

Climate Change Policy

South Yorkshire Pensions Authority's primary responsibility is to deliver the returns needed to pay scheme members' pensions, whilst maintaining stable and sustainable contribution rates. The Authority is a long-term investor and as such has to ensure that its investments are sustainable. In doing so it actively considers how environmental, social and governance (ESG) issues can be taken into account when managing investment portfolios.

The Authority has a fiduciary duty to consider ESG issues where it is considered that they could have a material financial impact on the Fund's performance. This is supported by the 2014 Law Commission review which concluded that ESG factors should be taken into account where Trustees think that issues are financially material to the performance of an investment. The applicability of this approach to the Local Government Pension Scheme was confirmed in the Supreme Court's 2020 judgement in the Palestine Solidarity Campaign case. The Pensions Regulator also issued guidance in 2017 for Defined Benefit schemes, stating that ESG factors need to be taken into account if they are deemed to be financially significant and the regulations for trust based pension schemes have been updated to require trustees to set out their approach to ESG issues. The Local Government Pension Scheme Regulations also require the Authority to set out its position in relation to the consideration of ESG issues as part of its Investment Strategy Statement. The greatest potential environmental risk, indeed the greatest single risk, without qualification, to the Authority's investments is climate change, where the associated risks and opportunities may have a material financial impact across all asset classes. The systemic nature of climate change risk has the potential to reduce returns across all asset classes and will have a macro-economic impact that could affect the entire Fund. Equally, however, the need to transition to a low carbon economy, and the innovation which that will require, presents a number of potential investment opportunities. Risks and opportunities can be presented in a number of ways and include:

- physical impacts,
- technological changes,
- regulatory and policy impacts,
- transitional risk and
- litigation risk.

The Authority will therefore consider climate change issues across the Fund in order to minimise financial risk and maximise long-term opportunities.

In December 2015 the G20 finance ministers and Central Bank governors asked the Financial Stability Board (FSB) to review how the financial sector can take account of climate related issues. Such information is needed by investors, lenders and insurance underwriters in order to be able to assess climate related risks and opportunities. This led to the Task Force on Climate-related Financial Disclosures (TCFD) being established. Its remit was to develop a set of voluntary climate-related disclosures, which would assist in understanding the associated material risks of climate change. The final report with recommendation was published in June 2017, and can be accessed through the TCFD

website here:

<https://www.fsb-tcfid.org/>

Supplemental guidance has been developed for financial and non-financial organisations which includes guidance for asset owners. The recommendations were based around four pillars;

- governance,
- strategy,
- risk management and
- metrics and targets.

The TCFD framework is widely recognised as the best practice guide against which investors' actions will be assessed, and is increasingly becoming part of the regulatory framework for reporting by corporates and asset owners, with regulations applying to the LGPS expected to be implemented with effect from the 2024 financial year. The Authority has reported in line with this framework for some years. This Climate Change Policy is therefore be structured around these four themes, and the Authority commits to continuing to report in line with this framework each year.

Governance

The Climate Change Policy is owned and approved by the Authority with implementation and oversight of the Policy being by the Director; it will be reviewed as necessary, but as a minimum every two years.

The Authority is required by the LGPS Investment Regulations to invest its assets through one of the LGPS investment pools, in this case the Border to Coast Pensions Partnership , however, the responsibility for strategic asset allocation and for responsible investment and ensuring the appropriate consideration of ESG issues remains with the Authority. The Authority expects Border to Coast to implement this policy on its behalf across all its investments; it will monitor implementation and require reports from the Company at least annually in order to fulfill its obligations under the LGPS Investment Regulations and any additional reporting requirements such as TCFD.

While the Authority will aim to work collaboratively with the other funds within the Border to Coast Partnership to achieve collectively agreed goals, given that it retains responsibility in this area it reserves the right to act independently should collective action not result in the delivery of its objectives in terms of ESG issues and in the context of this policy climate change in particular.

Strategy

Climate change is an issue of greater significance than other ESG issues. It has the potential to impact returns across all asset classes (not just individual companies or sectors), and therefore has very material financial implications. The Authority will therefore expect Border to Coast (and any other managers it may utilise) to:

- be aware of the investment risks and opportunities associated with climate

- change;
- incorporate climate considerations into the investment decision making practices and processes; and
- monitor and review fund managers in relation to their climate change approach and policies.
- engage with companies in relation to business sustainability and climate risk disclosure and to encourage companies to adapt their business strategies to support the transition to a low carbon economy.
- recognise that while active shareholder engagement should be the first option, the Authority encourages Border to Coast (and other fund managers) to consider actively reducing exposure to high-carbon intensity companies that fail to respond to engagement by not demonstrating a decrease in carbon intensity or carbon risk and/or by failing to develop credible plans for the transition to a low/no carbon economy.
- support climate related resolutions at company meetings when deemed appropriate, and
- consider co-filing shareholder resolutions at Annual General Meetings (AGMs) on climate risk disclosure, transition plans, science based targets and related issues, such as trade association lobbying after engagement with its Partner Funds.
- Set out as part of any climate related engagement clear measures for the success of the engagement and clear triggers for specific action up to and including divestment or denial of debt where the investment case for a company is fundamentally undermined.

The Authority will engage with both the Border to Coast operating company and the other funds within the Partnership to ensure this approach is taken both with internally managed assets and appointed external managers. The Authority will also expect the Border to Coast operating company to apply the same approach to engagement across asset classes, accepting that fixed income assets do not carry voting rights, although the opportunity to “deny debt” is potentially more powerful and impactful than voting.

The Authority will look to consider climate change and its potential impact when reviewing its investment strategy and formulating future asset allocation. This will include modelling the impact of differing climate scenarios on both the Fund’s assets and liabilities.

The Authority expects those managing money on its behalf to actively consider environmental, social and governance factors, and in this context specifically climate change, when selecting stocks in which to invest which is likely to result in investments not being made in companies which are not actively addressing the need to move to a low carbon economy. However, in light of the significant potential financial impacts of climate change, carbon risk and stranded assets, it has made the decision not to invest in public market companies or illiquid assets with >25% of revenue derived from thermal coal and oil sands, unless there are exceptional circumstances. Further exclusions apply to public market companies in developed markets with >50% revenue derived from thermal coal power generation. For companies in emerging markets, the revenue threshold is >70%, this is to reflect our support of a just transition to a low-carbon

economy. We expect the thresholds at which Border to Coast and other fund managers apply these exclusions to be reduced year on year, with a view to them reaching zero by 2030 at the latest, and we will engage with the operating company and partner funds in order to achieve this.

The Authority will encourage Border to Coast to consider how it manages carbon risk and exposure across its various portfolios, and as stated above will seek the agreement of partner funds to reduce exposure to high carbon intensity companies that fail to respond to engagement on climate change related issues and to adopt means to create portfolios structured in a way that supports the low carbon transition.

There are a limited range of low-carbon related investments in quoted markets, with more opportunities existing within the various alternative asset classes. The investment strategy which is being put in place to provide further diversification and reduce volatility of expected future returns, has resulted in a reduction in equities and a move into alternatives. This has therefore increased SYPA's exposure to assets that may be less sensitive to climate change risks, and/or support the transition to a low carbon economy.

The Authority's property allocation is mostly through direct property; and a standalone statement relating to responsible commercial property investing, details the approach taken. It takes into account current best practice regarding social and environmental considerations when managing its property portfolios and determining the selection, retention and realisation of investments. The Authority's aim is to reduce its impact on the environment and maintain a positive relationship with its customers, tenants and suppliers.

Risk Management

The Authority will look to measure and manage the risk of climate change, carbon exposure and stranded assets to the Fund. It will measure and manage climate risk across portfolios by monitoring carbon intensity (where possible) and expects Border to Coast as its principal investment manager to provide data on the carbon intensity of its listed asset portfolios on at least an annual basis, and to develop similar measures in relation to private market investments. It will take appropriate action to identify such risks by increasing internal knowledge and understanding of scenario and risk analysis tools available, and being aware of ongoing climate change policy discourse. The Authority's preferred approach is with Border to Coast to identify ways of structuring the various investment portfolios to secure carbon reduction across portfolios and ensure that they are prepared for the transition to a low carbon economy.

The Authority believes that collaboration with other like-minded investors leads to greater shareholder power to influence company change and behaviour. It will therefore, look to work in partnership with Border to Coast and other groups such as LAPFF, the Institutional Investors Group on Climate Change (IIGCC) and Climate Action 100+ to ensure there is appropriate engagement with companies on climate related issues, including business sustainability and disclosure of climate risk, in line with TCFD recommendations.

Governments' climate change policies are unpredictable leading to public policy uncertainty. Investors are lobbying policymakers to accelerate the development of a realistic carbon price. Carbon pricing is vital for businesses and investors to properly incorporate climate related risk into investment decision-making. The Authority will, therefore, actively engage with policy makers through its membership of IIGCC.

Metrics and Goals

The Authority's Goal is that its investment portfolios should be "net zero" in terms of carbon emissions by 2030. The Authority recognises that this is an ambitious goal, with a significant risk of non-achievement and is not in line with the ambitions of the wider Border to Coast Partnership. As such the Authority will need to rely on a combination of strategic asset allocation and the achievement of positive impacts from the legacy and non-pooled portfolios to support achievement of this goal.

The Authority will, where possible, report progress in line with TCFD recommendations; this Climate Change Policy has been structured around the TCFD's reporting themes. The TCFD believes that asset managers and asset owners, including public-sector pension funds, should implement its recommendations with disclosures made in annual public financial reports, and regulatory changes are beginning to be made to bring this into effect.

The Authority will measure its portfolios' exposure to carbon-intensive companies, where possible through requiring Border to Coast to provide as a minimum annual carbon data in line with the TCFD recommendations, the wider requirements arising from the Paris Aligned Asset Owner Initiative and any regulatory requirements. However, the Task Force recognises the challenges and limitations of current carbon footprinting metrics, but sees it as a move towards developing investment decision-useful, climate-related risk metrics. This information will be used to highlight specific risks and inform company and fund manager engagement.

The Authority will seek to use its influence within the wider Border to Coast Partnership to secure the agreement of appropriate goals for reducing the carbon intensity of portfolios and the identification of ways of structuring the various portfolios so that they are prepared for the transition to a low carbon economy.

It will also report on additional metrics which will include company engagement meetings, both direct and collaborative and the degree to which companies within portfolios have aligned their plans with the goals of the Paris agreement. It will request that Border to Coast integrates climate risk and opportunities into the investment decision making process for both internal and external mandates, and for the private market structures.

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