BTPS

Climate Change Policy

BTPS' approach to managing climate risk and taking action on climate change

www.btps.co.uk

Overview

BTPS' climate change policy was approved by the Trustee Board in September 2020. This document sets out why we believe climate change poses a clear and immediate risk to the Scheme meeting its long-term funding obligations, the steps we'll be taking to reduce emissions in the portfolio, the investment opportunities we see and how we'll track and report on our progress.

Foreword

BTPS has targeted to an ambitious goal to achieve net zero greenhouse gas emissions (absolute scope 1-3) by 2035 across our £55 billion portfolio.

In setting this goal, we will reduce the risks posed to the Scheme from climate change and align our investments with efforts to limit global warming to 1.5°C above preindustrial levels.

Getting to net zero will involve both reducing emissions from the Scheme's portfolio and investing in assets that will support the transition towards a low carbon economy. It is an ambitious goal that we cannot achieve alone - data on emissions needs to improve and companies, governments and consumers must act. Standing by and doing nothing is no longer an option.

BTPS has a long track record of considering climate change risks as part of our investment strategy. We first began in 2007 and over the years, we have benefitted from involvement with the Principles for Responsible Investment (PRI), the Institutional Investors Group on Climate Change (IIGCC) and the general improvement in the industry's understanding of the subject. In addition, we have participated in studies undertaken by Mercer in 2011, 2015 and 2019 investigating the potential impact of climate change on investment returns.

Earlier this year, we amended our core investment principle from finance first to sustainable long-term value creation. This was an evolution in our approach to responsible investment. One of the primary drivers has been the acceptance that climate change is a clear and present risk to the Scheme, not a future risk.

With the Intergovernmental Panel on Climate Change's (IPCC) fifth assessment report[1] categorically identifying human activity as the main cause of this climate change, there has been increasing action to develop mitigation and adaptation strategies to tackle global warming, manage the risks of climate change, and encourage a just transition to a sustainable low carbon economy. This new goal marks a step change in the action we are taking and we are committed to playing our part in the transition to a low carbon economy.

From the Scheme's perspective we recognise that climate change could have a material impact on our investments, both due to physical risks to the investments we own and because of risks from the global transition to a low-carbon economy. We also recognise that there will be significant investment opportunities created by this low-carbon transition that the Scheme can benefit from.

We believe that if humanity fails to change course now, we risk passing the point of no return on climate change, with disastrous consequences for the ecosystems that sustain us, the world's people and the global economy.

Morten Nilsson
CEO
BTPS Management Ltd.

Otto Thoresen
Chair
BTPS

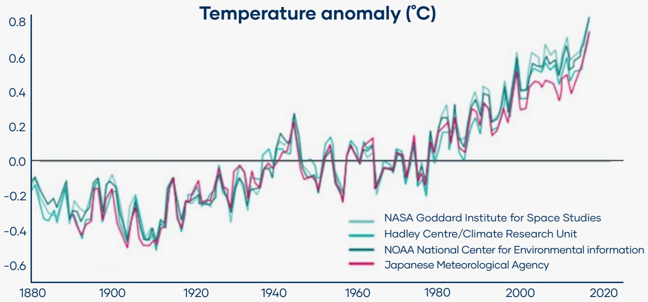
[1] IPCC, 2014: Climate Change 2014: Synthesis Report. Contribution of Working Groups I, II and III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change [Core Writing Team, R.K. Pachauri and L.A. Meyer (eds.)]. IPCC, Geneva, Switzerland, 151 pp.

Climate change science

There is overwhelming scientific evidence that climate change is rapidly accelerating. We have already experienced around 1.0°C[2] of average warming above preindustrial levels and continued increases will have an irreversible and catastrophic impact on the environment and our way of life.

The implications of climate change are systemic and apparent, with extraordinary weather events including flooding, drought, storms and wildfires increasing in frequency, with significant financial and human consequences.

Global temperatures relative to 1951-1980 average



Temperature data from four international science institutions. All show rapid warming in the past few decades and that the last decades has been the warmest on record. Data sources: NASA's Goddard Institute for Space Studies, NOAA National Climate Data Center, Met Office Hadley Centre/Climate Research Unit and Japanese Meteorological Agency.

[2] https://www.independent.co.uk/environment/climate-change/climate-change-global-average-temperatures-break-through-1c-increase-pre-industrial-levels-first-time-a6727361.html

Some of the risks deriving from projected temperature rises highlighted by the Intergovernmental Panel on Climate Change's (IPCC)[3] include:

- Widespread species extinction (with consequences for ecosystems)
- Food and water shortages
- Increased risk to coastal systems and low-lying areas from rising sea levels
- Increased health problems (resulting from factors such as increased heat or air pollution)
- Increased frequency of extreme weather events
- Increased displacement of people
- Reduced economic growth
- Indirect increase of violent conflict, owing to the above factors.

Humans have never lived in a world much warmer than today, yet the current trajectory of at least 3.0°C above the preindustrial average by 2100 could put us beyond the realm of human experience in the next 30 years.

Climate models indicate that by the end of this century the world's temperature is likely to increase by more than 4.0°C if we fail to change our ways.

Scientists believe that our best hope is to drastically reduce carbon emissions now, limiting the rise in global temperature to 1.5°C above the level it was at the start of the modern industrial era. This is what most countries in the world have committed to in the Paris Agreement.

[3] UN Intergovernmental Panel on Climate Change, Climate Change 2014 Synthesis report for Policymakers

Why BTPS cares about climate change

We believe that reducing exposure to carbon emissions over time will improve investment outcomes for the Scheme and help reduce the impact of future climate risks. Investments are potentially exposed to the physical risks of climate change and to the risk that the transition to a low carbon economy makes certain businesses, such as fossil fuel companies, unviable if they fail to change. We also believe that making investments that will aid the low carbon transition will deliver more sustainable returns to enable the Scheme to meet its financial obligations.

Our concerns are shared by our members. In February 2020, we undertook a wide-ranging member survey to which 8,500 members responded. They made it clear that they expect BTPS to continue taking into consideration the environmental and social impact of its investments.

Members want us to use our investments to make a positive impact on the environment and society:

74% expect BTPS to continue taking into consideration the environmental and social impact of the investments it makes.

65% expect BTPS to use its investments to make a positive impact on the environment and society.

62% expect BTPS to actively avoid investments that have a materially negative impact on the environment and society.

48% expect BTPS to prioritise performance over the environmental and social impact of its investments.

These views were reflected when the Trustee Board updated its **Responsible Investment Mission statement** earlier this year as follows:

> **"The Scheme's investments should be managed to create sustainable long-term value, supporting the generation of optimal investment returns to ensure the Scheme can pay all benefits in full."**

Our **Statement of Investment Principles** guides our approach to investing. In relation to climate change, we believe that reducing exposure to carbon emissions over time will improve investment outcomes and reduce the impact of potential adverse outcomes associated with future climate risk.

As long-term investors, we believe that integrating ESG considerations into the investment management process improves risk-adjusted returns.

We believe that long-term returns to investors are likely to be more sustainable if companies consider the interests of wider stakeholders – customers, employees, society and the environment, as well as shareholders and providers of capital.

How we are taking action

Over several months we have undertaken an in-depth analysis of our current portfolio, considered the evolution of our investment strategy, worked with several external experts and spoken with our fund managers on how we can set a goal to help manage climate risk.

On 30th September 2020, the Trustees of the Scheme agreed on a long-term climate change goal, Net Zero 2035, to address risks posed to the Scheme by climate change and for the Scheme to play a role in financing the journey to a net zero global emissions world.

Net Zero 2035

BTPS has targetted to be net zero GHG emissions (absolute scope 1-3) by 2035 and in doing so, to be aligned with the Paris Agreement's goal of net zero by 2050.

We will seek, over time, to decarbonise the portfolio and investment value chain and make investments that will reduce or remove carbon emissions from the atmosphere.

Our goal is supported by four pillars:
1. Portfolio construction
2. Mandates and managers
3. Stewardship
4. Advocacy

Beneath these pillars are 20 climate actions.

The 15-year goal, will be overseen by the Board of Trustees and will be made up of five-year targets, fully re-assessed every three years and tracked and publicly reported annually through our TCFD reporting.

Aligned with the IIGCC's Net Zero Investment Framework, achieving the goal will involve reducing emissions from the Scheme's portfolio and making investments that are aligned with the transition towards a low carbon economy. It is also dependent upon improved emissions data and strong policy action from governments, regulators, and industries to lower emissions. It will influence the Scheme's de-risking strategy and allow the Scheme to invest in opportunities that are sustainable and support the transition to global net zero emissions.

Progress towards the 2035 goal will not be linear. Over the next 15 years there will be periods when progress occurs more quickly, whilst at other times it will be more incremental. Understanding the factors contributing to the speed of progress will be important in helping to appropriately manage the Scheme towards the goal, particularly as some factors, such as climate policy movement, will be out of our control.

BTPS Net Zero 2035 Goal

1 Portfolio construction

2 Mandates & managers

3 Stewardship

4 Advocacy

20 Climate Actions

Improved data quality, depth and calculation methodologies

Policy, corporate & societal change

Scheme de-risking strategy & portfolio turnover

Investing in sustainable and transition opportunities

Four pillars and 20 climate actions

1 Portfolio construction

Over the next 15 years, there will be a major change in the investments held by BTPS. By 2035, almost all the Scheme's members will be retired. As a result, our investment strategy will need more investments focused on safe, predictable income such as bonds and secure income assets to meet our members' monthly pension payments. This creates a unique opportunity to make investments in companies that have lower emissions and increase investment in climate change transition solutions.

As part of the implementation of investment strategy we will:

1. Invest (a) to reduce emissions from our investments and (b) in transition investment opportunities, whilst ensuring we meet our fiduciary responsibilities;
2. Monitor and evaluate the portfolio impact of climate risk based on scenario analysis and stress testing, as well as exploring differentiated pathways by region and sector;
3. Assess how climate risks and opportunities affect different asset classes and strategies in which we invest;
4. Monitor and actively manage the Scheme's investments in order to deliver the net zero goal as a key pillar of our investment strategy.

2 Mandates & managers

We will align mandate objectives given to new and existing fund managers with the Scheme's decarbonisation goal. Mandate objectives will vary by asset class and the strategy of the fund manager. For example, the objectives we set our property fund managers will naturally have some differences to fund managers investing in shares of companies.

We will select and retain managers that we believe can help us achieve net zero. Managers will be required to report annually against a net zero climate scorecard, appropriately tailored by asset class. The scorecard will be reviewed to assess managers' progress to helping the Scheme achieve our goal and, if necessary, manager changes will be made.

In selecting and overseeing our managers we will:

5. Evolve the objectives and guidelines of new and existing manager mandates to align with our net zero goal;
6. Select and retain managers that we believe can support our net zero goal;
7. Require managers to report against a net zero climate scorecard with metrics relevant to the specific asset class. Examples of metrics include carbon footprinting, forward looking climate metrics, stewardship and advocacy activities, internal climate change knowledge, and the proportion of transition investments;
8. Annually review our managers against the scorecard to evaluate progress on the journey to net zero;
9. Encourage managers and counterparties to align their businesses, investment products and services with net zero and use their influence to promote net zero in the financial system.

3 Stewardship

We will implement a revised voting policy reflecting our net zero objectives. Over time we expect underlying investments to make appropriate emission disclosures and have clear plans for reducing their emissions to net zero. Failure to engage or make sufficient efforts to curb emissions after a period of engagement is likely to result in divestment.

As part of the stewardship undertaken on our behalf, we will:

10. Require our equity managers to follow a set climate voting policy to ensure consistency and alignment with BTPS on key issues;

11. Require managers investing in the equity and debt of companies to engage with those companies to set net zero aligned GHG reduction targets, good governance and climate change policies and improved TCFD climate disclosures;

12. Expect our managers to ultimately divest from investments which fail to align with net zero or make insufficient efforts to curb climate change after a set engagement period;

13. Encourage our managers to be active participants of industry bodies and initiatives working on climate change. For example, the Institutional Investors Group on Climate Change (IIGCC), Transition Pathways Initiative and Climate Action 100+;

14. Encourage our managers to actively influence other stakeholders in the financial system to promote net zero alignment.

4 Advocacy

We recognise the importance of third-party cooperation in achieving our goals and will advocate index and data providers, ratings agencies, financial industry groups, and consultants to urgently improve climate change data and disclosures.

We will use our influence to advocate for net zero aligned policy and regulation, with policy makers, governments, the investment industry, and other stakeholders. We will encourage the creation of government programmes to mobilise investments in clean and resilient growth.

To support achieving the net zero goal we will:

15. Call for index and data providers, ratings agencies, and consultants to improve climate change data and disclosures;

16. Advocate for net zero aligned policy and regulation with policy makers, governments, the investment industry and other stakeholders;

17. Encourage the creation of government programmes to mobilise investments in clean and resilient growth;

18. Collaborate and join industry groups promoting net zero Paris alignment, including the IIGCC's Paris Aligned Investment Initiative, the Net Zero Asset Owners Alliance, the IIGCC's Paris Aligned Investment Initiative, and Transition Pathways Initiative;

19. Include progressing towards the net zero goal in BTPSM's corporate objectives;

20. Continue to offset BTPSM's operational emissions but move to net zero operational emissions.

How we will monitor and report our progress

The Board of Trustees will oversee the net zero goal and BTPSM will implement its actions.

The Scheme will set a 15-year goal, divided into five-year targets, which will be fully reviewed every three years to ensure that it is in line with global climate negotiations and wider societal action on climate change.

The Trustee board will receive an annual deep-dive assessment on performance and the Scheme's activities will be publicly reported on as part of our annual Task Force on Climate Related Financial Disclosures (TCFD) reporting. Our **TCFD report** for 2019/20 has been published in the BTPS Annual report and accounts, which can be found at **www.btps.co.uk**

First 12 months

- Join Net Zero Asset Owner Alliance and IIGCC's Paris Aligned Investment Initiative and support Transition Pathways Initiative
- Undertake a deep dive on emissions performance and transition investment opportunities for Trustees
- Apply appropriate scenario analysis across the portfolio, including one in line with 1.5°C warming scenario
- Begin evolving manager mandates and develop manager Net Zero 2035 scorecards
- Set climate change engagement and voting priorities
- Integrate Net Zero 2035 into BTPSM's objectives
- Report on our progress as part of our TCFD reporting

By 2023

- Analyse three annual deep dives of the Scheme and manager net zero scorecard performance
- Review regulation and government action on climate change
- Undertake a full stocktake of target to determine what has been successful and what has not and determine if changes are necessary

By 2025

- Reduce Scheme emissions by a third
- All investment mandates to align with 2035 net zero goals
- Evidence increased investments in transition solutions
- Evidence clear examples of BTPS advocacy in promoting net zero
- Clear examples of BTPS advocacy in promoting net zero
- Undertake one 3-year full reassessment of net zero goal

About BTPS

The BT Pension Scheme (BTPS) is the largest private-sector pension scheme in the UK. It has c.300,000 members and c.£55bn of assets and pays out over £2.5bn in benefits every year.

Established in 1984, BTPS has a long history as a responsible and engaged investor. As part of its responsible investment strategy, the Scheme fully integrates environmental, social and governance (ESG) factors into its investment process and promotes active stewardship of its portfolio companies and assets.

About BTPSM

BTPSM is a wholly-owned subsidiary of the Scheme. It is a regulated entity and authorised by the Financial Conduct Authority (FCA). BTPSM is led by a board of directors that are authorised by the FCA.

BTPSM is the primary service provider (fiduciary management services, member services, operational and secretariat services) to BTPS.

The BTPSM Executive board is responsible for reporting and providing assurance to the Trustee that the business is well managed and aligned to the Trustee's objectives.

It also has the legal responsibility to ensure that it has adequate resources and governance arrangements to operate the business including the effective delivery and oversight of Scheme administration, operations, financial performance and the delivery and oversight of the implementation of the Scheme's investment strategy.

The operational responsibilities and liabilities borne by BTPSM directors and senior management are distinct from Trustee's fiduciary responsibilities. Accordingly, the BTPSM board consists entirely of Executive directors.

Richard Curtis, co-founder of Make My Money Matter said:

"

Today's announcement from BTPS is extraordinary.

"The savings of 300,000 people - totalling over £55bn in assets and representing the largest private pension scheme in the UK - are now committed to net zero by 2035. This is 15 years earlier than some of the most ambitious pension plans we've seen so far.

"BTPS's commitment shows what we at Make My Money Matter deeply believe - that pensions are the new frontier for purpose led businesses. Companies and their employees invest up to £20bn through pensions each year – money which could be directed toward clean energy, affordable housing, medical research, green infrastructure and thousands of companies and projects working for people and planet. Money which will help build a world fit for their employees' retirement.

"If all companies followed BTPS' lead and aligned their pensions with their values and their organisational Net Zero targets, we could ensure the billions invested each year through corporate pensions help build a better world. After all, what's the point of saving for retirement in a planet on fire?

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Stephanie Pfeifer, CEO, Institutional Investors Group on Climate Change (IIGCC), said:

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It is crucial all investors play their role in achieving net zero global emissions and BTPS is showing sector leadership in its commitments. Using IIGCC's Net Zero Investment Framework to deliver on the goals it has set itself, BTPS will be able to maximise the contribution it makes to addressing climate change. Placing the pursuit of a more sustainable future at the heart of its investment strategy will help BTPS safeguard the returns on which its members depend, by minimising exposure to climate change risks across its investment portfolio, while also helping to secure a cleaner future for the planet we all share.

"

Fiona Reynolds, CEO, Principles for Responsible Investment (PRI) said:

"

BT Pension Scheme's announcement that it has set a net zero goal by 2035 for its entire portfolio is hugely significant. The ambition behind this announcement is fantastic, and is all-the-more commendable coupled with clear, decisive commitment. In committing to net zero by 2035, the Scheme is recognising the material impact climate change can have on its portfolio, and demonstrating a clear consciousness of the world its beneficiaries will retire into.

"As a substantial and influential asset owner, BT Pension Scheme is setting an excellent example for others in the UK and globally. These commitments are vital to ensure we deliver on the goals of the Paris Agreement. Furthermore, asset owners hold a unique position in the investment chain, and have the power to mandate how asset managers invest. We hope the Scheme's announcement will inspire other asset owners to make similarly bold commitments to protect people, profit and planet.

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Catherine Howarth, CEO, ShareAction said:

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The BTPS climate policy will protect its members' financial security but it will do more than that. It will contribute to climate security for this and future generations, which is the very essence of responsible investment. We applaud the trustees for listening to members' views and responding to them with this powerful new policy. The approach adopted sets a fine example to the wider pension sector in the UK and beyond.

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Minister for Pensions and Financial Inclusion, Guy Opperman, said:

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The UK was the first G7 country to legislate for net zero and I warmly welcome the BT Pension Scheme's commitment to achieving their own net zero target by 2035. This is an encouraging sign of how government, industry and investors can work collaboratively to build an appropriate regulatory framework and promote sustainable investment opportunities as we build back better, and greener.

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Glossary

Asset class

A group of financial instruments which have similar financial characteristics. Examples of different asset classes are equities (stocks), fixed income (bonds), cash, foreign currencies, real estate, infrastructure and commodities.

Carbon footprint

A measure of carbon dioxide emissions associated with investments within an investment portfolio. It can help determine the emissions of an investment portfolio, allowing comparison with global benchmarks, inform investment strategy and help investors focus engagement efforts with heavy GHG emitters.
unpri.org/climate-change/

Carbon offsetting

Reducing carbon dioxide emissions emitted from your operations, investments or activities through buying a carbon credit equivalent to your carbon impact. This can be done either through buying carbon credits on an emissions trading scheme or purchasing credits in projects delivering carbon reductions such as a reforestation programme.
carbonfootprint.com

Climate Action 100+ (CA100+)

A global investor initiative of more than 500 signatories with over US$47 trillion assets under management. It engages with the 100 biggest emitters globally and more than 60 companies considered instrumental to the low-carbon transition. Launched in December 2017, Climate Action 100+ is coordinated by five partner organisations:
Asia Investor Group on Climate Change **AIGCC**;
Ceres **Ceres**;
Investor Group on Climate Change **IGCC**
Institutional Investors Group on Climate Change **IIGCC**;
and Principles for Responsible Investment **PRI**
climateaction100.org

Greenhouse gases (GHGs)

There are four GHGs linked to global warming: carbon dioxide (CO2), methane, nitrous oxide and fluorinated gases. The Greenhouse Gas Protocol, an international accounting tool, categorises GHG emissions into three scopes. Scope 1 covers direct emissions from the reporting company's owned or controlled sources. Scope 2 covers indirect emissions from purchased electricity, steam energy, heating and cooling that have been consumed by the reporting company. Scope 3 includes all other indirect emissions that occur in the reporting company's value chain.
ghgprotocol.org

Institutional Investors Group on Climate Change (IIGCC)

A European membership body for institutional investor action on climate change. Its work focuses on corporate governance, investor practices and public policy.
iigcc.org

Intergovernmental Panel on Climate Change (IPCC)

The United Nations intergovernmental body for assessing the science of climate change. The IPCC's assessment reports supported the creation of the Paris Agreement.
ipcc.ch

Just Transition

'Just Transition' was included as part of the Paris Agreement to ensure that workers and communities are not left behind as the world's economy responds to climate change.

Paris Agreement

The Paris Agreement was reached at COP21 in 2015. Its aim is to ensure global warming in the 21st century remains well below 2°C above the average level recorded for the period 1850 to 1900 and to support efforts to limit global warming to 1.5°C.
unfccc.int

Physical risk

Risks related to the physical impacts of climate change. Risks can be described as acute (e.g. increases in extreme weather events) or chronic (e.g. rising sea levels). They can have a range of effects on investments from direct damage to an asset value or requiring operational changes. Physical risk is anticipated to increase with warming and could increase exponentially.
tcfdhub.org

Glossary

Net Zero
Achieving net zero emissions (absolute scope 1-3) in the investment value chain and investing in transition solutions to reduce or remove carbon emissions from the atmosphere.

Net Zero Asset Owners Alliance
An asset owner alliance committing to transitioning their investment portfolios to net-zero GHG emissions by 2050 and playing a key role in helping the world deliver on a 1.5°C target and addressing Article 2.1c of the Paris Agreement.
unepfi.org

Task Force on Climate-related Financial Disclosures (TCFD)
Provides a framework for consistent climate-related financial risk disclosures for use by companies in communicating information to investors, lenders, insurers and other stakeholders.
fsb-tcfd.org

Transition investments and solutions
Financial products, services and investments that support companies, sovereigns and individuals to align with the goals laid out in the Paris Agreement. Examples include investments that provide low carbon solutions or help remove carbon from the atmosphere.

Transition Pathways Initiative (TPI)
An asset owner led initiative that supports investors in assessing how companies in high-impact sectors, including oil & gas, mining and electricity generation, are preparing for the transition to a low carbon economy.
transitionpathwayinitiative.org

Transition risk
Risks related to transitioning to a low carbon economy from policy and legal changes, technology innovation leaving incumbents behind, market movements and reputational changes.
tcfdhub.org

BTPS

www.btps.co.uk

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