

## PENSION FUND COMMITTEE – 5 JUNE 2020

### CLIMATE CHANGE POLICY IMPLEMENTATION PLAN

Report by Director of Finance

#### RECOMMENDATION

The Committee is **RECOMMENDED** to:

- (a) adopt the Climate Change Policy Implementation Plan; and
- (b) determine the action it wishes to take in respect of the transition of the existing UBS global equity mandate to Brunel considering the information provided under the second bullet point of paragraph 6.

#### INTRODUCTION

1. This document sets out how the Pension Fund plans to implement its Climate Change Policy (hereinafter referred to as ‘the Policy’). The key commitment of the Policy is to transition investment portfolios to net-zero Greenhouse Gas Emissions (GHG) by 2050, consistent with seeking to limit the temperature increase to 1.5°C above pre-industrial levels. The actions in the implementation plan have been developed to work towards delivery of this commitment. The Policy requires the Fund to establish intermediate targets in pursuit of the commitment.
2. In the 2019 UN Environment Programme annual Emissions Gap Report it was stated that global greenhouse gas emissions needed to fall by 7.6% per year between 2020 and 2030 to be on track to achieve the 1.5°C temperature goal of the Paris Agreement with no or limited overshoot. The Pension Fund’s commitment was set based on the Intergovernmental Panel on Climate Change (IPCC) 2018 Special Report which set out the 2050 net-zero emissions position using model pathways with no or limited overshoot. The model used in the Emissions Gap Report is consistent with the IPCC low or no overshoot models. **As such, the Pension Fund will target a 7.6% annual reduction in GHG emissions across its investment portfolios, provided that the 2020 baseline position of the Fund is broadly similar to that for global emissions.** The Pension Fund believes this is the key metric that will ultimately assess whether all the investment decisions and other actions it takes under the Implementation Plan are successful in delivering on the Policy commitment.
3. In the short-term the Fund will work to establish an appropriate baseline position and measurement technique for the emissions of its investments so it can report against this target. The target will be formally reviewed in 2025 but the Fund will keep abreast of the latest climate science to consider whether changes are required at an earlier date.

4. The Pension Fund will prioritise the following actions in the implementation of the Policy which are aligned with the delivery section subheadings in the Policy and take into account the feedback received in the Policy consultation:

Asset Allocation/Investment Options

5. As set out in the Policy the Pension Fund will seek to limit carbon risk by prioritising investments that best align with the Policy where those investments target broadly similar investment goals. The Pension Fund has already moved 5% of the Fund from standard passive equity funds to a low-carbon passive fund. This decision was made on the basis that while there are issues with standard low-carbon passive funds in terms of the effectiveness of their climate risk mitigation, it was a sensible first step while better alternatives are investigated.
6. Actions:
- Work with Brunel to establish whether alternative passive, or similar, equity funds are available that better deliver on the Policy than current options available to the Fund. If a suitable alternative is identified, seek to make this an option offered by Brunel and determine the appropriate re-allocation from existing passive investments.
  - Brunel are due to make available a Sustainable Global Equities portfolio shortly. The Pension Fund had initially planned to transition the c.£250m global equity mandate currently managed by UBS to the Brunel Global Core Equities portfolio. While all of Brunel’s portfolios operate under their Climate Policy, the Sustainable Global Equity portfolio focuses on identifying companies that are part of the solution to material sustainability challenges.

The IFA has provided a report on his recommendation in respect of considering an allocation to the Sustainable Global Equities portfolio which is included at Annex 1. The report recommends a 50/50 split between the Global Core and Global Sustainable portfolios and sets out the reasons for this. Officers consider that this approach is reasonable but would highlight to the Committee that the option to commit 100% of the UBS portfolio to the Sustainable Global Equities portfolio would also be consistent with the Policy position that where there are two investment options that broadly aim to deliver the same investment objective the Pension Fund will prioritise the option that delivers the best fit to its climate change commitment.

The table below compares the risk and return characteristics of the two portfolios as set out in the portfolio specifications provided by Brunel:

	<b>Global Core Equities</b>	<b>Sustainable Global Equities</b>
<b>Benchmark</b>	MSCI All Country World Index TR	MSCI All Country World Index TR
<b>Performance Target</b>	1-2% above the benchmark, net of fees, over 3-5 years	2% above the benchmark, net of fees, over 3-5 years

<b>Absolute Risk/Volatility</b>	High	High
<b>Relative Risk/Volatility</b>	Moderate	High
<b>Investment Styles</b>	The portfolio is not expected to exhibit strong style biases overall. On average, modest positive biases to established styles can be expected, particularly quality and low volatility, but this may vary from time to time.	The portfolio is likely to have quality, small cap and growth biases but these should be managed (particularly growth). It may also be prone to an anti-value bias which again will be managed if possible.

7. The Policy also commits to seeking to increase investments in climate change mitigation and adaptation.

8. Actions:

- Consider the renewable infrastructure weighting when making future allocations to the Brunel Infrastructure portfolio. The latest Brunel infrastructure portfolio cycle targets an allocation to renewable infrastructure of 40-60% with an option for clients to increase this weighting by specifying an allocation to a renewables sub-portfolio.
- Investigate an appropriate metric for measuring the proportion of assets invested in climate mitigation and adaptation.

#### Investment Monitoring

9. Actions:

- Investigate the requirements for the Pension Fund to report under the Task Force on Climate-related Financial Disclosures with a view to including in the Pension Fund's 2020/21 Annual Report.

#### Engagement

10. Actions:

- The Pension Fund will work with Brunel to set appropriate targets and measures of success in relation to engagement activity undertaken on the Fund's behalf.
- The effectiveness of the engagement approach operated by Brunel will be formally reviewed as part of the 2022 stocktake of their Climate Change Policy and the Pension Fund will contribute to this review. The review will consider whether the engagement strategy is achieving the necessary pace of change to deliver on Brunel's Climate Change Policy and will assess

whether changes to fund managers are needed and/or the introduction of selective divestment requirements. It is not intended that no action will take place prior to the 2022 stocktake where companies are deemed to be failing to take sufficient action in relation to climate change. To this end, the Fund will work with Brunel to ensure robust mechanisms are in place with Fund Managers to ensure action is taken where appropriate.

### Collaboration

#### 11. Actions:

- Consider the merits of joining investor groups whose aims align with those of the Pension Fund as set out in the Policy. In particular, consider joining Climate Action 100+, Institutional Investors Group on Climate Change, Net-Zero Asset Owner Alliance, and the Transition Pathway Initiative.

### Monitoring and Reporting

#### 12. Actions:

- Work with Brunel to identify, or develop if not available, appropriate metrics, across all investment portfolios, to monitor the successful implementation of the Policy. Consideration of metrics will include those set out in the Policy. For Brunel portfolios the Fund is currently provided with weighted average carbon intensity and extractive exposure metrics for equity portfolios compared to their benchmarks. The Pension Fund will report on the metrics it selects and will consider settings targets and timescales where these can be linked back to the Policy commitment and interim targets set out in this Implementation Plan.
- Investigate options for portfolio scenario analysis based on different climate change scenarios so that this can be incorporated in the next fundamental asset allocation review in 2023. The Fund is conscious that there are a number of criticisms of current widely used scenarios particularly around the assumptions for future carbon capture and storage capacity. Any use of scenarios will need to consider the appropriateness of the assumptions used in order to understand any inherent limitations.
- At present there are no widely used scenarios consistent with limiting warming to 1.5°C and the Fund will seek to support development and adoption of a credible 1.5°C aligned scenario so that investments can be assessed against them.

#### 13. As well as addressing the Pension Fund's investments the Policy also sets a target for the Pension Fund to be carbon neutral on its own operations by 2030. The Pension Fund will seek to establish the carbon emissions resulting from its operations so that it can identify where emissions arise and make plans to reduce them. This will cover areas including buildings used by the Pension Fund, printing, energy usage, and business travel. Where carbon emissions are

not able to be eliminated the Pension Fund will investigate the merits of using an offsetting fund.

14. The Fund feels it has benefitted from adopting a collaborative approach in developing its Climate Change Policy and is committed to continuing to work with stakeholders, including Fossil Free Oxfordshire, in implementing the Policy.
15. An annual review of the actions taken by the Fund under the Policy/Implementation Plan will be presented to the Pension Fund Committee at their June 2021 meeting, with interim updates at the intervening meetings.

**LORNA BAXTER**  
Director of Finance

Background papers: Nil

Contact Officer: Gregory Ley

May 2020

## Annex 1 – Views from the Independent Financial Adviser to the Fund

At the end of March the Fund’s Equity portfolio was allocated as shown in the table below. (The table includes the transfer of £120m into the Passive Low Carbon Equities Fund which took place after the end of March). The overall equity weighting of 54.2% is close to the current policy weight of 54% - to be reduced to 51% when the 3% allocation to Private Debt is made.

Code	Fund Name	Total %	UK %	O/S %
EPU	Passive UK Equities	5.2	5.2	0
EUK	Active UK Equities	14.8	14.8	0
	UBS Global Equities	10.4	0.8	9.6
EPD	Passive Developed Equities	6.0	0.4	5.6
EDH	High Alpha Developed Equities	10.0	0.6	9.4
EPL	Passive Low Carbon Equities	5.0	0.3	4.7
EEM	Emerging Market Equities	2.8	0	2.8
	<b>Total</b>	<b>54.2</b>	<b>22.1</b>	<b>32.1</b>
	<b>Strategic Allocation</b>	<b>54.0</b>	<b>21.0</b>	<b>33.0</b>
ESG	Sustainable Global Equities	0		
EGC	Core Global Equities	0		
	(1% =£24m)			

Brunel has awarded the mandate to manage the Sustainable Global Equities Fund (ESG) to four managers in equal shares. A total of £1.5bn has been committed to this Fund by other Brunel members. ESG will have a small/mid cap bias relative to its benchmark index, the MSCI ACWI, and will have a negative value tilt – in contrast to the existing UBS portfolio.

Three of the four managers have a nil weighting to Energy, while the fourth has an underweight to Energy by virtue of its positions in transitional energy companies. The portfolio’s overall carbon intensity will be significantly below that of the MSCI ACWI.

The ESG fund’s characteristics fit in well with the Oxfordshire Fund’s policy on Climate Change and Sustainable Investment. Because of its small/mid cap bias, the ESG fund is likely to display greater volatility relative to its benchmark than the Core Global Equities fund (EGC) for which the manager search will take place later this year.

I recommend re-allocating the existing UBS Global Equities portfolio equally between ESG and - when it becomes available – EGC. At current values this implies an allocation of some £130m to each of ESG and EGC.

Peter Davies  
Independent Financial Adviser  
May 13<sup>th</sup>, 2020