

SURREY COUNTY COUNCIL**PENSION FUND COMMITTEE****DATE: 10 MARCH 2022****LEAD OFFICER: ANNA D'ALESSANDRO, DIRECTOR CORPORATE FINANCIAL & COMMERCIAL****SUBJECT: RESPONSIBLE INVESTMENT POLICY UPDATE****SUMMARY OF ISSUE:****Strategic objectives****Investment**

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

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1. Notes the progress of the sub-committee on drafting a Responsible Investment Policy.
2. Approve for officers to continue work with the sub-committee, the independent investment advisor, investment consultant, Minerva and Border to Coast to receive further feedback on the Responsible Investment Policy.
3. Notes the progress on drafting the Fund's Taskforce for Climate Related Financial Disclosures (TCFD) report.
4. Approve for officers to continue work with the sub-committee, the independent investment advisor, investment consultant, Minerva and Border to Coast to receive further feedback on the Fund's TCFD report.
5. Approve for officers to continue work with the sub-committee, the independent investment advisor, investment consultant and Border to Coast to establish a decarbonisation curve that is ambitious enough to align with a 1.5°C scenario above pre-industrial levels.

REASON FOR RECOMMENDATIONS:

To keep the Pension Fund Committee apprised of the progress made drafting a standalone 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 and for further work on the following areas to inform key elements of the standalone Responsible Investment Policy:
 - a) An ambitious but realisable net zero carbon target date for the Fund to aspire to.
 - b) A robust framework to consider exclusions and the consequences of engagement.
 - c) Agreement of metrics for carbon measurement.
2. The Committee further approved for a sub-committee 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 sub-committee first met on 19 November 2021. At its meeting of 17 December 2021 the Committee agreed the following further recommendations from the sub-committee:
 - a) Officers to work with the sub-committee, the independent investment advisor, investment consultant and Border to Coast to establish a total emissions and weight adjusted carbon intensity (WACI) for backward looking metrics and portfolio aligned, implied temperature rise for forward looking metrics in respect of the Fund's Taskforce for Climate Related Financial Disclosures (TCFD) report.
 - b) Officers to work with the sub-committee, the independent investment advisor, investment consultant and Border to Coast to model a low carbon transition plan, applying scenario analysis using the agreed TCFD metrics based on dates of 2030, 2040 and 2050.
4. The sub-committee had its second meeting on 11 February 2022 and the recommendations in this report are derived from agreed actions from this meeting.

DETAILS:

Progress of the sub-committee on drafting a Responsible Investment Policy for further consideration.

5. At its meeting of 10 September 2021, the Pension Fund Committee approved the proposed structure for a standalone Responsible Investment Policy.
6. The structure includes five pillars:
 - a) Governance;
 - b) Investment;
 - c) Implementation;
 - d) Stewardship;
 - e) Monitoring and reporting.
7. In drafting the RI policy the sub-committee agreed to concentrate on the following specific areas of these five pillars, identified as key to this policy:
 - a) Investment:

- i- Definition of what RI means for the Fund, making the clear link to the UN Sustainable Development Goals (SDGs);
- ii- RI priorities – for the next year, highlighting any agreed specific objectives or areas of focus;
- iii- Outline different techniques available to the Fund to help identify RI risks – e.g. climate modelling.

b) Implementation:

- i- General approach to implementing the RI beliefs;
- ii- Delivering RI objectives in the short, medium and long term;
- iii- Explicit RI expectations for Border to Coast, asset managers, custodian and other third parties;
- iv- Surrey's approach to collaboration.

c) Stewardship:

- i- Surrey's high-level position on engagement focusing on the United Nations Sustainable Development Goals;
- ii- Engagement responsibilities - who is responsible for what;
- iii- Engagement policy themes and link to prioritised RI themes;
- iv- Position on 'divestment'/Just Transition to a low carbon economy;
- v- Engagement across asset classes – summary of different methods available.

d) Monitoring and progress:

- i- Commentary on monitoring expectations Surrey has of Border to Coast;
- ii- Reporting commitments (existing or aspirational);
- iii- Expectations of Border to Coast in terms of supporting the Fund's own RI reporting requirements.

8. The delivery timeline for the RI policy is expected to be as follows:

2021

November RI Sub-Committee

- affirm principles of the draft RI policy
- TCFD forward looking metrics agreed
- consider range of net zero options in respect of scenarios
- consider realizable initiatives to sign up to (e.g., net zero framework, Stewardship code etc)

December Pension Fund Committee

- draft RI policy progress update
- TCFD metrics approved
- ISS review framework approved

2022

January / February RI Sub-Committee

- agree draft RI policy including net zero date and measuring framework and reporting

March Pension Fund Committee

- discuss draft RI policy and for any resulting changes to ISS
- TCFD report presented

June Pension Fund Committee

- approve ISS

9. At its meeting of 11 February 2022, the Responsible Investment sub-committee considered the draft standalone Responsible Investment Policy.
10. The sub-committee considered the whole document, but concentrated on the following key areas of the policy:
 - a) 1.1.3: the purpose of the policy
 - b) 1.2.1: Surrey's RI beliefs
 - c) 1.2.1: Surrey's RI priorities
 - d) 4.3.3: engagement and RI themes
11. The comments and suggested amendments made by the sub-committee are shown in the draft Responsible Investment Policy (annexe 1).
12. It is proposed to allow further time for the committee and sub-committee to provide written feedback. This will be collated into a revised version, which will go back to a further meeting of the sub-committee for consideration. The expectation is that sub-committee will agree a proposed final version of the policy at its next meeting. This will be brought to the committee for its approval, before being shared in a consultation with scheme employers. A final version of the policy will then be brought to the committee for approval.

Taskforce for Climate Related Financial Disclosures (TCFD) report

13. At its meeting of 17 December 2021, the Committee agreed for officers to work with the sub-committee, the independent investment advisor, investment consultant and Border to Coast to establish a total emissions and weight adjusted carbon intensity (WACI) for backward looking metrics and portfolio aligned, implied temperature rise for forward looking metrics in respect of the Fund's Taskforce for Climate Related Financial Disclosures (TCFD) report.
14. The draft TCFD report (shown as annexe 2) details these metrics as follows:

- a) Weighted Average Carbon Intensity (“WACI”): measures the carbon emissions (in Metric tons) divided by sales (per \$million of sales). The contribution of each issue is weighted according to portfolio weights. This means that for funds, 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 a company with a lower carbon intensity but a higher weighting in the fund.
 - b) Absolute emissions: represents the company’s reported or estimated greenhouse gas emissions, where available. It includes various scopes of emissions:
 - i- Scope 1 “direct” emissions: those from sources owned or controlled by the company (e.g. direct combustion of fuel from vehicles); and
 - ii- Scope 2 “indirect” emissions: those caused by the generation of energy (e.g. electricity) purchased by the company.
 - c) Implied temperature rise: represents the implied temperature trajectory of a company’s operations expressed as °C portfolio weights. It allows for tilting of the portfolio towards companies with a <2°C implied temperature rise, to show alignment with the Paris Agreement ambition.
15. This iteration of the TCFD report concentrates on listed equities. The remaining assets consist of Fixed Interest Gilts, Property, Multi Asset Credit and alternative mandates, for which the ability to monitor these risks is currently less achievable.
16. The TCFD report shows a marked downward trend in all four metrics for the Fund’s listed equities over the three month period between June and September 2021:
- a) The Fund has been decarbonising its Listed Equity assets since 2018 with the transition of assets to Border to Coast, termination of Marathon and UBS legacy equity fund managers and transitioned 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 27.1% lower carbon footprint than MSCI ACWI.
 - b) 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.
 - c) The weighted average absolute emissions are equivalent to c.172k tCO₂e as at 30 September 2021.
 - d) The weighted average implied temperature rise (ITR) of the listed portfolio at 30 September 2021 was 2.2°C, which is 0.2°C lower as compared with the MSCI ACWI (at 2.4°C)
17. The draft TCFD report includes some examples of aiming for net zero by 2050 as an illustrative target to manage climate change-related risks and reducing carbon emissions.
18. It is proposed to convene a further meeting of the sub-committee to consider these targets, consistent with the detail of recommendation 5.
19. A further version of the policy will then be brought to the Committee for final consideration and approval.

20. It should be noted that it is not yet a regulatory requirement for LGPS funds to complete a TCFD report and they Fund will be reporting in 2022 on a voluntary basis. It should be noted that there may be changes to further reports in accordance with regulations.

Net zero scenario analysis

21. The sub-committee considered a high level low carbon transition plan including four stages:
- a) Establish a current emissions baseline: agree and apply Scope 1, 2 and 3 carbon emissions metrics to the total portfolio (Scope 3 expected to come in the future, assuming data availability and robustness);
 - b) Establish portfolio possibilities: analysis of 'grey', 'green' and 'in-between' transition possibilities of the portfolio;
 - c) Target and timing: e.g. 2030, 2040, 2050 and interim targets;
 - d) Transition plan for implementation: integration, stewardship, investment, screening.
22. It is recommended that the Committee approve for officers to work with the independent investment advisor, investment consultant and Border to Coast to model a low carbon transition plan, applying scenario analysis using the agreed TCFD metrics and assuming net zero carbon dates of 2030,2040 and 2050.

Modelling a low carbon transition plan

23. At its meeting of 11 February 2022 the sub-committee considered a discussion paper from the Investment Consultant which included scenario analysis using net zero decarbonisation targets based on dates of 2030, 2040 and 2050.
24. "Net zero" emissions refers to the balance between the amount of greenhouse gas produced and the amount removed from the atmosphere. We reach net zero when the amount we add is no more than the amount taken away.
25. The necessity for establishing credible decarbonisation curves to achieve net zero was discussed, including three common elements:
- a) Targeting 2050 or sooner, as this is the minimum target year for net zero globally to achieve a 1.5°C scenario above pre-industrial levels, according to the 90x 1.5°C scenarios analysed by the IPCC, and is in line with the Paris Agreement's aim of keeping global temperature increases "well below 2°C".
 - b) Including a number of interim decarbonisation targets along the pathway to net zero no more than 5 years apart, for example 2025, 2030 etc. where progress is reviewed and targets are revised as is necessary.
 - c) Prioritising genuine decarbonisation over carbon offsets and carbon credits.
26. The sub-committee agreed the importance of agreeing a decarbonisation curve that is ambitious enough to align with a 1.5°C scenario above pre-industrial levels, that is regularly reviewed and revised in line with the latest science and finally one which ensures "real world" decarbonisation occurs.

27. It was recommended that Committee approve for officers to work with the sub-committee, the independent investment advisor, investment consultant and Border to Coast to establish a decarbonisation curve that is ambitious enough to align with a 1.5°C scenario above pre-industrial levels.

CONSULTATION:

28. The Chairman of the Pension Fund Committee has been consulted on this report.

RISK MANAGEMENT AND IMPLICATIONS:

29. 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

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

DIRECTOR CORPORATE FINANCIAL & COMMERCIAL

31. 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

32. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

33. There are no equality or diversity issues.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT

35. The following next steps are planned:
- a) A further meeting of the sub-committee will be convened to action recommendations as outlined in this paper.
 - b) A further version of the policy will then be brought to the Committee approval subject to consultation with scheme employers.

Contact Officer:

Neil Mason, Assistant Director – LGPS Senior Officer

Consulted:

Pension Fund Committee Chairman

Annexes:

1. Draft RI policy (Part 2)
 2. Draft TCFD report (Part 2)
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