Item 6

8th September 2021

Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

Contact: Richard McIndoe, Director

Climate Change Strategy – Assessment of Energy Companies

Purpose of Report:

To present initial findings of an assessment of energy sector companies in SPF portfolios.

Recommendations:

The Committee is asked:

- **to NOTE** the content of this report and
- **to AGREE** that a further report will be considered once the next steps outlined at paragraph 10 have been completed.

Ward No(s):	Citywide: ✓
Local member(s) advised: Yes ☐ No ☐	consulted: Yes ☐ No ☐

1 Background

At its meeting on 2nd June 2021, the SPF committee considered a report on a motion approved by Glasgow City Council. The committee agreed that:

i. an assessment of energy sector companies in SPF portfolios be conducted to ensure all were meeting minimum standards to be agreed in consultation with investment managers and Sustainalytics;
ii. if any did not meet these standards, SPF should disinvest from them;
iii. any disinvestment should be completed as quickly as possible whilst ensuring no detriment to the financial stability of the fund; and
iv. a further report would be submitted to the next meeting of this committee.

2 Energy Sector Companies in SPF Portfolios

The table below provides a summary of the energy sector companies in SPF portfolios as at 30th June 2021. A full list is set out in Appendix A.

		Energy Companies Held	
Manager	**Portfolio Value**	**No.**	**Value**
	(£m)	**(#)**	**(£m)**
Baillie Gifford	2,450	**1**	**22.5**
Lazard	866	**5**	**44.4**
Oldfield	769	**2**	**56.2**
Veritas	827	**-**	**0**
JP Morgan	1,025	**7**	**21.4**
Lombard Odier	486	**9**	**22.4**
Total	**6,423**	**24**	**166.9**

3 Investment Managers

On 1st July, SPF wrote to the relevant investment managers asking them:

1. To briefly set out the investment rationale for each of the energy sector companies held in the SPF portfolio.

2. What ESG considerations were involved in the decision to buy and hold these companies.

3. Whether they have any minimum standards or “red lines” in respect of ESG criteria and, in particular, climate change which would prevent them buying or holding certain companies.

4. Any minimum standards in respect of climate change, and with particular reference to companies in the Oil and Gas sector(s), which might be agreed and applied to the SPF portfolio.

4 Manager Responses

Manager responses were varied, particularly with regard to the investment rationale for energy companies held. That is not surprising given that SPF deliberately uses a variety of investment managers to ensure diversification. Responses are summarised below.

4.1 Investment Rationale

The sample below illustrates the breadth of activity and climate adaptation across these holdings.

- An Italian renewable energy focused company with 86% of its EBITDA deriving from renewable energy (the remainder is linked to their highly energy efficient CCGT gas turbine which they are in the process of disposing).
- A Norwegian pure play on renewable energy development and operation in emerging markets.
- 2 companies together have a >60% global market share in offshore wind cables.
- Company provides a power optimizing solar inverter that is used in photovoltaic systems.
- Company is a provider of electrical balance of system (EBOS) solutions for solar energy projects.
- Company is one of the world's largest manufacturers of ground-mounting systems used in solar energy projects.
- An Indian conglomerate with operations spanning retail, telco and energy – including the largest and most complex refinery facility in Asia. The company is evolving from its position as India's leading retailer and owner of a rapidly growing telecom company (JIO) to pursue a vertically integrated "omni-channel" approach to commerce (physical + digital) which is a good fit for the manager's Empowered Consumer theme. -
- 6 stocks held in the portfolio as part of Energy Transition theme reflecting:
  - the global energy transition toward low carbon;
  - a shift in the balance of power that has administered oil prices – away from OPEC;
  - a long transition likely to raise uncertainty and volatility. Exposure to energy prices provides diversification benefits.
- Offers a free cash flow yield of 11-12% over the next couple of years with dividend yield of 8%. The company has made commitments to reach net zero by 2050 and has embarked on investing for the energy transition ahead.
- A leading US oil services company providing equipment and consumables to the oil and gas exploration and production industry. The company has yet to make commitments commensurate with achieving net zero emissions by 2050 but does have a rapidly growing business in offshore wind turbine installation vessels. Manager has begun a dialogue with the company on the need to commit to Net Zero by 2050.
- Provides biomass fuel and energy efficient solutions to reduce energy consumption and CO2 emissions. Manager would classify this company as an Environmental Enabler.
- Historically serving the oil and gas industry but today has the largest proportion of its pipeline coming from the offshore wind industry. Manager would classify this company as an Adaptor.
- Gas storage and Infrastructure. Also offshore renewables and decommissioning.
- A North Sea producer of predominantly gas (more than 80% of production). Current production reports a carbon intensity figure of <18 kgCO2e/boe - well below the UK North Sea average. The investment rationale reflects a discounted valuation, and investability is enhanced by compatibility with the UK's Oil & Gas 2035 Roadmap vision for indigenous oil & gas to fulfil as much domestic demand as possible.

4.2 ESG Considerations

All of SPF's investment managers are PRI signatories. So all incorporate ESG issues into investment analysis and decision-making processes. How they do this varies. Again, this is an expected outcome of SPF's policy of diversification. The sample of responses below illustrates this.

- ESG factors are integrated into our investment process, at the idea generation stage and throughout the investment horizon, and our starting point is not to exclude any particular sectors or countries
- We use a four-question framework to ensure the company in question fits with our growth philosophy. The second question asks, 'Is it sustainable?'
- Our ESG framework comprises:
  - A fundamental score based on a proprietary 40 point ESG checklist, asking the same detailed questions of each company under coverage globally.
  - A quantitative score based on key ESG factors across sub-industries.
- Our ESG framework focuses on the strength of company and industry relationships with society – the societal license to operate – and how this might change over time.
- For the Industry / Company Assessment we assess the relative strength of the company within its industry, any risks of disruption and the ability of the company to change. Inputs for this process are taken from both external ESG data providers (e.g. Sustainalytics & Trucost) as well as our own extensive ESG and sustainability resources.
- Given the lack of (small company) data both in aggregate or standardised form we have conceived a qualitative model to categorise companies as enablers, adaptors, passive or unresolved in relation to social, technological, environmental and political change.

4.3 Minimum Standards in respect of ESG

Most managers have few or no "red lines", preferring detailed research in order to fully understand companies. ESG decisions are mostly qualitative judgements, rather than quantitative or rules based. Most managers emphasised the importance of engagement with companies rather than exclusion.

4.4 Minimum Standards in respect of Climate Change

A variety of measures and approaches was suggested. Responses are perhaps best summed up in the following extract:
"The investment implications of climate risk are multi-faceted and complex. No single metric or framework can begin to capture all the interconnected issues or identify the full range of a company's vulnerabilities and strengths."

5 Assessment of Energy Sector Companies

Whilst the manager responses are complex and varied, the assessment of energy companies may come down to one key question: can this company be part of the energy transition that is required to address climate change?

On the basis of manager responses, it seems that the companies are likely to fall into 3 categories:

- Those that are already clearly a part of the solution – pure renewables players, or companies which have already adapted significantly
- Those that still have significant legacy fossil fuel businesses but have started the process of adaption and
- Those which cannot or will not adapt.

Initial assessment would suggest that most of the current holdings are in either the first or second category. That is not surprising. SPF's philosophy, policies, and processes are all directed towards sustainable, long-term, responsible investment. A few holdings may be in the third category. However, this initial assessment needs to be validated. In order to do that, a set of minimum standards, and a process for applying them, need to be developed and agreed.

6 Minimum Standards

As indicated at 4.4, no single metric can be applied. The complexity of the problem and the diversity of the portfolios require some form of framework approach. Manager responses have been very informative as to what might be included in the framework. SPF's investment consultants, Hymans Robertson, have provided very helpful advice on the form the framework might take, and will continue to advise as the framework is developed.

7 Principles

In developing the framework, certain principles may be applied.
These might include the following:

- standards should be forward looking where possible.
- measures should be objective wherever possible, though a measure of judgement will be required.
- third party validation should be used in addition to company reporting and investment manager views.

8 Framework

SPF's Climate Change Strategy follows the thematic approach set out by the Task Force on Climate-related Financial Disclosures (TCFD) – illustrated opposite.
This is also the most recognised and used framework for climate change reporting by companies and other entities.

It is therefore proposed that the TCFD framework should be used in this context.

9 TCFD Framework

Using the TCFD framework, standards would be set and companies would be assessed under the 4 key areas of governance, strategy, risk management, and metrics and targets. Each of these, and the standards which might be applied to them are considered below. Appendix B provides summary details of some of the data sources which might be used.

9.1 Governance

Key questions:

- Has the company recognised climate risk?
- Can the company demonstrate clear responsibilities for oversight and management of climate risk?
- Does the company provide adequate climate-related disclosure?
- Is management remuneration linked to climate targets?

Answers may potentially be sourced from the companies' own TCFDs or other disclosures, investment manager research, and externally from CPD (the Carbon Disclosure Project).

9.2 Strategy

Key Questions:

- Has the company recognised the risks and opportunities to its business from climate change?
- Does the company have a strategy to address these?
- Is the strategy (likely to be) sufficiently resilient?
- Has the company made a net-zero commitment?
- What proportion of capital expenditure is on adaptation or development of renewable production capacity?
- Does the company have any plans for new development of oil and gas capacity?

Answers may potentially be sourced from the companies' own TCFDs or other disclosures, investment manager research, and externally from Sustainalytics, and TPI (Transition Pathway Initiative).

9.3 Risk Management

Key questions:

- Has the company carried out scenario analysis to model the risks it may face from climate change?
- What proportion of turnover/profit is currently derived from fossil fuels?
- How will this change in future?
- Is the company significantly exposed to stranded asset risk?

Answers may potentially be sourced from the companies' own TCFDs or other disclosures, investment manager research, and externally from Sustainalytics.

9.4 Metrics and Targets

Key questions:

- Has the company made a net-zero commitment?
- Has it set interim targets?
- What progress can it demonstrate?

Answers may potentially be sourced from the companies' own TCFDs or other disclosures, investment manager research, and externally from Sustainalytics, TPI, CDP and Climate Action 100+.

9.5 Assessment

On the basis of assessment of the answers to the key questions, each company could be categorised in each TCFD area using a red, amber, green rating system. This would lead to an overall assessment of the company based on the single key question identified at 5 above - can this company be part of the energy transition that is required to address climate change? This is illustrated in Appendix C.

9.6 Overall Categorisation

A key question is how the overall categorisation would be determined.
A working assumption might be that:

- Where a company had a similar rating in 3 or more of the categories – i.e. 3 or more red, amber or green ratings – then that would apply as the overall rating; and
- In any other case, the overall rating would be amber.

9.7 Actions

Another key question is what action would be taken in respect of each of the overall categories. A working assumption for this might be as follows.

Red: disinvest.
Amber: hold (at manager's discretion) but keep under review. Basis and regularity of review would need to be determined, but annual review against pre-determined progress objectives might be a working assumption. These companies are the ones where SPF's policy of engagement may be most productive.
Green: hold (at manager's discretion). [Process note: some companies - e.g. pure renewables players - might be automatically determined as green without further assessment.]

10 Next Steps

The following steps will be required in order to produce a final version of the framework:

- Engage with managers and advisers on the draft framework;
- Develop detailed standards under each of the 4 TCFD categories;
- Set minimum threshold for each of the 4 categories;
- Agree detail of actions to be taken in respect of each of the overall assessment categories;
- Agree implementation details – timeline, responsibilities, reporting;
- Consider interaction with remainder of SPF Climate Change strategy.

External validation of the final framework will be sought, from one or more of the independent sources listed in Appendix B.

A further report will be prepared for consideration and approval by the SPF Committee once these steps have been completed.

11 Policy and Resource Implications

Resource Implications:

Financial:	None at this time.

Legal:	None at this time.
Personnel:	None at this time.
Procurement:	None at this time.
Council Strategic Plan:	Strathclyde Pension Fund aligns with the theme of a well governed city.
Equality and Socio-Economic Impacts:	
Does the proposal support the Council's Equality Outcomes 2017-22	None at this time.
What are the potential equality impacts as a result of this report?	None at this time.
Please highlight if the policy/proposal will help address socio economic disadvantage.	
Climate Impacts:	
Does the proposal support any Climate Plan actions? Please specify:	Yes. The report relates to Strathclyde Pension Fund's Climate Change strategy which is being developed in line with Item 34 of the Council's Climate Action Plan.
What are the potential climate impacts as a result of this proposal?	Once the proposal is fully developed its implementation will lead to fossil fuel divestment.
Will the proposal contribute to Glasgow's net zero carbon target?	Once the proposal is fully developed its implementation will contribute to Strathclyde Pension Fund's net zero carbon target.
Privacy and Data Protection impacts:	

12 Recommendations

The Committee is asked **to NOTE** the content of this report and **to AGREE** that a further report will be considered once the next steps outlined at paragraph 10 have been completed.

Appendices

Appendix A	**Energy Companies Held**
Appendix B	**Potential Data Sources for Minimum Standards**
Appendix C	**Minimum Standards Framework**

Energy Companies Held

Company	
Active Energy	Nexans
Array Technologies	None
BP	Pharos Energy
Capital Ltd.	Prysmian
ENI	Reliance Industries (x2 portfolios)
Equinor	Royal Dutch Shell
ERG	Scatec
I3 Energy	Serica Energy Plc
Infastrata	Shoals Technologies
IOG	SolarEdge Technologies
Lamprell	TotalEnergies
National Oilwell Varco [NOV]	

Potential Data Sources for Minimum Standards

Task Force on Climate-related Financial Disclosures (TCFD)

In April 2015, the Group of 20 (G20) Finance Ministers and Central Bank Governors asked the Financial Stability Board to convene public- and private-sector participants to review how the financial sector can take account of climate-related issues. To help identify the information needed to assess and price climate-related risks, the FSB established an industry-led task force — the TCFD. The FSB asked the TCFD to develop voluntary climate-related financial disclosures that would be useful to investors and others in understanding material risk.

The TCFD's final recommendations were released in 2017.

TCFD's 202 status report confirmed that the number of organizations expressing support for the TCFD has grown to over 1,500 organizations globally, including over 1,340 companies with a market capitalization of $12.6 trillion and financial institutions responsible for assets of $150 trillion. Many of these companies have begun to implement the TCFD recommendations or continue to refine and improve their climate-related financial disclosures. Through the efforts of the World Business Council for Sustainable Development, the Institute for International Finance, the United Nations Environment Programme Finance Initiative, and other organizations, peer companies implementing the TCFD recommendations have come together to discuss effective climate-related financial disclosure practices and undertake work needed to enhance the effectiveness of such disclosures. Similar to the growth in the number of organizations supporting the TCFD, investor demand for companies to report information in line with the TCFD recommendations has also grown dramatically. Over 110 regulators and governmental entities from around the world support the TCFD, including the governments of Belgium, Canada, Chile, France, Japan, New Zealand, Sweden, and the United Kingdom. In addition, central banks and supervisors from across the globe — through the Network for Greening the Financial System — have encouraged companies issuing public debt or equity to disclose in line with the TCFD recommendations. The Task Force is also seeing governments embed the recommendations in policy and guidance and move toward requiring TCFD disclosures through legislation and regulation.

Transition Pathway Initiative (TPI)

The Transition Pathway Initiative (TPI) is a global, asset-owner led initiative which assesses companies' preparedness for the transition to a low carbon economy. TPI looks at:

Management Quality: All sectors

Distribution of companies in all sectors according to the management of their greenhouse gas emissions and of risks and opportunities to the low-carbon transition.

Carbon Performance

CP alignment with the Paris agreement benchmarks by sector and cluster (number and % of companies. This information is not available for all sectors.

Companies are assessed on a rating of **1-4:**

(1 – Awareness, 2 – Building Capacity, 3- Integrating into operational decision-making, 4- Strategic Assessment)

Sustainalytics

In January 2019 GES International was acquired by Netherlands based Sustainalytics. The acquisition combined Sustainalytics' market leading environmental social and governance research and ratings with GES' engagement and screening services. Following the integration, Sustainalytics manages over 700 clients from 17 offices worldwide, with more than 600 team members, including over 200 analysts with multidisciplinary expertise across more than 40 sectors. The company's security-level ESG Risk Ratings are well-known among institutional asset managers and pension funds integrating ESG factors into their investment processes and decision-making. Sustainalytics' ESG research and ratings also underpin numerous indexes and sustainable investment products. Sustainalytics offers data on 40,000 companies in 172 countries and provides an engagement universe covering more than 23,000 companies which includes listed equity, fixed income, and private equity issuers. The engagement with companies on material ESG issues aims to raise sector standards in alignment with the UN Sustainable Development Goals (SDG) agenda.

Carbon Disclosure Project

The Carbon Disclosure Project (CDP) is a collaborative initiative to accelerate company action on carbon reduction and energy efficiency activities. SPF is an active supporter of three CDP initiatives:

- CDP Climate Change - Requests information on climate risks and low carbon opportunities from the world’s largest companies and encourages them to take action to reduce their Green House Gas emissions.
- CDP Water – Asks companies to provide data about their efforts to manage and govern freshwater resources.
- CDP – Forests – Asks companies to provide data on their efforts to stop deforestation.

Climate Action 100+

Climate Action 100+ was launched in December 2017 and has the support of 575 investors representing $54 trillion in assets. Entities backing the project include many of the UK's local authority schemes, and some of the most influential Australian, Canadian and US public pension funds. Co-ordinators include the Institutional Investors Group on Climate Change (IIGCC), and Principles for Responsible Investment (PRI). The five-year initiative uses carbon mapping data to target the worst climate offenders directly, to curb their emissions, improve climate governance and strengthen disclosure. Engagement is focused on 167 companies who have a major role to play in the transition to a net-zero emissions economy with the goal of cutting their global emissions by 80 per cent by 2050

Other Sources

Other potential data sources might include:

- **Hymans Robertson**
- **MSCI**
- **Northern Trust**
- **IIGCC**
- **World Benchmarking Alliance**
- **Science Based Targets Initiative**
- **Carbon Tracker Initiative**
- **New York State Pension Fund**
- **Just Transition Initiative**

Minimum Standards Framework

Company Assessment			Conclusion		Action
	Governance Strategy Risk Management Metrics & Targets	**Overall Rating**		Company which cannot or will not adapt.	**Disinvest.**
				Company that still has significant legacy fossil fuel businesses but have started the process of adaption.	**Keep under review. Engage.**
				Company already clearly a part of the solution – pure renewables players, or companies which have already adapted significantly.	**Hold. (At manager's discretion.)**