DFP/24/62
Investment and Pension Fund Committee
14 June 2024

CLIMATE CHANGE AND CARBON FOOTPRINT

Report of the Director of Finance and Public Value

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

1) Recommendation

That the Committee be asked to note the updated position against the agreed targets in the Fund's climate change policy.

2) Introduction

2.1 Climate change continues to be a significant concern nationally and internationally. Locally, Devon County Council has declared a climate emergency and continues to be lobbied to do more. The Devon Pension Fund believes climate change poses significant risks to global financial stability and could thereby create climate-related financial risks to the Fund's investments, unless action is taken to mitigate these risks.

2.2 In 2021 the Investment and Pension Fund committed that the Devon Pension Fund's portfolio of investments will be net-zero by 2050 at the latest and adopted a climate change policy in support of that objective. In order to achieve that objective, the Committee has agreed more detailed targets as follows:

a) A 7% per annum reduction in the Weighted Average Carbon Intensity (WACI) of the Fund's investments, based on the March 2019 calculation of the WACI, with the intention of achieving a 50-75% reduction by 2030.
b) The same targets also apply to the Fund's exposure to companies with fossil fuel reserves as a proxy for downstream scope 3 emissions which are not captured within the WACI calculation.
c) An allocation of 5% of the total Fund to be invested in renewable energy infrastructure assets by 2025.
d) 100% of developed listed equities should be aligned or aligning to the Paris Agreement by 2030 and 100% of all listed equities should be aligned or aligning by 2040. For a company to be considered to be aligned they need to:
    - Have credible targets to achieve net zero and strategy to deliver them.
    - Engage positively to achieve those targets (including not lobbying against climate change mitigation, directly or via affiliations).
    - Align financial processes and accounts.

- Publicly disclose on the above.

e) Engagement - 70% of financed emissions in material sectors for listed equity and corporate bonds should be either Net Zero, aligned to Net Zero pathways, or subject to direct or collected engagement and stewardship actions by June 2024, and that the threshold should be 90% by June 2027.

2.3 During 2022, the Government consulted on proposals to require administering authorities of the Local Government Pension Scheme (LGPS) to publish a range of metrics and targets for the assessment and management of climate risks and opportunities. These were based on the recommendations of the international industry-led Taskforce on Climate-related Financial Disclosures (TCFD). The Government has yet to bring these requirements into formal regulations, but the Brunel Pension Partnership have begun to look at the additional metrics that will be required.

2.4 This report reviews progress against targets (a) to (d) set out in paragraph 2.2 above. A full analysis of the Fund's carbon footprint is carried out on an annual basis, and this report provides details of the assessment as at 31 December 2023. It also includes some of the additional metrics that are likely to be required by future regulation, in line with the proposals in the 2022 Government consultation.

3) Carbon Footprint as at 31 December 2023

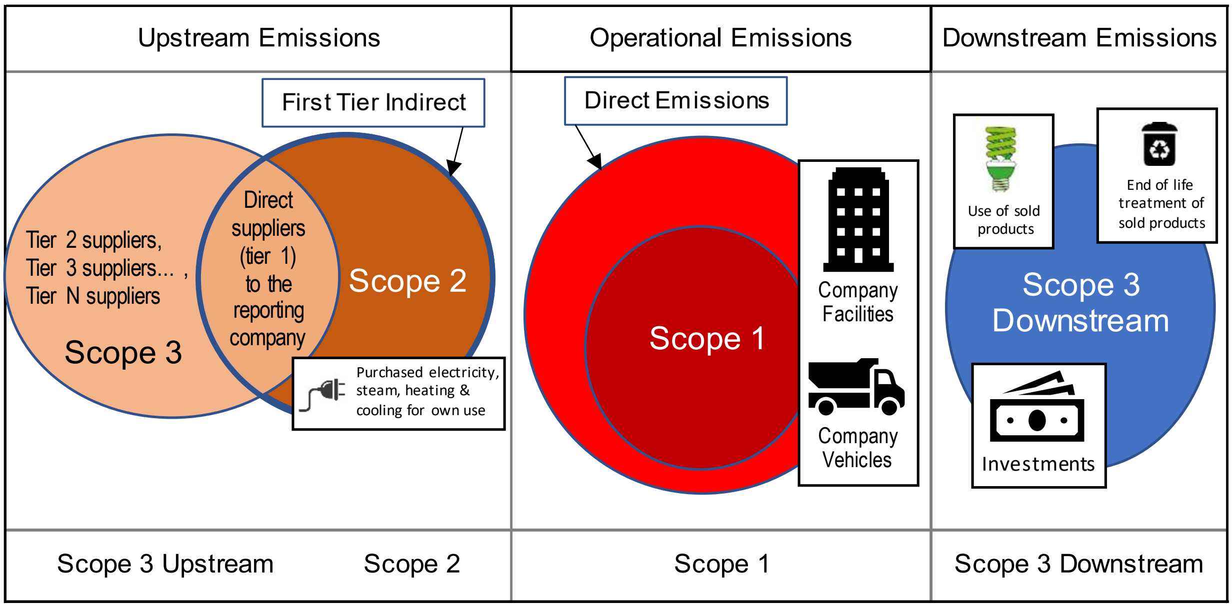
3.1 Brunel in partnership with S&P Capital IQ have analysed the Devon Fund's carbon footprint as at 31 December 2023. This is the sixth annual assessment of the Fund's carbon footprint.

3.2 Calculating the impact of a company's emissions involves looking not only at the operations of the company itself, but also looking at the impact of the products that it sells and the impact of its supply chain. Emissions are therefore split into scope 1, scope 2 and scope 3 emissions:

- Scope 1 – The direct emissions of the company's own operations.
- Scope 2 – The emissions related to the purchase of electricity, steam, heating and cooling for the company's use.
- Scope 3 Upstream – The emissions of the company's supply chain.
- Scope 3 Downstream – The emissions associated with the companies' products as they are consumed by customers.

These are illustrated in the following diagram.

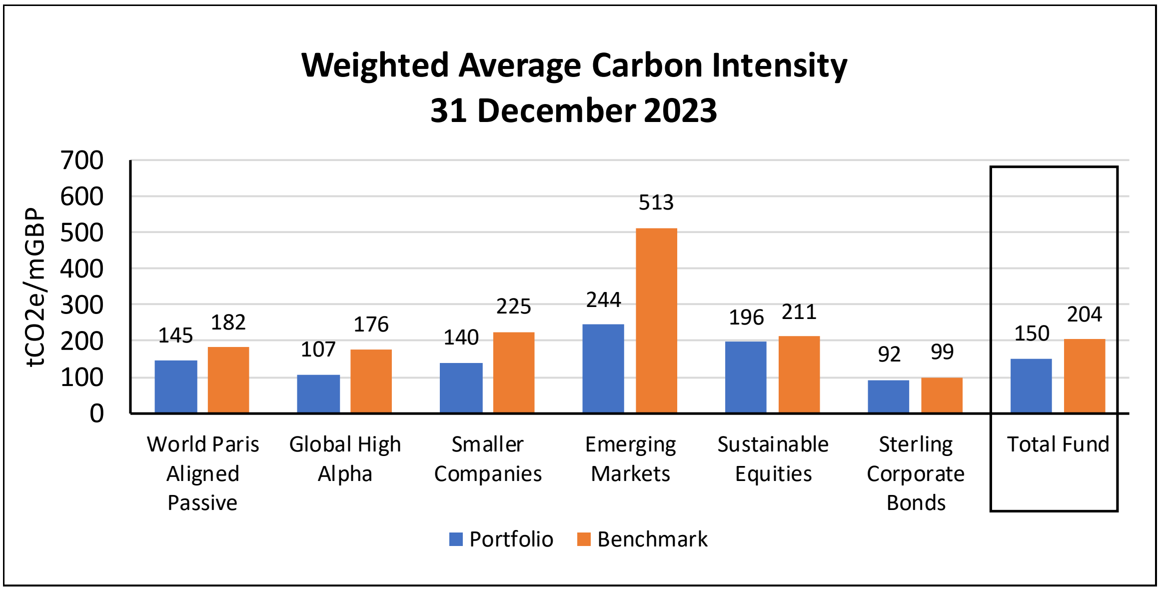
Greenhouse Gases – Scopes



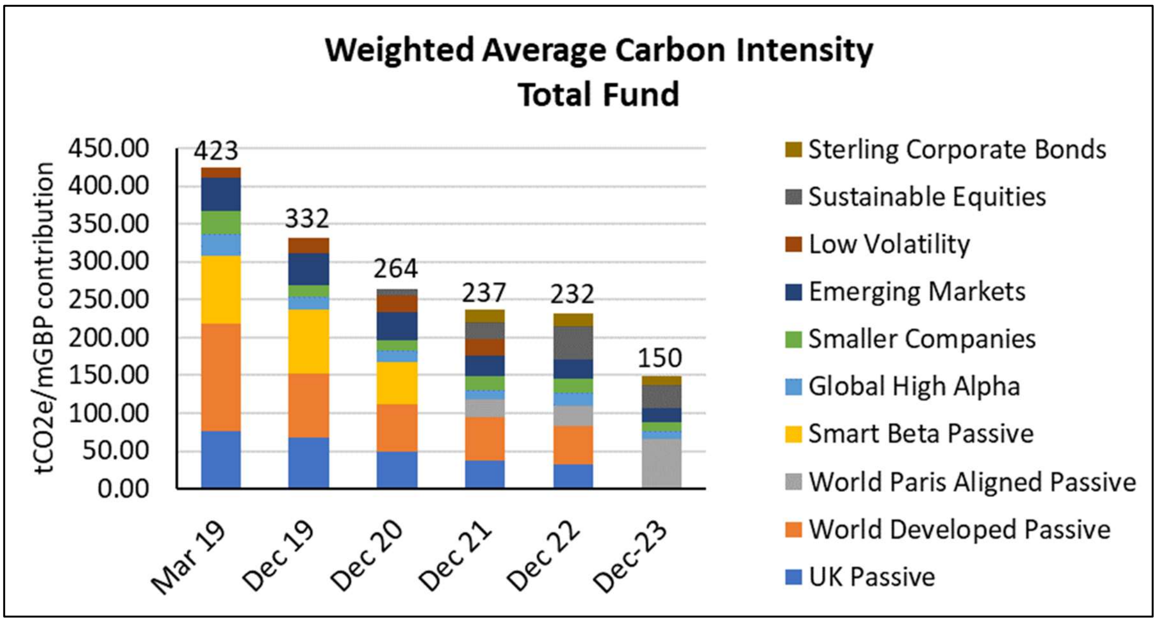
3.3 In analysing a portfolio of investment companies, there is the danger of double counting, where the scope 1 direct emissions of one company are the scope 3 downstream emissions of another company in the portfolio. However, from an investment risk perspective it is useful to know both the attribution of carbon risk (what is in the company's direct control) and also the aggregate risk, from carbon risk within the supply chain. The analysis of the Devon Pension Fund's equity investments therefore takes into account Scope 1 direct emissions, Scope 2 (e.g. purchased power) and the first tier Scope 3 (immediate supply chain) emissions of investee companies, as shown in the diagram above.

3.4 The analysis undertaken quantifies greenhouse gas emissions (GHG) embedded within a portfolio, presenting these as tonnes of carbon dioxide equivalents (tCO2e). Comparing the total GHG emissions of each holding, relative to either revenues generated or capital invested, gives a measure of carbon exposure that enables comparison between companies, irrespective of size or geography. The weighted average carbon intensity (WACI) of each portfolio is measured by summing the product of each holding's weight in the portfolio with the company level carbon/environmental revenue intensity.

3.5 The WACI for each portfolio and for the Fund's total equity and sterling corporate bond holdings as at 31 December 2023 is shown in the graph below. The total Fund WACI has fallen from 232 tCO2e/mGBP in December 2022 to 150 tCO2e/mGBP in December 2023, a reduction of 35%. The WACI in December 2023 is below the benchmark of 204 tCO2e/mGBP.



3.6 Progress since March 2019 is shown in the following chart, with the proportionate contribution from each equity portfolio also highlighted.

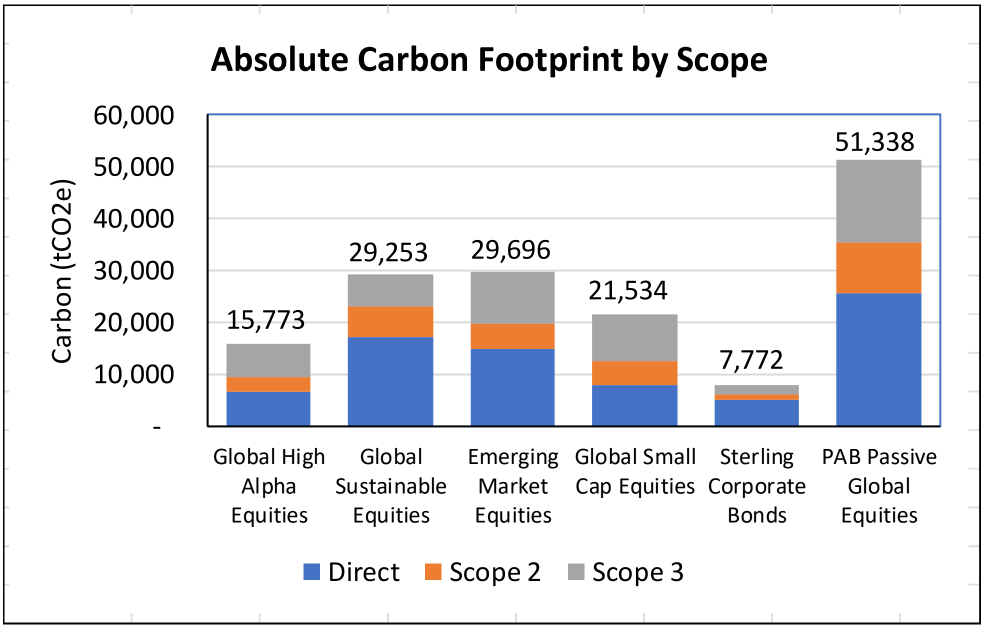


3.7 There are several factors contributing to the 35% reduction over the year:

- The decision to move the UK and core global developed passive allocations to the Paris Aligned Benchmark (PAB) fund will have achieved a reduction in overall WACI of around 7%, as the PAB fund has a lower WACI.
- The Paris Aligned Benchmark is itself constructed to take into account climate data in re-weighting companies within the index to ensure a 7% per year reduction in WACI.
- Companies with a low WACI, such as the big tech companies have performed better over the year than industrial companies and therefore form a larger part of the actively managed portfolios.

- There has been some real progress by individual companies in the portfolios in reducing their carbon emissions. Examples of companies that have reduced their emissions include Tesla, Linde plc, Nestle and Waste Management Inc.

3.8 In addition to the WACI data, the metrics proposed by the Government consultation also included the absolute carbon emissions of the portfolio. This is set out in the chart below.



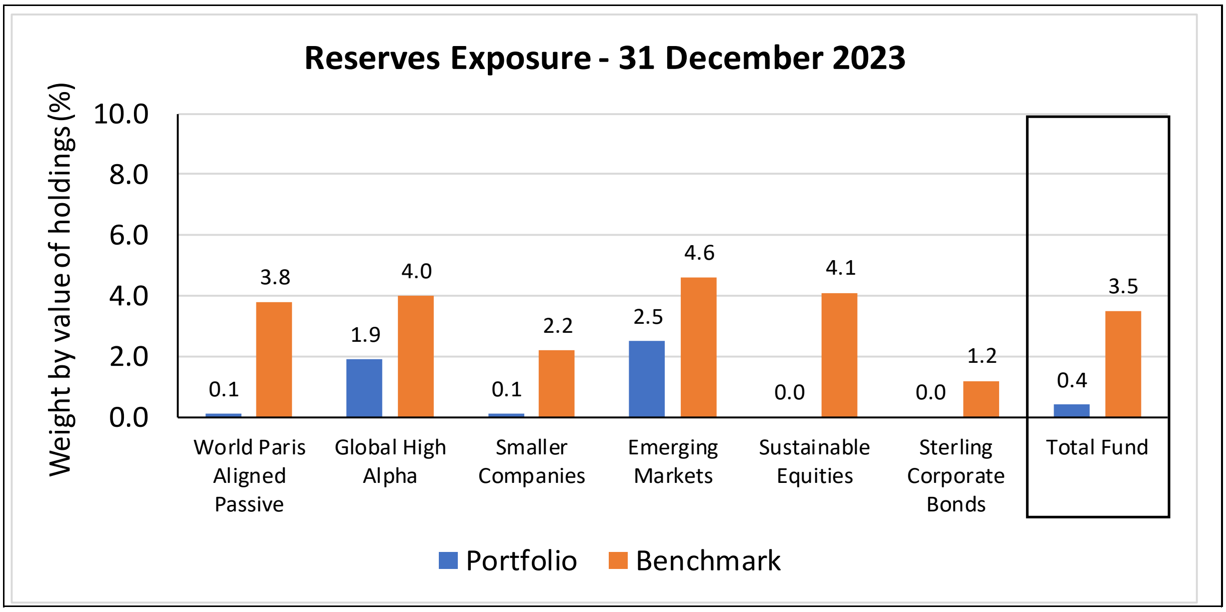
3.9 It should be noted that the absolute emissions will depend to a certain extent on the size of the investment, so if more is invested the absolute carbon emissions will be higher. For example, the Paris Aligned Passive portfolio has the highest absolute emissions because significantly more is invested in the portfolio than the active equity and bond portfolios. This metric does not therefore lend itself well towards assessing progress.

4) Reserves Exposure

4.1 One of the issues with the WACI measurement is that it does not capture the downstream tier 3 emissions. Downstream Scope 3 emissions based on product in use (or disposal) are not widely calculated by companies or reported. However, downstream Scope 3 are critical when looking at the impact / investment risk of car manufacturers and fossil fuel companies.

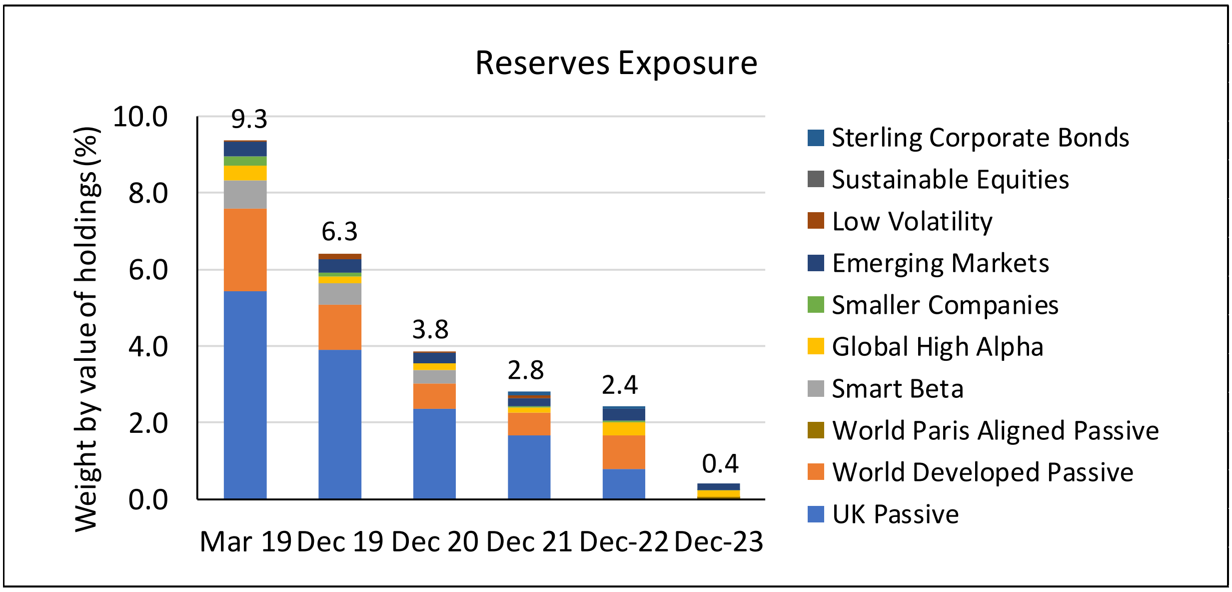
4.2 This is linked with the risk involved in stranded assets, where companies may have large reserves of fossil fuels that will not be usable if we are to achieve carbon reduction targets across the economy and so become “stranded”. Exposure to reserves data is therefore a useful proxy for downstream emissions.

4.3 The reserves exposure for each portfolio and for the Fund’s total equity and sterling corporate bond holdings as at 31 December 2023 is shown in the graph below. The figures shown are on a value of holdings basis, which means the value of any company with fossil fuel reserves is included in full in the analysis, regardless of what proportion of their business relates to extraction. Between December 2022 and December 2023, the reserves exposure fell from 2.4% to 0.4%. This equates to just under 0.25% of total assets.



4.4 The decision to move all of the Fund's passive equity allocation from the previous UK and Global Developed Passive funds to the Paris Aligned Benchmark Fund has resulted in a significant reduction in exposure to fossil fuel reserves. The majority of exposure was previously through those passive allocations, whereas the Paris Aligned Fund has virtually no exposure. The remaining exposure is through the Global High Alpha and Emerging Market Equities portfolio.

4.5 The reduction in reserves exposure since March 2019 is shown in the following graph:



5) Renewable Energy Investment

5.1 In addition to reducing the carbon emissions of its investments, the Committee also set a target to have invested 5% in renewable energy infrastructure by 2025. The Fund has a target allocation of 9% to Infrastructure investments, plus a 3% allocation to local impact investments, which could be infrastructure, affordable housing or local private equity, as part of its strategic asset allocation to private markets. The 5% target therefore represents around half the total infrastructure allocation.

5.2 The current investment in renewable infrastructure, as at 31 March 2024, is summarised in the following table. The DCC managed infrastructure funds column includes investments in the UBS Infrastructure Fund, the Hermes Infrastructure Fund and the Aviva Investors Infrastructure Income Fund, that were made before the advent of Brunel and are still retained. The Local Impact portfolio includes the Greencoat Wessex Gardens Fund and the Quinbrook Renewables Impact Fund that were agreed by the Committee during 2023.

Devon Pension Fund - Investment in Renewable Infrastructure

Category	Brunel Infra Portfolios	DCC Managed Infra Funds	Local Impact Portfolio	Total Investment
	£'000	£'000	£'000	£'000
Cogeneration	15,950			15,950
Hydro	229			229
Mixed Renewables	26,025			26,025
Solar	62,739	7,394	49,492	119,625
Waste to Energy	3,473	10,067		13,540
Wind	43,631	11,362		54,993
Power Storage	5,536		3,761	9,297
Smart & Efficient Grids	16,787		9,203	25,990
	174,370	**28,823**	**62,456**	**265,649**

5.3 The £266 million investment currently comprises around 4.5% of the total Fund value, just short of the 5% target. There is still a significant level of undrawn commitment to the Brunel Infrastructure portfolios which should increase the percentage towards the target level.

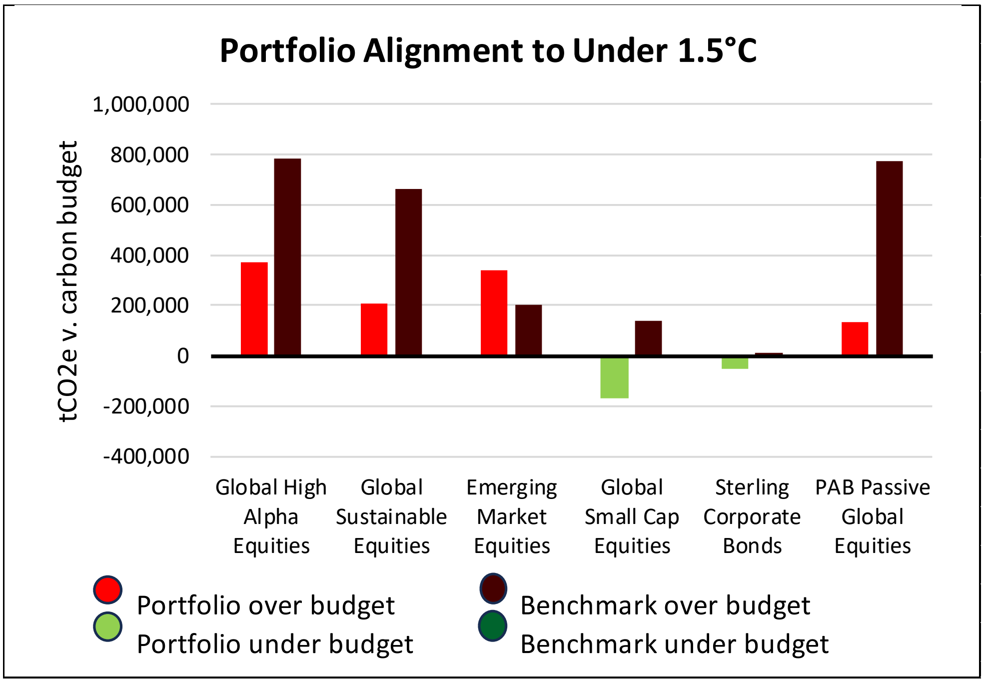
6) Alignment

6.1 The Fund has set a target that 100% of developed listed equities should be aligned or aligning to the Paris Agreement by 2030 and 100% of all listed equities (i.e. also including Emerging Markets) should be aligned or aligning by 2040. Measuring alignment is not straightforward and Brunel propose to use a matrix approach, using various objective methods. This is to a large extent still in development, but Brunel have provided initial metrics around the allocation of a carbon budget.

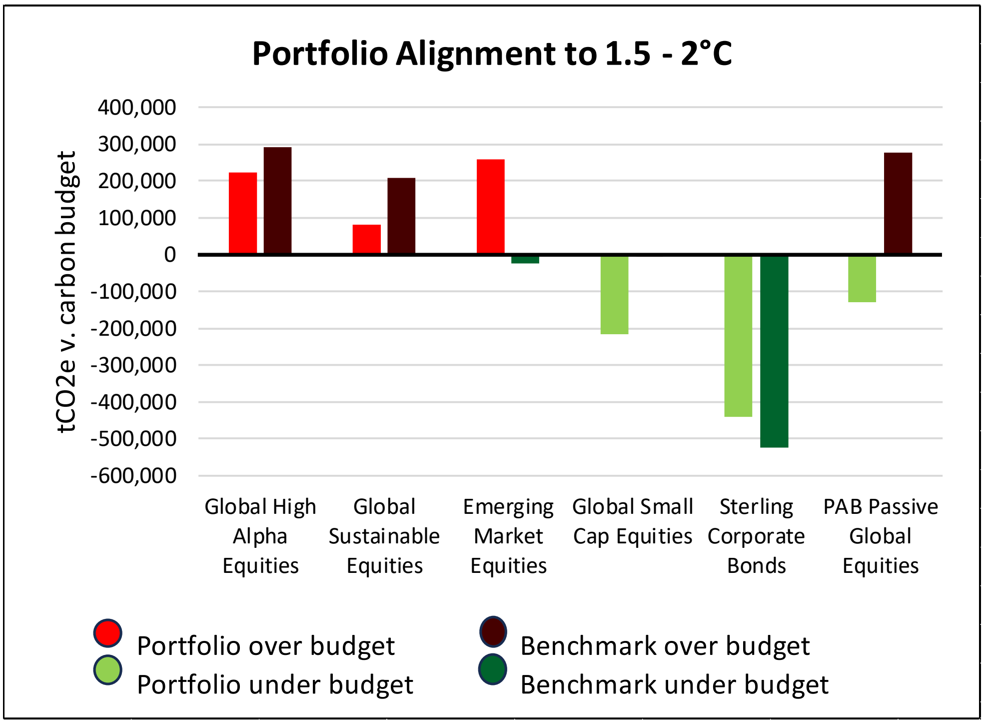
6.2 The carbon budget in the context of the Paris Alignment metric refers to the total allowable carbon emissions allocated to a company, aimed at aligning with the 1.5°C climate target. The carbon budget is designed to reduce each year to align with the goal of achieving net zero emissions by 2050. This means that the allowable emissions for companies and sectors will decrease annually based on climate models that outline the necessary reductions to limit global warming to 1.5°C.

6.3 The total carbon emissions of each portfolio over a period from 2012-2030, actual and forecast, is then compared to the carbon budget to determine whether the portfolio as a whole is aligned to 1.5°. The portfolio can be compared against different degrees of temperature increases, with a negative number indicating that the overall emissions of the portfolio are within the carbon budget that would be aligned with that level of temperature increase, while a positive figure indicates that the portfolio is not currently aligned.

6.4 The chart below indicates whether each portfolio is currently aligned to a below 1.5°C scenario. It shows that taken as a whole, the Global Smaller Companies Equities portfolio, and the Sterling Corporate Bonds portfolios are aligned to a below 1.5°C scenario, while the other portfolios are yet to reach that target.



6.5 The following chart indicates whether each portfolio is currently aligned to a 1.5-2.0°C scenario. It shows that taken as a whole, in addition to the Global Smaller Company Equities and the Sterling Corporate Bonds portfolios, the PAB Passive portfolio is also aligned to a below 2°C scenario, while the other portfolios are currently aligned to temperature rise scenarios of over 2.0°C.



6.6 Where the portfolio as a whole may be negative, it does not mean that the portfolio is 100% aligned, i.e. it does not mean that every company is aligned. Some holdings may be significantly over-performing, offsetting others that are not yet aligned. As such, the Paris Alignment metric in the report provided by Brunel does not directly relate to understanding where we are in terms of achieving our policy target. More work on the individual companies is required in order to provide this, but the figures do give an initial indication of where each portfolio stands.

7) Conclusion

7.1 The Committee are asked to note the progress made towards the targets set in the Fund's climate change policy, in particular:

- The 35% reduction in the WACI of the Fund's equity and corporate bond investments over the year to 31 December 2023.
- The reduction in exposure to companies with fossil fuel reserves to around 0.25% of total fund assets
- The investment of 4.5% of total fund assets in renewable energy infrastructure.

Angie Sinclair
Director of Finance and Public Value

Electoral Divisions: All

Local Government Act 1972: List of background papers

Nil

Contact for enquiries:
Name: Mark Gayler
Telephone: 01392 383621
Address: Room 196 County Hall