Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**15 DECEMBER 2023**
TITLE:	**CLIMATE POLICY REVIEW**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Mercer analysis (public) Appendix 2 – Brunel presentation (public) Appendix 3 – Climate Engagement Sessions – Summary note Appendix 4 – Member Survey – Summary results	

1 THE ISSUE

1.1 In March the Committee approved Phase 1 of the 2023 strategic investment review, which confirmed a diversified asset allocation with robust risk management to underpin more predictable employer contribution rates.

1.2 Phase 2 of the review focuses on the Fund's net zero target, aligned with short- and medium-term climate objectives.

1.3 Specifically the review examines whether the Fund can raise its ambition by bringing forward the current 2050 net zero target date, recognising the urgent and material financial risk climate change poses. The aim is to set targets that will drive real world change whilst achieving the appropriate risk/return required to meet our overriding investment objective.

1.4 Appendices 3 and 4 summarise the extensive engagement with various stakeholders through this process including elected councillors, employers, and trade unions as well as a member survey. In addition, the Committee held a workshop in October to discuss the implications of the climate analysis undertaken by the Fund's investment consultant in terms of the impact on investment strategy.

1.5 Broad consensus across the workshop, engagement sessions, and member survey frame proposals in this paper for the Committee to consider and approve.

2 RECOMMENDATIONS

The Committee agrees:

2.1 **The following climate targets for the Avon Pension Fund:**

a) Clear tangible targets for climate action in the years 2024-30:

- **By 2030 the Fund will divest from all developed market equity holdings in high impact sectors that are not achieving net zero or aligning to achieve net zero by 2050.**
- **The Fund will reduce carbon intensity of its listed equity portfolios by 43% and 69% by 2025 and 2030 respectively (versus 2019 baseline).**
- **By 2030 the Fund will reduce the carbon intensity of its corporate bond portfolio by 60% (versus 2019 baseline).**
- **70% of financed emissions in material sectors are covered by active engagement by the end of 2024 and 90% by 2027.**

b) To bring forward its overall net zero target to 2045 (from 2050) and review this formally again in 2026.

2.2 **To endorse and support collaborative engagement and climate policy advocacy work through membership of various industry leading climate advocacy bodies.**

2.3 **That the Committee supports nature-based investments and asks the Investment Panel to explore investment opportunities in 2024/25 and bring a recommendation to Committee.**

3 FINANCIAL IMPLICATIONS

3.1 Costs of the climate analysis and advice was provided for in the 2023/24 budget.

4 CURRENT STRATEGY

4.1 The Strategic Investment review confirmed the following investment beliefs that guide its strategic decision making:

- We believe in a long-term investment horizon.
- That diversification is core to managing risk.
- That we should invest responsibly.
- Lower costs drive higher net returns.

4.2 As a responsible investor the following beliefs underpin our climate policy:

- Climate change poses an existential threat to the wider world and long-term investments.
- By working with like-minded investors we can engage companies to drive positive real-world impact.
- That there is increasing convergence between financial returns and climate friendly investments. We accept that investing sustainably can lead to periods of over/underperformance vs an investment strategy that does not integrate climate risk, but we fundamentally believe that sustainable companies are more likely to deliver strong returns over the long-term.

4.3 The current climate objectives have been in place since 2020. Since then the Fund has made good progress against the objectives and the data and science around climate analysis has improved. As a result there is an appetite to be more ambitious, albeit at an acceptable risk in terms on the financial impact on the Fund.

4.4 Greater ambition is required given the temperate rise is already +1.2 degrees versus the Paris Agreement goal of limiting the increase to +1.5 degrees. Real world action based on current national policies projects a +2.7 degrees increase (by 2100). Pledges and targets submitted and binding long-term targets would take us to +2.0 degrees and the most optimistic forecast which assumes all announced targets are implemented would still result in +1.8 degrees. If the pace of transition does not increase, the greater the probability that our investment objectives will not be achieved; it poses a financial risk to the Fund.

4.5 The current targets and progress against each are as follows:

	Current Target	**Progress**
Net Zero	By 2050	Equities = good progress Other assets = insufficient data
Pathway reduction in equity emissions	-43% by 2025 -69% by 2030	Ahead, declined 49% vs. 2019 baseline
Sustainable assets **% in renewable infrastructure**	30% by 2025 5%	Delivered = £2bn invested Delivered = £500m committed

5 SETTING NEW CLIMATE TARGETS WITHIN THE INVESTMENT STRATEGY

5.1 When considering the climate policy, wider investment constraints must be taken into account such as the overarching investment return objective of CPI + 4.25% to protect the funding position, the impact on employer contributions and the need to manage liquidity within the asset portfolio to meet pension payments over time (currently have a c.34% cap on illiquid assets). Investment risk is not a constraint as long as the overall risk return profile will still deliver the funding objective.

5.2 The Avon Pension Fund determines the investment strategy and policies which includes the climate policy and targets. Brunel implements the strategy (except for one legacy portfolio and potentially any local impact investments). As a recognised leader in responsible and climate investing, Brunel has well developed policies and portfolios to drive the change that the Fund is seeking to achieve. Therefore, where possible, the Fund’s policies will be consistent with Brunel’s so that we can implement our strategy cost effectively; if not we will seek to develop investment solutions with Brunel that meet the Fund’s requirements. Furthermore as part of the Brunel partnership, we have far greater influence when engaging with investee companies and policy makers.

5.3 In framing a more ambitious climate policy a number of important trade-offs were discussed as follows:

- Real world change means there should be greater focus on the future transition rather than carbon intensity. This will mean that we continue to invest in high carbon assets where they are fundamental to the transition and have credible plans to decarbonise.

- At what point should we divest from high carbon impact companies? If we stay invested, through engagement we can encourage and demand credible transition plans are in place. If we divest then there may not be the same pressure on companies to implement transition plans, particularly if the asset sold by the Fund is picked up by an investor who does not consider climate change a risk. But at what point will we need to divest and on what criteria?
- The earlier the net zero target date the less diversification within the universe of listed assets which will increase investment risk within the portfolio (mainly through concentration of assets). Is this consistent with the overriding risk/return objectives and fiduciary duty? The earlier the net zero date the wider dispersion of returns, which will increase the risk of higher /lower employer contribution rates in the future and was this in line with our funding strategy.
- The earlier the net zero date the less real-world impact we will have as we would have to invest in companies that already have a lower carbon intensity due to the nature of their business.

5.4 The proposed targets address these trade-offs, ensuring the climate targets are as ambitious as possible without compromising the overriding investment objective.

6 STAKEHOLDER ENGAGEMENT

6.1 During 2023 the Fund has extensively engaged key stakeholders on our climate policy, through 7 sessions during October-November 2023 discussing options to increase ambition across the portfolio. In parallel a survey was undertaken to obtain views from members.

6.2 The engagement sessions considered climate targets and policy, focusing on trade-offs within the context of the Fund's overarching objective to pay pensions over time and to keep employer contributions as low and stable as possible.

6.3 Feedback received from the member survey and employer engagement sessions were largely aligned and supportive of the recommendations in this paper. In summary:

Member survey - this survey received over 5,000 responses.

- Climate change is important when making investment decisions.
- There is support for taking on more risk to get to net zero more quickly but not by increasing risk excessively.
- Both engaging with investee companies and divesting are tools the Fund should use.

Non-member Stakeholder engagement

- Net Zero – bring forward and move faster with acceptable risk.
- Transition alignment – invest in assets aligned to net zero, engage to influence, divest where insufficient impact has been achieved.
- Employer contributions – there is little appetite to increase risk around employer costs to meet NZ ambition. Employers stressed the importance of stable and affordable contribution levels, given the current difficult funding environment for public sector bodies.
- Communicate – the Fund needs to improve and do more with all stakeholders on climate issues, to explain the positive actions more widely being taken and help councillors explain its climate strategy.

6.4 Further information relating to the stakeholder engagement sessions and member survey can be found in Appendix 3 and 4, respectively.

7 PROPOSED CLIMATE TARGETS

7.1 At the workshop in October, the Committee discussed Brunel's climate policy (see Appendix 2 for overview of their presentation) and the wider investment context as well as Mercer's climate analysis (which included detailed analysis of portfolios that could meet earlier net zero dates) and advice on new targets for the Fund (see Appendix 1).

7.2 It was acknowledged that there are material weaknesses, e.g. incomplete and inconsistent data across asset classes and geographies, lack of policy commitments, and investment solutions that are still developing. In addition, economic modelling for climate change and the transition scenario analysis is still developing and it is accepted that these models may currently understate financial risks. Despite this, it is still possible to have an ambitious but credible policy that meets the Fund's fiduciary duty both in the short and longer term and does not leave the Fund open to accusations of green-washing or reputational risk.

7.3 The Fund is a member of the Institutional Investors Group on Climate Change (IIGCC) and are a signatory of the IIGCC Net Zero Investment Framework which provides a framework for monitoring investments against net zero criteria. Our current and proposed targets are consistent with this framework.

7.4 There are three pillars of our climate strategy namely, decarbonisation to manage transition risk, transition alignment to drive real economic change and climate solutions to support economy wide decarbonisation. In addition, other levers such as climate metrics will monitor progress and provide transparency, and stewardship activities including engagement will help drive greater transition alignment.

7.5 The proposed climate targets are as follows:

	Current Target	New Target
Transition Alignment	None	All developed market equity holdings in high impact sectors must be achieving net zero, aligned or aligning (meeting specific criteria) by 2030; if not will divest.
Pathway reduction in equity emissions	-43% by 2025 -69% by 2030 versus 2019 baseline	-43% by 2025 -69% by 2030 No change as already ambitious and consistent with a 2045 target.
Carbon analysis % assets coverage	None	Reduce carbon intensity in Corporate Bonds by 60% by 2030. Coverage of the portfolio has increased from 42% to 62% and the Fund seeks to increase coverage to 100% of assets over time.

Sustainable & transition-aligned assets	30% by 2025	The Fund has exceeded this target and will seek to adopt more formal targets around climate solutions utilising best practice definitions (e.g. green revenues) in time. The Fund will also consider whether a dedicated allocation to Nature Based Solutions is appropriate in the context of its existing private markets allocations.
% in renewable infrastructure	5%	5% allocation to renewable infrastructure.
Stewardship	None	70% of financed emissions in material sectors to be covered by active engagement by end 2024 and 90% by 2027 for all listed equities across Brunel portfolios.
Policy advocacy	None	To endorse and support collaborative engagement and advocacy work through membership of various industry leading climate advocacy bodies.
Net Zero	By 2050	By 2045 recognising the need for greater public policy actions if we are to achieve this target.

7.6 A summary of each target is as follows:

a) Transition alignment of equity portfolio

- Developed market companies in high impact sectors (a company whose activities are intrinsically high carbon) must be either aligned with or aligning with NZ by 2030 and to divest if this is not achieved.
- This will be monitored against specific criteria provided by external organisations such as Climate Action 100+.
- This is in line with Brunel's climate policy and will be monitored annually by Brunel in consultation with the client group. This target gives a strong steer to managers and investee companies as to Avon's expectations in terms of transition alignment and that the Fund will divest from companies that do not demonstrate a process of alignment between now and 2030.

b) Decarbonisation

- The current carbon reduction targets for the equity portfolio for 2025 and 2030 are already very ambitious. The Fund has made good progress but without significant asset allocation changes the targets are challenging. Therefore these targets will be retained.
- New target to reduce the carbon intensity of the Corporate Bond portfolio by 60% by 2030 versus 2019 baseline, on a carbon footprint basis.

- Ambition is to have 100% coverage across assets but highly dependent on industry developing and reporting on meaningful metrics in all asset classes.

c) Explicit engagement target

- Have 70% of the financed emissions covered by active engagement in 2024 and 90% by 2027.
- Engagement is an important tool to achieve the Fund's desired outcomes and early engagement with companies that are essential to the economy and need to decarbonise is vital for a successful transition to net zero.

d) Policy advocacy

- Prioritise policy advocacy as the development and implementation of public and regulatory policy is essential if we are to meet our ambition.
- To endorse and support collaborative engagement and climate policy advocacy work through membership of various industry leading climate advocacy bodies.
- We are currently members of IIGCC and LAPFF and a signatory of Climate Action 100+. The Fund currently spends c.3% of the investment advisory budget on subscriptions which provide significant engagement activity for the Fund, far more than could be done by the Fund in isolation.

e) Net Zero Target

- Bring forward from by 2050 to by 2045 to be kept under regular review (at least every 3 years in line with our investment strategy but more frequently as required).
- States our ambition but acknowledges that significant progress needs to be made in public policy implementation for this target to be achieved.
- If too early a target date, fewer transition companies qualify for investment which translates into less real-world impact.
- It is accepted that it will not lead to any material changes in the investment strategy at this time but will inform future asset allocation decisions.

7.7 **Nature Based investments** – This is a nascent asset class such as investing in forests/timber, agriculture and funds targeting biodiversity solutions that can be considered alongside climate solutions. Such investments are less liquid and would be held for the long-term. Therefore an allocation would have to take the overall liquidity of the Fund into account (currently at c.32% of assets). It is recommended that the Investment Panel explore the potential of such investments in 2024 before bringing a report to committee.

8 ANNUAL REVIEW OF CLIMATE TARGETS

8.1 The climate targets will be reviewed at least every 3 years, as part of the investment strategy review cycle. However, if for example, new opportunities arise, climate metrics/data improve, there is significant progress in public policy or the pace of transition increases or slows, the targets will be revised in between the normal review cycle.

8.2 Each year the Fund will receive a climate analysis from Mercer which will inform the Committee if any changes to targets should be considered.

9 RISK MANAGEMENT

9.1 An effective governance structure, defining clear responsibilities, and ensuring that the decision-making body has an adequate level of knowledge and access to expert advice, is a key aspect of the risk management process.

10 EQUALITIES STATEMENT

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

11 CLIMATE CHANGE

11.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint in line with the Council's Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change and addresses this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

12 OTHER OPTIONS CONSIDERED

12.1 None.

13 CONSULTATION

13.1 The Council's Director of One West has had the opportunity to input to this report and has cleared it for publication.

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Background papers	None
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