Dear Cllrs Cody, Hoyland, McFarling and Turner,

Thank you for your letter of 15 September. I have liaised with the Head of Pensions over the letter and am pleased to respond below.

I would hope that the Committee share your concern for the urgency of the climate change challenge.

Through our partnership (known as Brunel) with nine other Funds in the South West of England, which includes the Environment Agency Pension Fund, Brunel owns and maintains a Responsible Investment and Stewardship Policy on behalf of us all, which aims to deliver stronger investment returns over the long term, protecting our interests through contributing to a more sustainable and resilient financial system, which supports sustainable economic growth and a thriving society.

The partnership believes that wholesale change is needed for the investment industry to be fit for purpose to limit human-made climate change to well below two degrees – preferably 1.5 degrees – above pre-industrial levels.

Furthermore, I'm sure the committee shares your belief that, if pension funds fail to invest sustainably, they risk failing to fulfil their long-term fiduciary duties.

**A whole-economy challenge**

You frame the challenge of climate investing almost entirely in terms of the fossil fuel sector. The partnership believes both that the problem is far bigger than that – and that the solution has to be far more ambitious than what you propose.

The reality of climate change is that it is not the problem of one sector, but a challenge for the whole economy. It is the entire global economy that relies on fossil fuels – across every sector. To simply divest from the fossil fuel sector is, in the view of the partnership, not ambitious enough to address the gravity of the challenge. Asset owners and asset managers need to apply Net Zero principles and targets to how they invest right across the investment universe.

To change the whole economy, the partnership believes you need to engage meaningfully across the whole economy. The position as a partnership is that the most effective approach at present is: ***engagement with the threat of divestment***.

If you engage with no ultimate threat behind your engagement, companies will lack a key motivation to change. If you divest without engaging, it may win you headlines, but you are then allowing the company to continue with its current practices – and potentially leaving it in the hands of far less climate-conscious investors. There is certainly evidence to suggest that a divest-only approach achieves less for the climate than a mixed approach.

Brunel, on our behalf, engages primarily through investment managers, with additional resource through a dedicated provider EOS at Federated Hermes. Brunel does undertake some direct engagement, such as for the climate resolution at HSBC. Engagement through large-scale shareholder actions are impossible for companies to ignore entirely – and sometimes shareholders can force even the most reluctant company's hand. Nevertheless, as you would doubtless agree, engagement needs to lead to tangible progress.

**Running the numbers**
The proof of whether a climate policy is really working is, of course, not in the arguments but in the numbers. Brunel have always published our total partnerships carbon exposures – and progress against our own partnerships ambitions.

Brunels most recent Stewardship & Responsible Investment Outcomes Report showed that, over the reporting year, they **have reduced the carbon intensity of our Partnerships Aggregate Portfolio by 30%**. That would not have been possible by simply pursuing a single-sector divestment policy. Furthermore, Brunel achieved a carbon efficiency that was 15.4% better than our benchmark – up from 11% in the previous reporting year. These are major reductions, and all the more so for a set of partner funds that *already* had climate concerns baked into their structures – and into manager selection and monitoring processes.

Brunel also provide detail of our partnerships active holdings' carbon exposure in the Climate Change Action Plan Report (aligned with TCFD) and supported by the Carbon Metrics Report. The report offers further insight into the approach to fossil fuels. As the report shows, the Partnerships Aggregate Portfolio was much less exposed to fossil fuel revenues in the reporting year than its custom benchmark (1.4% vs 2.2%).

In terms of specific holdings for Gloucestershire, our portfolios' low exposure (1.4% as at 31 December 2020) to the fossil fuel sector is simply the outworking of the partnerships Climate Change Policy. The investment area that has proved more of a challenge, however, is passive investing, where the lack of climate-sensitive benchmarks has left passive funds lagging their active peers in incorporating climate change risk into how they are invested.

**Changing the investment industry**
Despite our partnerships relatively small size, we were determined to task Brunel to find a solution to this challenge. They therefore worked with FTSE Russell to develop a new set of benchmarks, not least for passive funds, that integrate climate objectives into how they are constructed – and that are flexible enough to change in future in line with developments within RI and climate, such as improved data.

I would just highlight a couple of details about these benchmarks. The benchmarks apply a transparent tilt exposure towards or away from index constituents according to several exposure objectives, including fossil fuel reserves, carbon reserves and green revenues – all in order to achieve Paris alignment. They also limit the active weight of banking sector constituents to no more than their underlying index weight, in order to reflect the sector's funding role for large carbon emitters as a contributory factor in climate change. You can find more details on FTSE Russell's website.

These groundbreaking benchmarks were formally announced earlier this summer and these will be available towards the end of the year. The benchmarks are crucial to changing the broader investment universe and the partnership will be pushing other asset owners and asset managers to adopt them, too. Again, a whole-economy approach is needed to address climate change, and these benchmarks help to meet that need.

**Consultation**
Furthermore, I should just highlight that, in the autumn, Brunel will be launching a 2022 Climate Stocktake. This will provide us with a chance to conduct a comprehensive review of our partnerships Climate Change Policy, in order to see what is working and how we can ensure we continue to deliver best practice. Brunel will be engaging with a range of stakeholders to elicit their views during the consultation phase.

Finally, I should just reemphasise two points. Firstly, there may be more than one effective approach to climate investing, but it is always important to look at the data – and through Brunel we are showing radical improvements in carbon exposure across our portfolios, as a result of the partnerships Climate Change Policy. Secondly, we continue to review both performance and our partnerships policies on an ongoing basis, but the 2022 Climate Stocktake will be especially comprehensive on this front.

Many thanks for your letter.

Best wishes,

**Cllr Lynden Stowe**
**Chair of the Gloucestershire Pension Fund Committee**