SURREY PENSION FUND COMMITTEE – 13 MARCH 2020

PROCEDURAL MATTERS – SUPPLEMENTARY QUESTIONS AND RESPONSES

2. Supplementary Question asked by Simon Hallett

Firstly may I congratulate the Committee on its commitment to engagement. Using your influence as shareholders to push high emission consumers of fossil fuels towards a low carbon transition is surely vital. However twice in answers to questions at the last meeting the Committee argued against divestment from fossil fuels on the grounds that it had no impact on emissions. Please explain why you see engagement and divestment as incompatible?

(1) The agenda materials for the December 20 2019 meeting cite success stories from engagement through the LGPS including as one of the two 'substantial improvement' cases that of Centrica agreeing to sell its oil and gas assets. Surely in that case the engagement was asking for divestment?

The above point comes from point 4 of Item 6 in the public reports pack for the December 20 2019 meeting, extract shown below:

The LAPFF had engaged with 108 companies on issues ranging from employment standards to Sustainable Development Goals and shareholder rights during the Quarter Ending 30 September 2019.

108 Company engagements over the quarter including the following meetings, voting alert submissions and filing of shareholder resolutions

Company	Activity	Topic	Outcome
ARCELORMITTAL SA	Meeting	Climate Change	Change in Process
BAE SYSTEMS PLC	Meeting	Human Rights	No Improvement
CENTRICA PLC	Meeting	Climate Change	Substantial Improvement
GENERAL MOTORS COMPANY	Meeting	Environmental Risk	Small improvement
GLENCORE PLC	Meeting	Audit Practices	Small Improvement
NATIONAL GRID PLC	AGM	Climate Change	Substantial Improvement
PETROBRAS-PETROLEO BRASILIERO	Meeting	Reputational Risk	Moderate Improvement
RYANAIR HOLDINGS PLC	Alert Issued	Governance (General)	
SOUTHERN COMPANY	Meeting	Climate Change	Change in Process
SPORTS DIRECT INTERNATIONAL PLC	Alert Issued	Governance (General)	
WALT DISNEY	Resolution filed	Climate Change	Dialogue

SUBSTANTIAL IMPROVEMENTS: Centrica plans to exit oil and gas production, including selling its stake in Cuadrilla which operates fracking operations in Lancashire. **National Grid** is joining the Powering Past Coal Alliance, which had been a request at the last meeting with the company.

(2) Border to Coast's resolution put to National Australia Bank asking them to reduce their exposure to fossil fuel assets is another example of the same thing. More broadly, surely a successful engagement strategy on climate change will necessarily reduce the demand for fossil fuels along with emissions, therefore directly undermining the economics of your fossil fuel holdings. It seems to me that believing in engagement while not divesting is inconsistent. By not divesting surely you are either planning for failure or planning to lose money.

The above point comes from page 10 of the Border to Coast Quarterly Stewardship Report for Q4 2019.

To be clear my question is not about why the engagement policy is seeking to achieve these goals – they are entirely appropriate in my view.

My question is why the Committee remains so dead set against divesting from fossil fuels given:

A. The climate goals of the engagement strategy seek to reduce emissions and thereby directly undermine the business of fossil fuel producers, so why own them?
B. In the specific instances cited, the engagement strategy is pushing other organisations towards divestment as a positive goal – if that is the right goals for other organisations, why not for the pension fund itself?

Rather than an either/or, I am suggesting the Pension Fund see divestment (limited to fossil fuel producers) as working in tandem with and supporting the engagement strategy. In such a way the pension fund expresses confidence that its engagement will drive real outcomes. Not to do so implies the engagement strategy is just a sop to public opinion, intended to achieve nothing, at least on climate change. So engage with the c. 95% of companies who are primarily consumers of fossil fuels (encouraging them to consume less) and divest from the c.5% of companies who are primarily fossil fuels producers. What could be more consistent and straightforward?

Supplementary response:

With reference to Question A (below), the goal is not to 'undermine' a company or industry but to ensure that it follows a policy of a just and stable transition to a low carbon economy, to ensure communities and those reliant on fossil fuels are not being put at a disadvantage. If Investors are influencing companies to accelerate change they are encouraging them to be part of the solution going forward, to ensure they remain viable investments for shareholders.

A. The climate goals of the engagement strategy seek to reduce emissions and thereby directly undermine the business of fossil fuel producers, so why own them?

The obvious examples being employees of these companies as well as communities in developing countries, whose livelihoods could be at risk if the world stopped using fossil fuels in an instant. A just transition is needed to ensure economies and communities are not at risk as we make the transition to a low carbon economy.

B. In the specific instances cited, the engagement strategy is pushing other organisations towards divestment as a positive goal – if that is the right goals for other organisations, why not for the pension fund itself.

The role of Surrey Pension Fund as an investor is to make sustainable returns to meet the long term liability of its pensioners, and also considering ESG risks (including climate risk) that can be detrimental to its financial returns. This involves pressuring those companies through their chosen method, to divest from carbon intensive operations and transition more toward low carbon/ carbon neutral operations.

The questioner highlights the need for the Pension Fund to only apply divestment to fossil fuel producers, when another member of the public have differing and sometime competing priorities, which can include divestment views in other sectors; e.g. weapons manufacturers, tobacco companies, etc.

The Open Letter **(Annex B)** issued to the Pension Fund on 2 March 2020 quotes an article by the International Energy Agency, but ignores a few other points in the same article:

- Without the oil and gas industry, the transformation of the energy sector will be more difficult and more expensive
- The oil and gas industry will be critical for key capital-intensive clean energy technologies to reach maturity
- Electricity cannot be the only vector for the energy sector's transformation

https://www.iea.org/reports/the-oil-and-gas-industry-in-energy-transitions

6. Supplementary Question asked by Chris Neill

Surrey Pension Fund presents its position on divestment of fossil fuel assets as a matter of ESG - that is Environmental, Social and Governance - assessment. It then fails to present its assessment specific to climate change. This is fundamentally confused.

*You enumerate the risks that SPF must consider in its activities on page 65 of your 2018-19 Annual Report. The final item on your list is ESG. You explicitly state that this is a non-financial risk that your Fund Managers should consider.
*The statement from your investment advisor on page 41 of the annual report on research into the carbon intensity of your portfolio, subsumes the matter of carbon intensity into a discussion of ESG.
*The presentation of your ESG policies on page 67 of the annual report deals largely with the corporate governance of companies in which you invest and does not in any way address climate risk, unless that is your comment that you have no specific policy with regard to wholly divesting as a function of ESG issues.

But investing in fossil fuels is a financial risk, and an important one. Recent price history shows not only the pressure on fossil fuels in a decarbonising world, but the exposure of these investments to the behaviour of autocratic regimes in Saudi Arabia and Russia. These assets have proven to be both financially risky and poorly performing. Not ideal assets for a pension fund to hold.

-Will SPF now accept the need to identify and disclose the carbon intensity of both its equity and debt investments, both public and private?

-Further, will SPF disclose the performance of investments in the fossil fuel sector specifically?

-In your future public reports will SPF discuss its risk to the climate emergency and its fossil fuel investments as a separate matter from its ESG concerns?

-And finally, will you reconsider your statement that you will not fully divest from fossil fuels?

Supplementary response:

The questioner should be encouraged to review the Taskforce for Climate Related Financial Disclosures (TCFD) as well as the Committee reports. The Pension Fund has stated numerous times that it has become a supporter of TCFD, which addresses a number of the supplementary questions, specifically how we will be measuring Climate Risk from a financial perspective, in our 2019/20 Annual Report. The TCFD is also completely consistent

with the Transition Pathway Initiative, which measures the risks of individual companies and industries in the 2 Degree Scenario Analysis.

Please see the link below for Surrey Pension Fund's action to become a supporter of the Taskforce for Climate Related Financial Disclosures (TCFD) in September 2019, where the Fund will report against Climate Related Financial Disclosures in its 2019/20 Annual Report: https://mycouncil.surreycc.gov.uk/documents/s62861/Report.pdf

Please see below the Fund's recommendation on 13 December 2019 and 13 March 2020 to continue to enhance its Responsible Investment Approach: https://mycouncil.surreycc.gov.uk/documents/s65129/Item%2011%20-%20Responsible%20Investment%20Policy%20Review.pdf

https://mycouncil.surreycc.gov.uk/documents/s62861/Report.pdf