BCSSS
British Coal
Staff Superannuation Scheme

INVESTING TO TAKE ACCOUNT OF CLIMATE CHANGE

March 2024

BCSSS and TCFD

Introduction to the Scheme

The British Coal Staff Superannuation Scheme ("The Scheme") provides benefits for around 40,000 pensioners and deferred members.

The Scheme is run on behalf of the members by the Trustees ("The Trustee") who have overall responsibility for investing the Scheme's assets in order to pay members their benefits.

Coal Pension Trustees Investment Limited ("CPTI") is responsible for providing investment advice and investment management services to the Trustee.

Investing to Take Account of Climate Change

It is critical for the Trustee to understand any financial risks and opportunities that the Scheme's investment portfolio faces. In 2021, the Trustee prioritised climate change as a key investment focus.

CPTI, on behalf of the Trustee, is actively seeking growth opportunities in climate transition investments while managing climate risks in the portfolio. CPTI is also working on integrating climate factors into the Scheme's investment strategy, including allocating to new asset classes or strategies that may benefit from expected energy transition changes, like commodities and infrastructure. At the same time, the Trustee has to focus on its primary fiduciary duty of ensuring the investments can support all the Scheme's future payments. Thus, integrating climate must consider relevant financial factors such as changes in global regulation and the pace of the transition in the broader economy.

The Trustee reports every year on the Scheme's approach to climate change through a TCFD (Task Force on Climate-related Financial Disclosures) report. The report is very detailed and enables the members and other interested parties to monitor the Scheme's activity.

The Trustee has now published its third TCFD report, for the year ending March 2024. It is accessible here. Below we summarise the main points for members' information.

Climate Change's Impact on Investments

Climate change will, and already has, impacted the Scheme's investments in many ways, both positive and negative. There are three areas of risk and opportunity that are material to the Scheme:

Physical risks

- These are the harmful effects of climate change, like extreme weather events, rising sea levels, heatwaves, floods, and droughts. These risks can damage homes, infrastructure, agriculture, and ecosystems.
- The Scheme's assets are at direct risk mostly through the physical assets it holds such as buildings and infrastructure which could flood or burn, but also through secondary impacts such as the changes that will come to insurance premiums, mortgage rates and consumer preferences in choosing where they live, work and make purchases. For example, one of the solar farms that the Scheme invests in was inaccessible for months last year following significant flooding.

Transition risks

- These are challenges that companies face when choosing whether and how fast to adapt to a low-carbon economy. These risks can include policy changes, pricing changes, changed supply and demand, stranded assets (those suddenly worth much less or viewed as undesirable).
- The Scheme has already faced transition risks, such as the need to refurbish some buildings in the property portfolio to achieve higher EPC ratings (which measure a building's energy efficiency) due to upcoming regulations. Future transition risks will depend on regulatory changes. One potential risk is having properties that are not able to reduce their carbon emissions enough and such will be become stranded assets. To address this, the Scheme is identifying and implementing interventions to mitigate stranded asset risks.

Climate opportunities and solutions

- The transition brings new technology and changing consumer preferences which lead to investment opportunities.
- The Scheme has already made investments in some of these opportunities, investing in renewables, grid electrification and commodities which will benefit from the transition.

While it is possible to identify and invest around expected impacts, there are still many uncertainties: it is difficult to know exactly when and where these opportunities will arise; there is still a significant lack of data which makes decision-making harder; and there is very little foresight in relation to regulation that can lead to substantial changes. Despite this, it is paramount that the Trustee is presented with all the relevant information relating to the Scheme's current emissions and possible areas of opportunity on an ongoing basis and the portfolio will continue to be adapted appropriately.

Changes and Achievements through to March 2024

Overall, whilst significant work has been undertaken around climate risk and opportunities, the Trustee recognises there remains significantly more to do in order to position the portfolio for a low-carbon world. This is true of the broader market as well and carefully pacing the portfolio’s transition to go neither too fast nor too slow is critical to successful financial outcomes.

The Trustee has not set a Net-Zero target for the Scheme and instead is focused on gradually reducing exposure to climate risk and increasing investment in climate opportunities. While the carbon emissions of the portfolio have fallen through time, this may change with changes to asset allocation or as more data is collected.

The Trustee has set a target to improve the level of carbon reporting across the assets of the entire Scheme – through pressuring companies and managers to report carbon emissions there will be better understanding of climate risk and consequently better management of these risks.

This carbon data ranges from carbon emissions (the release of carbon dioxide (CO2) and other greenhouse gases into the air) that the Scheme’s investments have financed, to the intensity of the Scheme’s emissions (a measure of how many emissions are produced per unit of something, like energy or economic output). The full TCFD III report highlights how many of the investments are “Paris Aligned” (i.e. how much of the portfolio is on-track for a 1.5C global warming situation versus a much higher level of warming).

Significant progress has been made in terms of collecting more data than last year (and it being real data, rather than estimated) and there has been a reduction in the Scheme’s emissions (albeit as a function of changes to the asset classes that the Scheme invest in, rather than a targeted reduction in higher emitting assets).

By making Climate Change a theme, the Scheme is reducing exposure to risky climate-affected areas and increasing investments in promising areas. This has meant changes in the portfolio, including:

- Investing in a “Low Carbon Transition Readiness” portfolio which aims to invest more in companies that are better prepared for the shift to a low-carbon economy and less in those that are not as ready.

- Selling out of a portfolio that invested in Chinese companies partially because of the manager's lack of attention to climate-related risks and opportunities.

- Identifying attractive opportunities to invest in, such as commodities or infrastructure companies. Detailed examples of such opportunities can be found in Appendix 2 of the full TCFD report and a selection of which follow overleaf.

BCSSS Investment in Climate Opportunities

At the end of March 2024, total investment in climate opportunities for the Scheme was estimated to be around £520 million, spread across different types of investment. We have included some here:

Commodities: In 2022, The Trustee decided to invest in a new commodities portfolio designed to capture the opportunities created by the global shift toward a low-carbon future. This portfolio focuses on the growing demand for sustainable resources, such as metals which are essential for renewable energy and carbon credits (these are effectively permission slips that allow companies to release a certain amount of carbon dioxide into the air. Every credit gives them the right to release one ton of CO_2, but there is a limit to how many credits a company can get).

Crucially, it avoids high-carbon commodities like oil, which no longer align with a world striving for net-zero emissions. Instead, it focuses on those commodities whose prices are expected to rise as climate action ramps up and extreme weather impacts key resources like agriculture.

Managed by Wellington, this portfolio goes beyond financial returns. Through active engagement with industry players, Wellington promotes transparency and sustainability, working on innovations like responsibly sourced gas and cutting-edge carbon credits. This approach ensures the portfolio drives real-world change while capturing climate-driven investment opportunities.

Power Grid of India: The backbone of India's energy system, Power Grid helps deliver electricity across the country, keeping the lights on in millions of homes, factories, and offices.

India is gearing up for a huge change: Over the next 10 years, the country plans to add a lot more clean-energy into its system—aiming for an incredible 500GW of renewable power by 2030. Power Grid, being a major player in the transmission of electricity, will be at the heart of this shift, helping to move this new wave of renewable energy from where it is generated to where it is needed.

India is planning to invest Rs 2.8 trillion (that is about US$34 billion) into upgrading its transmission systems over the next decade. Since Power Grid is the biggest company in this space, it stands to gain a lot from this investment.

Emerging Market Debt: In 2023, the Scheme invested in an Emerging Market Debt portfolio, which is made up of both corporate bonds (loans made to companies) and sovereign bonds (loans made to governments). About 40% of the Emerging Market Debt portfolio is invested in “climate opportunities”.

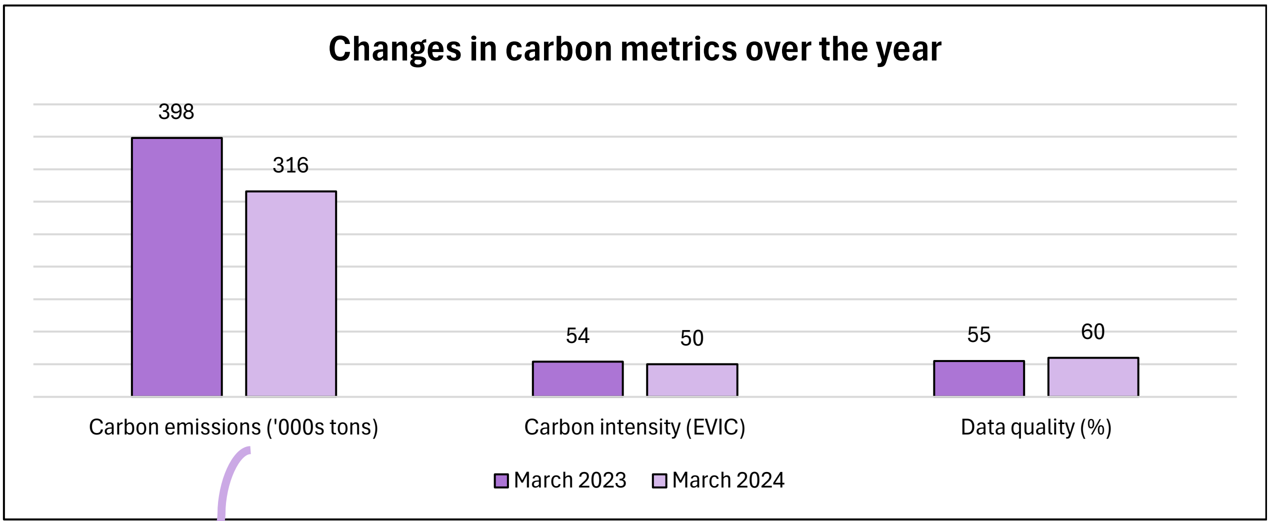
This includes special types of bonds called green bonds and sustainability-linked bonds. Green bonds raise money specifically for projects that help the environment, like building wind farms or improving energy efficiency. Sustainability-linked bonds go a step further by rewarding companies for meeting certain climate targets.

The portfolio also invests in bonds from countries that are leading the way in reducing their carbon emissions, according to a rating system called the Net Zero Sovereign Index. It also includes companies and countries that are top performers in tackling climate change.

Carbon Footprint and Changes

Over the year the Scheme saw advances across all carbon related metrics, with total carbon emissions (shown below in thousands of tons of CO_2 emissions) and total carbon intensity (shown below as emissions relative to the value of a company (EVIC)), both falling. As noted above, this may not continue through time – the Trustee is focused on investing in assets which will manage climate risk through time rather than simply on the starting numbers at the point of investment.

Data quality measures the amount of real data rather than estimated data around carbon emissions and this metric has improved (i.e. the Scheme has more data here than at the start of the year). The Scheme is targeting 90% data quality by the end of 2024, meaning there is a long way to go from the current 60% but improvements are being made. The target will not be achieved before the end of 2024 and the Trustee will review and likely extend the target.



The reduction in the Scheme's carbon emissions over the year is equivalent to planting about 1,350,000 trees (that's 33 trees per member)!

Future Plans and Commitment

While there remains progress to be made, the Scheme has made encouraging strides over the past year towards transitioning its investments to better manage risks and seize opportunities in the shift to a low-carbon world. In the coming twelve months, the aim is to further reduce exposure to unrewarded climate risks, explore new investments in climate opportunities, and enhance data coverage. The annual TCFD reports will continue to offer a clear and transparent overview of the Scheme's ongoing strategy and progress in this area.

If you have any questions relating to something you've read in this summary, don't hesitate to contact bcsss.enquiries@coal-pension.org.uk.