Environment Agency
Pension Fund

October 2015

Policy to address the impacts of climate change

Our objective is to ensure that our Fund's investment portfolio and processes are compatible with keeping the global average temperature increase to remain below 2°C relative to pre-industrial levels, in-line with international government agreements.

Introduction

The Environment Agency Pension Fund (the Fund) is a defined benefit Local Government Pension Scheme with over 40,000 members and assets of £2.9 billion. The participation rate of eligible members is 95 per cent and the funding level at 31 March 2015 was 93 per cent.

As long-term investors, with liabilities reaching beyond 2100, our aim is to deliver a truly sustainable Pension Fund by ensuring that it is affordable, delivers financially to meet the objectives of our scheme employers and is invested responsibly.

The Fund's fiduciary duty is to act in the best long-term interest of our members and to do so requires us to recognise that environmental, social and governance (ESG) issues can adversely impact on the Fund's financial performance and should be taken into account in the funding and investment strategies and throughout the funding and investment decision making process. [i]

Our climate change investment beliefs

We believe that:

- Climate change presents a **systemic risk** to the ecological, societal and financial stability of every economy and country on the planet, with the potential to impact our members, employers and all our holdings in the portfolio.
- Climate change is a **long term material financial risk** for the Fund, and therefore will impact our members, employers and all our holdings in the portfolio.
- Considering the impacts of climate change is both our **legal duty**[ii] and is entirely consistent with **securing the long term returns** of the Fund and is therefore acting in the best long term interests of our members.
- **Selective risk-based disinvestment** is appropriate but **engagement for change** is an essential component in order to move to a low carbon economy.

"Climate change will impact every country on the planet. No nation is immune,"
US President Barack Obama, 20 May 2015

Our climate change investment principles

Our Statement of Investment Principles (SIP) and Responsible Investment (RI) Policy informs our commitment to reduce climate risk and seek opportunities, and in addition, we have developed more climate specific principles to further articulate our commitment.

We operate to the following climate risk principles - We will:

- Apply **long-term** thinking in managing the complexity of climate risk and opportunities using a **multi-faceted** approach.
- Act as **universal owners,** recognising that the climate actions, or inaction, of one company can positively or negatively affect another and the overall economy.
- **Support change** and assist others in the transition to a low carbon economy.
- Seek to **innovate and improve** carbon and climate related tools and techniques and actively promote solutions and support other institutional investors in considering impacts of climate change.
- Be transparent **and accountable** in all we do and with those in which we invest.

We believe the application of these principles will allow us to deliver our commitments as a signatory to the **Global Investor Statement on Climate Change**, **United Nations Principles of Responsible Investment** and the **Portfolio Decarbonization Coalition**. It will also complement our work in supporting sustainable capitalism and the application of good stewardship globally.

"We need an outcome that keeps our goal of limiting global warming to 2 degrees within reach,"
UK Prime Minster David Cameron May 2015

Our climate change goals
Invest, decarbonise and engage

We aim by 2020 to:

- **Invest 15 per cent of the fund** in low carbon, energy efficient and other climate mitigation opportunities. This will contribute to our wider target to invest at least **25 per cent of the Fund in clean and sustainable companies and funds,** across all asset classes.
- **Decarbonise the equity portfolio**, reducing our exposure to "future emissions" by **90 per cent for coal** and **50 per cent** for **oil and gas by 2020** compared to the exposure in our underlying benchmark as at 31 March 2015. **'Future emissions'** is the amount of greenhouse gases that would be emitted should these reserves be extracted and ultimately burnt, expressed in tonnes of carbon dioxide equivalent.
- **Supported progress** towards an orderly transition to a low carbon economy through **actively working** with asset owners, fund managers, companies, academia, policy makers and others in investment industry.

Background

Climate change presents one of the greatest threats ever to face humanity. There will be few, if any, areas of life that will not be impacted by the rise in mean global temperature of the planet.

Our approach needs to reflect this, thinking about every aspect of the Fund, both now and also for the array of scenarios the future may hold.

Climate change is a material financial risk for the Fund, and as such we have developed a comprehensive and robust strategy to minimise the long term impacts on the Fund value and to capitalise on the opportunities of mitigating and adapting to climate change. We believe we can meet the climate objective and is entirely consistently with our risk framework and long term funding objectives.

"Shifts in our climate bring potentially profound implications for insurers, financial stability and the economy."
Governor of the Bank of England Mark Carney, 29 September 2015

We believe it essential that the Fund acts as a 'future maker'[iii], actively considering the risks posed by climate change but also actively shaping a sustainable future for our members through a smooth transition to a low carbon economy. **Our belief is not to do so would be a breach of our legal duty to act in the best, long term interests of our members.**

Climate change[iv] - what's the problem?

There is a growing international consensus that climate change is unequivocal, and since the 1950s many of the observed changes are unprecedented over decades to millennia.[v] The atmosphere and oceans have warmed, the amounts of snow and ice have diminished, and sea level has risen (IPPC, 2014 Climate Change Synthesis Report).

Whilst our environment is already responding to these changes, the most severe physical impacts will impact future generations. Taking just one scenario[vi], research suggests a rise of 4C by 2100 results in:

- Sea level rise of 70cm (average)
- 50% less freshwater availability
- 80% increase in North Atlantic Cyclone activity
- High to medium risk of a decline in fish stocks
- Limits to 'normal' human activity due to increased heat and humidity
- Increase risk of wildfires

Other studies highlight the impacts on food scarcity, major health issues and concerns of reaching a potential tipping point that result in runaway change beyond 4C. All such impacts could have unprecedented economic and social consequences.

"Continued emission of greenhouse gases will cause further warming and long-lasting changes in all components of the climate system, increasing the likelihood of severe, pervasive and irreversible impacts for people and ecosystems." Climate Change 2014: Synthesis Report. Fifth Assessment Report of the Intergovernmental Panel on Climate Change (2014)

We view the financial risks and opportunities arising from the impacts of climate change to include, but not limited to;

- The **physical impacts** of a changing climate (e.g. increasing temperatures, changing weather patterns, sea level rise and severe weather events) on businesses directly or indirectly through their supply chain.
- The impact of **policy and regulation** e.g. carbon pricing, limits on carbon and other emissions, such as mercury.
- The impacts of increased **competition and substitution** e.g. cost of alternative energy.
- The investment **opportunities** from low carbon, climate mitigation and adaption technology and innovations.

Where are we now?

- Globally, economic and population growth continue to be the most important drivers of increases in CO_2 emissions from fossil fuel combustion. The contribution of population growth between 2000 and 2010 remained roughly identical to that of the previous three decades, while the contribution of economic growth has risen sharply.[vii]
- Studies suggest 80 per cent of coal, 50 percent of gas and 30 per cent of oil reserves would need to remain unused in order to keep within 2 degrees warming[viii] – also known as 'unburnable carbon'.
- The world's fossil fuel companies have plans to spend over $1trillion over the next decade on finding and developing more reserves which would take us beyond a 2 degree trajectory.[ix]

"The human environment and financial cost of climate change is fast becoming unbearable"
UN Secretary General Ban Ki-Moon, 24 September, 2014

- However a fifth of the world's population lack access to power, 40 per cent lack access to clean cooking facilities and global GDP is expected to treble by 2060.[x]
- United Nations (UN) forecasts that by 2030 almost half of the world population will live in areas facing water stress or water scarcity and less than 1per cent of the world's water is easily accessible fresh water.[xi]
- The strong growth of renewable energy in many countries raises their share in global power generation to one-third by 2040.[xii]
- The long term financial models and assumptions used by investors, regulators and Governments do not typically consider these risks and potential limits to growth.

The impacts of climate change (from water distribution changes) intersect and amplify other environment concerns such as water quality and availability which present material financial risks (see later section).

The examples above illustrate the complexity of the challenge in balancing the needs for energy, clean water and growth in some parts of the world whilst applying constraints on the availability and use of some types of energy.

We will continue to develop a sophisticated, risk based approach to deliver sustainable growth of the Fund, meeting our financial objectives in a carbon constrained economy.

What we will do

In 2014 we were one of 16 global investor partners, together with IFC[xiii] , DECC[xiv] and a panel of 13 advisers who supported our investment consultants, Mercer, in their groundbreaking study looking at **Investing in a Time of Climate change[xv].** Our policy commitments and future strategy are informed by this work, together with other publicly available research.

We will continue to support further research and studies to enable investors, globally, regardless of size of assets, to integrate impacts of climate change into their investment decision making.

We have been incrementally integrating the assessment of the effect of the impacts of climate change into our investment strategy for over a decade. Each year increasing scientific analysis of the impact on the world and in the financial markets allows us to develop this work, share it and continually improve.

We endeavour to use this experience to support our employers, in particular the Environment Agency, with programmes to engage with policy makers and the financial sector.

In our Investment Strategy, we will:

- **Fully integrate climate risk and opportunities in the investment strategy design and implementation, with a view to further decarbonise the portfolio in line with our objective.**
- **Proactively seek low carbon energy and other climate mitigation opportunities where these are compatible with our financial objectives.**
- **Develop mechanisms to evaluate our progress in aligning the portfolio to 2 degrees, leveraging the work being developed by others (See Our partners in tackling climate change)**

Working with our managers, we will:

- **Require them to integrate climate risk assessment of all holdings in their portfolios, promote climate change resilience and evidence this work though published case studies.**
- **Actively engage, with specific objectives and key performance indicators, with carbon intensive companies in their portfolios. We will set investment case review dates for specific companies and where insufficient progress has been made by the underlying company we will consider selective disinvestment.**
- **Encourage them to invest in companies whose business strategy is aligned to a 2 degree world.**
- **Use proxy voting to support our policy and principles of good governance, including considering co-filing of shareholder resolutions, for example in support of 'Aiming for A' initiative.**

To deliver the commitments above and deploy capital, aware of the climate change risks and opportunities, requires accurate disclosure material information to support informed investment decision making. The failure of companies to do so is a significant barrier to progress.

For example, in 2014, almost three quarters (68%) of Global 500 which responded Water Disclosure Programme reported that water poses a substantive risk to their business. For some respondents, anticipated financial impacts are as high as US$1 billion, and for the first time, almost a quarter (22%) reported that issues around water could limit the growth of their business. However, whist their peers identify water as being a material financial risk 42% of Global 500 companies requested to disclose information related to water issues failed to do so.[xvi]

We will continue to engage with companies, regulators, policy makers and other intermediaries to demand higher disclosure standards and increased transparency for, and by, investors.

We will continue to actively support the organisations working for better disclosures and integration of climate risk and impacts of climate change.

In addition we are keen to seek to explore how professional bodies and key intermediaries in the whole investment chain can engage and use their skills to tackle climate risk.

We will directly contribute to academic and industry research that seek to explore and evidence how the industry can better integrate the impacts of climate change into 'standard' industry tools and techniques, specifically priorities for us are;

- **Actuarial valuation and funding strategy development**
- **Strategic asset allocation**
- **Benchmark and indexation**

We acknowledge that the goals we set to demonstrate our implementation take time and perseverance. We are committed to making continual improvement to the processes that underpin the delivery of this policy and providing updates on our progress through our website, newsletters and annual reporting.

Approved by the Pensions Committee on 30 September 2015 and will be reviewed in 2017.

Our partners in tackling climate change

We work directly with other asset owners and collaboratively with many organisations across the world. We have identified (and provided links to) the main ones below:

- **Carbon Tracker** is a not for profit financial think tank aimed at enabling a climate secure global energy market by aligning capital market actions with climate reality.
- **CDP** works with over 800 institutional investors (holding US$95 trillion in assets) and 5000 of the largest corporations in the world to tackle climate change through initiatives on carbon and additional projects on water, supply chain, forests and cities. The main focus is to improve corporate reporting and disclosure.
- **Institutional Investor Group on Climate Change (IIGCC)** – is a forum for collaboration between pension funds and other institutional investors on issues related to climate change. We became a founder member of the IIGCC in 2001 and it remains the main way we engage with financial regulators and policy makers on the investor implications of climate change. We are signatories to the **Global Investor Statement on Climate Change** and will work to achieve its aims and objectives.
- **Portfolio Decarbonization Coalition** is a small group of investors who are seen as climate leaders, with the objective of finding solutions to decarbonizing the economy.
- **ShareAction** is a charity that promotes Responsible Investment and gives savers a voice in the investment system.
- **UK Sustainable Investment and Finance Association** is a membership association for UK financial services firms with an interest in responsible investment.
- **United Nations Environment Programme Finance Initiative (UNEP-FI)** is a global partnership between UNEP and the financial sector who together with United Nations Global Compact (UNGC) support the **United Nations Principles for Responsible Investment which** is an investor led coalition, which the EAPF joined in 2006.

References

[i] & [ii] Law Commission Fiduciary Duties of Investment Intermediaries
iii Investing in a Time of Climate Change http://www.mercer.com/services/investments/investment-opportunities/responsible-investment/investing-in-a-time-of-climate-change-report-2015.html
[iv] iv https://www.gov.uk/guidance/climate-change-explained
[v] IPPC – Climate Change 2014: Synthesis Report. Fifth Assessment Report of the Intergovernmental Panel on Climate Change (2014) http://www.ipcc.ch/index.htm
[vi] Victor DG, Kennel, CF. "Climate policy: Ditch the 2°C warming goal," Nature: International Weekly Journal of Science, 1 October 2014, accessed 2 April 2015. (extracted pg 98 Mercer Investing in a Time Climate Change).
[vii] IPPC – Climate Change 2014: Synthesis Report. Fifth Assessment Report of the Intergovernmental Panel on Climate Change (2014) (pg 46)
[viii] The geographical distribution of fossil fuels unused when limiting global warming to 2 °C (Christophe McGlade & Paul Ekins), published in Nature 7 January 2015.
[ix] Carbon Tracker – carbon supplied cost curves www.carbontracker.org//research
[x] Citi group, 2015 – Energy Darwinsim II
[xi] CDP –- https://www.cdp.net/en-US/Pages/events/2014/cdp-water-report.aspx
[xii] IEA's World Energy Outlook -
http://www.iea.org/publications/freepublications/publication/WEO_2014_ES_English_WEB.pdf
[xiii] International Finance Corporation
[xiv] Department of Energy & Climate Change
[xv] http://www.mercer.com/content/mercer/global/all/en/insights/focus/invest-in-climate-change-study-2015.html.
[xvi] CDP Global Water Report 2014 https://www.cdp.net/en-US/Programmes/Pages/cdp-water-disclosure.aspx