

## CLIMATE CHANGE STRATEGY OF THE CHURCH PENSION FUND

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### Introduction

Climate change is one of the megatrends of our time and, as such, plays a key role in the UN's *Sustainable Development Goals*. Climate change is a global phenomenon that will have an unavoidable impact on the world's societies and economies in the future. Climate change will have an initial and stronger impact on those people and environments that are already among the most vulnerable.

In order to slow climate change, humankind will have to reduce the generation of greenhouse gases in the atmosphere. At the Paris Climate Change Conference in 2015, the international community approved a new goal to limit global temperature rise to 1.5 degrees Celsius. Experts estimate that our attempts to limit the temperature rise to less than 2 degrees Celsius will mean that we will only be able to use one fifth of the world's known fossil fuel reserves. This restriction has not yet been taken into consideration in the pricing of such reserves by companies and markets. If the so-called *carbon bubble* were to burst, it could significantly decrease the value of companies that produce fossil fuels.

In addition to the carbon bubble, another significant factor is *carbon risk*. Carbon risk comes from the idea that, as a result of attempts to slow global warming, a higher price or tax will need to be placed on the use of fossil energy sources worldwide. This would result in carbon-intensive companies facing increasing costs and investment needs in order to retain their competitiveness. Furthermore, the changing operational environment driven by environmentally-aware consumers, new technological solutions and increasing legislation may, in the future, result in a further price increase for the use of these reserves and a reduced demand for fossil energy sources. A large portion of the reserves may be left unused for economic reasons.

In terms of the intensity of its carbon dioxide emissions, coal is one of the worst fossil fuels. The world cannot retain its 2 degree warming scenario, if the amount of coal utilised in energy production remains at the current levels. In order to achieve the climate goals, it is important that the use of coal be reduced as soon as possible.

The Evangelical Lutheran Church of Finland is doing its part to help slow climate change. The practical recommendations were compiled for the parishes and Church members in the *Climate Programme of the Evangelical Lutheran Church of Finland*, published in 2008. The Church Pension Fund wants to contribute to work related to climate change, and the Pension Fund's climate change strategy was approved on 19 December 2016. The Church Pension Fund's Responsible Investment Work Group participated in the preparation of the strategy. This climate change strategy is valid until further notice and will be updated as necessary.

### **Climate change affects the value of investments**

The changes resulting from climate change represent new risks and opportunities for investors. In practice, this means that the efforts of companies and states to control climate change will have a gradual impact on the return and risk development of the Church Pension Fund's investment operations. Climate change work is an integral part of risk management within the Church Pension Fund's investment operations. The key task of the Church Pension Fund is to ensure the payment of pensions to Church employees, now and in the future.

The financial impacts of climate change on global markets and sectors are multidimensional and vary along with the different global warming scenarios. The risks induced by climate change are especially critical in sectors with high greenhouse gas emissions, such as utilities, basic industries and energy production. The climate impacts are significant also in the agriculture and forestry sectors as well.

### **Corporate climate reporting supports investment decisions**

As an owner and investor, the Church Pension Fund wants to encourage companies to address climate change in a suitable manner for their own business operations. As a signatory of the *Carbon Disclosure Project* (CDP), the Church Pension Fund is involved in encouraging companies all over the world to report on their own climate change efforts. Comprehensive reporting provides the Church Pension Fund with better investment analyses of a company's actual profit and risk prospects and of the commitment of company management to long-term climate change development.

### **The Church Pension Fund utilises different climate change tools to reduce its carbon footprint**

The goal of the Church Pension Fund is to consistently reduce the carbon footprint of its investment operations. In November 2015, the Church Pension Fund signed the investors' *Montréal Carbon Pledge*.

By participating in the initiative, the Church Pension Fund pledges to report annually on the carbon footprint of its investments.

In order to reduce the carbon footprint of its investment operations, the Church Pension Fund has identified a set of climate change tools. The applicable tools and their uses vary in accordance with the different asset classes. The following table shows the tools used by the Church Pension Fund for its different asset classes:

	A. ESG analysis	B. Engage- ment	C. Green invest- ments	D. Carbon reporting	E. Exclusions	F. Low-carbon indexes
<b>Direct equity investments</b>	✓	✓		✓	✓	
<b>Equity funds</b>	✓	✓	✓	✓	✓ partly	✓ monitoring
<b>Fixed income funds</b>	✓	✓	✓	✓	✓ partly	
<b>Other investments</b>	✓	✓	✓			

*This table was drafted in accordance with the situation on 25 November 2016.*

The primary tools of the Church Pension Fund include the ESG analysis (A.) and engagement activities (B.), which can be used in all asset classes. Green investments (C.) also play a key role, since they are necessary for the development of new low-carbon solutions within different sectors and form the so-called positive *carbon handprint*.

Carbon reporting (D.) provides the Church Pension Fund with an up-to-date picture of the climate risks of its investments. Exclusion criteria (E.) in fossil fuel investments reduce the Church Pension Fund's carbon risk in direct equity investments and serve as a basis for discourse with asset managers. Low-carbon index products (F.) are noteworthy options in terms of passive equity investments.

#### A. ESG analysis

In an ESG analysis, the investor includes environmental, social and governance issues in the investment analysis alongside traditional economic indicators. An ESG analysis can be done for all asset classes.

The goal of the Church Pension Fund is to take ESG issues into consideration in all its investment decisions, including perspectives related to climate change. The Pension Fund favours asset managers that actively monitor ESG issues as part of their investment activities and strive to understand the impacts of ESG issues on an investment object's potential risks and profits.

## B. Engagement

Engagement is an essential tool for a responsible investor. As concerns the theme of climate change, the Church Pension Fund can influence authorities, companies and the broader investment community. The goal of *engagement with authorities* is to reduce insecurity regarding the development and direction of regulations in the field. Our *corporate engagement* involves encouraging companies to reduce their carbon dioxide emissions and to step up their energy efficiency, among other actions. *Engagement within the investment community* involves investors jointly considering solutions to climate challenges, for example, in terms of the different forms of investment.

The climate change engagement of the Church Pension Fund concerns all asset classes. Particularly in terms of equity investments, the Church Pension Fund and its asset managers have the opportunity to conduct direct engagement discussions with companies. The participation of the Church Pension Fund in investor initiatives, such as the CDP, promotes, among other things, the environmental reporting of companies, which provides information that is useful within the different asset classes. As a signatory of the Principles for Responsible Investment (PRI) and a member of Finland's Sustainable Investment Forum (Finsif), the Church Pension Fund has a network through which to collaborate with other institutional investors, academic research organisations and authorities.

## C. Green investments

Green investments help to finance the shift to a more low-carbon economy and they directly impact on the current emissions level. Investment opportunities can be found from different markets and asset classes, as well as from sustainable development theme funds, renewable energy projects, green bonds and forest investments.

The goal of the Church Pension Fund is to increase the number of green investments in the coming years as investment opportunities become available. The Church Pension Fund closely monitors green investment opportunities in different asset classes.

## D. Carbon reporting

With the help of carbon reporting, the Church Pension Fund can monitor the actual climate risks of its investment operations and measure the results of its climate change work.

Carbon calculations and reporting are expanded from direct equity mandates to include equity funds. Asset managers are responsible for company analyses in the investment funds utilised by the Church Pension Fund, so co-operation with the asset managers in the calculating of the carbon footprint of investments is vital. The goal of the Church Pension Fund is for all asset managers and investment funds to complete their own carbon footprint calculations and to report on them to the Church Pension Fund. The calculation methods will continue to be developed and carbon calculating and reporting will also be expanded to cover corporate bond investments.

## E. Investment exclusions

As concerns fossil fuels, the Church Pension Fund has specified the following exclusion criteria to be observed in its direct equity mandate portfolios:

- *Companies in the mining and utilities sector* that derive more than 25 per cent of their turnover from coal used in energy production.
- *Companies in the energy sector* that derive more than 25 per cent of their turnover from coal, oil or natural gas used in energy production.
- A company can also be excluded, on a case-by-case basis, if the *amount of fossil fuels it produces is absolutely significant*, even though the share of the turnover is less than 25 per cent.

*A company can avoid exclusion*, if it can provide evidence of a reduction in the use of fossil fuels or a clear plan to cease using them or to initiate a corresponding increase in renewable energy sources and projects. These assessments are carried out on a case-by-case basis.

Some of the asset managers used by the Church Pension Fund have made the *decision to exclude from their investment portfolios any coal mining companies and electric companies who utilise a significant amount of coal power*. The Church Pension Fund monitors the exclusion criteria of asset managers with the help of its annual ESG survey. Generally, the Church Pension Fund does not have the possibility to influence the criteria of the investment funds after the point of investment, so the investment policies of the investment fund are approved at the point of investment. The Church Pension Fund does, however, have the possibility to influence the investment policies of fund management companies as part of its ongoing dialogue.

From 2017 onward, the Church Pension Fund will employ external experts to conduct a bi-annual *survey on the exposure of all its equity and corporate bond investments to fossil fuels*. The results will be used to monitor its investment portfolio and as a foundation for ongoing discussions with fund management companies.

Engagement (B.) is a key climate change tool for the Church Pension Fund. The goal of engagement is, among other things, *to take part in engagement discourse with the most coal-intensive companies*. The largest greenhouse gas producers also have the greatest potential to reduce the absolute emission amounts.

## F. Low-carbon equity indexes

The range of low-carbon equity index products has seen a constant increase, particularly within the European equity markets. The goal of the low-carbon equity indexes is to achieve a smaller carbon footprint by overweighting low-carbon companies.

The Church Pension Fund utilises equity index investments for passive investment purposes in different geographic areas. Index investments provide cost-efficiency and minimal deviation from the general market. The Church Pension Fund actively monitors the characteristics and pricing of low-carbon equity index funds in the different markets. The goal is to find low-carbon equity index products that also exclude land mines and cluster bomb manufacturers.

### The implementation of the climate change strategy for the years 2016–2020

The goal of the Church Pension Fund is to consistently reduce the carbon footprint of its investment operations. The Church Pension Fund reports on the progress of its climate change work in an *annual report on responsible investing*.

The following table summarises the means and related indicators used by the Church Pension Fund to implement its climate change goals:

Tool	Methods	Indicators
<b>A. ESG analysis</b>	<b>The Church Pension Fund</b> ✓ favours asset managers committed to ESG analyses.	<b>Number</b> of asset managers conducting ESG analyses.
<b>B. Engagement</b>	<b>The Church Pension Fund</b> ✓ continues working with the CDP and other investor initiatives. ✓ encourages its asset managers to take climate risk into consideration and to support the shift to a low-carbon economy. ✓ participates in climate dialogue with other investors, companies, organisations and authorities.	<b>Number</b> of climate initiatives and discussions.
<b>C. Green investments</b>	<b>The Church Pension Fund</b> ✓ increases, in a diversified manner, the share of green investments.	<b>Percentage</b> of green investments in the overall portfolio.
<b>D. Carbon reporting</b>	<b>The Church Pension Fund</b> ✓ reports annually on the progress of its carbon footprint and climate work. ✓ encourages asset managers to calculate and report the carbon footprint of investment funds and mandates.	Annual level of the <b>absolute carbon footprint</b> of equity investments.
<b>E. Exclusions</b>	<b>The Church Pension Fund</b> ✓ integrates the new criteria into its direct equity mandates. ✓ annually monitors the criteria used by its asset managers with the help of an ESG survey.	<b>Excluded companies</b> in mandate portfolios.  <b>Number of funds</b> using exclusion criteria.
<b>F. Low-carbon indexes</b>	<b>The Church Pension Fund</b> ✓ monitors the characteristics and pricing of low-carbon equity indexes within the different markets.	<b>Percentage</b> of indexes among passive equity investments.