Border to Coast Pensions Partnership Ltd – Joint Committee

Meeting date: **4 June 2019**

Report Title: **Climate Change Working Party Update**

Report Sponsor: **Border to Coast CEO – Rachel Elwell**

1 Executive Summary:

1.1 As part of the 2018 Border to Coast Responsible Investment Policy review, it was agreed by the Joint Committee and the Border to Coast Board that a working party of Partner Fund Officers and Border to Coast personnel, with support from others including our external partners, would be established to consider in depth the implications of climate change on our approach to investment.

1.2 This was in response to a recognition that a commitment to Responsible Investment is becoming increasingly important to Partner Funds. In order to ensure we continued to make the most of the strong voice that collective policies give us, it is important we work together to develop a shared understanding of the implications of climate change. And, we hope, a shared response building on the approach to climate change already set out in the RI policy agreed by all Partner Funds (see section 3).

1.3 The working party kicked off in February 2019 and included officers from Lincolnshire, South Yorkshire Pensions Authority, Surrey and Tyne and Wear together with Border to Coast's CEO, Chief Risk Officer, Head of Responsible Investment, an experienced Portfolio Manager and an operations analyst. We invited Jaap Van Dam, Head of Strategy at PGGM, the asset management business supporting the large Dutch pension fund PFZW, who has been a driving force in the development of their approach to managing climate change. Jaap helped the working party to set out its objectives and a plan of work whilst sharing PGGM's experiences and those of other large asset owners around the world. See section 4 for further details.

1.4 Since then, the working party has met twice more, considering risk identification and monitoring (with support from Aon) and the case for engagement (with support from Robeco). We are now halfway through the programme of work; the next sessions will consider the role of asset managers (working with LGIM), collaboration (working with the Church of England's Pensions Board RI team, who are world leading in this area) and finally communication and review of our climate change policy (supported again by Jaap) ahead of reporting back to the Joint Committee and Board later in 2019.

2 Recommendation:

2.1 The Joint Committee is asked to note the update provided in this report.

3 What is Border to Coast already doing?

3.1 Border to Coast and the Partner Funds already have an agreed approach to climate change, as set out in the Responsible Investment Policy (para 5.5):

Border to Coast will actively consider how climate change, the shifting regulatory environment and potential macroeconomic impact will affect its investments. These pose significant investment risks and opportunities with the potential to impact the long-term shareholder value of investments across all asset classes. Risks and opportunities can be presented through a number of ways and include: physical impacts, technological changes, regulatory and policy impact, transitional risk, and litigation risk. Border to Coast will therefore look to:

- *Assess its portfolios in relation to climate change risk where practicable.*
- *Incorporate climate considerations into the investment decision making process.*
- *Engage with companies in relation to business sustainability and disclosure of climate risk in line with the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD)[1] recommendations.*
- *Encourage companies to adapt their business strategy in alignment with a low carbon economy.*
- *Support climate related resolutions at company meetings which we consider reflect our RI policy.*
- *Encourage companies to publish targets and report on steps taken to reduce greenhouse gas emissions.*
- *Co-file shareholder resolutions at company AGMs on climate risk disclosure after due diligence, that are deemed to be institutional quality shareholder resolutions consistent with our RI policies.*
- *Monitor and review its fund managers in relation to climate change approach and policies.*
- *Participate in collective initiatives collaborating with other investors including other pools and groups such as LAPFF.*
- *Engage with policy makers with regard to climate change through membership of the Institutional Investor Group on Climate Change (IIGCC).*

3.2 In line with good practice in this area, and reflecting guidance issued recently by Central Banks, Regulators and Policymakers globally (including the UK), Border to Coast has developed a three-pronged approach to considering climate change risk:

3.2.1 Analysis of risk in investment decision-making: building on the work already started at South Yorkshire on how to embed climate risk into its investment process. This includes developing information to enable analysis of climate risk including data from MSCI, RepRisk and Bloomberg. We are working to improve our understanding of the reliability of these datasets before considering their use for reporting purposes. We also actively engage with companies to encourage compliance with TCFD[1] principles to support our analysis.

3.2.2 Engagement: working in conjunction with both Robeco, our engagement and voting partner (whose 20 themes include climate change and milestone reporting), and with other bodies such as Climate Action 100+ and IIGCC[2], to ensure we join with others to make a greater impact through scale. LAPFF are also active in this area.

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[1] TCFD, Task Force on Climate-related Financial Disclosures

[2] IIGCC, Institutional Investors Group on Climate Change

3.2.3 Ensuring external managers with whom we partner also consider climate change through a rigorous assessment process at appointment stage and ongoing discussions and engagement post appointment for both public and private markets.

3.3 It remains early days in ensuring that these are fully embedded. It is important that Partner Funds are kept informed and involved as this evolves.

4 Progress Update

4.1 Climate Change has the potential to be game changing in terms of how the world operates; impacting the way we live and work and, as a consequence, the ways in which industry develops and capital flows between the old and the new economies. The impact on the way in which we invest will be significant as government policy brings new regulation including carbon pricing; research into new, cleaner technologies starts to deliver better returns; and demand for (and supply of) more climate-aware products gathers pace.

4.2 It is also an area where there is significant pressure on at least some Partner Funds to take action: with some groups calling for disinvestment, others calling for measurement and action on particular metrics such as carbon foot printing. We want to ensure that these areas have been considered carefully and judged on their own merits as potential tools alongside other measures.

4.3 Climate change risk is of course only one aspect of Responsible Investment. Information about the work undertaken and progress made in this important strategic area, including our collaborations with other asset owners and managers and our quarterly voting and engagement reports, can be found on Border to Coast's website.

4.4 On 4th February, we had our kick-off working party session – the first of six sessions scheduled for the next six months. We discussed our objectives for the working party, our scope and how we wanted to work together. Based on the insights from the Partner Fund survey carried out prior to kick-off, together with learnings from others across the industry, common goals were agreed for the working party over the next six months:

- Improve understanding of climate change risks and opportunities
- Identify actions to improve investment outcomes. What does "good" look like in:
  - Risk analysis and integration into investment process
  - Engagement vs divestment / exclusion
  - Collaboration and influencing policy
  - Communication and education
- Develop a clear climate change strategy, including what we will and won't do, success metrics and a list of the instruments and portfolio activities we will put to work in the next 1-2 years
- Develop a plan to help Pensions Committees to consider and manage climate change as part of strategic asset allocation decision-making.

4.5 A climate change briefing newsletter was issued in March 2019. Further briefings are anticipated throughout the process. There will also be a climate change section in the Border to Coast Annual Responsible Investment Report, which is due to be published in early July.

4.6 On 19th March we had a session to understand more about the identification and quantification of climate change risk. The research undertaken prior to the meeting highlighted the growing change in regulation since the Paris Agreement and the tools available to measure and quantify climate risk.

4.7 We noted that there is an increasing number of companies providing ESG screening tools, scenario analysis, carbon metrics and climate-related indices. Users must be aware of the limitations of the data and use it as a starting point for deeper analysis. As noted in section 3, Border to Coast is already carrying out work in this area for our equity portfolios. We have identified opportunities to look at further development including additional scenario analysis and the extension of the assessment of carbon risk into other asset classes. There are costs associated with these and therefore we will consider prioritisation and resourcing when we have reviewed the other aspects of managing climate risk and can make a case for additional resource requirements in the round.

4.8 The third session took place on 23rd April and took the form of a debate between the case for engagement versus the case for divestment. This is fundamental to the heart of the pressure that Partner Funds are experiencing from action groups who want to see urgent action as part of the Climate Emergency movement. We heard examples of the ways in which engagement can be powerful but also that it can take time and requires significant effort and collaboration between asset owners. A strong example is the recent successful climate change shareholder resolution at BP, which was supported by the Board after significant work by the IIGCC (and of which Border to Coast was a co-filer). However, there are also examples of where engagement has not worked and, for example, LGIM took the decision to “blacklist” eight companies last year, all of whom have since started to engage.

4.9 We also discussed whether “low carbon” strategies were a potential way for Partner Funds to start to manage transition risk through their strategic asset allocation, as opposed to asking asset managers (including Border to Coast) to manage purely against a traditional index, perhaps weighting stock allocations to those companies within a particular sector who are more climate change aware. There remain issues with the data underlying such low carbon strategies (with the data generally being backwards looking and not always accurate, although this is starting to improve) and, again, this is more of a divestment approach than one of engagement.

4.10 The key action coming out of this workshop was to consider further the circumstances in which Partner Funds might want to divest and to be clear about these situations in order to help with engagement and / or managing transition risk.

5 Risks

5.1 In order to maintain collective policies and the strong voice this gives us, we need to ensure that Partner Funds are in agreement about a common approach to climate change. The development of the narrative regarding engagement is key: for example, at the recent Border to Coast Investment Conference, over 60% of delegates voted for engagement as the right way to effect a change with regards to climate change risk. Engagement (including with Governments to effect changes to policy) is not an overnight fix. We need to be able to set clear goals for the impact of our engagement, not just with the companies in which we invest but via the initiatives that we are collectively supporting.

5.2 Climate change risk has the potential to have a material impact both on the physical environment and on the financial world. Physical risks could impact members and administering authorities / participating employers as well as certain types of investment; the transition to a low carbon economy (including the potential intervention by regulators / governments) is likely to impact the value of investments.

5.3 Responsible Investment and sustainability are central to Border to Coast's corporate and investment ethos and a key part of delivering our Partner Funds' objectives. There may be reputational risk if we are perceived to be failing in our commitment of this objective.

6 Conclusion:

6.1 The Committee is asked to consider the recommendations as set out in section 2.

7 Report Author:

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