CAMBRIDGESHIRE PENSION FUND

Agenda Item No: 7

To:	Investment Sub Committee
Meeting date:	14 November 2024
Report by:	Mark Whitby Head of Pensions Mark.Whitby@Westnorthants.gov.uk
Subject:	Analytics for Climate Transition
Purpose of the report:	To provide the Investment Sub Committee with an update on the decarbonisation progress for listed equities, corporate bonds, and combined assets.
Recommendations:	The Investment Sub Committee is asked to:

a) Note the Analytics for Climate Transition (ACT) report from Mercer including decarbonisation progress to date.

b) Agree the decarbonisation targets for

   i) the corporate bonds portfolio; and

   ii) the combined listed equity and bonds portfolio

   to be aligned with the already agreed decarbonisation targets for listed equity.

c) Note the next steps outlined in section 8.

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1. Background

1.1 In November 2021 the ISC noted the climate change reporting baseline data presented by Mercer. This was restricted to the listed equity portfolio but provided a starting point to develop plans for carbon reduction.

1.2 The ISC approved the proposed metrics for the Fund's reporting of climate risk as:

1.2.1 Absolute emissions: tCO2e* (value of investment/company);

1.2.2 Emissions intensity: Carbon Footprint (tCO2e/$million invested) and Weighted Average Carbon Intensity ("WACI") (=tCO2e/$million sales);

1.2.3 Forward looking: implied temperature change.

1.3 At the February 2022 ISC meeting Mercer's report set out the starting point for climate metrics as at June 2021, covering scope 1 and 2 emissions within the listed equity portfolio. The baseline emissions were:

1.3.1 Absolute emissions 132,500 tCO2e

1.3.2 Carbon Footprint 44.4 tCO2e/$million invested

1.3.3 Implied Temperature Rise 3.1ºC

1.3.4 Weighted Average Carbon Intensity "WACI" 104.2 tCO1e/$million sales.

1.4 In May 2023 the ISC approved the adoption of the carbon footprint metric as the primary metric for monitoring progress against the existing decarbonisation targets. The target reductions remained 23% by 2024 and 57% by 2030.

1.5 ACT analysis as at June 2023 showed that 42.5% of the total Fund was analysed, all of which related to listed equities. In May 2024 the ISC agreed that a further 15% of the Fund relating to Multi Asset Credit would be analysed and an additional forward-looking, non-emissions metric, SBTi alignment, would be incorporated into the analysis.

2. Executive summary

2.1 Mercer's Analytics for Climate Transition (ACT) is a tool to assist funds in planning to align to a net zero outcome by 2050 using a step-by-step approach.

2.2 This June 2024 ACT report analyses listed equity and corporate bond mandates totalling c. £2,720 million (based on strategic asset allocation), representing 57.5% of the entire Fund. The Fund's primary metric for reporting decarbonisation progress is carbon footprint.

2.3 The carbon footprint of the Fund's listed equity portfolio decreased by 59.2% from June 2021 to June 2024. Weighted Average Carbon Intensity (WACI) and the Absolute Emissions have also decreased significantly.

2.4 Decarbonisation of the Fund's corporate bond portfolio has been measured for the first time. The overall carbon footprint of the corporate bond portfolio has decreased by c.27.4% from a 2021 baseline.

2.5 Decarbonisation of the Fund's combined listed equity and corporate bond portfolio has also been measured for the first time. In relation to a June 2021 baseline, the overall carbon footprint of the combined listed equity and corporate bond portfolio has decreased by c.35.8%.

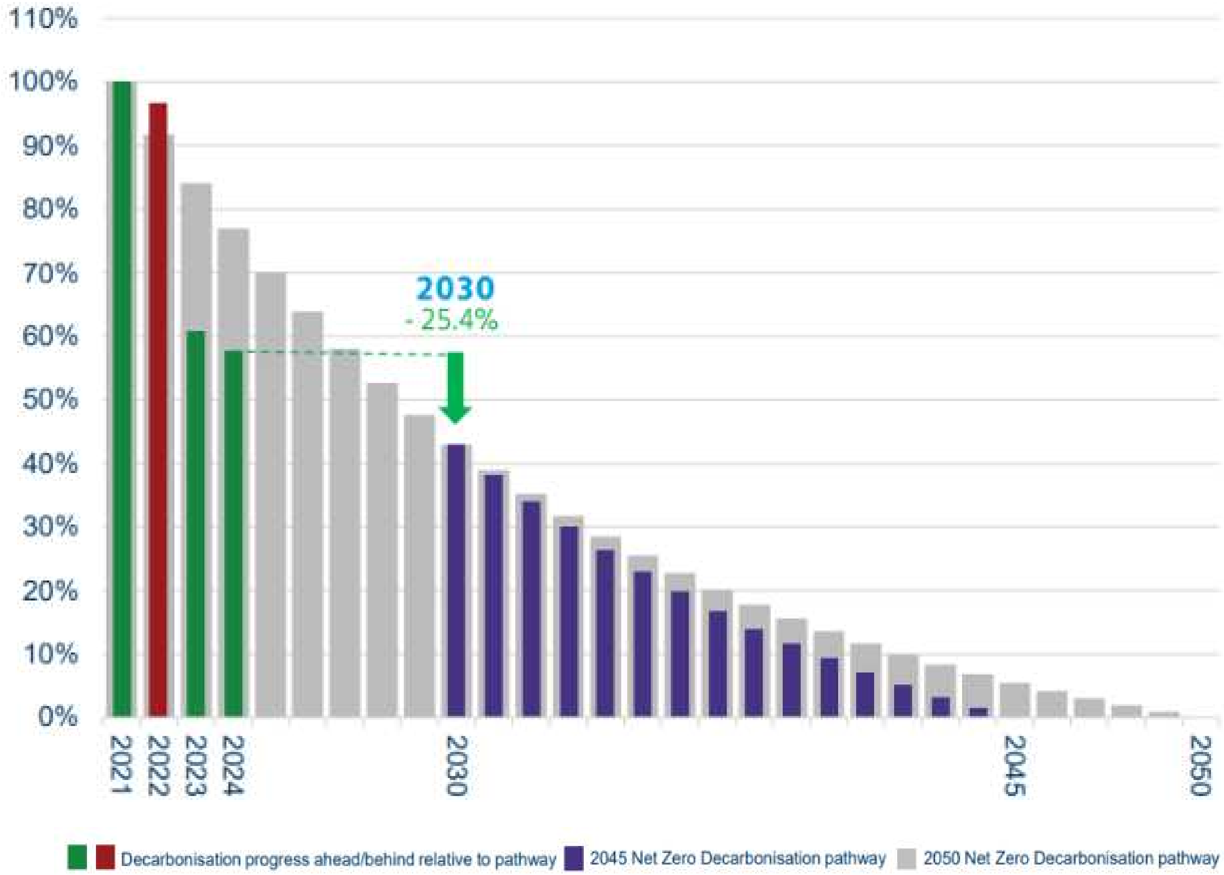
2.6 The SBTi metric has been incorporated into the current analysis to track the number of companies within the portfolio that have submitted climate transition plans approved by the SBTi. 40.9% of companies analysed have set SBTi-approved targets.

2.7 The ACT spectrum refers to a framework used to evaluate and categorise the alignment of financial assets or funds with the transition to a low-carbon economy. Further information is provided in Section 7 of this report.

2.8 A number of next steps have been recommended as set out in Section 8.

3. Decarbonisation progress – Listed Equity

3.1 The chart below, replicated from Appendix 1, illustrates progress against the agreed decarbonisation pathway for the Fund's listed equity portfolio, which is based on its carbon footprint, starting from a baseline of June 30, 2021.



3.2 It compares the Fund's listed equity portion against decarbonisation targets, which include a 23% reduction by 2024, a 57% reduction by 2030, and achieving net zero by 2050 or earlier.

3.3 The Fund's listed equity portfolio decreased by 42.4% on a carbon footprint basis, from June 2021 to June 2024. The Weighted Average Carbon Intensity (WACI) decreased by 43.7% in the same period, and the Absolute Emissions decreased by 52.1%.

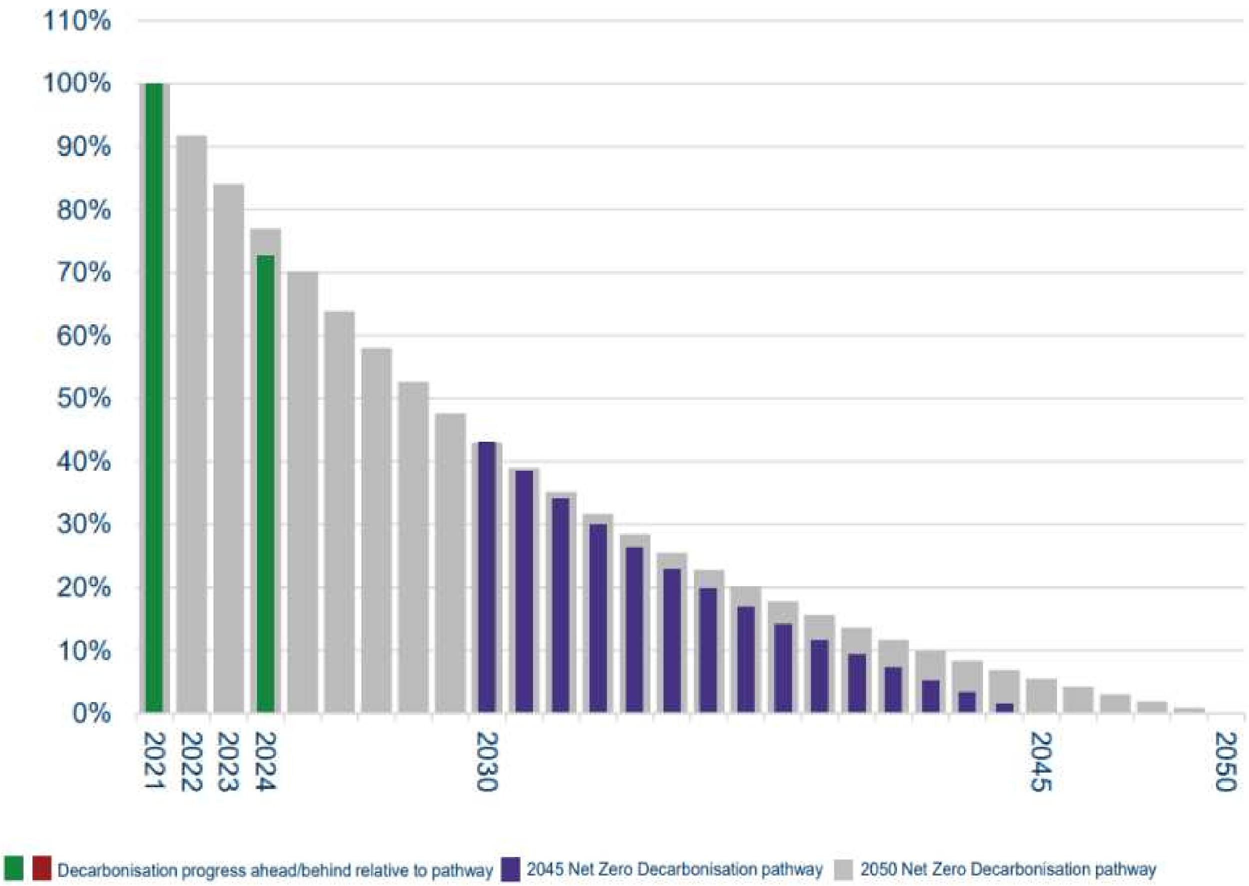
3.4 The JO Hambro Global Equity mandate experienced a significant increase in its carbon footprint, rising by approximately 70.2% over the past three years. Officers are currently reviewing this portfolio as part of the ongoing equity review.

3.5 The Dodge & Cox Global Equity mandate is the most carbon-intensive mandate by a significant margin; however, it has demonstrated substantial improvement in recent years. Notably, the mandate has achieved a reduction in its carbon footprint of approximately

23%. Officers are actively engaging with Dodge & Cox, alongside other ACCESS investors, in connection with a number of carbon intensive stocks.

4 Decarbonisation progress – Corporate bonds (MAC)

4.1 The chart below, replicated from Appendix 1, illustrates the decarbonisation progress for the Fund's corporate bond portfolio, based on its carbon footprint, starting from a baseline of June 30, 2021.



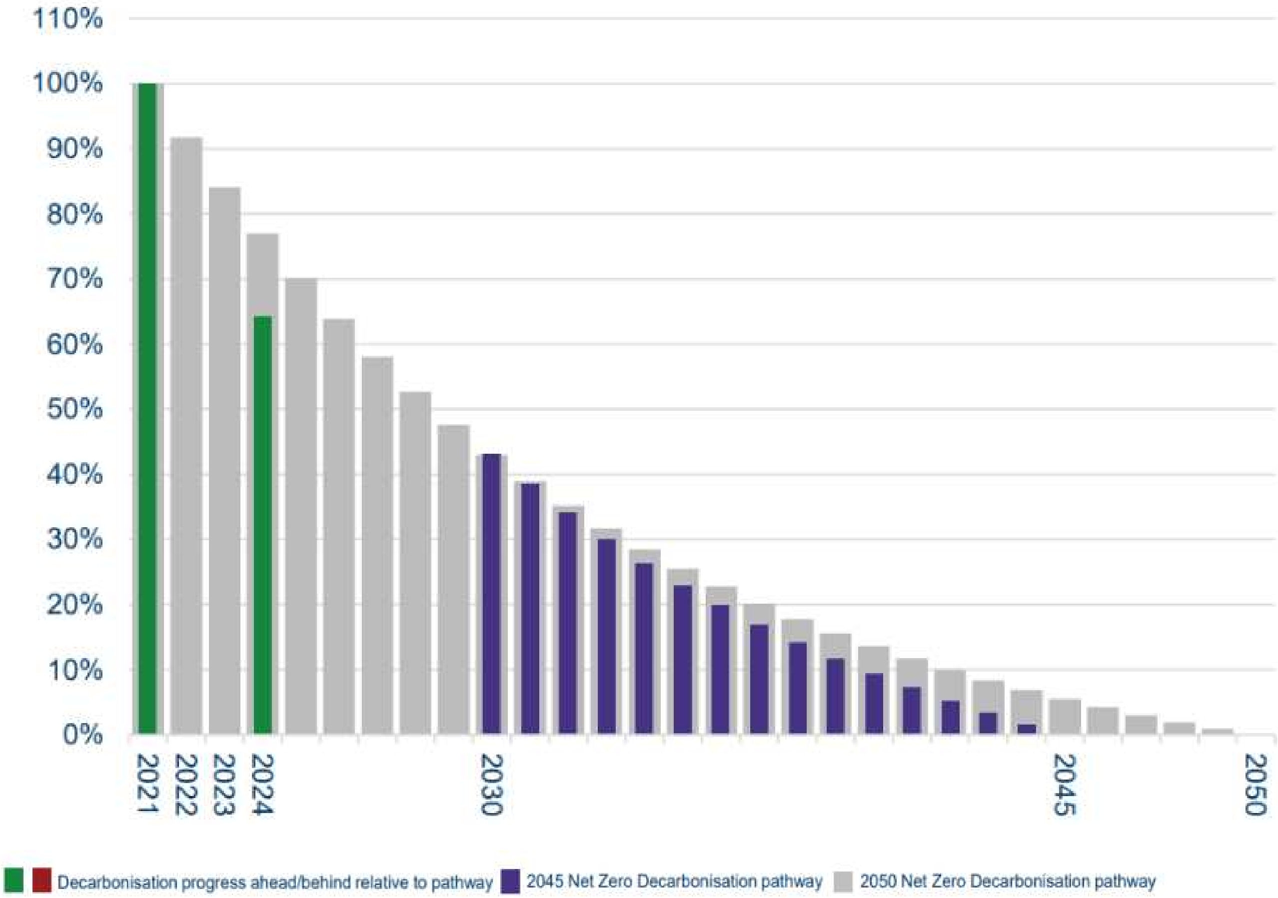
4.2 Mercer has increased its coverage over the year in order to extend the ACT analysis to the corporate bonds portion of the Multi-Asset Credit mandates. A 2021 baseline has been established using stocklists as at 30 June 2021. Further details are provided at the foot of page 27 of Appendix 1.

4.3 The chart above assumes the same decarbonisation pathway as for the listed equity portfolio i.e. it compares this portion of the Fund to the decarbonisation targets: a 57% reduction by 2030, and achieving net zero by 2050 or earlier. As this target has not previously been set, approval is sought for this target within the recommendations.

4.4 The overall carbon footprint of the corporate bond portfolio has decreased by c.27.4% from the 2021 baseline. To meet the 2030 reduction target, the carbon footprint of the corporate bond portfolio needs to decrease by 41% by 2030.

5. Decarbonisation progress – Combined

5.1 The chart, replicated from Appendix 1, illustrates the decarbonisation pathway for the Fund's combined listed equity and corporate bonds portfolio, beginning with a baseline carbon footprint as of June 30, 2021.



5.2 The chart compares this segment of the Fund against the decarbonisation targets of a 23% reduction by 2024, a 57% reduction by 2030, and the goal of achieving net zero by 2050 or earlier. As these targets have not previously been set for the combined portfolio, approval is sought for these targets within the recommendations.

5.3 In relation to the June 2021 baseline, the overall carbon footprint of the combined listed equity and corporate bond portfolio has decreased by c.35.8%.

5.4 To meet the 2030 reduction target, the carbon footprint of the listed equity and corporate bond portfolio needs to decrease by a further 33% by 2030.

6. Science Based Targets Initiative (SBTi)

6.1 The SBTi metric has been introduced in the current analysis to monitor the number of companies within the portfolio that have submitted climate transition plans approved by the SBTi.

6.2 As of the current analysis, 44.2% of companies in listed equities and 21.7% in corporate bonds have set SBTi-approved targets, with an overall figure of 40.9% across both equities and bonds.

6.3 A more detailed breakdown of this analysis is provided on page 11 of Appendix 1.

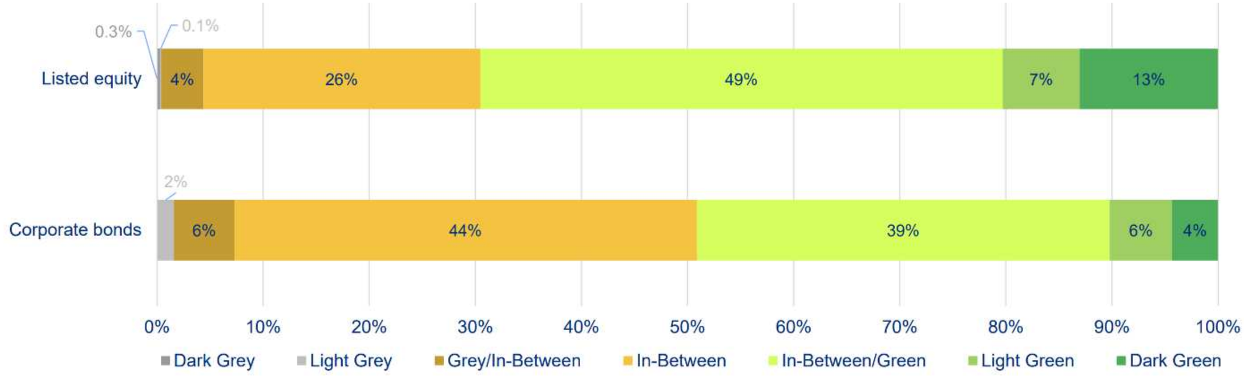
7. ACT Spectrum

7.1 The ACT spectrum provides an indication of climate transition capacity across the portfolio.

7.2 The green area shows where funds are well aligned with the low carbon transition and the grey area shows where they are not. The areas in between show a varied carbon intensity and transition potential.

7.3 Further details regarding the ACT Assessment by mandate and percentage are provided on page 18 of the Appendix 1.

7.4 The below chart repeated from Appendix 1, illustrates the assessment by asset class according to percentage allocation weight.



7.5 For listed equities, c. 70% of assets are "In-Between/Green" or better, which means that the majority of portfolio companies are transition aligned. For corporate bonds analysed this transition alignment is only reflected within c. 50% of the companies.

7.6 For both asset classes, the percentage of companies that show a "grey" alignment is very small (c. 0.4% for listed equity and c.2% for corporate bonds).

7.7 The top 10 contributors to carbon footprint of listed equities and corporate bonds are set out in Exempt Appendix 2.

8. Next steps

8.1 Mercer has recommended a number of next steps for working towards reduction targets.

8.2 Monitor interim decarbonisation targets for listed assets:

8.2.1 Listed Equity - Maintain a watching brief on the suitability of the 2030 decarbonisation target by evaluating the portfolio's carbon efficiency relative to MSCI ACWI, the overall 2050 net-zero target, and the heightened emphasis on portfolio alignment with climate solutions.

8.2.2 Corporate Bonds - Adopt separate decarbonisation target for corporate bond mandate. This has been added as a recommendation alongside a combined listed equity and corporate bonds target.

8.3 Adopt additional metrics:

8.3.1 The Fund has already commenced monitoring SBTi alignment, climate transition capacity, and top 10 contributors.

8.3.2 In future analysis the Fund could measure exposure to climate solution companies and agree a future target.

8.4 Implement an Engagement Plan:

8.4.1 Develop a more formal engagement plan for top contributors to carbon footprint within the portfolio (i.e. a "climate target list") based on agreed criteria.

8.4.2 Currently, officers are engaging directly with Dodge & Cox alongside other investment partners as set out in paragraph 3.5. Additionally, JO Hambro is being evaluated as part of the ongoing equity review. ACCESS is also procuring a Voting & Engagement Provider to undertake engagement in the name of the ACCESS authorities against pre-agreed themes.

8.5 Progress private markets disclosures:

8.5.1 Some private market managers responded positively to the request for portfolio carbon metrics whilst others were unwilling or unable to provide meaningful data. This makes reliable aggregation at this point in time challenging.

8.5.2 Mercer recommend the focus at this stage should be on engaging with managers, in order to improve data coverage and quality.

9. Relevant Pension Fund objectives

9.1 To have robust governance arrangements in place, to facilitate informed decision making, supported by appropriate advice, policies and strategies, whilst ensuring compliance with appropriate legislation and statutory guidance.

9.2 To manage the Fund in a fair and equitable manner, having regard to what is in the best interest of the Fund's stakeholders, particularly the scheme members and employers.

9.3 To ensure employer contributions are as stable as possible, recognising the characteristics, circumstances and affordability constraints of each employer.

9.4 To put in place a Strategic Asset Allocation ensuring it is appropriately maintained taking into account the Funding Strategy.

9.5 To maximise investment returns over the long term within agreed risk tolerances.

10. Implications (including financial implications)

10.1 Resources and financial

101.1 All internal costs will be met by existing resources and the cost of the Fund's Investment Consultants' Mercer, are included within the 2023/24 budget. Any further financial implications will be included in Pension Fund Committee reports as required.

10.2 Legal

10.2.1 There are no legal implications arising from the proposals.

10.2.2 Squire Patton Boggs have conducted a review of the paper for legal implications.

10.3 Risk management

10.3.1 The mitigated risks associated with this report has been captured in the Fund's risk register as detailed below -

Risk	Residual risk rating
As long-term investors, the Fund believes climate risk has the potential to significantly alter the value of the Fund's investments.	Amber
Fund assets are not sufficient to meet obligations and liabilities as they become payable.	Amber
Failure to act appropriately upon expert advice and/or risk of poor advice.	Green
Investment decisions and portfolio management may not achieve the return required or be performed in accordance with instructions provided.	Green

10.3.2 The executive summary of the Cambridgeshire Pension Fund risk register can be found here.

10.4 Consultation

10.4.1 This paper has been produced in conjunction with the Fund's Investment Consultants, Mercer and additionally supported by the Fund's appointed Independent Advisor.

11. Background papers

11.1 ISC paper November 2021 – Responsible Investment.

11.2 ISC paper February 2022 – Climate Action Plan

11.3 ISC paper May 2023 - Analytics for Climate Transition

11.4 ISC paper November 2023 – Analytics for Climate Transition

11.5 ISC paper May 2024 – Analytics for Climate Transition

12. Appendices

12.1 Appendix 1 Mercer paper – Analytics for Climate Transition (ACT) 30 June 2024 (Public).

12.2 Exempt Appendix 2 Mercer paper – Analytics for Climate Transition (ACT) 30 June 2024