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ASSET OWNERS
NETWORK

SETTING A NET ZERO INVESTMENT STRATEGY

Case study: South Yorkshire Pensions Authority

THE PRINCE OF WALES'S
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SOUTH YORKSHIRE
PENSIONS AUTHORITY

WHAT?

South Yorkshire Pensions Authority (SYPA) is responsible for administering the Local Government Pension Scheme (LGPS) for South Yorkshire. It is a defined benefit scheme with £9.7 billion in assets, 600 employers and 166,000 members. Most of our scheme's assets were transferred to the Border to Coast pension pool in 2018.[1]

The scheme is governed by a board of 12 councillors (elected members) rather than trustees. These are public representatives drawn from the four districts of South Yorkshire and represent a number of local councils across the county, many of whom have made net zero commitments.

We have set a net zero target of 2030 to align with the net zero commitments of our local councils.

WHY?

Our net zero ambition is driven by climate change being the most significant risk on our scheme's risk register, and the belief that it is our fiduciary duty to manage the threat that climate change poses to the long-term financial performance of our assets.

Securing broad consensus to move climate change risk to the top of our risk register took a while, but once this was agreed, it was relatively easy to agree on the route to mitigating these risks via a net zero approach. It also helped that our councillors were already working within their respective local authorities on delivering their own net zero targets, policies and action plans.

1. LGPS underwent an investment reform, pooling its assets into eight investment pools. Border to Coast Pensions Partnership is one of the largest pension pools in the UK. Some of SYPA's assets, such as a holding in arable agricultural land, are managed directly as the pool does not have equivalent expertise or products.

HOW?

Our first step was to present a proposed net zero target deadline of 2050 to our elected members at our September 2020 Pensions Authority meeting. After a lengthy debate, the elected members unanimously resolved that "SYPA's investment portfolios should be 'net zero' in terms of carbon emissions by 2030 rather than 2050".[2] The next step was to define a roadmap that would demonstrate how this goal would be reached.

Next, we assessed our investment holdings and identified the carbon sources and sinks. We had to perform this analysis without comprehensive greenhouse gas (GHG) emissions data, particularly for our alternative investments (a large proportion of our portfolio). This lack of comprehensive data is systemic and we have taken measures to fill in data gaps by asking an external consultancy to assess our property and alternative investments, calculate their carbon footprints and provide advice on how we can reduce our emissions.

In forming our strategy and roadmap to reduce GHG emissions, we identified the following levers and actions:

1. **Reducing GHG emissions in emerging markets.** We have taken steps within our emerging markets portfolio by choosing to work with a specialist manager in China, alongside our existing managers, to provide deeper expertise on companies in China. We can leverage this on-the-ground knowledge to be more selective on high and low carbon emitters.
2. **Committing to more active, and less passive, management.** This allows our managers to have a higher level of discretion over our investments and their GHG emissions intensity than simply tracking passive indices.
3. **Clarifying our stewardship approach.** In line with our councillors' steer, we are clarifying in our strategy our desire for engagement first before any potential divestment, as well as the process to adopt if engagement has run its course.
4. **Engaging with our pooling partners.** We had already been heavily engaged with Border to Coast on our net zero ambitions. We are now seeking to understand what extra measures SYPA can take within the boundaries of the pool arrangement to help us meet our target.
5. **Identifying climate positive opportunities.** We are identifying existing climate positive investments (eg within infrastructure) with a view to increasing our exposure to new investments in this area.
6. **Reducing the carbon footprint of our real estate investments.** We identified a series of specific actions that our property manager could take to reduce the carbon footprint of our real estate portfolio eg considering a property's BREEAM rating[3], and tasked our manager with executing these.

In setting out our net zero roadmap, we used the **Institutional Investors Group on Climate Change's (IIGCC) Net Zero Investment Framework** (NZIF) and the **Task Force on Climate-related Financial Disclosures (TCFD) framework**. We find the two frameworks complement each other, with NZIF helping us to map out our approaches for different asset classes and stewardship, and the TCFD framework helping us define what targets, measurements and scenario analysis to use.

Our net zero roadmap and action plan was agreed by our elected members in March 2020.

2. SYPA Agenda and Minutes, 30th September 2020: **https://meetings.southyorks.gov.uk/ieListDocuments.aspx?CId=174&MId=4333&Ver=4&zTS=C**
3. BREEAM is a sustainability standard for assessing new and upgraded property developments.

KEY STEPS

INFLUENCING POOLED INVESTMENTS

A significant percentage of our investments are managed by Border to Coast, so our pooling partner is a critical component for us to meet our net zero ambitions.

As one of 11 pension schemes within the Border to Coast pool, we have led a campaign to drive net zero consensus across the pool. In 2019, with one vote per scheme, the pool unfortunately voted against formal net zero alignment. But since then, we have continued to have direct conversations with Border to Coast and other schemes from other pools which has helped to build the evidence base.

One of the positive outcomes of this engagement is that Border to Coast has now started the process of formalizing their own net zero commitment, including changes to their equity fund management to reflect this. These benchmark-driven changes will take effect towards the end of this financial year (2021–2022).

MANAGING THE GHG EMISSIONS TRAJECTORY OF OUR INVESTMENTS

Once our roadmap and interim targets had been defined, we continued to use the IIGCC's NZIF to make even more granular investment plans and decisions to reach our 2030 net zero target date. This analysis highlighted that we needed to reduce GHG emissions by 50% in our equity portfolios by 2025.

However, we cannot forecast a simple straight-line reduction in GHG emissions from now to our target date. To overcome this challenge we will be engaging a specialist external consultancy to provide us with additional scientific advice and expertise on what this reduction trajectory could realistically look like.

By researching and discussing with our investment managers, we have identified further climate positive investment opportunities such as renewable energy holdings, anticipating that they will grow and replace current fossil fuels in listed indices, yielding greater financial benefits for the scheme while acting to mitigate climate risks.

MONITORING AND REPORTING PROGRESS

We use the TCFD framework to report and monitor the GHG emissions of our investments. Our pooling partner, Border to Coast, also uses the TCFD framework, so this means we can benefit from a level of standardization in ESG reporting. We have also requested our asset managers provide data in a similar format. We are currently using an external consultancy to reconcile and aggregate our reporting methodologies.

In due course, we will report on our net zero progress externally, using our annual report and annual impact report. These documents are written for the benefit of members to keep them informed of SYPA's activities. We are conscious that we need to use language that is not too technical, which can be a challenge. We have engaged an external consultancy to produce key data and information for us in a visual and easy to digest format, which we can readily use in external publications and to bring to life the key facts and figures for our members and external stakeholders.

To date, we have not formally consulted with scheme members on our net zero plans. However, we have significant ongoing dialogue with members on net zero, especially through some of the councillors who engage on climate change in their day-to-day political work and in their councils.

MANAGING A JUST TRANSITION

By the nature of their set-up, local government pensions are specifically connected to their locale. South Yorkshire historically experienced a rapid transition away from the coal industry which had significant consequences for the local communities. Therefore ensuring a just transition around any climate-driven change in our own investment strategy is both meaningful and essential to SYPA.

We manage our oversight of this by mandating that our investment managers engage underlying investments and ensure a just transition. We request that our managers ask to see transition plans, for example from fossil fuel companies on the steps they are taking to protect local communities from refinery closures and scrutinize the plans to ensure they make suitable provision for the communities. We have also contributed to work by the All Party Parliamentary Group for Local Authority Pension Funds, which is producing a report on the just transition to influence government before COP26.[4]

4. **https://www.smith-institute.org.uk/2021/01/20/call-for-evidence-responsible-investment-for-a-just-transition-an-inquiry-by-the-all-party-parliamentary-group-for-local-authority-pensions/**

NEXT STEPS

The next iteration of our investment strategy statement will refer explicitly to our net zero targets. As a result, the priority of focus for the scheme over the coming months is to track our performance against our plan. Our first year's reduction has not been as high as we had hoped, so we need to keep tracking and understand why and how this will change.

To help with this tracking, we are incorporating carbon measurements into our private equity impact reporting. We are awaiting Border to Coast's launch of a listed alternatives fund and are also completing our analysis to identify where our investments are having positive climate impact. As we start to receive more data, we will understand better how we are progressing on our net zero journey.

We will continue to engage with Border to Coast and other funds within the pool, informing them of our progress and lobbying for a more formal net zero ambition from the pool. We also continue to track the engagement activities that Border to Coast undertakes with investee companies.

TOP TIPS

DEFINE YOUR NET ZERO INVESTMENT BELIEFS CLEARLY FROM THE START

All other actions and considerations for net zero will flow from your top-level investment statement.

PROVIDE A 'SAFE SPACE' FOR COUNCILLORS (OR TRUSTEES) TO DEBATE

It is important to plan ahead for plenty of learning and to provide a suitable environment for brainstorming and discussions, before then presenting unified outcomes or consulting publicly.

ENGAGE NET ZERO SPECIALISTS

Net zero is a complex topic with many systemic considerations to be factored in. Engaging external specialists has helped us to improve our data and plan our GHG emissions trajectory and forecast.

GET IN TOUCH OR FIND OUT MORE

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A4S ASSET OWNERS NETWORK

The A4S Asset Owners Network is a grouping of pension fund chairs and trustees to discuss integrating sustainability into investment decision making. Click here to find out more.