SURREY PENSION FUND COMMITTEE – 12 JUNE 2020

PROCEDURAL MATTERS – QUESTIONS AND RESPONSES

1. Question submitted by Steve McDonald

I never fail to be unimpressed by your superficial and facile concern about the environment when fending off the constantly growing call for you to withdraw all direct investments in the fossil fuel industry.

We have had years now of laughable quotes and ridiculously pathetic targets issued from leaders of the industry in an effort to persuade us of their intent to move rapidly to clean energy. This has been followed by the SPF enthusiastically throwing out this grossly misleading information to your pension members in an attempt to justify your engagement Vs divestment policy.

Your latest scam, has not gone unnoticed as I read from page 55 of the SCC Climate Emergency Strategy document which proudly announces your firm "commitment to establish a Committee subgroup to develop the Fund's Responsible Investment Approach". A strategy which you are well aware, effectively stalls any short-term action on divestment.

I admit that a generous helping of amnesia can be a useful tool, but I will remind you that 3 years ago you appointed your Surrey Pension Board to do exactly the same thing. Their feedback was presented to the SPF committee meeting on 10 November 2017, and resulted, after further consideration, in no reduction in direct fossil fuel investments.

One questions whether you understand what a climate emergency actually is, let only have any concept of the horrendous consequences of it.

I would like to give you some information which will then prompt my question;

- 417 Latest world atmospheric CO2 reading in parts per million (ppm)
- 414 This time last year
- 392 10 years ago
- 280 Pre-industrial level
- 350 Scientific safe level

Scientists have warned for more than a decade that concentrations of more than 450ppm risk triggering extreme weather events and temperature rises as high as 2C, beyond which the effects of global heating are likely to become **catastrophic** and **irreversible.**

My question to you as a Committee is, what is it that you do not understand regarding the above?

Response:

As a direct result of the review of the Environmental, Social and Governance (ESG) compliance in spring 2017 by the Local Pension Board, the Committee approved the recommendation to determine the fund's equity carbon asset exposure, which then led to a significant reduction in the Fund's exposure to fossil fuel companies. That included the reallocation of c9.5% of the equity portfolio (c£400m at the time) to a low carbon fund, starting a continuing trend of a reduction in the Fund's exposure to fossil fuel companies.

The Fund's exposure in September 2018 was 5.65% and reduced down to 1.83% as of 31 May 2020.

The work in reviewing the Fund's investment strategy is to ensure that it is in line with its Mission Statement and the emphasis on all Environmental, Social and Governance (ESG) considerations, is a hugely relevant and ambitious project.

The Committee understands fully the risks of climate change and the critical need to transition to a low carbon economy. The fact that it does not agree with the blunt tool of automatic divestment that you advocate, does not in any way undermine its commitment to a lower carbon future.

The Committee has explained on numerous occasions its rationale for engagement (please refer to our open letter of 9 April 2020) and are constantly seeking to verify the validity of our approach. The work in reviewing the Fund's investment strategy provides us with the tools to do this.

2. Question submitted by Ian Chappell

My question explores your justification for your policy of engagement; specifically that you have strong evidence that engagement works. This implies that you can identify engagement activities which have led to significant changes in company policy and that you can show a causal link between these activities and the outcome.

With specific regard to BP and Devon Energy, could you please detail:

- **The engagement activity(ies)**
- **The significant improvement in BP and Devon Energy's sustainable energy policy**
- **The causal link (not a correlation) between activity and outcome**

Response:

The main organisations which engage on behalf of Surrey Pension Fund are in accordance with how its assets are managed. For its passively managed equity funds, Legal and General Investment Management (LGIM) engage on behalf of the Fund, while its assets that are managed within Border to Coast Pensions Partnership (BCPP), Robeco, are the appointed Voting and Engagement Providers of the BCPP. The Fund is also a member of the Local Authority Pension Fund Forum, which also engages on behalf of the majority of Local Government Pension Funds in the UK.

The Fund chooses to collaborate with these bodies along with other long term investors, to strengthen its influence as shareholders, when engaging with these companies to promote more sustainable practices.

Devon Energy

We do not currently hold investments in Devon Energy, but should that happen in the future, our engagement representation would be through our engagement partners.

Engaging and Improving Sustainability Energy Policy – LGIM
The Fund's Indexed Equity Manager, LGIM had mentioned that its Climate Impact Pledge targets primarily the largest companies in key sectors, with the view that other companies will emulate the tone set by leaders in the sector. Devon Energy is not currently one of the companies on its target list. However, at the company's latest annual general meeting, LGIM

voted against the re-appointment of Devon Energy's current auditors (due to the length of their tenure) and against the pay packages of its directors, which were not aligned with our own principles on executive remuneration.

Engaging and Improving Sustainability Energy Policy - LAPFF
Through the Local Authority Pension Fund Forum's membership in the Insitutional Investors' Engagement Group, Ceres, the Devon engagement is making progress but the company has yet to set broad emissions targets. As you likely know, the company divested the Canadian oil sands business which has altered the profile. There was a constructive Climate Action 100+ engagement in August of 2019, and a planned in-person meeting for March of this year which was postponed with the Covid-19 disruptions. Progress to date includes:

- Creation of a board-level committee responsible for ESG
- Methane intensity target of 0.28% by 2025
- 2019 Climate Change Assessment Report
- Report on political activity and lobbying
- Advances in leak detection and significant reduction in flaring

Areas of continued focus for the engagement team:

- Greater transparency around Paris-aligned strategy
- Report Scope 3 emissions and targets
- Set company-wide GHG targets
- Board participation in engagement
- Climate expertise criteria used in the director selection process

BP

Engaging and Improving Sustainability Energy Policy - LAPFF
The LAPFF's engagement with BP has spanned many years. In 2005, a series of engagements over health and safety concerns resulted in LAPFF voting against the remuneration report at BP's 2007 AGM. In 2012, LAPFF joined the 'Aiming for A' investor initiative and began to engage BP regarding the transition towards a low carbon economy. This culminated in the filing of a shareholder resolution requesting BP assess its asset portfolio resilience against a range of International Energy Agency (IEA) scenarios, which included remaining within two degree temperature increase limits. After lengthy engagement regarding the composition of the resolution, the management recommended support and the item was approved with over 98% support.

More recently, LAPFF has been a member of the Climate Action 100+ BP investor group. Last year, this investor group presented a resolution calling for the company to set out a strategy consistent with the Paris Goals, together with its goals and targets to achieve this. During 2019/20 LAPFF met with BP representatives, including the recently appointed CEO Bernard Looney, to work on what this strategy will look like and how it will be implemented. As part of the company's response to this request BP, in early 2020, announced the ambition to become a net zero company by 2050 or sooner. The company has announced 10 aims that accompany this ambition. Of particular note is the aim to reduce the absolute emissions associated with BP's oil and gas production to net zero and to recognise, explicitly, the need to work within a finite carbon budget. These engagement activities and resulting outcomes address the first two points of the question.

Engaging and Improving Sustainability Energy Policy - LGIM
Was a co-lead investor responsible for engaging with the company under the Climate Action 100+ investor led coalition.

Following the co-filed shareholder resolution, BP have announced ambitious carbon targets, with the company pledging that by 2050 or sooner it will:

- have net zero emissions across operations;
- 'reduce and neutralise the carbon in the oil and gas we dig out of the ground'; and
- halve the emissions intensity of all sold energy (not all of which comes from BP's own production).

The company's targets are notable for including a commitment to reduce to zero the *absolute* level of emissions associated with BP's upstream operation and products (rather than relying just on the *relative* carbon intensity target which are more common in the sector). As the company notes, if every single oil & gas company adopted a similar policy, the emissions problem of the sector would be solved.

BP have also announced they will stop brand-focused advertising, quit three lobbying groups, and redirect this budget towards more positive lobbying for net zero policies – all of which are welcome developments.

The shareholder resolution also asked for more transparency in reporting how each material new capital expenditure is aligned with the goals of the Paris Agreement – in their latest annual report the company has for the first time presented a methodology for how investors can assess 'capex consistency'. LGIM and other investors had been engaging with the company over the past year to help develop this methodology, and we will be pressing for future improvements.

Engaging and Improving Sustainability Energy Policy - Robeco
Although not specific to BP or Devon Energy, Robeco had also launched a 3 year engagement program with 11 oil and gas companies to prompt companies on their energy transition plans.

One of its objectives is to expect companies to implement a strong governance framework that clearly articulates the board's accountability and oversight of climate change risks and opportunities, and to explicitly show the management's role in assessing and managing climate related issues. The companies under engagement have shown progress in their climate governance. Most of the companies (eight out of 13) have shown clear board responsibility for climate changes risks and opportunities and were able to demonstrate a sound climate change management system. Areas where the lagging companies could improve the most are linking their executive compensation to climate change goals or allocating climate change oversight responsibility to the board. Another goal of the engagement is to ensure that the focus companies have aligned their business strategies with Paris Agreement through a range of measures. Robeco expects companies to set targets, and to demonstrate that they are implementing strategies to achieve their targets. Most of the companies under engagement (nine out of 13) have made positive progress in the alignment of their business strategies with the Paris Agreement goals. According to TPI's research, three companies are aligned with emissions reductions pledged by governments as part of the Paris Agreement via Nationally Determined Contributions. One company is aligned with the more ambitious climate scenario of 2°C.

The Causal Link of Engagement - LAPFF
On the causal link between engagement and outcome, as a member of LAPFF – GBP300 billion AUM- and Climate Action- GBP240 trillion AUM, members are afforded a channel of communication to decision makers at BP. LAPFF met with the BP CEO on a number of occasions during 2019/20 to discuss the energy transition and outline the forums expectations on BP's ambition and how it will be implemented. This engagement has resulted in in the publication of a report on how BP evaluates new material capex investments for consistency with the Paris goals as well as undertaking an industry association mapping exercise with the aim of ensuring the company is not operating at cross purposes. The engagement process is a huge contributing factor in maintaining influence in how BP aligns its operations with its net zero ambition. LAPFF recognises that, despite some notable progress, significantly more needs to be done by the world's largest corporate emitters, including BP, in tackling climate change. LAPFF also recognises that an ambition is different to effective action which is why it took the opportunity at the BP 2020 AGM to highlight that the period to 2030 will be critical to BP's future and to meeting the Paris Goals. LAPFF will continue to work on behalf of its members to ensure the resilience of investments whilst operating within the expectations of society more broadly.

The Causal Link of Engagement - LGIM
For a number of years, oil majors including BP had been reluctant to set carbon targets that went beyond their own operations – arguing that it is ultimately their consumers who decide how much oil is used. However, we believed that oil companies faced significant demand downside – and therefore should measure, disclose and take action on reducing its overall carbon footprint – including reduction production in line with the Paris Agreement. Following investor engagement, BP and several of its European peers have now adopted more ambitious targets which include their own oil & gas products (Scope 3 emissions, in the lingo) – by far the largest contributor to the sectors' carbon footprint. This represents significant progress in the conversation, and both privately and publicly the company has acknowledged the positive – causal - role that LGIM and the CA100+ investors have played. At the company's recent AGM, the new CEO is on record discussing the follow-up to our resolution:

"We listened and we learned. The Board supported the resolution and we acted on your advice. I personally continue to value and benefit from our ongoing engagement with Climate Action 100+ and the investors it represents".

There remain areas of ongoing work with the company – not least on having more clarity around the intermediary targets and strategy between now and the 2050 carbon neutrality goal. We understand the company is expected to announce more details in a Strategy day update in September.

3. Question submitted by Nina Mileksic

The negative impact of the pandemic on oil prices, and related fossil fuel investments, has been vast. Globally, there are growing calls to governments to prioritise the green recovery coming out of the pandemic, with many countries and cities already taking action. Do you still believe that continuing to hold fossil fuel investments is in the best interest of the pension fund members, and if so, please explain your rationale why?

Response:

Although the Fund's Investment Strategy Statement has no specific divestment policy at a sector level, it challenges and expects its Fund Managers, as well as its asset pool Border to

Coast Pensions Partnership to demonstrate strong risk management processes in relation to Environmental, Social and Governance issues.

Border to Coast also holds strong risk management processes in place when identifying environmental, social and governance issues which carry an investment risk and will consider material ESG factors when analysing potential investments. ESG factors tend to be longer term in nature and can create both risks and opportunities. It is therefore important that, as a long-term investor, we take them into account when analysing potential investments.

The factors considered are those which could cause financial and reputational risk, ultimately resulting in a reduction in shareholder value. ESG issues will be considered and monitored in relation to both internally and externally managed assets. The CIO will be accountable for the integration and implementation of ESG considerations. Issues considered include, but are not limited to:

Environmental	Social	Governance	Other
Climate change Resource & energy management Water stress	Human rights Child labour Supply chain Human capital Employment standards	Board independence/ diversity Executive pay Tax transparency Auditor rotation Succession planning Shareholder rights	Business strategy Risk management Cyber security Data privacy Bribery & corruption Single use plastics Political lobbying

The Fund understands the severity of Climate Change and has begun work to understand the risk of its current portfolio of investments in relation to Climate Change, through the Taskforce for Climate Related Financial Disclosures (TCFD), to be published in its 2019/20 Annual Report. The analysis covers all sectors not limited to only fossil fuel investments, within its Equity and Fixed Income holdings, and the risks they face in relation to Climate Change.

As the world transitions to a carbon neutral economy, the Fund will continue to seek sustainable investments, provided they can generate a competitive risk-adjusted return. These investments primarily exist in Private Markets, evident in the Fund's 40m Euro commitment to Glennmont Clean Energy Partners, in December 2018.

4. Question submitted by Jenifer Condit

My question follows up on an observation by the Chairman made during the discussion of the supplementary question I raised at the last meeting (13 March 2020 - regarding fossil fuel companies' cost of capital. It was observed that new capital raising by fossil fuel companies comes mostly in the form of debt, as opposed to equity finance.
I am sure this is true, and in fact estimates of required capital raising by the fossil fuel industry to finance projected new exploration and project development was truly enormous as at end 2019. And much of this will come through public bond markets such as debt instruments invested in by SPF.

Having understood the Pension Committee's endorsement of responsible investment, the Committee will doubtless agree with this comment from **Principles of Responsible Investments**, April 2020:

"Capital investment decisions are critical in shaping the nature and pace of the climate transition and the role of the financial sector is central to the process. Fossil fuel resource extraction is capital intensive and firms in the energy industry traditionally run highly

leveraged balance sheets. The two primary sources of debt for firms are public bonds and private bank loans. Hence, bond markets and banks can either play an important role in facilitating continuing fossil fuel investments or, contrarily, ***play a decisive role in channelling funds away from the fossil fuel sector****."*

My question is this:

- SPF held 16.5% of its assets in bonds at March 31, 2019, per your annual report (nearly £500mn). How much of this was issued by fossil fuel companies at that time? By what amount (in absolute £ and as a percentage of bond holdings) did this increase or decrease in the year to March 31, 2020?
- Given the vast array of corporate bonds available for purchase, will the Committee instruct its asset managers that it will not participate in purchase of new bond issuance by fossil fuel companies in the future? Will the Committee divest whatever fossil fuel company bonds it currently holds?
- Finally does the Committee recognise that the interest rate it receives on any fossil fuel debt securities it owns reflects, in part, the risk of stranded assets backing the security of these investments?

Response:

The Fund's fixed income managers, Western Multi Asset Credit and Franklin Templeton, have both confirmed that they do not have holdings in the fossil fuel industry as at 31 May 2020.

The Fund understands the severity of Climate Change and has begun work to understand the risk of its current portfolio of investments in relation to Climate Change, through the Taskforce for Climate Related Financial Disclosures (TCFD), to be published in its 2019/20 Annual Report. The analysis covers all sectors not limited to only fossil fuel investments, within its Equity and Fixed Income holdings, and the risks they face in relation to Climate Change.

5. Question submitted by Chris Neill

The issue of divestment vs engagement appears crucial regarding the SPF's relationship to the fossil fuel industry. I would like more fully to understand the Committee's position, which I find very puzzling. On the one hand you say that you must make decisions which are in the best financial interests of pension holders and that this overrides consideration of ethical matters or ecological aims. On the other hand you say that your choice not to divest from the fossil fuel industry is partly driven by your concern that, were you to divest, the industry would be more likely to pursue policies which are unethical or environmentally harmful; in other words, you invest in order to have an influence for the better.

These two positions seem to me contradictory: either you are investing purely for financial gain or you are investing for ethical and ecological purposes.

-If in fact, however, you would assert that you are pursuing both these aims, by what criteria do you seek to strike a balance between them?
-How lucrative or financially risky does the investment have to appear before you decide to override ethical / ecological considerations and choose to invest or divest?
-How harmful or immoral does the behaviour of a company have to be to make it an unsuitable company to invest in regardless of its financial value?
-One would intuitively assume that the worse the behaviour of the company, the less likely you would be to invest in it. But if I understand your rationale for engagement correctly, in

fact the reverse is true: the more harmful or immoral the behaviour of the company, the more important it is for you to give them money. This would presumably mean that even very risky or unwise financial investments might be made in order to preserve an influential foothold as an investor where the company in question is engaged in particularly bad practice. Is this correct?

Response:

In formulating its investment strategy the Fund must adhere to the LGPS (Management and Investment of Funds) Regulations 2016:
http://www.lgpsregs.org/schemeregs/invregs2016/timeline.php

Statutory guidance to the Regulations says the following regarding social, environmental and corporate governance factors:

"Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision."

The Fund enacts its compliance with the Regulations (including its policy towards social, environmental and corporate governance factors and engagement) through its Investment Strategy Statement: https://www.surreypensionfund.org/media/4424/20190208-investment-strategy-statement.pdf

For assets managed in the Border to Coast (BCPP) pool, the Fund supports the Responsible Investment Policy of BCPP:
https://www.bordertocoast.org.uk/?dlm_download_category=download-responsible-investment-policy

For assets managed outside of the BCPP pool, the Fund will comply with the principles of the Responsible Investment Policy of BCPP.

The Fund continues to develop its Responsible Investment and Engagement approach. The Fund have recently appointed a new provider to establish how the Fund can map its Investment Strategy against the United Nations Sustainable Development Goals most applicable to Surrey Pension Fund as investors and how this informs our core investment beliefs.

6. Question submitted by Helena Ritter

In answer to a question posed about the risk to the valued of assets at the March 2020 meeting, the Surrey Pension Fund Committee responded with a recognition of the 'severity of Climate Change as an environmental and financial risk' and pointed toward the Fund being a supporter of the TCFD. In reading the report referenced in the answer (https://mycouncil.surreycc.gov.uk/documents/s62861/Report.pdf), the focus is strongly on engagement with fossil fuel and highly polluting companies. One specific project mentioned is the Climate Majority Project - which calls on the '20 largest carbon emitting US utility companies to commit to achieving net-zero carbon emissions by 2050, and to make this commitment by September 2020.'

To what extent will the Surrey Pension Fund Committee advocate for divestment as the action to be taken if or when companies do not meet even such minimal target commitments (both for this specific project and in other engagements)?

Response:

Although the Fund's Investment Strategy Statement has no specific divestment policy at a sector level, it challenges and expects its Fund Managers, as well as its asset pool Border to Coast Pensions Partnership to demonstrate strong risk management processes in relation to Environmental, Social and Governance issues.

Border to Coast also holds strong risk management processes in place when identifying environmental, social and governance issues which carry an investment risk and will consider material ESG factors when analysing potential investments. ESG factors tend to be longer term in nature and can create both risks and opportunities. It is therefore important that, as a long-term investor, we take them into account when analysing potential investments.

The factors considered are those which could cause financial and reputational risk, ultimately resulting in a reduction in shareholder value. ESG issues will be considered and monitored in relation to both internally and externally managed assets. The CIO will be accountable for the integration and implementation of ESG considerations. Issues considered include, but are not limited to:

Environmental	Social	Governance	Other
Climate change Resource & energy management Water stress	Human rights Child labour Supply chain Human capital Employment standards	Board independence/ diversity Executive pay Tax transparency Auditor rotation Succession planning Shareholder rights	Business strategy Risk management Cyber security Data privacy Bribery & corruption Single use plastics Political lobbying

For assets managed in the Border to Coast (BCPP) pool, the Fund supports the Responsible Investment Policy of BCPP:
https://www.bordertocoast.org.uk/?dlm_download_category=download-responsible-investment-policy

The Fund understands the severity of Climate Change and has begun work to understand the risk of its current portfolio of investments in relation to Climate Change, through the Taskforce for Climate Related Financial Disclosures (TCFD), to be published in its 2019/20 Annual Report. The analysis covers all sectors not limited to only fossil fuel investments, within its Equity and Fixed Income holdings, and the risks they face in relation to Climate Change.

As the world transitions to a carbon neutral economy, the Fund will continue to seek sustainable investments, provided they can generate a competitive risk-adjusted return. These investments primarily exist in Private Markets, evident in the Fund's 40m Euro commitment to Glennmont Clean Energy Partners, in December 2018.

The Fund continues to develop its Responsible Investment and Engagement approach. The Fund have recently appointed a new provider to establish how the Fund can map its Investment Strategy against the United Nation's Sustainable Development Goals (SDGs) most applicable to Surrey Pension Fund as investors and how this informs our core investment beliefs.

This page is intentionally left blank