Clwyd Pension Fund

Responsible Investment Training: Net Zero and Sustainable Equity

May 2021

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Introduction

This presentation is addressed to the Pension Fund Committee (the 'Committee') of the Clwyd Pension Fund (the 'Fund'). In this presentation we provide background to three key Responsible Investment topics. At the 9 June 2021 meeting the Committee will be asked to adopt a number of key recommendations linked to these topics.

More specifically in this presentation we consider:

1. What is driving investors' policy decisions to adopt a Net Zero commitment (e.g. being Net Zero by 2050).

2. How the Fund could adopt net zero targets and implement a plan.

3. A high level introduction to global sustainable listed equity.

We appreciate this is a complex subject area and this training session is intended to allow for questions and discussion to enable further understanding for all.

We would encourage all attendees to ask any questions they would like answered or seek clarification in respect of any area covered.

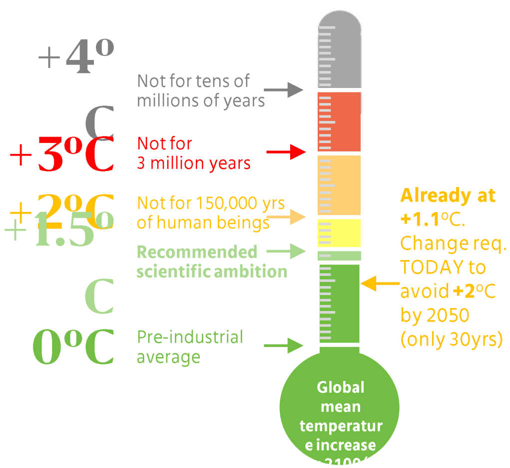
Adopting a Net Zero Commitment

1

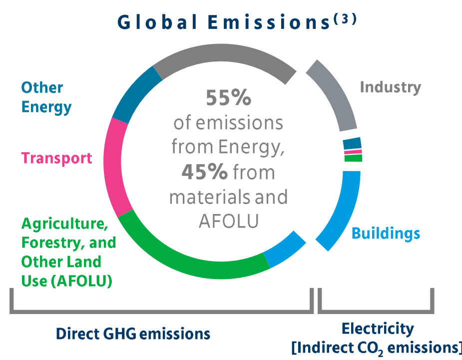
Climate Change Context

Why investors need to transition

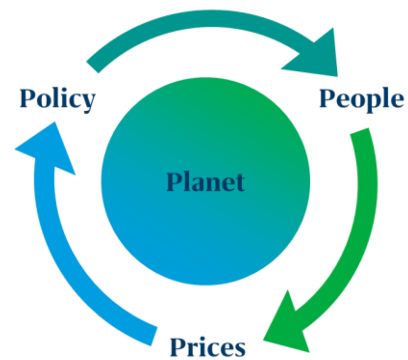
To address climate change requires us to reduce fossil fuel emissions to limit temperature increases



We must reduce greenhouse gas emissions by 45% by 2030 (on 2010 levels) to achieve net zero by 2050, according to the Intergovernmental Panel on Climate Change (IPCC)(2), for the greatest probability to achieve <2ºC, ideally 1.5ºC



In response, governments, companies, consumers, voters, and market prices are changing. As the planet warms for more people in more places, we expect the transition momentum will only increase

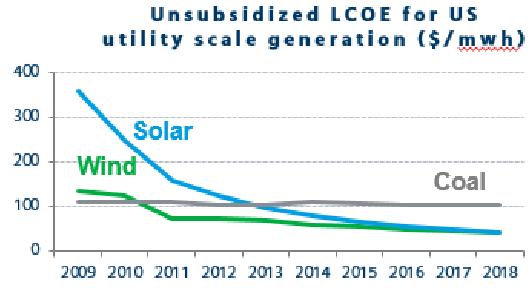


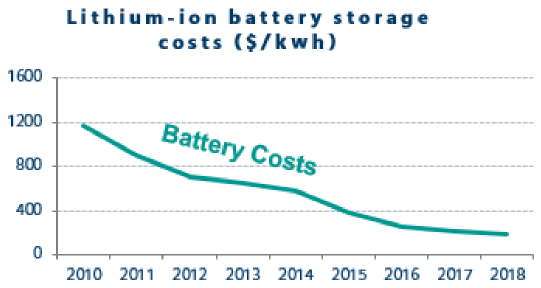
(1) Climate Action Tracker (http://climateactiontracker.org/) - last updated September 2020; (2) Intergovernmental Panel on Climate Change, the source of scientific information and technical guidance for Parties to the UN Framework Convention on Climate Change (UNFCCC) 2018 1◦C Report ; (3) IPCC, 2014: Climate Change 2014: Synthesis Report. Contribution of Working Groups I, II and III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change [Core Writing Team, R.K. Pachauri and L.A. Meyer (eds.)]. IPCC, Geneva, Switzerland, 151 pp

Transition to a Low-Carbon Economy
What is already happening

Technology development and price disruption in the energy sector is already evident.

The costs of renewable energy (1) and storage (2) have meaningfully fallen. This, together with development and uptake in energy efficiency, greener grids, and electrifying new sectors is changing whole supply chains.





(1) Lazard; (2) Bloomberg New Energy Finance. (3) Bloomberg, 2020

Markets are recognising climate in pricing already and investors want to be on ahead of the curve.

Investors already face transition risk, including stranded assets potential, if the market moves more quickly or suddenly than expected towards a 'well below 2°C' scenario. Assessing those companies and countries most vulnerable to transition disruption and opportunities is needed to stay ahead of market movements.

A renewables company has recently eclipsed the market capitalisation of an oil company that has been one of the biggest household names (3).

From Disclosure to Transition Commitments

Investors Are on the Move

After 10 years on investor radars, 5 years since the Paris Agreement, 3 years since the TCFD framework, a growing investor cohort are now focused on action plans for decarbonising.

- **Disclosure** framework released in 2017, with the UK Chancellor of the Exchequer announcing mandatory disclosure across the UK economy by 2025. LGPS can expect a consultation on TCFD requirements this year.
- 500+ companies have approved **Science Based Targets** (SBTs).
- The Institutional Investor Group on Climate Change (IIGCC) published the **Net Zero Investor Framework** developed by >70 investors.
- **The UN's 'Race to Zero'** that tracks net zero by 2050 targets suggests positive momentum (120 countries + hundreds of cities, companies, universities and investors). Financial regulators are also signalling change, not just in Europe.

Sources: Asset Owner Alliance - https://www.unepfi.org/net-zero-alliance/; Science Based Targets - https://sciencebasedtargets.org/; IPCC 1.5^{0}C report; Deutsche Bank Research: 'Past the Tipping Point with Customers and Stockmarkets, Sept 2019

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Transition to a Low-Carbon Economy
Why investors are targeting a <2ºC Scenario

Mercer supports the increasing investor focus to move forward from scenario analysis[1] to target a <2ºC scenario as a priority, because in this scenario:

1. **Risks more likely in the short term** – divergence in sectors (e.g. energy and utilities) and asset classes (e.g. equities and infrastructure), means investors should be monitoring for disruption to reduce portfolio risk where possible

2. **Opportunities more likely in next decade** – targeted allocations to companies delivering the solutions to building transition capacity and adapting to physical damages is expected to provide additional diversification benefits and new return opportunities.

3. **Transition scenario more likely than not** – investors need to navigate the pace of possible transition between a 3°C and 1.5°C scenario and build resilient portfolios accordingly. It is unlikely that there will not be a transition of some magnitude.

4. **In investors' best interests over the long term** – setting targets and aligning action to influence a <2°C scenario, where possible, is consistent with fiduciary duty as this is expected to be most beneficial scenario for long term investors (like pension funds, insurers, endowments), particularly for those with beneficiary timeframes over multiple decades.

(1) Mercer's Investing in a Time of Climate Change (2015) and The Sequel (2019) document the scenario analysis findings that compare the asset class and sector impacts on returns under a 2°C scenario as compared to a 3°C or 4°C scenario over different time periods.

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Setting a Path to Net Zero

2

How we can shift a portfolio from Grey to Green

Investing in a Time of Transition

Seek to manage the 'grey' risks, including fossil fuel exposure, through detailed analysis

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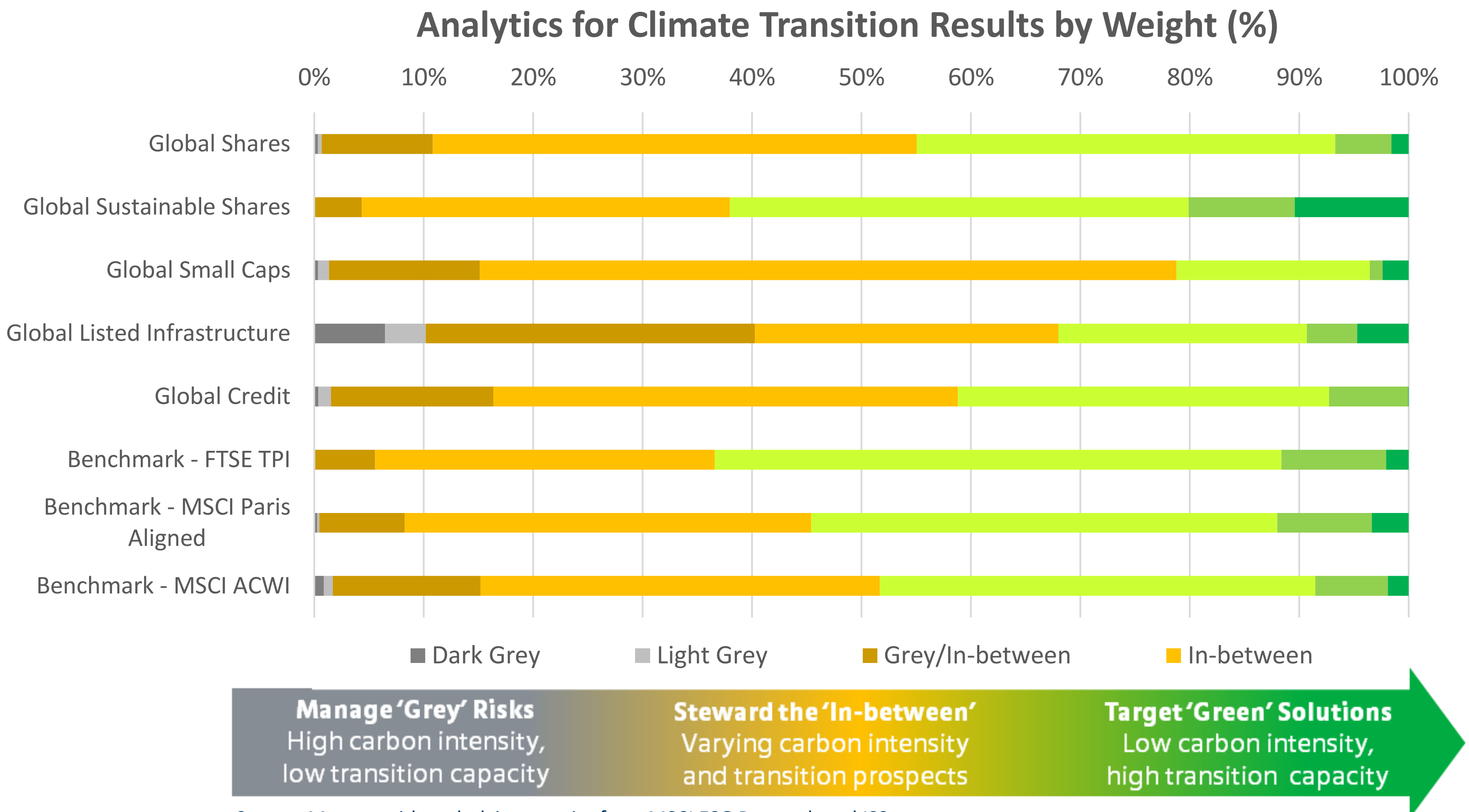
Single Sector Funds Example

Transition assessment by weight (%)



Source: Mercer, with underlying metrics from MSCI ESG Research and ISS

Case Study
Mercer Investment Solutions Europe

- Mercer Investment Solutions Europe is aiming to:
  - transition all fund of funds assets towards **net zero emissions by 2050**
  - with **at least 45% reduction in emissions by 2030**
- Emissions reductions will be on an absolute emissions basis.
- Aligns with the ambitions of the Paris Agreement to target a 1.5°C limit on global temperature increases.
- Covers the majority of multi-asset funds and the Model Growth Portfolio which is held by the majority of UK based fiduciary management clients.

Transition Metrics and Targets

Example Implementation Plan

	Integration (Risk Reduction)	Stewardship (Transition Support)	Investment (Solutions)

2025 and 2030	• **Emissions Reduction Targets across asset classes**
	33% and 50% reduction in carbon intensity by 2025 and 2030 respectively across asset classes:
	  • Equities, fixed income etc.
	• **Decrease allocation to high carbon / low transition portfolio exposures.**
		• **Transition Improvement Target**:
		20% and 33% shift by 2025 and 2030 respectively from lower transition category to higher transition category exposures across listed assets and property.
		• **Engagement Target**:
		A targeted focus on the top twenty holdings – particularly utilities – in proactive voting and engagement.
			• Increase allocation to low-carbon / sustainability-themed exposures.
			• **Green Solutions Target:**
			20% and 33% allocation by 2025 and 2030 respectively in total across all asset classes:
			  • Equities, fixed income etc.

2021 - 2023	• Achieve c. half of emissions reductions by 2023 via listed equities and corporate credit.	• Mercer Climate Transition Assessment tool to be a reference for annual monitoring together with manager engagement.	• Current analysis expects 15% increases can be achieved by the end of 2023.
2021/ 2022	• Undertake first set of analysis • Develop implementation plan • Communicate to stakeholders		

The plan would be revisited annually and implemented over three yearly cycles. Longer term 2025 and 2030 targets would also be introduced

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3

Sustainable Global Listed Equity

What is sustainable equity?

Combining long-term thematic changes with emerging technologies and having a broader perspective on risk

- A portfolio of companies focused on sustainable business management and global trends.
- Often based around selecting companies aligned with sustainability themes, such as health, energy efficiency, education, labour rights, etc.
- Generally long-term time horizon and lower expected turnover.
- Can be concentrated and typically quality/ growth oriented.

- Strategies are increasingly considering sustainable impact reporting and alignment with the Sustainable Development Goals (SDGs).
- Sustainable equity strategies are well-placed to capture positive investment opportunities associated with the shift to a low carbon economy
- **Mercer has identified several highly-rated strategies taking a broad, diversified approach as well as those with a more specialist (regional or sustainability theme) approach**.

Supporting positive social and environmental impacts

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Listed Equity Portfolio

Manager / Fund	Strategic Assset Allocation %
Russell - WPP Global Opportunities – Global Equity	5.0
BlackRock ESG Fund – Global Equity	5.0
Total Developed Global Equity	**10.0**
Wellington Emerging Markets (Core) - EM Equity	3.0
Wellington Emerging Markets (Local) - EM Equity	3.0
BlackRock EM (Passive) – EM Equity	4.0
Total Emerging Market Equity	**10.0**
Total Equity	**20.0**

- ESG funds, like sustainable equity, are naturally biased towards companies with better governance practices and those with less environmentally and socially damaging business models.
- Based on the current investment opportunities and long-term themes, we strongly believe sustainable equity strategies should form a material allocation of the Fund's equity investments.

We believe sustainable equity strategies are well positioned for the 'new normal'

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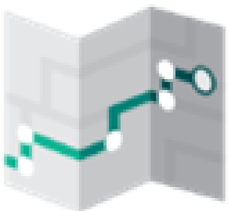
Key Takeaways

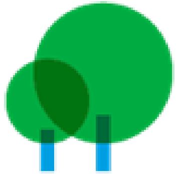
4

Three Upcoming Recommendations

Adopt a Net Zero Ambition for the Fund



Support your Net Zero target with a credible implementation plan



Formally request that the Wales Pension Partnership offer a Sustainable Global Equity Fund

Appendix 5

Responsible Investment roadmap

Climate change scenario analysis and carbon footprinting
Q4 2020 / Q1 2021

Work with WPP to develop an active Sustainable Global Equity Fund
H2 2021

Net Zero Commitment and target setting
H2 2021

Update ISS for latest decisions – asset allocations, plus overarching decision as to whether to adopt a net zero ambition and framework
H2 2021

Work with WPP to produce UK Stewardship Code report rand TCFD report
2021/22

Build up exposure to sustainable private market allocations
Ongoing

Transition and Decarbonisation Principles
What we mean

What we DON'T mean by Decarbonisation …	…and what Mercer DOES mean by Decarbonisation
Immediate…	A multi-year plan to significantly reduce emissions in the portfolio, with the decade to 2030 critical to a net zero 2050 target, and 3-5 year targets also helpful.
… divestment from only fossil fuel energy …	Scope 1,2, (and soon scope 3) emissions for all sectors, energy supply plus the demand side sectors.
… only in equities, …	A total portfolio approach, including real assets (property and infrastructure), that seeks reductions in portfolio emissions (intensity) and real world emissions (absolute).
… regardless of price …	'Decarbonisation-At-The-Right-Price' to build flexibility into the strategic plan to capitalise on opportunities that may arise in the shorter term.
… or capacity for emissions reduction in the future, …	Looking beyond emissions today to account for transition plans expected to impact emissions tomorrow and transformative solutions opportunities.
… with disregard for broader investment and ESG principles	Traditional investment and ESG factors must continue to be considered to ensure the focus on carbon doesn't miss other issues or create unintended consequences.

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Net Zero Commitments and Action
What are Investment Managers Doing?

Making net zero commitments

- Net Zero Asset Managers initiative launched in December 2020.
- International group of asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050 and supporting investing aligned with net zero emissions by 2050.

87 signatories

$37 trillion in assets under management

Launching products that support their net zero ambitions

Managers are innovating and launching climate change strategies to help meet their net zero targets.

Innovative strategies include:

- Passive equity/fixed income funds based on EU Paris-aligned Benchmarks / Climate Transition benchmarks.
- Sustainable thematic / impact equity funds focused on climate solutions.
- Fixed income funds incorporating green bonds.
- Real estate and infrastructure funds with net zero targets.
- Low carbon transition / physical resilience focused private market funds.

Five climate change parameters of the FTSE TPI Climate Transition Index:

Fossil fuel reserves
Management quality
Carbon emissions
Carbon performance
Green revenues

Source: FTSE Russell

Climate Transition: The How and What?

How does Mercer help you align to Net Zero?

Mercer's climate transition advice, supported by Mercer's Analytics for Climate Transition (**ACT**), follows a step by step approach to align to a net zero* outcome by 2050. Mercer will help you to:

1. **Calculate the baseline -** current emissions, transition capacity and green exposures
2. **Analyse portfolio possibilities** for implementing a portfolio wide transition by asset class
3. **Set measurable targets** for reducing emissions and growing transition capacity, tested against different scenario pathways
4. **Implement a plan**, drawing on outputs from each step and our recommended priorities.

What is the End Result?

At completion, **you will be well prepared to establish a climate transition plan, including targets, and have confidence in answering key questions**: Can we reduce emissions and set aligned targets while a) meeting investment objectives? & b) not just divesting today's high carbon companies? And can this be practically implemented and monitored?

*'Net zero' means emissions are reduced as far as possible, where there are options to do so, with any remaining emissions offset by absorbing an equivalent amount from the atmosphere e.g. in nature (trees and soils) or via carbon capture and storage or use technologies

Mercer Climate Transition Framework

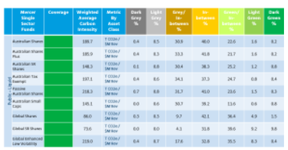
Manage 'Grey' Risks
High carbon intensity,
low transition capacity

Steward the 'In-between'
Varying carbon intensity
and transition prospects

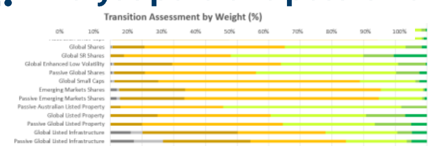
Target 'Green' Solutions
Low carbon intensity,
high transition capacity

2020 — 2030 — 2050

1. Determine current baseline



2. Analyse portfolio possibilities



3. Set measureable goals

For example:

- Support the net zero by 2050 ambition
- Set aligned 2030 targets for reducing emissions + growing green exposures and transition capacity
- Establish 1-3yr plan by asset class

4. Implementation

Integration

- Incorporate scenario and transition analysis into strategy and portfolio construction decisions
- Monitor developments and prices (DARP*)

Stewardship

- Engage with companies , particularly those in transition, and policymakers
- Utilise voting rights

Investment

- Allocate to new innovation and solutions
- Monitor developments and prices (DARP*)

Screening

- Restrict high-carbon exposures if required

Disclosure consistent with the TCFD framework – including metrics and targets

(*DARP - Decarbonisation at the Right Price)

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Calculate the Baseline
Sample dashboard

The 'Grey' High carbon intensity, low transition capacity

The 'In-between' Varying carbon intensity and transition prospects

The 'Green' Low carbon intensity, high transition capacity

	Mercer Single Sector Funds	Coverage	Investor's Contribution to Absolute Emissions	Metric By Asset Class	Weighted Average Carbon Intensity	Metric By Asset Class	Dark Grey %	Light Grey %	Grey/ In-between %	In-between %	Green/ In-between %	Light Green %	Dark Green %
Public – Liquid	Global Shares		74,543.4	T CO2	86.0	T CO2e / $M Rev	0.3	0.3	9.7	42.1	36.4	4.9	1.5
	Global Sustainable Shares		5,711.9	T CO2	73.6	T CO2e / $M Rev	0.0	0.0	4.1	31.8	39.6	9.2	9.8
	Global Small Caps		47,031.3	T CO2	108.8	T CO2e / $M Rev	0.3	1.0	13.5	62.4	17.3	1.2	2.3
	Global Listed Infrastructure		11,115.2	T CO2	1085.1	T CO2e / $M Rev	6.0	3.5	27.9	25.7	21.1	4.3	4.4
	Global Credit		22,219.0	T CO2	Corporate: 135.7 Sovereigns: 15.8	T CO2e / $M Rev & TCO2e / $M GDP	0.2	0.7	8.8	25.3	20.2	4.3	0.0
Private – Illiquid	Australian Direct Property		12,153.4	T CO2	69.7	TCO2e / $ Sqm	-	-	-	-	-	-	-
	Global Unlisted Infrastructure		TBC	T CO2	758.2	T CO2e / $M Rev (proxy)	-	-	-	-	-	-	-

Source: Mercer, with underlying metrics from MSCI ESG Research and ISS

The impact of Covid-19
Fast forward to the future?

- The Covid-19 pandemic has accelerated a number of existing trends, and magnifying distinctions between winners and losers:

Stay at Home
Remote working and staycations

Winners: Internet based technology companies; warehouses; supermarkets; renewable energy; healthcare.

Losers: Retail; offices; travel; fossil fuel market; leisure.

Climate Change
Move to a low carbon economy

Lower carbon emissions generated over last 12 months but emissions reductions caused by previous economic shocks have been temporary.

Learnings from this pandemic can help to support the development of investor practices, which better prepare portfolios to weather other systemic risks, like climate change.

Corporate resilience
Focus from Shareholder to Stakeholder

Resilient companies in the short and long term are those that have:
- Comprehensive business plans;
- Prudent cash reserves;
- Strong stakeholder relations; and
- Positive response to labour rights.

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