Oxfordshire Pension Fund Climate Change Policy

Foreword

The Pension Fund has a fiduciary duty to invest in the best financial interests of its members. The investment goals of the Pension Fund are set out in its Investment Strategy Statement. Climate change presents a material risk to the Pension Fund's investment returns over the long-term. It follows that the Fund's fiduciary duty inherently requires that it is managing climate related risks to its investments, particularly given the Pension Fund's long-term investment horizon; even if the fund closed to future accrual today the fund would still be operating 80 years later. The Pension Fund currently views climate change risk as the single most important factor that could materially impact its long-term investment performance given its systemic nature and the effects it could have on global financial markets and has thus determined to produce this policy document on its approach to climate change.

Background

Climate change refers to long-term changes to climate patterns, such as changes to temperatures or precipitation. A significant element of climate change is global warming; the long-term rise in the average temperature of the Earth's climate system. Global warming has been demonstrated to have increased significantly over recent decades. The Intergovernmental Panel on Climate Change (IPCC) Fifth Assessment Report concluded, *"It is extremely likely that more than half of the observed increase in global average surface temperature from 1951 to 2010 was caused by the anthropogenic increase in greenhouse gas (GHG) concentrations and other anthropogenic forcings together"* (1).

The impacts of climate change are wide ranging and include more extreme temperatures, more natural disasters (flooding, fires etc), permanent loss of land due to rising sea levels, disruption to infrastructure networks (e.g. electricity, water supply), loss of ecosystems, and a severe impact on food supplies. There are also secondary impacts, such as on migration patterns. All of these have the potential to impact on both individual investments and financial markets more generally. A business as usual approach could have a material negative impact on global investment markets (2) (3).

In 2015 the United Nations Climate Change Conference (COP21) was held in Paris. The agreement (4) that was reached brought most of the world's nations together to undertake ambitious efforts to combat climate change and adapt to its effects, with enhanced support to assist developing countries. The central aim of the Paris Agreement is to keep a global temperature rise this century to below 2^{o}C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5^{o}C.

The Paris Agreement has been ratified by 186 states, including the European Union, China and India. Although the United States served notice in November 2019 that it will withdraw as soon as it can legally do so (November 2020), the agreement has international momentum. Rules for implementation were agreed at a meeting in

Poland in 2018, including a requirement for countries to be transparent about their emissions and progress towards emissions reduction targets. There continues to be growing focus on climate change globally and further discussions will take place at future United Nations Climate Change Conferences.

In order to meet the Paris Agreement goals countries will have to take significant policy action. What these policies are and how they operate will be key drivers in how climate change mitigation impacts on investments. The United Nations Principles for Responsible Investment has produced a document forecasting some of the likely policy responses (5).

It is acknowledged that irrespective of the action taken to reduce global warming some climate related impacts, such as rising sea levels (6), are already expected to occur due the greenhouse gas emissions to date (7). Even if global temperature rises are limited to 1.5°C, climate related risks for natural and human systems are greater than they are at present. As such, climate change presents investors with both investment risks associated with these impacts and investment opportunities in terms of mitigation (reducing GHG emissions) and adaptation (adapting to the climate change taking place).

Beliefs

The Paris Agreement was reached based on the best available science and is clear that in order to prevent significant negative impacts, including to the global economy, from climate change the Agreement's goal of keeping global temperature rises to well below two degrees Celsius must be achieved. The investment returns and the beneficiaries of the Pension Fund are reliant on a healthy, functioning global economy, and the Pensions Fund's interests are best served by the delivery of Paris goal and the Pension Fund should therefore actively contribute to their achievement.

From an investment perspective the Pension Fund believes that climate change should be an integral part of the assessment of risks as well as a factor in identifying investment opportunities arising from the transition to a low carbon economy.

Commitment

The Pension Fund commits to transitioning its investment portfolios to net-zero GHG emissions by 2050. The Pension Fund also commits to transitioning its investment portfolios consistent with the best available scientific knowledge, including the findings of the Intergovernmental Panel on Climate Change, to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels. The Pension Fund will regularly report on progress, including establishing intermediate targets consistent with the annual carbon emissions reduction targets set in the United Nations Environment Programme's Emissions Gap Report

The Pension Fund will seek to reach this Commitment through its investment activity as well as through advocating for, and engaging on, corporate and industry action, as well as public policies, for a low-carbon transition of economic sectors in line with science and under consideration of associated social impacts. This Commitment is made in the expectation that governments will follow through on their own commitments to ensure the objectives of the Paris Agreement are met.

This commitment covers all investments made by the Pension Fund over all asset classes. The Pension Fund is cognisant that some asset classes are more progressed in the level of disclosure and transparency around climate risks and so may take longer to reach a point where assessment can be undertaken appropriately.

The Pension Fund also commits to achieving net-zero GHG emissions on its own operations by 2030

Delivery

The Pension Fund Committee has responsibility for the direction of policy and the committee will have access to expert advice and have members with appropriate skills and knowledge. Responsibility for the implementation of this policy lies with the Service Manager - Pensions.

The Fund views two strands to its approach to climate change; aiming to be part of the solution in seeking to deliver its commitment and risk mitigation where actions may not directly contribute to a reduction in global warming but protect the fund from climate change related risks.

This second part becomes increasingly important if it becomes clear that efforts may be unsuccessful in achieving the goals of the Paris Agreement – based on current commitments temperatures are forecast to increase by ~3°C (8). If this is the case the Pension Fund will need to focus on the physical and economic impacts associated with climate change and how these manifest in investment risk so that it can position itself to minimise its exposure to these risks.

A Paris aligned world requires significant changes to industry; this has significant societal implications in terms of employment, access to energy and the affordability of energy. The Pension Fund supports the Just Transition (9), seeking to manage the social and economic impacts of the transition to a low carbon economy on communities, and will reflect this in its policy advocacy activity.

Asset Allocation

When determining the Fund's asset allocation, the Fund will consider climate change in terms of mitigating climate risks, and opportunities through investments seeking to deliver solutions to the low carbon transition. 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. For example, if making an allocation to passive equities the Fund may select a low-carbon index as opposed to a regular market-cap index as a means of reducing exposure to climate risk.

The Fund will seek to increase investments in climate change mitigation and adaptation and will report on the level of relevant investments.

The Pension Fund considers that currently there are limited opportunities to invest in companies focused on climate change solutions in the public markets with more opportunities existing in the private markets across private equity, private debt, infrastructure and real assets. This has asset allocation implications due to the illiquidity and complexity of some of these asset classes.

Investment Options

The Pension Fund makes investments through the portfolios made available by the Brunel Pension Partnership. Where the fund determines that it has climate related policies not deliverable by existing Brunel portfolios it will seek to make these available through the agreed process for the creation and amendment of portfolios. This may require the Fund to seek support from other Brunel client funds.

The operating model chosen for Brunel utilises external fund managers and so the Pension Fund is reliant on the investment products available in the market. With Brunel, the Pension Fund will work with the asset management industry to ensure that appropriate products are made available that deliver against its climate commitment while meeting its investment goals.

Investment Monitoring

The Pension Fund will hold Brunel to account for the delivery of the Fund's investment objectives including its approach to climate change as set out in this policy. In turn, Brunel will hold to account the fund managers it has appointed, and the Fund will assess whether this is working effectively.

The Pension Fund expects investee companies to be transparent in their climate related disclosures and at a minimum expects the adoption of globally accepted disclosure standards such as the Task Force on Climate-related Financial Disclosures. The Pension Fund will itself work towards reporting in-line with the TCFD recommendations.

Fund managers are typically benchmarked against a market index. The fund manager will typically set risk limits against the index, such as tracking error. Therefore, there is a risk that the choice of benchmark could lead to managers being unwilling to take significant sector positions. The Pension Fund will therefore work with Brunel to ensure the benchmarks used for portfolios do not encourage positions inconsistent with the Fund's climate commitment, whether this is non-index based benchmarking or the use of indices that reflect a Paris aligned world.

Engagement

The Pension Fund believes that engagement is a key tool in pursuing the achievement of its climate change commitment. Engagement has led to some progress on climate change matters, but overall the Pension Fund believes the magnitude and pace of change needs to increase. The Pension Fund does not view engagement and divestment as mutually exclusive but rather as two complementary tools that can be used in the escalation of climate concerns with companies. The

Pension Fund further believes that divestment on its own is primarily a way of reducing the climate risk of its investments rather than in actively supporting the transition to a low carbon economy. The Fund believes that engagement to delivery real change, and selective divestment with clear public explanation is a more effective approach.

Engagement on behalf of the Pension Fund will primarily take place through Brunel, their appointed fund managers, and their engagement provider, in accordance with the approach set out in Brunel's Climate Change Policy (10). The Pension Fund expects engagement to take place with clear metrics, targets and timescales with appropriate sanctions if these are not met. The Fund will monitor and report on the engagement activities undertaken by Brunel on the Fund's behalf. The Fund will also monitor the effectiveness of the engagement approach adopted by Brunel. Engagement will also be undertaken on behalf of the Fund by investor groups of which it is a member, such as the Local Authority Pension Fund Forum.

The Pension Fund believes there is still time for companies not currently aligned with the Paris Agreement to respond to the requirements of the low carbon transition and so believes the most appropriate approach is to continue engaging with these companies. To be clear, any such investments will only be held where they still present a sound investment case over the medium term and there is reasonable evidence of an action plan to ensure that climate risk can be managed to appropriate levels. The Fund will pursue divestment where this is not the case rather than retain investments simply for the purpose of maintaining the ability to engage. Although fundamental business change may be difficult the Pension Fund believes it can be achieved.

For passive investments although there is still the ability to engage with investee companies the ultimate sanction of divesting is not an option, as such the Pension Fund will need to be mindful of climate risks in passive portfolios. If insufficient progress is made by companies in an index as a whole the Pension Fund will need to consider the appropriateness of these investments and consider alternative options such as exclusion-based or tilted indices.

Voting

As a shareholder in listed companies the Pension Fund has voting rights. The Pension Fund will utilise its voting rights to the fullest extent practicable. Ultimately voting is undertaken on behalf of the Fund by Brunel utilising the expertise of their voting and engagement provider and appointed managers.

Voting will be used to support climate concerns and to promote good practice by supporting appropriate climate related shareholder proposals, supporting increased disclosure of climate risks and scenario planning, and voting against boards where insufficient progress is seen to be made on climate risk. Voting activity will take account of the ongoing engagement with a company so that if progress is seen to be being made through engagement voting action may be postponed allowing time for any changes to be implemented.

We support the Brunel approach to voting escalation whereby they will escalate voting activity from voting against the reappointment of the Chair to other board members where they have not met their climate disclosure expectations. These expectations will increase over time with the aspiration of all their material holdings being on TPI Level 4 by 2022 and having made meaningful progress to alignment with a 2 degree or below pathway. In some sectors, e.g. oil and gas, they will aim to stimulate more rapid change.

Policy Advocacy

The Pension Fund will seek to influence policy development in the climate change arena, particularly where investment focused, through engagement with policymakers and regulators. The Fund may seek to do this through Brunel, on its own, in collaboration with other like-minded investors, or through a combination of these depending on how it thinks maximum impact will be achieved. In particular, the Pension Fund will look for the development of a meaningful carbon price, mandatory climate risk disclosures by listed companies, and the removal of fossil fuel subsidies.

The Fund sees policy development as being an important driver in providing the impetus needed for industry to deliver the changes required to achieve the Paris goals. By participating in policy development, the Pension Fund will also be in a strong position in terms of understanding the developing regulatory landscape and how this could affect the Fund’s investments.

Collaboration

We believe collaboration with other investors helps influence and improve market best practice standards as well as strengthening the voice of asset owners and their pension beneficiaries. Consequently, through our own activities and by our membership of groups such as the Local Authority Pension Fund Forum, we aim to support the goals of the Paris Agreement.

The Pension Fund will also work closely with Brunel and the other Brunel clients in the development of Brunel’s approach to climate change. This will include ensuring that the investment offering from Brunel incorporates comprehensive climate change assessment into all portfolios. To this end the Pension Fund has been engaged in the production of and fully supports the Brunel Climate Change Policy.

The Pension Fund will also seek to collaborate with the wider investment community in order to promote its climate change goals. This may include signing investor statements, co-filing AGM resolutions, policy consultation responses and developing reporting standards. The Pension Fund will also seek to join groups, climate change specific or otherwise, whose aims on climate change correspond with those of the Fund.

Monitoring and Reporting

To enable effective assessment of the climate change risk faced by investee companies and how this is being managed investors need accurate and comparable information. To this end the Pension Fund supports efforts to increase transparency of climate risk management and related metrics in the investment industry and work to develop globally accepted disclosure standards such as the Task Force on Climate-related Financial Disclosures.

In order to track progress in meeting its climate change commitment the Pension Fund will utilise relevant metrics. The Pension Fund will work to understand the best available metrics, being aware of any inherent limitations, and to develop new metrics where deemed beneficial. As set out in their Climate Change Policy Brunel are seeking to assess whether their listed equity portfolios are at least 2ºC aligned by 2022.

As a minimum the Pension Fund will utilise the following metrics where applicable to given investments:

- Carbon Intensity
- Extractive Exposure
- Transition Pathway Initiative Scores
- % of Total Investments in Fossil Fuel Companies
- % of Total Investments in Climate Change Solutions

The Committee supports the Transition Pathway Initiative [11]. The TPI assess both management quality, through review of public disclosures, and carbon performance, including the benchmarking of companies' emissions pathways against the international targets and national pledges made as part of the 2015 United Nations Paris Agreement.

The Pension Fund will also develop metrics to monitor the performance of Fund Managers including their voting records on climate change resolutions.

The Pension Fund will explore opportunities to undertake scenario analysis on its investment portfolio which provides estimations of the relative performance of asset classes and sectors under different climate change scenarios.

Review

The Pension Fund wishes to adopt a flexible approach, enabling it to respond to changes in the science, policy action, or investment markets. As with all forecasting, as more detailed analysis is undertaken there are likely to be changes to the current understanding. Accordingly, the policy should be subject to regular review. The Pension Fund will also seek to undertake training to ensure that it remains abreast of the latest developments in climate change and related policy action.

The Pension Fund will produce an annual report on the operation of this Climate Change Policy including any actions undertaken, such as engagement results, any divestments based on climate risk grounds and the level of investment in climate change mitigation and adaptation. The Policy will be formally reviewed in 2022 to tie-in with Brunel's stocktake on the outcomes achieved through the operation of their Climate Change Policy.

References

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