ENVIRONMENTAL SOCIAL AND CORPORATE GOVERNANCE (ESG) (Part I)	ITEM 6

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Papers with this report	

SUMMARY

At the Pensions Committee in December 2017 a discussion took place on Environmental, Social & Corporate Governance (ESG) issues including climate change; this paper provides further information in relation to Fossil Fuel impact from existing holdings.

In addition to this report there is a supporting note in Part 2 on profiting from an environmental tilt.

RECOMMENDATIONS

It is recommended that Pensions Committee:

1. **Consider this report**
2. **Delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group;**

INFORMATION

In 2016, 195 countries signed up to the United Nations (UN) Paris Agreement where they committed to limiting the global increase in temperature to 2°C above pre-industrial levels, while pursuing efforts to limit it to 1.5°C. Trends in greenhouse gas show that climate change is a serious challenge and changes are required across the world to meet the requirements of the agreement.

We are already seeing the impact of climate change with erratic and severe weather conditions and climate change is considered to be one of the top 5 risks to the world due to likelihood of the risk and the potential impact. Systemic risks posed by climate change and required changes to address these risks, will fundamentally impact on economic and political systems.

Climate related risk can be within our portfolio in many guises, all sectors can have financial repercussions. Most attention in this space is drawn towards fossil fuel companies as they have a direct link to greenhouse emissions and the expectation is that some of the natural fuel reserves will have to remain in the ground to achieve the Paris Agreement levels. However, the financial risk to the fund can also be in areas such as insurance companies, haulage companies, energy users, food producers; companies also need to be resilient to flood risk and temperate changes.

Fossil Fuel holdings

The impact to the Pension Fund is across all asset classes, sectors and market; but as well as creating risks there are also opportunities for investors.

The fund has done an analysis of the underlying equity holdings within its active and passive equity mandates and equity exposure in its Diversified Growth funds to identify the scale of the exposure to fossil fuel companies where this potential risk is likely to bear the biggest impact. The aim is to understand the decision making of the fund managers and to consider if they are investing in assets that will meet the funding strategy set in April 2017 by achieving the predicted growth and dividend return profiles and avoiding unnecessary financial risk.

For the purposes of this report we have looked at the following sectors - Cement, Coal mining, Mining, Oil& Gas, Steel and Utilities. Data for this exercise is as available in December 2018.

Transition Pathway initiative

We have utilised data collated from the Transition Pathway initiative which has been established as a joint initiative between the National Investing Bodies of the Church of England and the Environment Agency Pension Fund. The initiative assesses how companies are preparing for the transition to a low-carbon economy by evaluating and tracking the quality of management of greenhouse gas emissions and of risks and opportunities related to the low-carbon transition. It evaluates how future carbon performance would compare to the targets of the Paris Agreement and publishes the results through an online tool.

Companies are provided a management quality level from 0 to 4
Level 0 – Unaware of (or not Acknowledging) Climate Change as a Business Issue
Level 1 – Acknowledging Climate Change as a Business Issue
Level 2 - Building Capacity
Level 3 - Integrated into Operational Decision Making
Level 4 - Strategic Assessment

Exposure

Exposure to the Fossil Fuel sectors by manager show £99,182k invested within this area with the biggest exposure held by UBS. This equates to 10% of the fund value at the time the data was assessed.

Manager	**Exposure £'000**
Epoch	28,762
Ruffer LLP	5,943
UBS	40,555
LGIM	23,922
Grand Total	**99,182**

Within this over half was invested in Oil and Gas companies and nearly a quarter in utilities.

Looking at the company's management quality as rated through the Transition Pathway initiative 46% of the investment exposure was held in companies ranked at the highest transition quality position of level 4.

Manager / Quality rating	**Exposure £'000**
Epoch	**28,762**
Level 1 - Awareness	3,474
Level 2 - Building Capacity	4,930
Level 3 - Integrated into operational decision making	3,652
Level 4 - Strategic Assessment	5,233
Not rated	11,473
LGIM	**23,923**
Level 0 - Unaware	25
Level 1 - Awareness	311
Level 2 - Building Capacity	4,131
Level 3 - Integrated into operational decision making	2,621
Level 4 - Strategic Assessment	12,532
Not rated	4,303
Ruffer LLP	**5,943**
Level 1 - Awareness	907
Level 2 - Building Capacity	2,600
Level 4 - Strategic Assessment	1,160
Not rated	1,276
UBS	**40,554**
Level 2 - Building Capacity	10,260
Level 4 - Strategic Assessment	26,788
Not rated	3,506
Grand Total	**99,182**

Passive funds track an index and as a result, exposure across all elements of this industry is expected. No further analysis has been carried out on the passive funds held by LGIM. Passive funds are available at a slightly higher cost than the existing passive sub funds which have a tilt towards being low Carbon. Products are also available with tilts towards companies that are demonstrably better at managing their water, energy inputs and waste outputs. Please see "Profiting from an environmental tilt" note in Part 2 for further information.

Investments held as "Not rated" are companies that have not been assessed by the Transition Pathway initiative. Nine investments were held by the two active equity managers without a rating and have been reviewed internally to see if there are any obvious concerns with the management from a climate impact perspective; this has been taken from a very high level perspective based on company annual reports. Of the nine not rated companies, seven have significantly reduced emissions and appear to have awareness of risks and on track for improvements; however, for two companies it is not clear beyond awareness on whether they are making changes integrating to transition to meet the Paris agreement. Total value for these two companies is £1,727k (0.12% of the fund) and the managers will be asked to confirm all financial risks have been assessed in relation to holding the companies.