERCIAL COMMENTARY

10. The Director of Corporate Finance & Commercial is satisfied that all material, financial and business issues and possibility of risks have been considered, and that equities have been a good performing asset class for the pension fund.

LEGAL IMPLICATIONS – MONITORING OFFICER

11. There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

12. The review of the Fund's investment programme will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

13. There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

14. The following next steps are planned:

    a. Continued monitoring of Real Estate holdings with a performance review report to be brought to the committee on an annual basis

Contact Officer:
Lloyd Whitworth, Head of Investment & Stewardship

Consulted:
Pension Fund Committee Chair

Annexes:

1. Summary report from the Fund's Independent Investment Advisor – Annexe 1

Sources/background papers:

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MJ HUDSON Allenbridge

Surrey Pension Fund Committee

Manager Review Meeting Minutes

3rd August 2022

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Attendees

Lloyd Whitworth, Head of Investment and Stewardship
Neil Mason, Assistant Director – LGPS Senior Officer
Anthony Fletcher, Independent Adviser

Background

The purpose of this meeting was to receive an update from CBRE on the performance, activity and outlook for the UK and Global property funds managed on behalf of the Surrey Pension Fund. And to receive a progress report from BCPP on the development of their investment solutions for global and UK property.

CBRE

David Inskip - Head of Research
Shamaan Malik - Deputy Portfolio Manager
Nahid Abdin - Intern Analyst

Akash Shivashankara - Deputy Fund Manager: CBRE Global Alpha Fund

Mandate Summary

Property Fund-of-Funds with holdings valued at £340.5 million in 30 underlying funds at 30th June 2022. The Portfolio of funds is made up of 75% invested in a range of UK funds and 25% in the CBRE Global Alpha Fund.

Performance

CBRE provided separate performance data for the UK and global funds due to accounting period differences. The Global Alpha fund's return was reported to 31st March whereas the UK fund's return was calculated to 30th June 2022, each fund also has a different performance objective.

The total return of the UK property fund over 12 months to the 30th June 2022 was estimated at 22.4% in GBP, which was 1.4% behind the performance objective's return of 23.8%. Over 3 years the estimated return was 8.3% p.a. in GBP, compared to the performance objective's return of 9.7% p.a. The performance objective for the UK fund is to outperform the MSCI/AREF UK QPFI All Balanced Property Fund Index + 0.5% p.a. over a rolling 3 year period.

The total return of the Global Alpha fund over 12 months to the 31st March 2022 was 16.7% in local currency terms, well ahead of the funds 9% to 11% performance objective but behind the market comparators (MSCI GPFI) return of 20%. Over 3 years the fund delivered 8.6% p.a. in local currency terms, compared to its objective of 9% to 11% p.a. over a rolling 3 year period.

Over the 12 months to June 2022 CBRE's attribution analysis estimates that currency made the largest positive contribution to overall returns followed by the global alpha fund which slightly outperformed 2 of the specialist core industrial/logistics funds in the UK portfolio. From a sector perspective Industrial/logistics and long income remained top performing sectors for both funds, with retail and hospitality continuing to suffer from structural headwinds made worse by covid.

In the UK the Industrial, funds produced the largest sector returns and the retail sector the lowest. In terms of the individual funds, the Nuveen UK retail warehouse fund was the best performer delivering a +80.7% return, whereas Nuveen's UK shopping centre fund delivered -38.6%. Only 6 of the portfolio's individual funds matched or outperformed the 23.8% performance objective over 12 months. There was a long tail of funds which underperformed the objective, 11 of which delivered a total return of less than 10%, but only 2 delivered a negative return, Palmer Capital development fund III, which is in "wind-down" and returning capital to investors and as mentioned above the shopping centre fund.

The largest contributor to the performance of the global fund over 12 months was currency. The global fund's performance is stated in local currency and with more than 95% of the fund's investments denominated in currencies other than GBP, changes in the value of the GBP can have a big influence on the total return. Regional performance was also denominated by the strength of the US dollar but the aggregate return on investments in Europe and Asia Pacific did outperform those in the UK. At the sector level contributors and detractors for the global fund were similar in to those of the UK fund, while logistics funds were 3 of the top performers, the greater sector diversity of the global fund also had a US residential fund as a top performer and a hotel in Europe as its worst performer.

Current Positioning

As would be expected from a property portfolio over the year there has been no significant change to overall portfolio positioning; the main themes remain unchanged overweight core and defensive strategies including Long Lease property and underweight opportunistic. Both funds are focussed on resilience of income, they are overweight industrial/logistics and in the global fund residential, underweight and reducing office and retail, neutral alternatives. In the office sector where they have maintained exposure it has been focussed on prime properties with high ESG

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ratings and lower impact from "working from home" because they offer a broader experience for employees. In the last 12 months the UK fund has made only 2 outright purchases and 1 outright sale. Most of the investment activity in the UK fund has been through the return of capital from funds that are in "wind-down" or drawdown of already committed capital. The global fund made 3 sales and purchases of roughly similar size and due to strong positive cashflow from investors made new commitments to invest the equivalent of 7.5% of the funds NAV. The % turnover of the global fund was roughly double that of the UK fund.

Outlook

CBRE's macro-economic outlook was pretty bearish, they are expecting a recession in the UK, although not as bearish as the Bank of England's very next day forecast of stagnation in 2023. CBRE expects inflation to fall quite quickly next year as "base effects" from this year's high energy prices and a weakening economy, caused by falling household incomes (cost of living crisis). They also see higher bond yields as having a twofold negative technical impact on property. The first being a higher cost of debt and increased yields required to attract investment. The second a portfolio effect caused by the negative returns from bonds causing property weights in pension funds to become overweight leading to forced sales of property assets to re-balance overall asset allocations or at least reducing demand for the asset class. This second impact is of particular importance to corporate pension funds, which are typically closed and have a very high proportion of assets invested in bonds and property.

CBRE presented evidence that higher interest rates and bond yields, and a weakening outlook were already having an impact on the property market with markedly falling capital growth in all sectors in the second quarter of 2022. They also pointed to falling investment volumes and a big negative swing in sentiment. As a result, they are forecasting rising yields and falling capital values in 2023 and 2024 leading to very low total returns from the market over the next two years. In May they reduced the 5 year annualised total return expectation for the asset class to 4.8%, with 4.6% coming from income, this is the second downward revision this year, their last expected return published in February was 5.5% p.a. The weakness is widespread with CBRE expecting the total return from all sectors to be lower over the next 5 years.

The global team seemed to be more optimistic about the returns from property but they do have a much broader set of market sectors and countries in which to invest. Regionally they see the best opportunities in the US and Asia and are least comfortable with continental Europe, mainly because of the war between Russia and Ukraine and the uncertainty around how long the actual conflict lasts but also because of the longer-term implications for security. They could see post covid opportunities in both office and retail and stated that the global fund had "dry powder" in the form of increased cash commitments from investors, but they also suggested that the second quarter of 2022, could have been the last quarter of strong returns for a while.

Adviser View

This was a much more confidently presented and clear meeting than the last time we saw the CBRE teams. I have no concerns with the team or how they are managing the portfolio on Surrey's behalf. However in future I believe we should ask CBRE to report the performance of both the UK and Global funds over the same period.

(Hold)

BCPP

Alistair Smith - New Head of Real Estate
Paul Campbell – Portfolio Manager
Milo Kerr – Head of Client Relations

Surrey's pooling partner BCPP is in the process of designing their property offering for Global and UK. The Global offering will be similar to the CBRE approach of gaining indirect access via a mixture of property funds, but the UK approach will involve migrating away from funds to a property portfolio that will be predominately made up of direct property investments.

The process of designing the new fund offerings has been very slow and drawn out and was not helped by the departure of the last Head of Real Estate in the second half of 2021. BCPP have now appointed a new Head of Real Estate, Alistair Smith, Alistair's background is in property surveying and valuation and for the last few years has led the team that consolidated Abrdn's various legacy property offerings into one new platform. As a result, he has gained considerable experience of the intricacies of consolidating a complex portfolio of indirect and direct investments from a range of managers.

Some progress has been made on the provision of the Global Property offering with Aon Townsend appointed to be the investment adviser to the Fund in July 2022. Northern Trust has also been appointed as Third-Party Administrator and Depositary for the whole of BCPP real estate offering. Paul Campbell who has been involved from the beginning will be the BCPP Global Property Investment Manager. There will be two indirect global property funds with different performance objectives, which can be combined to meet the needs of each partner fund. The property team will be working with partner funds to establish a plan for transition of legacy assets from each LGPS to the Pool. Some work needs to be done to finalise the exact requirements for each partner fund including the balance of risk and return and the potential need for currency hedging and income distribution. BCPP will be seeking commitments from partner funds later this year with a view to launching the global offering in the 1st half of 2023.

The UK offering is going to be a much more difficult solution as some of the partner funds already have established portfolios of direct holdings and others like Surrey have existing portfolios of indirect funds all of which need to be transitioned in such a way to keep the very high transaction costs to a minimum.

Adviser View

This transition is potentially the most expensive and complicated task that BCPP has undergone. Nonetheless I believe it is the right choice for Surrey to take, provided it can be delivered at a lower price than the Fund's current property solution provided by CBRE. The global element is a fairly straightforward substitution of CBRE as fund selector by the team at BCPP. I believe the real savings will be achieved by the substitution of UK indirect property funds by direct property investments in the UK. In my experience, bearing in mind past experience will not always play out in the future, direct property investment delivers better risk and return outcomes at a much lower price, with much lower volatility and not much less liquidity.

In determining the balance between Global and UK property investments, Surrey needs to decide exactly what it wants the property allocation to do in the Strategic Asset Allocation. If it's more about growth than income maybe a higher weight to global property, if however, it's about certainty of income maybe a higher weight to UK property should be considered.

Anthony Fletcher – Independent Adviser to the Surrey Pension Fund

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SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **23 SEPTEMBER 2022**

LEAD OFFICER: **ANNA D'ALESSANDRO, DIRECTOR CORPORATE FINANCIAL & COMMERCIAL**

SUBJECT: **RESPONSIBLE INVESTMENT POLICY UPDATE**

SUMMARY OF ISSUE:

This paper provides details of the progress made in developing the Surrey Pension Fund's (the Fund's) standalone Responsible Investment (RI) Policy and its consultation, consistent with the actions agreed in the Pension Fund Committee meetings of 10 September 2021, 10 December 2021,10 March 2022 and 17 June 2022, and sub-Committee meetings of 19 November 2021, 11 February 2022 and 26 April 2022.

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1. Notes the progress of the consultation as agreed at the Pension Fund Committee meeting of 17 June 2022.
2. Approve for officers to continue work with the independent investment advisor, investment consultant, Minerva and Border to Coast Pensions Partnership (BCPP) to undertake planning to implement the RI Policy.

REASON FOR RECOMMENDATIONS:

To keep the Pension Fund Committee apprised of the progress made in producing a standalone RI Policy. This is consistent with the Fund's strategic investment objectives.

BACKGROUND:

1. At its meeting of 10 September 2021, the Pension Fund Committee approved the proposed structure for a standalone Responsible Investment Policy.

2. The Committee further approved for a responsible investment sub-committee (RISC) of Committee members to be convened to work with officers, Minerva and the Fund's consultants and independent advisors to progress the drafting of a policy for future consideration.

3. The RISC met on 19 November 2021, 11 February 2022, and 26 April 2022.

4. The discussions during these meetings and subsequent feedback were incorporated into the RI Policy.

5. The Responsible Investment Policy was approved at the Pension Fund Committee meeting of 17 June 2022, subject to consultation.

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DETAILS:

6. The RISC held meetings on 19 November 2021, 11 February 2022, and 26 April 2022 where the RI Policy was discussed and developed in conjunction with officers the independent investment advisor, investment consultant and Minerva.

7. A draft RI policy was delivered in the February meeting and feedback was subsequently requested from and provided by RISC members. This feedback was collated, categorised, and distributed prior to the April meeting.

8. In the April meeting it was agreed that itemised queries would be distributed with an officer recommendation against each item. RISC members were asked to provide feedback for each item - Note, Agree or Decline. Space for comments for each item was made available and a window of 10 days was provided for RISC members to complete this process. Feedback was collated and summarised, opinions were tallied, and sections were amended where required.

9. The RISC recognises that having gone through a thorough escalation process, the ultimate sanction for a company not complying with the RI Policy is its divestment from the Fund's portfolio, subject to pooling restrictions. The primary mechanism will be engagement with monitoring to check its effectiveness in agreement with best practice of escalation.

10. Further Consultation – it was raised in the April RISC that a consultation should be launched with members and employers.

11. The Responsible Investment Policy was approved at the Pension Fund Committee meeting of 17 June 2022, subject to consultation with members, employers, Committee, Board and the general public.

RI Policy Consultation

12. The consultation will be run and managed by the independent BIA Research, who are within Surrey County Council, the Fund's Administering Authority. This team has managed many large-scale consultations on a myriad of topics. This allows the Fund to utilise the full resources and expertise available whilst maintaining standard processes.

13. There are two separate consultations, one for members, employers, Board and Committee members, and one for the general public. The questions will be the same, except for an additional question on the former survey to identify the responder's classification.

14. The consultation questions are attached in Annexe 1. The first question relates to the responder and their classification. The second question seeks to reaffirm the commitment to the UN SDGs. The third question, and its parts, relate to the core RI beliefs, as listed in the RI Policy. The fourth question regards the engagement escalation policy, and the fifth demonstrates the Fund's collaborative engagement. There is a text box at the end for further comment if required.

15. The email communication will have a link that leads to the questions and RI Policy. Each link will have a unique identifier associated with it in order to avoid duplicate entries.

16. For members where no email address is on record, notification will be sent in the post. The letter will provide instructions on how to access the on-line survey with the unique link. Where a member requests to receive the survey in paper format, this will be sent to them together with a reply-paid envelope.

17. Internet access is available at all libraries throughout Surrey to access the full RI Policy online. It is also possible to post the full RI policy if requested. In the interest of the environment, we would not encourage this approach, but it will be made available where necessary.

18. The consultation is expected to start in September 2022.

19. Results to be collated by the independent BIA Research and reviewed by officers, Pension Fund Committee members and consultants.

20. The consultation will run for 6 weeks. The public consultation will only be available on the website, including checks to avoid duplicate submissions.

CONSULTATION:

21. The Chair of the Pension Fund Committee has been consulted on this report.

RISK MANAGEMENT AND IMPLICATIONS:

22. The consideration of risk related issues, including investment, governance and reputational risk, are an integral part of this project and will be considered as part of the project development.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

23. There are no financial and value for money implications contained in this report.

DIRECTOR CORPORATE FINANCIAL & COMMERCIAL

24. The Director Corporate Financial & Commercial is satisfied that all material, financial and business issues, and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER

25. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

26. There are no equality or diversity issues.

OTHER IMPLICATIONS

27. There are no potential implications for council priorities and policy areas.

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WHAT HAPPENS NEXT

28. The following next steps are planned:

    a) Analysis and consideration of results of the consultation with the Pension Fund Committee to review at the December 2022 meeting.

    b) Officers to continue work with the independent investment advisor, investment consultant, Minerva and BCPP to undertake planning for the implementation of the RI Policy.

Contact Officer:
Lloyd Whitworth, Head of Investment & Stewardship

Consulted:
Pension Fund Committee Chair

Annexes:

1. Consultation questions (Part 2)

Sources/background papers:

Surrey Pension Fund Responsible Investment (RI) Policy

Consultation for members, employers, Committee and Board members

Thank you for taking an interest in this stakeholder consultation on the Surrey Pension Fund Responsible Investment (RI) Policy.

This short survey should take no longer than five minutes to complete.

Accessibility (TO BE ADDED)

This survey complies with GDPR. If you require any further information about how we store and use the data you provide, please see our privacy policy here.

Q1: Which of the following groups best describe you?

1. LGPS member (including active, deferred and pensioners)
2. Employer
3. Board or Committee member

United Nations Sustainable Development Goals (UN SDGs)

The Sustainable Development Goals are a collection of 17 interlinked global goals designed to be a "blueprint to achieve a better and more sustainable future for all". THE 17 GOALS | Sustainable Development (un.org)

Q2: To what extent do you agree or disagree with the following statement?

Surrey Pension Fund believes that the UN SDGs should be the guiding principles for ESG engagement

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

The Surrey Pension Fund Responsible Investment Beliefs

Q3: To what extent do you agree or disagree with the individual RI beliefs set out below?

A: Surrey Pension Fund believes that the United Nations Sustainable Development Goals represent an appropriate foundation in terms of the Fund's overall RI approach

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

B: Surrey Pension Fund believes that taking account of RI considerations can provide investment opportunities, as well as identifying investment risks

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

C: Surrey Pension Fund requires the consideration of Environmental, Social and Governance (ESG) factors to be incorporated into the portfolio construction process of all investments made by its investment managers

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

D: Surrey Pension Fund believes RI considerations are important irrespective of asset class

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

E: Surrey Pension Fund believes RI considerations are important across all time horizons. This is true not just in terms of protecting and enhancing long-term investment return, but also increasingly in terms of the interests expressed by our stakeholders

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

F: Surrey Pension Fund believes that ESG factors are relevant in the context of benchmarking, risk analysis and investment opportunity identification

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

G: Surrey Pension Fund believes responsible management of RI Issues by Surrey Pension Fund and its agents is also considered a reputationally important issue

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree

5. Strongly agree

H: Surrey Pension Fund views climate risk - and the issues which contribute to it - as being of significant direct and indirect concern to all stakeholders, and as a result the Fund's approach towards 'Net Zero' is a prominent area of focus.

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

I: Surrey Pension Fund believes in an 'Engagement with Consequences' approach. This advocates the use of engagement over divestment as the means to promote our RI beliefs – however, taking legal action against company management or selling an asset remain options when it comes to inadequately addressed ESG concerns in the investments made by our managers

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

J: Surrey Pension Fund recognises the value in engaging collaboratively to leverage greater influence together with other investors who share our priorities through joint initiatives and organisations.

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

K: Surrey Pension Fund believes the exercise of Surrey Pension Fund's ownership rights through voting is an important part of implementing our RI beliefs

6. Strongly disagree
7. Disagree
8. Neither agree nor disagree
9. Agree
10. Strongly agree

Divestment

Divestment means selling an existing investment for a specific reason(s), which can include Environmental, Social or Governance (ESG) reasons.

Q4: To what extent do you agree or disagree with the following statement?

Surrey Pension Fund's approach to responsible investment is first to engage with companies to improve their business practices toward positive adoption of ESG principles. Where companies do not seek to improve their business practices then there should be a thorough escalation process where the Surrey Pension Fund works, including with its partners in pooled funds, to seek

improvements in their business practices and with the ultimate sanctions of exclusion or divestment considered

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

Working Collectively

Surrey Pension Fund collaborates with a number of organisations, for example, the Local Authority Pension Fund Forum (LAPFF), and is one of 11 LGPS Partner Funds within the Border to Coast Pensions Partnership. Whilst the assets within the Fund are in excess of £5 billion, this is small in comparison to market capitalisations, hence collaborative efforts maximise impact.

Border To Coast Pensions Partnership - UK Pensions Pool

LAPFF | The leading voice for local authority pension funds across the UK (lapfforum.org)

Q5: To what extent do you agree or disagree with the following statement?

Surrey Pension Fund's view is that more can be achieved by working with other like-minded investors than working alone

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

Final thoughts

Q6: Do you have any additional comments you would like to share regarding Surrey Pension Fund's RI Policy?

TEXT BOX

Closing page

Thank you for taking the time to complete this stakeholder consultation on the Surrey Pension Fund Responsible Investment (RI) Policy. Your opinion really matters!

End of survey

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SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **23 SEPTEMBER 2022**

LEAD OFFICER: **ANNA D'ALESSANDRO, DIRECTOR CORPORATE FINANCIAL & COMMERCIAL**

SUBJECT: **TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TCFD) REPORT**

SUMMARY OF ISSUE:

The Surrey Pension Fund Committee has committed to publishing a Task Force on Climate-related Financial Disclosures (TCFD) report annually. The report for the financial year 2021-22 can be found in Annexe 1.

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1. Approves the Surrey Pension Fund TCFD report for the financial year 2021-22.

REASON FOR RECOMMENDATIONS:

To continue the commitment of the Fund to publish a TCFD report.

BACKGROUND:

1. The Task Force on Climate-related Financial Disclosures is an industry-led initiative, created by the Financial Stability Board in December 2015. The aim of the TCFD is to develop voluntary, consistent, climate-related financial risk disclosures across a wide range of sectors, demonstrating the risk that climate change poses at a macro-economic level. This will then provide useful decision-making information for investors, lenders, insurers and other stakeholders. The disclosures enable organisations to identify and consider relevant information about material climate-related financial risks and opportunities that can have an impact on the decisions made by their stakeholders.

2. The recommendations are also applicable to asset owners and asset managers. As of October 2021, more than 2600 organisations globally had declared their support for the TCFD, representing a market capitalisation of over $25 trillion [Source: 2021 Status Report] Since its launch, TCFD has become the de-facto climate framework for global regulators. In November 2020, the UK Chancellor of the Exchequer announced that in order to accelerate progress on climate risk disclosures, the UK will move towards mandatory TCFD reporting across major segments of the UK economy by 2025, with a significant portion of requirements to be introduced by 2023.

3. Surrey Pension Fund became a supporter of TCFD in June 2019, because the Fund recognised the importance of understanding climate risks and opportunities relative to its role as an institutional investor. Over the past 12 months, the number of organisations expressing support for the TCFD has grown more than a third, emphasising the significance of having a standardised set of disclosures for all organisations to follow at a global level. This will provide a familiar and useful reporting format for the benefit of all stakeholders.

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DETAILS:

4. The TCFD report for the financial year 2021-22 can be found in Annexe 1

5. The data used in this report is as at 30 September 2021 and highlights the reduction in carbon emissions within the Fund in the preceding 3 months.

CONSULTATION:

6. The Chair of the Pension Fund Committee has been consulted on this report.

RISK MANAGEMENT AND IMPLICATIONS:

7. The consideration of risk related issues, including investment, governance and reputational risk, are an integral part of this project and will be considered as part of the project development.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

8. There are no financial and value for money implications contained in this report.

DIRECTOR CORPORATE FINANCIAL & COMMERCIAL

9. The Director Corporate Financial & Commercial is satisfied that all material, financial and business issues, and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER

10. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

11. There are no equality or diversity issues.

OTHER IMPLICATIONS

12. There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

13. The following next steps are planned:

a) If approved by the Committee, the TCFD report will be published on the Surrey Pension Fund website.
b) Future reports will use data as at the end of March each year and establish a base year for future comparison.

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Contact Officer:
Lloyd Whitworth, Head of Investment & Stewardship

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Annexes:

1. TCFD - Draft TCFD report (Part 2)

Sources/background papers:

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Surrey Pension Fund

Task Force on Climate-Related Financial Disclosure Report

September 2022

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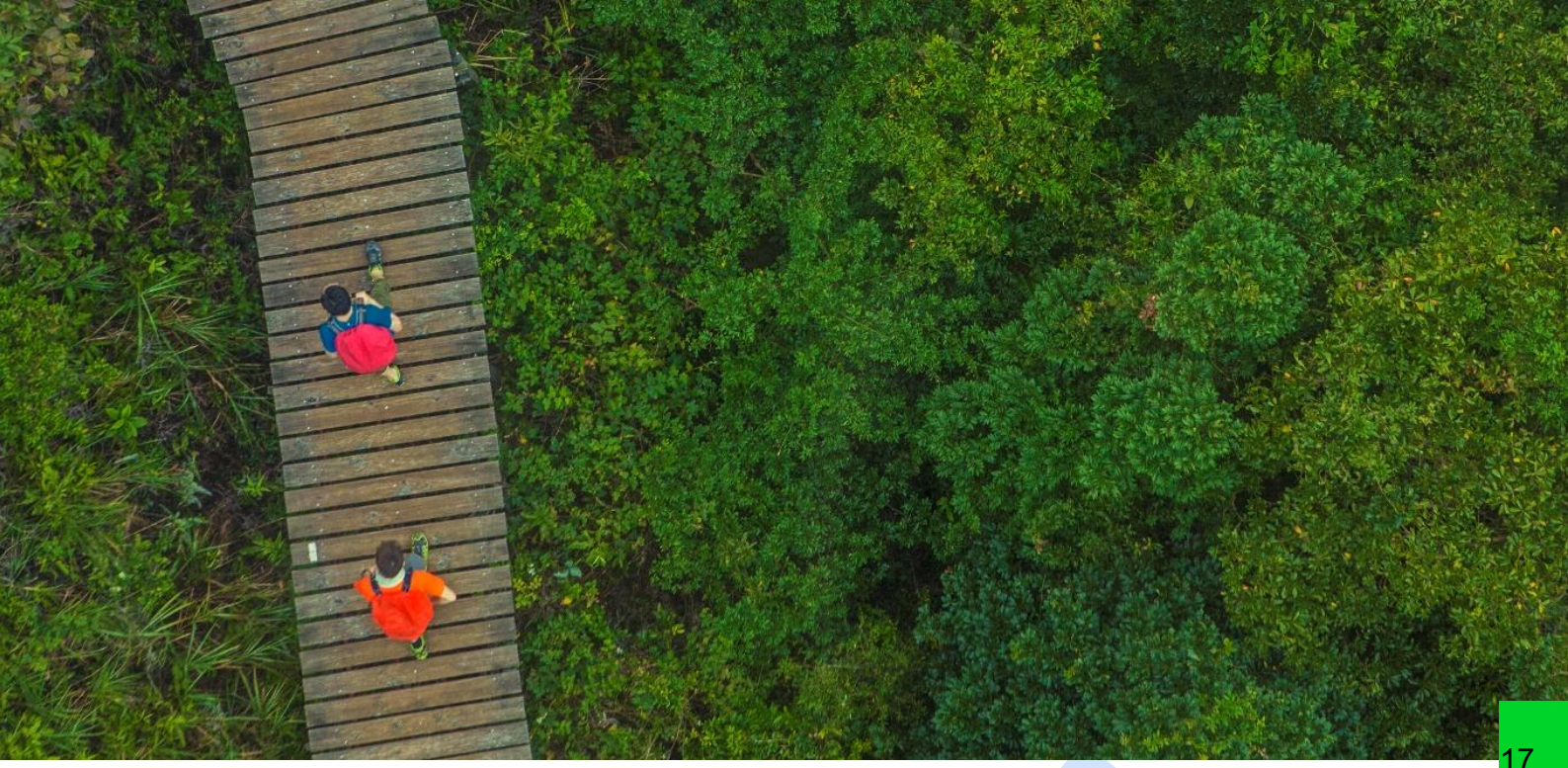


INTRODUCTION

The Pensions Fund Committee ("the Committee") of the Surrey Pension Fund ("the Fund") supports the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) as a framework to help manage and report on the actions being taken to identify climate change related risks and opportunities in the Fund's investment strategy.

The report explains how the Committee has established and maintains oversight and processes to satisfy itself that the Fund's relevant climate-related risks and opportunities are considered appropriately by all stakeholders involved in the day-to-day management of the Fund.

This report should be read in conjunction with the Border to Coast Pensions Partnership Ltd (BCPP)'s Responsible Investment Policy[1] and the Fund's Climate Policy[2, 3].

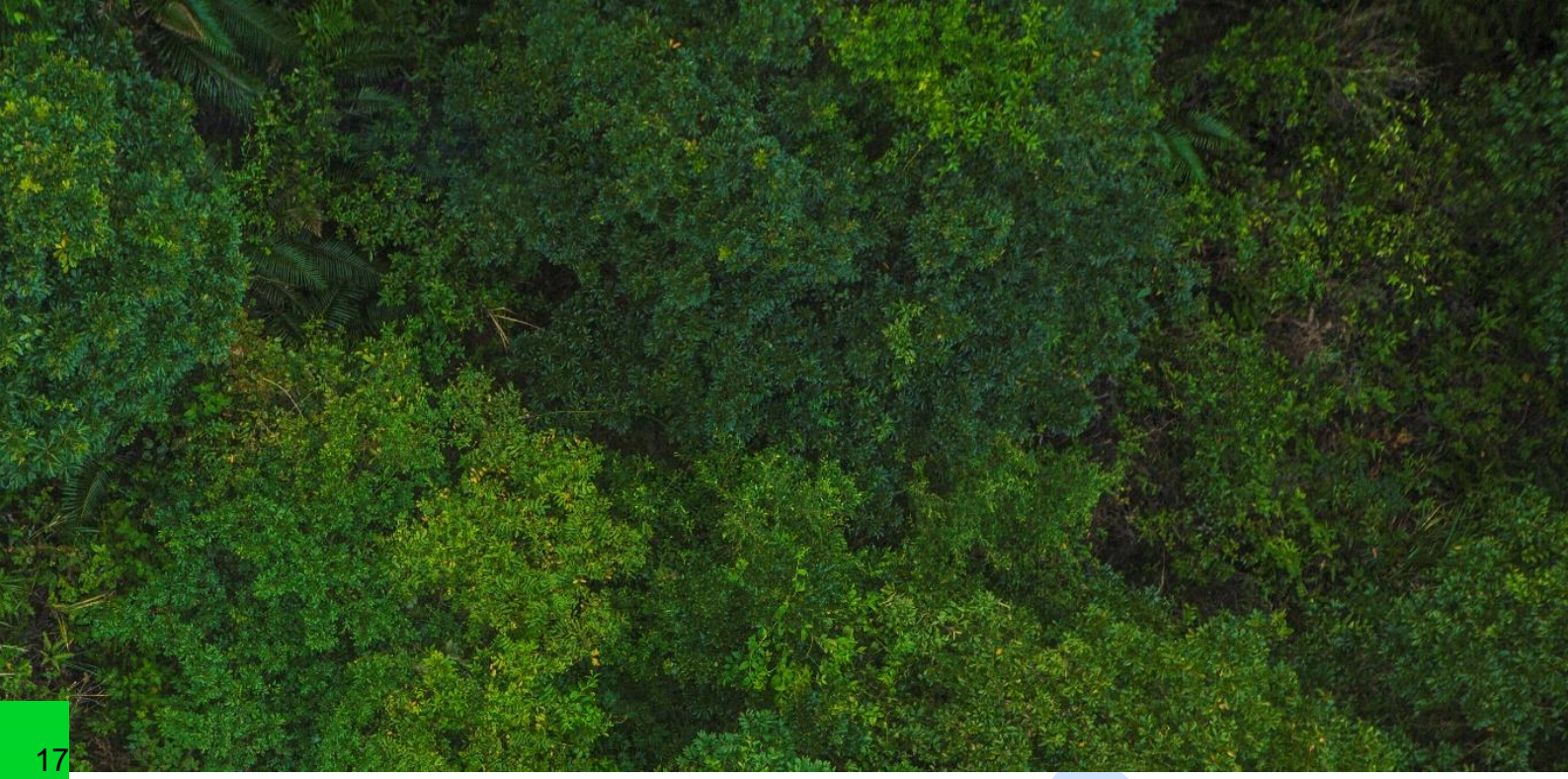
The Committee looks to fully integrate climate change and wider Environmental, Social and Governance ("ESG") issues into all decisions regarding the investment strategy of the Fund. This is done with the overriding objective of achieving the long-term investment returns required to help in the provision of paying pensions.

The Committee expects the Fund's approach to evolve over time, recognising a rapidly changing regulatory, societal, technological and macroeconomic backdrop.

The Committee recognises that climate issues can be more relevant and readily implementable for some parts of the portfolio than others. This statement outlines where governance of climate risk and opportunities has been applied. For example, the carbon footprinting analysis currently covers the Listed Equities holdings of the Fund, which represented c.60% of the Fund's total asset exposure as at 30 September 2021.

The Committee will seek to expand the remit of this reporting to cover the entirety of its portfolio as and when the ability to monitor these risks becomes more achievable via improved availability of data.

[1] https://www.bordertocoast.org.uk/wp-content/uploads/2022/07/TCFD-Report-2021-22.pdf
[2] https://mycouncil.surreycc.gov.uk/documents/s69261/13%20-%20Taskforce%20for%20Climate%20Related%20Financial%20Disclosure%20Report%20TCFD%202019-20%20-%20Annexe%201.pdf
[3] https://www.surreypensionfund.org/



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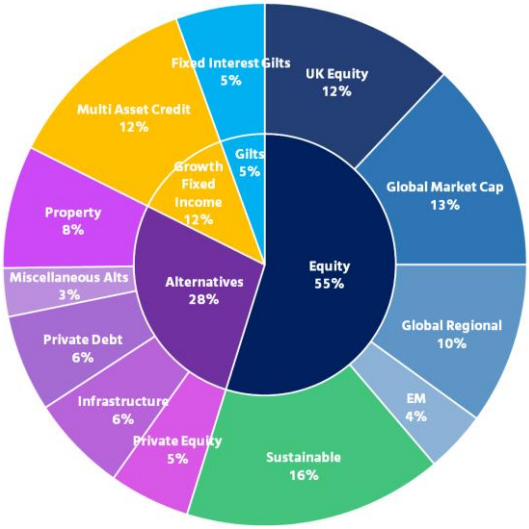
Summary

The Committee is pleased to note the following key highlights from this report:



- The Fund has c.16% (as a percentage of total fund benchmark assets) invested in strategies dedicated to addressing the risks associated with climate change and wider ESG issues.
- This is achieved by investing in LGIM's Future World index strategy. Assets that had higher exposure to carbon related risks and were less forward looking were sold to fund this allocation.
- The Fund has committed £235m for investment in the BCPP Climate Opportunities Fund. This strategy will look to invest in opportunities focused on reducing carbon emissions and supporting the transition to a low carbon economy.
- The Committee will be reviewing the Fund's investment strategy in 2022. A key part of this will be to further consider appropriate ways of addressing the risks and opportunities from climate change.
- The Fund first undertook carbon footprinting analysis of its equity holdings in June 2018 with 376.3 tCO2e per £million revenue compared to MSCI ACWI benchmark of 420.5 tCO2e per £ million revenue. The Fund at that time was below the benchmark by 10.5%.
- As at 30 September 2021, the Fund had 41.0 tCO2e per $ million invested compared to MSCI ACWI benchmark with 56.3 tCO2e per $ per million invested. The listed portfolio had a 27.2% lower carbon footprint than the MSCI ACWI index.

THE TCFD FRAMEWORK

The Financial Stability Board, an international body established by the G20 that monitors and makes recommendations about the global financial system, created the Task Force on Climate-related Financial Disclosures (TCFD) in 2017. TCFD was created to improve and increase reporting of climate-related financial information that can promote more climate-informed investments. This TCFD statement is prompted by that drive for transparency. Our aim is that members and stakeholders can better understand the climate-related risks and opportunities from ownership of companies and other investments.

Figure 1: TCFD Framework

TCFD recommendations are categorised under four pillars: Governance, Strategy, Risk Management, Metrics and Targets:

Governance
The organisation's governance around climate-related risks and opportunities.

Strategy
The actual and potential impacts of climate-related risks and opportunities on the organisation's business strategy, and financial planning.

Risk Management
The processes used by the organisation to identify, assess, and manage climate-related risks.

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities.

Asset owners, like the Fund, sit at the top of the investment chain and therefore have an important role to play in influencing the organisations through which they invest and companies in which they ultimately invest to provide better climate-related financial disclosures. Disclosure of climate-related risks and opportunities by asset owners allows beneficiaries and other audiences to assess the asset owner's investment considerations and approach to climate change.

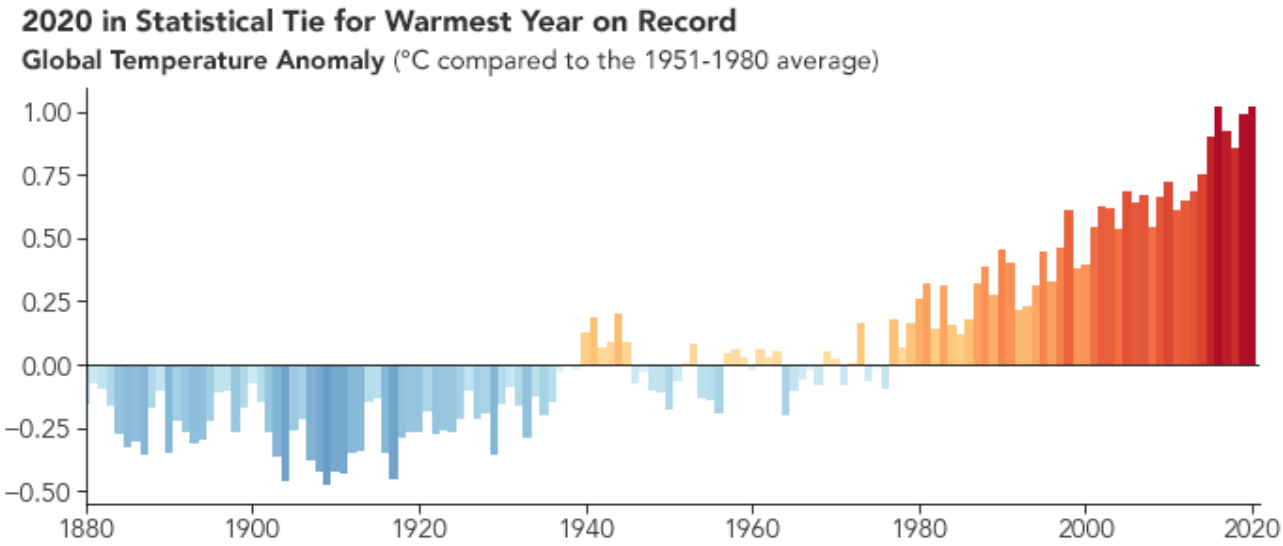
For the Fund this means an assessment of our integration. Integration is the way we incorporate all material and relevant climate-related financial and non-financial information into our investment activities and decision making. How we think about climate change when we set our investment strategy, when we make new investment decisions, and when we manage our existing portfolio are all examples of integration. We hope and believe that our climate-related financial disclosures encourage better disclosures across the investment chain — from asset owners to asset managers to underlying companies.

CLIMATE-RELATED RISKS

Human activities are estimated to have caused approximately 1.0°C of global warming above pre-industrial levels. Most of this warming has occurred in the past 35 years, with the five “warmest” years on record taking place since 2010. Between the years 2006-2015, the observed global mean surface temperature was 0.87°C higher than the average over the 1850-1990 period. The overwhelming scientific consensus is that the observed climatic changes are the result primarily of human activities. This includes electricity and heat production, agriculture and land use change, industry, and transport.

In a report from August 2021, the UN's Intergovernmental Panel on Climate Change (IPCC) stated that "it is unequivocal that human influence has warmed the atmosphere, oceans and land“ and that it is “already affecting many weather and climate extremes in every region across the globe”.

Figure 2: Graph showing Global Temperature Anomaly.



Source: NASA

In order to mitigate the worst economic impacts of climate change, there must be a large, swift, and globally coordinated policy response. Despite this, the majority of climate scientists anticipate that given the current level of climate action, by 2100 the world is estimated to be between 2°C and 4°C warmer, with significant regional variations. This is substantially higher than the Paris Climate Change Agreement, which reflects a collective goal to hold the increase in the climate’s mean global surface temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C.

Given its contribution to global greenhouse gases (GHG) emissions, the energy sector is expected to play a significant role in the long-term decarbonisation of the economy. It is important to recognise however that not only is the supply of energy expected to be a factor in global decarbonisation, but the demand for energy plays a crucial role too. In addition, the behaviour of private and state-owned energy companies is as important as their publicly traded counterparts. The issue faced by diversified investors such as pension funds is not limited to the oil and gas and power generation sectors, but also to downstream sectors. Investors focusing exclusively on primary energy suppliers could fail to identify material climate risks in other sectors.

Research suggests that the oil and gas sector is not homogeneous with regard to climate risk: were climate policies to affect the oil price negatively, those companies with assets lower down the cost curve are less likely to be financially compromised than those companies with higher cost assets. Investors that assume each fossil fuel company bears an equal magnitude of climate-related risk could be led towards sub-optimal decision-making. The Fund recognises that climate-related risks can be financially material and that consideration of climate risk falls within the scope of the Fund’s fiduciary duty.

Given the Fund’s long-dated liabilities, investment time horizon and the timeframe in which climate risks could materialise, a holistic approach to risk management covering all sectors and all relevant asset classes is warranted.

GOVERNANCE

Describe the Committee's oversight of climate change-related risks and opportunities

The Fund is administered by Surrey County Council, ("the Administering Authority"). The Administering Authority has delegated all its functions as administering authority to the Pension Fund Committee ("the Committee").

The Committee maintains an Investment Strategy Statement, which outlines how the Committee will invest the Fund's assets. The Committee is also responsible for approving and monitoring the Fund's approach to responsible investment and climate change, as part of its approval of the Climate Policy[1], input into BCPP's Responsible Investment Policy[2] and Climate Change Policy[3].

The Committee meets at least four times a year and more frequently, as deemed required. The Committee takes independent investment advice to help assess climate risks and opportunities, and looks to ensure that any decisions are integrated into a coherent investment strategy that supports the Fund's ability to provide pensions over the long-term in an affordable way.

The Committee undertakes training on a regular basis, including training and information sessions on matters of social, environmental and corporate governance.

A focused sub committee has been established to specifically consider the Fund's Responsible Investment Policy. This working group is convened on a regular basis to work with Officers, the Fund's consultants and independent advisor to progress the Responsible Investment Policy.

Describe management's role in assessing and managing climate change-related risks and opportunities

The implementation of the management of climate change-related risks with respect to specific securities is delegated to the Fund's appointed investment managers. The Committee monitors the Fund's investment managers on an ongoing basis, including with respect to stewardship activities. Each manager's approach to climate change risks and opportunities and how these are integrated into their investment process is assessed as part of the manager selection and monitoring process.

The Committee reviews how its managers assess, manage and integrate climate risks into their portfolio construction and security selection decisions. The Committee will engage with managers where they are perceived to be lagging their peers in terms of ESG integration and climate risk management or active ownership.

BCPP is an FCA-authorised investment fund manager. It operates investment funds for its twelve shareholders which are Local Government Pension Scheme funds, known as Partner Funds. BCPP takes a long-term approach to investing and believes that businesses that are governed well and run in a sustainable way are more resilient, able to survive shocks and have the potential to provide better financial returns for investors.

The commitment to responsible investment is communicated in the BCPP UK Stewardship Code compliance statement. BCPP takes a holistic approach to sustainability and as such it is at the core of its corporate and investment thinking. Sustainability, which includes Responsible Investment, is considered and overseen by the Board and Executive Committees. Specific policies and procedures are in place to demonstrate the commitment to Responsible Investment, which include the Responsible Investment Policy and Corporate Governance & Voting Guidelines. Border to Coast has a dedicated staff resource for managing Responsible Investment within the organisational structure.

[1] https://mycouncil.surreycc.gov.uk/documents/s69261/13%20-%20Taskforce%20for%20Climate%20Related%20Financial%20Disclosure%20Report%20TCFD%202019-20%20-%20Annexe%201.pdf
[2] https://www.bordertocoast.org.uk/wp-content/uploads/2022/03/RI-Policy-2022.pdf
[3] https://www.bordertocoast.org.uk/wp-content/uploads/2022/03/Border-to-Coast-Climate-Change-Policy-Oct-2021.pdf

STRATEGY

Describe the climate-related risks and opportunities the Fund has identified over the short, medium and long term

The Fund became a supporter of TCFD in June 2019, as it recognises the importance of understanding climate risks and opportunities relative to its role as an institutional investor.

The Fund aims to deliver a first-class service through strong partnerships with members, employers, BCPP and the wider LGPS community. Environmental, Social and Governance factors are fundamental to this approach which is underpinned by risk management, informed decision making and the highest standards of corporate governance.

The integrated nature of climate change and its ability to impact most industries, means that the Fund chooses not to take a sector wide exclusion approach to its investments. Undoubtedly in every sector there will be best in class and worst in class companies, representing both investment risks and opportunities. It chooses therefore to engage with its fund managers, companies and where possible, policy makers, to influence them directly to move towards a sustainable financial strategy that ultimately provides long term value for its shareholders. Engagement not only covers the Fund's investments but engagement is equally vital with governments, regulators and policy makers to enable those companies to transition to a carbon neutral economy. Similar to the Fund's investment approach, engagement is also a long-term approach with the goal for companies and economies globally to be carbon neutral by 2050 to limit global warming to within the 2 Degree Scenario.

In terms of the impact of climate-related risks and opportunities on the Fund's strategy, the approach chosen can vary considerably between different asset classes. Within the Fund's current assets, it applies mainly to its listed and unlisted equity investments. From a listed equity perspective, the Fund currently holds a 16% allocation to a sustainable equity fund, including a tilt to companies less reliant on carbon in their business operations. From a Private Market perspective, the Fund also seeks environmentally sustainable investments, which is where the majority of climate-related investment opportunities currently exist. In this regard, the Fund has invested in a Renewable Energy Infrastructure strategy, and recently committed to a Climate Opportunities fund.

From the perspective of BCPP, climate risk is factored into the selection and appointment of external managers and ongoing monitoring of these mandates. This will therefore inform future engagement initiatives, and collaboration opportunities.

The Committee has chosen to use the United Nations Sustainable Development Goals (SDGs) as a reference to help guide its approach to Responsible Investment.

The Committee is working with its consultants and advisor, together with BCPP to understand what future opportunities might be available and how these would fit with the overall Responsible Investment Policy and investment strategy.

As a long-term investor, the Committee recognises that the risks and opportunities arising from climate change are diverse and continuously evolving. The Committee believes that climate change presents risks over the short, medium and long-term that the Fund should better understand and mitigate where possible. The Committee has considered the following short, medium and long term drivers of risk:

Over the short term (0 to 10 years), risks may present themselves through rapid market repricing relating to climate transition as:

- Scenario pathways become clearer. For example, a change, in the likelihood of a below 2°C scenario occurring becoming higher and driving the transition risk to occur.
- Market awareness grows. For example, the implications of the physical impacts of climate change become clearer to markets and impact asset valuations.
- Increases in the energy/heat efficiency of buildings and infrastructure the Fund holds.
- Perceived or real increased pricing of greenhouse gas emissions/carbon.
- Substitution of existing products and services with lower emission alternatives may impact part of the portfolio.
- Litigation risk relating to dangerous warming becoming more prevalent.

The Fund's ability to understand these short-term changes can position it favourably, for example taking advantage of the climate transition by avoiding and reducing investment in high-emitting carbon sensitive sectors, etc.

Over the medium term (10 to 30 years), risks associated with the transition to a low carbon economy are still likely to dominate. This includes the development of technology and low carbon solutions. Policy, legislation and regulation are likely to also play a key role at the international, national and subnational level. Technology and policy changes are likely to produce winners and losers both between and within sectors. Advancement of transition is likely to have started to crystallise stranded asset risks over the medium term. The Fund's ability to understand these changes may positon it favourably, for example by allocating investments into new technologies or by avoiding and reducing portfolio reliance on high-emitting carbon sensitive sectors, etc.

Over the long term (30 to 80 years), physical risks are expected to come to the fore. This includes the impact of natural catastrophes leading to physical damages through extreme weather events. Availability of resources is expected to become more important if changes in weather patterns such as temperature or precipitation affect the availability of natural resources such as water. The Fund's ability to understand these changes may position it favourably, for example by allocating investments to infrastructure projects that display high levels of climate resilience, etc. A changing climate may directly impact the viability of some assets or business models (for example, flood risk for real estate, or drought / fire risk for timberland assets).

Figure 3: Climate-related risk and opportunities.

Source: TCFD annex report

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Describe the impact of climate change related risks and opportunities on the Fund's business, strategy and planning

The Committee considers exposure to carbon risk in the context of its role in setting investment strategy. The Committee has been on a journey to lower the Fund's carbon footprint since 2018 by regularly monitoring the Fund's decarbonisation progress and analysing how the Fund is performing in terms of its carbon footprint. This analysis has led to the implementation of more carbon-aware strategies.

In 2021, the Fund made changes to invest in the LGIM Future World. The Committee believes that this fund is well positioned from an ESG perspective and is expected to help reduce exposure to companies with poor ESG practices. The Committee views this as both an attractive return opportunity and an important way of positively contributing to the transition to a lower carbon world.

Looking forward, the Committee have discussed setting explicit decarbonisation targets and these will be considered further in due course.

Figure 4: Climate Change Scenario Analysis

Long Term Strategic Investment Strategy		
2ºC	2030	
	2050	
	2100	
3ºC	2030	
	2050	
	2100	
4ºC	2030	
	2050	
	2100	

<-10 bps >-10 bps, < 10 bps > 10bps

Impact on the expected long term returns in basis points per annum of the Fund's strategy compared to the baseline

Describe the resilience of the Fund's strategy, taking into consideration different climate-related scenarios, including a 2˚C or lower scenario

Climate change scenario analysis has been undertaken on the Fund's strategic asset allocation to assess the potential implications of climate change under three modelled scenarios (2-3-4˚C warming) and over three time periods (2030, 2050 and 2100), with 2˚C warming acting as the transition scenario. The analysis is based on research from Mercer's report in 2019, titled "Investing in a Time of Climate Change: The Sequel".

The indicative analysis suggests that from a long-term strategic investment perspective, the Fund is relatively well positioned in scenarios of lower levels of global warming for the periods to 2030 and 2050. As the time periods increase, it is expected that the overall returns will be negatively impacted by climate change, underlying the need for further review and action. The Committee notes that the modelling may understate the true level of risk and uncertainty is likely to be greater for higher warming scenarios, in particular due to the difficulty in being able to accurately predict the future.

The analysis helps the Committee to understand that asset prices may not fully reflect the financial impact of future physical risks or the transition costs associated with policy action required to limit global warming to 2˚C or less, nor that asset prices fully reflect the technology risk inherent in the transition.

The Fund's long term strategic asset allocation is well positioned to contribute and benefit from limiting global warming by the end of the decade.

The analysis supports the view that long term investors collectively trying to bring about an effective transition is aligned to their fiduciary duty to seek the best returns within risk, liquidity and complexity constraints.

RISK MANAGEMENT

Describe the Fund's process for identifying and assessing climate change-related risks

The Committee takes an active role in ensuring it invests with due attention to ESG issues. The Fund's focus remains on maintaining appropriate investments having every regard to climate change implications. The Committee has an annual ESG monitoring framework by covering carbon footprinting analysis and TCFD monitoring indicators. The Committee will engage with its investment managers and BCPP on the key findings as necessary by inviting managers to outline their activities as required that enable the Committee to monitor and manage climate risk. The Committee outlines in the following Metrics and Targets section the key findings of the carbon footprinting analysis. On a regular basis, investment managers and BCPP are invited to present to the Committee to explain their approach to climate change risk management, amongst other topics.

The Committee receives regular updates from its investment managers on how they integrate ESG considerations, including climate change, into their investment processes and active ownership activities. If a manager is considered to be "lagging the market", the Committee will engage with the relevant manager(s) to strongly encourage that it improves in policies and practises in this areas.

The Committee uses stewardship monitoring to identify how the managers it chooses vote and engage on climate issues in order to manage climate risks in the portfolio.

The Committee has identified long-term investment strategy risks and included such risks into its risk register. The register is monitored in the course of its overall risk management approach and is reviewed regularly. It is used to effectively identify, prioritise, manage and monitor risks associated with the Fund and the escalations of risk are managed by internal controls in place:

1. The asset allocation is formally reviewed as part of quarterly reports to the Committee and necessary action is taken to correct the balance.
2. The Committee receives formal quarterly reports on both the overall performance of the Fund and individual investment managers.
3. A full investment strategy review is undertaken by the Fund's investment consultant after every triennial valuation with ad-hoc strategy reviews undertaken in intervening years to ensure the strategy is still appropriate to achieve long-term funding objectives.
4. BCPP has set a long-term goal of being net zero carbon by 2050 or sooner, and are working to establish interim targets to help achieve this, which will be regularly monitored.
5. The Fund has in place a Responsible Investment policy.

Describe the Fund's process for managing climate change related risks

All of the Fund's investment managers have been asked to provide carbon footprinting metrics, where available, in order to take a "total portfolio" approach and be consistent with TFCD recommendations. This analysis helps identify key sources of carbon risks in manager portfolios and helps the Committee to engage with the manager(s) on such risks.

The Committee manages risk by prioritising those it believes may be most financially materially linked to the Committee's beliefs.

The Committee recognises the challenges with various metrics, tools and modelling techniques used to assess climate change risks. The Committee aims to work with its consultants and advisor, and investment managers on a regular basis with the aim of improving its approach to assessing and managing risks over time.

The Fund sees engagement as a fundamental tool in managing climate risk within its portfolio companies. The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), which collectively engages with multinational companies on behalf of most Local Authority Pension Funds in the UK. Collaboration with other institutional investors enhances the Fund's own influence in engagement with companies, regulators and policy makers, all playing significant roles in the low carbon transition. The Fund will support climate-related shareholder resolutions after having consulted with BCPP, provided it is in line with their Corporate Governance & Voting Policy1, also adopted by all partner funds.

Describe how processes for identifying, assessing and managing climate change-related risks are integrated into the Fund's overall risk management

Both climate change-related risks and wider investment risks are considered by the Committee. Where possible, climate change and wider investment risks such as demographic trends are treated in a holistic manner by recognising they are often interrelated. Climate change and ESG risks are included alongside other material risks in the Investment Strategy Statement and the risk register.

The climate change scenario analysis is strategic in nature and has therefore been incorporated into wider investment strategy discussions and considerations.

[1] https://www.bordertocoast.org.uk/wp-content/uploads/2022/03/RI-Policy-2022.pdf

METRICS AND TARGETS

Disclose the metrics and targets used to assess climate change-related risks and opportunities in line with strategy and risk management process.

This section presents carbon data analysis of the Listed Equities holdings of the Fund which represents c.60% of the Fund's investment mandates as at 30 September 2021. Due to practical data availability, the fund-level figures quoted in the report assume that companies not covered by the analysis are represented within the range of companies that have been covered in the analysis – the 'pro-rata approach' (i.e. it is not assumed that companies not covered have emissions of 0) in line with statutory guidance.

The remaining assets consist of Fixed Interest Gilts, Property, Multi Asset Credit, Diversified Growth, Private Equity and Infrastructure mandates, for which the ability to monitor these risks is currently less achievable. The Committee recognises that the availability of accurate data for some asset classes is an industry wide issue and encourages the Fund's investment managers and the companies in which they hold these assets to improve their carbon reporting as quickly as possible.

The Committee has initially focused on carbon footprinting analysis as a key metric for assessing risks and has compared this against a relevant benchmark or other comparator. Since 2018, the Committee has analysed the carbon intensity of the Fund's equity assets. In 2021, the Committee analysed additional indicators, such as absolute emissions and implied temperature rise.

The Committee will undertake carbon footprint analysis on an annual basis.

The carbon footprinting metrics measured aid the Committee in assessing the potential climate change related risks to which the Fund is exposed, and identifying areas for further risk management, including company engagement and investment manager monitoring:

- **Weighted Average Carbon Intensity ("WACI")** – measures the carbon emissions (in Metric tons) divided by sales (per $million of sales). The contribution of each company is weighted according to its portfolio weights. This means, for example, a company with a very high carbon intensity but a low fund weighting might contribute to the WACI measure to a lesser extent than an company with a lower carbon intensity but a higher weighting in the fund.
- **Absolute emissions** – represents a company's reported or estimated greenhouse gas emissions, where available. It includes various scopes of emissions:
  - **Scope 1 "direct" emissions:** those from sources owned or controlled by the company (e.g. direct combustion of fuel from vehicles); and
  - **Scope 2 "indirect" emissions:** those caused by the generation of energy (e.g. electricity) purchased by the company.
- **Implied temperature rise** – represents the implied temperature trajectory of a company's operations expressed as ºC portfolio weights. It allows for tilting of the portfolio towards companies with a <2ºC implied temperature rise, to show alignment with the Paris Agreement ambition.

Carbon footprinting

The carbon footprint analysis includes scope 1 and 2 emissions (those emitted either directly by a company or indirectly through its procurement of electricity and steam) but does not include scope 3 emissions (those emitted by a company's suppliers and customers). This means that for some companies the assessment of their carbon footprint could be considered an 'understatement'. Examples could include an online retailer whose logistics emissions are not included in scope 1 or 2.

Scope 3 emissions are currently not included in the carbon footprint metrics for two reasons:

- The rate of scope 3 disclosure remains insufficient to use reliably in carbon footprinting analysis
- The inclusion of scope 3 emissions may lead to double counting at the portfolio level.

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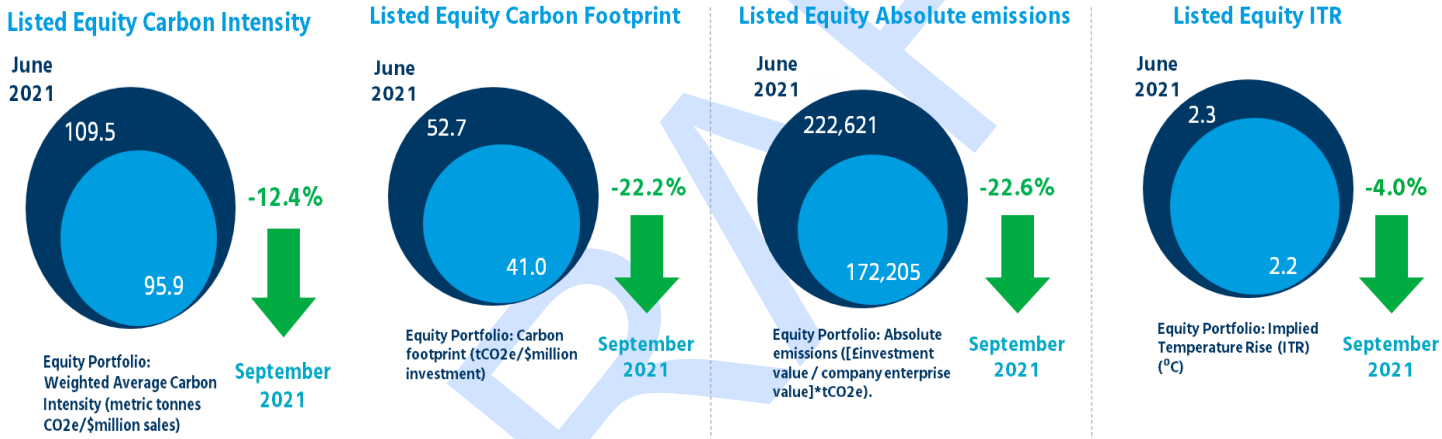
TCFD analysis summary

- The Fund has been decarbonising its Listed Equity assets since 2018 with the transition of assets to BCPP, termination of Marathon and UBS equity fund managers and transition into a Future World fund with LGIM. As at 30 September 2021 the Fund had 41.0 tCO2e per $ million invested compared to MSCI ACWI benchmark with 56.3 tCO2e per $ per million invested. The listed portfolio had a 27.2% lower carbon footprint than MSCI ACWI.
- In absolute terms, the WACI reduced further over the period and was c. 38% lower than the market (as represented by the MSCI ACWI) as at September 2021. This was largely driven by the changes made to the equity portfolio.
- The weighted average absolute emissions are equivalent to c.172k tCO2e as at 30 September 2021.
- The weighted average implied temperature rise (ITR) of the listed portfolio at 30 September 2021 was 2.2ºC, which is 0.2ºC lower as compared with the MSCI ACWI (at 2.4ºC).

Figure 5: Summary Analysis



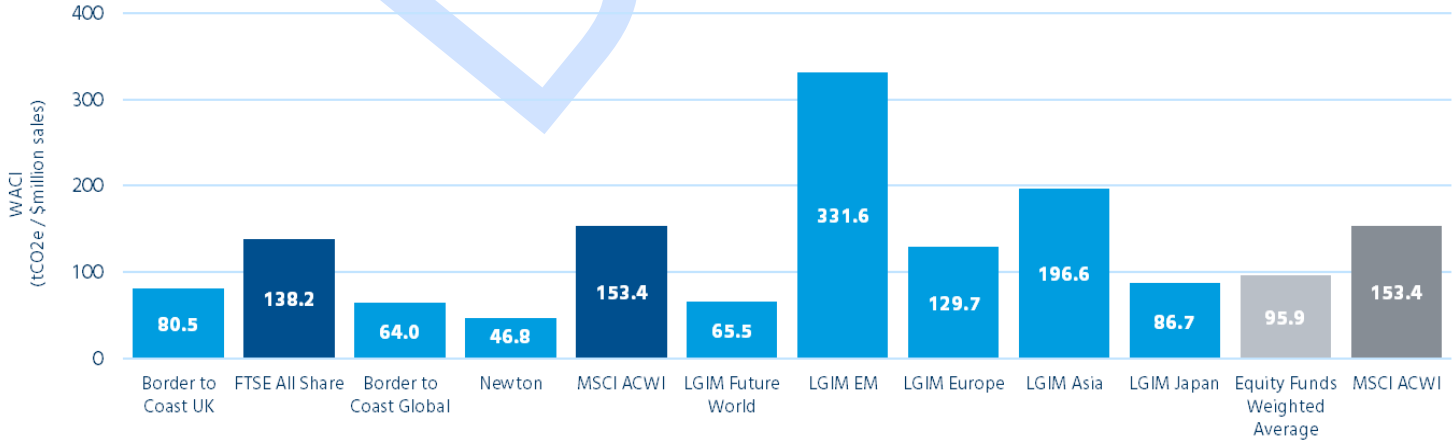
The **listed equities holdings' carbon intensity (WACI) fell by c.-12.4%** over the 3 month period to September 2021.

The **listed equities holdings' carbon footprint fell by c.-22.2%** over the 3 month period to September 2021.

The **listed equities holdings' absolute emissions fell by c.-22.6%** over the 3 month period to September 2021.

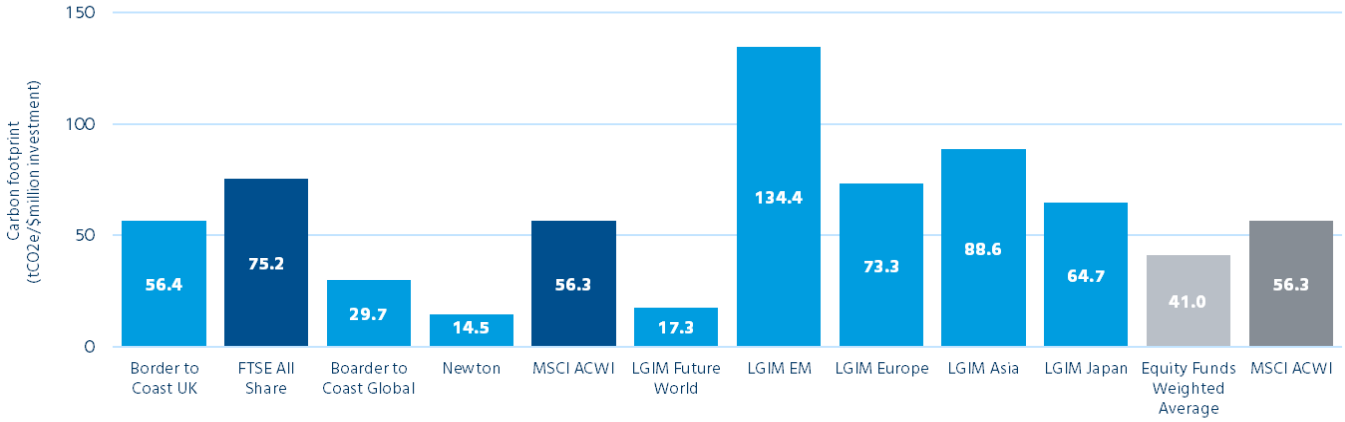
The **listed equities holdings' ITR fell by c.-4.0%** over the 3 month period to September 2021.

Figure 6: Equity Assets – Weighted Average Carbon Intensity



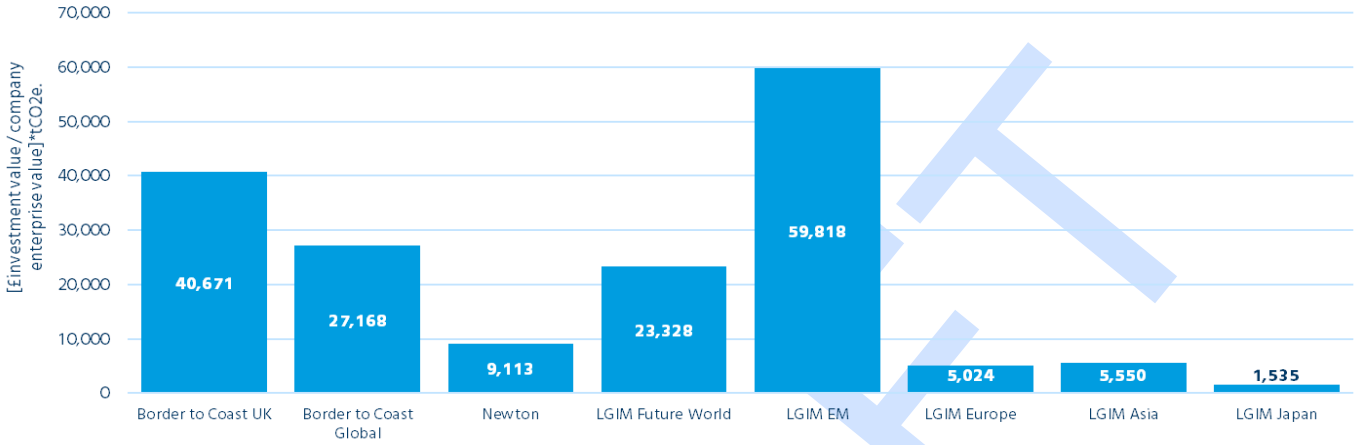
Note: Underlying data as at 30 June 2021. The weighted average figure is based on the actual allocation of the at 30 September 2021.

Figure 7: Equity Assets – Carbon Footprint



Note: Underlying data as at 30 June 2021. The weighted average figure is based on the actual allocation of the assets at 30 September 2021.

Figure 8: Absolute Emissions ([£investment value / company enterprise value]*tCO2e)

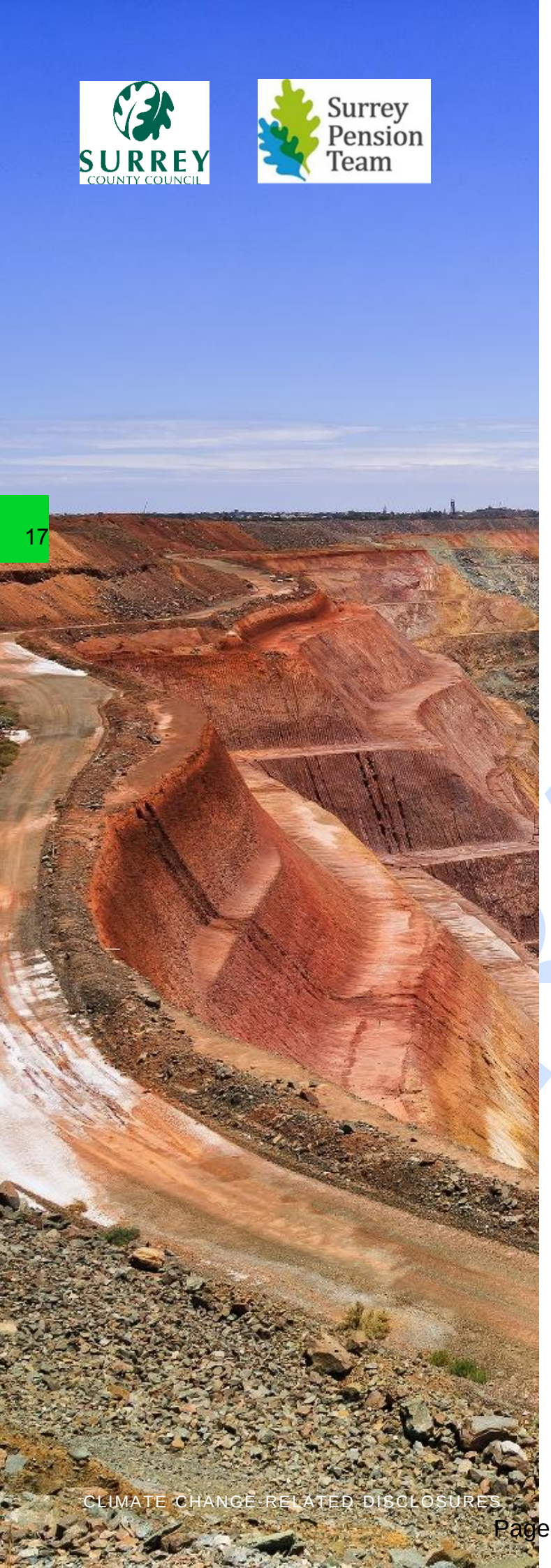


Note: Underlying data as at 30 June 2021. The weighted average figure is based on the actual allocation of the assets at 30 September 2021.

Figure 9: Implied Temperature Rise (˚C)

Asset Class	Manager/ Mandate	% of Fund Covered by Assessment	Benchmark	Benchmark ITR	Fund ITR	Percentage of Portfolio
				°C	°C	(%)
Listed Equity	Border to Coast UK	92.9%	FTSE All Share	2.3	2.3	10.6%
	Border to Coast Global	96.5%	MSCI ACWI	2.4	2.2	13.4%
	Newton	97.2%	MSCI ACWI	2.4	2.1	9.1%
	LGIM EM	95.0%	-	-	2.9	6.3%
	LGIM Europe	96.6%	-	-	2.3	1.0%
	LGIM Asia	97.6%	-	-	2.8	0.9%
	LGIM Japan	98.3%	-	-	2.6	0.3%
	LGIM Future World	93.8%	-	-	2.1	18.7%

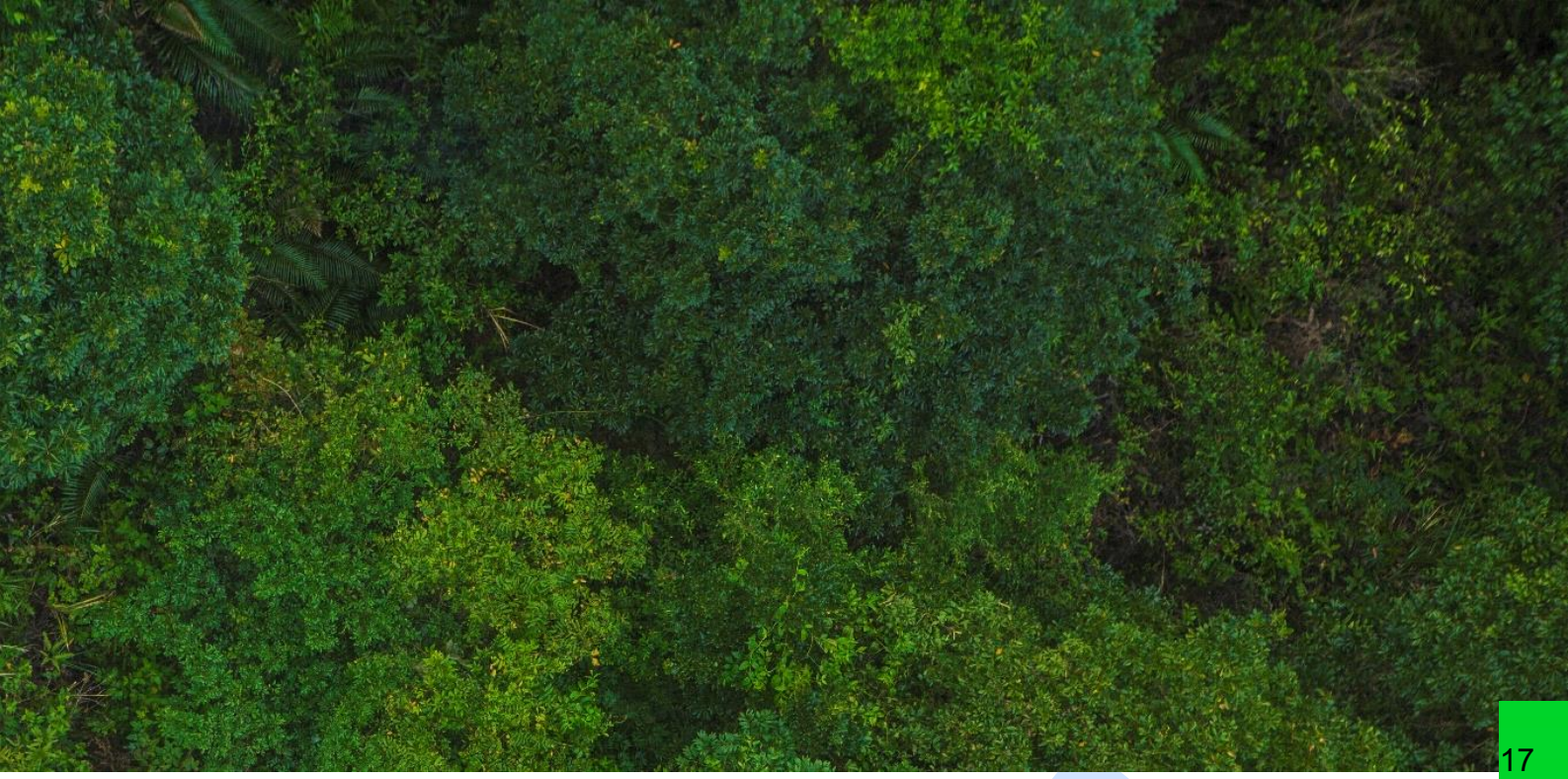
Source: Investment managers and Mercer. Analysis as at 30 June 2021,



GLOSSARY OF TERMS

Acronym	Meaning
ESG	Environmental, Social & Governance
GHG	Greenhouse Gas
G20	Intergovernmental forum comprising 19 countries and the European Union
IPCC	UN's Intergovernmental Panel on Climate Change
MSCI ACWI	Morgan Stanley Capital International All Country World Index
Net Zero	Achieving a balance between the carbon emitted into the atmosphere, and the carbon removed from it.
Paris Aligned	Achieving net zero emissions by 2050 or sooner, in line with the Paris Agreement.
RI	Responsible Investment
SDG	Sustainable Development Goals
TCFD	Task Force on Climate-related Financial Disclosures
WACI	Weighted Average Carbon Intensity

All analysis in this document is subject to change and should not be relied upon.



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MSCI

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SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **23 SEPTEMBER 2022**

LEAD OFFICER: **ANNA D'ALESSANDRO, DIRECTOR CORPORATE FINANCIAL & COMMERCIAL**

SUBJECT: **NET ZERO CONSIDERATIONS**

SUMMARY OF ISSUE:

This paper provides an update on analysis by Mercer in consideration of the Surrey Pension Fund's desired date for achieving net zero.

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1. Note the analysis of the Fund's investment consultant, Mercer, in respect of a pathway to carbon net zero.
2. In light of recommendation 1, and in tandem with the proposed pathway to carbon net zero from BCPP, approve a carbon net zero target date for the Surrey Pension Fund of 2050 or sooner, and work towards establishing interim targets for 2030, 2035 and 2040.

REASON FOR RECOMMENDATIONS:

To establish a carbon net zero date in accordance with the Responsible Investment Policy. This is consistent with the Fund's strategic investment objectives.

BACKGROUND:

1. At its meeting of 10 September 2021, the Pension Fund Committee approved the proposed structure for a standalone Responsible Investment Policy.

2. Part of the RI Policy is to set a target date for the Fund's net zero ambition.

3. The RISC has explored a different partner fund approach in determining their own net zero aspirations.

4. The Committee requested further information from BCPP and Mercer to support its decision-making process.

DETAILS:

5. The RISC held meetings on 19 November 2021, 11 February 2022, and 26 April 2022 where net zero targets were discussed.

6. The committee requested analysis to understand what is possible with regard to net zero dates.

7. In the February RI sub-committee meeting, Mercer presented evidence showing the difficulty of achieving net zero status in the short-term given the limited number of investment opportunities currently available.

8. An updated presentation from Mercer showing this analysis is available in Annexe 1. Focusing investments on companies aligned to a 1.5 degree implied temperature rise now, using current analysis (generally excluding Scope 3 emissions), reduces the investable universe in terms of number of companies by 85%, and 77% on a market capitalisation basis. Diversification is reduced significantly and value at risk rises.

9. The analysis prepared by Mercer is consistent with their view of attaining net zero status by 2050 or sooner.

CONSULTATION:

10. The Chair of the Pension Fund Committee has been consulted on this report.

RISK MANAGEMENT AND IMPLICATIONS:

11. The consideration of risk related issues, including investment, governance, and reputational risk, are an integral part of this project and will be considered as part of the project development.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

12. There are no financial and value for money implications contained in this report.

DIRECTOR CORPORATE FINANCIAL & COMMERCIAL

13. The Director Corporate Financial & Commercial is satisfied that all material, financial and business issues, and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER

14. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

15. There are no equality or diversity issues.

OTHER IMPLICATIONS

16. There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

17. The following next steps are planned:

    a) Officers to continue work with the independent investment advisor, investment consultant, Minerva and BCPP to undertake planning for the steps required to meet the net zero target.

Contact Officer:
Lloyd Whitworth, Head of Investment & Stewardship

Consulted:
Pension Fund Committee Chair

Annexes:

1. Mercer presentation

Sources/background papers:

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Mercer

Surrey Pension Fund

Net zero considerations

August 2022

Steve Turner
Sandy Dickson

welcome to brighter

Summary

This is a discussion document on Net Zero decarbonisation targets. 2050 is the current globally accepted “standard” target date, which is supported by science. If investors wish to adopt more ambitious targets, a key point to understand is that potentially radical changes will be needed to investment portfolios, leading to increased levels of concentration risks and reductions in diversification. Crucially, such changes may not necessarily translate into real world impact and help make progress to a lower carbon world.

Earlier targets are possible but will be harder to achieve and involve reduced diversification

Investing only in companies aligned with an Implied Temperature Rise of 1.4/1.5°C would increase 3 year VaR (funding risk) by c.£200m

Balancing actual portfolio metrics or real world change?

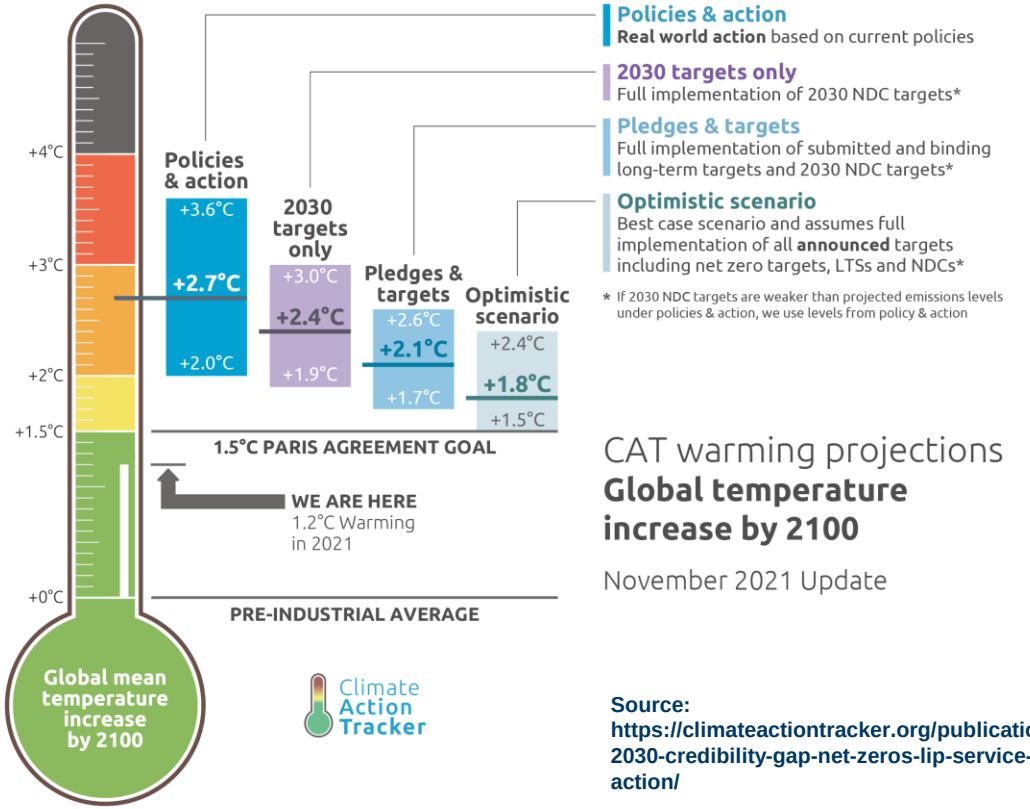
Divestment, bias to low carbon investment, engagement all needed

Implementation challenges: actions taken by LGPS pools will be key

Regular review

Credible transition plans are key

- Climate Action Tracker's latest estimates highlight the 'credibility gap', noting that **current policy commitments put the world on track for 2.1 degrees**, with an 'optimistic scenario' resulting in warming of 1.8 degrees.
- Under current policies, the end-of-century warming is estimated to be 2.7 degrees.
- **There has been insufficient momentum from leaders and governments to increase 2030 climate targets** ahead of, and at, Glasgow.
- Even with all new Glasgow pledges for 2030, we will emit roughly twice as much in 2030 as required for 1.5°. **Therefore, all governments need to reconsider their targets.**



Source: https://climateactiontracker.org/publications/glasgows-2030-credibility-gap-net-zeros-lip-service-to-climate-action/

'Actions speak louder than words': Investors will need to demonstrate how they are transitioning their investments for real world impact. **Commitments and pledges are important, but only the practical application and implementation of a credible net zero transition plan will position investors well over the coming decade.**

Net zero and offsets
Industry debate

- Increasingly, investors are considering how ambitious they can be when it comes to net zero targets and commitments. **Setting more ambitious net zero targets will be reliant on the use of carbon offsets.** At present, the market is not sufficiently developed to rely on them to meet targets but they do present an opportunity through both negative emissions technologies and nature-based solutions.
- **The Institutional Investor's Group on Climate Change (IIGCC) Net Zero Framework notes:**
  - Investors **should not offset emissions in one part of their portfolio through accounting for avoided emissions in another part**. Given the necessity of effectively reaching zero emissions from investments over time, trading these two against each other is not consistent with creating incentives for investors and underlying assets to maximise their efforts to decarbonise their portfolios to the full extent possible.
- **The Net Zero Asset Owner's alliance notes:**
  - Investments in carbon dioxide removal (CDR) and negative emissions technologies and solutions (including nature-based solutions) will also be complementary and necessary to accelerate progress and keep global average warming to 1.5°C.

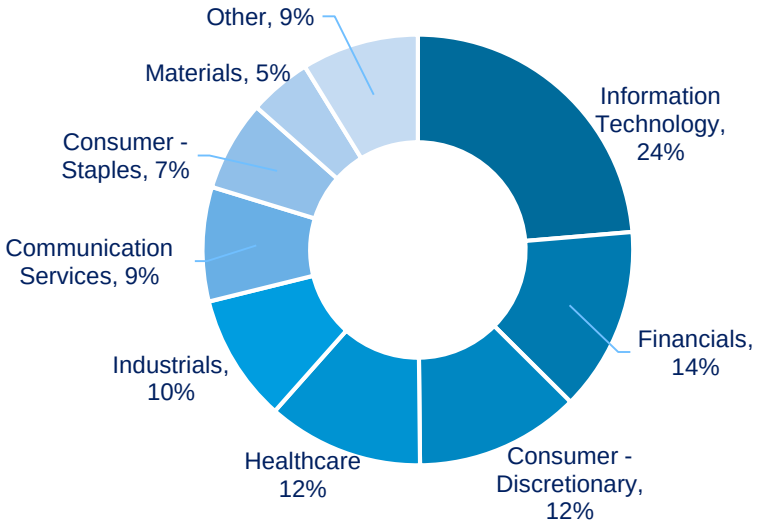
Industry thinking will evolve and we expect the use of offsets will become more sophisticated

Equities: how many companies are aligned to 1.5°C & 1.4°C Implied Temperature Rise?

Reduction in investible universe

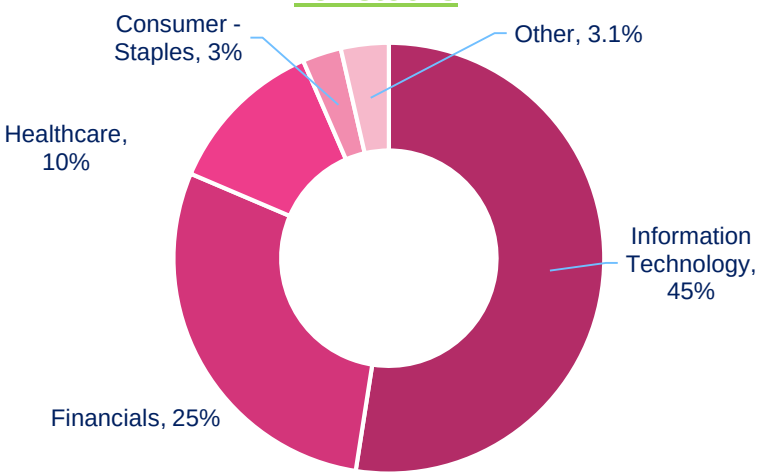
Global Equity Universe (MSCI ACWI)

2953 stocks



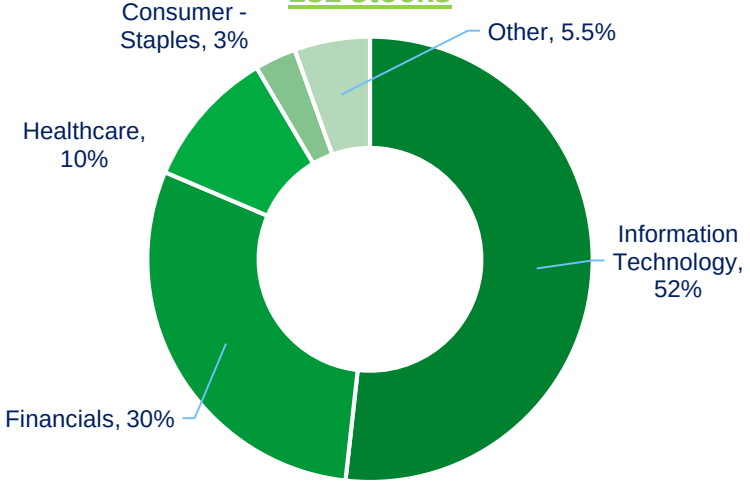
Stocks aligned to 1.5 Implied Temperate Rise

432 stocks

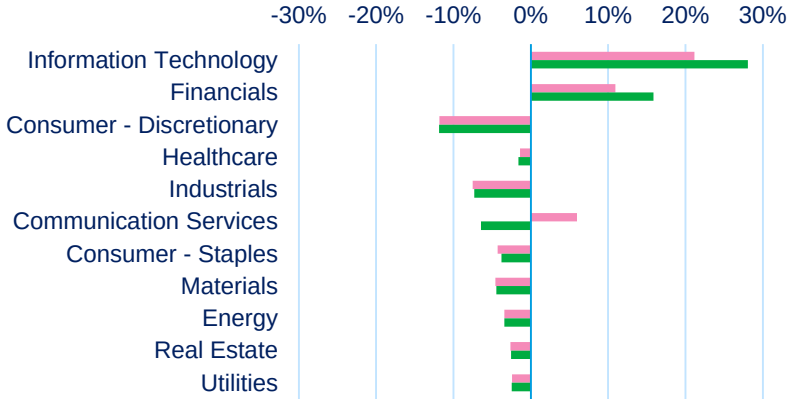


Stocks aligned to 1.4 Implied Temperate Rise

181 stocks



Relative Sector Positions



c.85% reduction of universe in terms of number of companies c.77% reduction in terms of market cap screened out

c.94% reduction of universe in terms of number of companies, c.88% reduction in terms of market cap screened out

Investment products currently don't exist to be able to invest on this basis. Loss of diversification is a concern

Mercer

*Sector Coverage 99.8% for Total Universe. Data as at 31 December 2021

What does a portfolio of companies aligned to 1.5°C & 1.4°C Implied Temperature Rise look like? Portfolio holdings

For the two implied temperature rise portfolio's 1.5°C & 1.4°C, we have analysed the expected risks and portfolio tilts compared to the MSCI AC World Index in order to assess the potential impacts the restrictive universe could have on a portfolio composition. For each implied temperature rise portfolio we have analysed the portfolio in two ways; the first is to take the current market cap weightings and scale up the holdings, so for example in the 1.5°C scenario the universe is reduced to c.23% of market cap, so all holdings, in effect will be just over 4x as large as in the full market cap weighting. The impact on the 1.4°C scenario is even more exaggerated as the 12% residual market cap means that the holdings are c. 8x larger. To counteract the concentration risk, we have also looked at equally weighted portfolios for all the available holdings. Whilst this reduces the potential concentration risks of the largest holdings, this results in a significant bias to small cap holdings.

Company	MSCI AC World Index Market Cap	1.5°C Market Cap Weight	1.5°C Equal Weight
Apple	4.2%	18.5%	0.2%
Alphabet	2.4%	10.8%	0.2%
United Health Group	0.7%	3.0%	0.2%
Visa	0.5%	2.3%	0.2%
Mastercard	0.5%	2.0%	0.2%
Adobe	0.4%	1.7%	0.2%
Cisco	0.4%	1.7%	0.2%
Accenture	0.4%	1.7%	0.2%
Salesforce	0.4%	1.6%	0.2%
Paypal	0.3%	1.3%	0.2%
Total top 10	**10.0%**	**44.5%**	**2.6%**

Company	MSCI AC World Index Market Cap	1.4°C Market Cap Weight	1.4°C Equal Weight
Apple	4.2%	36.2%	0.6%
Cisco	0.4%	3.3%	0.6%
Accenture	0.4%	3.2%	0.6%
Salesforce	0.4%	3.1%	0.6%
Novo Nordisk	0.3%	2.3%	0.6%
AstraZeneca	0.3%	2.2%	0.6%
SAP	0.2%	1.8%	0.6%
La Banque Toronto	0.2%	1.7%	0.6%
Commonwealth Bank of Australia	0.2%	1.6%	0.6%
AIA Group	0.2%	1.5%	0.6%
Total top 10	**6.6%**	**57.0%**	**5.5%**

Source: MSCI, products may not sum due to rounding. 31 December 2021
MSCI AC World Index column shows the weight of the 1.5 &1.4 degree stocklists in the full MSCI AC World Index, actual top 10 of MSCI AC World Index is different to above, the numbers are to show comparison weightings. Actual top ten has weighting of 17.8%.

Significant concentration risk in a few stocks, in particular Apple

What does a portfolio of companies aligned to 1.5°C & 1.4°C Implied Temperature Rise look like? Portfolio Characteristics

	Risk		Portfolio Biases				ESG Scores
Portfolio	**Expected volatility increase of portfolio above MSCI AC World Index**	**Potential Fund 3 year Value at Risk Increase**	**Style Bias**	**Market Cap Bias**	**Sector Bias**	**Regional bias**	**MSCI E, S & G impacts**
1.5°C Market Cap Portfolio	12.8% increase	c.£212m	Slight bias to growth	Large Cap Bias	Overweight to IT and Financials	Slight America bias / underweight Asia	Improved Environmental Below benchmark on Social & Governance
1.5°C Equal Weight Portfolio	6.1% increase	c.£100m	Huge Value bias	Significant small cap bias	Significant overweight to Financials	Towards Europe and Asia, bias away from America	Social much worse, Environmental worse too
1.4°C Market Cap Portfolio	15.8% increase	c.£262m	Slight bias to growth	Large Cap Bias	Overweight to IT and Financials	Slight European bias	Improved Environmental Some deterioration on Social & Governance
1.4°C Equal Weight Portfolio	4.9% increase	c.£80m	Huge Value bias	Significant small cap bias	Significant overweight to Financials	Large Europe bias and Asia bias, bias away from America	Social much worse, Environmental worse too

Source: MSCI, Style Analytics.
Expected volatility increase has been calculated using expected absolute volatility of the portfolio divided by that of the benchmark.
Full portfolio analysis can be found in the appendix.
All portfolio biases comments are relative to the benchmark.
Fund total 3 year Value at risk as at 31 March 2022 was £2bn

Additional risks and consequences from focusing solely on carbon reduction

Summary Comments

- **Return** – we have not looked to estimate expected returns, we do not have return assumptions for individual stocks. Ordinarily, we would expect a reduced investment universe to reduce the expected return. In practice, the range of potential returns will be much greater (positive or negative) and likely highly dependent on one stock – Apple.
- **Risk** – absolute volatility of the portfolios modelled is higher than the benchmark. Arguably the only known is that these portfolios will take more risk. The additional concentration risk in the market weighted portfolios is particularly concerning.
- **Portfolios biases** – all the portfolios in one way or another have significant biases, the market cap portfolios have large cap and significant top ten holding concentration risks. The equally weighted portfolios have very significant small cap and value styles biases as well as a significant concentration in financials. All portfolios would be expected to deviate significantly from the benchmark at times for a variety of reasons. There are also significant sector and regional biases seen across the portfolios.
- **ESG** – whilst the companies, and portfolios, should and do, score well on carbon metrics, the analysis indicates that this is potentially at the detriment of other ESG factors. In particular social and governance scores are worse than the benchmark, indicating that the restrictive opportunity set would likely impede the Funds wider UN SDG ambitions. More detail on this can be provided, if required.
- **Implementation** – to our knowledge there are no investment strategies for listed equities that are systematically targeting net zero significantly in advance of 2050. Any implementation which had severe limits on the companies available from investment managers to invest would likely need to be conducted outside of the Border to Coast pool, this would have potentially significant cost implications for the Fund.
- **Limited real world impact** – investing only in companies already aligned to a 1.5/1.4°C Implied Temperate Rise (ITRs) arguably will have limited additional real world impact on carbon reduction. Real world impact will require companies with currently higher ITRs to implement credible carbon reduction plans.

The example portfolios are highly unconventional and raise material suitability concerns

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Appendix

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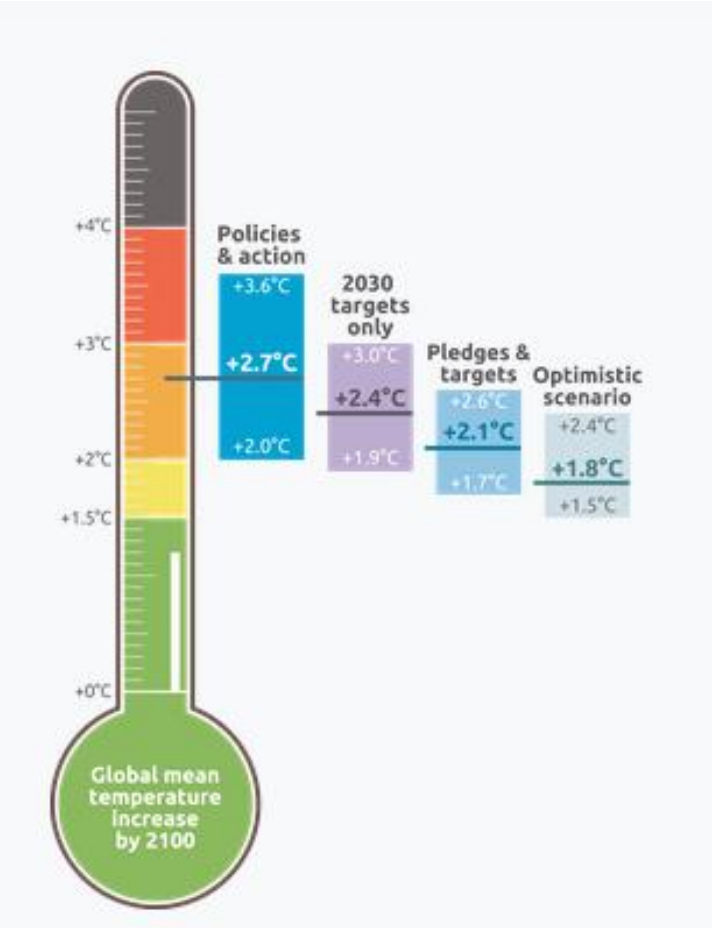
Climate Change Scenarios
Commitments and the Science



What the low carbon scenarios mean in practice:

- 50-67% chance of achieving a **1.5°C scenario** needs:
  - 45% emissions reduction by 2030 (vs 2010)
  - net zero ~2050.
- 50-67% chance of achieving a **2°C scenario** needs**:**
  - 25% emissions reduction by 2030 (vs 2010)
  - net zero ~2070.

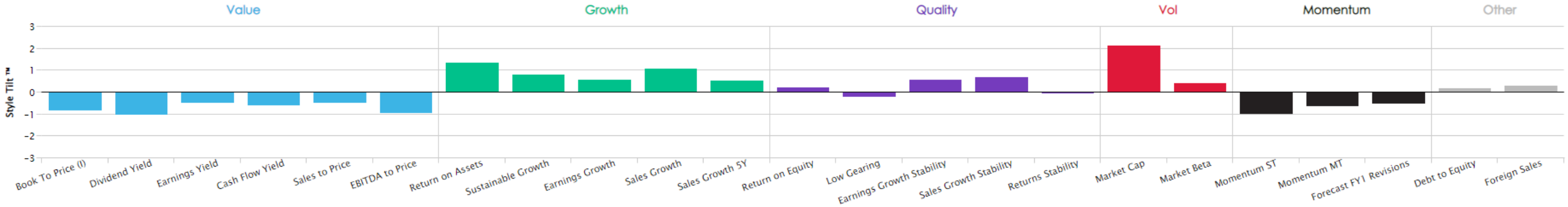
Paris Agreement Aim: 1.5°C
Actual trend: ~2.7°C
Current pledges: ~2.1°C

A net zero commitment by 2050 is aligned with a 50-67% probability of achieving 1.5ºC.

1.5°C Implied Temperature Rise Market Cap

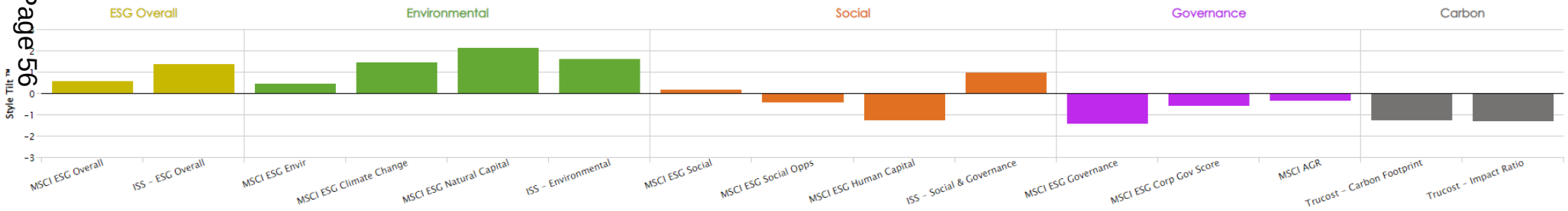
Investment Characteristics

STYLE SKYLINE™



ESG SKYLINE

STYLE SKYLINE™



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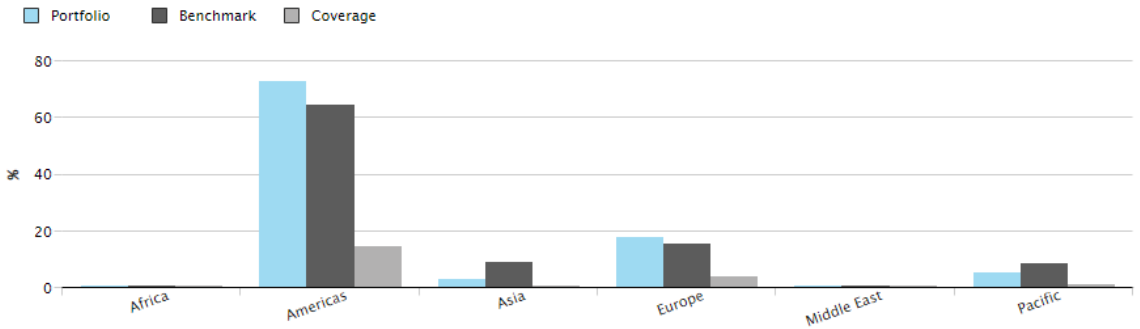

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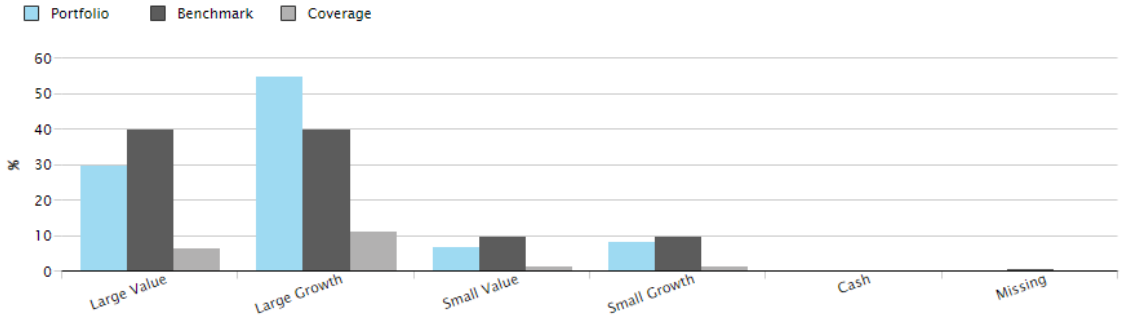

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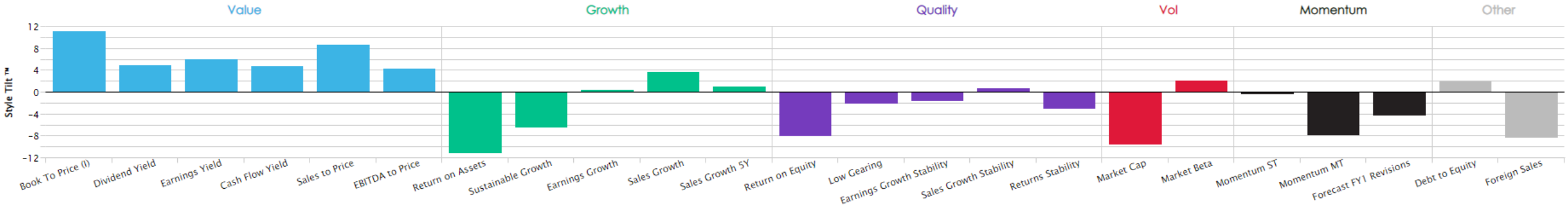
1.5°C Implied Temperature Rise Equal Weight

Investment Characteristics

STYLE SKYLINE™



ESG SKYLINE

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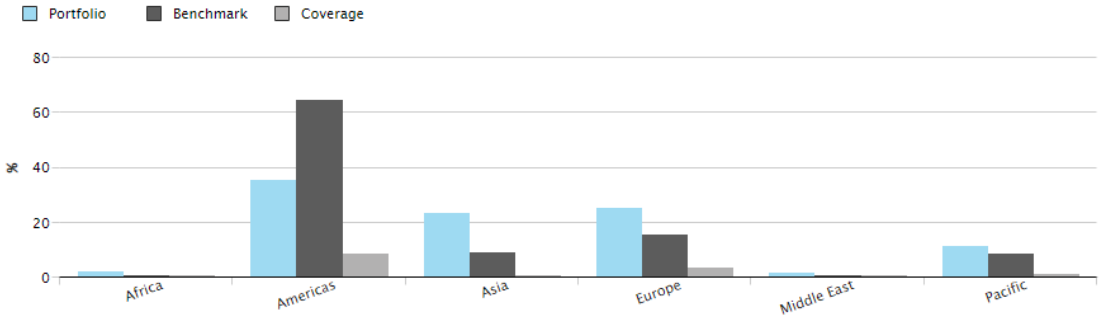

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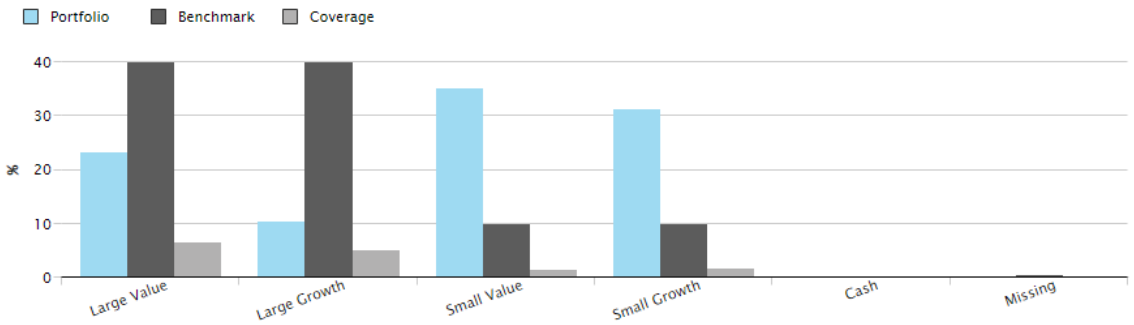
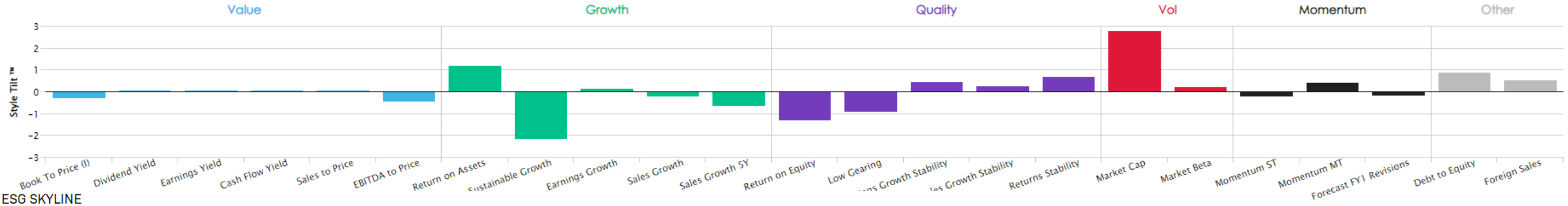


Mercer

1.4°C Implied Temperature Rise Market Cap

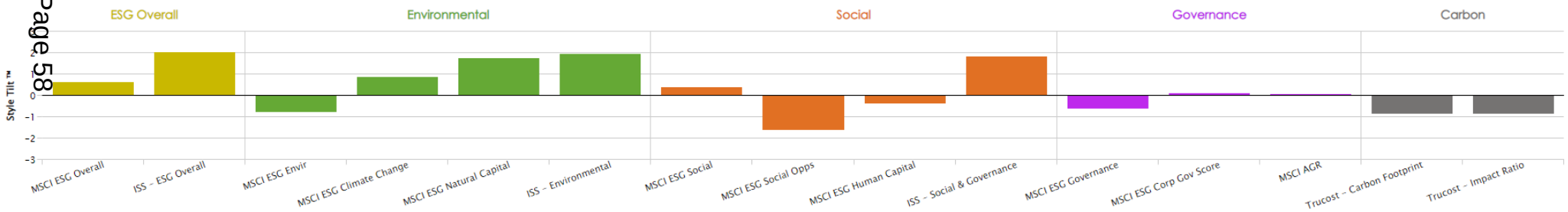
Investment Characteristics

STYLE SKYLINE™



ESG SKYLINE

STYLE SKYLINE™



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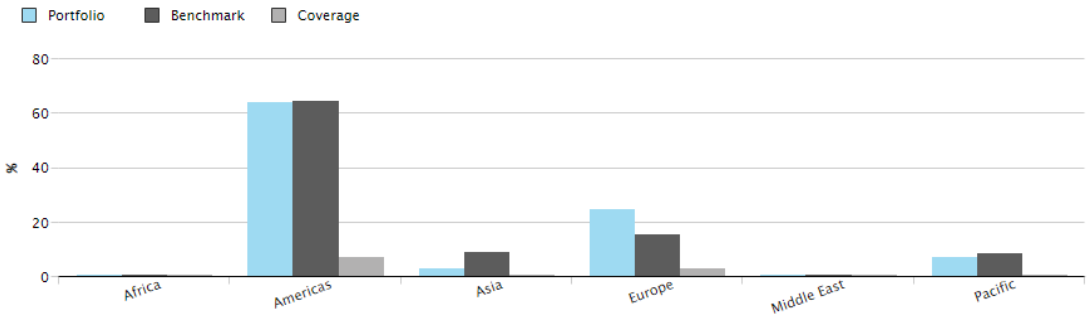

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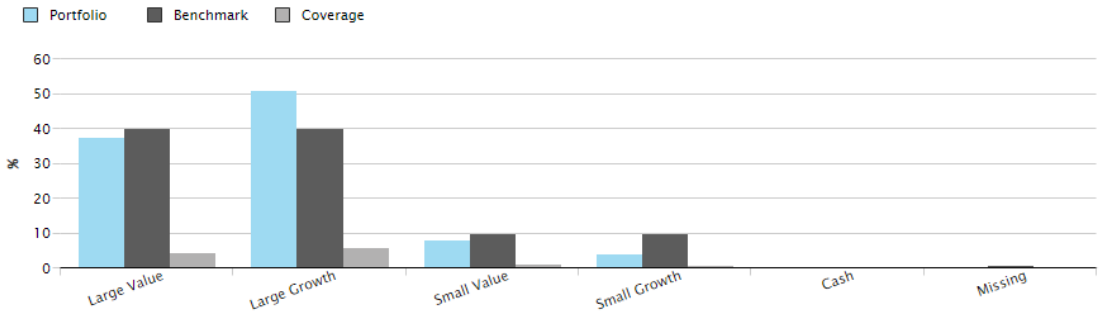

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1.4°C Implied Temperature Rise Equal Weight

Investment Characteristics

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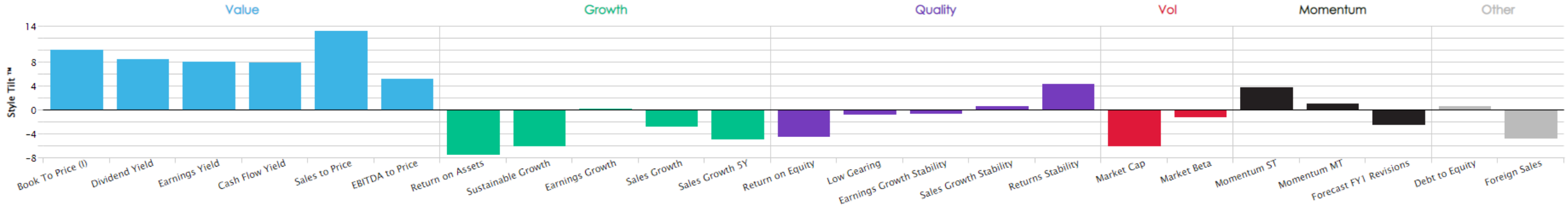

ESG SKYLINE

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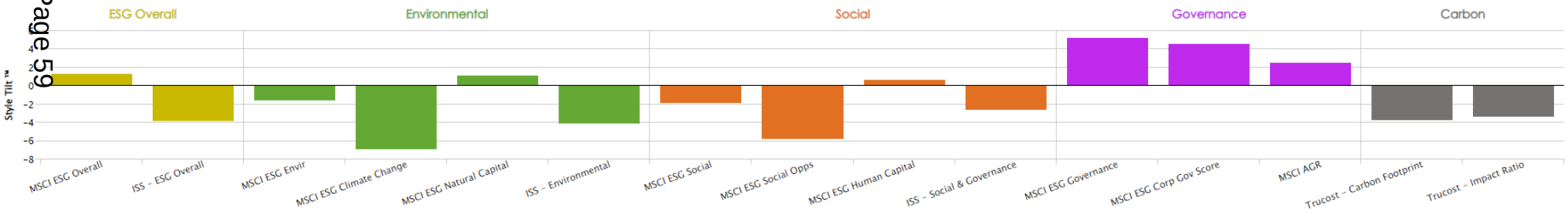

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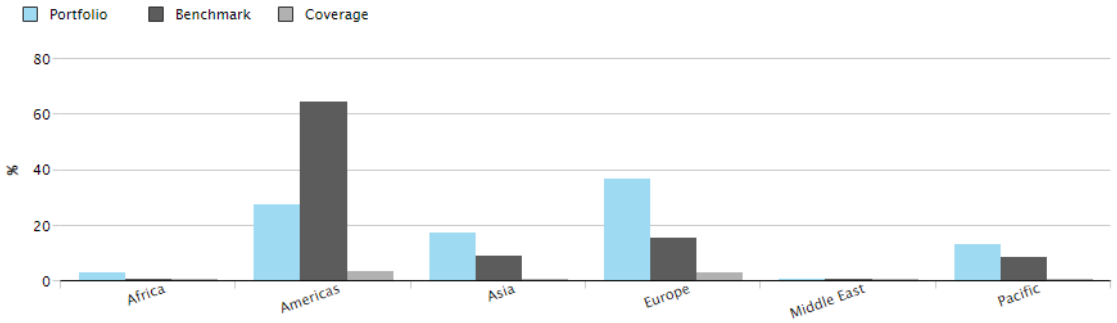

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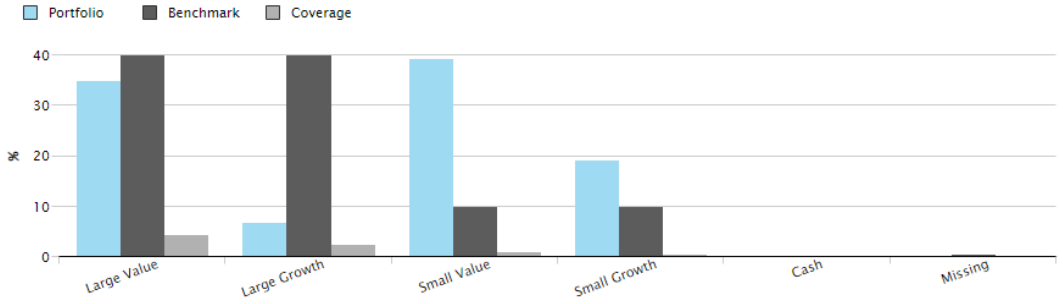

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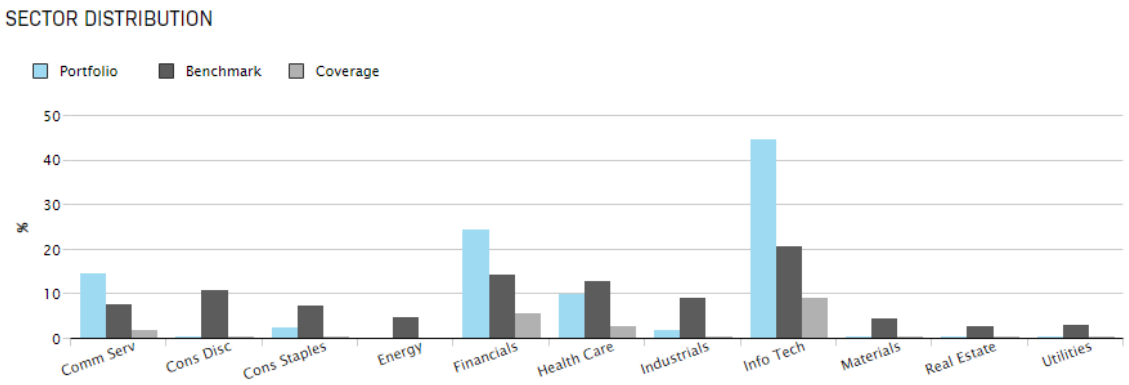
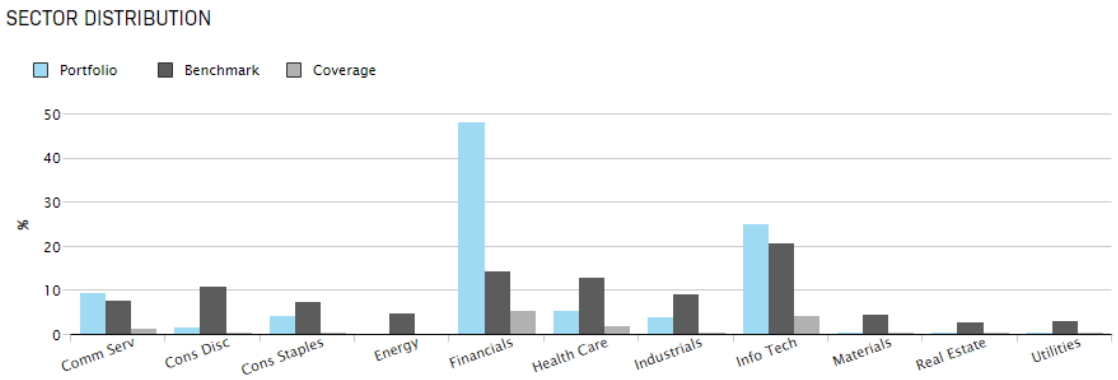
Implied Temperature Rise Portfolios
Sector Biases

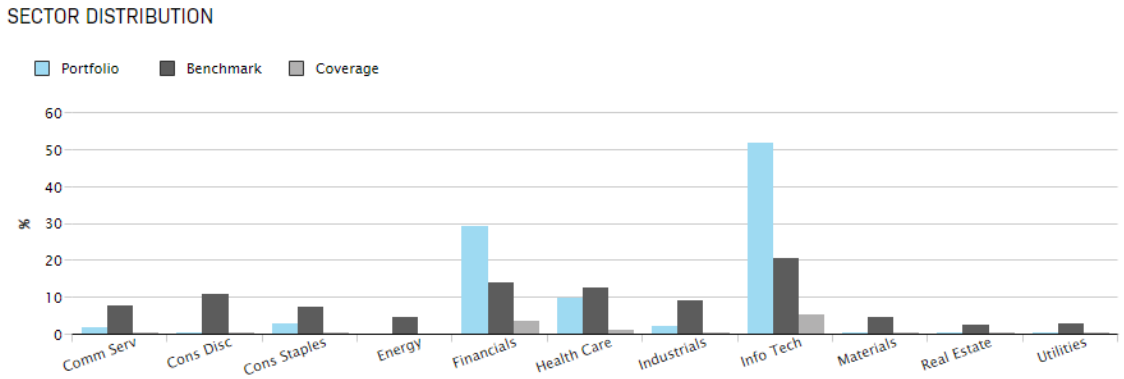
1.5°C Implied Temperature Rise Market Cap



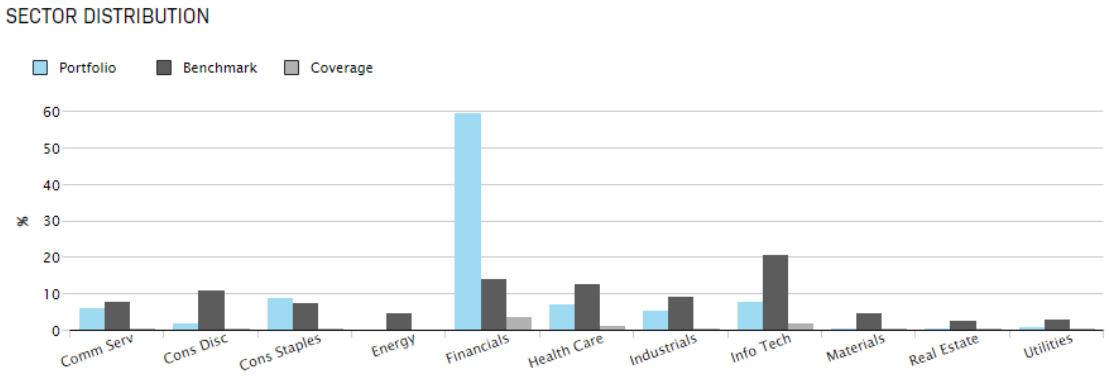
1.5°C Implied Temperature Rise Equal Weight



1.4°C Implied Temperature Rise Market Cap



1.4°C Implied Temperature Rise Equal Weight



Mercer

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