Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**27 MAY 2022**	**AGENDA ITEM NUMBER**
TITLE:	**Climate Policy update**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: **Exempt Appendix 1 – Mercer Paper: Analytics for Climate Transition (ACT) Analysis – TO FOLLOW** **Appendix 2 – IIGCC Paris Aligned Investment Initiative: Net Zero Asset Owner Commitment**		

1 THE ISSUE

1.1 The Fund's approach to managing climate risk is threefold. Firstly, it measures its financial risk using carbon metrics that inform the Committee of the carbon exposure and intensity and thus the potential financial impact on the Fund. Secondly, it proactively invests in the transition to a low carbon economy through its capital allocation decisions. Thirdly, through its engagement with companies and public policy makers it is driving change to positively impact the real economy. It does this as the Fund believes that such actions will generate sustainable returns that meet the Fund's overriding investment objective.

1.2 To support its strategic investment objective the Fund has set climate targets that require regular monitoring so we can evaluate progress and to develop our policy as improved data emerges and new investment solutions are developed.

1.3 The Fund has committed to achieve net zero alignment by 2050 or sooner by drawing on IIGCCs Net Zero Investment Framework (see Appendix 2). Critically, the commitments set out under this framework include setting interim decarbonisation targets, increasing investment in climate solutions and implementing a stewardship and engagement strategy consistent with an objective for all assets in the portfolio to achieve net zero emissions by 2050 or sooner.

1.4 Brunel, and a number of underlying partner funds, have signed up to the same commitments independently creating a strong alignment of principles and ambition to meet the objectives set out in the framework.

1.5 The Fund is using Mercer's Analytics for Climate Transition (ACT) analysis to monitor progress against its climate commitment and targets. The analysis also suggests further actions the Fund could take which will be considered as part of its strategic review later in 2022/23 and provides input for Brunel's 2022 Climate Stocktake. This paper reports on progress made in 2021.

1.6 Section 6 of this report updates Panel on the key discussion points from the first client workshop held on 17 May 2022 and workstreams being developed by Brunel as part of the 2022 Climate Stocktake.

2 RECOMMENDATION

2.1 **The Panel notes the outcomes of the ACT analysis as summarised in Exempt Appendix 1 and further notes the proposals for additional climate targets that will be considered as part of the 2022/23 strategic review.**

2.2 **The Panel notes the summary of the first Brunel 2022 climate stocktake workshop.**

3 FINANCIAL IMPLICATIONS

3.1 The budget for the strategic review includes a provision for climate analysis. The costs arising from any changes to the asset allocation as a result of such analysis is not provided for in the current year budget.

4 OUTCOMES OF 2021 ANALYSIS FOR CLIMATE TRANSITION (ACT)

4.1 To monitor progress against our climate commitments the Fund commissioned Mercer to undertake Analytics for Climate Transition (ACT) analysis on the Fund's listed equity portfolio last year as part of the equity allocation review. The outcomes of that analysis helped advance the Fund's existing climate objectives by adding two interim targets, namely, a 43% absolute emissions reduction by 2025 and a 69% absolute emissions reduction by 2030 relative to a 2020 baseline, for its listed equity portfolio.

4.2 In order to monitor progress and, over time expand the scope of what is covered under our climate objectives, the Fund agreed to undertake ACT analysis on an annual basis. The analysis presented at Exempt Appendix 1 (TO FOLLOW) includes details of how the Fund has decarbonised since it first undertook the analysis, how the transition alignment of the portfolios has evolved and a progress check against the Fund's overarching 2050 net zero flightpath.

4.3 The ACT analysis will also be used as part of the 2022/23 investment strategy review to explore setting more granular targets across climate solutions and stewardship, which will include identifying the most strategically important companies from a climate perspective. Furthermore, key outcomes and insights will be fed into the Brunel climate stocktake process.

4.4 Future iterations of ACT will seek to expand the net zero approach beyond listed assets to real estate and infrastructure (data permitting) and will also serve to enhance the Fund's climate-related disclosures, noting that further work is still required on data consistency, and the adoption by industry of common definitions of net zero 'aligned' or 'aligning' companies and 'climate solutions'.

4.5 **The outcomes of the 2021 analysis are as follows:**

4.6 **Decarbonisation progress versus the 2020 baseline:** The equity portfolio has decarbonised across all three metrics measured as part of the analysis. On an absolute emissions basis the equity portfolio has decarbonised by c.6.3% despite having increased the strategic allocation to equities in the period covered by the analysis (from 37.5% to 41.5%). Progress versus the 2020 baseline was also observed across metrics that are normalised to account for the increased allocation to equities. On a carbon footprint basis the equity portfolio saw a 24.7% reduction in intensity, while Weighted Average Carbon Intensity (WACI) saw an 11.4% decrease.

4.7 **Transition alignment of portfolio:** The analysis also measures how aligned the portfolios are to the low carbon transition by taking a number of backward- and forward-looking inputs to arrive at a ranking, where 'grey' assets represent those least prepared for the transition and, for instance, exhibit a high carbon intensity and low green revenues, to 'green' assets which are typically climate solutions oriented and have a high transition capacity. 20.5% of the Fund's listed equities are invested in so-called 'green' assets; a significant increase from 5.7% in the baseline year.

4.8 **Decarbonisation pathway to 2050:** Since the initial analysis was undertaken, the Fund's listed equity portfolio has decarbonised faster than the decarbonisation flightpath used to determine emissions reductions required to meet net zero by 2050.

5 SCOPE FOR DEVELOPMENT AS PART OF 2022/23 STRATEGIC REVIEW

5.1 The results of the analysis will be considered as part of the strategic investment review later in 2022/23 and to inform the 2022 Brunel Climate Stocktake. Specifically, it will assist in reviewing our current climate targets, whether they could be changed, or new ones introduced. For example;

(I) Further decarbonising the portfolios. For instance, the current results show that a high proportion of 'grey' assets are held in the passive BlackRock mandate, which is used for collateral purposes as part of the Fund's Risk Management Framework (RMF). Officers are working with BlackRock, Brunel and Mercer to identify efficient ways of replacing the legacy equity index with a solution that would allow the Fund to gain exposure to a Paris-aligned index compliant with the regulatory requirements of the RMF.

(II) Identifying assets with the highest transition capacity and consider adopting a Climate Solutions Target that sits within the existing commitment to invest at least 30%of total assets in sustainable and net-zero transition aligned investments by 2025.

(III) Developing further our Stewardship and Engagement approach by working with Mercer and Brunel to ensure engagement is focussed on the companies that are most material to the Fund's decarbonisation objectives and to work toward the IIGCC recommendation which states that 70% of financed emissions in material sectors such as energy and utilities should either be aligned to net zero or part of an active engagement programme.

6 UPDATE ON 2022 CLIMATE STOCKTAKE

6.1 The 2022 Stocktake is now underway and the first of several client group workshops took place earlier this month. This first workshop covered:

(I) Scene setting in terms of

a. Wider landscape of Climate change
b. How the current Climate Policy has been implemented
c. A summary of the stakeholder perspectives
d. How the investment environment affects the policy

(II) Initial discussion of

a. The use of a benchmark to monitor/measure implementation of the policy (this would not replace portfolio benchmarks but be a secondary benchmark)
b. The engagement framework including evaluation for escalation where engagement is not delivering as expected

6.2 In addition Brunel is asking clients for feedback on specific aspects of the climate Policy to feed into the next stage. Once we have these, we will circulate for discussion at the Panel meeting so we can provide feedback from the Fund.

6.3 Meanwhile Brunel's analysis and proposals for policy development is ongoing with the intention to review the full analysis and proposed policy changes towards the end of 2023. Some of the aspects being analysed and developed are:

a) Analysis of green revenues/climate solutions within portfolios – this will help us understand our exposure, monitor against some of our targets and also help explain our impact.
b) The ambition to have 70% of material emissions being aligned to net zero or have engagement in place across the equity portfolios.
c) What climate stress testing modelling can be done so we are able to demonstrate we have scenario tested our portfolio (disclosure requirement).

7 RISK MANAGEMENT

7.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

8 CLIMATE CHANGE

8.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint. The Fund acknowledges the financial risk to its assets from climate change and is addressing this through its strategic asset allocation to Low Carbon Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

9 EQUALITIES

9.1 A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

10 OTHER OPTIONS CONSIDERED

10.1 None.

11 CONSULTATION

11.1 The Council's Section 151 Officer has had the opportunity to input to this report and have cleared it for publication.

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Background papers	Mercer papers
Please contact the report author if you need to access this report in an alternative format	