SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **10 DECEMBER 2021**

LEAD OFFICER: **ANNA D'ALESSANDRO, DIRECTOR CORPORATE FINANCIAL & COMMERCIAL**

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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 meeting of 10 September 2020 and a sub-Committee meeting of 19 November 2021.

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1. Notes the progress of the sub-committee on drafting a Responsible Investment Policy for further consideration.
2. Approve 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.
3. Approve for 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. Supports the revised Border to Coast Responsible Investment (RI) Policy 2022 and Corporate Governance and Voting Guidelines 2022, subject to the continuing work between the Fund and Border to Coast to align our approaches consistent with the Fund's standalone Responsible Investment Policy currently in design stage.

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

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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 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.

4. At its meeting of 10 September 2021, the Pension Fund Committee approved the proposed structure for a standalone Responsible Investment Policy (this is included as Annexe 1).

5. The structure includes five pillars:

a) Governance;
b) Investment;
c) Implementation;
d) Stewardship;
e) Monitoring and reporting.

6. 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. 6

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.

7. 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

Taskforce for Climate Related Financial Disclosures (TCFD) metrics

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8. The first point in the delivery timetable is to agree the metrics for measuring Scope 1 and 2 carbon emissions in respect of TCFD. Scope 3 is expected to come in the future, assuming data availability and robustness

9. The Department of Work and Pensions (DWP) Regulations came into force on 1 October 2021, which impose requirements on trustees of larger occupational pension schemes, and all authorised schemes, for the identification, assessment and management of climate-related risks and opportunities. The DWP is currently consulting on changes to existing climate reporting for schemes. This impacts all trust-based schemes who are, or expect to be, required to report in the TCFD framework and/or Implementation Statements. The proposals include a requirement to report on a forward-looking Paris alignment metric.

10. It is important to note that the Department for Levelling Up, Housing & Communities (DLUHC) have yet to consult on the requirements of LGPS funds regarding TCFD, however, it is prudent to be minded of developments in the area under DWP regulations.

11. The investment consultant, Mercer, introduced a high-level analysis of the differing Scopes 1, 2 and 3 and recommends the following approach (see Annexe 2):

    a) Absolute greenhouse gas (GHG) emissions: likely market standard to report on total GHG emissions;
    b) Weighted Average Carbon Intensity (WACI): average exposure (weighted by portfolio allocation) to GHG emissions normalised by a factor such as enterprise value or revenue.
    c) Implied Temperature Rise (portfolio alignment): seeks to consolidate the carbon reduction and net zero targets of issuers in whom the Fund is invested into a forward-looking measure of exposure to climate related risks and their ability to capitalise on opportunities in the low-carbon transition.

12. It is recommended that the Committee approve for officers to work with the independent investment advisor, investment consultant and Border to Coast and taking account of any developments from the DLUHC, to establish Scope 1,2 and 3 carbon emissions metrics in respect of the Funds TCFD report.

13. A further proposed objective is to increase over time the proportion of the assets which the Committee have high quality and robust data in order to calculate the above metrics. At present, such metrics are widely available for listed equities, but data is limited for other asset classes such as bonds and private market assets. By engaging with managers, and making it clear that we expect data availability to improve over time, we expect to be able to improve measurement over time.

Net zero scenario analysis

14. 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 and2 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.

15. 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.

The revised Border to Coast RI Policy 2022 and Corporate Governance & Voting Guidelines 2022

16. The Border to Coast Responsible Investment Policy and Corporate Governance & Voting Guidelines (included as Annexe 2 and Annexe 3) are reviewed annually and updated as necessary through the appropriate governance channels. The process for review includes the participation of all the Partner Funds to ensure a strong, unified voice.

17. Both policies have been evaluated by Robeco using the International Corporate Governance Network Global Governance Principles, UK Stewardship Code and Principles for Responsible Investment as benchmarks. Policies have also been reviewed against asset managers and asset owners seen to be RI leaders.

18. Responsible Investment workshops are held at regular intervals for the Partner Fund Officers and the Joint Committee to discuss RI topics and issues to be included in the policy review. Topics covered included the development of the Climate Change Policy, Net Zero, the approach to exclusions and refreshing the priority engagement themes.

19. The annual review and governance processes need to be completed, with policies approved and ready to be implemented ahead of the 2022 proxy voting season. Partner Fund Officers have provided feedback on the proposed revisions and suggested amendments.

20. The policies of best-in-class asset managers, and asset owners considered to be RI leaders were also consulted to determine how best practice has developed. Policies assessed included RLAM, LGIM, NZ Super, NEST and Brunel. The Investment Association Shareholder Priorities for 2021 have also been taken into account.

21. There were some areas highlighted as part of last year's review that were due to be addressed during 2021. Transition risk and scenario analysis being one area. Following the ESG/carbon data procurement and appointment of

successful providers, Border to Coast will be able to conduct scenario analysis from early next year. Border to Coast are also looking at how to support Partner Funds in their TCFD reporting and this has been considered in the procurement.

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22. One other area was exclusions. As Border to Coast advocate engagement over divestment, they have previously not had any exclusions in place. Development of the Climate Change Policy has, however, led to the exclusion of companies with >90% of revenues derived from thermal coal or tar sands. Any exclusions must be explicit for them to be adopted by our private market managers. Considerable engagement has been conducted with Partner Funds to reinforce Border to Coast's active stewardship approach and dispel any concerns of being influenced by pressure group lobbying.

23. This year's RI Policy review reflects work undertaken during the year, including the development of the Climate Change Policy and associated exclusions, and the refreshment of the key engagement themes.

24. The proposed amendments to the RI policy are highlighted in the table below.

Section	**Page**	**Type of Change**	**Rationale**
1. Introduction	2	Addition	Include wording on diversity/diversity of thought.
5.4 Integrating RI into investment decisions – Real estate	5	Addition	New asset class.
5.6 Climate change	6	Revision	Section edited as Climate Change Policy details our approach.
5.6 Climate change	6	Addition	Wording on exclusions covered in Climate Change Policy.
6. Stewardship	8	Revision	Explanation on UK Stewardship Codes signatory status.
6.2.1 Engagement themes	11	Addition	New section on key engagement themes and review process.

25. The Corporate Governance & Voting Guidelines have been reviewed by Robeco considering best practice. Asset owner and asset manager voting policies and the Investment Association Shareholder Priorities for 2021 have also been used in the review process. There are several minor amendments including proposed additions and clarification of text.

26. Proposed amendments to the Corporate Governance & Voting Guidelines are highlighted in the table below:

Section	**Page**	**Type of Change**	**Rationale**
Diversity	5	Addition	Strengthening position on ethnic diversity at FTSE 100 companies.
Long-term incentives	8	Clarification	Splitting out executives from other employees.
Directors' contracts	8	Clarification	Executive pensions.

Lobbying	10	Addition	Company stance on climate change lobbying.
Shareholder proposals	12	Clarification	Shareholders' best interests.
Climate change	12	Addition	Strengthening voting stance to include CA100+ net zero benchmark indicators.

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27. In 2018 Border to Coast set three priority areas for engagement with portfolio companies. These are 'Governance', 'Diversity' and 'Transparency and Disclosure'. Whilst they recognise that these areas continue to be important, they wanted to reflect their growth and maturity as an organisation and review the themes whilst also considering the views of the Partner Funds. They developed an Engagement Themes Framework consisting of four stages, to assist with the process and set our themes for the next strategic period.

28. The four final themes with high-level aims are as follows:

    a) Low Carbon Transition: Climate change is a systemic risk with potential financial impacts associated with the transition to a low-carbon economy and physical impacts under different climate scenarios. Transition will affect some sectors more than others, notably energy, utilities and sectors highly reliant on energy. The focus will be on the big carbon emitting companies and banks.

       Engagement objective: Climate change is a systemic risk that poses significant risks and opportunities for our portfolio investments. In high emitting sectors companies need to adapt and, in some cases, fundamentally change their business models. The aim of this engagement is to focus on the companies in high emitting sectors and banks identified as key to financing the transition to a low-carbon economy, to commit to credible plans to meet net-zero targets.

    b) Waste and Water Management: The focus is on companies assessed as having high exposure to water-intensive operations and/or producing high levels of packaging waste and plastic pollution.

       Engagement objective: Water is becoming an increasingly scarce and costly resource and a material financial risk for companies and investors. Packaging waste is a huge environmental problem with increasing regulation. This engagement theme will focus on engaging portfolio companies with high exposure to water-intensive operations, exposure to operations producing high levels of packaging waste to develop policies and initiatives to address the issue(s).

    c) Social Inclusion through Labour Management: This theme seeks to blend two of the previous proposed themes around Social Inclusion and Supply Chain Management. The focus is on companies assessed as having high exposure to labour intensive operations, those scoring lower on human capital development and those that are scoring lower on supply chain labour management. This includes engaging with companies on modern slavery policies.

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Engagement objective: Human capital management and supply chain issues are recognised as financial risks emphasised by the pandemic. Engagement will be with companies with high exposure to labour-intensive operations and lower scoring companies in relation to human capital development and supply chain labour management risk. The aim is to promote sustained, inclusive growth with productive and decent work for all, including elimination of child labour in supply chains.

d) Diversity of Thought: The focus will be on companies that have been flagged as not having diversity management programs in place, including UK companies that are not meeting the recommendations of the Hampton Alexander and Parker Reviews where we believe we hold sufficient market cap to have an influence.

Engagement objective: The need for diversity of thought and experience on boards has never been more compelling. The pandemic has caused massive economic disruption with companies needing to be able to adapt and be innovative in order to be resilient and survive for the long-term. The focus of this engagement is to enhance the diversity of boards reducing the risk of 'group think' leading to better decision making and wider diversity across the organisation to increase the resilience and long-term sustainability of companies. To ensure a pipeline of diverse talent is being developed and utilised, this engagement will also cover improving the approach to building diversity and inclusion in executive committees, other senior leadership roles.

29. Border to Coast is the jointly owned asset manager of the Surrey Fund and its RI Policy and Corporate Governance & Voting Guidelines are intrinsic to how the Surrey Fund manages its RI approach.

30. Through consultation with all partner funds, including Surrey, Border to Coast has produced its revised 2022 RI Policy and Corporate Governance & Voting Guidelines. It is recommended that the Committee approves the revised Border to Coast RI Policy 2022 and Corporate Governance & Voting Guidelines 2022, subject to the continuing work between the Fund and Border to Coast to align our approaches consistent with the Fund's standalone Responsible Investment Policy currently in design stage.

CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

32. 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

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

DIRECTOR CORPORATE FINANCIAL & COMMERCIAL

34. 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

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35. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

36. There are no equality or diversity issues.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT

38. 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.

Contact Officer:
Neil Mason, Strategic Finance Manager (Pensions),

Consulted:
Pension Fund Committee Chairman

Annexes:

1. RI policy framework.
2. Mercer report.
3. Revised Border to Coast RI Policy
4. Revised Border to Coast Corporate Governance & Voting Guidelines

Sources/background papers:

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