Avon Pension Fund
Local Government Pension Scheme

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Date: 1 April 2021

Dear Councillor Martin Fodor,

Thank you for your statement to the pension fund on 26 March 2021.

The scale of the challenge of climate change for pension funds is significant given so much is outside our immediate sphere of influence and control as we are a single entity acting within the investment industry; it's against this background that we invest and set our strategy. To achieve our goals we need to use a range of tools and approaches. This includes influencing some of the largest companies in the world and policy makers at the very highest level which we can only do via engagement and collaboration. A crucial dependency is the development by the investment industry of real-world investible products which can deliver carbon alignment to mitigate emissions growth to below 1.5^{0}C. The recent investor led initiative, which we participated in, to create a framework to assess whether investments meet the Paris Goals, is the most significant step yet to developing such solutions. We appreciate that our goals are not the same as the councils and employers in the Fund. Theirs reflect the context they operate within and focus on aspects they can directly influence and deliver. Likewise, our strategy, ambition and approach reflect the context within which the Fund operates and the need to achieve our overriding objective which is to pay our members pension benefits as they fall due.

To address your questions, I have provided context on how the Fund is currently tackling climate change and how we see this evolving in the months leading up to COP26 and beyond. The Fund undertakes annual carbon analysis which highlights the Fund's fossil fuel reserves exposure, enables us to measure the current position against targets and is reported to members in our annual reports. We also use climate change modelling which looks at the impact of various temperate increases on future portfolio returns when we review our investment strategy; the outcome of this in 2020 determined our current climate change objectives, which are;

1. To achieve net zero emissions by 2050 or earlier
2. Double our allocation to renewable energy infrastructure projects to at least 5% of all assets
3. Support a 'just transition' by investing at least 30% of total assets in sustainable and low carbon investments by 2025
4. Reduce the carbon intensity across all equity holdings to become 30% less carbon intensive than the benchmark by 2022

The steps we have already taken include a combined £1.2bn allocation to low carbon and global sustainable equities and, in addition, £350m committed to renewable infrastructure projects with over £140m invested to date in established forms of renewable energy such as wind and solar as well as emerging technologies such as bioenergy. Reducing our exposure to high emitting sectors and companies and increasing the capital we invest into 'transition ready' technologies will help us move toward our ultimate net zero goal however we recognise that more needs to be done. A review of our equity allocation later this year will look at the viability of shifting our entire equity allocation (37.5% of total assets) into low carbon and sustainable solutions. This is a complex area with very little standardisation and a proliferation of new products. The review will require us to revisit the effectiveness of current market products and approaches. For instance existing passive low carbon equity funds (such as the one the Fund is currently invested in) are extremely effective in removing emissions from a portfolio at the point of investment and exhibit low 'stranded asset' risk relative to their market-cap equivalents due to the lower allocations to oil & gas companies. However, in order to maintain risk adjusted returns these products might increase allocations to companies that are highly correlated with the oil & gas industry, which is fundamentally inconsistent with a net zero pathway.

As already mentioned, the Fund played an integral role in the Paris Aligned Investment Initiative and the Net Zero Investment Framework, co-ordinated by the Institutional Investors Group on Climate Change. This framework recommends actions to help investors align portfolios to net zero and maximise the contribution to the decarbonisation of the real economy. The work undertaken as part of this initiative, along with the outcomes of our equity allocation review, will inform a wider stocktake undertaken by Brunel in 2022 where underlying asset managers, and, indeed, the holdings themselves will be assessed based on the steps taken to manage climate risks and enable overall net zero alignment. The criteria to evaluate companies and managers is being developed but could, for instance, take account of current emissions, the level of capital expenditure committed to renewables projects and other forward looking metrics designed to capture transition risk such as future reserves emissions and the extent to which net zero commitments are backed up with credible net zero plans. As part of the stocktake the Fund will use tools such as the Transition Pathway Initiative to build the best picture of current and future risk. Once this major piece of work is concluded we will review our strategic allocations, and where there are investment solutions that meet our investment objective, we will seek to bring our milestones forward.

We will be publishing our next annual carbon metrics report next quarter. This will include an analysis of the weighted average carbon intensity of our equity investments as well as granular detail relating to direct, tier 2 and modelled tier 3 emissions, reserves and fossil fuel sub-sector exposures as well as disclosure rates among portfolio companies. Further information relating to recent climate change activity undertaken by the Fund can be found on our microsite here. Information relating to Brunel RI activity is available on their website here and here.

Although the focus is certainly on the impact of climate change on our portfolio we do have wider Responsible Investing priorities which are also important. Given the need to tackle the shortage of affordable housing, we are investing an Affordable Housing Fund as part of our property portfolio. We expect there to be more sustainable investment opportunities in the future that address the 'S' of ESG.

The pace of change in the area of climate change and sustainable investing is unrelenting and we expect this to continue, providing the Fund with good investment opportunities in the future. However, as with any investment, strategies must be robust, measurable and meet our investment objectives.

Yours sincerely,

A R Bartlett

p.p. Tony Bartlett on behalf of Councillor Bruce Shearn, Chair of the Pension Committee