Appendix 1

Net Zero ambition

Introduction

This paper is addressed to the Pension Fund Committee ("the Committee") of the City and County of Swansea Pension Fund ("the Fund"). It discusses the Fund's Net Zero aspirations and next steps following previous advice and discussions with the Committee and Pensions Board at the Net Zero workshop on 26 October 2021.

This paper should be read in conjunction with our previous papers on Net Zero, including:

- "Swansea- Net Zero Roadmap", dated August 2021;
- "Swansea- Net Zero Next Steps", dated October 2021; and
- "Swansea- Responsible Investment Beliefs", dated November 2021.

This paper should not be disclosed to any third parties without our prior written permission and then only in full. We accept no liability to third parties unless expressly accepted in writing.

Background

Over the past few years, the Committee and Officers have made significant progress in understanding the impact of Environmental Social and Governance ("ESG") issues and taking steps towards improving the Fund's credentials in this area. In 2017, the Committee set out a set of investment beliefs for the Fund and we started working with the Officers on an ESG policy which was completed in 2018. In September 2019, the Committee formally set out a Statement of Responsible Investment, including specific ESG statements and objectives for the Fund. In particular, the Committee made an ambitious commitment to significantly reduce the Fund's listed equity portfolio's carbon exposure (to below 50% of the global stock market benchmark by 2022).

In March 2021, the Committee carried out a full review of the Fund's carbon exposure which found that the 2022 objective had successfully been achieved a year ahead of schedule, with the Fund's listed equity portfolio having a 'carbon footprint' broadly equivalent to 42% of the MSCI World Index as at March 2021.

The success in reaching this climate objective set the stage for further work on Responsible Investment, including a project to understand the potential implications for the Fund of setting a formal Net Zero objective. Following a conversation on Net Zero in September, the Committee and Board attended a Net Zero workshop on 26 October 2021 to discuss next steps for the Fund. This paper sets out a summary of decisions and next steps following the workshop, including the implementation of a Net Zero greenhouse gas emissions target of 2037.

Net Zero ambitions

Following the Net Zero workshop in October, the Committee and Officers have suggested adopting a **Net Zero target date of 2037**. The rationale for the 2037 target is for the Fund to be an early adopter, lining up with 3 electoral cycles whist fitting in with Swansea counties' wider aim of achieving Net Zero by 2040. The date situates Swansea as a leader both relative to LGPS funds and the wider finance universe, and leaves the Fund well placed to capitalise on climate opportunities with first mover advantage.

Alongside the Net Zero target date, the Committee is in the process of agreeing a set of Responsible Investment beliefs (set out in a separate paper) which reflect its views on climate risk and the implications for the Fund's investment strategy.

The following sets out proposed next steps and a framework to help the Fund achieve its Net Zero ambitions. These are based on our '3-dimensional' approach to Net Zero, which covers climate metrics, climate opportunities and engagement.

Reporting: Climate Metrics and Targets

The Fund has made strong progress to date in reducing its carbon footprint. However, the Fund's approach to climate monitoring has focused upon backward-looking carbon metrics (i.e. carbon emissions and intensity). In order to achieve its wider climate related ambitions, a more rounded reporting approach will be needed. Forward-looking metrics which cover, for example, projected emissions, impact of future emissions, and temperature implications should be incorporated into the Fund's climate reporting.

The following table sets out a range of proposed climate targets for the Fund as part of the journey to Net Zero.

Metric	Current position	Proposed 2030 Objective
Average Warming Potential and/or Implied Temperature Rise	c3.5°	1.5°
Portfolio emissions intensity, tCO_2e/\$m revenue	c50% reduction vs index, mainly from using derivatives	Maintain c50% reduction relative to market at it evolves (reduces) using physical assets (rather than current carbon overlay)
Emissions budget	c150 $ktCO_2$ p.a.	Total emissions from 31 March 2022 onwards consistent with 'fair share' of global emissions for a c2/3rds chance of 1.5° temperature rise
Proportion of portfolio with a specific ESG / climate related focus	c25%	At least 55% by 2024
Proportion of portfolio invested into 'impact' investments[1]	Tbc, but very low	c15% by 2024
Average portfolio exposure to green/transition supporting revenues and activities	c18%	At least 30%
Proportion of the portfolio with fossil fuel ties	c9%	0%
Proportion of investments in **material sectors** aligned with relevant transition pathway	Currently unknown	75%
Proportion of investments in **material sectors** that are subject to engagement action	Currently unknown	100%

[1]Investments made with the intention of generating positive, measurable environmental and social impact alongside a financial return

Proportion of investments assessed and included in carbon reporting	c73% (listed equity only)	100%
Data quality - proportion of investments where carbon metrics are measured not estimated	c90% public markets c50% private markets	100%

Adopting additional climate metrics will position the Fund well for future TCFD reporting once this becomes a statutory requirement for LGPS funds (likely in 2023/24). In addition, climate risk reporting should expand to incorporate alternative asset classes beyond listed equities, subject to availability of information.

We also recommend increasing the monitoring frequency, so the Committee receives 6 monthly reporting against objectives as well as an annual report on engagement and voting activity. We suggest that each report provide a deeper dive review of 2 or 3 of the target metrics to provide the Committee with greater insight into their key drivers and considerations to help facilitate future decision making and the evolution of the portfolio.

Implementation: Opportunities

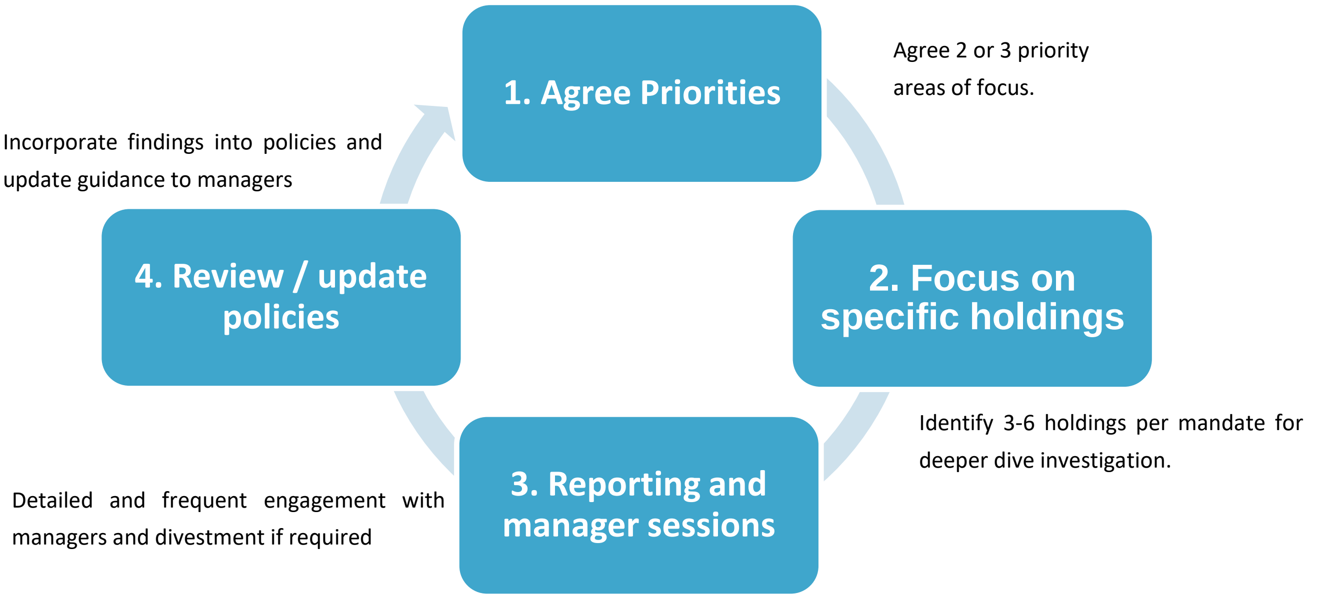
Most of the short-term progress towards Net Zero will be made through the implementation of new investments that reduce carbon emissions and help the climate transition. As set out in the table above, we propose that the Fund adjust its investment strategy over the next few years and invest c30% more of the portfolio into ESG-linked investments with a focus on climate-related solutions. We further propose that at least 15% of the portfolio should be invested in a way which directly supports the transition to a low carbon economy (e.g. via investments which provide alternatives to the use of fossil fuels and other carbon intensive activities). In doing so, we suggest a balanced approach is taken between supporting the transition to Net Zero and lowering the Fund’s carbon emissions. Since the Fund’s emissions have already be materially reduced, the priority for next year will be to identify appropriate ‘impact’ investments.

The Fund is currently looking at alternative asset classes which could provide a source of net-negative carbon exposure. As a first step, the Committee and Officers are looking to make a meaningful (up to 5%) commitment to Timberland and sustainable agriculture. Included within the Timber asset class is the potential for investing in a Carbon Offset fund which would provide the Fund with Carbon Credits, the primary means by which companies and schemes can offset emissions. Other opportunities for ESG linked investments will be considered over the coming months, such as impact ESG equity/credit and renewable infrastructure.

Engagement:

Engagement includes both communications with managers/WPP and wider industry level engagement. As such, the Fund should challenge actions and encourage best practice, referencing the Fund's beliefs and climate ambitions.

The following figure sets out the proposed approach for enhanced engagement in a bit more detail.



Step 1 – The Net Zero workshop identified **Climate Change** (SDG 13), **Decent Work and Economic Growth** (SDG 8) and **Responsible Consumption and Production** (SDG 12) as initial priorities.

Step 2 – Hymans will work with the officers to identify appropriate holdings and prepare a questionnaire for Robeco, WPP and other managers to complete [by end December 2021]

Step 3 – Hymans and officers (and/or Robeco where there is no conflict of interest) will review the responses and prepare an initial report for the Committee commenting on the key findings and the extent to which there is sufficient evidence of the following [March 2022]:

- the relevant party giving appropriate weight (consistent with the Committee's beliefs) to ESG factors, and in particular climate change considerations, as part of their investment and decision making processes;
- engagement with underlying companies and appropriate challenge of their activities and plans in a way which demonstrably adds value; and
- voting which is aligned with the relevant party's policies, their engagement activity, and the Committee's beliefs.

Step 4 – Hymans and officers will review the Fund's policies and manager guidelines in light of the findings and the Committee's views on these, and make any recommendations to the Committee on how these can be enhanced to make the engagement process more effective and transparent [June 2022].

We look forward to discussing this paper with you at the November Committee meeting.

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For and on behalf of Hymans Robertson LLP

General Risk Warning

Please note that the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether directly held or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.