South Tyneside Council

Local Pension Board

Date: 17 December 2024

Annual Climate Change Update 2023/24

(for information and discussion)

Report of the Head of Pensions

Purpose of Report

1. The Service Plan for 2024/25 – 2026/27 includes a number of actions which relate to responsible investment and climate change.

2. At the meeting of Pensions Committee on 29 November 2024, there was a focus on climate related issues. This included the approval of a new Climate Change Policy, including revised Net Zero targets and an updated Net Zero Roadmap. The 2023/24 carbon footprint analysis was also approved along with the latest TCFD report. This report seeks to update the Board.

3. The Board is recommended to note the report.

Contact Officer: Paul McCann, Head of Pensions

Background

4. The Fund has had a significant focus on climate change in recent years. This led to the agreement of the Climate Change Policy, a Net Zero Carbon target and a range of interim carbon reduction targets at the Pensions Committee meeting in November 2021.

5. A summary of the agreed targets and commitments, are:

    - Annual review of the Climate Change Policy (excluding carbon reduction targets).
    - A net zero carbon target for the Investment Portfolio of “2050, or sooner”.
    - A net zero carbon target for the administrative functions of the Pensions Service of 2030.
    - A reduction in carbon emissions of 30% to 35% by 2025.
    - A reduction in carbon emissions of 50% to 60% by 2030.
    - To undertake a carbon footprint on the Fund each year.
    - To undertake a formal review of the carbon reduction targets every three years (next due November 2024).

6. This report summarises the progress against the Service Plan objectives in relation to climate change and gives an update on the carbon footprint analysis.

Climate Change Policy

7. Climate change is a material financial risk to the Pension Fund. The focus and emphasis on this risk has increased substantially in recent years. In November 2021, the Fund approved its first standalone Climate Change Policy.

8. The Climate Change Policy sets out how the Fund is responding to the challenges posed by climate change and how this links to the Investment Strategy Statement and Responsible Investment Policy.

9. The Policy also covers the Fund’s views in terms of risk management and climate risks and the approach to issues such as carbon offsetting, engagement, and potential exclusions. It reflects the progress made by the Fund’s investment managers in developing their approach to climate change and how this is being implemented in terms of investment decisions and company engagement.

10. The Policy has been aligned to the Fund's Investment Beliefs, which underpin the overall approach to investment. The full range of Investment Beliefs are included in the Investment Strategy Statement.

11. The Policy also sets out a number of commitments from the Fund in relation to climate change. These include the Net Zero '2050, or sooner' pledge and interim targets to reduced carbon emissions. There was also a commitment to review the Climate Change Policy on an annual basis.

12. Material changes to the policy were made following the work to review the Net Zero targets (see below) which led to new interim targets and the adoption of a decarbonisation pathway by Committee.

13. The updated Climate Change Policy includes the latest carbon footprint results which show the Fund is making significant progress in terms of reducing carbon emissions. Further detail on the carbon footprint can be found in the TCFD report referred to below.

14. The updated Climate Change Policy also notes the Fund's belief in engaging with 'high emitting' companies and its collaborative approach in formulating climate change policies. It also states the role of the Pensions Committee in focusing on investment strategy and challenging its investment managers.

15. An updated version of the Climate Change Policy, with material amendments shown in grey shading for ease of reference, has been shared with Board members by email. A copy is also available on the Extranet.

Net Zero targets

16. Following the publication of the Fund's first Climate Change Policy and carbon footprint analysis in November 2021, work was undertaken to develop an understanding of the climate metrics available to measure the Fund against.

17. This period of research led to a set of metrics being identified which the Fund adopted to monitor and report progress against the Fund's Net Zero commitments.

18. Following a number of meetings and training sessions in 2021, the Fund adopted a Net Zero target date of "2050 or sooner", which is consistent with the Paris Agreement to limit the rise in average surface temperatures by 1.5 degrees. It also aligns with the majority of developed countries own targets and is consistent with the approach taken by all of investment managers, including Border to Coast and LGIM.

19. The recent Net Zero review considered alternative target dates and concluded that "2050, or sooner" remains the most appropriate target for the Fund as it allows the Fund to maintain access to a wide investment

universe to deliver investment returns whilst ensuring climate change is a key consideration in all investment decisions.

20. Given the lack of progress globally against the targets set in the Paris Agreement, the “2050, or sooner” target has become more challenging than it appeared three years ago. This means adopting an earlier Net Zero target date would increase the financial risks to the Fund.

21. Committee therefore agreed to retain the Net Zero “2050, or sooner” target as it remains a challenging objective, and this is supported by Border to Coast and the Fund’s other investment managers. The focus will be on the interim targets set out below as the short and medium term is crucial in determining the global impact of climate change over the next decade. This also aligns with the choice of decarbonisation pathway covered below.

22. In 2021, the Fund selected the Weighted Average Carbon Intensity (WACI) metric 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.

23. 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.

24. 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 also provides a better overview of how the Fund manages it emissions across the whole of its portfolio. It is also a 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.

25. In order to facilitate this change, Committee also approved the Fund changing its baseline date to March 2022, as this is the first year for which emissions / EVIC calculations were performed for the Fund.

26. Using 2022 as the baseline will provide a more robust basis for setting interim objectives and measuring progress. It should be noted that the 2022 baseline, and the interim targets below, are based on scope 1 and scope 2 emissions only. This is due to a lack of reliable data on scope 3 emissions at this time. Notwithstanding this, we should be mindful of the importance of scope 3 emissions and look to incorporate this information when sufficient data is available.

27. The Fund will continue to report on all previously agreed metrics, including WACI. These metrics will be calculated as part of the annual carbon footprint analysis and the results reported in the annual TCFD

Report. The 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.

28. The Net Zero review also looked at the interim emissions reduction targets initially set for 2025 and 2030 and how these should evolve following the success in achieving the 2025 targets two years early. The review considered the use of a decarbonisation pathway as the most suitable way to set interim targets based upon current projections to reach Net Zero by 2050.

29. As set out in the Climate Change Policy, the review considered a number of scientifically based reference pathways which meet the requirements of the Paris Agreement. Border to Coast have adopted the IEA Net Zero 2050 pathway and this was considered to be a suitable choice for the Fund. Using the projections in the pathway, and the Fund's current carbon footprint analysis, modelling was undertaken to plot suitable interim targets for the Fund.

30. The Fund has now committed to new interim targets in transitioning its investment portfolios to net-zero GHG emissions by 2050 or sooner as follows:

    - To cut emissions by 40% - 45% by 2030; and
    - To cut emissions by 65% - 75% by 2036.

31. The new interim targets are based upon the 2022 baseline. Progress will be monitored through an annual carbon footprint analysis and reports will be brought to Committee and the Board as well as being published online. These new commitments will be measured against the new primary EVIC metric.

32. 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.

33. Based upon current Net Zero Investment Framework (NZIF) guidance, the Fund will adopt 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.

34. Progress against the above targets will also be reviewed and reported on as part of the annual carbon footprint analysis.

Border to Coast Climate Change Policy

35. Border to Coast have also recently revised their Climate Change Policy. A copy of the updated Policy is available on their website or from officers.

36. The only notable change is around how Border to Coast are now considering nature-based issues and specifically deforestation risks. An additional focus in voting and engagement activity will be to highlight these risks to companies with material deforestation risks / impact. The new wording in the policy is:

    "For companies that have high exposure to deforestation risk commodities (palm oil, soy, beef, and timber, paper and pulp), but either don't have adequate policies and processes in place to reduce their impact or are involved in severe deforestation-linked controversies, we will oppose the re-election of the Chair of the Sustainability Committee (or most appropriate agenda item). Assessments of the quality of mitigating actions are based on external benchmarks such as the Forest500.

    We will generally vote in favour of shareholder proposals that ask companies to mitigate deforestation risks, taking a 'comply or explain' approach, publicly disclosing our rationale if we vote against."

37. Border to Coast have set short and medium-term reduction targets for carbon emissions, targeting a 53% reduction in financed emissions (normalised by AUM) by 2025 and a 66% reduction by 2030 in order to reach 100% emission reductions by 2050 or sooner. They have also set Net Zero alignment targets for portfolios based on specific assessment criteria, with the aim of reaching 100% Net Zero alignment by 2040 and asset class level engagement targets with 80% of finance emissions to be under engagement by 2025, reaching 100% coverage by 2030.

38. These targets are more ambitious than the current Tyne and Wear targets and this is a key factor in the Fund achieving its own 2025 interim target two years early.

39. The policy has also clarified the support for a Just Transition which should be inclusive and acknowledge existing global disparities. It recognises that not all countries are at the same stage in their decarbonisation journey and will need to consider the different transition timelines for emerging market economies. Therefore, in the interests of a just transition

Border to Coast will assess the implications of the exclusion policy and, where appropriate, may operate exceptions.

Net Zero Roadmap

40. In line with the IIGCC framework, and as included in the 2024/25 Service Plan actions, Fund Officers have reviewed and updated the Net Zero Roadmap. A copy of the updated Roadmap, with changes shown in grey shading, has been shared with Board members by email and can also be found on the Extranet.

41. The Roadmap sets out the actions the Fund will undertake in the short, medium and long term to achieve its Net Zero or sooner target.

42. The Roadmap highlights the work that is ongoing between Officers, the investment adviser and investment managers, including Border to Coast, to manage climate related risks and improve reporting in this area.

43. The amendments to the Roadmap are shown in grey shading. The amendments are minor in nature and largely relate to updates due to the passage of time and tweaks to timescales for certain actions.

44. The actions identified in the Roadmap cover the work needed to meet the commitments made by the Fund in the Climate Change Policy. These cover the measurement of climate risk and working with the Fund's investment managers to improve data quality and strengthen engagement on climate-related issues.

45. There are also a number of actions in relation to the work the Fund is doing around the Investment Strategy and reviewing existing mandates as well as seeking new investment in climate change solutions.

46. A number of the actions are addressed annually, and all have progressed as planned. This includes several items on the agenda for today's meeting, such as:

    - Review the Climate Change Policy.
    - Publish a roadmap of actions and report on progress annually.
    - Publish an annual Carbon Footprint analysis to measure climate metrics.
    - Publish an annual TCFD Report to report on the climate metrics.
    - Work with each of the Fund's Investment Managers to improve the quality of data provided across all of the Fund's metrics.

47. A data quality metric has not yet been added to the carbon footprint analysis although good progress has been made in terms of overall data coverage and through discussions with individual managers

improvements are being made. This work will continue with the aim of developing a metric for a future TCFD Report.

Taskforce for Climate Related Financial Disclosures Report

48. The Taskforce on Climate-Related Financial Disclosures (TCFD) is an industry-led group which helps investors understand their financial exposure to climate risk and works with companies to disclose this information in a clear and consistent way. It was launched at the Paris COP21 in 2015 by the Financial Stability Board (FSB) and Mark Carney, the UN Special Envoy on Climate Action and Finance and UK Finance Adviser for COP26.

49. To enable investors to make high-quality decisions and to encourage better pricing and capital allocation in markets, high quality disclosures will be needed regarding how their assets will affect and be affected by climate change.

50. The Taskforce on Climate-related Financial Disclosures published a set of recommendations in 2017 with the aims of improving assessment, management, and disclosure of climate-related financial risks. In November 2020, the government announced the UK's intention to make TCFD-aligned disclosures mandatory in the UK by 2025, with a significant portion of mandatory requirements in place by 2023.

51. The Government has consulted on the introduction of the TCFD regime into the LGPS, but, as things stand, this has not yet been progressed. Further information is set out below on this.

52. The Fund has been developing its response to climate change in recent years. In November 2021, the Fund approved its first standalone Climate Change Policy.

53. The Climate Change Policy included a number of commitments made by the Fund, including the publication of its first TCFD Report in November 2022 for the 2021/22 financial year. The Fund is committed to producing a TCFD report each year as a matter of good practice, even in the absence of regulatory requirement.

54. The TCFD report explains the Fund's approach to managing climate-related risks. The report is broken down into four main areas, specifically: governance, strategy, risk management and metrics and targets. The report also comments on climate scenario analysis.

55. The revised report for 2023/24 includes the carbon footprint as at the end of March 2024 which is based upon the original climate metrics agreed in 2021. This report has now been approved by the Pensions Committee and is available on the Fund's website. A copy has also been emailed to the Board for information purposes.

Carbon Footprint Analysis

56. In accordance with the Service Plan and Net Zero Roadmap, the Fund is committed to undertaking an annual carbon footprint analysis.

57. This exercise was first undertaken in 2021, when the Fund commissioned Hymans Robertson to produce a whole of Fund carbon footprint analysis. This type of analysis and detail was still relatively new to the LGPS. In fact, the Fund was the first Hymans LGPS client to request this level of information.

58. The Fund has completed the carbon footprint analysis for 2023/24. Hymans Robertson were again commissioned to undertake this exercise. The exercise for 2023/24 builds upon the report issued in 2023. Whilst a similar approach has been taken this year, the methodology has been refined to reflect increased understanding and progress across the investment industry. The output of the carbon footprint exercise was presented to Committee and Board members in September and was also touched upon during the Net Zero workshop in November.

59. As previously discussed, the carbon footprint analysis shows the Fund's carbon footprint as at March 2024, and compares this to the position in March 2023 and the agreed baseline date of March 2019.

60. The carbon footprint work undertaken shows that the Fund continues to make good progress in reducing Weighted Average Carbon Intensity (WACI) with a **42.4% reduction** over the five-year period, from 2019 to 2024. This is the Fund's primary risk metric and the metric that is used for measuring against the net zero commitments. This represents an improvement of 6% from 2023. The Fund is now 10% below the benchmark level.

61. This is excellent progress, and as reported in 2023, the Fund has achieved its first interim carbon emissions reduction target of a 30-35% reduction by 2025, two years ahead of schedule.

62. Despite the excellent progress to date, it should be noted that the journey to reduce carbon emissions will not be linear and some progress could be reversed in the short term. However, the Fund is currently ahead of its medium-term targets.

63. In addition, using the results calculated for March 2010 shows there has been a 52% reduction in carbon emissions for the Fund from this date through to March 2024.

64. The exercise to produce the carbon footprint and establish the position against the climate metrics has been extremely informative. Whilst improvements are being made, notably in private markets, the coverage and poor quality of data continues to be a concern. Officers are continuing to work with each of the investment managers to raise this issue and drive improvements. As previously reported, this is one of the

biggest challenges when looking to make decisions on the data available. Whilst the position is clearly improving, there is still a lot of work to be done in this area before a high level of reliance can be placed on this information.

65. The Fund's former primary climate metric WACI (Revenue), is widely considered one of the more robust data measures but even with this metric the market coverage of the data is only 68%. This is actually a small reduction from 2023, however, this is due to the increase in asset values over the year rather than actual drop in the availability of data. Whilst this level of coverage is low, it is a material improvement on the position from 2019 when data coverage was only 34%.

66. Following its introduction in last year's report, the Thermal Coal metric shows the Fund is around 38% below the benchmark. This is a very similar level to last year once allowance is made for the overall increase in asset values

67. In addition, Hymans Robertson now have sufficient data to calculate a Scope 3 Emissions metric. This shows the Fund is around 7% below the benchmark. However, it should be noted that data coverage is only 54% which is why the Fund does not place significant reliance on these figures. It is expected that, going forward, the accuracy of this metric will improve each year. This should then enable the Fund to consider this metric as part of future investment strategy reviews.

68. At asset class level, Emerging Markets is the highest emitting equity market which would be expected with the UK market having the highest exposure to fossil fuels due to the large oil and gas companies within that market. Multi Asset Credit has the highest emissions intensity and Infrastructure provides the bulk of the green revenues.

69. The results of the 2024 carbon footprint analysis were presented to the Pensions Committee and Local Pension Board at the September training event and were used to inform the review of Net Zero targets which is covered above.

Recommendations

70. The Board is recommended to note the report.

Reason for Recommendation

71. To develop the Fund's approach to managing ESG and Climate Change Risks.

Annual Climate Change Update 2023/24 Report

The following is a list of the background papers (excluding exempt papers) relied upon in the preparation of the above report:

Background Paper	File Ref:	File Location
Climate Change Files		Investments Office, South Shields Town Hall

Contact Officer: Paul McCann, Head of Pensions