OAKTREE

Brunel Pension Partnership

Sustainability in Action:

How Brunel and Oaktree Collaborate on Climate Integration

Introduction

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Brunel Pension Partnership – one of eight UK Local Government Pension Scheme pools aims to forge better futures by investing for a world worth living in, and does this by making long-term, sustainable investments on behalf of its clients. Brunel has been a client of Oaktree since 2021, and over the past four years, we have collaborated to implement and advance Brunel's climate objectives within the bespoke multi-asset credit portfolio managed for Brunel by Oaktree. This partnership has not only supported Brunel's goals but also helped Oaktree strengthen its ability to support other clients in their integration of bespoke climate characteristics into their separately managed accounts.

Faith, can you outline Brunel's sustainability goals and approach?

Brunel's mission is all about investing for a world worth living in – balancing strong, long-term returns with a positive impact on people and the planet. At the heart of Brunel's approach are three pillars: integration (embedding sustainability into every investment decision), collaboration (working with asset managers, industry peers, and policymakers), and transparency (leading on open reporting and sharing best practice).

Brunel's Responsible Investment (RI) strategy is built around seven priorities, split into "Top" and "Enabling" themes. The top three – climate change, biodiversity & nature, and human rights & social issues – are the areas to which we commit the majority of our internal resources. For climate, Brunel aims to drive systemic change in the investment industry, keeping global warming well below 2°C. On biodiversity, the goal is to halt and reverse nature loss, while human rights work ensures investments support a fairer, more resilient society.

Supporting these are enabling priorities: diversity; equity & inclusion; circular economy; cyber & AI; and tax, cost, transparency & fairness. These are tackled through collaboration and targeted engagement.

Brunel's strategy is practical and forward-looking, recognising the need to encompass a wide range of investment styles, approaches, asset classes and geographies into a robust risk management framework, with a clear commitment to real-world outcomes. The approach is flexible – ready to adapt to policy changes and new challenges – while always keeping partner funds' interests and ambition for a sustainable future for all at the core.

Daniel, what was Brunel's ambition when it launched its multi-asset credit search in 2019? What were your findings?

The ambition was to work with multi-asset credit managers that could adhere to the Brunel Climate Change Policy. This is in addition to the managers integrating broader responsible investment considerations into their investment process. During the initial search, it was observed that, while most managers incorporated responsible investment practices into their processes, many were not fully aligned with our Climate Change Policy. There was a notable difference between the multi-asset credit universe and equities with respect to climate considerations. As a result of our findings, we decided to look for managers who we could partner with to implement our climate goals. This was in addition to focusing on leading managers in this space.

Figure 1: Brunel's Multi-Asset Credit Invitation (2019)

Extract - Climate questions

1. How do you think about climate change in the context of ESG?
2. What climate change integration already exists within your proposed strategy?
3. What is currently in the process of being implemented (with anticipated completion time scales)?
4. What are you more ambitious long-term goals?

Please note that your answer to the questions above should be specific to your proposal for this mandate, not fixed income in general.

Please provide an overview of your approach to Climate Change analysis for the multi-asset credit portfolio, with reference to the following:

- How and why do you integrate climate change factors into the multi-asset credit Investment process?
- To what extent does climate change data impact investment decisions for this portfolio?
- If you have developed proprietary climate change ratings, please explain how these are created and monitored.
- How do you overcome the challenge of limited carbon data in the multi-asset credit universe?
- If you utilise any third-party climate change data, please specify the data providers and how this data is incorporated.
- What climate change parameters do you impose on this portfolio and why?

Please provide an example or report you will be able to provide.

Source: Brunel Pension Partnership

Greer, how does Oaktree approach sustainability?

Oaktree's approach to sustainability is an extension of our investment philosophy, which emphasizes risk control. By integrating sustainability considerations into our investment processes, we strengthen our ability to manage risks and identify opportunities. Given we invest across a wide range of asset classes and employ a bottom-up investment strategy, we take a nuanced approach – recognizing that sustainability is not "one-size-fits-all."

Oaktree's sustainability strategy is overseen by our centralized Sustainability team. In addition, senior investment professionals within each of our investment strategies, such as Wayne Dahl, serve as Sustainability Leads and are instrumental in building and implementing sustainability approaches that are tailored to their strategy and aligned with client goals.

Wayne, how do you approach sustainability in multi-asset credit?

Our investment analysts lead sustainability diligence efforts, as they are best positioned to assess how risks and opportunities may materialize for a given issuer. Analysts use our ESG Assessment Tool to evaluate 15 E, S, and G risk factors based on (a) industry materiality (as informed by the Sustainability Accounting Standards Board materiality rankings) and (b) companies' risk management practices for each of the material factors. This tool helps investment professionals evaluate and prioritize risks by identifying the companies that have the poorest risk management of the most financially material sustainability risks.

Engagement is key to our sustainability approach. We aim to use our role as lenders to encourage progress in material areas. We prioritize engagement efforts based on financial materiality, which means we concentrate our efforts on factors that can directly impact company value.

Faith, what are Brunel's climate goals and how do you partner with managers to achieve these?

In broad terms, we believe that decarbonizing our economy and making investments that accelerate this transition, alongside those in adaptation and physical resilience, contribute to ecological, societal, and financial stability. This aligns with our partner funds' long-term financial interest. We aim to drive meaningful change in the financial system, enabling ourselves, our partner funds and other investors to address climate change more effectively. While targeted actions can mitigate specific risks, broader transformation is essential for lasting impact. Our focus is on catalysing large-scale change, both independently and through partnerships, particularly with our asset managers and strategic partners.

We appointed external fund managers based on their depth of expertise, insight, and resources, which we would not otherwise have access to directly. While we think it is critical to set expectations and have clear shared objectives around what we are seeking to achieve, we trust our managers to help shape how those objectives are achieved. We seek to cultivate strong, partnership-based relationships with asset managers, moving beyond traditional transactional models. For example, we encourage them to focus on desired investment outcomes rather than simply executing instructions verbatim. This may involve exploring alternative approaches to achieve those objectives and, if appropriate, recommending amendments to investment agreements – such as broadening risk parameters – to facilitate better results and mitigate against unintended consequences.

Given both the starting point of climate change integration into multi-asset credit across the market, and the inherent complexity of the "multi" part of 'multi-asset credit', we recognized the need for creativity. Accordingly, we agreed on tailored action plans with each of our managers to develop a robust approach.

Daniel, how did you approach climate targets in difficult asset classes like multi-asset credit? What were some of the hurdles you faced when speaking to managers?

The way Brunel approached this was to set the objective on alignment – in our case 100% aligned/aligning by 2040 – in asset classes where this was feasible, such as corporate bonds. For more challenging areas, like sovereigns and structured credit, we instructed managers to work in the spirit of the policy, and lend capital to issuers with the principles of the policy in mind. As a result, capital in the more challenging areas of multi-asset credit is biased away from material emitting sectors.

In terms of hurdles faced, coverage and timelines were challenging. When the portfolio was launched, it was tough to even get full coverage of items like carbon intensity, let alone climate targets or alignment data for underlying issuers. Most data sets were biased towards listed equities at the time of launch. Managers also flagged concerns about applying a policy across multi-asset credit due to some asset classes remaining behind the curve on alignment. Leveraged loans were flagged as being tough to impose targets on, given the size and resource of the underlying companies involved. The same argument can be applied to structured corporate credit.

Greer, how did you build a process to meet Brunel's needs?

The starting point for us was understanding how we could partner with Brunel to create an approach that met their requirements while being practically implementable within a multi-asset credit context. This is why we created our Net Zero Alignment Tool. The Tool is informed by the Institutional Investors Group on Climate Change's Net Zero Investment Framework and helps analysts assess companies' alignment with a net zero pathway. The Tool enables analysts to track whether a company has disclosed its GHG emissions, set emission reduction targets, announced plans to meet those targets, and started to reduce its carbon footprint.

In addition to net zero alignment, we also incorporate (a) emissions and (b) engagement into our management of Brunel's goals. For emissions, we utilize our Carbon Emissions Dashboard, which aggregates climate data using company-reported data, third-party estimates, and our own internal estimates to allow issuer and portfolio-level analysis. For engagement, we leverage our internal Engagement Tracker for analysts to systematically track engagement activity, monitor progress, and evaluate outcomes.

Over the past few years, our Sustainability team has built a suite of resources to support our analysts in this work. We've hosted trainings on a range of climate topics, created guides to help analysts identify and quantify material topics, and introduced resources to support company engagement.

Wayne, how did you implement this approach in Brunel's multi-asset credit portfolio?

We focus our net zero alignment analysis on high impact issuers – those that are most exposed to climate risk. This allows us to get the most "bang for our buck." High impact issuers are a relatively small amount of the portfolio but represent the bulk of the emissions. This means that focusing on these issuers helps us mitigate this risk most effectively. The Tool allows us to categorize issuers according to whether they are aligned, aligning, or committed to align to net zero. We engage with high impact names that are not aligned to encourage progress.

Monitoring is a key part of adhering to these targets. Our Sustainability Dashboard collates our sustainability information, including ESG assessments, net zero alignments, engagements, and carbon emissions. This dashboard helps us analyze sustainability characteristics at a holding-, sector-, and portfolio-level, identify and highlight trends, and identify opportunities for engagement. Being able to view this data in real time helps us monitor progress, particularly for clients like Brunel with specific portfolio targets.

We also partner with Oaktree's Sustainability team to host quarterly sustainability reviews where we discuss both portfolio-wide sustainability progress as well as portfolio holdings with sustainability concerns – known as our "Sustainability Watch List."

Daniel, what information do you need to monitor progress of your climate objectives?

Transparency is key. The primary measure for success in this portfolio is the level of alignment and direction of travel across our issuers. This requires our managers to provide alignment status per issuer along with justification for those ratings. Examples include, but are not limited to, carbon data, company targets and prior engagements with the issuer.

Progress in our strategies cannot be made without collaboration with our managers. Our managers possess valuable insights on the rate of progression at a company and asset class level. We encourage managers to feed this back to us, which enables Brunel to set sensible policy targets and provide clarity to clients on what to expect.

Wayne, what is your approach to reporting?

We have a suite of portfolio-level reports we can provide to help our clients like Brunel understand the sustainability profile of their portfolio. This includes our Carbon Report, Engagement Report, and Net Zero Alignment Report. We also provide bespoke issuer-level reporting on net zero alignment to Brunel and have periodic calls to share progress on their goals and discuss relevant market developments.

Faith, how has this partnership with Oaktree supported Brunel in their goals?

Our ambition was to influence the whole financial system, and credit is such a core, but complex, component of that system. Oaktree has designed the appropriate tools and processes that ensure our credit investments can form part of our overall climate strategy. We need to continue to be creative, as many areas of the credit market lack the transparency that would enable better risk management on not only climate but other sustainability issues – and Oaktree is actively exploring new data sets, resources, and tools for engagements with these parts of the system.

Greer, how has this partnership with Brunel supported the evolution of Oaktree's sustainability program?

Our partnership with Brunel has helped us advance our overall sustainability program. The tools and processes we built are now used across a range of strategies at Oaktree. This partnership centers around close collaboration and knowledge sharing on both sides. We have learned a great deal from Brunel and have been able to share teach-ins with their team on multi-asset credit investing and climate. We look forward to continuing this partnership and our sustainability progress.

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