

## **Tyne and Wear Pension Fund**

### **Climate Change Policy**

**November 2024**

#### **Introduction**

As stated in the Fund's Corporate Governance and Responsible Investment Policy, the Committee's fiduciary duty is to act in the best financial interests of the Fund's beneficiaries. This requires recognition that Environment Social and Governance (ESG) issues, including climate change, can positively and negatively impact on the Fund's financial performance.

The Fund also recognises that climate change is inextricably linked with a number of related ESG issues notably biodiversity, waste management, water management and the Just Transition. These issues will also be taken into consideration as part of the investment process, to ensure there are no adverse implications from any of the actions taken to address climate change.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ("LGPS Investment Regulations") require the Fund to set out its approach to ESG issues within its Investment Strategy Statement (ISS). Included within the ISS are the Fund's Investment Beliefs and summarised below are the beliefs relating to Climate Change:

- Well run companies will produce superior returns for shareholders over the long term. There should be a focus on governance and engagement over disposal.
- ESG issues can represent long term financial risks to the Fund and its holdings. Climate change is one of the most significant of these risks, reflecting the changing nature of the world we live in. The investment strategy includes approaches to addressing these issues for both actively and passively managed assets.
- Effective oversight of Responsible Investment requires monitoring of ESG and Climate Related Metrics.
- It is not just through the shareholding in public companies but also holdings in bonds, property and private market investments that can influence and effect improved outcomes over the longer term.
- Engagement with companies on climate related issues can be effective in creating change to protect shareholder value.
- Climate change provides investment opportunities as well as risks.
- Asset owners and managers have a responsibility to ensure there is effective engagement on climate related issues.
- Diversification will produce a better risk adjusted returns over the long term. This applies at asset class and manager level.

The Pension Fund views climate change risk as a materially important factor that could significantly impact its long-term investment performance given its systemic nature and the

effects it could have on global financial markets and has therefore decided to produce this policy document on its approach to climate change.

The Climate Change Policy will assist the Fund to develop its approach towards governance, risk management, climate metrics and goals and investment strategy. These areas are all explored further below.

### **Implications of Climate Change**

Climate change refers to long-term changes to climate patterns, such as changes to temperatures or precipitation. A significant element of climate change is global warming; the long-term rise in the average temperature of the Earth's climatic system. Global warming has been demonstrated to have increased significantly over recent decades. The Intergovernmental Panel on Climate Change (IPCC) Fifth Assessment Report concluded, *"It is extremely likely that more than half of the observed increase in global average surface temperature from 1951 to 2010 was caused by the anthropogenic increase in greenhouse gas (GHG) concentrations and other anthropogenic forcings together"*.

The impacts of climate change are wide ranging and include more extreme temperatures, more natural disasters (flooding, fires etc), permanent loss of land due to rising sea levels, disruption to infrastructure networks (e.g. electricity, water supply), loss of ecosystems, and a severe impact on food supplies. There are also secondary impacts, such as on migration patterns. All of these physical risks have the potential to impact on both individual investments and financial markets more generally. In addition, transition risks associated with global decarbonisation could be significant over the short/medium term.

The impacts of climate change will affect all investors, even those adopting a strategy of divestment from certain sectors and/or asset classes. In order to support the ambition of global decarbonisation, the Fund believes in engagement with "high emitters" to encourage them to develop decarbonisation plans and ensuring they are delivered.

In 2015 the United Nations Climate Change Conference (COP21) was held in Paris. The agreement that was reached brought most of the world's nations together to undertake ambitious efforts to combat climate change and adapt to its effects, with enhanced support to assist developing countries. The central aim of the Paris Agreement is to keep a global temperature rise this century to below 2 degrees above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees.

In order to meet the Paris Agreement goals countries will have to take significant policy action. What these policies are and how they operate will be key drivers in how climate change mitigation impacts on investments.

The Paris agreement advocates progressive decarbonisation over time along scientifically based pathways which will vary by region and sector. This is to avoid the risks of decarbonising too quickly, which could destabilise key economic sectors, or too slowly which would mean that emissions exceed the amount necessary to achieve the 2 degrees target.

It is acknowledged that irrespective of the action taken to reduce global warming some climate related impacts, such as rising sea levels, are already expected to occur due to the greenhouse gas emissions to date.

## **Governance**

South Tyneside Council is the administering authority of the Tyne and Wear Pension Fund. The Council has set up a Pensions Committee to control and resolve all matters relating to the Fund. The Council has also established a Local Pension Board to assist in the areas of governance and administration.

The Pensions Committee has responsibility for the direction of policy and has access to expert advice to support any decisions taken. Responsibility for the implementation of this policy lies with the Fund's Head of Pensions.

The Fund is required by the LGPS Investment Regulations to invest its assets through Border to Coast Pension Partnership, its asset pooling company. Most of the Fund's assets are now either pooled or under pool management, although some investments (such as legacy private market investments) remain outside of the pool. Until all assets have transitioned to Border to Coast, the Fund will maintain relationships with a number of other investment managers across a range of asset classes.

Whilst all of the Fund's investment managers, including Border to Coast and Legal and General, invest the assets on the Fund's behalf, the responsibility for responsible investment and ensuring the appropriate consideration of ESG issues remains with the Fund. The Fund expects all its investment managers to implement this policy on its behalf across all its investments. Fund Officers will monitor implementation of this Policy and require reports from investment managers at least annually to fulfil the LGPS Investment Regulations requirements.

The Fund will require all of its investment managers to explain and report upon their approach to Climate Change and to consider the Fund's approach as set out in this policy. Investment managers are expected to take climate change into account in their capital allocation decisions and stewardship activity.

The Fund works collaboratively with its partners in formulating and agreeing the Climate Change and Responsible Investment Policies for Border to Coast. We expect all investment managers to provide information on climate metrics and their ongoing engagement and voting activities which support this policy.

The Fund supports the IIGCC Net Zero Investment framework and will utilise the approach set out in the framework to agree our actions and ensure our Investment Strategy has a focus on:

- decarbonising investment portfolios in a way that is consistent with achieving a global net zero GHG emissions by 2050.
- increasing investment in the range of 'climate solutions' needed to meet that goal.

## Risk Management

Climate change is included in the Fund's risk register in the context of the risk of the investment strategy or investment managers underperforming. Relevant controls and mitigating actions are also documented. The risk register is reviewed quarterly by the Management Team and the Local Pension Board and annually by the Pensions Committee.

The systemic nature of climate change risk has the potential to reduce returns across all asset classes and will have a macro-economic impact that could affect the entire Fund. Equally, however, the need to transition to a low carbon economy and the innovation which that will require presents a number of potential investment opportunities.

The risks and opportunities related to Climate Change are summarised below:

- Physical impacts – damage to land, infrastructure and property due to extreme weather events, rising sea levels and flooding.
- Technological changes - technological innovations such as battery storage, energy efficiency, and carbon capture and storage will displace old technologies with winners and losers emerging.
- Regulatory and policy impact - financial impairment due to policy and regulation changes such as carbon pricing or levies, capping emissions or withdrawal of subsidies.
- Transitional risk - financial risk associated with the transition to a low-carbon economy, also known as carbon risk. It may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change, creating investment opportunities as well as risks.
- Litigation risk - litigation is primarily aimed at companies failing to mitigate, adapt or disclose.

Attached at Appendix 1 is a summary of the climate change scenario analysis undertaken by the Fund's Investment Adviser, Hymans Robertson, as part of the 2022 investment strategy review. The analysis suggests that the current investment strategy is reasonably placed in terms of the scenarios considered but the position needs to be continually monitored. Climate Scenario Analysis is typically undertaken on a triennial basis as part of the review of the Investment Strategy. The next review will be in 2025/26.

There are also significant risks in attempting to decarbonise significantly more quickly than the economies in which the Fund invests. This would require policymakers globally to take additional action to bring forward carbon reduction targets and for new technologies to be developed for these changes to be delivered in practice. This could result in additional market exposure risks and could lead to lower investment returns. As set out above, the Fund will continuously monitor and challenge all of its investment managers to support the Net Zero commitments made by the Fund. This will also include a review of the voting and engagement activities carried out in respect of climate change and the approaches used to assess progress against individual climate change plans such as the Transition Pathway Initiative.

Climate change risks are managed at four levels within the Fund:

1. Investment Strategy decisions taken by the Pensions Committee.
2. Oversight undertaken by Fund Officers and periodically reported to Pensions Committee.
3. Investment structure and investment manager selection decisions which will largely be the responsibility of Border to Coast.
4. Stock selection decisions taken by investment managers

The Pensions Committee will primarily focus on the investment strategy where it can exert the most influence on addressing climate change. However, it will continue to challenge and support its investment managers along with Border to Coast to ensure actions to address climate change are prioritised and delivered.

### **Climate Metrics and Decarbonisation challenges**

The Fund must remain focused on its primary obligation to pay benefits to its members, including consideration of any associated risks. It is recognised that decarbonising a Pension Fund which is invested globally, across many sectors, is more challenging than decarbonising an individual organisation. Decarbonising the planet without causing grave damage to global economies and living standards will take many years, and a balanced and progressive approach is required.

The world needs to decarbonise quickly, but without causing grave economic damage and widespread poverty. Decarbonising companies in certain key sectors will take time and require capital. Those companies require support and engagement from long-term investors like the Fund. It is important to recognise that climate change is already happening so investments in adaptation and resilience are also an important part of the investment universe and can present opportunities in climate solutions. Decarbonisation will require huge levels of investment from the private sector as well as national Governments and long-term investors such as the Fund are a key source of the capital required.

It is important that the Fund remains broadly invested to reduce financial risks whilst capturing the opportunities presented in the decarbonisation process. Alongside this approach the Fund will maintain its engagement with portfolio companies to ensure decarbonisation plans are delivered.

The Fund has commissioned its own carbon footprint, as explained below, to measure future carbon reduction targets against. However, it is important to recognise the existing limitations around the climate metrics which have been produced. Many companies are not yet fully reporting carbon emissions and hence, in some cases, estimates are being used based upon geography and sector level experience. As the level of reporting increases, this could affect the figures reported for individual portfolios and at the total Fund level. There is also a lack of consistency in terms of the methodology in producing metrics and the use of different metrics between sectors. Changes in the approach used will have a material impact upon the figures calculated.

Currently, there are three widely accepted different categories for measuring carbon emissions as follows:

Scope 1 – All Direct Emissions from the activities of an organisation or under their control. Including fuel combustion on site such as gas boilers, fleet vehicles and air-conditioning leaks.

Scope 2 – Indirect Emissions from electricity purchased and used by the organisation. Emissions are created during the production of the energy and eventually used by the organisation.

Scope 3 – All Other Indirect Emissions from activities of the organisation, occurring from sources that they do not own or control. These are usually the greatest share of the carbon footprint, covering emissions associated with business travel, procurement, waste and water.

Currently, most carbon metrics focus on Scope 1 and 2 emissions, as there is limited data available for Scope 3. Therefore, some companies may currently be assessed as a low carbon company, but once better reporting is available on Scope 3 emissions, this position may materially change. The inclusion of scope 3 emissions targets will be considered once data quality and availability improve (in March 2024 scope 3 reporting covered only 53.8% of the Funds total assets). In addition, some asset classes, primarily quoted equities, have made more progress in developing and reporting climate metrics. Other asset classes such as Fixed Income and Private Markets have less developed reporting and so initial carbon footprint analysis has involved estimation to produce a whole Fund position.

Following a period of research and discussion between the officers, Hymans Robertson and Border to Coast, the Fund agreed a set of metrics which it has used to monitor and report progress against the Fund's Net Zero commitments. The Fund believes that the approach and targets are consistent with those produced by Border to Coast.

At the Pension Committee meeting in November 2021 the following metrics were adopted (and subsequently retained):

- Weighted average carbon intensity (WACI), tCO<sub>2</sub>e/\$m Revenue
- Weighted average emissions (tCO<sub>2</sub>e) normalised by Enterprise value \$m (this can be used to calculate absolute emissions)\*
- Weighted average % of green revenues
- Percentage of assets under management with fossil fuel reserves
- Percentage of assets under management with thermal coal reserves
- Transition pathway alignment, for material emissions sectors
- Data quality, percentage of assets under management covered by metrics actually reported and independently validated, rather than by estimates
- Percentage of assets under management of companies in material emissions sectors subject to meaningful engagement.

The Fund will continue to target emissions intensity rather than absolute emissions. Emissions intensity offers a more flexible approach that accounts for the size of the Fund. This approach allows the Fund to focus on improving its efficiency in relation to carbon emissions without being penalised for growth in assets under management.

In 2021, the Fund selected Weighted Average Carbon Intensity (WACI) as its primary metric, largely due to the level of available data at the time whilst also noting that the choice of metrics may need to evolve as industry practice develops.

As part of the Net Zero targets review undertaken by Fund Officers and Hymans Roberson, and following discussions with Border to Coast, it was recognised that Emissions per Enterprise Value Including Cash (EVIC) metric is now considered better suited for investors such as the Fund.

While WACI provides a better picture of how efficiently a company is managing its emissions, EVIC directly links carbon emissions to the capital an investor has committed and naturally adjusts to changes in capital markets, which better reflects the shifts towards decarbonisation. EVIC provides a better overview of how the Fund manages its emissions across the whole of its portfolio and also better comparison across sectors, by normalising emissions based on enterprise value, allowing for a better comparison of carbon intensity across companies regardless of size, sector or geography.

**Therefore, the Fund will now adopt Emissions per Enterprise Value Including Cash (EVIC) as its primary metric to measure progress towards the Net Zero targets.**

**In order to facilitate this change, the Fund will also switch its baseline date to March 2022, as this is the first year for which emissions/EVIC calculations were performed for the Fund. Using 2022 as the baseline will provide a more robust basis for setting interim objectives and measuring progress.**

The Fund will continue to report against the WACI metric, but this will now become a secondary metric.

All adopted metrics will be calculated as part of the annual carbon footprint analysis and the results reported in the annual TCFD Report. The continued appropriateness of these metrics will also be assessed periodically in discussion with the Investment Adviser, Border to Coast and all other Investment Managers. It is expected that some of these metrics will need to evolve with the legislative requirements and industry practice as this develops.

Working with the Fund's Investment Adviser, Hymans Robertson, a carbon footprint analysis has been produced to identify the current and past carbon exposures using a range of metrics including the Fund's new primary climate metric EVIC .

A total Fund position including all assets was calculated for EVIC as at March 2024. As explained above, the approach taken involved using estimates and assumptions where more accurate data was not available.

The carbon footprint work undertaken shows that the Fund has made good progress in reducing carbon emissions (as measured by the Fund's original primary metric WACI Revenue) with a 42.4% reduction over the five year period from 2019 to 2024. Using the new primary metric (EVIC) over the 2 years from the March 2022 baseline, there has been a 12% reduction in emissions and the Fund is 14% below the benchmark emissions as at March 2024.

Climate metrics are often backward looking, and companies carbon disclosures can be up to two years out of date. There is the need therefore, to make use of forward-looking metrics to forecast expected carbon exposures and to align with the Fund's carbon reduction targets. Forward-looking climate metrics are important because they measure the credibility of companies plans to decarbonise and their commitment to deliver them. Engagement with companies and policy makers is a key part of the approach to secure commitments on emissions reduction targets and to improve reporting on progress made against climate strategies.

In recent years, a number of scientifically based reference pathways have been defined which meet the requirements of the Paris Agreement. It is vital that companies establish and maintain alignment with an appropriate reference pathway as soon as practicable. It is not appropriate for the Fund to prescribe specific pathways for portfolio companies. However, awareness of these pathways enables the Fund to understand the approach to decarbonisation and assists the Fund to set realistic emissions reduction targets.

In 2022, Border to Coast adopted the IEA's Net Zero 2050 Scenario to support its work on decarbonisation. This is a well-regarded, scientifically based framework which complies with the Paris Agreement. It aims to achieve an orderly transition whilst safeguarding energy security. It establishes different reference pathways for different regions (advanced economies and developing countries) and different sectors including power generation, high-emissions industries, transportation and buildings. It assumes that a wide range of current and prospective clean energy technologies are ultimately deployed but does not allow for increased GHG removals through changes in land use. One key limitation is its focus on the generation, transmission and use of energy which account for a high proportion, but not all of global emissions; other material emissions sectors include agriculture and waste management.

Table 1 below shows the path projected under the IEA scenario for net emissions from the energy sector globally, which peak at nearly 40GtCO<sub>2</sub>e per year, falling to zero by 2050. The table also shows the annualised percentage reduction in emissions implied by the IEA pathway in each 5-year period. It is important to note that the projections cover absolute emissions; emissions intensity (e.g. emissions per £m revenue or emissions per £m capital invested) and will need to fall at a faster rate to allow for real economic growth over the period. In setting targets, we have assumed that both operational and capital intensity metrics fall at the same rate. The annualised reduction in emissions intensity is shown in the final row of the total. This should be the case over the long-term, as a company's growth should eventually be reflected in its market capitalisation, but it may not be so over the short-term. This is evidenced by WACI having fallen faster than Emissions/EVIC over the last couple of years.

**Table 1. IEA scenario projected net energy sector emissions. Global Energy Sector**

Global Energy Sector		2022	2025	2030	2035	2040	2045	2050
Absolute emissions	GtCO2e, pa	36.930	30.235	24.030	13.375	6.470	2.499	0
Annualised change over each period	%pa	-	-6.5%	-4.5%	-11.1%	-13.5%	-17.3%	-
Annualised reduction in emissions intensity	%pa	-	-9.4%	-7.2%	-13.5%	-15.9%	-19.6%	-

A Paris aligned world requires significant changes to the global economy; this has significant societal implications in terms of employment, access to energy and the affordability of energy. The Fund supports the Just Transition, seeking to manage the social and economic impacts of the transition to a low carbon economy. The Fund supports the work of the Local Authority Pension Fund Forum (LAPFF) in this area and through company engagement will ensure decarbonisation plans consider the implications for communities, workers, consumers and supply chains.

### Investment Strategy

We are aware that climate change will impact all asset classes over the lifetime of the Fund. As a result, many assets will be re-priced. The timing of this is uncertain and the impact will vary by asset class due to geography, liquidity and the underlying life of our assets. We recognise that there is uncertainty over the direction and speed of policy changes in this area. We aim to integrate climate change considerations into the Investment Strategy in a number of ways.

The Fund aims to achieve a progressive reduction in GHG emissions in line with recognised pathways, supported by robust engagement with portfolio companies. While the Fund is open to financing decarbonisation solutions, this should be done only where rigorous analysis shows there is a good investment opportunity (so that Committee Members can comply with their fiduciary obligations). These two aims may conflict, at least in the short-term, and trade-offs will need to be made (e.g., some companies providing decarbonisation solutions may have high current emissions).

The Fund aims to remain well diversified (e.g. by region or sector) so as to limit investment risk. The investment strategy has been developed using an evolutionary approach to capital reallocation given current exposure to climate change is unclear, future path of climate change is uncertain and many climate-driven investment strategies remain unproven.

During 2022 the Committee undertook a review of the Investment Strategy alongside the 2022 valuation. The new strategy was approved at Pensions Committee in September 2022.

The review showed that the current strategy remained appropriate. However, it also identified some opportunities to switch some of the holdings in Growth Assets into Income Assets which will also involve moves from public market assets to private market assets.

These switches only provide for a marginally better long term outcome for the Fund and also a marginally reduced downside risk and are probably not justified on financial grounds alone. However, these switches also provide a good opportunity for the Fund to increase the allocations to lower carbon asset classes, which would be supportive of the Fund's carbon reduction targets.

The review did recognise that the Fund was not immune to the impact of climate change. It noted that the downside risks in certain climate change scenarios could be material. However, it concluded that long-term funding outcomes across a wide range of scenarios (including the downside risk from climate change and other factors) was considered acceptable. Reflecting the fiduciary duty that in order to generate a return the Fund has to invest, and investment brings risk.

The new high level strategy involved a 3% allocation to the climate opportunities fund from Border to Coast, and a further 3% increase in the allocation to other private market asset classes, which the Fund's carbon footprint suggests have improved carbon and climate metrics, all funded from quoted equities.

The Fund will review its investment strategy again in 2025, alongside the 2025 Triennial Valuation. Climate risk will form part of this review process.

### **Asset Allocation and Investment Management Structure**

We will consider a range of alternative investment approaches to manage risks and opportunities related to climate change. These may include active management of carbon risk which results in some reduction of exposure, such as a tilt towards low-carbon companies and assets, alongside company engagement and an increased allocation to low-carbon investment opportunities.

The Fund already has exposure to a range of low carbon investments through its existing strategy in areas such as fixed income (green bonds), infrastructure (renewable energy) and private equity (clean tech). The increased allocation to private markets including the new Climate Opportunities fund will provide a greater focus on investment in climate solutions. The Fund will consider other low carbon investments but notes that many have limited track records and capacity and due to competitive pricing, these could lead to adverse impacts on financial returns.

In July 2020, the Fund committed 6% of its assets (15% of the overall long term quoted equity allocation) to the Legal and General Future World regional equity funds. These funds use an ESG (Environmental, Social and Governance) framework to score companies to select the best performing. This framework includes a number of climate related metrics which

means the overall exposure to companies with carbon reserves drops by around 47%. In addition, the Fund's investments in the Border to Coast UK Equity Fund and Global Equity Fund have benefitted from carbon emissions scores around 50% below the benchmark level.

Within our investment strategy the Fund now has a 6.5% allocation to global infrastructure and these investments already include a range of renewable energy projects, electric vehicle charging and the manufacture of electric trains and buses. These projects are utilising new technologies to remove carbon emissions and will hopefully lead to widespread adoption of these solutions.

Property is a significant asset class and we are aware that buildings are responsible for around one fifth of total greenhouse gas (GHG) emissions in the UK.

Following the transfer of the UK Commercial Property Assets to Border to Coast the Fund will continue to encourage improved energy management and use of renewable energy alongside increasing data collection from occupiers to reduce carbon emissions, and we expect indirectly held property managers to do likewise.

Included in the Fund's Service Plan for 2024/25 (and previously) is an action to assess the role of private markets in managing climate risk. This is an ongoing exercise through frequent engagement with the Fund's private market managers. A particular focus has been around the availability and quality of data for calculating climate related metrics and significant progress has been made over the last three years. However, the Fund recognises further progress is necessary and this work will continue.

In 2022, Border to Coast launched a Climate Opportunities fund and the Fund made a commitment of £465 million. In March 2024, the Fund made a further £200 million commitment to this strategy. This fund represents an opportunity to increase the Fund's allocations to investments involved in the transition to a low carbon economy and the associated energy transition globally which is a step towards achieving the Fund's climate ambitions. This strategy covers a range of asset classes and to be considered for investment, an asset will need to make a material positive impact on the climate transition over the long term. This strategy includes the ability to invest in natural capital (which could cover a range of asset classes including agriculture and forestry).

## **Carbon Exposures**

Through the carbon footprint analysis, the Fund has identified carbon metrics for each asset class and individual portfolios. This has enabled the Fund to understand the regions with higher carbon emissions such as Asia and the Emerging Markets and asset classes such as listed equities and corporate bonds. This information will be incorporated into the development of the Investment Strategy, in line with our commitments set out below. The analysis has also shown the carbon emissions at portfolio level and this has facilitated discussions with the Investment Managers to explain the drivers behind these figures and helps in understanding the rationale for holdings in specific companies.

The carbon footprint analysis also produced other metrics around fossil fuel exposure and green revenues that have been included in the TCFD Report which explains the Fund's

approach to climate related risks and monitors progress against the Fund's Net Zero commitments. This demonstrates the positive benefits of the Fund's investments in Infrastructure and Private Equity and also highlights how the majority of the Fund's active equity managers are already well below the benchmark level of carbon emissions.

The impact of benchmarks on the carbon metrics has become an increasing focus for the Fund and is an area that will be investigated further. In order to achieve the commitments made in this policy the use of benchmarks which recognise the need to reduce carbon emissions in line with the Paris agreement will be considered. However, many of the recently constructed benchmarks have a very limited track record and it is important that the Fund fully appreciates the implications of any changes in benchmark before any decision is taken. This includes the risk and return expectations and particularly any unintended consequences such as an overweighting to certain low carbon sectors, as measured by scope 1 and 2 emissions, such as Financials and Technology which may be identified as having higher scope 3 emissions over time.

The Fund believes that blanket exclusion policies are not in the long term interests of the Fund's stakeholders and will not contribute to our shared ambition of global decarbonisation. It should be noted however, that the Fund does not invest in pure coal and tar sand companies in its investments with Border to Coast and the Future World series of funds with Legal and General. Any decision on divestment should be based upon investment criteria including climate risk at an individual stock level. If it is determined that a company is not making the necessary progress towards the energy transition and this raises concerns over the risk and return prospects of this company, it will not be held by the Fund. By taking this considered and balanced approach it is believed that the Fund can help drive global decarbonisation and meet the fiduciary duty of acting in the best financial interests of the members and employers.

The progress to carbon neutrality is unlikely to be linear for any company or sector. The pace and size of reduction will vary across portfolios, strategies and asset classes. There will also need to be different pathways to carbon neutrality depending on the starting point of each company, the sector in which it operates and the region/country in which it is located.

### **Carbon Offsetting**

For a pension fund to hit net zero it needs not only to reduce emissions attributed to it because of the companies in which it invests but also to take out of the atmosphere any of the remaining emissions caused by its investments – also known as offsetting.

We do not plan to materially offset at Fund level at this stage. This is in line with the IIGCC Net Zero Investment Framework which currently advocates as a general principle, for investors to not use purchased offsets at the portfolio level to achieve emissions reduction targets. Holding offsets at fund-level does nothing directly to reduce the transition or physical risks being faced. Instead, the focus should be on reducing carbon emissions which will ultimately contribute towards the reduction in global warming.

Some companies which we invest in may offset and some may provide offsetting opportunities to others. Where offsetting is used, we think it should focus on proven nature-based solutions and use technology that is shown to be clean and viable. Whilst carbon offsetting is a reasonable tool for some companies or sectors, ultimately it does not solve the problem and it is believed that companies should not use this as an alternative to reducing carbon emissions.

Whilst the Fund has no plans to use financial offsets it expects that through its existing and new investments there will be positive carbon impacts which can be offset against its overall carbon emissions. This would include current assets in infrastructure and potential new areas of investment such as agriculture and forestry which could be considered as part of future investment opportunities.

### **Engagement and Collaboration**

Climate Change has the potential to impact returns across all asset classes (not just individual companies or sectors) and therefore has very material financial implications. The Fund will expect all of its investment managers to:

- be aware of the investment risks and opportunities associated with climate change.
- incorporate climate considerations into the investment decision making practices and processes.
- monitor and review companies and assets in relation to their approach to climate change and
- consider the use of frameworks such as the Transition Pathway Initiative (TPI) to assess the progress made by companies towards limiting temperature rises to 1.5 degrees as part of the climate risk management process.

The integrated nature of climate change and its ability to impact most industries, means that the Fund chooses not to take a sector wide exclusion approach to its investments. As stated in the Fund's investment beliefs, we believe in diversification to deliver better risk adjusted returns. Undoubtedly, in every sector there will be best in class and worst in class companies, representing both investment risks and opportunities. The Fund chooses therefore, to remain invested in companies which are committed to decarbonise and have credible plans. Through our investment managers we will engage with companies to ensure these plans are delivered. Consistent with the Fund's investment strategy, engagement is also a long term approach with the goal for companies and economies globally to be carbon neutral by 2050 and to enable those companies to transition effectively to a carbon neutral economy.

The Fund's approach recognises that engagement takes place at multiple levels: industry/public policy, investment manager, portfolio company. Whilst the Fund will focus on the first two (with support from Border to Coast and LAPFF), investment managers will take responsibility for direct company engagement.

Inevitably, there are limits to engagement and the progress that can be made. In these situations, the Fund would usually expect its investment managers to consider divesting, eg where:

- Companies cannot decarbonise or cannot do so quickly enough.
- Companies which fail to align with a decarbonisation pathway relevant to their sector, whether because they lack a credible plan or the commitment to do so.
- Companies which are unwilling to engage effectively with owners or lenders on these issues.
- Companies whose values and beliefs are misaligned with the Fund.

The Fund does not have a policy of divesting from specific sectors such as Oil and Gas and considers active engagement with companies a more productive approach to effecting change. Once the Fund divests, its ability to influence both the short-term and long-term direction of individual companies is severely curtailed. This policy of active engagement is strongly supported by the Fund's investment managers, including Border to Coast, Legal and General and the Investment Adviser, Hymans Robertson.

The Fund has been a long-standing member of LAPFF which engages directly with companies on behalf of the LGPS on a range of ESG issues from executive pay and reliable accounts to a just transition to a net zero economy. The Forum has been engaging with major companies on climate risk, for many years and also works with other investors through initiatives such as Climate Action 100+ and 'Say on Climate'.

The Fund will use its shareholder rights to engage directly, collaboratively (including with LAPFF) and through our fund managers, with companies exposed to the greatest risks, to encourage them to adapt their business models to ones that are better aligned to a net zero-carbon economy. We further encourage companies to take account of the Financial Stability Board's Taskforce on Climate-Related Financial Disclosure (TCFD) recommendations. Company responsiveness to engagement is taken into account in voting activity and the Fund will co-file and support relevant shareholder resolutions where appropriate. Where possible, we extend this engagement to investee companies across all asset classes.

The Fund believes collaboration with other investors helps influence and improve market best practice standards as well as strengthening the voice of asset owners and their pension beneficiaries. Consequently, through our Investment Managers including Border to Coast and by our membership of the LAPFF, we aim to support maximum 1.5 degree temperature rise scenarios through:

- engagement with companies to improve their approaches to climate change as well as encourage them to report on their actions for future business model scenarios;
- influencing policymakers;
- promotion of relevant research projects in areas such as developing standardised carbon intensity measures and investment initiatives that improve information flow and investment opportunities.

One of our investment managers, Legal and General has published a “Climate Change Pledge”. This is a commitment to engage with the world’s largest companies to address climate change, leading to voting and investment decisions. This is designed to effect positive change in the companies in which we invest. In some of their funds, including the Future World series in which we are invested, where it is clear that the engagement is not working and companies continually breach the standards of the climate change pledge, this can result in Legal and General divesting. At the current time 14 companies have been divested from over concerns they are not appropriately engaging and addressing climate change risks. These companies cover a range of sectors and include oil companies such as Exxon Mobil and Rosneft.

Border to Coast has identified the Transition Pathway Initiative (TPI) as a means of assessing how individual companies are progressing and using this approach is likely to identify those companies that are not making sufficient progress. The Fund will continue to challenge Border to Coast in this area and support any climate related engagement at the companies within the portfolios.

### **Commitment and Targets**

The Tyne and Wear Pension Fund commits to transitioning its investment portfolios to net-zero GHG emissions by 2050 or sooner and to reduce emissions by 40% - 45% by 2030 based upon the 2022 baseline calculated in the carbon footprint analysis. In addition, a reduction of 65% – 75% will be targeted by 2036 and reporting against these targets will be published annually. These new commitments will be measured against the new primary EVIC metric.

The Fund will also align with the IEA NZE2050 decarbonisation pathway as a predictor of future emissions performance and this pathway has been used as the basis for calculating the interim targets stated above.

The Fund also commits to undertake climate based financial risk assessments and to report the results as part of an annual Taskforce for Climate Related Financial Disclosures (TCFD) Report. This will require the Fund to develop a range of metrics and targets. The exact metrics to be used are the subject of an ongoing government consultation on the adoption of TCFD reporting in the LGPS. The TCFD report includes the metrics set out above which the Fund believes are the most appropriate at the current time.

In addition to the backward looking emission targets, the Fund believes that setting a forward looking alignment objective is a crucial indicator of future emissions. Such an objective would measure progress in achieving and maintaining alignment with decarbonisation pathways. While reporting remains a challenge, a few of the Fund’s managers were able to provide Transition Pathway Alignment statistics in respect of some asset classes, with the 2024 exercise showing that there is scope for significant improvement in aligning underlying holdings.

Based upon current NZIF guidance, the Fund has adopted the following targets for Transition Pathway Alignment across its listed equities and corporate fixed income portfolios:

- 70% of emissions aligned to Net Zero by 2050 or sooner before 2030;
- 85% of emissions aligned to Net Zero by 2050 or sooner before 2035;
- 100% of emissions aligned to Net Zero by 2050 or sooner before 2040.

In order to ensure that the Fund achieves its targets we will undertake an annual carbon footprint analysis and regularly report on the progress being made.

In addition, we will undertake a triennial review of the medium and long term targets along with an annual update of the Roadmap to ensure that they remain appropriate and challenging, given the ever changing, economic, environmental and technological environment. The review will look for opportunities to bring forward the Net Zero targets where this is considered reasonable.

The Fund also commits to working with other investors along with our Investment managers to promote the change necessary and to pursue efforts to limit the temperature increase to 1.5°C set out in the Paris Agreement. This includes our Pool Company, Border to Coast, who have made a similar commitment, and we support their policy objectives.

The Fund has developed and published a clear Net Zero Roadmap which will cover how these commitments will be achieved in terms of the strategy, metrics and targets to be implemented and the governance arrangements which will oversee this plan. The Roadmap contains a number of actions under the categories set out in the table below along with indicative timescales:

	Short term	Medium term	Long term
Measuring climate risk	✓		
Pressuring managers to provide better climate data	✓	✓	
Strengthening climate engagement	✓	✓	
Reviewing investment strategy	✓	✓	✓
Altering current investment mandates	✓	✓	
Reallocating capital to climate-focused strategies	✓	✓	✓

The Fund will monitor and challenge the climate approach of all of its Investment Managers including their commitments to the IIGCC Net Zero Investor framework and publication of Climate Change policies. We also expect all of our investment managers to support the UNPRI and to work towards the production of appropriate climate metrics to enable the Fund to monitor its overall position.

The Fund will continue to identify and invest in green solutions which will help build a clean, biodiverse and climate-resilient world. The Fund will determine a suitable metric (Green Revenues) to measure this ambition and report progress against this metric as part of our annual reporting.

The Fund will seek to reach this Commitment through its investment activity as well as through advocating for, and engaging on, corporate and industry action for a low-carbon transition of economic sectors in line with science and under consideration of associated social impacts. This Commitment is made in the expectation that governments will follow

through on their own commitments to ensure the objectives of the Paris Agreement are met.

This commitment covers all investments made by the Pension Fund over all asset classes. The Pension Fund is aware that some asset classes are more progressed in the level of disclosure and transparency around climate risks and so may take longer to reach a point where assessment can be undertaken appropriately.

The Pension Fund also commits to achieving net-zero GHG emissions on its own administrative operations by 2030 in line with target set by South Tyneside Council who are the Administering Authority of the Fund.

## Tyne and Wear Pension Fund

### Climate Change Scenario Analysis 2022

#### Summary of Analysis Produced by Hymans Robertson

The 2022 review of the Investment Strategy undertaken by Hymans Robertson included a climate change scenario analysis which looked at how the investment strategy would perform under three different climate change scenarios:

- **Head in the Sand** – A range of outcomes resulting from a total lack of response to climate risk from global policymakers and asset owners: global crop failures, influx of new diseases, severe temperature fluctuations/extreme weather patterns, etc.
- **Challenging times** – Some adaptation is achieved: peak oil flow is reached constraining economies of the future, increasing fuel prices, constrained government finances, difficulty obtaining access to imported foods, etc.
- **Green revolution** – Rapid technological advances leading to positive adaption to climate change: healthier lifestyles prevail (walking, cycling, etc.), diets improve with less processed food consumption, homes protected against extreme temperatures etc.

The analysis was undertaken on the above different climate change scenarios and assessed how effective the proposed investment strategy may be under those scenarios.

A summary of the observations coming out of the analysis is shown below:

- The proposed new investment strategy is unlikely to be significantly impacted by any of the three climate scenarios. This suggests it is resilient to climate change risk.
- Outcomes in all three climate scenarios are expected to be worse than the “base case”, due to the assumptions of higher volatility.
- It is important that, in absence of a strong belief of which climate scenario we may experience, that the Fund continues to remain well diversified across a range of investments that will do well during different climate outcomes.

This has led to the following conclusions and next steps

- The analysis suggests that the 2022 Review of the Investment Strategy should be implemented.

- The Fund can and should continue taking action to manage climate risk or benefit from the transition to a low carbon economy as it has done with the Border to Coast Climate Opportunities Fund and Legal and General Future World Funds, e.g. by exploring options regarding the Future World and RAFI allocations in the future (this is a recommendation in the 2022 review of the Investment Strategy).
- The Fund also continues to measure its exposure to climate risk through the annual carbon foot printing exercise, which will flag up specific risks and opportunities at individual mandate level and across asset classes.

In summary the Fund is considered to be a good position to manage the risks from Climate Change, but the position needs to be continually monitored. No specific additional action is needed, other than the actions already contained in the service plan and those detailed in the 2022 Review of the Investment Strategy.

As part of the 2022 Triennial Valuation, the Fund Actuary will consider climate scenario analysis and reflect the results in the final report. It is expected that this will be repeated in future triennial valuations. The usefulness of updating the climate scenario analysis on an annual basis will be considered.

The climate change scenario analysis highlights the financial risks to the Fund, especially if sufficient action is not taken by policy makers, organisations and individuals to address these risks. The report, however, confirms that the actions the Fund has identified to address these risks are appropriate. Although the Fund still needs to deliver against these actions.

## Glossary

<b>IIGCC</b>	Institutional Investor Group on Climate Change: membership body for investor collaboration on climate change, comprising 330+ members, mainly pension funds and asset managers responsible for €39+ trillion in assets under management
<b>ESG</b>	Environmental, Social and corporate Governance
<b>Responsible Investment</b>	The integration of ESG factors into investment decision making and asset stewardship practices
<b>Scope 1 emissions</b>	GHG emitted directly by the company in conducting its operations
<b>Scope 2 emissions</b>	GHG emitted in the generation of energy consumed by the company
<b>Scope 3 emissions</b>	Indirect GHG emissions arising from a company's supply chain and use/disposal of its products
<b>Transition pathways</b>	Technologically achievable, scientifically-derived, decarbonisation roadmaps which are being developed for high-emissions sectors
<b>TCFD</b>	Taskforce on Climate-Related Financial Disclosures. Standards are expected to be adopted by DLUHC in 2022/23 for all LGPS funds
<b>Material sectors</b>	Companies undertaking activities material to the transition to net zero, specifically NACE code categories A-H and J-L