THE INSIGHT SHARING

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

TOWARDS A GREENER FUTURE:

CASE STUDIES FROM THE PENSION SECTOR

MONEY TALKS AND THE POWER OF THE CAPITAL MARKETS IS MASSIVE. IT'S NOW BECOMING CLICHÉ TO WRITE THAT CLIMATE CHANGE IS ONE OF THE MOST SIGNIFICANT RISKS WE FACE, BUT, AS WITH ALL CLICHES, THERE IS TRUTH AT ITS CENTRE. SO LET'S PUT THESE TWO TOGETHER AND GET THE CAPITAL MARKETS TO HELP FIX THE CLIMATE CRISIS.

Before we published our *A Changing Climate* report last year, we ran a series of workshops. These were attended by close to 100 delegates representing, directly, 60 of the biggest pension funds in the UK and, indirectly, through the fund managers and consultants that came along, many hundreds of others. There were two things that struck me during those roundtables. The first was that, although there wasn't universal acceptance of climate change, there are still a few who doubt the argument, there was universal acceptance that we should recognise it as a risk and seek to mitigate that risk. The second was the overwhelming desire by pension funds to be part of the solution. Pension funds want to use the assets they manage in accordance with their fiduciary responsibilities and to make the world a better place.

Despite the desire, this won't be easy. *A Changing Climate* sets out many of the practical barriers pension funds face – although good progress has been made on many of these since we published – but it also, though, sets out potential answers.

This document sets out some practical solutions in action. Some of the pension funds that are leading the way on investing for good share their experiences and the lessons they learnt. In sharing their experience, they allow us to learn from them. I thank them for sharing.

Pension funds have a big responsibility, not just to provide security to their millions of members, but also, within their fiduciary responsibilities, to help make the world a better place. This document should help you to play your part in that project.

Richard Butcher
Chair, Pensions & Lifetime Savings Association

CONTENTS

1 NOW IS THE MOMENT FOR FINANCE TO ACCELERATE TOWARDS NET ZERO BRUNEL PENSION PARTNERSHIP

"WHERE IS WINTER?" ASKED CANADA'S GLOBAL NEWS IN JANUARY.

THE QUESTION HAD BEEN POSED IN WINNIPEG, HOME TO CANADA'S SHARPEST TEMPERATURE DROPS EVERY WINTER.

I should know, as I grew up on a farm in the area. By mid-January, it was normal to have seen around 24 days of -20°C since winter had begun. Not so last winter – by 14 January 2021, Winnipeg had seen just six such days. In July this year, the highest recorded temperature in Canada's history was verified at Lytton in British Columbia: 49.6°C. These are not just historic climate events – they are also deeply alarming.

COP 26 is just one month away and could yet prove similarly historic. It is the best chance we have since Paris 2015 to make global progress in the fight against climate change. But progress in the loose sense is not good enough. The climate emergency is getting exponentially more severe, which means we need exponential progress to address it. Finance lies at the centre of how we do that.

The IPCC report published this summer showed some of the extreme climate consequences we are already living with due to global temperatures rising by 1.1°C – such as rising sea levels and diminishing Arctic ice. Without huge cuts to carbon emissions rates, global temperature rises will exceed 2°C this century – meaning a 56cm rise in sea levels by 2100, 29% rise in ocean acidity, and 37% increase in the global population facing at least one severe heatwave every five years, to name but three of the many consequences.

A PATH FORWARD FOR FINANCE

Finance will play a key role at COP 26. Indeed, it will be the first sector to receive a full day's programme. Finance is a key lever for reforming the entire economy – right across different countries, communities, sectors, geographies and political systems.

For investors to make meaningful progress, this universalism is crucial. We need full global cooperation to create a level playing field – and remove the option possibility of investors arbitraging less climate-committed jurisdictions just to maximise profits. That's why cross-border solutions are a must when it comes to limiting carbon emissions.

One reason for hope is that asset owners and managers alike now have the frameworks they need to enable them to follow through on their commitments to transition to Net Zero. They have an opportunity to sign up to the Asset Owner and Asset Manager commitments, and then to adopt the respective frameworks, too, such as the IIGCC's Net Zero Investor Framework. That enables investors to target not just Net Zero by 2050, but to hit interim targets by 2030.

These frameworks mean finance really can make the shift.

A NEW STRUCTURE FOR FINANCE

But structural impediments in finance have persisted, chiefly, the problem of indices. Benchmarks are a central feature of finance, since they give something for investors to measure their performance against. As a result, they shape the contours of the industry.

But benchmarks have only looked at immediately apparent financial factors – and have never integrated climate risk into their calculations. In reality, of course, climate factors are financial risks too, so there is all the more reason to include them when constructing benchmarks.

The problem is particularly acute for passive investing, since managers do not choose the companies they are investing in – and are therefore all the more reliant on indices. Passive vehicles now hold just over 50% of all US publicly-traded equity assets, according to Bloomberg figures.

Fortunately, new indices are now being rolled out that integrate climate risk into their makeup. This summer, FTSE Russell and Brunel launched a series of new, Paris-aligned benchmarks. These meet the requirement of the EU's Paris-aligned Benchmarks by meeting 50% reduction in carbon emissions over ten years. They include systemic underweights to – or exclusions of – companies with fossil fuel reserves and companies with excessive GHG emissions. They also integrate an overweight to companies with higher green revenues. Further TPI and Net Zero pathway data is also integrated into the benchmarks.

It is benchmarks like these that will enable a more wholesale transition of the investment universe towards Paris alignment.

CLIMATE TRANSITION: THE SOCIAL CHALLENGE

The shift to a new economic model will have all kinds of consequences, and there is a major risk that it causes serious hardship to the most vulnerable across societies worldwide.

That is why we signed up to the Financing the Just Transition Coalition, which is led by the London School of Economics. It's why we need a taskforce to ensure that Just Transition is fully integrated into the climate transition – we are among those to have written to the prime minister to make this point clear.

The social challenge is a real one, but the very fact of planning an economic transition means there is already greater scope than before to reconfigure the economy in other ways, too. Climate transition could be a historic opportunity to build back better more broadly.

FINISHING THE JOB

Investors today are fundamentally very fortunate. While we face a historic global crisis, investors also have an unprecedented opportunity to address it. That is because we have new approaches and tools at our disposal: the Paris-Aligned Investor Initiative, the new Net Zero investment frameworks, new climate-integrated benchmarks, even social integration frameworks.

Practically, investors need to make their Net Zero 2050 targets – as well as interim targets for 2030. But I'd also recommend setting out a comprehensive climate strategy for your investment approach. That strategy needs to feed into everything an asset manager or owner does, in terms of stewardship, fund design, manager appointment and monitoring, stock selection, procurement and so on.

Finance, then, needs a great acceleration. We have the tools and we know the threat. "Where is winter?" is a question we cannot afford to be asking too much more.

Denise Le Gal
Chair, Brunel Pension Partnership

2 ACHIEVING NET ZERO; HARNESSING THE POWER OF STEWARDSHIP BT PENSION SCHEME

THE FOSSIL FUEL DIVESTMENT MOVEMENT, WHICH BEGAN ABOUT A DECADE AGO, HAS GAINED CONSIDERABLE MOMENTUM IN RECENT YEARS. BILL MCKIBBEN, CO-FOUNDER OF THE INTERNATIONAL ENVIRONMENTAL GROUP 350.ORG, HAS SAID MANY TIMES, "MONEY IS THE OXYGEN ON WHICH THE FIRE OF GLOBAL WARMING BURNS." BUT SIMPLY DIVESTING FROM SHARES OF FOSSIL FUEL COMPANIES WON'T HELP MAKE CHANGE HAPPEN IN THE REAL ECONOMY.

As the largest corporate pension scheme in the UK, and one of Europe's largest, we are acutely aware that how and where we invest matters and we take our responsibilities very seriously.

The Scheme first considered climate risk in 2007 when it had become clear that climate change threatened the Scheme's ability to meet its long-term commitments.

Last year's decision to set our 2035 net zero goal was the culmination of many years work assessing the potential impact of climate change on the Scheme's portfolio and its investment returns.

Our analysis revealed that roughly 80% of the Scheme's emissions comes from 20% of assets across our equity and corporate bond exposures. In our equity portfolio's scope 1-3 emissions, six companies represent over 50% of emissions but just 2.5% of the portfolio by weight. Unsurprisingly, these companies are from the oil and gas, utilities and chemicals sectors.

So why not sell these holdings and re-invest in 'greener' companies to advance our net zero target? The problem with that approach is that we don't believe it will reduce global emissions. Firstly, simply divesting from these high emitting companies will likely result in them being owned by less-engaged owners. Secondly, these high emitting companies can do more to change the trajectory of global emissions than low emitters. Finally, to be able to pay our members their pensions we need to carry on investing in the real economy.

To see meaningful reductions in global emissions we need to finance green technologies and work with the worst polluters to support their transition. But the engagement with these companies has to be meaningful. If certain sectors or companies persist in their divergence from the Paris Agreement, the time will come when they cease to meet our investment criteria and divestment will follow.

MEANINGFUL STEWARDSHIP

Of the world's 2,000 largest public companies, just one-fifth (21%) have made net zero commitments. Worse still, research from the Energy and Climate Intelligence Unit found widely varying quality in these net zero commitments.

We believe that persuading highly carbon-emitting companies to implement transition plans will lead to better investment outcomes compared to divesting and only investing in companies that are already 'green'. We have seen some significant successes through actions like Climate Action 100+ which demonstrates the power of investor collaboration and corporate engagement.

But much more needs to be done. In July, the IIGCC announced an investor position statement supported by more than 50 global investors with over $14 trillion of assets calling for companies to publish details of their net zero plans, make a board director responsible for those actions and allow investors to vote annually on progress on the plan, where it is permissible in local law.

The joint statement builds on the work done by hedge fund investor Chris Hohn, who popularised the concept of a so-called "say on climate" vote last year following a campaign that resulted in airport group Aena becoming the first company in the world to give shareholders an annual vote on its climate change efforts.

It's a forceful approach and there are benchmarking and voting machinations that need to be resolved, but the aim is not to overburden or punish companies. Those working in the space will know the current mishmash of net zero plans is proving confusing for both companies and investors and there is no way for investors to easily communicate what they want. Therefore, a clean solution is for shareholders to have a regular vote on director oversight and corporate commitments to achieving a net zero future.

THE OPPORTUNITY

The impact of financing the transition of brown assets to green shouldn't be under-estimated. This transition will be global and essential for the UK to reach its net zero goal and will have a significant positive impact on the planet while at the same time providing strong financial returns.

For example, held in our equity mandate are two large scale US utilities; WEC Energy and XCEL Energy. Their current power generation mix includes coal and gas which is why WEC and XCEL contribute strongly towards the Scheme's current carbon emissions.

Looking at the numbers, they are big emitters, however XCEL and WEC have significantly reduced their emissions and target 80% and 70% respectively reduction in CO_2 by 2030 (vs 2005 levels) and to deliver carbon free electricity by 2050. WEC has an explicit commitment to be net neutral by 2050.

They are also heavily supported by state net zero policies meaning they must achieve net zero emissions of 100% clean energy by 2050.

Government support for net zero is powerful because it compels corporates to make strong climate commitments, giving investors confidence that these targets and, as a result, portfolio net zero commitments will be achieved.

Time is against us and the stakes couldn't be higher. To stand any chance of closing the gap between current carbon emissions and meeting the goals of the Paris Agreement, more companies need to set scientifically credible net zero targets. Investors have a critical role to play in driving the urgent change we need to see. McKibben is right that money is oxygen, but let's give those companies a chance to change before we pull the plug.

BTPS

Victoria Barron
Head of Sustainable Investment, BT Pension Scheme Management

3 DEMYSTIFYING THE NET ZERO COMMITMENT RAILPEN

Climate change is a critical risk, already affecting us with trillions of financial assets being at risk from global temperature increases. Leading researchers indicate that limiting global warming needs a reduction of at least 40-50% in CO2 emissions from 2010 levels by 2030.

Now what does all this have to do with pension schemes and what are all these headlines around reaching 'Net Zero' longer term?

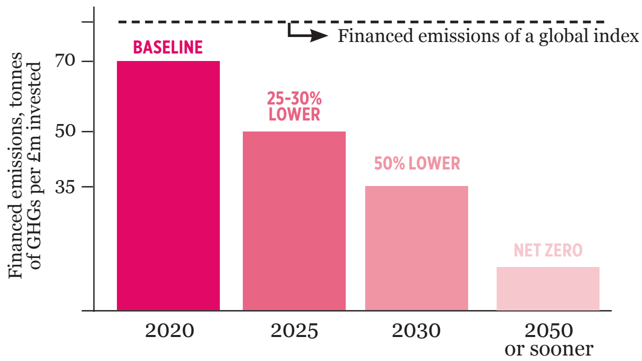
'Net Zero' refers to an equal balance between the amount of CO2 emissions produced and removed from the atmosphere. Climate change does carry material financial risks. Pension scheme trustees have a fiduciary duty to consider current and evolving risks of investment decisions, and act in the best interest of beneficiaries. Therefore incorporating climate risks and opportunities is a core part of a pension scheme's fiduciary and legal duty.

UK pension fund Railpen, which manages £32 billion in assets, reinforced its view on the critical importance of tackling climate change with its plan to deliver a Net Zero portfolio by 2050, or sooner. Its plan aligns with the trustee's investment beliefs, the goals of the Paris climate agreement and the policy goals of the UK government. The plan lays out the key steps to deliver its climate-related ambitions and is a key step in its investment, fiduciary and climate change journey. To deliver its climate goals, Railpen plans to engage with the companies it invests in on climate-related topics, to reduce their overall emissions profile and increase the climate resilience of its investment portfolio.

Being a firm believer that perfection cannot be an enemy of good, Railpen adopted a simple approach with concrete and constructive steps ahead of time. Railpen formed an internal climate working group last year to review and discuss CO2 emissions risks, challenges and climate-related opportunities and improved climate-related communications to its members. Focusing on public equities, the largest part of its investment portfolio, Railpen began aggregating data on CO2 emissions by company, following a simple and structured process prescribed by the IIGCC Net Zero Investment Framework (IIGCC NZIF).

The process included a review of all holdings for the country of risk and domicile, and sector classifications. The holdings with countries and sectors are then classified as material or non-material emissions sectors as per the IIGCC NZIF framework. As per the framework, energy, utilities, transportation, industrial machinery and manufacturing amongst others classify as material emissions sectors.

The process then moved to emissions data collection, using a few key data sources. Where data was not available, Railpen used close proxies as appropriate and arrived at a total company level emissions. These were then weighted based on the amount held in the portfolio and the respective company valuation to produce financed emissions by company, by material sectors and by portfolio.



Railpen aims for a 25-30% reduction in emissions by 2025, a 50% reduction in by 2030 and net zero emissions by 2050 or sooner, following a clear roadmap.

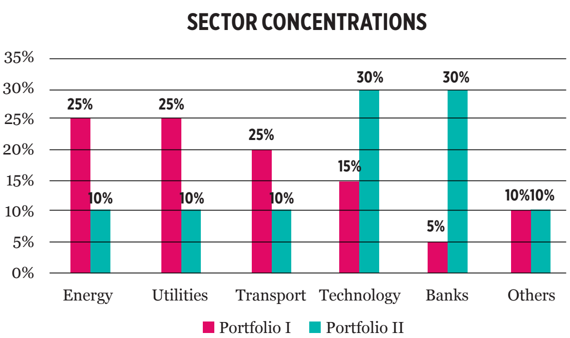
The roadmap has a target to engage today, with companies responsible for 70% of portfolio material financed emissions.
By 2030, the roadmap targets engaging with companies responsible for 90% of portfolio material financed emissions.

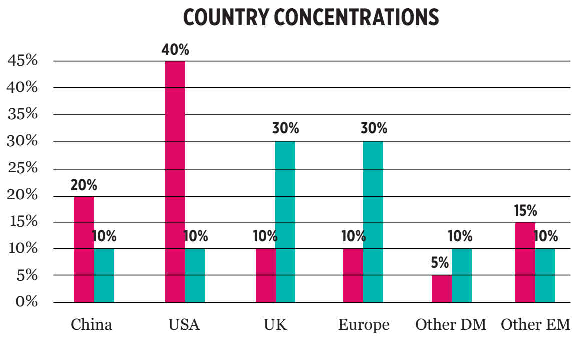
The target emission reductions of 25% by 2025 and 50% by 2030 are termed as 'interim targets'. 'Interim targets' are not mandatory but definitely recommended to ensure portfolio emissions reductions are on track, and to adopt corrective measures, if needed, prior to 2050.

In practice, emissions can be reduced from a portfolio by either divesting holdings or engaging with the portfolio company. While divestments are not ruled out in extreme scenarios, Railpen's primary focus is on real world decarbonisation by owning, actively engaging, voting and steering emission reductions. This highlights voting rights (with equities for example) and active control (with directly managed investments) as key levers to steer emissions in a portfolio company. The percentage of external versus internally managed assets can also determine the extent of control an asset owner can have on its portfolios and thereby determine the emissions targets and pathways. However, this can be supplemented by effective guidelines on engagement, voting policies and stewardship reporting in investment manager agreements.

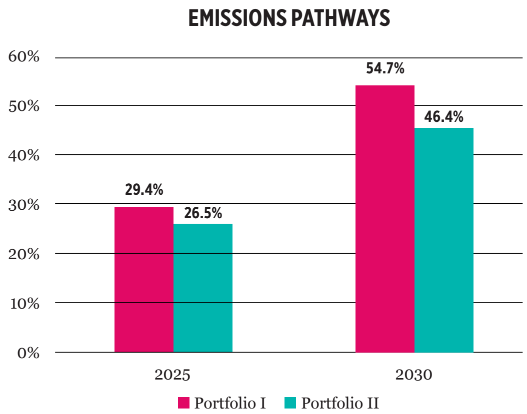
Climate research provides several models and methods available to set emissions pathways and interim targets. However, the challenges of incorporating climate-related risks, setting and implementing Net Zero and climate-related commitments are manifold. They range from policy uncertainty across jurisdictions, data quality and availability, estimations without associated variability, stakeholder awareness and education, high reliance on external managers and internal resource constraints, to name just a few. Asset owners, especially smaller organisations with thin or no ESG teams can find the process daunting even to start.

Irrespective of the specific model used, the key is that emissions pathways vary by sector and country. A basic yet effective starting point therefore for an asset owner's emissions footprint, pathway and target is dependent on three key factors, namely its strategic asset allocation, concentration in specific sectors and country exposure.



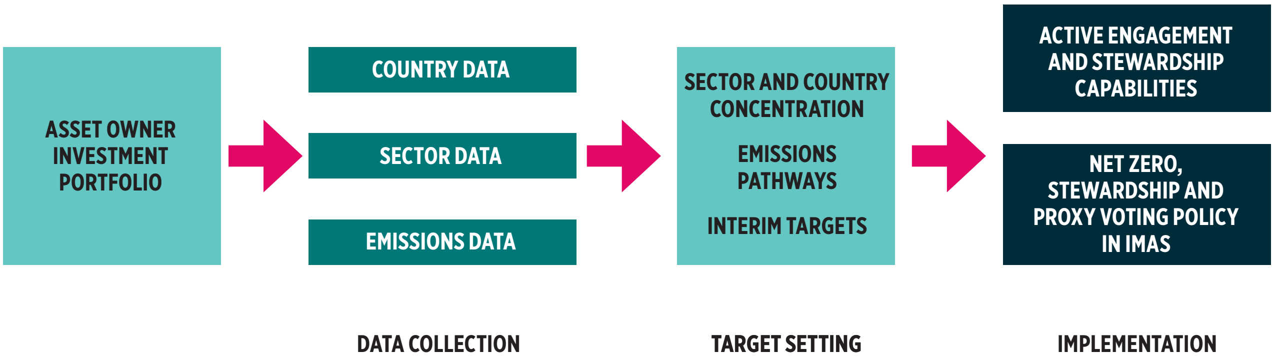


For example: In the below Portfolio I has 70% exposure to high emissions sectors in the US and China and hence needs to decarbonise more aggressively with higher emissions reduction targets versus Portfolio II with 30% exposure to the same high emissions sectors and countries.



For a small or medium size asset owner with high exposure to public equities, getting a handle on the sector and geographic breakdown along with basic emissions data at the company level, is a very powerful starting point and will in itself highlight key areas of the fund exposed to high climate risk.

For an internally managed pension scheme, this can be further supplemented by adding some capabilities in due diligence, governance and active engagement. For externally managed portfolios, updating the investment management agreements (IMAs) incorporating effective guidelines on engagement, voting policies and stewardship reporting is also a substantive next step. Engagement involves the asset owner or manager working on climate risk identification and integration with investee companies and building its capital invested in low carbon investments.



With the key foundational steps of aggregating asset class, sector, geography and emissions exposure, bolstering engagement capabilities, and IMA amendments on stewardship, voting policy and reporting, pension schemes can begin their journey towards climate resilience.

RAILPEN

Chandra Gopinathan
Sustainable Ownership, RPMI Railpen.

RAILPEN

Michael Marshall
Head of Sustainable Ownership, RPMI Railpen

4 LESSONS FROM OUR FIRST TCFD REPORT NEST

NEST HAS BEEN A SUPPORTER OF THE RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TCFD) AND HAS INCLUDED A TCFD STATEMENT IN ITS ANNUAL REPORT AND ACCOUNTS SINCE THE 2017/18 FINANCIAL YEAR. IN 2020, NEST PUBLISHED ITS FIRST SCHEME-WIDE CLIMATE CHANGE POLICY, SETTING AN AMBITION TO ALIGN ITS WHOLE INVESTMENT PORTFOLIO WITH LIMITING GLOBAL WARMING TO 1.5C ABOVE PRE-INDUSTRIAL LEVELS BY REACHING NET ZERO CARBON EMISSIONS BY 2050 OR EARLIER. AS PART OF THE CLIMATE CHANGE POLICY, NEST COMMITTED TO TAKE ACTION ACROSS ITS ASSET ALLOCATION, STEWARDSHIP AND MANAGER SELECTION AND TO REPORT PROGRESS ANNUALLY IN ITS TCFD REPORT.

From October 2021, Nest will also be subject to new climate change disclosure requirements under the Pension Schemes Act 2021. Nest engaged with the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR) on the proposed disclosure requirements and responded to a number of consultations. To prepare for these new requirements, Nest used the DWP's draft statutory guidance to develop its 2020/21 TCFD report and identify any potential gaps and challenges before the regulations come into force.

In previous years, the TCFD statement had been included in the annual reports and accounts. This year, in complying with the DWP's guidance the amount of information that needed to be included in the TCFD report meant that it was too long to include in the scheme annual report and accounts. We therefore decided to publish it as a standalone report on a dedicated webpage.

The most significant changes from previous years were made to the sections on strategy, risk management and metrics. These sections were expanded to reflect the publication of Nest's climate change policy and the work carried out to date to implement it.

One of the most challenging aspects of the report was to identify and measure appropriate metrics and targets. This year Nest requested information on individual portfolio-level carbon emissions from all investment managers for the first time. It found that data coverage and quality vary across asset classes. Many companies still do not report scope 3 emissions. Gaps in reporting are sometimes filled by data providers that estimate scope 3 emissions based on a company's activities. In private markets there are also some gaps in reporting on scope 1 and 2 emissions. Nest also requested that fund managers provide metrics using the GHG Accounting and Reporting Standard by the Partnership on Carbon Accounting Financials (PCAF) using enterprise value including cash (EVIC) to attribute corporate emissions to equity and bond investments. However, not all managers were familiar with this standard and many still use Weighted Average Carbon Intensity (WACI) as the core metric which uses revenues for the attribution factor instead. Some managers were also unable to provide financed emissions in pound sterling. Due to these inconsistencies Nest was not able to aggregate the data at scheme-level and currently only tracks and reports this data at the individual portfolio level.

Another challenging area is scenario analysis. During market engagement earlier in 2020, Nest identified that to meet its objectives of stress-testing its asset allocation decisions under different climate scenarios, it would require the support of a dedicated consultant or data provider. Under the new regulations, pension schemes are required to carry out scenario analysis in the first scheme year during which they are subject to the regulations and every three years thereafter. For Nest, the first reporting year would be 2021/22. It was decided that scenario analysis would therefore not be carried out until late 2021 due to the cost and resource requirements. This section of the report is therefore mostly qualitative as Nest carried out some work internally on the impact of a transition to net zero on different asset classes.

Finally, the required disclosures ask that a reasonably engaged and informed member be able to interpret and understand the disclosures. However, Nest also wanted to be transparent and ensure that all relevant information is included. As a result, the final report is 40 pages long and contains a lot of technical information particularly in the metrics and targets section which make it difficult to digest.

NEXT STEPS

Following the publication of the TCFD report, Nest is carrying out a gap analysis against the final regulations. As a result of the experience of publishing the report, Nest is taking the following actions ahead of its 2021/22 report:

- Develop a programme of trustee training on climate change risks and TCFD disclosure requirements
- Procure of scenario analysis services and carry out market engagement on climate change metrics
- Develop dedicated member communications to make the contents of the report more digestible

The new regulations set a high bar for disclosure and preparing the TCFD report is a resource-intensive undertaking. Climate change has been a priority area for Nest for a number of years and the TCFD recommendations have provided a useful framework particularly in drawing out transition and physical risks that impact investors. For Nest, the key benefit of preparing this report was as a dry run for next year, when these disclosures become mandatory. It means that there is now a baseline for future reporting and sufficient time to address any gaps.

nest

Katharina Lindmeier, CFA
Senior Responsible Investment Manager, NEST

5 THE SMALLER SCHEME PERSPECTIVE ISLE OF WIGHT PENSION FUND

AT THE ISLE OF WIGHT COUNCIL PENSION FUND, WE FIND OURSELVES WITH THE PASSION AND COMMITMENT TO RESPOND TO THE CHALLENGE OF CLIMATE CHANGE, BUT WITH ONLY A FRACTION OF THE RESOURCE OF SOME OF OUR FRIENDS ACROSS THE LGPS! WITH ONLY 8 MEMBERS OF STAFF, THE MAJORITY OF WHOM WORK IN PENSION ADMINISTRATION, AND A MASSIVE WORKLOAD ALREADY COVERING INVESTMENT STRATEGY, EMPLOYER ENGAGEMENT AND GOVERNANCE, WE'RE VERY MUCH AT THE BEGINNING OF THE JOURNEY. HOWEVER, EVEN AS A SMALLER SCHEME, I BELIEVE WE ARE IN A GOOD PLACE TO PROTECT OUR MEMBERS' SAVINGS FROM THE IMPACT OF CLIMATE CHANGE.

Our pension committee recently convened a working group to consider our position on ESG. The group will look at our currently held investment beliefs and ESG/RI statements, as set out in our Investment Strategy, and consider whether those beliefs are still relevant, how they might be expanded upon, and whether we need to add anything to ensure we fully consider the full variety of issues that made impact our members' savings.

Over the past 12 months we've been expanding our investment asset allocation to include alternatives – such as private debt and infrastructure – and have also rebalanced our equity portfolio by moving into a passive climate aware fund. Though we haven't formalised our full responsible investment strategy yet, we've ensured throughout this process that ESG considerations are integral in allocations and in the selection of managers.

The Fund has already commissioned a carbon footprint baseline report on its current portfolio, which will enable us to consider where we currently are, where we need to get to, and how we can best get there. We have also started challenging out investment managers more on the decisions they make on our behalf in relation to ESG.

We are working with others in the ACCESS pool to develop a collective statement on ESG, which we hope will reflect the beliefs of the 11 funds that participate, and which will inform the investment decisions and manager selection of the pool.

We have already worked with a consultant to review of all of the scheme's documents from an ESG perspective, and we've been pleased that it appears we are in a good place with regards to having the relevant policies in place to support our ambitions!

So, though in many ways we're at the beginning of the journey - and don't have all the answers on where we need to be, or how we will get there - even by taking the initial steps to establish the current 'state of play', putting a plan in place that will hopefully lead to a long term strategy, and working with our partners, we are feeling much more confident in our abilities to respond to climate change.

In terms of our concerns in this area, we're aware that the Taskforce for Climate Related Financial Disclosures is on the horizon and, though we are keen to ensure that we understand and publish the full extent of the impact of climate risk on our fund, we realise that this will be especially challenging for us as a smaller scheme. At the time of writing, its not clear when LGPS will need to publish their first reports, or what the specific requirements will be, but we're hoping that the lessons learnt from the private sector will be helpful when the time comes for us to report. We are reassured that, as part of a pool, we will benefit the collaboration in terms of monitoring and reporting risk.

Clearly, as a small scheme, we face particular challenges when it comes to ESG considerations. However, the steps we've taken to take have made us feel reassured that we can act on climate change and the fund is committed to ensuring a long-term strategy is in place to protect our members' interests.

ISLE of WIGHT COUNCIL

Jo Thistlewood
Technical Finance Manager,
Isle of Wight Pension Fund

6 TOWARDS A GREENER FUTURE: LESSONS FROM THE PENSIONS INDUSTRY USS INVESTMENT MANAGEMENT

CLIMATE CHANGE – AS A KEY SYSTEMIC RISK – HAS BEEN AN ENDURING AREA OF FOCUS FOR USS: WE DID OUR FIRST WORK ON THIS AREA AND ITS IMPACT ON INVESTMENT IN 2001, THE SAME YEAR WE CO-FOUNDED THE INSTITUTIONAL INVESTORS GROUP ON CLIMATE CHANGE (IIGCC).

As a long-term investor, we recognise that climate change presents critical issues for us now and into the future. Rising sea levels will impact property and infrastructure asset valuations and weather events will disrupt supply chains. Regulatory and company activity to support the transition to a low carbon future will create winners and losers. Indeed, some of this is already happening as those who have observed flooding and wildfires this year have witnessed.

Given the long-dated nature of our liabilities, it is in USS's interests to encourage the companies, assets and markets in which we invest to focus on delivering sustainable long-term investor value. We believe the way a company is run and overseen, and how it manages its environmental, social and governance (ESG) risks, such as its approach to climate change, will impact the long-term returns that it will make for its investors. We also believe that supporting our investments in delivering on this will also positively impact returns. These principles are key to how we invest.

Last year we took a further step forward in the integration of ESG factors into our investment processes by announcing our first exclusions policy. We have realised that, as long-term investors, the further one looks out into the future, the more the returns generated by some sectors will be impacted by climate change and societal expectations. We undertook financial analysis to determine whether certain ESG factors had been properly priced into those sectors that we thought were most vulnerable. As a result of this, we announced plans to exclude and ultimately divest from tobacco manufacturing, thermal coal mining, (specifically where this activity is more than 25% of a company's revenue) and companies that may have ties to certain controversial weapons. This list will be kept under review and we may add to it over time.

Earlier this year we announced our ambition for the Scheme to be Net Zero for greenhouse gas emissions by 2050 if not before - in line with the Paris Agreement. As a pension scheme trustee, it is our fiduciary responsibility to act in the best financial interests of the Scheme. It is increasingly clear that the transition and physical risks which climate change present mean that, for many assets, this responsibility is well served by pursuing actions to minimise the effects of climate change.

This ambition will involve new benchmarking processes, adding to our £1.2 billion already invested in green technologies, and reducing our exposure to assets and companies unable to transition and survive in this low carbon future. To be clear, it is our view that we cannot divest our way to meeting this ambition: the key will be working with the management teams of our investments to make sure they can transition to a Net Zero world. This will require companies to develop the processes, technologies and low carbon fuels to make this transition happened. We will also continue to collaborate with industry peers and Government entities to make sure this happens. The world must decarbonise for us to decarbonise.

But is well worth noting that this process is made harder by the lack of the data and metrics that we need. Which is why the efforts of industry bodies, regulators and vendors to produce useful and credible metrics is appreciated.

Two years ago, we undertook Scheme-wide climate scenario analysis and stress testing, looking at the impact of global warming based on different temperature increases. Using the scenarios assessed, unsurprisingly, the outcomes showed that the Scheme had lower expected returns under the more adverse climate scenarios. This was as a result of both greater economic disruption and increased physical impact.

We are planning to go through this process again for our 2022 Task Force on Climate-related Financial Disclosures (TCFD) report (now a mandatory requirement for large UK pension funds) and are in the process of selecting a scenario analysis data provider.

Running alongside this, our most immediate priority in our working towards Net Zero is to establish our own baseline of data. We are selecting a data provider who will enable us to measure our progress over time.

We know we are not alone in going through this complex process which comes at the same time as a raft of new reporting requirements covering ESG and Stewardship. Hence, earlier this year USS, in conjunction with Brunel Pension Partnership, BTPS, the Church of England Board, Railpen and Chronos Sustainability, launched a new reporting tool specifically designed to help asset owners meet their RI and stewardship reporting requirements.

Being challenged, measured and encouraged to keep moving forward is essential if responsible and sustainable investment is to drive the outcomes necessary to protect and enhance our environment, our societies and our economies.

However, as with everything else that we do, we need to ensure that the time and resources we commit to reporting are well spent. We want to produce information that is useful for both our stakeholders and for our own decisions, and we want to provide this information in a timely manner, and to do so as efficiently as possible.

The resource implications of reporting are huge – the UN-backed PRI, the FRCs stewardship code, Implementation statements and, from 2022, mandatory TCFD reporting require hundreds of distinct items of information or data points. The reporting tool, we hope, will streamline this process to a certain extent.

Net Zero and responsible investment are complex issues and we need everyone to play their part to ensure we all get to the desired outcome. Pension funds and asset managers working together will make these outcomes easier to achieve.

USS

David Russell

Head of Responsible Investment,
USS Investment Management

7 THE POWER OF PENSIONS TO TACKLE THE CLIMATE EMERGENCY SCOTTISH WIDOWS

CLIMATE CHANGE IS ONE OF THE BIGGEST ISSUES FACING SOCIETY TODAY AND HAS BEEN RECOGNISED BY NUMEROUS GOVERNMENTS AS A GLOBAL EMERGENCY. THE IMPERATIVE FOR US ALL TO ACT NOW WAS DRIVEN HOME IN THE RECENT REPORT FROM THE UN'S INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE (IPCC), WHICH WAS UNEQUIVOCAL IN ITS ASSESSMENT OF WHAT WILL HAPPEN IF WE DON'T.

Long-term changes to our climate are the result of human activities. Excess carbon dioxide and other greenhouse gases have built up in the atmosphere, forming a blanket and causing global temperatures to rise. The amount of carbon dioxide in the atmosphere is now almost 40% higher than it has been at any time in the past 800,000 years. Once it is there, it is thought to take anywhere between 300 and 1,000 years to leave.

So we need to put a brake on the build-up of greenhouse gases and particularly carbon dioxide. We urgently need to achieve a balance between the amount of gas emissions produced, and the amount removed from the atmosphere - what has been termed 'net zero'.

A two-pronged attack is required; reduce current emissions and actively remove existing gases, while at the same time ensuring that residual emissions are fully offset, mainly through natural carbon sinks such as oceans and forests, or new technologies like carbon capture and storage.

It's accepted that net zero is challenging and won't be delivered without radical behavioural and economic transformation from all segments of society, including asset owners like us.

We have set 3 key decarbonisation goals: 1) a 2025 target of increasing investments in climate solutions, 2) a 2030 target of halving the carbon footprint of our total investment portfolio, and 3) a 2050 target of net zero across the entirety of Scottish Widows' investments.

We have already taken significant steps in achieving these goals and making sure that our portfolios are moving to be aligned with the Paris Climate Agreement. Last year, we integrated ESG considerations into our multi-asset portfolios by investing in the new BlackRock ACS Climate Transition World Equity Fund, which we designed in collaboration with BlackRock. The fund focuses on companies that are decreasing carbon emissions, increasing clean technology revenue, reducing water consumption and improving waste management. In addition to this, we have relaunched the Scottish Widows Environmental Fund, which is now fully fossil-fuel-free and invests in UK companies that are making a positive environmental impact.

As well as investing more in environmentally sound companies, we have also disinvested around £1.4bn from companies that are not compatible with our sustainability goals. We achieved this by directly implementing exclusions in our mandated funds and also working closely with BlackRock and StateStreet, who manage many of the external pooled funds we invest in, encouraging them to align with our exclusions policy for the benefit of all investors in these funds.

In addition to making these changes on behalf of our customers, we can also see their growing interest in investing sustainably across a variety of topics, so we strive to offer them options that support investment themes that most resonate with pension savers according to the in-depth research that we carried out in 2020.

We strongly believe that by taking actions such as these, we are not only helping to protect the global environment but are also crucially safeguarding our customers' financial interests. Companies that do not amend their businesses to be less carbon-intensive face an uncertain future. They are likely to see growth severely limited by regulation and fines, their reputation tarnished, and their products and services no longer being sought. We don't want our customers invested in them.

With over £170bn of assets, we are a significant shareholder in many of the world's largest companies and therefore in a unique position to influence their decisions and encourage them to make the changes needed to meet the targets of the Paris Climate Agreement.

When engaging with companies, we often collaborate with others within our industry as we know that when investors speak with one voice, the impact can be much more powerful. There are a number of organisations facilitating co-operation, one of the key ones for us being the Institutional Investors Group on Climate Change (IIGCC), a forum for European investors. We were involved with the development of the IIGCC's Net Zero Investment Framework and on its launch in March this year we became signatories to it. We believe that it's vital that the Framework succeeds and we are therefore keen to stay involved with its implementation, with members of our Responsible Investment team sitting on three of its working groups.

The Framework acts as a guide on how to decarbonise investment portfolios, while investing more in companies offering climate solutions. The aim is to achieve portfolios that are consistent with the 1.5 °C Paris Climate Agreement target.

Our main priorities at the moment are working on our Task Force on Climate-related Financial Disclosures (TCFD) report and putting together our Climate Action Plan (CAP), which will include the details of the steps we need to reach our ultimate goal of net zero within our portfolios by 2050. It's important for us to be transparent and accountable in how we are achieving this.

The CAP will include information such as the methodology used for measuring carbon exposure in equities and other asset classes such as bonds. As we don't undertake stock-picking in-house, we will also be considering the instructions that we need to give to our fund managers, while still allowing them the level of discretion that they need to outperform. We do make strategic asset allocation decisions for our portfolios in-house and so we will be looking how to incorporate our decarbonisation goals within these. We will also be considering our approach to collaboration and engagement with governments and regulators, and many other elements besides.

None of this will be easy and part of our planning is trying to anticipate the challenges ahead, particularly given the long-term nature of the CAP. For example, any steps we take towards our decarbonisation targets must consider the pace and shape of change within the wider economy. We will need to adjust our tactics to take account of these. This is just one of the many issues that we will be deliberating upon.

The race to get to net zero is more pressing than ever and we are doing all we can, alongside our peers in the asset management industry. We have made important changes already but we need do more and this is what we are working on. By taking these steps, we are first and foremost protecting our customers and safeguarding their investments for the long-term, in addition to making a positive impact on the wider world.

SCOTTISH WIDOWS

Maria Nazarova-Doyle, CFA
Head of Pension Investments and Responsible Investment, Scottish Widows

8 THE PATH TO NET ZERO LONDON CIV

OVER THE NEXT FEW DECADES ONE BILLION LIVES AND TRILLIONS OF POUNDS ARE AT RISK DUE TO A SINGLE ISSUE: CLIMATE CHANGE. RECOGNISING THE DUAL MATERIALITY OF THIS GLOBAL EMERGENCY AND THE ASSOCIATED FINANCIAL OPPORTUNITIES ASSOCIATED WITH THE GREEN TRANSITION, LONDON CIV HAS A FIDUCIARY DUTY TO INTEGRATE CLIMATE RISK ANALYSIS INTO OUR INVESTMENT PROCESS.

Climate change presents an immediate systemic risk to the ecological, societal, and financial stability of every economy, country, asset type and sector on the planet. It will have significant physical and economic impacts on most aspects of human activity and multiple implications for our clients and their beneficiaries which is why addressing climate change remains a strategic investment priority.

The Earth's temperature is now rising faster than any time in recent history, evidenced by more numerous and volatile weather events, rising sea levels and warming marine temperatures. It is impacting agriculture and food supply, infrastructure and water availability which in turn leads to increased migration and conflict.

Human activities are contributing to approximately 1.0°C of global warming above pre-industrial levels. Current emission patterns indicate that this could reach 1.5°C by 20405 and on the current path of carbon dioxide emissions, temperature is expected to increase by 3-5°C by the end of the century. The net damage costs of climate change are likely to be significant and increase over time.

The Paris Agreement remains the best example of international action, binding 197 countries to undertake ambitious efforts on risk mitigation and adaptation. It aims to stop global temperatures rising more than 2.0°C above pre-industrial levels this century and limit that increase to 1.5°C. As COP26 approaches it is likely that commitments will only proliferate.

Whilst government action matters, all sectors of society including individuals, companies and investors must take responsibility. The United Kingdom has taken a lead on assessing climate change impacts and continues to spearhead the way by being the first major economy to pass net zero emissions law in 2019.

LEADERSHIP IN LONDON

London brought its own carbon neutral target forward from 2050 to 2030. Out of every English region, we have the lowest carbon emissions per person thanks to high population density, extensive public transport and lack of heavy industry. However, 1.25 million people living in London and £277bn worth of assets may be severely impacted by climate change by the year 2050.

As the most populous metropolitan region, home to the largest number of businesses in the UK and responsible for nearly a quarter of the UK's GDP, London needs to be ambitious in its climate change policy. Inspired by our clients – London CIV is committed to taking positive action and demonstrating leadership.

WHERE ARE WE NOW?

"We must consider the financial implications of global warming and encourage emissions reductions now, rather than later if we are to deliver on our long-term investment strategy and manage risk. Our expertise in managing climate related risks, our industry influence and the leadership of our clients provides us with a unique position and exciting opportunity to drive change".

Mike O'Donnell, CEO, London CIV

Our approach begins by integrating climate change risk analysis throughout the design, selection and management of our investment decisions by enabling our clients to understand and mitigate their own risk. We engage with others including fund managers, corporates and wider stakeholders - whilst remaining transparent in our reporting to support our clients and track progress.

Having identified climate risk as doubly material from a financial and social perspective, we have progressed significantly with our strategy. Climate risk is now included as one of our investment beliefs, our first climate change risk analysis in line with TCFD recommendations covers all of our listed equity, fixed income, sovereign debt and infrastructure assets.

TOWARDS NET ZERO EMISSIONS

Net zero refers to achieving an overall balance between emissions produced and removed from the atmosphere. The Paris Agreement sets an objective to "achieve a balance between anthropogenic emissions and removals by sinks of greenhouse gasses". London CIV will publish an ambitious net zero target this month that requires drastic reductions in induced emissions across all funds.

Source: London CIV (2021)

Reaching this goal will only be possible by increasing the range of offerings available to our clients. Whilst client funds manage their own strategic asset allocation and are free to choose which funds to invest in - offering new net zero funds and supporting the decarbonisation of existing products will help our clients, with a wide range of ambitions, achieve their emissions reduction goals.

CHALLENGES AHEAD

One of the key challenges we face is that there is currently a limited supply of investment products which meet our climate change objectives (low carbon, socially just) and investment requirements (the right risk-return profile). Thus, encouraging innovation is critical to our product development and fund launch strategy.

Our strategy focusses on reducing our emissions: through robust, collaborative engagement and contributing to avoided emissions: through innovative products such as the Renewable Infrastructure Fund. Of course, neither of these approaches provide a 'silver bullet' for solving the climate emergency alone.

Reducing emissions through company engagement often requires a three-year cycle of activity until real-world outcomes are achieved. Simply divesting from companies who don't meet our climate ambitions today would not only be financially unviable but fundamentally ineffective at making any real difference to global emissions.

Contributing to avoided emissions through investments in renewables is an exciting opportunity but one which brings with it new challenges arising from embedded emissions or other environmental, social or governance risks these assets can be exposed to. Understanding all the impacts for all our funds is key to ensuring that positive action does not simply displace negative impacts elsewhere.

To truly achieve net zero, emissions reductions and avoided emissions will not complete the puzzle alone. London CIV must balance out net-positive investments by investing in net-negative assets. These funds may include afforestation, reforestation, soil carbon management, direct air capture and carbon capture and storage and bioenergy with carbon capture and storage.

We must also consider climate risk alongside other interrelated and complex ESG issues such as diversity, (a possible facilitator for combating climate change), water use, hazardous materials and other impacts such as forced labour which may increase with the adoption of greener solutions that require increasingly scarce resources.

Whilst we have come a long way, the real journey is only just beginning. Along with the companies, peers and the managers we work with, on behalf of all our client funds and their members we must continue to work together and support not just a transition but a just transition that lo with a world worth living in.

London CIV

Jacqueline Amy Jackson
Head of Responsible Investment, London CIV

9 HOW PENSION FUNDS CAN PLAY THEIR PART IN THE TRANSITION TO A NET ZERO ECONOMY? BARCLAYS BANK UK RETIREMENT FUND

THERE IS NO ONE WAY FOR PENSION FUNDS TO PLAY THEIR PART IN THE TRANSITION TO NET ZERO BUT THE KEY IS TO ENGAGE, COLLABORATE AND NEVER LOSE SIGHT OF THE COMPELLING EVIDENCE THAT SUSTAINABLE BUSINESS PRACTICES LEAD TO BETTER RETURNS FOR MEMBERS, SAYS THE UKRF.

The Trustee of the Barclays Bank UK Retirement Fund (UKRF) has been carefully planning how to align the UKRF's investments with the goals of the Paris Agreement, with the ambition of achieving net zero carbon emissions by 2050. Like many defined benefit (DB) pension funds, the UKRF is a mature scheme, and our investments are designed to generate stable cash flows for our members to meet their future retirement benefits. As such, we have largely divested from liquid equity markets, meaning our push for net zero will be driven via the credit side.

We laid the foundations for our net zero journey through the development of a Responsible Investment (RI) policy. The RI policy is rooted in the compelling evidence that sustainable business practices lead to better risk-adjusted returns and outcomes for members, which is our primary objective.

The policy provides a framework for analysis and decision-making on a day-to-day basis, and it has guided the UKRF's approach to strategic asset allocation, manager selection, risk management, the monitoring of relevant carbon emission metrics and climate scenario analysis. What follows is a description of some of the actions and initiatives introduced by the UKRF as we implemented our RI policy and took steps on our journey towards net zero, in the hope that it prompts ideas, questions and debate among other schemes both large and small.

INVESTMENT IN RENEWABLE ENERGY ASSETS BRINGS WIDESPREAD ENVIRONMENTAL AND SOCIAL BENEFITS

Over the last few years, we have re-positioned existing investments and established exposures in several new investments that acknowledge climate risk and contribute towards meeting climate change targets, while at the same time being financially sound investments and consistent with the Trustee's long-term investment strategy of delivering stable returns for members in the long-term.

For example, the UKRF provided over £200m financing to support UK-based renewable energy assets in the last five years. In addition, the scheme purchased 26 UK-based solar farms worth around £270m, representing c1.5% of UK-installed solar capacity with c25-30 years useful life.

These solar assets provide the stable cash flows required by a scheme of the UKRF's maturity, while also contributing to the UK's net zero emission targets and creating additional environmental and social benefits. The sites provide ideal habitats for a range of species. In line with the UKRF's desire to maximize the social impact of its investments, Octopus Renewables, which manage and operate the sites, has engaged with landowners, ecologists and local councils to implement and review site-tailored land management programmes that consider biodiversity needs in the area (11 total in 2020).

The sites are managed to accommodate different species from invertebrates to larger mammals and birds; for example, bird and bat boxes have been installed and mammal gates around the sites' perimeters have allowed passage for badgers and other animals. On-site sheep grazing has been adopted on 9 of the solar sites, as studies have shown that grassland managed with grazing has a higher carbon sequestration potential and can lead to higher biodiversity on site.

INTEGRATING ESG FACTORS AND CLIMATE RISK INTO OUR FUNDS

Another key strategic change announced at the start of 2021 was the integration of ESG factors and climate risk into our £1.3bn Diversified Growth Fund (DGF). The DGF is a diversified multi-asset fund with wide-ranging underlying investments (multi-asset class, rather than equity focused only) that form the main building block within the default option of the UKRF Defined Contribution (DC) scheme. Reflecting the Trustee's RI policy, the changes brought an explicit focus and application of ESG factors into investment decisions to improve risk management, including climate change, and generate sustainable, long-term returns for members.

The overall expected return and risk targets for the fund remain broadly unchanged, along with other key investment restrictions and guidelines under which we operate on a day-to-day basis. What the changes mean is that we have introduced a screening process that will identify material ESG risks and future growth opportunities; it will reduce exposure to companies with high carbon emissions, while increasing investments in assets that conserve natural resources and businesses that integrate with the communities in which they operate.

We made this change because we think it will have a positive impact on members' retirement savings in the long term. We expect that investments with improved ESG characteristics will face fewer risks and perform better in the long term compared to investments with weaker ESG characteristics and less focus on sustainable long-term practices.

DAY-TO-DAY WORK: ENGAGEMENT, MEASUREMENT AND SPREADING BEST PRACTICE

The actions described above do not stand in isolation; responsible investment considerations are integrated within the UKRF's strategic and day-to-day management processes and decision-making, aiming for improved risk-adjusted returns for members across both the DB and DC sections.

ENGAGEMENT

We play an active role in voting and engaging, where possible, with investment managers and other stakeholders. Such engagement can, in our experience, improve ESG outcomes and returns for members, and it can provide the basis for positive change.

In 2019, the UKRF appointed EOS at Federated Hermes (EOS) as a dedicated specialist engagement provider to maximise Trustee influence as an active owner, with the aim of improving outcomes and sustaining returns for the long-term in both our equity and credit investments. With the help of EOS, the Trustee is engaging (and voting, where applicable) with the investee entities, regulators and markets in a more proactive basis. EOS is identifying companies in which the UKRF is invested (either through equity or debt) and is conducting a programme of engagement drawing on the considerable collective voting power EOS clients hold, in order to influence change. Areas that may prompt EOS to identify engagement opportunities on behalf of the trustee include management of environmental, social and strategy issues, including climate risk, with a view to improving long-term outcomes. EOS is also providing the Trustee with the opportunity to endorse or sign on to responses to consultations where practical.

TRANSPARENCY, DISCLOSURE AND MEASUREMENT

The UKRF fully supports the TCFD recommendations because greater disclosure will allow better measurement of climate change risks and will enable all stakeholders in the investment chain to assess and minimise such risks.

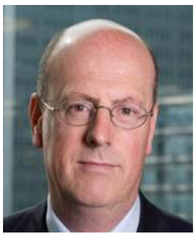
Detailed disclosures and measurement have, for example, enabled us to introduce CO_2 guidelines for the UKRF's public equity allocation, which meaningfully improved the ESG profile of the UKRF equity portfolios without any impact on the investment strategy's effectiveness. It has also enabled High-Quality Credit managers, with whom we work, to model and conduct scenario analysis of the portfolio level impact of reducing carbon exposure.

COLLABORATING TO CONTRIBUTE TO BEST PRACTICE AND HAVE AN IMPACT ON THE REAL ECONOMY

There are a huge number of macro-level debates underway, and they are intensifying in the run up to COP26. We are involved in these debates and collaborate with other asset owners (through the Institutional Investors Group on Climate Change and A4S, for instance) and our underlying investment managers to contribute to the definition of best practice across ESG investments and sustainability.

We already collaborate with underlying issuers of equity and debt, and with the underlying real assets e.g. properties and their tenants, and infrastructure assets, to understand their climate risk management processes, how they measure their emissions, how they plan to reduce emissions and align to the Paris goals and net zero. The exchange of information enables all parties to help each other towards the shared goal of reducing emissions. For example, we have worked with underlying leaseholders and businesses in our property portfolio to improve building energy efficiency (e.g. solar panels on top of two distribution centres we own). Such engagement, rather than buy/sell actions, is particularly important for long term strategic portfolio assets (like credit and real assets), and it brings real economy outcomes.

This collaborative approach is only going to become more important as the disclosure regime evolves (e.g. on Scope 3 emissions through the value chain) and the policy and regulatory focus on ESG intensifies to the point where the real economy demonstrably shifts. Indeed, we see such idea sharing and contribution to emerging investment management frameworks as a key part of our fiduciary responsibility in managing the UKRF for the long-term benefit of members.



BARCLAYS

Tony Broccardo
Chief Investment Officer, Barclays Bank UK Retirement Fund

10 MANAGING THE RISKS OF CLIMATE CHANGE BORDER TO COAST PENSIONS PARTNERSHIP

CLIMATE CHANGE IS A SYSTEMIC RISK WHICH IF LEFT UNCHECKED POSES AN EXISTENTIAL THREAT TO SOCIETY. THERE MUST BE FUNDAMENTAL CHANGES IN HOW SOCIETY CONSUMES, USES, AND GENERATES ENERGY IF WE ARE TO CUT CARBON EMISSIONS AND LIMIT THE DAMAGE DONE TO THE WORLD WE LIVE IN.

Asset owners and managers cannot isolate themselves from what is happening in the world – and they have a critical role to play in supporting a transition to a net zero future. But if accepting the scale and urgency of the situation is the easy part, agreeing – and implementing – effective solutions is the hard part. At Border to Coast – as the representative of 11 LGPS Partner Funds with c.£55bn of assets – we use our scale and expertise to engage with firms to understand how they are managing and mitigating climate risk and to push for positive action.

We are firm believers in the power of engagement. However, much of the climate change debate is dominated by calls for investors to drive change by unilaterally divesting from problematic sectors. However, this does not solve the underlying issue of societal demand, or recognise that for every seller there must be a buyer. Indeed, this urge to divest can have unintended consequences – when Anglo American spun off its thermal coal business as Thungela Resources, investors in Anglo-American saw a rapid improvement in portfolio emissions. However, Thungela continues to operate as a standalone coal business and has seen production increase in the past five years. What may look good for your Investment Portfolio does not mean it is good for the climate – or the macro risks your Portfolio faces.

Carbon intensive sectors need significant investment if they are to stop being part of the problem and become part of the solution. This is not a debate about how to squeeze the last juice of return from a stranded asset; it is about how we can act as a responsible investor and drive effective change in the sectors that have the biggest impact on climate change – and can deliver the transition we all need.

Actively engaging with all companies, not just those with a low carbon footprint, is critical to this transition – and this is more important in sectors that currently have a high carbon footprint. It would be easy to dismiss such companies as high-risk, too damaging to the environment, and divest. However, doing so risks oversimplifying what is a more nuanced and complicated matter. Take Holcim, a manufacturer of building materials and cement, which is a is a highly carbon-intensive process. We hold a position in the company because of its work to create lower-carbon building materials and lead the way on carbon capture storage projects, supporting crucial work in the energy transition. Another example would be German utility company, RWE. While a relatively large carbon emitter, the company is also the third-largest renewable energy producer in Europe and generates electricity from alternative energy sources such as wind, hydro, biomass, energy storage, and solar power plants. It also provides construction services for wind, biomass, and combined heat and power plants.

While we will continue to exit investments in business where we believe they will be a poor performer because of climate exposures, we nonetheless recognise that change does not happen overnight, and long-term consistent engagement is key. As a long term investor, we believe it is important to take a balanced approach and the right long-term decision may be to invest in a firm which has high emissions today if we believe it is part of the solution to build a low-carbon economy.

As well as our engagement and activity in public markets, we have also taken direct steps to support the transition to a net zero-economy via a recent investment in Sleaford Power Station – a biomass renewable energy station capable of generating electricity for 65,000 homes, saving 50,000 tonnes of CO2 a year. And, reflecting the challenge of clear and consistent data in private markets, we have partnered with Albourne to develop an industry-leading ESG reporting framework for the sector to improve measurement.

Our approach to climate change focuses on using our influence as a large, institutional investor to work with companies, policymakers, and standard setters to drive real-world change. There is no doubt that our world is warming, and the climate is changing. The planet is 1°C hotter today than it was prior to industrialisation and we are already experiencing the damaging effects. Without urgent action, global society will be catastrophically disrupted with material capital market implications.

While there is no single solution to this challenge, we recognise that the investments we make, in every asset class, will both impact climate change and be impacted by climate change. We take the responsibilities of our role as a multi-billion-pound investor seriously, and, as such, we are working to address this urgent issue at every stage of our investment process and play our part in driving change towards a net zero future.

BORDER TO COAST PENSIONS PARTNERSHIP

Jane Firth
Head of Responsible Investment, Border to Coast

11 TACKLING CLIMATE CHANGE RISK IN A POOLED ENVIRONMENT
LONDON PENSIONS FUND AUTHORITY

OUR INAUGURAL CLIMATE CHANGE POLICY WAS INTRODUCED IN 2017, A YEAR AFTER POOLING TRANSFORMED THE C£250 BILLION LOCAL GOVERNMENT PENSIONS SCHEME. LIKE SO MANY OTHER FUNDS ACROSS THE PENSIONS UNIVERSE, THE LPFA RECOGNISES THE FINANCIAL RISK THAT CLIMATE CHANGE POSES TO SOCIETY, BUSINESSES, THE FINANCIAL HEALTH OF OUR FUND AND THE UK'S PENSIONS SYSTEM. WHILE POOLING HAS UNDOUBTEDLY STRENGTHENED THE ABILITY OF MANY LGPS FUNDS TO TACKLE CLIMATE CHANGE, CHALLENGES REMAIN AS OUR INDUSTRY'S MOVE TO NET ZERO ACCELERATES.

ABOUT POOLING

Pooling was instigated in 2016 by the Government to drive down investment costs and increase investment in infrastructure. Rather than 86 England & Wales local government pension scheme funds operating by themselves these LGPS Funds now sit in one of eight pools. Funds retain control of their policies, provide oversight, set overall strategic asset allocation but day-to-day asset management is delegated to the pool, in our case Local Pensions Partnership (LPP). Funds are held in common ownership: essentially the LPFA Fund has shares in the pooled vehicles rather than owning the assets directly as an individual fund. Lancashire County Council Pension Fund and Berkshire County Pension Fund are also in the Local Pensions Partnership Pool.

Pooling intended that Funds could reduce costs by sharing economies of scale, expertise and wider investment expertise. Indeed, for the LPFA, we have consistency beaten our actuarial return target and saved over £19 million in asset manager fees in 2019-2020.

INVESTING IN A LOW CARBON FUTURE

Pooling was also intended to provide Funds with greater direct access to large scale, high-yielding energy infrastructure projects; projects that are crucial in helping the UK transition to a low carbon economy. In 2015, LPP, the LPFA and the Greater Manchester Pension Fund set up GLIL Infrastructure specifically to help funds invest directly into these large projects. Lancashire County Pension Fund, Merseyside Pension Fund, Nest and West Yorkshire Pension Fund joined GLIL in 2016 increasing GLIL's committed capital to £1,275 billion. GLIL has taken stakes in the likes of Anglia Water, Clyde Windfarms, Smart Metre Assets, Cubico Sustainable Investments and Flexion Energy Storage.

Case study 1:
The investment in Flexion will see the company develop, build, own and manage energy storage systems in the UK, specifically large-scale batteries connected to and servicing the electricity grid. Energy storage underpins the switch to renewable sources of energy, serving as a critical pillar in enabling electrification to help the UK meet its net-zero carbon emissions targets. Flexion's development of storage infrastructure will help stabilise the transition to renewable energy in the UK and provide security to the grid by reducing volatility associated with the production of renewable energy.

Case study 2:
Smart Metre Assets finances the procurement of smart meters before renting them to energy suppliers over a contracted period and management of the meter portfolio over its life. Aside from ensuring accurate billing, SMA's smart meters play a role in the UK's energy transition and net zero emissions ambitions. They have a direct positive impact on end energy consumers by improving their ability to monitor energy usage, helping them achieve energy cost savings and improving overall user experience.

Currently, 2.7% of the LPFA's c£7bn portfolio is invested in such assets identified as 'Green.'

MOVING AWAY FROM EXTRACTIVE FOSSIL FUELS

Whilst the LPFA are the only Fund in the pool to have a specific climate change policy, alongside its RI policy, with support from LPPI and their well-established ESG processes, real progress has been made by LPFA in tackling climate change risk.

Our climate change policy stipulates engagement rather than blanket divestment and we require companies to be demonstrably planning for the transition to a low carbon economy. We monitor our portfolio's exposure to conventional energy -– "Brown" companies - and we support and advocate for corporate planning and emissions reduction targets that support global decarbonisation in line with the Paris Agreement. For LPFA, as at 30 March 2021, only 0.6% of the Fund's investments in listed equities are in traditional energy (compared to 3.2% for the MSCI All Countries World Index benchmark).

We review listed oil and gas companies the Fund continues to hold using management quality assessments produced by the Transition Pathway Initiative (TPI). TPI scores confirm how the world's highest-emitting listed companies are positioned against a series of benchmarks which help asset owners like LPFA judge if they are demonstrating appropriate planning for a low carbon future.

At 31 March 2021 (by value) 13% of listed companies were within TPI coverage (signifying a low exposure to global high emitters). Of these companies, 91% (by value) are assessed as demonstrably integrating climate change into their operational decision-making (rated TPI3) or into their strategic planning (rated TPI 4).

However, as the PLSA's report A Changing Climate highlighted, a major challenge is the lack of consistency in the availability of data and in how information is presented. Our analysis so far has been focused on listed equities as that sector tends to have better data. Going forward, we know that a major challenge will be accessing and reporting on accurate data beyond the listed equity asset class.

A LOUDER VOICE

Pooling also provides us with a louder voice when it comes to engagement with companies on climate change. LPPI votes on our behalf and their voice – representing clients with a combined £21.5 billion in assets - carries more weight than the individual funds. In the 12 months to March 2021, LPFA, through LPPI, voted at 574 company meetings on 6,762 separate resolutions relating to remuneration, human rights, health and diversity. We supported 100% of climate change resolutions that sought greater information on how companies are managing the risks of climate change. If after engagement, companies remain unwilling to demonstrate the move to a low carbon economy, then we will consider divestment.

Pooling has also given us greater opportunity to collaborate with others. LPFA supports numerous climate focused investor initiatives, including C40 Cities Divest Invest, membership of the Institutional Investor Group on Climate Change (IIGCC), the CDP and the Occupational Stewardship Council. The activities are enhanced by LPPI which is a tier 1 signatory to the 2012 Stewardship Code and a signatory to the Principals of Responsible Investment. LPPI have adopted the recommendations of the Taskforce on Climate Related Financial Disclosure (TCFD) and published two annual reports on progress already.

While tackling climate change is a risk and financial decision for the LPFA, we cannot ignore the increased interest in the issue from wider society and our members. Encouraging people to engage with their pension can be challenging at the best of times and communicating our progress on climate change even more so. An investment in our website, animations and a member forum is paying dividends but we are challenging ourselves to continuously improve our communications.

THE PATH TO NET ZERO

The move to net zero is gathering speed and the LPFA's Board have recently committed to the IIGCC Net Zero Framework. This involves a net zero commitment for 2050 and significant progress by 2030. LPPI have also made a commitment as part of the IIGCC Asset Managers framework. We will publish our Action Plan describing how we'll get to net zero over the coming months and involve significant engagement with the other Funds in our pool, with LPPI and with our external stakeholders to determine scope and focus areas.

This process underlines one of the main challenges facing pooled Funds. It's a truism to say that every Fund in a pool is different and collaboration is essential. Pools are partnerships that can deliver real change by working together while retaining individual voices.

your pension our world

Robert Branagh
CEO, London Pensions Fund Authority

12 TOP TIPS FOR SCHEMES! HSBC BANK (UK PENSION SCHEME)

AT HSBC BANK (UK PENSION SCHEME) WE'VE BEEN ON A JOURNEY FOR SOME YEARS TO ENSURE THAT WE FULLY INTEGRATE ESG CONSIDERATIONS INTO OUR RISK MANAGEMENT CONSIDERATIONS. WITH 190,000 MEMBERS, AND ASSETS UNDER MANAGEMENT OF AROUND £35BN, WE'VE ALWAYS BEEN MINDFUL OF THE IMPORTANCE OF GIVING FULL CONSIDERATION TO ESG ISSUES. ALONG THE WAY WE'VE HAD SOME CHALLENGES, BUT WE FEEL LIKE WE HAVE DEVELOPED OUR UNDERSTANDING OF THE ISSUES AND ARE BUILDING A MANAGEMENT INFORMATION FRAMEWORK BASED ON SELECTED METRICS TO ASSESS RISK AND INFORM PROACTIVE ENGAGEMENT WITH OUR ASSET MANAGERS. BELOW WE SET OUT OUR 'TOP TIPS' FOR OTHER SCHEMES STARTING THE JOURNEY!

1. TRAIN YOUR DECISION MAKERS

Things move fast in this area, and training trustees makes for better decisions for the scheme. At HSBC, our training focuses on ESG risk management strategies and the "pros and cons" of our proposed metrics. We also present alternatives, so that trustees can evaluate the advantages and disadvantages of each approach, which influences our decisions hugely.

For example, as our understanding of climate change and other ESG risks has developed, the trustees have increasingly emphasised the need for management of these risks within the scheme's DB and DC assets. Over the past year we have worked to integrate more specific climate risk considerations into our overall Risk Management Framework. We have set up trustee working groups specifically to develop better ESG risk management practices.

This has only been possible due to training and constantly evolving our understanding of the ESG landscape.

2. UNDERSTAND YOUR METRICS

Metrics is one of the most challenging areas of understanding ESG risks, and an area in which things move very quickly. However, it is vital that trustees get to know how selected metrics can be used to make decisions on ESG, what they can and cannot tell you, and what data is needed to calculate them. And trustees must also be aware of their limitations!

In looking at this, we note three key processes:

- Developing metrics - The trustees work closely with our investment consultants to identify metrics which provide good quality, unbiased and consistent data which are produced by an independent data provider to ensure a consistent methodology across all asset portfolios.
- Metric approval: Metrics are part of an overarching risk management framework which is managed by the Scheme's Asset and Liability Committee whose members participate in regular ESG risk management training.
- Using the metrics: The trustees use metrics as a risk management tool to develop understanding of how asset managers are managing ESG risk in their respective portfolios, as such they aim to be decision useful. The trustees are developing asset manager "scorecards" to collate ESG risk metrics relevant to each mandate to help track progress against developing forward looking Paris aligned ESG risk strategic objectives, and to identify key asset manager engagement topics.

ESG risk metrics are currently imperfect, and the data used to produce them is partial in coverage and continually evolving. Therefore, we consider ESG metrics as a source of information about risk, rather than as a standard that all assets must meet. In our experience, this becomes a starting point for fruitful conversations with asset managers about ESG risk management and policies.

3. PLAN YOUR DISCLOSURES

Start planning your disclosures – be they regulatory or optional - early. You need to ensure that the metrics you intend to use are incorporated in enough time to ensure that you leave yourself enough time to fully review the data you've received, and how you plan to present it.

We've been producing an annual Taskforce for Climate Related Financial Disclosure (TCFD) report since 2017. In the coming years this is something all schemes will need to do, and our key advice would be to get started as early as possible!

4. KEEP YOUR METRICS UNDER REVIEW

This area is changing rapidly, with research organizations constantly developing new metrics and companies generating better data. As well as considering how you make use of metrics, we would recommend you build in regular reviews to ensure that you continue to use the metrics that best suit your needs, and that you have access to the data you require. As the requirements to report on the TCFD framework fully embeds in the coming years, we can expect that our ability to access data will improve significantly – and regulators' expectations on how the statutory requirements are reported on change - and you should be prepared to evolve your internal processes to reflect this.

At HSBC, we continue to review developing research conclusions and evolving industry practice on ESG, and ensure our policies on portfolio construction, stewardship and engagement strategies reflect it. We find that being a member of groups such as the UN Principles for Responsible Investment, and the Climate Action 100+ gives us access to the research from those organisations, and helps us develop our own understanding of what is considered 'standard'.

5. USE EXTERNAL ADVISERS

Talk to a range of people – advisers, fund managers, others working in the industry. You'll get new ideas and different perspectives. The more diverse your knowledge sources, the more informed you will be, and the better outcomes your scheme will have!

HSBC

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