

SURREY COUNTY COUNCIL**SURREY PENSION FUND COMMITTEE****DATE: 21 JUNE 2024****LEAD OFFICER: ANNA D'ALESSANDRO, INTERIM EXECUTIVE DIRECTOR, FINANCE AND CORPORATE SERVICES****SUBJECT: RESPONSIBLE INVESTMENT UPDATE****SUMMARY OF ISSUE:**

The Fund continues to implement the agreed priorities of the Pension Fund Committee (Committee) in relation to Responsible Investment (RI). It was agreed that the RI policy be reviewed annually for industry best practice and that the investable universe with regard to Net Zero dates be analysed annually as well. The Committee also requested an analysis of the potential impact of excluding the largest 25 fossil fuel companies from Fund investment.

RECOMMENDATIONS:

It is recommended that the Committee:

- 1) Note alignment of the RI Policy to industry best practice.
- 2) Note the report by Mercer, the Fund's investment consultant, on the investable universe in relation to potential Net Zero dates.
- 3) Note the report by Mercer on the potential impact on the Fund from excluding the largest 25 fossil fuel companies globally from the Fund's investment universe.
- 4) Note the Fund's current underlying exposure to the largest 25 fossil fuel companies.

REASON FOR RECOMMENDATIONS:

To enable the Committee to fulfil previously agreed actions.

BACKGROUND:

1. When the Committee approved the Fund's RI policy at the meeting of June 2023, it was agreed that the policy would be reviewed annually for industry best practice.
2. When the Committee approved the Fund's Net Zero date of 2050 or sooner at the meeting of June 2023, it was agreed that the investable universe would be reviewed annually for varying Net Zero dates.

3. At the December 2023 meeting, the Committee agreed to request analysis of potential impacts on the Fund if the largest 25 fossil fuel companies globally were excluded from the Fund's investment universe.

DETAILS:

RI Policy Review

4. Minerva have reviewed the Fund's RI policy for industry best practice. The updated policy can be found in Annexe 1.
5. Pleasingly, the policy stacks up well against best practice guides, for example the Principles for Responsible Investment's (PRI) 'Developing and Updating a Responsible Investment Policy'.
6. The RI priorities in section 1.2.3 have been updated to reflect that a Net Zero date has been agreed and that the Fund's voting and conflicts of interest policies have been revised. The table in 4.2.2 has also been changed given the new voting policy covering areas such as sustainability and shareholder proposals. Other minor wording changes have also been made.
7. The Fund has not initiated any collaborations directly but continues to work through the Local Authority Pension Fund forum (LAPFF), Border to Coast Pensions Partnership (BCPP) and the Cross-Pool RI Group, all of which further extend the Fund's collaborative efforts to magnify its voice. (Section 3.3.1)
8. Through a gap analysis against the PRI's best practice guidelines referenced above, Minerva have highlighted some potential areas for future development, such as reporting on governance and fund history, better disclosure from all parties and the integration of RI into the Fund's Investment Beliefs. The latter point will be covered in the sub-committee sessions to be held over the summer, if agreed.

Net Zero Investable Universe Review

9. Mercer have produced a report reviewing the current investable universe for varying Net Zero dates. This report can be found in Annexe 2.
10. The investable universe for dates earlier than 2050 has not materially changed since the Net Zero date of 2050 or sooner was agreed. If company statements on their Net Zero targets are more stringently filtered for credibility, the investable universe shrinks, further limiting the diversification opportunities at earlier dates.

Exclusion Review

11. Mercer have produced a report analysing the potential risk / return impact from excluding the largest 25 fossil fuel companies from the Fund's investable universe. This report can be found in Annexe 3.
12. The report is focused on equities. There is no current or expected investment in these companies through the Alternatives asset class. There is minimal exposure through the BCPP Multi-Asset Credit fund. These 25

companies are usually able to raise finance through developed market investment grade bonds, which the BCPP fund has no allocation to. Benchmark analysis is also compromised with regard to bond indices. If the nature of the Fund's credit investments changed, there may be a greater impact on risk/ return metrics. For example, if in future there was an allocation to investment grade bonds.

13. This process has calculated the tracking error of a new index, with the 25 companies excluded, to the original index. This is done by using historic observed data that may or may not be representative in the future.
14. This analysis more naturally applies to a passive approach where the weighting to companies is in line with the benchmark weight. For active managers, the weighting to companies held is rarely in line with the benchmark weight. Therefore, the actual impact on return for the actively managed mandates may be significantly higher than this base line analysis suggests.
15. Excluding the 25 companies generally lowers the exposure to carbon for the benchmarks. Carbon metrics would be lower for the index tracking mandates. Carbon metrics may or may not be lower for the actively managed mandates. Other Environmental, Social and Governance (ESG) scores will be either positively or negatively affected. For the index tracking mandates the impact on these other scores is generally small, but there are exceptions. For example, excluding these companies from the LGIM Europe ex-UK fund lowers the biodiversity score by 6.2%.

Current Fund underlying exposure to the largest 25 fossil fuel companies

16. The Fund's current underlying exposure to the largest 25 fossil fuel companies, in sterling, can be found in Annexe 4.

CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

18. 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

19. Responsible investment decisions can have an impact on the Fund's risk and return.

INTERIM EXECUTIVE DIRECTOR, FINANCE AND CORPORATE SERVICES COMMENTARY

20. The Interim Executive Director, Finance and Corporate Services is satisfied that all material, financial and business issues, and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER

21. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

22. There are no equality or diversity issues.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT

24. The following next steps are planned:

- a. Produce TCFD for the year 2023-24
- b. RI policy review in June 2025
- c. Net Zero investable universe review in June 2025

Contact Officer:

Lloyd Whitworth, Head of Investment & Stewardship

Consulted:

Pension Fund Committee Chair

Annexes:

1. Annexe 1 – RI Policy
2. Annexe 2 – Mercer report reviewing the current investable universe for varying Net Zero dates
3. Annexe 3 – Mercer report reviewing the potential impact on the Fund from excluding the largest 25 fossil fuel companies
4. Annexe 4 – Fund's exposure to largest 25 fossil fuel companies as at 31 March 2024

Sources/background papers:
