Surrey Pension Fund Committee – 15 December 2023

Item 4 - Public Questions

Q1 – submitted by Kevin Clarke

In BCPP's Multi Asset Credit Fund (invested by SPF), how many of the 32 banks fund exploration of fossil fuels?

Reply:

BCPP's Multi-Asset Credit, (MAC), fund allocates capital to 6 underlying managers, BCPP itself, PIMCO, PGIM, Wellington, Ashmore and Barings.

MAC holds some financial sector issuers. Traditional banking entities with some degree of fossil fuel financing sum to 45 issuing entities. Each banking institution's exposure to the fossil fuel sector will vary depending on their governing policies on criteria, scope and targets linked to fossil fuel financing. The breakdown is as follows.

- Barings and PGIM portfolio have reported no exposure to fossil fuel exploration linked to their bank holdings within their mandates.
- Wellington hold 5 banks with limited exposure. The ESG team estimate <+1% of assets exposed to fossil fuel exploration.
- PIMCO hold 14 banks with indirect exposure, with whom they actively engage about their net zero policy.
- Ashmore hold 24 banks with fossil fuel exposure. It is noted for those companies held that exposure may be understated given the lack of disclosure and data availability within the emerging market complex.
- Border to Coast hold 2 banks with exposure to fossil fuel exploration.

Q2 – submitted by Lindsey Coeur-Belle

The 2933 IPCC report states

"In urban areas, observed climate change has caused adverse impacts on human health, livelihoods and key infrastructure. Hot extremes have intensified in cities. Urban transportation, water, sanitation and energy systems have been compromised"

Hong Kong has just experienced the hottest summer on record and the September typhoon brought the heaviest rains since records began in 1884; flooding malls and subway stations, causing landslides and tearing up roads, causing some population evacuation and paralysing the city.

This shows what can happen to a major financial centre when weather patterns worsen. Given the increase in number and frequency of such events worldwide, is it not reasonable to rethink the risk posed by climate change to the Committee's portfolio?

Reply:

The Committee takes climate change and potential impacts on the Fund extremely seriously. To this end the Committee approved a new Responsible Investment, (RI), policy in June 2023. At the same time, after commissioning a dedicated report, the Committee set a Net

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Zero date of 2050 or sooner for the Fund. Therefore, the Committee has just had a major review of the risk posed by climate change on the portfolio.

However, it was also noted that data, assumptions and modelling are always changing in this area and therefore the Committee has committed to review the RI policy annually for best practice and to consider if a review is necessary of the Net Zero date, with changes to the set of investment opportunities.

The underlying assets must be managed by the Fund's investment managers in such a way as to align with the Fund's commitments. Border to Coast Pensions Partnership, (BCPP), the Fund's pooling partner, recognises that climate change is a systemic risk and that this presents a variety of material investment risks which need to be managed across the investments they manage for the Fund over the short, medium and long-term. They do this by: integrating ESG factors, including climate considerations, into the investment processes across all asset classes; using their influence as a steward of capital; committing to a Net Zero carbon emissions target by 2050 or sooner; and aligning their own operations with this goal.

As the Fund's most significant investment partner, BCPP have a duty to ensure that the Fund's investments are well-positioned to manage the physical climate risks, regulations, and policies that are developed to promote a Net Zero economy.

Climate-related risks can be characterised as physical or transition risks, and BCPP consider both in their investment decisions. The former describes the physical impacts and associated costs arising from a changing climate. These might include damage to assets or disruption to supply chains from extreme weather events; flooding from rising sea levels and storm surges; wildfires; or the impacts of rising temperatures on, for example, social infrastructure or human health.

These risks will manifest over short, medium and long-term horizons. For example, we are already seeing significant economic impacts from extreme weather events. Other physical impacts, such as rises in sea-levels, are likely to be felt over the coming decades.

In the Risk Management Chapter of their Climate Change Report, BCPP outline a variety of tools and metrics used to measure and monitor climate risk in the portfolios. They use third-party data and analytics, continue to develop their internal analytical capabilities, and work collaboratively with partners to better assess carbon-related risk.

BCPP consider material ESG risks, including transition risks and the physical risks of climate change as part of the investment decision-making process. They work with their internal portfolio managers and their external asset managers to firstly understand the risk, conducting carbon screens to identify the largest emitters and potential risks around stranded assets.

They use a variety of data sources to develop and evolve the approach to managing climate risk and reporting, and to support the Net Zero commitment. They utilise third-party carbon data to implement carbon analysis across portfolios. This is used alongside other tools to understand intrinsic and physical risks at stock, sector and portfolio level.

Q3 – Submitted by Jackie Macey

Earlier this year Shell's CEO Wael Sawan vowed to shift Shell's focus towards high profit oil projects and to expand its gas business, despite strong warnings from the International Energy Agency that there must be no new oil and gas projects in order to be compatible with the global goal of limiting global heating to within 2C of pre-industrialised levels.

A plan to cut 200 jobs within the team developing solutions for hydrogen-powered vehicles appears to be in line with Sawan's policy and not a step towards a greener future.

Having made record profits last year Shell has recently announced that it plans to pay shareholders at least $23bn in rewards this year and not to increase its investment in renewable energy projects. This suggests that Shell's commitment to a low carbon future is little more than tokenistic.

Does the committee feel that divestment of funds from Shell should now be treated with urgency?

Reply:

Stock level investment decisions are delegated to the Fund's investment managers. These managers are required to consider all material factors, including Environmental, Social and Governance factors, as laid out in the Responsible Investment policy, when making these decisions. The policy highlights that the Fund takes an engagement approach, rather than straight divestment, if issues arise relating to any factor that has fed into the investment decision making process.

Specifically on Shell, the Fund's direct holding is through the Newton global equity mandate.

Shell is one of Newton's company-specific engagement priorities. They have held a series of engagement meetings with senior management this year. The primary objective of these discussions has been to encourage Shell to set out a clear, credible and achievable energy transition plan that they can implement and control.

These discussions have included Newton's direction to the management that their transition strategy should include absolute Scope 3 emission reduction targets. Other ground has been covered in these interactions. For example, profiling investment in clean energy, disclosure on clean alternatives and planned investment therein. Other factors that they should outline are plans around staff re-training/upskilling, job security, employee satisfaction surveys and suchlike. Newton's understanding is that they will be announcing their new climate transition plan towards end-Q1/early-Q2 2024.

Newton believes their regular dialogue is open on both sides and that they are now getting a clearer understanding of Shell's plans and expectations around these important issues. These factors are incorporated in Newton's overall assessment of the investment case.

Shell is also a point of special focus for the Local Authority Pension Fund Forum, (LAPFF), and a priority for climate engagement in the oil and gas sector for Border to Coast Pensions Partnership, (BCPP).

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Q4 – Submitted by Janice Baker

A recent update to the EU environmental crime directive due to be formally passed in Spring 2024, intends to criminalise “cases comparable to ecocide”, and requires member states to put the directive into law within two years. It specifically covers actions that substantially damage large or significant ecosystems, habitats or the quality of air, water and soil, on a wide scale, in the long term or irreversibly.

To what extent does the Committee see its investment portfolio being affected by the impact the Directive will undoubtedly have on its overseas investments, including those in fossil fuels?

Reply:

The Committee expects all its investments to comply with domestic laws at all times.

The Fund asked its 2 most significant managers, Border to Coast Pensions Partnership, (BCPP), and Legal and General Investment Management, (LGIM) to comment.

BCPP

Environmental Crime Directive

On 16 November 2023, following several months of discussions, the European Council and the European Parliament reached a provisional agreement regarding the proposed Directive on the protection of the environment through criminal law (the “ECD”) and replacing Directive 2008/99/EC. At the end of its legislative road, if adopted, the ECD would require EU Member States to ensure that their criminal laws punish a series of environmental offences and apply minimum penalties. Like any EU Directive, the ECD will now follow the formal adoption procedure. Once adopted, the ECD will need to be transposed into the Member States' national law. According to the ECD, from its date of entry into force, Member States will have 18 months to adopt national provisions.

Impact on BCPP

The ECD impacts asset management firms making available financial products within the EU/to EU investors. Non-EU fund managers will be in scope to the extent that they register any of their funds for marketing under Article 42 of the AIFMD[5]—i.e., private placement—in any EU member state. They are also potentially in scope to the extent that they manage or advise EU-domiciled funds, even if those funds are not privately placed in the EU.

BCPP is a Non-EU fund manager and subject to UK legislation post BREXIT.

Currently no individual companies have been found liable for climate change damage, but this may change in the future. We will be monitoring the situation in respect to the development of the laws and jurisprudence along with our Voting & Engagement Partner.

LGIM

‘’LGIM broadly welcome the new EU Environmental Crime Directive (ECD), which will replace the 2008 ECD. The strengthening and broadening of the new ECD demonstrates the European Commission’s commitment to creating a robust policy and regulatory environment to tackle nature and biodiversity loss. This demonstrates the EC’s commitment to the Global Biodiversity Framework, of which we - LGIM - are also supportive of, reflected within our strategic Nature stewardship theme.

As a global investor, LGIM is committed to addressing the issue of nature change and biodiversity loss. Nature-related risks could have significant macroeconomic implications and be a source of risk to financial institutions and financial stability. Therefore, LGIM has prioritised nature as one of its strategic themes. LGIM is supportive of the Kunming-Montreal Global Biodiversity Agreement's mission of taking urgent action to halt and reverse nature loss by 2030, and the vision of living in harmony with nature by 2050. Transitioning to protect and restore nature across markets will be hugely complex, requiring both public and private sector commitment and collaboration.

LGIM has structured its approach to nature engagement across four 'sub-themes': natural capital management; deforestation; circular economy; and water. These sub-themes target the five direct drivers of nature change (Climate Change; Land / Freshwater/ Ocean use change; Natural resource use; Pollution; and Invasive Alien Species) that are having the largest global impact, as identified by Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Service (IPBES – equivalent to the IPCC for climate change).

Examples of how we have been addressing nature issues through our engagement in 2023 include:

- Expanding our LGIM ESG Score to include an assessment of whether companies have a deforestation programme, a biodiversity programme and a water management programme: *https://esgscores-lgim.huguenots.co.uk/srp/documents-id/dc2ca5ef-933d-4748-b221-7085515bfa04/Methodologyforratingcompanies.pdf*
- Integrating our expectations of companies regarding assessment of their impacts and dependencies upon nature and biodiversity, and appropriate mitigation actions, into our Climate Impact Pledge sector guides: *https://www.lgim.com/uk/en/responsible-investing/climate-impact-pledge/*
- Under our deforestation campaign, our minimum expectation is that all companies in 'deforestation-critical sectors', for which we have data, have both a deforestation policy and a programme. When we assess that companies are not meeting these minimum standards, we will apply a vote sanction against them. This will usually be applied against the re-election of the chair of the board. Please see our deforestation policy for more information: LGIM Deforestation Policy
- Developing and documenting our approach to nature, including development of an LGIM Nature Framework (as detailed above) and underlying sub-themes policies for natural capital management, water, and circular economy, and updating our deforestation policy
- Engaging with refinement of key integration and disclosure frameworks, such as the Taskforce for Nature-related Financial Disclosures, and domestic and regional policies and regulation, such as the EU Nature Law and Global Roadmap for the Agriculture and Land-use sector''

Q5 – Submitted by Lucianna Cole

On 7th October the Californian Governor signed the Climate Corporate Data Accountability Act into law which will require US companies with annual revenues of over $1billion to report both their direct and indirect greenhouse gas emissions from 2026.

This should mean many multinational companies, including the likes of Apple, ExxonMobil and Chevron will have to report on their scope 3 emissions - data that has previously not been available.

California is the fifth largest economy in the world, so these new laws will have a substantial impact worldwide, and history suggests that that this could even lead to changes at a federal level too. You can read more about this in this article.

Given this big development, will Surrey Pension Fund factor in the availability of scope 3 emission data in the near future as part of your Net Zero targets?

Reply:

The Surrey Pension Fund always tries to include the most up-to-date and complete data set possible for any of its decisions. Net Zero is no different.

The Fund's Net Zero target currently covers the portfolio's scope 1 + 2 emissions. This is in line with current market practice and is largely driven by the availability and quality of scope 1 + 2 data relative to scope 3. However, there is growing pressure for investee companies to report scope 3 emissions and the Fund is committed to incorporating scope 3 emissions into its target setting, especially across high-impact sectors, when data quality improves.

A recent analysis by CDP across high-impact sectors found that scope 3 emissions account on average for 75% of total scope 1 + 2 + 3 emissions. This highlights the importance of considering scope 3 emissions when making investment decisions. However, where companies do currently report their scope 3 emissions, they often don't report against the same categories as one another, and even when they do, their underlying assumptions can differ materially. When reported data availability improves sufficiently, the Fund anticipates setting scope 1 + 2 targets and scope 3 targets (or some combination). In the interim, however, the Fund expects managers to consider the key companies and sectors responsible for scope 3 emissions when assessing climate risks and managing to scope 1 + 2 decarbonisation targets (i.e. it may make sense on a scope 1 + 2 basis to sell out of utilities and into automobiles, but it may be counterproductive from a scope 3 perspective).

The example given of the "Climate Corporate Data Accountability Act" is one example of many initiatives promoting the disclosure of scope 3 emissions. The International Sustainability Standards Board (ISSB) also launched IFRS S2 Climate-related Disclosures earlier this year. The standard requires companies to disclose absolute gross greenhouse gas emissions generated during the reporting period, measured in accordance with the Greenhouse Gas Protocol, classified as scope 1 + 2 + 3 emissions. The Financial Conduct Authority, (FCA), welcomed the launch of IFRS S2 and the UK Government has signalled its support, announcing it would be establishing a mechanism for formal UK endorsement and adoption of the standards. Border to Coast Pensions Partnership, BCPP, will highlight that scope 3 emissions data is vital for investment managers to understand the transition risk of investee companies and the importance of the ISSB standard in their submission to the scope 3 reporting consultation. The Fund, its consultants and investment managers continue to track industry developments closely, with a view to integrating scope 3 data more formally into investment decision making, including in relation to the Fund's Net Zero target, when available.

Q6 – Submitted by Jennifer Condit

At COP 28 and elsewhere, negative - but also possible positive - tipping points are on people's minds. Among the latter, regulatory pressure to stem carbon demand and emissions is accelerating. What effect may this have on the risks and rewards in holding high carbon investment assets?

In the past week, the European Central Bank has warned major European banks that they must speed up implementation of controls on financing carbon, or the ECB will impose daily penalties, already under discussion, and may increase individual banks' capital requirements.

(https://www.bloomberg.com/news/articles/2023-12-06/ecb-warns-banks-of-penalty-escalation-if-climate-risks-ignored?srnd=green&leadSource=uverify%20wall)

Meanwhile the International Monetary Fund has said that subsidies on carbon must be withdrawn, and even redirected to renewable sources of energy. While decrying the failure to implement effective carbon pricing, the IMF says there is more than one way to 'bake a cake'. "We can also use regulatory compliance in which standards lead to implicit prices on carbon."

https://www.theguardian.com/environment/2023/dec/07/carbon-pricing-would-raise-trillions-needed-to-tackle-climate-crisis-says-imf

The fossil fuel companies understand that arrival of the regulatory tipping point is fast approaching - that's a big reason they are scrambling to get oil out of the ground while they still can. This tipping point will increase the cost of carbon throughout the economy, thus reducing demand, and increase the fossil fuel companies' cost of doing business. Both effects will be bad for their results and ultimately their value as investments.

What is the Committee's view on whether the potential acceleration of regulation should be addressed explicitly by its investment managers and in SPF's own consideration of the investment risk of holding fossil fuel assets?

Reply:

Stock level investment decisions are delegated to the Fund's investment managers. These managers are required, by the Committee, to consider all material factors, including any regulatory changes. Fundamental to any company investment decision is an analysis of demand and supply of the product and the resultant pricing. These elements will always be explicitly considered in forecasts to reach an active investment decision.

The Fund believes that climate issues require a broader consideration than just avoiding those companies that may be at greatest risk. In order to avoid the worst possible outcomes from climate change a coordinated approach is required which involves active ownership and engagement to drive for real world change. Engagement on climate and transition plans may present investors with the potential to both unlock shareholder value and drive a positive impact on the world's realised climate outcome.

Regulatory pressure to stem carbon demand and emissions does seem to be accelerating. The outcome of the COP 28 summit may be important because it will give an indication of direction of travel of government policy, with regards to fossil fuels, in different countries. The role of COP is to raise climate issues and focus on climate action. However, the translation

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and implementation of the actions is left to individual countries. Decisive enabling policies are needed from governments that provide clear policy frameworks for companies and investors to deliver the investment needed for the transition to a low carbon economy. These transition risks can be in the form of removal of fossil fuel subsidies, implementation of carbon taxes, or incentives for investing in capital intensive projects that will enable the transition to a low carbon economy and will support the demand for non-fossil fuel energy supply. Investors will be better able to assess, in a comparable way, the risks and opportunities in holding investee companies operating in high carbon intensive sectors.