Divest USS: USS's actions in relation to the climate emergency

Thank you for sharing your report on USS's actions in relation to the climate emergency and your detailed analysis around this. We welcome the opportunity to discuss our approach to Net Zero and the challenges that both we, and society, face in getting there.

We have reviewed your report and would like to outline why we believe our approach is the right way forward for USS, our members, and our stakeholders. We agree that we must do more to achieve our interim targets, and to support the global transition to Net Zero, but this will be a journey – one that we are addressing with great seriousness and commitment.

Achieving Net Zero is of critical importance from both a financial and a societal perspective. We have been working hard over the past 18 months to put the right policies and processes in place to reach our targets. Some of the actions noted in your report, such as the introduction of a climate 'tilt' and our new £500m Sustainable Growth mandate, which complements the £1.9bn we have invested in renewable energy, are just some of our first steps on the long journey ahead of us. They most certainly won't be the only steps.

We want to reassure you that there is a lot of work going on behind the scenes to embed these policies and processes and ensure we are making progress. We are further integrating climate change and carbon into our investment decisions, analysts are increasingly factoring climate impact assessments into their valuations, and portfolio managers will be given their own targets, relevant to their investment universe, to make sure we meet our climate-related objectives.

Divestment vs engagement

While there are some who believe that divestment, particularly of fossil fuel companies, is the only answer to achieving Net Zero, we strongly believe that engagement is the most effective way of driving positive change. And there is an increasing body of academic research that supports this position.

We believe divestment risks being seen as 'greenwashing' because, while it is possible to divest from some carbon-exposed assets, it would make no difference to the actual carbon emitted to the atmosphere and therefore will not address the climate challenge. If we were to simply sell a high carbon asset, another investor without an agenda to address climate risk may buy it, reducing the incentive for that company to transition. As such, we could be seen as washing our hands of our responsibilities as a trustee (with a primary fiduciary duty to invest in the best financial interests of our members and beneficiaries*) and as a global investor with a role to play in supporting society's transition to Net Zero.

This transition involves both society and companies fundamentally shifting their "business as usual" models. And as asset owners and investors, we can help to drive this forward. This is evidenced in a recent report by InfluenceMap on European pension funds engaging with sustainable finance policy. It found that USS is one of only four of the 25 funds assessed that have shown meaningful engagement with sustainable finance policy, illustrating that many funds do not appear to be engaging proactively on emerging efforts in this area.

We firmly believe that we can drive positive change by:

- Actively engaging with the management teams of the companies in which we invest, encouraging them to change, and being willing to finance that change.
- Backing businesses that act as catalysts for change (either through their products or the services that they offer), as well as those businesses that will replace high-carbon competitors.
- Proactively engaging with policy makers to create sustainable and climate finance related policy.

A move away from fossil fuels must also be a transition not a cliff edge: recognising that fossil fuels have a role to play in the near term, but that for most sectors fossil fuels will not be there in the long term. As a long term investor, we therefore must try and encourage the assets and markets in which we invest to make this transition.

That is not to say that we will not use divestment as a tool if it becomes clear that a particular sector or company cannot transition to Net Zero. We have divested from, or will not invest in, several sectors, such as companies that mine for thermal coal where this activity made up more than 25% of a company's revenue. We did this because of our belief that this sector cannot make the transition to Net Zero.

But where a sector, or company, can evidence that it **can** make the transition, and is committed to doing so, we will support it. One example of this is our engagement with investors as part of Climate Action 100+ that led to Shell's announcement to become a Net Zero emissions energy business by 2050 or sooner.

Our voting actions

We use our voting power at company AGMs to support climate change resolutions. While we support the majority of climate related resolutions, we are discerning and will only support those which make sense for us as a long-term investor with a primary fiduciary duty to invest in the best interests of our members and beneficiaries*. We carefully consider each resolution on its merits before voting and often engage with other investors during this process. In the first half of 2022 (a year with more climate resolutions than before), we supported 74% of shareholder resolutions and 77% of company resolutions specifically on climate change. For high emitting companies that we invest in, we accompany our vote with an engagement letter setting out our expectations (for example, the inclusion of Scope 3 metrics). However, in some cases it is important for us to show support for companies, so that we can encourage further innovation and development around climate change.

Your report notes that much of the climate data is unavailable or poorly researched. This reflects the fact that issues with data are industry wide and not specific to USS. For example, the availability and reliability of Scope 3 data for many companies and sectors is still poor and disclosure of this data remains rare. As noted, we plan to report Scope 3 data (where available) in our TCFD report from next year, as the quality and availability of it improves.

An example of how we are pushing for this Scope 3 data is through our shareholder voting rights – as your report notes, we voted 'For' Shell's shareholder resolution 21, which was a proposal that pushed for them to start reporting Scope 3 emissions. This is something we would very much welcome so that we can begin to measure and report on this ourselves.

Engaging with members and stakeholders

We agree that we should provide regular updates to our members and stakeholders on our progress to Net Zero, and that is certainly on our agenda – we have a Net Zero member webinar on 26 October 2022. This will inform and educate members on our journey to Net Zero, how we are addressing climate change, what our targets are, and how it impacts members. The webinar will be supported by an ongoing communications strategy that will 'educate', 'evidence' and 'engage' across all our stakeholders throughout our journey.

We will also be publishing the Maastricht University survey results. This piece of research was led by Maastricht University and was something we partnered with them on, to get a better understanding of our member's views on responsible, sustainable, and ethical investments and, in particular, to inform the way we communicate about these investments to members and the investment options we provide.

As Maastricht University led on this piece of work, we agreed to give them the time to prepare and submit a working paper on the survey first. We then wanted to make the research available to members alongside the refreshed Ethical Guidelines, to make sure it was meaningful to members. We will shortly be publishing the relevant survey results on our website, plus supporting communications to explain some of the interim changes that have been made following the survey.

In summary

We recognise that the financial risks of not addressing climate change are legion, and we want to see a world that is worth retiring into. So, we don't just want a Net Zero pension scheme, we want a Net Zero world. Clearly there is a long way to go – our work to Net Zero is very much work in progress and has only recently begun.

Our recent TCFD report is backwards looking, highlighting what we have done in the previous year – our first year since announcing our ambition. Many of your recommendations are things we are considering internally as we speak, but they are still works in progress. We will be reporting on our updated progress and latest actions in the 2023 TCFD report.

In the meantime, we are wholeheartedly committed to delivering against our Net Zero ambition and we are working hard in the background to progress against our targets. We will of course continue to make decisions that are in the best interest of our members, believing that better run companies and aligned paths to Net Zero will achieve better returns for the scheme, so we can pay our members well-earned pensions when they are due; our primary fiduciary duty.

Please note: *References to* ***we, us, or our*** *mean the trustee or USS Investment Management Limited, where the trustee has delegated responsibilities to USSIM to act on its behalf. For more information visit our key terms and important information.*

**Extensive legal advice has concluded that one of USS's primary fiduciary duties in respect of the scheme is to invest in the best financial interest of members and beneficiaries.*