ASSET OWNERS NETWORK

ENGAGING WITH HIGH-EMITTERS: A STEWARDSHIP PLAN IN ACTION

Practical example: Church of England Pensions Board

THE CHURCH OF ENGLAND

KING CHARLES III CHARITABLE FUND

WHAT

The Church of England Pensions Board has £3.2 billion in assets under management and serves over 42,000 beneficiaries. Climate change is an important consideration for us. We developed our climate change policy in 2015, co-founded the Transition Pathway Initiative (TPI) in 2017 and played a leading role in the first phase of Climate Action 100+. In 2020, we set our target to achieve net zero by 2050, and in 2023 we published our first Climate Action Plan.

We have integrated climate considerations throughout our stewardship approach, guided by our Stewardship Implementation Framework. One key expectation we have for investee companies is that they align their plans and strategy with the Paris Agreement goal to limit the average global temperature increase to 1.5°C above preindustrial levels.

Voting and engagement, especially with high-emitting investee companies, is core to our approach to climate change. While we aim to support companies' net zero transitions, we don't always see the changes we need to see at the pace we need to see them. When this happens, we use our escalation framework to guide our next steps, which can include voting, filing, supporting shareholder resolutions or divestment.

In 2023, following a five-year programme of intense engagement, we assessed whether oil and gas companies' plans aligned with a 1.5°C benchmark. Unfortunately, none did, so we took the difficult decision to divest.

WHY

We aim to be a responsible and ethical investor, and we have a fiduciary duty to pay pensions to our beneficiaries well into the future. As one of the investing bodies for the Church of England, we also incorporate ethical investment advice and guidance aligned with the teachings of the Church into our strategy and decision making.

As a pension fund, with both defined contribution and defined benefit schemes, we also operate on long time horizons. Major systemic challenges today can challenge our ability to pay pensions into the future and affect the world into which our members will retire – with climate change presenting an urgent and existential threat both to our fund and the world. As well as addressing risks we believe that, by modelling good practice, our efforts can drive better performance from individual companies, industries and the wider finance sector.

A thoughtful and effective stewardship approach is critical to achieving these goals. For us, divestment is a valid part of an engagement strategy. Divestment generally follows a long-term period of engagement in which expectations are clear, credible and well-communicated.

> "The Board takes a high-level perspective often referred to as 'systemic stewardship' which recognises that systemic risks to the global economy, like climate change and biodiversity loss, will have an impact on our portfolio over the long term … Though these are challenging topics, their importance and our position in the investment chain as an asset owner means that we have an opportunity to set the agenda."
>
> **Church of England Pensions Board,**
> Stewardship Report 2022

HOW

Ethical issues are fully integrated into our responsible investment approach, and our governance and oversight structure reflects this. The Church of England's Ethical Investment Advisory Group provides timely and practical advice to the three Church of England National Investing Bodies to enable each of the institutions to invest in a way that is distinctly Christian and Anglican. Climate change is a major consideration and is explicitly a board-level issue, as clarified in the Church of England National Investing Bodies' 2015 climate change policy.

The Church of England Pension Board's investment team is led jointly by our chief investment officer and our chief responsible investment officer. This is the result of a strategic decision to embed ethical and responsible investment into both our executive leadership and the operations of our investment team, so that we have one integrated approach across the fund.

Meaningful engagement is resource-intensive, as it is most effective when stewardship professionals have a strong understanding of a company and its context. Given the importance of stewardship to responsible investing and addressing climate change, we made a strategic choice to keep stewardship activities in-house. We have prioritized bringing sufficient expertise into the team, which includes professionals focused on responsible investment and with thematic expertise. While we have stewardship expectations of our asset managers – and actively engage managers on this – we primarily manage our own stewardship and do our own proxy voting.

The next sections provide more detail about how we have used our stewardship approach to support alignment with the Paris Agreement through:

- Drawing on investor tools
- Structuring our engagement with high-emitting companies
- Considering the role of policy

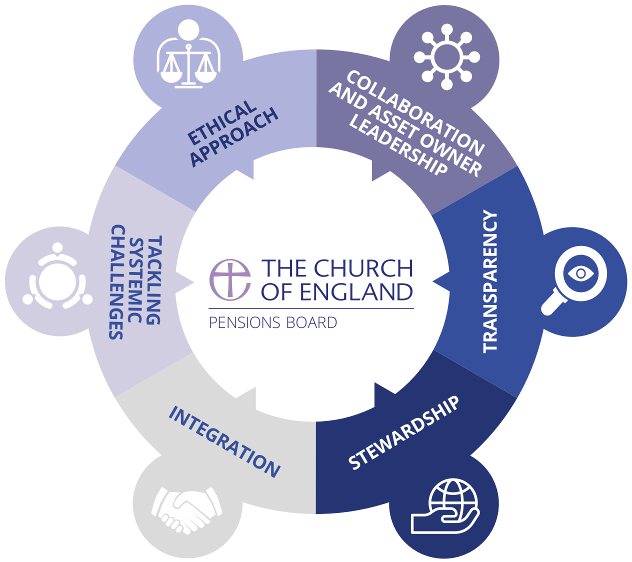

Figure 1: The Church of England Pensions Board – our investment approach

DRAWING ON INVESTOR TOOLS AND INITIATIVES

We can't drive change alone – and neither can other asset owners. Recognizing the potential for collaboration, we have played a role in shaping, supporting and championing various investor tools and initiatives. In turn, the availability of these has enhanced our engagement process.

Created and led by investors, Climate Action 100+ is an initiative that engages with companies, and we joined in the first phase of its work. We also work with InfluenceMap, Ceres, the Principles for Responsible Investment, the Institutional Investors Group on Climate Change and others on our climate initiatives. In 2017 we co-founded the TPI with other investors and have played a key leadership role in building this important investor initiative.

The Transition Pathway Initiative

TPI offers an independent, academically rigorous tool to help asset owners and managers assess companies' progress on climate change and alignment with the goals of the Paris Agreement. The tool is based on robust data and methodologies, and provides information across a range of climate metrics. Asset owners and managers can then use the results of their TPI assessments to inform their engagement with companies.

We co-founded TPI in 2017, and until September 2023 the TPI board was chaired by our chief responsible investment officer. As of May 2023, 139 asset owners had signed up as supporters of TPI, representing over US$50 trillion in assets under management and advice.

Figure 2: Launch of the TPI at the London Stock Exchange in 2017

TPI's focus on forward-looking indicators enables us to make informed decisions about our engagement strategy and approach to stewardship, both by sector and for individual companies. We use the tool to determine whether companies are meeting our expectations to align their targets and plans with the temperature goals of the Paris Agreement. This has helped us to engage more strategically, based on a solid understanding of what the net zero transition really meant in practical terms for companies in the real economy.

For example, when engaging with auto companies, we can use TPI carbon performance data to assess how aligned a particular company's emissions reduction targets are to our expectation of alignment with the Paris Agreement. We can also engage them by calling for stronger targets and more ambitious plans to produce electric vehicles and to phase out internal combustion engines more quickly. This enables us to take a science – and evidence-based approach to our engagements.

STRUCTURING OUR ENGAGEMENT WITH OIL AND GAS COMPANIES

Over a five-year period of engagement, aligned with Climate Action 100+, we set out a series of hurdles for target oil and gas companies. We set these expectations based on an assessment using robust data from sources such as TPI. We asked companies to meet specific standards and make improvements each year. The idea was to continually push and incentivize companies to make real progress, following a realistic transition pathway.

Each year, we set expectations for the target companies, outlining where they were falling short and our concerns. Our voting activity supported our approach, too. We reflected on the signal that we would be sending by voting – or declining to vote – with management.

We hoped that through consistent, meaningful and transparent engagement, at least some of the companies would have made enough progress for us to realistically continue to invest in them. While some companies came close and demonstrated a real willingness to improve, others fell far short – and a few had even rolled back some of their previous commitments. Ultimately, the companies had failed to meet expectations. In line with our escalation framework, we chose to divest as a last resort. We also felt the intensive time needed for productive engagement with these companies could be more usefully spent elsewhere. This was the final step of a five-year process.

We have been clear that if these companies take concrete steps to meet our expectations, then we could consider including them in our portfolio again. We would expect them to:

- Disclose against the Net Zero Standard for Oil and Gas
- Put in place credible short-, medium- and long-term targets that are independently assessed as aligning with limiting global warming to 1.5°C
- Include all scopes of emissions and capital expenditure in their transition plan
- Align their direct and indirect lobbying with what is needed from policymakers to support the net zero transition

This means that we haven't closed the door on future investment in these companies but the standard we have set for re-entry is high. None of the companies we divested from have met that standard yet.

We see securing robust and ambitious climate policy in all jurisdictions we invest in as a critical enabler of investment in the transition to net zero. Our main activities are engaging with investee companies on their own lobbying and engaging with other investors to make the case for stronger policy positions, aligned with the interests of our beneficiaries.

Corporate climate lobbying: We monitor the corporate climate lobbying activities of our investee companies and their industry associations. We do this monitoring directly, drawing on data sources such as TPI, Climate Action 100+ and InfluenceMap to support us. Unfortunately, there is still far too much negative lobbying from the corporate sector that seeks to prevent, delay or distort putting in place climate policies that would enable us to transition more rapidly to net zero.

We use engagement to counter or challenge corporate climate lobbying. Sometimes companies have a highly engaged approach, and sometimes they are unaware that industry associations are doing obstructive negative lobbying on their behalf. We see managing this risk as a key governance issue for company boards – and frequently vote against the re-election of directors where we see misalignment or a lack of transparency from companies.

Since we began this work in collaboration with the Institutional Investors Group on Climate Change and other investors, over 70 of the Climate Action 100+ focus companies have produced disclosures on corporate climate lobbying. This number needs to be higher, and the quality of disclosure can vary enormously, so there is still much to do in addressing this critical issue.

Advocating with the investment sector: Partnering with other investors can be a powerful way to advocate for positive change on the areas most important to us. We talk with policymakers, regulators and other important institutions in the broader investment ecosystem such as multilateral development banks. By working together, investors can have a stronger voice when engaging on policy and regulation.

NEXT STEPS

We expect that the phase out of fossil fuels will continue to be the single most important area of focus for transitioning to a net zero economy. We are focusing on several areas, including:

1. **Demand** – we have a strategy for engaging with the sectors that have the highest demand for fossil fuels, such as the utility, industrial and transportation sectors.
2. **Debt** – while we no longer have investments in oil and gas in our fixed-income portfolio, we can continue to address the debt side in other ways, such as by engaging with banks' lending to oil and gas companies.
3. **Just transition** – throughout our stewardship work, we want to do more to support and enable a net zero transition that is equitable for emerging markets and acknowledges the different path that transition needs to take for those countries (ie a just transition).

The UK Asset Owner Roundtable's review of the relationship between asset owners and asset managers will also help to inform our future engagement with fund managers.

UK Asset Owner Roundtable

A group of asset owners recently conducted a review of how asset managers have interpreted their stewardship responsibilities, as reflected in their proxy voting.

Our view following the 2023 proxy season was that asset managers weren't using their votes in the way we would have expected if they had been aligned with our long-term interests on oil and gas. For example, despite public backtracking on climate targets, companies still saw high levels of support for the re-election of board directors.

The UK Asset Owner Stewardship Review 2023 was published in November 2023. The report explores the extent of the misalignment between asset owners' interests and asset managers' stewardship and proxy voting activities, in relation to oil and gas companies. Some potential explanations for misalignment were considered, including cultural or political misalignment, different understandings of the importance of stewardship and climate change, and asset manager misunderstandings about the nature of fiduciary duty.

Faith Ward, the Chair of the UK Asset Owner Roundtable, stated: "UK asset owners are concerned that despite unequivocal warnings from the United Nations and the IPCC [Intergovernmental Panel on Climate Change] of the risks of delayed action on climate change, that short-term interests are trumping long-term interests of pension funds."

TOP TIPS

"If you're waiting for perfect data, for perfect insight, you're never going to do anything, and quite frankly that will be an excuse for inaction. And you actually have a responsibility to act." – **Adam Matthews, Chief Responsible Investment Officer**

USE THE RESOURCES AVAILABLE

The net zero transition needs to take place at a scale and complexity that we have never seen before. Far more information sources, tools and frameworks are available to help you with this than ever before. Draw on these and engage with collaborative investor networks and platforms to help you navigate the challenges.

NARROW YOUR FOCUS

Define the issues that are most significant to you and plan your engagement on that basis. Focused engagement on a smaller number of issues can be more meaningful than going for a broad reach with less depth. Some useful questions to consider are: What matters to your stakeholders? What's financially material? Where do you have influence? Where are the systemic risks?

HAVE A ROBUST ESCALATION PLAN

Within your engagement strategy, having a clear and robust escalation plan will guide your work with investee companies so that you are operating in an effective and structured way. Communicating with investee companies about your engagement strategy and escalation plan can also help to manage expectations on both sides.

VOTE

Voting is crucial to an engagement strategy, especially for companies that haven't yet aligned with a 1.5°C or 2°C pathway. How you vote – or how asset managers vote on your behalf – sends a signal to investee companies about your priorities. Where possible, bringing voting in-house can help to ensure consistency in your stewardship approach.

SUPPORT A JUST TRANSITION

It's crucial that we act fairly to enable the net zero transition globally in a way that doesn't create greater social problems and barriers. Focusing on industries, companies and communities where there are expected closures and transitions can be a useful place to start. Asset owners can call on companies to develop well-consulted, well-funded, early plans for closures that are fair to communities and workers.

INCLUDE EMERGING MARKETS

A failure of emerging markets to transition to net zero is a systemic risk to everyone, everywhere. Finance and investment will need to play a key role. Considering your allocation to emerging markets – as well as your approach to advocacy with both sovereign issuers and companies in these markets – can form a meaningful part of your stewardship approach.

GET IN TOUCH OR FIND OUT MORE

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Accounting for Sustainability (A4S)

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info@a4s.org

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More from the A4S Essential Guide Series:

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Important information

A4S ASSET OWNERS NETWORK

The A4S Asset Owners Network is a grouping of pension fund chairs sharing insights on embedding sustainability into their strategic and investment decision-making processes.

Click here to find out more.