Surrey Pension Fund Committee – 10 September 2021

Item 4 - Public Questions

Q1 – submitted by Jenifer Condit

At the July meeting, the Committee confirmed that you "reserve the right to disinvest from companies where engagement has not driven the changes expected". Asked about the term "changes expected", and in particular how these changes will be measured and over what time period, Chair Harrison replied that he noted these were "well made" points and that they would address these issues seriously.

Could I therefore ask you to confirm that you have specific, measurable targets for each fossil fuel company you own, which you will use as a benchmark to trigger divestment? Could you please disclose each of these targets?

As the recent IPCC report made clear, urgent action is critical. We do not have the luxury of waiting a number of years to see if a high intensity carbon emitter fails to respond satisfactorily. Surrey Pension Fund has been engaging with these companies for the last decade. It would grossly overlook the efforts of previous committees by starting the clock from today. Companies which are not engaging responsibly today have been failing to engage seriously for the last decade and timescales for radical change should reflect that. Can I therefore ask what timeframe you have established to exclude any of these companies who have not engaged in a robust way?

Reply:

When the transition to Border to Coast is complete, engagement of all of Surrey's holdings will be ongoing through LGIM and Robeco which is structured with specific aims and objectives. This is shown through partnership with other like-minded investors and through collaborations such as Climate Action 100+ and, as members of the Institutional Investors Group on Climate Change to achieve our objectives.
In the specific case of LGIM, there is a focus within the investable universe on 'climate-critical' sectors, resulting in circa 1000 large companies where their publicly available climate scores are linked to voting and investment decisions. A subset of those companies – circa.58 – have been selected for further in-depth engagement. Using quantitative and qualitative measures, they assess them under a 'traffic light' system, drawing on independent data providers and our pioneering climate modelling.
This methodology is aligned with the best practice recommendations of the Task Force on Climate-related Disclosures (TCFD). It brings together data from reputable ESG data providers as well as LGIM's proprietary climate modelling information.
For the 58 companies on their 'deeper' engagement list – divestment remains on the table if companies:

- Score poorly in their qualitative assessment
- Are unresponsive to their engagement, and
- Fail to meet their 'red lines' as set out in our sector-specific guidance (for example, lack of comprehensive emissions disclosure in the oil & gas sector). Specific sector guides can be found on the Climate Impact Pledge web page, https://www.lgim.com/uk/ad/responsible-investing/climate-impact-pledge/.

All divestments are not only limited but controlled within a tracking error budget (in Future World index funds, it is 30 basis points) - if the divestment candidates exhaust that budget, the exposure will be reduced, but complete divestment will not take place. The point of this

limited divestment is the power of applying public scrutiny to companies, rather than changing the risk/return profile of the funds.

Divestment and reinvestment candidates are reviewed by a 'challenge committee' with representatives from across the Investment teams and the Investment Stewardship team. The Investment Stewardship team presents a recommended divestment/reinstatement list – alongside supporting evidence for actions taken (or not) by the companies. Our recommendations are challenged by the committee and assessed for tracking error implications by the index team. A final investment decision is then made by the Divestment Oversight Group, which includes representation from index and asset allocation teams. With regards to Border to Coast, we are in agreement that responsible investing involves working with companies to manage and mitigate risks, including those linked to climate change, which they view as a systemic risk that can impact upon a wider range of sectors, not simply those involved in energy and mining.

Excluding companies that have, in their view, the capability to transition their business to support net-zero ambitions does little to address the wider systemic risk linked to fossil fuels. Acting responsibly involves using our influence to engage with companies, with a view to both enhancing our investment case and mitigating wider systemic risks.
Companies in sectors where it is more challenging to reduce emissions, for example the steel and cement sectors, require capital to develop technologies with lower emissions. These industries are crucial for the shift to a low carbon economy and therefore require investor capital.

Divestment, therefore, may make immediate de-carbonising improvements to the portfolio, however the engagement efforts required to reduce real world emissions would be discharged, potentially to shorter-term investors with less emphasis on de-carbonising the planet.

Engagement can take several forms from direct conversations via portfolio managers, utilising our voting and engagement partner and collaborative efforts to provide further scale. If they do not see sufficient progress and mitigation of risks, and the long-term investment case has been fundamentally weakened as a result, the decision may be taken to sell the shares.

There are no quantitative triggers or hard targets. An evaluation of investment case weakening is carried out on a case-by-case basis and balanced against multiple factors. As an active equity manager, Border to Coast has more levers to pull than engagement and divestment alone. There are a variety of reasons – both in ESG space and in terms of the investment case – why they may elect to sell shares in a company, or simply not hold it in the first place.

Responsible investment is a key facet of Border to Coast's investment process across all asset classes. ESG risks and opportunities are considered at a stock level - and detailed rationale are provided for any stocks held that score lowly in ESG terms.

By way of illustration, our Global Equity Alpha Fund, which Surrey invests in, holds only 177 companies from an investible universe of c.3,000. This Fund is materially below its benchmark (by more than 50%) for both carbon emissions and carbon intensity and has a significantly lower holding in fossil fuel reserves. They believe this illustrates our active, responsible approach to investment management.

They monitor all Funds, both internally and externally managed, for exposure to fossil fuels. Companies in higher emitting sectors are also frequently monitored on their progress in

managing climate risks. For example, how their Transition Pathway Initiative (TPI) carbon management level has changed over time or whether they have stated a net-zero target. Recently they have taken material action by voting against Company Chairs and CEO's who are not making the required progress and are rated as Level 0 or Level 1 (the lowest TPI rankings). The voting policy will continue to be strengthened in future policy reviews.

Q2 – submitted by Isobel Griffiths

On a couple of occasions in the last year, Surrey Pension Fund has noted its support of Make My Money Matter. Are you aware of its latest website entry at https://makemymoneymatter.co.uk/green-your-pension/ with the message:
"There's £2.6 trillion invested in UK pensions. Much of it funds harmful industries like fossil fuels, tobacco, and arms. We're here to make sure it does better. After all, what's the point in retiring in a world on fire?"

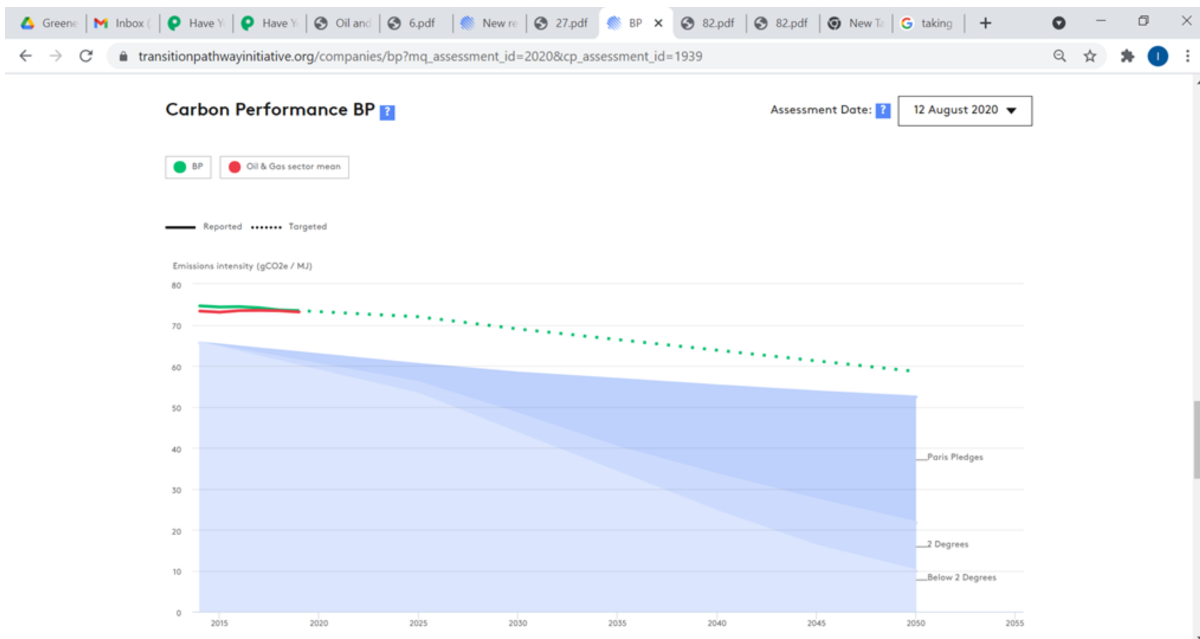
In developing your new responsible investment policy, I wondered (as a member of the scheme) if you would ask your members for their views on fossil fuel investments and respond accordingly? It is our money and our retirement, and many of us would not want you to invest our money in industries which will cause harm to us, our children and grandchildren. It seems entirely reasonable to ask our views on a factor which will drastically affect our retirement and I therefore ask you to do this.

Reply:

The Surrey Pension Fund is exploring new ways to engage with all our stakeholders, including more granular reporting of holdings via sector. There are over 100,000 members in the scheme and the Pension Fund Committee exercises its fiducary duty in the best interest of this group as a collective. This is encompassed by the Committee's ambition to incorporate all 17 of the United Nations Sustainable Development Goals in its investment strategy. This will also form a core part of the standalone Responsible Investment Policy currently being worked upon.

Q3 – submitted by Ian Chappell

I attach a screenshot and link from Transition Pathway Initiative https://www.transitionpathwayinitiative.org/companies/bp showing that the carbon emissions intensity of BP (and the overall Oil & Gas sector) has not changed significantly since 2014. Further, BP's planned emissions through to 2050 do not remotely align with Paris Pledges, which are themselves well in excess of an increase of 2 degrees C. Current BP plans will contribute to over 3.5 degrees C heating.



Over this six-year period since 2014, Surrey Pension Fund has been committed to an investment policy of engagement, a policy which the current committee apparently continues to prefer. This evidence strongly shows, without doubt as far as I can see, that engagement has had no effect on BP past performance and is having a woefully inadequate impact on their future plans. Given this data, could you please explain how you justify your policy of engagement?

In your attempt to defend engagement, could you please ignore the attempts of BP hypocritical attempts to greenwash. For example, whilst CEO Bernard Loomey pronounces that ""The world's carbon budget is finite and running out fast; we need a rapid transition to net zero" he simultaneously commits to open new oil exploitation across the world, ignoring the International Energy Agency's warning that net zero is only achievable if no new oil fields are opened from the end of this year.

In passing, it is worth noting that, holding fossil fuel shares in this period of engagement has also incurred low returns and high risks, which makes your policy of engagement, compared to divestment, even more perverse.

Reply:

We believe the Transition Pathway Initiative (TPI) is an excellent tool for understanding companies' management of climate change, their emissions trajectory and for comparing them against peers. These tools are used alongside a wide range of other resources, including third party data providers and collaborative initiatives such as CA100+

Since the last ranking of Management Quality by the TPI (March 2020 – rated 4*[1]) and Carbon Performance (August 2020) BP have set an ambition to be net-zero by 2050 or sooner and a completely new strategy to deliver this transition:

- Reduce absolute operational emissions to net-zero by 2050; with intermediate targets of -30 to -35% by 2030 and -20% by 2025.
- Net-zero carbon on energy produced from upstream oil and gas production by 2050; with intermediate targets of -35 to -40% by 2030 and -20% by 2025.
- Reduction of hydrocarbon production by 40% by 2030.

[1] *Transition Pathway Initiative (TPI) rates companies from Level 0 (Unaware) to Level 4* (Strategic Assessment) based on their management of greenhouse gas emissions risks and opportunities. More information can be found here: https://www.transitionpathwayinitiative.org/

- Cutting the carbon intensity of products (lifecycle scope 3 emissions) by 50% by 2050 or sooner; with an intermediate target of >15% by 2030 and 5% by 2025.

The Climate Action 100+ Net Zero Company Benchmark framework was launched earlier this year. This framework considers data from several sources on disclosure and capital allocation. TPI are one of the providers of carbon disclosure data.

- This framework consists of 10 indicators covering three goals; "Aligning emissions", "Improved Climate Governance" and TCFD aligned Reporting".
- According to this framework, BP at least partially meets all 10 indicators and as such is in the top third of all Oil & Gas companies.
- BP is one of only six companies in the entire benchmark credited with explicitly committing to aligning future capital expenditures with their long-term GHG reduction target.
- Specifically, for BP this means that all projects must include a review of the full economic return on investment (ROI) using Paris-consistent oil and gas prices over the period to 2050.

In May 2021, Carbon Tracker provided an update to their 'hallmarks of Paris compliance' framework and relative ranking table of climate goals for 10 of the largest oil and gas producers.

- BP ranked in the top tier of this and was in the top three Oil & Gas producers. This ranking was primarily driven by their "absolute reduction" targets for 2030 and 2050 rather than purely "emissions intensity" targets.

Although we do think BP has made some promising progress in the last 12-18 months, we do feel there is more that they can do. The best way to hold companies accountable to their climate goals is through active engagement and voting.

- Border to Coast are currently engaging with BP via Robeco on the "Net-zero Carbon Emissions" theme and also through ongoing dialogue via our external investment managers.
- In May 2021, they supported the shareholder resolution filed by Follow This regarding GHG reduction targets. While we did agree with company management that they have made significant progress setting a strategy and targets aligned to Paris and net-zero; we felt the shareholder resolution was complimentary to the work already conducted by BP and would not require anything contrary to their current climate strategy. The resolution was supported by 20% of all shareholders.

From an investment perspective, the impact of lower oil prices has been notable, alongside the growth of investment options which seek to screen out companies within the sector. However, we believe companies such as BP will be vital to the lower-carbon transition, through investment in cleaner energy. In 2020 (the last full year of data) BP increased their low carbon investments, including wind, solar and hydrogen, by 50% from $500 million to $750 million. Such a strategy, if successfully managed, should see a re-rating of the shares over the longer term.

Finally, it is worth noting that, at the portfolio level, both of the Border to Coast equity funds in which the Surrey Pension Fund invests are materially below the benchmark in terms of both carbon emissions and carbon intensity.

The Surrey Pension Fund is committed to addressing the climate emergency with thoughtful investment strategies which will both support the necessary investment returns required to pay pensions today as well as addressing the longer-term just transition to a low carbon economy and pay pensions tomorrow and long into the future.

The issue of climate change is much greater than one individual company. From a systems perspective, all economic activities - and so energy consumption - are interconnected. Therefore, to have any meaningful impact on climate change, the industrial and financial system as a whole, together with broader society and governments, national and local, need to take positive steps towards a just energy transition across the board.

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The energy transition and global dependency on oil and gas is a global systemic issue. In 2021 over 50Gt of carbon and other GHGs were burned by the global economy and as such impacts the entirety of our portfolio. Removing one company from our portfolio does not decarbonise the planet or reduce the total climate impact of all of our holdings.

The Surrey Pension Fund therefore remains committed to achieving the targets set by the Paris Agreement and, with its partners in the Border to Coast pool, where the majority of our assets are now managed, we are actively working towards a net zero future. Through our participation in investor initiatives such as Climate Action 100+, the investor-led coalition representing $32 trillion in assets under management, more and more carbon intensive companies are accelerating their transition to a low carbon future. These achievements can be directly attributed to a blended strategy, including engagement and voting, together with international policy formulation which pushes global governments to work together to set carbon reduction targets.

Reducing the carbon footprint of the entirety of the Surrey fund by reducing GHG demand in aggregate, will, based on the expert guidance of bodies such as the United Nations Environment Program Finance Initiative, (UNEPFI) TCFD and others, lead to materially better outcomes in alignment with the best scientific evidence available. To that end, the Surrey Pension Fund is already well positioned to meet the requirements of the TCFD reporting standards that will be introduced by the UK government over the next 6-9 months.