PENSIONS COMMITTEE 17TH MARCH 2023

PUBLIC QUESTION TIME

1. **Question from Jamie Russell**

Recent climate risk reports received by the Shropshire County Pension Fund included financial models for a 3C world. Can the Pension Fund Committee please tell concerned Shropshire residents what a 3C world would look like for them & their families and how their lives would change as a result? For context, I note that Shropshire Council's climate emergency declaration in 2019 stated that crossing 2C would be catastrophic; meanwhile, a recent open letter from 250 UK lawyers - from junior lawyers to King's Counsel, senior partners and Professors of Law - said that crossing 1.5C would result in "mass loss of life and the end of the rule of law."

Response:

A 3-degree temperature increase would have an enormous impact on people around the world. These impacts include immediate geographical and human impacts as a result of rising temperatures, rising sea levels, and increased extreme weather conditions, as well as further effects resulting from the socio-economic consequences of these impacts.

SCPF & LGPS Central, in order to mitigate the likelihood of such a scenario, has committed to achieving net zero by 2050 or sooner. This goal is aligned to the pathway proposed by the Paris Agreement, which aims to limit the global temperature rise to 1.5C above pre-industrial levels. As managers of pension funds, we are long-term investors who are focussed on ensuring that our pension members can maintain a high standard of life through retirement. This naturally entails maximising our member's pension returns, but also ensuring that members can retire into a world that is safe and prosperous. We firmly believe that a Paris-Aligned strategy is the best way to achieve both these goals.

When carrying out the climate risk analysis, we take care to consider how the portfolio may perform in a variety of potential long-term scenarios, and we think it prudent to incorporate a failed transition scenario as well as rapid and orderly transition scenarios. However, from a stewardship perspective we are committed to furthering the aims of the Paris Agreement. Through this approach we have helped encourage meaningful and real-world progress towards the decarbonisation of the economy, and we will continue to engage along these themes as we seek to achieve our own net zero ambitions.

2. **Question from Kris Welch**

I write about the gulf between climate science predictions for global heating eg over 2°C will be game over for humanity, and economic forecasts eg 6°C of heating predicted to reduce global consumption per capita by only 1.6%. The scientific and economic views cannot both be right.

Prof Steve Keen, Associate Professor of Economics & Finance from University of Western Sydney, has analysed economic modelling of climate, and explains why their predictions are dangerous underestimates. Extremely briefly:

1. Data for economic models come from measurements of average temperature and GDP in different locations (mostly USA states). From the scatter of results a graph is constructed of GDP against temperature. It's assumed that this is a valid cause and effect, and that the assumed relationship will hold under future conditions.

2. The models are based on temperature only. No modelling of impacts from floods, drought, heat waves, biodiversity loss etc. One model acknowledges : "*effects of precipitation are yet to be incorporated*". Only temperature is considered.

3. The models assume that only outdoor industries will be impacted - forestry, agriculture, fisheries. Since other industries take place in 'controlled environments' (indoors) they will be minimally affected.

Table 2 in SCPF's TCFD report is an example of the belief that economics will be unaffected by global heating. Are you sure of that?

My questions:

Does the committee have full confidence in the TCFD economic predictions of fund performance as global heating increases?

Is the committee confident that the TCFD report is legally watertight?

Response:

The evidence is clear that climate change will have an enormous economic impact, and every fraction of a degree of global warming will have major implications for physical risk associated with climate change. Recognition of this fact is reflected in SCPF's commitment to the goals of the Paris Agreement, whereby engagement is carried out with companies in its portfolio to align strategies to a 1.5C scenario.

Table 2 in SCPF's 2022 TCFD report relates to the Climate Scenario Analysis. Scenario Analysis refers to a process for identifying and assessing a potential range of outcomes of future events under conditions of uncertainty. The purpose of scenario analysis is to consider and better understand how a fund might perform under different future states (i.e., its resiliency/robustness). In the case of climate change, scenarios allow SCPF to explore and develop an understanding of how the physical and transition risks of climate change may impact its investment performance over time. Scenario analysis, therefore, evaluates a range of hypothetical outcomes by considering a variety of alternative plausible future states (scenarios) under a given set of assumptions and constraints.

By analysing SCPF's current asset allocation against benchmark data across three different climate scenarios, the Climate Scenario Analysis represents a practical insight which is grounded in the latest climate and economic insight. This makes it a valuable tool for assessing the Fund's exposure to climate risk within each scenario. That said, Climate Scenario Analysis remains a prediction and should be viewed with these limitations in mind.

3. Question from Michael Cripps

I note with some concern that BP was not engaged with, on the topic of climate change by Columbia Threadneedle Street. As BP is one of the major extractors of fossil fuels it is very hard to understand why this has not happened. As we know the climate emergency is worsening so could the fund publish the cost to the fund for the engagement that takes place. Given that Columbia Threadneedle Investments and LGPS engage companies for multiple clients and charge each client it could be said they are making a lot of money for proxy voting and sending out emails/letters. Whilst the actual results on any change in the climate emergency is really non-existent.

As a result of no change taking place, and as long-term investors, could the fund produce their road map to net zero which it intends to put in place to achieve net zero and avoid the financial catastrophe of stranded assets? Because if fossil fuels do not stay in the ground, we are heading for catastrophic breakdowns both environmentally and socially.

Response:

SCPF has always been committed to integrating ESG factors into its investment process. As a pension fund with a long-term investment horizon, we believe that ESG is material to our investment portfolios and that ESG integration will allow us to deliver better risk-adjusted returns as a part of our fiduciary duty to our partner funds.

SCPF & LGPS Central published a Net Zero Statement in January 2022, strengthening our commitment to the transition to a low carbon economy. The statement highlights our approach to developing a roadmap to net zero emissions and we have made considerable progress since its release. We aim to decarbonise our assets through engagement, voting and the integration of ESG considerations into our investment process and strive to achieve real world decarbonisation rather than avoiding emissions.

Complementing our long-term targets, we are in the process of proposing medium term targets for listed equity and corporate bonds; consisting of metrics like financed emissions, portfolio coverage and engagement thresholds. In terms of carbon footprinting target, along with listed equity and corporate credit, we are also considering asset classes like sovereign debt and private assets. A formal update on our net zero strategy can be expected later in 2023.

In respect of Columbia Threadneedle Investments (CTI), they have had three climate engagements with BP in the last 12 months, there was just no climate related engagement in the quarter October to December. CTI has raised BP's backtracking on commitments and advised the company that this undermines the relative strength of their climate strategy, calls into question the board's governance of climate issues and weakens confidence in their forecasts on spending of any kind. They have highlighted to the company that the only way through this issue is to improve clarity and disclosure, to provide clear information on their low carbon spending, disclose all commitments within the context of overall emissions and spending and be very clear on how their product mix will evolve. They believe that despite extremely poor optics BP's plan must still be viewed within the context of their peers', and the company still has stronger capex alignment and fossil fuel reduction commitments and disclosure than the next best companies in the sector.

4. Question from Jonathan Lill

In the last few years oil majors including BP and Shell (both of which companies the pension fund invests in) have announced net-zero pledges and have invested millions of dollars in advertising their new strategy for clean energy. The Pension Fund Committee has previously praised the shift and said it shows that these companies are tackling the climate crisis and that the policy of ‘engagement’ rather than divestment is working.

However, this year BP & Shell have announced that they are changing their plans and doubling down on fossil fuels instead.

Shell told investors that they plan to slow investment in renewables in 2023 and invest in climate-wrecking natural gas instead.

BP plans to use its record profits from 2022 to expand its investment in fossil fuels and spend $8 billion more on oil and gas exploration than previously anticipated. BP also said its plans to cut greenhouse gas emissions by 35-40% by 2030 had now been reduced to a 20-30% decrease in emissions.

Would the committee agree that its strategy of engagement has been a complete and utter disaster?

5. Question from Paul Cooper

As a Shropshire County Pension Fund recipient, I’ve repeatedly said I don’t want to be paid from the profits of earth wrecking companies. In view of the unremitting refusal of BP and Shell to scale down oil and gas (in fact they are doing the exact opposite), isn’t it time to take a moral stand and pull out of those companies?

6. Question from Joanna Blackman

Does the Pension Fund Committee have a pathway in place should it decide to divest from fossil fuel companies and follow the example of other council funds that have divested? If not, how can it assume that divestment wouldn’t be beneficial?

Responses to Questions 4, 5 and 6:

Like many responsible investors, we were disappointed when BP announced its plan to “scale back” its transition targets. However, it is important to see engagement as an ongoing process, where progress must be considered from a broad perspective.

Despite BP’s recent announcement, the company remains a sector leader regarding the ambition of its transition targets and strategy. It also remains on track to achieve its goal of a 50/50 capital expenditure split across clean energies by 2030. SCPF also has holdings in Shell, which is another industry leader regarding the transition within Oil & Gas. Both companies are spending significant proportions of their capex on low-carbon energy and transition technologies, and their existing energy infrastructure will play a crucial role in a successful and just transition.

That said, directing our engagement efforts to encourage increased ambition and action remains critically important to fulfil our fiduciary duty to our shareholders and ensure alignment to the goals of the Paris Agreement. The effectiveness of engagement has been repeatedly proven. The differences in climate transparency and ambition between those companies engaged by CA100+ and those not, as well as differences between publicly and privately owned companies, is clear. Glencore, a major Swiss mining company, changed their net zero targets as a direct result of investor pressure. Transparency around climate-related lobbying is clearer than ever, also as a result of increased investor demands for such changes. Active ownership and engagement does generate tangible and positive impacts.

LGPS Central is at the forefront of these engagement efforts. It is present in CA100+ collaborations for both BP and Shell, the latter for which it is active in the focus group. LGPS Central has voted against management at both companies in the 2021 and 2022 AGMs, and earlier this year escalated its engagement strategy with Shell presenting evidence to the Court alongside ClientEarth's claim against the company's Board. Such actions are crucial in demonstrating our expectations to investee companies, and are taken equally seriously by those companies who must act in the best interests of their shareholders.

We are confident in our conviction that responsible ownership and engagement is the best method of instigating real world change. It is clear that this cannot be the only solution. The absence of ambitious government policy, including meaningful prices on carbon, has facilitated record demand for high-emission products during an energy security crisis. However, universal divestment risks passing ownership onto less responsible owners. Instead, through responsible ownership and meaningful engagement, we can utilise and amplify our influence to instigate the change that must take place if we are to meet the goals of the Paris Agreement.