East Sussex Pension Fund

Summary: Engagement vs Divestment

September 2023

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Contents

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Modelling limitations and risk warnings

- The only risk factors considered in our modelling are those that affect the values of pension fund assets. The modelling results should be viewed alongside other qualitative considerations including portfolio complexity, governance burden, and liquidity risk.
- The model's projections are sensitive to the starting position and the econometric assumptions. Changes to the assumptions can have a material impact upon the output. There can be no guarantee that any particular asset class or Investment Manager will behave in accordance with the assumptions. Newer asset classes can be harder to calibrate due to the lack of a long-term history.
- The modelling analysis is based on portfolios containing a range of asset classes and different approaches to fund management. Clients should not make decisions to invest in these asset classes or approaches to fund management based solely on the modelling analysis.
- Portfolios that make use of derivatives are exposed to additional forms of risk and can experience losses greater than the amount of invested capital.
- No guarantee can be offered that actual outcomes will fall within the range of simulated results. Actual outcomes may be better than the simulated 95th percentile or worse than the simulated 5th percentile.

Background

Climate action

In 2015, global governments agreed the Paris Agreement, to achieve a well below 2ºC scenario with ambition towards 1.5ºC (with the latter associated with a ~2050 net zero commitment). Since then, there has been an acceleration in global decarbonisation commitments - with 88 percent of global emissions occurring within jurisdictions covered by a net zero commitment[1], alongside increasing investor commitments. Whilst these commitments are promoting decarbonisation action, the United Nations are also calling on investors to support the scaling up of climate financing, including investments in low carbon opportunities (e.g. renewables and electric vehicles) and nature-based solutions (e.g. forests).[2]

Fossil fuels

There has been increasing public scrutiny on fossil fuel companies, in light of global climate ambitions. As public oil and gas majors continue to set out ambitious climate aims, their fossil fuel-related capex continues.[3] Private market companies are increasingly integrated in the fossil fuel sector.[4] Private firms should not be the only focus, as national oil companies (fully or majority government owned) account for over half of oil and gas production, and a greater proportion of fossil fuel reserves.[5]

Meanwhile, rising inflationary forces, alongside the Russian war in Ukraine, Covid-19 pandemic and other factors are contributing to rising fossil fuel prices and returns,[6] resulting in new fossil fuel exploration and production.

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[1] Net Zero Tracker. *Homepage*. Net Zero Tracker | Welcome

2 Including reference in: United Nations Environment Programme (UNEP). (2022) *State of Finance for Nature*. State of Finance for Nature 2022 | UNEP - UN Environment Programme. And: United Nations (UN). *Financing Climate Action*. Climate Finance | United Nations

3 Wilson, C., Limburg, A., & Caldecott, B. (2022). *Implications of the International Energy Agency Net Zero Emissions by 2050 Scenario for Net Zero Committed Financial Institutions*. Implications-of-the-International-Energy-Agency-Net-Zero.pdf (ox.ac.uk)

[4] Environmental Defence Fund (EDF). *Transferred Emissions: How risks in oil and gas M&A could hamper the energy transition*. Transferred-Emissions-How-Oil-Gas-MA-Hamper-Energy-Transition.pdf (edf.org)

[5] IEA. (2020). *The oil and gas industry in energy transitions*. The Oil and Gas Industry in Energy Transitions – Analysis - IEA And: IEA. (2022) *Share of government/SOE ownership in global energy investment by sector, 2015 compared to 2019*. Share of government/SOE ownership in global energy investment by sector, 2015 compared to 2019 – Charts – Data & Statistics - IEA. And: Armour, J., Enriques, L. and Wetzer, T. (2022) *Dark and Dirty Assets: Greening Climate-Driven Asset Partitioning*. Dark and Dirty Assets: Greening Climate-Driven Asset Partitioning | Oxford Law Blogs

[6] International Energy Agency (IEA). (2021) *What is behind soaring energy prices and what happens next*? What is behind soaring energy prices and what happens next? – Analysis - IEA

Overview of the East Sussex Pension Fund

The East Sussex Pension Fund's (the Fund's) strategy on climate is a market leading one looking across the LGPS peer group and also broader corporate pension plans, having made significant progress to decarbonise its portfolio and increase allocations to low carbon impact opportunities (amongst other sustainability objectives). Currently, there is minimal structural exposure to fossil fuels within the strategy, with some explicit fossil fuel exclusions in place within certain liquid mandates.

The current regulation for Local Government Pension Schemes (LGPS) has directed the English and Welsh LGPS funds to combine assets into investment pools, to deliver increased value to their members. The Fund forms part of the ACCESS Pool, which currently offers its members just two sustainable funds, with an equity fund available and a credit fund in the process of being launched.

The ACCESS Pool's climate approach needs to be agreed by the broader LGPS fund participants in the Pool. These participants include the East Sussex County Council, alongside 10 others: Cambridge County Council, Essex County Council, Hampshire County Council, Hertfordshire County Council, Isle of Wight Council, Kent County Council, Norfolk County Council, Suffolk County Council, West Northamptonshire Council, West Sussex County Council. Consensus in this respect may be challenging to achieve, and to divest from fossil fuel companies fully, the Fund would most likely have to move away from the Pool. This would be a move against the current government direction (which will likely be strengthened as a result of the currently live pooling consultation), may result in government intervention, and not be in members best interests given the loss of efficiencies of scale sought from pooling.

The Fund also owns a range of private market investments. These assets are invested with the intention of holding them for the long term. Many of these are very long term in nature and were invested many years ago. Divestment within these mandates is a particular challenge given the nature of the investments and the costs involved in making changes where there is no liquid market in which to trade existing holdings.

Market Context

The Fund is operating in the context of wider industry and market developments, in relation to climate commitments and fossil fuels.

Decarbonisation commitments are on the rise, and currently, 88 percent of global emissions are within jurisdictions covered by a net zero commitment[7], alongside increasing company and investor commitments. A 2050 net zero outcome would align with the most ambitious temperature goal of the Paris Agreement. The UN is calling on investors to scale up climate financing in support of this aim.[8]At the same

[7] Net Zero Tracker. *Homepage*. Net Zero Tracker | Welcome
8 Including references to private financing in:
United Nations Environment Programme (UNEP). (2022) *State of Finance for Nature*. State of Finance for Nature 2022 | UNEP - UN Environment Programme
And: United Nations (UN). *Financing Climate Action*. Climate Finance | United Nations

time, rising inflationary forces, alongside the Russian war in Ukraine, Covid-19 pandemic and other factors have contributed to rising fossil fuel prices,[9] resulting in new fossil fuel exploration and production. There is increasing scrutiny on public firms, as fossil fuel-related capex continues for oil and gas majors.[10] A sole focus on public companies is unlikely to be sufficient, as national oil companies (fully or majority owned by governments) account for a significant proportion of oil and gas production and fossil fuel reserves.[11] Private market investments in fossil fuel projects are also rising in importance, with potentially fewer environmental commitments[12] and a risk of reduced responsiveness to engagement (albeit this may be changing in the context of the Taskforce on Climate-related Financial Disclosures for pension schemes).

Beyond fossil fuels, and as part of a broader sustainability focus, there have been wider ethical forces resulting in investor divestment movements targeting other sectors, such as tobacco and controversial weapons.

Summary Paper Overview

In this summary paper, we provide an overview of the research undertaken for the Fund, with a focus on key recommendations. This follows an assessment of the following four key areas, as requested by the Pension Committee at its meeting on 20 July 2022.

1. Assessment of the fiduciary and legal consequences of fossil fuel divestment for the Fund.

2. A review of the industry evidence on the efficacy of either approach [of divestment vs engagement] in promoting the energy transition.

3. Exploration of the financial implications of divestment within the context of the ACCESS pool and the Fund's wider operating environment.

4. Consideration of how either course of action [divestment vs engagement] aligns with any relevant industry regulation, guidance, and advice.

The definitions used in this report are provided in Appendix 1.

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[9] International Energy Agency (IEA). (2021) *What is behind soaring energy prices and what happens next*? What is behind soaring energy prices and what happens next? – Analysis - IEA
10 Wilson, C., Limburg, A., & Caldecott, B. (2022). *Implications of the International Energy Agency Net Zero Emissions by 2050 Scenario for Net Zero Committed Financial Institutions*. Briefing Paper. Oxford Sustainable Finance Group, Smith School of Enterprise and the Environment, University of Oxford. Implications-of-the-International-Energy-Agency-Net-Zero.pdf (ox.ac.uk)
[11] IEA. (2020). *The oil and gas industry in energy transitions*. The Oil and Gas Industry in Energy Transitions – Analysis - IEA
And: IEA. (2022) *Share of government/SOE ownership in global energy investment by sector, 2015 compared to 2019*. Share of government/SOE ownership in global energy investment by sector, 2015 compared to 2019 – Charts – Data & Statistics - IEA
And: Armour, J., Enriques, L. and Wetzer, T. (2022) *Dark and Dirty Assets: Greening Climate-Driven Asset Partitioning*. Dark and Dirty Assets: Greening Climate-Driven Asset Partitioning | Oxford Law Blogs
[12] Environmental Defense Fund (EDF). *Transferred Emissions: How risks in oil and gas M&A could hamper the energy transition*. Transferred-Emissions-How-Oil-Gas-MA-Hamper-Energy-Transition.pdf (edf.org)

Fiduciary, Regulatory and Legal Consequences of Fossil Fuel Divestment

Chapter one of the report provides the legal Fiduciary responsibilities of the Pension Committee, the regulations in which investment decisions must and should be made, financial and non-financial factors for decision making, whether maximum returns are required, what sources of information or guidance on divestment that the Pension Committee must or should follow and the legal requirement associated with the ACCESS Pool.

The detailed report which was prepared for the Pension Committee (and of which this document is a summary) was compiled from various legal documents.

This summary has been prepared for the Pension Committee to provide a list of the key issues the Committee need to take into account in its decision making. A key observation that the Pension Committee has identified is the need for the Fund to deliver benefits as laid down in statute which are affordable.

Chapter one of the report aims to provide the information requested by the Pension Committee to enable them to assess the fiduciary and legal consequences of fossil fuel divestment for the Fund and examines how such divestment would align with relevant guidance and advice. The below section summarises Chapter one of the report.

Fiduciary Duties

The Pension Committee is subject to fiduciary duties in the discharge of its functions in relation to the Fund, including with respect to investment matters.

Accordingly, the Pension Committee must act in accordance with the following when taking decisions in relation to the investment of the Fund's assets:

- the power to invest the assets of the Fund must be made for investment purposes only (and not for any collateral purpose, such as a political view)[13];
- the core purpose of the investment power is to generate returns to enable benefits to be paid to members and their contingent beneficiaries when due[14];
- investment decisions must be taken prudently[15], with a reasonable level of skill and care, and on the basis of proper advice[16];
- these three principles are often encapsulated by referring to the need to act in members' best (financial) interests[17];

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[13] Law Commission (2014). Paragraph 6.12(1) of the Law Commission's *Report on the Fiduciary Duties of Investment Intermediaries*. Fiduciary Duties of Investment Intermediaries - Law Commission.
[14] Law Commission (2014). Paragraph 6.6 of the Law Commission's Report on the Fiduciary Duties of Investment Intermediaries (2014). Fiduciary Duties of Investment Intermediaries - Law Commission.
[15] English Case Law: Re Whiteley (1886) 33 Ch D 347.
[16] Martin v City of Edinburgh District Council. (1989) Pens LR 9 and Regulations 7(1) and 9(4) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. For the regulations, see: The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (legislation.gov.uk)
[17] Law Commission. (2014) Paragraph 6.15 of the Law Commission Report. Fiduciary Duties of Investment Intermediaries - Law Commission.

- the Pension Committee's primary investment objective is to secure the best realistic return over the long-term given the need to control for risks[18];
- any factor which goes to this primary investment objective is financial in nature and should be considered by the Pension Committee[19];
- any factor which does not go to the primary investment objective is non-financial and can only be considered if certain conditions are met[20]; these are that the Pension Committee is satisfied that:
  a) there is good reason to think the Fund's beneficiaries would share the concern[21],
  b) acting in accordance with the non-financial factor would not involve a risk of significant financial detriment to the Fund[22], and
  c) it is otherwise appropriate, in the round, to act in accordance with the non-financial factor[23]; and

  all of this is a question of proper process and balanced judgment – there is no single right approach and decisions cannot be criticised simply in hindsight[24].

Regulation

In addition to these fiduciary duties in relation to investment, the Pension Committee must also comply with numerous other applicable legal duties, including:

- Statutory duties under the various primary and secondary legislation relating to the LGPS[25]; and public law duties to act rationally (and not perversely) – albeit these are unlikely to require anything different or additional to the fiduciary duties[26].

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[18] Law Commission (2014). Paragraph 5.56 of the Law Commission Report. Fiduciary Duties of Investment Intermediaries - Law Commission.

[19] Law Commission (2014). Paragraph 6.24 of the Law Commission Report. Fiduciary Duties of Investment Intermediaries - Law Commission.

[20] Law Commission (2014). Paragraph 6.33 of the Law Commission Report. Fiduciary Duties of Investment Intermediaries - Law Commission.

[21] Law Commission (2014). Paragraph 6.34(1) of the Law Commission Report. Fiduciary Duties of Investment Intermediaries - Law Commission.

[22] Harries v Church Commissioners [1992] 1 WLR 1241 and paragraph 6.34(2) of the Law Commission Report referred to in footnotes above. We note that, in R (on the application of Palestine Solidarity Campaign Ltd and another) v Secretary of State for Communities and Local Government [2020] UKSC 16, the Supreme Court referred to the test as requiring no "significant risk of financial detriment" (rather than no risk of significant financial detriment). The difference is not just semantics and can have practical consequences, but we believe it was inadvertent.

[23] Law Commission. (2014) Paragraph 6.78 of the Law Commission Report referred to in footnotes above. Fiduciary Duties of Investment Intermediaries - Law Commission.

[24] Law Commission. (2014) Paragraphs 5.56 and 6.23 of the Law Commission Report referred to in footnotes above. Fiduciary Duties of Investment Intermediaries - Law Commission.

[25] This includes the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (legislation.gov.uk)

[26] Paragraph 8 of the Opinion which Nigel Giffin KC prepared for the Local Government Association on the Duties of Administering Authorities under the Local Government Pension Scheme (25 March 2014).

- The Fund must take proper advice.
- The Fund must invest in a wide range of assets, properly diversified to avoid excessive reliance on any particular asset, issuer, or group of undertakings and to avoid accumulations of risk in the portfolio as a whole.
- The powers of investment must be exercised in a manner calculated to ensure the security, quality, liquidity, and profitability of the portfolio as a whole, and not for any other purpose including political.
- The Fund must set out its approach to pooling investments.
- The Fund must set out its policy on how social, environmental, and corporate governance considerations are taken into account.
- The Fund must set out its policy on the exercise of rights attaching to investments.
- The Secretary of State has the power to intervene in the investment function of an administering authority if satisfied that it is failing to act in accordance with regulations and guidance.
- The UK government currently advocates collaboration with business, as opposed to divestment for Pension Funds.[27]

Responsibilities of the Pension Committee

One important aspect of being a fiduciary is that the law requires fiduciaries to be scrupulous about conflicts of interest and potential conflicts of interest whether, in each case, those conflicts are actual or perceived. The Pension Committee is subject to the statutory obligation to have political balance in their membership, in accordance with the provisions contained in s.15 Local Government and Housing Act (LGHA) 1989. Whilst all Pension Committee Members bring with them their own knowledge and experience, political views must form no part of the consideration of issues or of the decision-making process. Pension Committee members must act as fiduciaries, safeguarding the interests of those to whom they owe their duties – beneficiaries of the Fund.

In 2014, the Local Government Association on behalf of the LGPS Shadow Scheme Advisory Board obtained legal advice from Nigel Giffin King's Counsel about whether and to whom an LGPS administering authority owes a fiduciary duty and how the wider functions, aims or objectives of the administering authority should influence the discharge of its LGPS investment duties.

The opinion concluded that the administering authority's power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must therefore be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the Fund and ultimately

[27] UK Government. (2021) *The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021*. Taking action on climate risk: improving governance and reporting by occupational pension schemes - GOV.UK (www.gov.uk)

beneficiaries (balancing risk and return in the normal way). The opinion recognised that investment decisions are for administering authorities to take and that authorities are under no legal obligation to consider investment decisions from any other perspective than the maximization of returns, whatever scope there may be for wider matters to be taken into account if they choose. An example provided highlighted that an administering authority may take account of social housing needs but only if an investment in a particular opportunity in this asset class stands up as an investment in its own right and the administering authority can demonstrate that it is not preferring its own interests over other scheme employers in making the investment.

Maximum, Reasonable or Realistic Returns?

The Law Commission concluded that the primary purpose of the investment power given to pension trustees is to *secure the best realistic return over the long-term, given the need to control for risks* and emphasised that this is a question of broad judgment rather than mathematical formulae – and must be judged at the time of the decision, not in hindsight[28]

Risk

The courts have recognised that the concept of risk must adapt to current economic conditions and contemporary understanding of markets and investment. Those subject to duties of care are now required to manage risk by diversification and by considering the suitability of investments.[29] Accordingly, modern trustees acting within their investment powers: are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation.[30]

Assets which may individually be hazardous may be offset by safer investments to form a balanced portfolio. The theory is that: The risk of a portfolio is wholly distinct from the risk of a particular investment contained in the portfolio. The risk of a portfolio is a function of the interrelation of its component investments. Thus, a trustee can use securities and instruments that are highly risky viewed in isolation to assemble a portfolio that is safe.[31]

The legal position indicates that it is likely to be appropriate for the Fund to gain exposure to investments which may be riskier over the long-term if the exposure is relatively small and can be reduced (potentially to nil) when necessary, without losing value. There is no fiduciary duty for the Fund to invest only in assets which

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[28] Law Commission. (2014) Paragraph 5.56 of the Law Commission report. Fiduciary Duties of Investment Intermediaries - Law Commission.
[29] Nestle v National Westminster Bank plc [1993] 1 WLR 1260 at 1282. See also the standard investment criteria in section 4 of the Trustee Act 2000.
For the act, see: Trustee Act 2000 (legislation.gov.uk)
[30] Nestle v National Westminster Bank plc (1996) 10(4) Trust Law International 112 at 115, by Hoffmann J.
[31] Gordon, J. (1987) "The Puzzling Persistence of the Constrained Prudent Man Rule" (1987). The Puzzling Persistence of the Constrained Prudent Man Rule (columbia.edu)

can be bought and held into the long-term without any subsequent dynamism or right-sizing.

It is possible an asset which is not currently considered suitable for long-term investment has the potential to change its characteristics over time. It may then be advantageous to be holding that asset before market demand rises. And the asset could then present opportunities which were not presented before. It is not inconsistent with fiduciary duty to hold an asset on the basis that this could happen. An example could be an equity holding in an oil and gas producer which is expected to make a successful transition, in time, to clean energy. It is legitimate for the Fund to consider that such a change in the characteristics of an asset could be achieved through the stewardship actions which potentially enable it to cause changes which ultimately result in less risk and more return. However, the investment must not be made to avoid a disengaged investor taking on the investment, the quality and suitability of the investment must take primacy over the stewardship opportunities.

Quality of Life

Funds should take financial considerations into account. Financial factors are any factors which are relevant to trustees' primary investment duty of balancing returns against risks[32] while, Funds may take non financial considerations into account if two tests are met – that there is good reason to think beneficiaries support the decision and where there is no significant financial detriment from the decision. A non-financial factor is one motivated by other concerns, such as improving members' quality of life or showing disapproval of certain industries. Financial factors will be ones that have a direct bearing on the ability of the portfolio to generate the targeted level of risk-adjusted return over that time horizon. Accordingly, a desire to invest the Fund's assets to ensure that Fund beneficiaries can live in a world which, for example, avoids the most deleterious effects of climate change is not a financial factor, but a non-financial one. An investment decision made on that basis would be closer to what the Law Commission has described as the non-financial factor of being motivated by a concern to improve members' quality of life[33].
As such, it would only be permissible for that motivation to influence the Fund's investment strategy if the Pension Committee is satisfied of the three matters set out above – namely:

(a) the Pension Committee has good reason to think Fund beneficiaries would share the concern;
(b) acting in accordance with that particular non-financial factor would not involve a risk of significant financial detriment to the Fund; and
(c) it would be appropriate, in the round, for the Pension Committee to act in accordance with this non-financial factor.

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[32] Law Commission. (2014) Paragraph 6.30 of the Law Commission Report. Fiduciary Duties of Investment Intermediaries – Law Commission
[33] Law Commission. (2014) Paragraph 6.33 of the Law Commission's Report on the Fiduciary Duties of Investment Intermediaries. Fiduciary Duties of Investment Intermediaries – Law Commission

It is likely to be necessary for the Pension Committee to be satisfied that the parties ultimately responsible for funding the Fund would not only:

(a) be sufficiently accepting of an investment approach which sought to ensure that Fund beneficiaries can live in a world which avoids the most deleterious effects of climate change, but would also
(b) be able to repair any funding deficit that might emerge in the Fund if some significant financial detriment did ultimately emerge.

Industry Evidence on the Efficacy of Engagement versus Divestment

This section provides a summary of the academic and industry literature on the efficacy of engagement and divestment. It has been prepared to provide an accessible summary of the key points in the various literature. We have also produced a reference document for those that wish to read further on more of the detail on the reference made in this executive summary.

The research indicates that neither engagement nor divestment have been entirely effective to date in delivering a low carbon transition,[34] and that a step change is needed.

We summarise below the key points from the review of the literature, including the areas where focus is required, the key actors in the fossil fuel markets and the arguments for divestment and engagement. We also touch on some broader issues highlighted by the literature that we believe are also relevant for the Fund.

Literature review

Climate action – areas of focus

The research indicates that approximately ninety percent of fossil fuel external financing comes from debt investments,[35] and therefore a focus beyond listed equity holdings is essential.

The literature also highlights that fossil fuel investment is flowing from listed into private markets, at an increasing rate, and that this carries the risk of fewer environmental commitments,[36] lower emissions transparency,[37] and lower receptiveness to stewardship activities. Engagement with listed entities will be an important factor in managing the potential risks posed by this trend, whereas divestment may reduce the engagement required.

The literature highlights the importance of new and additional financing in primary markets, and the need to focus on venture capital, private equity, and later IPOs to tackle high carbon expansion.[38] It also highlights that these financial investments in private markets and infrastructure assets have an impact in terms of support for new fossil fuel developments or expansion.[39]

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[34] Various sources, including: Quigley, E., Bugden, E. and Odgers, A. (2021) *Divestment: Advantages and Disadvantages for the University of Cambridge*. sm6_divestment_report.pdf (cam.ac.uk)
And: Broccardo, E., Hart, O., and Zingales, L. (2020) *Exit vs. Voice*. exit_vs_voice_1230 (harvard.edu)
[35] Quigley, E and Davies, S. (2021) *Stock picking for humanity*. Here are responsible shareholder tactics that actually work | Aeon Essays
[36] Environmental Defense Fund (EDF). *Transferred Emissions: How risks in oil and gas M&A could hamper the energy transition*. Transferred-Emissions-How-Oil-Gas-MA-Hamper-Energy-Transition.pdf (edf.org)
[37] There is debate as to the extent of transparency amongst privately owned energy companies. For example, see: MSCI. (2021) *2022 ESG Trends to Watch: Private-Company Emissions Under Public Scrutiny*. Private-Company Emissions Under Public Scrutiny - MSCI
[38] Quigley, E and Davies, S. (2021) *Stock picking for humanity*. Here are responsible shareholder tactics that actually work | Aeon Essays
[39] Quigley, E and Davies, S. (2021) *Stock picking for humanity*. Here are responsible shareholder tactics that actually work | Aeon Essays

Actors

The literature points to the importance of moving beyond a siloed focus on corporates - given fully or majority owned public oil companies account for well over half of global production and an even greater proportion of reserves.[40] A broader engagement with Governments is needed.

Banks' loan origination provides circa two-thirds of new capital for fossil fuels and underwrites new fossil fuel-related bond issues and IPOs.[41]

The literature suggests that collective engagement with fossil fuel companies remains essential (and some argue that a focus on capital expenditures should be central to this[42]).

Divestment

Divestment has had some success in reducing financing to fossil fuel companies,[43] This is often a key driver for a divestment strategy being introduced. However, the literature notes that domestic divestment pressures can simply result in the re-allocation of fossil fuel financing overseas given the global nature of markets.[44] The impact of this on fossil fuel companies is therefore **limited unless a global approach is taken**.

The literature highlights that whilst significant divestment may result in higher fossil fuel prices, it may not ultimately impact on fossil fuel demand. Without tackling a change in underlying demand, divestment **can lead to stronger returns for investors and encourage more capital into the sector**.[45] Arguably, the experience of the past 18 months, with the shock to fossil fuel prices arising from the war in Ukraine, has illustrated this dynamic (with strong returns for investors in fossil fuels and increased investment). Therefore demand-side reduction needs to be front and centre of any climate change response.

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[40] IEA. (2020). *The oil and gas industry in energy transitions*. The Oil and Gas Industry in Energy Transitions – Analysis - IEA

[41] Quigley, E. and Davies, S. (2021) *Stock-picking for humanity*. Here are responsible shareholder tactics that actually work | Aeon Essays

[42] IEA. (2020). *The oil and gas industry in energy transitions*. The Oil and Gas Industry in Energy Transitions – Analysis - IEA

[43] This focuses on bond and loan financing, or the majority of fossil fuel financing. Source: Cojoianu, T. Ascui, F. Clark G, Hoepner, A. and Wojcik, D. (2021) *Does the fossil fuel divestment movement impact new oil and gas fundraising?* Does the fossil fuel divestment movement impact new oil and gas fundraising? | Journal of Economic Geography | Oxford Academic (oup.com)

[44] Caldecott, B., Ansar, A. and Tilbury, J. (2013) *Stranded assets and the fossil fuel divestment campaign: what does divestment mean for the valuation of fossil fuel assets?* SAP-divestment-report-final.pdf (ox.ac.uk)

[45] Carlyle. (2022) *Global Insights: Energy Transition*. Carlyle_Global_Insights_Energy_Transition_Jason_Thomas_May_25_2022.pdf

Within the literature, an exit from company offenders is not seen to be effective in bringing about the desired societal change (versus broader engagement).[46] It is noted that the **indirect implications of divestment can be more impactful in influencing market norms, with downward pressure on fossil fuel prices because of stigmatisation**.[47]

The literature does indicate that investors could consider a more nuanced exclusion approach on select fossil fuels or projects, depending on when different fossil fuel projects are expected to become uneconomic (or stranded). For example, investors adopting exclusions on thermal coal, whilst continuing to engage with oil and gas producers on decarbonisation. – given peak coal production should have occurred in 2020 to align with a 2050 net zero outcome.[48] There is inherent risk that rising oil and gas prices result in harmful substitutions of oil and gas with more emissions intensive coal. As well as general moves of funds (particularly tactical funds) into fossil fuel opportunities, as a resulting of rising fossil fuel prices.

A **major concern in the literature is that divestment could leave capital in the hands of less climate conscious investors**.[49] Ultimately this could slow down the transition to a low carbon economy.

Engagement

The **attribution of climate action gains to make the case for engagement activity remains difficult to demonstrate**.[50]

With broad passive investments on the rise,[51] investors are potentially less exposed to active ownership approaches (albeit the largest UK passive managers in the UK market have significant engagement programmes).[52] A range of passive strategies (such as those used by the Fund) now exclude certain sectors.

There are concerns a significant amount of oil and gas majors' shareholder capital is being deployed to climate branding and lobbying.[53] With the mismatch between discourse and action leading to accusations of greenwashing,[54] and requiring the

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[46] Broccardo, E., Hart, O. and Zingales, L. (2020) *Exit vs Voice*. exit_vs_voice_1230 (harvard.edu)
[47] Caldecott, B., Ansar, A. and Tilbury, J. (2013) *Stranded assets and the fossil fuel divestment campaign: what does divestment mean for the valuation of fossil fuel assets?* SAP-divestment-report-final.pdf (ox.ac.uk)
[48] International Energy Agency (IEA) (2021) *Net Zero by 2050*. Net Zero by 2050 – Analysis - IEA
[49] James, C. (2022) *Don't Sell Your Fossil-Fuel Stock If You Want to Make a Climate-Change Difference in 2022*. Don't Sell Your Fossil-Fuel Stock If You Want to Make a Climate-Change Difference in 2022 | TIME
[50] Cited by various investment managers, with which Isio continue to engage with on an annual basis, on behalf of our clients.
[51] Bloomberg. (2021) *Passive likely overtakes passive by 2026, earlier if bear market*. Passive likely overtakes active by 2026, earlier if bear market | Insights | Bloomberg Professional Services
[52] "a passive investment style is not a barrier to having a leading approach to responsible investment". See report: ShareAction. (2022) *Point of No Returns 2023*. Point-of-No-Returns-2023-General-Findings_2023-03-01-115320_htgw.pdf (assets-servd.host)
[53] Influence Map. (2019) *Big Oil's Real Agenda on Climate Change* . InfluenceMap Big Oil's Real Agenda on Climate Change
[54] Li, M., Trencher, G. and Ausaka, J. (2022) *The clean energy claims of BP, Chevron, ExxonMobil and Shell: A mismatch between discourse, actions and investments*. The clean energy claims of BP,

assessment of the credibility of companies' climate claims. **Focussed engagement by asset owners will be important to hold companies to account.**

The literature highlights that **collective engagement action is helpful in exerting influence**, representing more material investment ownership, even if only to pool knowledge and the costs of engagement.[55] If the full weight of pensions influence being brought to bear on the issue, and further actors, this could help to shift investment norms and influence regulatory developments more quickly.

Combining engagement with disinvestment

The literature indicates the **need for an emphasis on the escalation of stewardship activities to improve traction** – moving from voting activities to engagement meetings with management (including the setting of measurable KPIs).

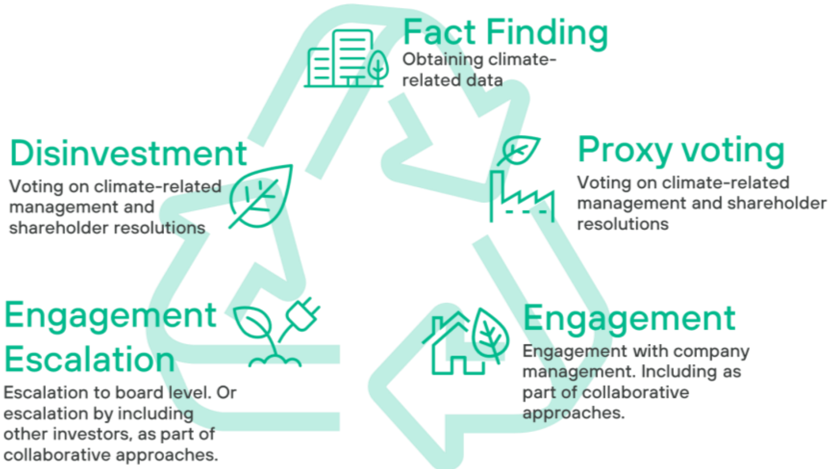

Chart: Example escalation approach[56]

Escalation policies often include the threat of disinvestment. This threat appears to be necessary to ensure some companies are receptive to engagement. However, for others, the knowledge that vocal shareholders may eventually disinvest could disincentivise them from acting on shareholder concerns, believing they can wait these shareholders out.[57]

Chevron, ExxonMobil and Shell: A mismatch between discourse, actions and investments | PLOS ONE

[55] For example: The Investor Forum. (2019) *Collective Engagement: An essential stewardship capability.* The-case-for-collective-engagement-211119.pdf (investorforum.org.uk)
And: PRI. (2013) *Getting Started with Collaborative Engagement: How Institutional Investors Can Effectively Collaborate in Dialogue with Companies.* download (unpri.org)

[56] Adapted from: Lazard Asset Management. *Active Ownership.* Active Ownership | Lazard Asset Management

[57] Principles for Responsible Investment (PRI). (2022) *Discussing divestment: Developing an approach when pursuing sustainability outcomes in listed equity.* download (unpri.org)

The literature notes that where companies' decarbonisation position changes over time, **this warrants a circular approach to provide an incentive for companies to improve.**

Broader issues to consider

Alongside the efficacy of divestment vs. engagement, the review of the literature highlighted a range of broader considerations. This includes consideration of the regulatory framework, the risks posed by stranded assets and the broader implications of any strategy that is adopted, which can trigger other consequences.

Regulation

The UK regulatory landscape does not directly touch on engagement versus divestment. The UK Government is ramping up pension scheme stewardship expectations over time,[58] which **places an emphasis on engagement.**

When looking to other countries, the French government is gearing up to recommend exclusions on Article 9 Funds,[59]. The UK Government has sought to set the tone on climate action via decarbonisation commitments,[60] carbon pricing,[61] and the Taskforce on Climate-related Financial Disclosures (TCFD) for pension schemes.[62]

Stranded assets

Stranded assets could be a significant risk for financial markets as the "switch away from fossil fuels to renewables, if not actioned in an orderly and planned way, risks stranding at least $100 trillion of assets across financial markets".[63] The discounting of future cashflow projections into present value terms may significantly underrepresent the risk set out in asset valuations. This may lead to a lower responsiveness to asset stranding risk, across the industry.

A potential first step to address this could be to address thermal coal mining/power exposure, given coal should have been in decline since 2020 (assuming 2050 net

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[58] Recent stewardship regulation includes: UK Government. (2022). *Reporting on Stewardship and Other Topics through the Statement of Investment Principles and Implementation Statement: Statutory and Non-Statutory Guidance*. Reporting on Stewardship and Other Topics through the Statement of Investment Principles and the Implementation Statement: Statutory and Non-Statutory Guidance - GOV.UK (www.gov.uk)

[59] According to the EU SFDR rules. See: AMF. (2023) SFDR: The AMF proposes a targeted review to include environmental criteria. The Sustainable Finance Disclosure Regulation: the AMF proposes a targeted review to include minimum environmental criteria | AMF (amf-france.org)

[60] UK Parliament. (2023) *Net zero transformation: Industry and Regulators Committee report*. Net zero transformation: Industry and Regulators Committee report - House of Lords Library (parliament.uk)

[61] Ember Climate. (2023) *Carbon Price Tracker*. Carbon Price Tracker | Ember (ember-climate.org)

[62] UK Government Legislation. (2021) *The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021*. The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (legislation.gov.uk)

[63] Carbon Tracker Initiative. (2023) *ExxonMobil, Shell and systemic risk – prisoners of their assets?* ExxonMobil, Shell and systemic risk – prisoners of their assets? - Carbon Tracker Initiative

zero alignment).[64] Fossil fuel stranding may be delayed by carbon capture, usage, and storage (CCUS), as well as offsetting (nature) solutions..

Broader environmental and social implications

A holistic view on the direct and indirect implications of decarbonisation can help to influence investor engagement versus divestment decisions. The decisions are inherently complex and need broader consideration.

For example, where fossil fuel divestment in favour of renewables results in increased exposure to the metals and mining industry. The latter is associated with significant emissions,[65] human rights violations,[66] as well as the decline of the high carbon industry with associated job losses,[67] albeit some potential health-related gains from cleaner air.[68]

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[64] Wilson, C., Limburg, A., & Caldecott, B. (2022). *Implications of the International Energy Agency Net Zero Emissions by 2050 Scenario for Net Zero Committed Financial Institutions*. Implications-of-the-International-Energy-Agency-Net-Zero.pdf (ox.ac.uk)
[65] McKinsey. (2022) *The raw materials challenge: How the metals and mining sector will be at the core of enabling the energy transition*. The raw-materials challenge: How the metals and mining sector will be at the core of enabling the energy transition | McKinsey
[66] Business and Human Rights Resource Centre. *Transition Minerals Tracker*. Transition Minerals Tracker - Business & Human Rights Resource Centre (business-humanrights.org)
[67] World Economic Forum (WEF). (2022) *What's the price of a green economy?* Transitioning to a green economy will cost the world another $3.5 trillion a year | World Economic Forum (weforum.org)
[68] IISD. (2019) *Tackling Coal-Driven Air Pollution in China and India: Lessons learned for Indonesia*. Tackling Coal-Driven Air Pollution in China and India: Lessons learned for Indonesia (iisd.org).

Fossil Fuel Exposure and the Implications of Fund Divestment

Fossil Fuel Exposure

As at 31 March 2023, 3.3% of the Fund's investments had fossil fuel exposure (equivalent to £151.9m across the ~£4.5bn fund). We estimate that 63% of exposure is structural (2.1% of the Fund) and 37% is 'short term tactical' (1.2%) in nature.

Mandates:	**Asset class (public vs private market)**	Definition alignment	Proportion of the Fund's exposure (%)	Size of fossil fuel investment (£m)	Nature of Exposure	Type of fossil fuel exposure	Manager response
IFM Global Infrastructure Fund	Infrastructure (private)	Aligned (real assets) - >10% mandate investments	45%	67.9	Structural	Primary exposure to Buckeye Partners LP and Naturgy Energy Group SA, Freeport Train 2 and VTTI, amongst others.	The manager is investing in assets deemed to be aligned to transition opportunities, with a 2050 net zero objective.
Ruffer Absolute Return (ACCESS)	Multi asset (public)	Aligned (companies) – companies with >10% revenues	28%	42.2	Tactical	Primary exposure to Wisdom Tree Brent Crude Oil, followed by e.g. BP, Shell and other small allocations.	Long-term positions require credible transition plans (vs short-term positions temporarily held).
Newton Absolute Return (ACCESS)	Multi asset (public)	Aligned (companies) – companies with >10% revenues	9%	13.3	Tactical	Approximately half of the exposure is Shell, followed by other smaller allocations.	Internal framework assesses transition plans to inform investments and engagements.
M&G Alpha Opportunities (ACCESS)	Multi credit (public)	Aligned (companies) – companies with >10% revenues	6%	9.3	Structural	Small exposures, including BP, ENI, Repsol, ENGIE E.ON and others.	Invests in climate transition leaders and engages on decarbonisation. Thermal coal exclusions apply.
*M&G Sterling Corporate Bonds**	*Corporate bonds (public)*	*Aligned (companies) – companies with >10% revenues*	*4%*	*6.1*	*Structural*	**(Not assessed further given planned disinvestment)**	**(Not assessed further given planned disinvestment)**
UBS Infrastructure Archmore 1**	Infrastructure (private)	Aligned (real assets) - >10% mandate investments	4%	5.6	Structural	Primary exposure at Northern Star Generation, which makes up >50% of the Fund. Assets run primarily on natural gas, with one asset burning fuel oil as a backup fuel.	Northern Star Generation has forward sold three of the five assets. The remaining two assets are important components to the energy transition. The Fund has been reporting greenhouse gas data since 2016 and UBS directly engages with NSG on transition risks.
Adams Street private equity fund-of-funds	Private equity fund-of-funds (private)	Not aligned (companies) – GICS sectors	3%	4.0	Structural	Highest exposure in underlying Adams Street 2014 Global Fund LP and Adams Street 2018 Global Fund (EU Inv) LP, etc.	All portfolio companies will be exited over lifetime of Fund. Developing climate strategy in 2023.
Harbourvest private equity fund-of-funds	Private equity fund-of-funds (private)	Not aligned (companies) – GICS sectors	2%	3.4	Structural	Highest exposure in the underlying HIPEP VIII Partnership and Fund XI-Combined.	Assess GPs for their climate risk management, including asset stranding and low carbon opportunities.

Table: Summary of the Fund's Fossil Fuel Exposure as at 31 March 2023

Notes: Totals may not sum due to rounding. All data provided by managers. We provide a more comprehensive overview of the definitions in the background paper **(for corporates, this is any company with >10% of revenue from fossil fuels, whilst for real assets, this is where mandates hold >10% of investments in fossil fuels)**. We also provide further detail of the Fund's holdings in the Appendix.

*The Fund is in the process of disinvesting from the M&G Sterling Corporate Bond Fund and we have excluded the fund from further analysis.

The UBS Infrastructure Fund I is winding down and is expected to completely **wind down over the next 2 years

Fossil Fuel Exposure – extraction only

As at 31 March 2023, 0.6% of the Fund's investments had fossil fuel *extraction* exposure (equivalent to £28.2m across the ~£4.5bn fund). We estimate that 27% of exposure is structural (0.2% of the Fund) and 73% is 'short term tactical' (0.4%) in nature.

The table below shows the proportion of the East Sussex Pension Fund

Mandates:	Asset class (public vs private market)	Definition alignment	Absolute "extraction" exposure (£m)	Proportion of the Fund "extraction" exposure (%)	Nature of exposure	Type of extraction exposure
Ruffer Absolute Return (ACCESS)	Multi asset (public)	Aligned (companies) – companies with >10% revenues	10.5	37%	Tactical	Exposure to BP, Pioneer Natural Resources, EOG Resources Inc and ConocoPhillips results in extraction exposure
Newton Absolute Return (ACCESS)	Multi asset (public)	Aligned (companies) – companies with >10% revenues	10.1	36%	Tactical	Exposure to Shell, Hess Corp, Schlumberger and ConocoPhillips results in extraction exposure
Adams Street Private Equity fund-of-funds	Private equity fund-of-funds (private)	Not aligned (companies) – GICS sectors	3.3	12%	Structural	Exposure to Oil & Gas Exploration & Production, & Coal & Consumable Fuels (i.e. coal mining exposure)
M&G Alpha Opportunities (ACCESS)	Multi credit (public)	Aligned (companies) – companies with >10% revenues sectors	1.6	6%	Structural	Exposure to BP, Wintershall and Var Energi results in mandate exposure to fossil fuel extraction activities
Harbourvest Private Equity fund-of-funds	Private equity fund-of-funds (private)	Not aligned (companies) – GICS sectors	1.4	5%	Structural	Exposure to Oil & Gas Drilling, Oil & Gas Exploration & Production, & Coal & Consumable Fuels (i.e. coal mining exposure)
*M&G – Corporate Bonds**	*Corporate bonds (public)*	*Aligned (companies) – companies with >10% revenues sectors*	*1.2*	*4%*	*Structural*	***(Not assessed further given planned disinvestment)***

Table: Summary of the Fund's Fossil Fuel Extraction Exposure as at 31 March 2023
Notes: Totals may not sum due to rounding. All data provided by managers. **Definitions are similar to the previous table but focus on extraction only. We describe exposure as corporates with >10% of revenue from fossil fuel extraction, whilst for real assets, we describe this as mandates with >10% of investments in fossil fuel extraction.**
*The Fund is in the process of disinvesting from the M&G Sterling Corporate Bonds Fund and we have excluded the fund from further analysis.
The column "Proportion of the Fund "extraction" exposure (%)" represents the East Sussex total portfolio absolute exposure.

Fossil Fuel Divestment

In general, the Fund's managers prefer engagement (over divestment) when addressing the fossil fuel exposures present in their investments. However, in this section, we focus on divestment, and the expected financial impact blanket divestment would have on the Fund.

When implementing a fossil fuel divestment policy, there would be potential challenges (e.g. reduced investment diversification, expected returns, broader asset sales beyond fossil fuels when from exiting pooled investments, given the absence of fossil fuel-free investment options in the ACCESS pool, and associated transaction costs) and advantages (e.g. clearly defined and unambiguous constraints). These dynamics are clearly present in the ACCESS pool but not unique to ACCESS and can be witnessed more widely in LGPS asset pooling.

Financial impact

Risk/return

The impact on risk and return from divestment could be potentially significant:

- Public markets only – the diversified growth mandates would need to be replaced with liquid building blocks, with an ex-fossil fuel alternative resulting in expected foregone returns of ~£5m and ~£3m, for Ruffer and Newton, respectively, over the last 12 months.[69]
- Total portfolio (public & private markets) – Before allowing for costs, the expected return would decline by 0.4% p.a. (£18m p.a.) and the risk (the 3-year 1 in 20 Value at Risk) would increase by 12%.[70] There is a reduction in diversification as the IFM and UBS infrastructure equity and private equity are replaced (with listed infrastructure and listed equity, respectively, to reflect the desire for asset pooling and associated liquidity requirements).

Developing a divestment strategy outside the Pool via segregated ex Fossil Fuel mandates or sustainable mandate allocations may result in a far lesser risk/ return impact, but also move counter to Government direction, and we have not modelled this approach.

Costs

When allowing for the transaction costs of a fossil fuel divestment strategy, we find the below (whilst noting the subjectivity in calculating accurate cost estimates and so some of the costs may be underestimated:[71]

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[69] Data provided by the investment managers, Ruffer and Newton.
Data was not available for the M&G Sustainable Alpha Opportunities Fund, but we are chasing the manager on this.
[70] Isio modelling, please see below and Appendix for assumptions.
[71] For example, we have been unable to quantify any increased fees for direct investment (outside the Pool) vs the economies of scale of the Pool, additional custodian fees as a result of ex-fossil fuel segregated mandates, additional fees for leaving the Pool, and any additional fees from increased

- Public markets only – focusing divestment activities only on the liquid assets, we expect that the one-off costs would be around £1m.[72] This would mean that private market assets are allowed to run-off.
- Total portfolio (public & private markets) - if the private market assets were also divested immediately, this would incur a significant haircut. The total portfolio cost in year 1 ~£61m, with ~£60m the result of the infrastructure equity and private equity trading costs (haircuts to pricing due to exit).[73]
- If the target exit timeframe is increased to five years, the expected cost in relation to private markets would reduce to ~£21m (a reduction of ~£39m). While there is also partial phase down of the fossil fuel exposure in both the private equity mandates (Adams Street and Harbourvest) over the five year period as the private equity portfolio winds down over time. The Adams Street private equity portfolio is expected to fully wind down by the end of 2037, while Harbourvest is expected to fully roll off by 2036 (as provided by the managers).

Mandate	1-year expected cost	5-year projected cost (difference to 1 year)	Time to full wind down
UBS Infrastructure Archmore Fund I	~£4.2m	- (~-£4.2m)	-
Adams Street Private Equity portfolio	~£29.4m	~£11.5m (~-£17.9m)	2037
Harbourvest Private Equity portfolio	~£26.9m	~£9.6m (~-£17.3m)	2036
Total	**~£60.5m**	**~£21.1m (~-£39.4m)**	

Table: Expected cost related to the Fund's private market mandates as they wind down

In addition, should the divestment avenue pursued be without the Pool, there would be an upfront £140,000 outlay to cover annual pooling costs (even in the event of exit), with additional exit penalties (yet to be quantified by the Fund).[74] If a strategy out with the Pool was developed, we would also expect there to be some drag on overall returns as efficiencies of scale from pooling would be reduced.

Below, we present the results from the strategic modelling:

Long term risk/ return modelling scenarios[75]

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level of resulting due diligence, manager selection exercises, and performance monitoring. We Further note some managers (M&G, Adam Street and Harbourvest) were unable to provide information of alternative ex-fossil fuel offerings in order to incorporate into this analysis. As a result the estimated return and cost implications may be underestimated.

[72] Isio calculations. Based on data provided by the investment managers.

[73] Isio calculations. Based on data provided by the investment managers.

[74] Data provided by the Fund pensions team.

[75] Modelling conducted by Isio, drawing on the risk/return analysis provided by the managers with fossil fuel exposure.

Metric:	1. Current target strategy	2. Disinvest from UBS Infrastructure Archmore I Fund and IFM with listed infrastructure	3. Continue investing via ACCESS but replace current Newton and Ruffer exposure with existing Pool building blocks	4. Replace Newton and Ruffer exposure with existing Pool building blocks and replace UBS/ IFM with listed infrastructure	5. Replace Newton and Ruffer exposure, replace UBS/ IFM and replace private equity
Expected return (%) (absolute)	7.8%	-0.1%	+0.1%	-	-0.4%
Expected return difference (£m) p.a.	-	-4.5	+4.5	-	-18
Value at Risk (£m and % difference change)	1,779	+121 (+7%)	+124 (+7%)	+228 (+13%)	+211 (+12%)

Table: Strategic modelling scenarios

The impact to the overall strategic risk/return from excluding the private market fossil fuel investments (UBS and IFM) is relatively small in the context of the overall strategy. There is a small impact on return and an increase in risk as measured by Value at Risk. Albeit there is potentially a significant transaction cost for exiting UBS. The impact from divesting private equity and replacing this with listed equity is more significant in terms of reducing overall return.

The impact from replacing the absolute return holdings using current building blocks (equity and credit) available on the Pool also leads to a higher level of risk. This is not unexpected given the loss of diversification. The Fund's allocation to Ruffer currently represents the largest fossil fuel exposure (albeit this is a tactical position pursued for enhanced short-term returns). The Ruffer mandate has provided significant diversification benefit to the overall Fund.

Other considerations[76]

Beyond long term risk and return implications, the following are important considerations:

Repricing risk

A key risk analysed was re-pricing risk, impacting on the Fund's performance, with stranded asset risk considered to be an extreme case of this (where assets become uneconomic). As previously noted, the widespread discounting of impacts on future cashflow projections will significantly underestimate stranding asset risk, in current valuations. The manager responses to this risk differed slightly:[77]

[76] Information provided by the Fund and its investment managers.
[77] Data provided by the investment managers.

- Ruffer and M&G conduct company (or asset) specific due diligence to inform investment decisions and ongoing monitoring, as well as assessing the management strategic response to climate change.
- Ruffer adjusts depreciated prices on balance sheets, **to reflect its view of the potential losses from assets being written-off**.
- Newton seeks to invest with a future focus, seeking out climate change opportunities, and **avoid stranding and liabilities in the process**.

Costs of disinvestment

Exiting Fossil Fuel exposures has an immediate transaction cost that needs to be considered.

- Transaction costs of divestment – the cost of divestment from the current fossil fuel exposure could be up to ~£61m which equates to ~£1m in trading costs (charged via a dealing spread) for the public exposures and ~£60m for secondary market discounts for the UBS Infrastructure Archmore I Fund and private equity mandates,[78] alongside additional transaction costs. We estimate the latter could be reduced by ~£39m, to ~£21m if the timeframe for exit was extended to 5 years as the current private market mandates wind down.
- Penalties from pool exit – if the Fund decided to fully exit the Pool (noting that only a partial disinvestment is required to re-establish Ruffer and Newton outside the Pool), the Fund would be required to pay all member costs until the membership expiry period ends (~£140k a year), as well as paying any further exit penalties (which have yet to be quantified by the Fund, given no precedent of investment pool exit).
- Non-financial costs – such as the additional costs arising from any additional scrutiny/ intervention if moving away from pooling assets.
- There are additional costs associated with loss of diversification that need to be considered as a result of divestment. These are a result of the narrowing of investment options for the strategy, given that divestment could minimise the potential strategic asset allocation that the Fund may consider (e.g. by excluding certain sectors in equity mandates, or limiting exposure to infrastructure assets with fossil fuel exposure).

Climate Implications

Research suggests divestment from fossil fuels may not be the optimal way of lowering overall emissions. We use one of the Fund's mandates with fossil fuel exposure to illustrate this point, versus a sustainable version, and a comparable segregated mandate which excludes fossil fuels:

- The Newton Sustainable Real Return Fund focuses on picking companies with credible transition plans, as well as gaining exposure to environmental products and services and results in a -38% reduction in the weighted average carbon intensity of the Fund.

[78] Within the UBS Infrastructure Archmore I Fund, NSG currently provides a necessary service in the transitioning of the energy system to net zero carbon emissions.

- This can be compared to a segregated fossil fuel divestment mandate run by the same team achieving a -16% reduction.

It is also important to look beyond current reported emissions, which are inherently backward-looking and to consider how transition is supported. Whilst fossil fuel companies may be carbon intensive, today, they may have plans to align with a low carbon world, in the future. For example, the forward-looking Transition Pathway Initiative (TPI) has reviewed BP and Shell (for which there were portfolio exposures in March 2023). Whilst to 2025, these companies do not align with a low carbon future the longer term picture is more positive, by 2050, they are expected to be aligned with a 1.5°C scenario and were also awarded the highest rating of climate management quality.[79] (We acknowledge the recent signs of backtracking by BP and Shell, which may mean some of this analysis is subject to revision. Nevertheless, we believe it is important to use third party views to verify opinions of energy and transport companies. The TPI assessments are conducted on a semi-regular basis - and therefore it is vital to consider any significant developments which have occurred since the last available TPI assessment. This should be conducted by the managers in line with their expectations of climate responsibilities.

ACCESS Pool – Practical Considerations

Fossil fuel policy

The Pool does not employ a formal fossil fuel policy, which means LGPS funds investing via the Pool do not have standardised approach in this area, resulting in a fluid fund-by-fund approach. There are currently only two fossil fuel free investment options within the Pool (both of which the Fund is investing in).

This makes it very challenging for the Fund to implement a fossil fuel divestment policy via the current pooling arrangements without compromising the investment strategy in some way. Although this would be a challenge given the Fund's relationship with the ACCESS pool, these dynamics are not unique to ACCESS and can be witnessed more widely in LGPS asset pooling.

To pursue a full divestment policy, the Fund will likely need to look outside of the ACCESS Pool – with implementation costs, a potential exit penalty, reputational risk, and possible government intervention.

Manager	Investment option(s)	Key considerations
Baillie Gifford	Paris Aligned Fund	- The Fund currently invests in this mandate via the Pool - Screens out carbon intensive companies where energy transition is not a key focus.
Bluebay	Sustainable Multi Asset Credit (MAC)	- The Fund has agreed to switch from M&G Sterling Corporate Bonds to the Bluebay fund upon launch (over the next 6-12 months). - Avoids companies deriving revenues from unconventional oil and gas extraction and production, and those with exposure to thermal coal or fossil fuel exploration.

[79] In conducting a complete "strategic assessment" of climate change A "strategic assessment" represents the presence of a climate strategy, quantitative decarbonisation targets, plans to integrate climate-related risks and opportunities, an internal shadow price applied to carbon to inform the economic forecasting of projects, and senior remuneration linked to climate-related performance. TPI. *Transition Pathway Initiative Tool.* Tool – Transition Pathway Initiative

ACCESS Pooling Context

There is currently a live government consultation in progress in relation to LGPS investments. "Next steps on investments", is seeking views on proposals relating to asset pooling, levelling up, opportunities in private equity, investment consultancy services and the definition of investments. (The levelling up agenda focuses on boosting economic productivity, improving public services and empowering communities, particularly in those areas that need it most.)

Specifically with regards to asset pooling, the LGPS Consultation proposes an acceleration and expansion of investment pooling, with administering authorities confirming how they are investing their funds and why.[80] The consultation believes this will deliver further benefits (and more quickly) including improved net returns, more effective governance, increased savings, and access to more asset classes. The consultation proposes LGPS funds pool all assets by March 2025 (with a fall back on "all liquid assets"). This would mean the Fund would be under increased pressure from a regulatory standpoint in the coming years to invest via the pool and therefore could potentially have reduced freedom to invest in fossil fuel free options off-pool. Considering this is the direction of travel, there may be increased pressure on the pools to add new sustainable offerings to the pool in the future, which are not currently available.

We however acknowledge that development of new sustainable investment options within the pool is not necessarily a streamlined process and can take significant time to design and launch. Particularly given the addition of any new investment options to pools requires the individual authorisation of each new fund by the Financial Conduct Authority (FCA). An example of a possible alternative route taken by the Wales Pension Partnership, in order to streamline this product approval and launch process, was to invest via a sustainable global active equity fund of fund approach advised on by a third party investment advisor. This invests across a number of underlying specialist managers and allows access to these five exposures via a single vehicle. This allow the pool to make use of the third party advisors FCA permissions which has the potential to expedite the process. This could potentially be explored as a possibility to set up a single fund on the ACCESS Pool which would provide the Fund with access to sustainable fund propositions, without requiring numerous funds to be added to the Pool. This is particularly relevant to the Fund given the good work done to date in implementing fossil fuel equity mandates, where there is risk that an increased mandate to pool assets could see a step back in this respect..

[80] UK Government. (2023) *Local Government Pension Scheme (England and Wales): Next steps on investments* Local Government Pension Scheme (England and Wales): Next steps on investments - GOV.UK (www.gov.uk)

Stewardship approach[81]

The Pool has an agreed set of voting guidelines[82] to provide a unified approach to voting across the Pool's participating LGPS schemes, with active managers also required to report on their voting activity quarterly. The expectation is that companies should publish a formal statement on the approach to dealing with environmental issues – and disclose policies and verification procedures related to auditing/reporting on environmental risks within annual reports. Therefore, votes against management are expected where significant environmental risks in relation to the company's activities are not disclosed or reported on or reporting is considered poor or inadequate.

The Pool's policy on engagement[83] aims to positively influence companies' ESG approach, through active ownership (votes and/or formal shareholder engagement inclusive of discussions with management). If, after several attempts there has been no evidence of constructive progress, disinvestment is possible. There is also an element of circularity, to reflect the ongoing process of engagement. This therefore follows an escalation process (which aligns with the approach of many of the Fund's managers, set out overleaf), The Pool however recognises engagement will be easier in some asset classes than others.

With an ongoing review of the ACCESS Pool voting and engagement policies to strengthen the stance, as well as the current consideration to procure an ESG Advisor (to deliver specific ESG advice and reporting), we detail some areas for consideration below:

- Improve the granularity of the voting guidelines by e.g. giving practical voting advice and climate change case study examples
- Consider new and innovative ways to capture the ACCESS Joint Committee views on climate-related proxy votes, implemented by managers via split voting approaches
- Establish clearer thresholds as to when to escalate an engagement and when disinvestment should be considered
- Publicly setting out the responsibility for stewardship activities amongst Link, the investment managers, the Pool and the ACCESS Joint Committee
- Where thematic topics are addressed, such as the Just Transition or fossil fuel divestment, the practical guidance could be strengthened
- Ensuring the new ESG advisor has a focus on ramping up public ESG and climate-related disclosures

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[81] ACCESS Pool. (2023) *Access Responsible Investment (RI) Guidelines*. ACCESS Responsible Investment (RI) Guidelines | Access Pool
And: ACCESS Pool. *Voting Guidelines for Investment Managers of LGPS*. ACCESS Voting Guidelines | Access Pool

[82] ACCESS Pool. *Voting Guidelines for Investment Managers of LGPS*. ACCESS Voting Guidelines | Access Pool

[83] As set out in the following document: ACCESS Pool. (2023) *Access Responsible Investment (RI) Guidelines*. ACCESS Responsible Investment (RI) Guidelines | Access Pool

We note that resourcing within the Fund and wider ACCESS Pool is finite, and any changes to the Pool's stance would not necessarily be straightforward, as it would require extensive engagement with the other participating LGPS schemes in the Pool. An emphasis may therefore be needed on prioritisation, to focus on the most material issues for the Pool. Of the 11 Funds in the ACCESS Pool, East Sussex County Council can be seen as a leader in its considerations of sustainability and explicitly climate change. Because of the partnership nature of the pooling system, the ACCESS Pool will necessarily only progress at the speed of the slowest moving LGPS Fund. For some of the participating LGPS Funds within the ACCESS Pool, sustainability and in particular, climate change, is not a priority area. Therefore, in order to move the Pool as a whole forward, effort needs to be spent on alignment of priorities, to explicitly mention climate change.

Chart: Fund managers' key considerations on the engagement journey

1. Understand company's climate position

Seek out qualitiative and quantitative information
. Compare the data to understand its credibility and if it aligns with good practice.

2. Set engagement priorities

Climate action determined to be a priority for the investor
Engage with highest intensity companies without credible transition plans.

3. Set engagement plan

Type (e.g. email vs meeting)
Target (e.g. senior management or board)
Frequency (i.e. the regularilty with which engagement occurs)

4. Monitor engagement process & escalate as needed

Engagement journey should start with setting key milestones at the outset and KPIs along the journey to track progress. Tracking system used to ensure progress, or lack thereof, is measured and documented.

5. Consider disinvestment, where engagement is deemed unfruitful

Where there has been no evidence of effort made to encourage transition plans to be set, disclosure to be improved or transition risks managed, consider disinvestment.

6. Cyclical nature

Companies may flow in and out of the investible universe as determined by engagement progress, given changing strategies and industry expectations.

Considering the approaches of other LGPS Pools

We note the direction of travel of some of the other LGPS pools who offer a range of low carbon or fossil fuel exclusion investment options, although we do observe that challenges remain. For instance, Brunel, Border to Coast, and London CIV are examples of asset pools that have worked to provide appropriate products available to their underlying LGPS clients should they choose to use them.

Brunel supports disinvestment from specific fossil fuels and other carbon-intensive companies, if they present a material investment risk (e.g. risk of stranding) based on analysis by the investment managers.[84] Brunel has chosen to require their managers to analyse the companies they invest in thoroughly and justify their investments, as opposed to applying a blanket divestment on all fossil fuels.

Border to Coast have committed to engaging with all oil and gas companies they are exposed to on their decarbonisation strategies.[85] They encourage the use of voting and engagement ("using the strength of their collective voice") to drive progress. They further use the TPI and Climate Action 100+ initiatives to support risk analysis and decision making.

London CIV reports on their fossil fuel exposure via extraction or energy generation activities, reporting that their exposure has reduced by 26% in recent years[86]. Their Sustainable Equity Exclusion Fund has a divestment policy, while other funds on their pool have retained the ability to selectively invest and continue to engage and support the (just) transition.

Strathclyde, the largest LGPS in the UK, is not required to pool assets given they operate under Scottish regulation and has experienced pressure from its members to divest in full. Their climate action plan includes a target to decarbonise 50% of assets by 2030 including the use of gas and other fossil fuels.[87] This tangible target, and increased flexibility from operating outside of pooling regulation, enables them to transition over time and focus on engagement targets in the meantime.

We also note there are a number of LGPS pension funds, party to different LGPS Pools in England and Wales, who have explored, or are currently exploring, the relative merits of fossil fuel divestment versus engagement. The absence of a material number of fossil fuel divestment pledges to date may be in part the result of the practical challenges of individual funds pursuing fossil fuel divestment outside of their LGPS Pools, as previously discussed. It is however likely that fossil fuel divestment pressures will continue for LGPS funds for the foreseeable future.

For example, Oxfordshire Pension Fund has decided to reduce its exposure to UK markets that have links to oil and gas companies and have freed up funds to be invested via their pool, Brunel.[88] The Royal Borough of Kensington and Chelsea have also faced discussions on divestment at public meetings, while grappling with the pooling system as a whole.[89] Further, Leicestershire County Council has

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[84] Brunel Pension Partnership (2023) *Our approach to engagement and divestment:* Our approach to engagement and divestment - Brunel Pension Partnership

[85] Border to Coast (2023) *Border to Coast Calls for Greater Climate Action from Oil Majors and Banks* BORDER TO COAST CALLS FOR GREATER CLIMATE ACTION FROM OIL MAJORS AND BANKS - Border To Coast

[86] London CIV (2022) *London CIV TCFD Report 2022* London CIV - Climate Change

[87] Strathclyde Pension Fund (2023) *Climate Action Plan* SPF_Climate_Action_Plan_2023_002.pdf (spfo.org.uk)

[88] Room 151 (2023) *Oxfordshire Pension Fund divests from UK and emerging markets over ESG concerns* - Room 151

[89] Room 151 (2023) *Council's climate team targets pension fund divestment* - Room 151

submitted documentation for consideration of divestment from fossil fuel companies and increased investment in zero carbon technology.[90]
The discussions undertaken by each of these Funds is expected to continue as the pressure remains in place and to the regulatory background of asset pooling.

[90] Leicestershire County Council (2023) *Representations from Climate Action* - Document.pdf (leics.gov.uk)

Charting a Course: Engagement versus Divestment Considerations

We seek to understand how either course of action, of divestment versus engagement, aligns with any relevant industry regulation, guidance and advice:

Assessment of the fiduciary and legal consequences of fossil fuel divestment for the Fund

The Pension Committee has a fiduciary duty to invest the Fund's assets in the best interests of beneficiaries – and "the fiduciaries' investment powers must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question", as well as with the aim of diversification of investments.

Under the pooling requirements for LGPS funds, the Government recognises there may be bespoke circumstances where an alternative arrangement may be more appropriate, such as for illiquid infrastructure and direct holdings in property. The Secretary of State has powers to intervene in the investments of LGPS funds in certain circumstances, but these powers have yet to be tested.

There is a general Government preference for engagement (over divestment). Where the "Government continues to believe blanket divestment from certain assets is the wrong approach – engagement with high-carbon companies, when done effectively, can reduce the climate risk to which the scheme is exposed."[91]

A review of the industry evidence on the efficacy of either approach (of divestment versus engagement) in promoting the energy transition

Neither engagement nor divestment has been entirely effective to date in bringing about the low carbon transition, albeit there remain challenges in analysing the effectiveness of these processes (as compared with the numerous other influences in climate outcomes). It is however clear that the fossil fuel industry has not made the adjustments required to align with a low carbon future and a step change is needed to tackle the climate emergency. This requires escalation in the name of climate action, with investors working alongside companies and governments towards change, including:

- using disinvestment as a measure of last resort, to support engagement escalation where a fossil fuel companies' transition plans are deemed to lack credibility, and to improve traction with fossil fuel companies
- leveraging the collective influence of pension scheme investments, alongside other investors, to bring to bear greater weight on the issue
- a circular approach to incentivise companies to improve, over time

When seeking to understand key focus areas for such an approach, attention could be warranted on:

- tackling exposure to thermal coal, which has the most emissions intensive fossil fuel, carries a greater risk of asset stranding[92]

[91] DWP Consultation outcome – Climate and investment reporting: setting expectations and empowering savers – consultation on policy, regulations and guidance. Updated 17 June 2022. Climate and investment reporting: setting expectations and empowering savers - GOV.UK (www.gov.uk)
[92] International Energy Agency (IEA) (2021) *Net Zero by 2050*. Net Zero by 2050 – Analysis - IEA

- moving beyond a focus on shareholder activism in listed equities, given the preponderance of debt in fossil fuel markets,[93] and tackling additional financing for fossil fuel expansion, such as in venture capital and, private equity[94]
- expanding the focus beyond oil and gas majors, to also focus on government-owned enterprises[95] and banks[96], with significant links to the fossil fuel industry

Exploration of the financial implications of divestment within the context of the ACCESS pool and the Fund's wider operating environment.

As at the 31st March 2023, circa 3.3% of the Fund's investments had fossil fuel exposure (equivalent to £151.9m across the ~£4.5bn Fund). Whilst circa 0.6% of the Fund's investments had fossil fuel *extraction* exposure (equivalent to £28.2m). The majority of fossil fuel exposure is structural, with the exception of *extraction* which falls predominantly within the tactical diversified growth mandates.

When implementing a fossil fuel divestment policy, the impacts could be significant. For example, combining Isio modelling efforts and manager investment analysis, divestment could cost the Fund circa £79m, including an £18m shortfall in returns (alongside a 12% increase in the 3-year 1 in 20 Value at Risk and reduction in diversification),[97] £61m incurred in transaction costs (with £60m of this coming from infrastructure equity and private equity haircuts),[98] and in the event of pool exit to pursue a divestment strategy incur upfront £140,000 outlay to cover annual pooling costs (even in the event of exit, with additional exit penalties not yet quantified).[99] This is likely to be an underestimate, as it ignores some costs, such as the losses of efficiencies of scales from pooling investments, additional custodian fees from ex-fossil fuel segregated mandates, and additional fees from the burden of implementing and monitoring the divestment strategy across the Fund's managers, for example.

Fossil fuel divestment policies in the context of the ACCESS Pool would be complicated by the lack of fossil fuel-free mandates available, the diverse climate-related views of different LGPS schemes within the pool, and the slow progress to rectify these two barriers. Pursuing this outside the pool would run counter to government guidance. Analysis suggests a divestment strategy may also not generate the greatest decarbonisation outcomes, versus alternative approaches, such as increasing exposure to low carbon opportunities.

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[93] Quigley, E and Davies, S. (2021) *Stock picking for humanity*. Here are responsible shareholder tactics that actually work | Aeon Essays

[94] Quigley, E and Davies, S. (2021) *Stock picking for humanity*. Here are responsible shareholder tactics that actually work | Aeon Essays

[95] IEA. (2020). *The oil and gas industry in energy transitions*. The Oil and Gas Industry in Energy Transitions – Analysis - IEA

[96] Quigley, E. and Davies, S. (2021) *Stock-picking for humanity*. Here are responsible shareholder tactics that actually work | Aeon Essays

[97] Isio modelling, please see below and Appendix for assumptions.

[98] Isio calculations. Based on data provided by the investment managers.

[99] Data provided by the Fund pensions team.

Appendix 1 – Definitions

We set out below an overview of the definitions used in our analysis of pursuing an engagement or divestment approach in relation to fossil fuel exposure. Unfortunately, there are few investment industry standard definitions of many of these terms.

Fossil Fuel Exposure

There is no single definition of fossil fuel exposure. Throughout this work, we have defined this according to recognised external industry frameworks, as follows.

Fossil fuel exposure: is defined in line with the European Union Sustainable Finance Disclosures Regulation (EU SFDR) principal adverse indicators, as follows: [100]

- The company exposure definition is focused on share of revenues: "companies active in the fossil fuel sector' [and] means (i) companies that derive any revenues from exploration, mining, extraction, distribution or refining of hard coal and lignite; (ii) companies that derive any revenues from the exploration, extraction, distribution (including transportation, storage and trade) or refining of liquid fossil fuels; and (iii) companies that derive any revenues from exploring and extracting fossil gaseous fuels or from their dedicated distribution (including transportation, storage and trade)".
- The real asset exposure definition is focused on share of investments: the "share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuels".

Materiality of exposures: we must also define the point at which fossil fuel exposures become material. We have aligned this definition with the Institutional Consultant Sustainability Working Group (ICSWG), a group of nineteen investment consultants (including Isio), who reached a consensus on this matter, and we take this to represent the broad UK industry view on fossil fuel exposure. This is deemed to be those companies with at least ten percent of revenues exposed to fossil fuel exploration, extraction, processing, refinement and transport activities, as well as products and services that support the exploration, extraction or processing of fossil fuels.[101] This could also be applied to the real assets' definition as at least ten percent of investments involved in the aforementioned activities.

For completeness on what is included within the definition, and what is excluded, we set out the following notes on the definitions adopted (as clarified with the investment managers):

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[100] European Securities and Markets Authority, European Banking Authority, European Insurance and Occupational Pensions Authority and Joint Committee of the European Supervisory Authorities. (2021) *Final Report on Draft Regulatory Technical Standards*. jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf (europa.eu)
[101] Institutional Consultant Sustainability Working Group (ICSWG). (2021) *ESG Metrics – November 2021*. PowerPoint Presentation (icswg-uk.org)

- We have defined fossil fuel exposure to include utilities, such as power generation from natural gas or coal sources.
- We note that the ICSWG definition includes the "products and services that support the exploration, extraction or processing of fossil fuels", beyond direct fossil fuel exposures.[102]
- We have adopted a production-orientated approach, in focusing on the production (rather than the consumption) of fossil fuels.

We note that different investment managers adopt different definitions of fossil fuel exposure (including different thresholds for setting exclusions) and many of the existing systems make it challenging for them to report against different definitions. We have sought to identify each instance of this with your managers to better align data with the definitions set out above.

Many energy and transport companies are in the process of transitioning to a lower carbon economy. This should result in a significant shift from high to low carbon goods and services over time, and therefore requires regular monitoring of classifications. The transition in companies is important in reducing overall carbon emissions.

[102] Institutional Consultant Sustainability Working Group (ICSWG). (2021) *ESG Metrics – November 2021*. PowerPoint Presentation (icswg-uk.org)

Fossil Fuel Exclusion

We adopt the following definitions in relation to fossil fuel exclusions. These seek, to differentiate between the driving forces that bring about an absence of investment in fossil fuels within a portfolio. Again, there is no industry standard definition of these terms.

Divestment: Divestment is defined as a situation where the owner of assets commits to a blanket removal of a specific investment class from the investable universe.

This can include the complete removal of a set of companies, sectors or regions with the intention to fully remove exposure from the undesired risk, (in this case fossil fuel exposure). This ensures no material exposure will be permitted within the portfolio, either on a temporary or long-term basis.

The divestment of the specific investment class is often undertaken to demonstrate adherence to sustainable finance practices and climate risk management.

Disinvestment: The specific investment class remains part of the investable universe, but an active decision is taken to completely sell down or reduce exposure for financial reasons. For example, the asset owner may disinvest from a company deemed to have an inadequate approach to managing climate risk – whilst this is removed from the portfolio, it remains in the investable universe, such that if climate risk management is improved in future, the asset owner could choose to invest again.

Disinvestment may remove fossil fuel exposure through engagement escalation, to (at least temporarily) sell out from a particular name, should engagements with the company not yield the required outcome from an engagement perspective.

Exclusions: Fossil fuel exclusions are defined similarly to divestment. Exclusions are often (but do not need to be) more granular than a blanket fossil fuel sector divestment.

For example, investors could opt to exclude just *select* fossil fuel companies, such as thermal coal companies, or those fossil fuel companies which undertake unconventional fossil fuel exploration, extraction and production (e.g. from oil sands or the arctic region).

Stewardship Definitions

We defined the stewardship terms used in the Fund's divestment versus engagement papers, as follows.

Active Ownership: the use of the rights and position of ownership (either via debt or equity investments) to influence the activities or behaviour of investee companies. Whilst active ownership can be applied in each asset class, the avenues to do so will differ. For example, in listed equities, it includes engagement and voting activities, whilst for debt the focus is on engagement.[103]

Engagement: is a "purposeful, targeted communication with an entity (e.g. company, government, industry body, regulator) with the goal of encouraging change at an individual issuer [level] and/or the goal of addressing a market-wide or system risk (such as climate)"[104] via a range of approaches and methods. This definition is taken from the ICSWG definition, where the focus is on climate change engagement. Regular communication to gain information as part of ongoing research, however, is not considered as engagement (although it is worth noting some managers would classify this as such).

Escalation: Investment managers typically have stewardship escalation processes in place, including on climate change matters. This is a process: starting from voting activities, to bring about changes in investee firms for which they own equity holdings; to engagement activities, including the setting of specific engagement key performance indicators (KPIs) to measure progress. Many investment managers may use the threat of disinvestment as part of their escalation process if companies are not engaging with them.

Stewardship: We define stewardship as "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society", in line with the definition provided by the Financial Reporting Council's 2020 UK Stewardship Code.[105]

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[103] Principles for Responsible Investment. (2018) *Introduction to active ownership in listed equity*. Introduction to active ownership in listed equity | Technical guide | PRI (unpri.org)
[104] ICSWG. (2021) *ICSWG Engagement Reporting Guide Version 2: introductory guidance*. Firm-level questions. b25a61_2f1090f92f30484590358785cd7a3a34.xlsx (live.com)
[105] Financial Reporting Council. (2020) *UK Stewardship Code*. Stewardship-Code_Dec-19-Final-Corrected.pdf (frc.org.uk)

Other Definitions

Other key definitions used in the Fund's divestment versus engagement paper series include:

Fossil fuels: Fossil fuels result from decomposing animal and plant matter. Fossil fuels include coal, oil and gas fuels. Coal is the most carbon intensive fossil fuel, upon burning, whilst natural gas is the least carbon intensive.[106]

Just transition: The just transition is a process of greening the economy, in a way that is fair and inclusive, with respect to everyone concerned, creating decent work opportunities, and leaving no one behind.[107]

Greenhouse Gas (GHG) emissions: GHG emissions are released into the atmosphere as a result of the burning of fossil fuels, primarily from energy, transport and industrial or manufacturing processes.

Low carbon transition risk: Low carbon transition risk arises from companies realigning themselves from high to low carbon goods and services. Risks arising from the transition include climate-related regulatory developments, market trends and decarbonisation action.

Net zero emissions: A state where the GHG emissions released into the atmosphere are balanced out by the removal of GHG emissions back out the atmosphere (e.g. using nature-based approaches, such as reforestation, or man-made technologies, such as carbon capture usage and storage).

Stranded assets: Stranded assets will no longer be able to generate an economic return (before the end of their economic life) due to changes in market preferences (e.g. falling costs of low carbon technology) and regulatory environment (e.g. decarbonisation policy and carbon pricing). [108] Whilst partial stranding is where assets will start to generate returns below anticipated levels. They will result in unanticipated devaluations or conversions into liabilities.[109]

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[107] International Labour Organisation. (2023) *Climate change and financing a just transition*. Climate change and financing a just transition (ilo.org)
[108] Carbon Tracker Initiative. (2017) *Stranded Assets*. Stranded Assets - Carbon Tracker Initiative
[109] Caldecott, B., Tilbury, J. and Carey, C. (2014) *Stranded Assets and Scenarios*. Microsoft Word - Stranded Assets and Scenarios - Discussion Paper - 27.01.14.docx (ox.ac.uk)

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