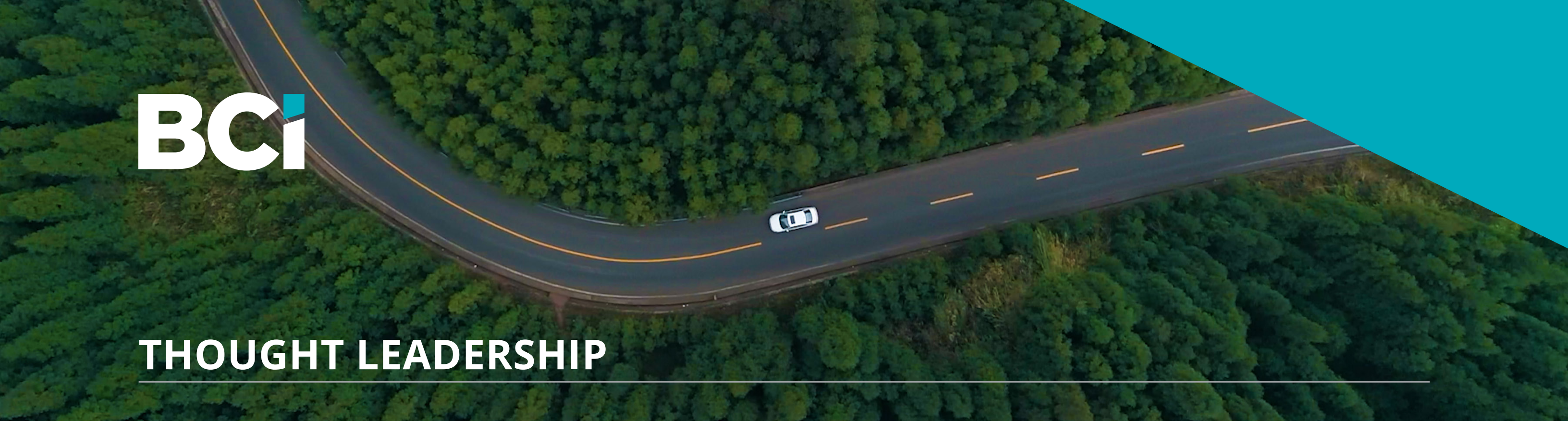


THOUGHT LEADERSHIP

Driving to Net Zero Through Our Influence

INTRODUCTION

At BCI, we are responsible for managing the retirement savings and employment benefits of 2.5 million workers in British Columbia. It is our mandate to manage risk and identify opportunities to meet our target investment returns. BCI acknowledges the importance of climate change as a systemic risk that requires integration at every level of investment decision-making. On occasion, BCI and other investors have been scrutinized for holding onto high-emitting assets instead of divesting from them. This paper outlines the rationale for our approach, and why we believe engagement is the most effective tool for addressing climate change risks and driving tangible progress in the path towards net zero.

BCI believes the investor voice and capital are vital to financing the transition, restructuring, and innovation in high-emitting assets required to achieve a low-carbon economy.

Our engagement approach reflects these beliefs and does not include broad-based divestment as a part of our strategy. Divesting from high-emitting assets purely to reduce our own carbon footprint does not reduce global carbon emissions — it simply makes those emissions someone else's problem. In contrast, BCI is committed to using our influence to drive actions aligned with the global goal of achieving net-zero greenhouse gas emissions by 2050.

WHAT IS DIVESTMENT?

The goal of divestment is to sell a subset of investments from a portfolio based on a variety of reasons, such as ethical concerns or personal values. In the case of climate change, the relevant investments are companies that own producible coal, oil, or gas reserves. The idea is to withdraw capital from businesses that are harmful to the environment, which, according to the proponents of divestment, creates stigma and business constraints, impedes operations, and ultimately limits their financial viability. Ideally, withdrawn capital from these divestments is reinvested into sustainability-focused investments, such as renewable energy companies. In practice however, this is not the case; any downward pressure created from one investor withdrawing the relatively small proportional stake they have in a public company is quickly resolved through the balance of the market recognizing that the share prices have fallen below what they perceive as the fair value for the company, thereby enticing buyers and driving the price back towards fair value.

Presently, 1,559 institutions representing $40.5 trillion in assets have made some form of fossil fuel divestment statement.[1] BCI does not plan to do the same. For BCI, the positive impacts we have observed from integrating climate risk into our investment decisions and engaging on climate change confirm our belief that these options are the most effective strategies available for achieving positive real world outcomes compared to broad-based divestment from all fossil fuel companies. To mitigate the risk of climate change on our investment portfolios, we must incentivize companies to actively reduce their emissions to align production with international targets and to support a just transition to a low-carbon economy. Broad-based divesting would typically involve selling our shares to others that likely care less about the long-term sustainability of the company, and the environment, than we do. Giving up our ownership means we give up our influence.

WHAT IS ENGAGEMENT?

Engagement is having constructive conversations with the companies we are invested in on environmental, social, and governance (ESG) issues such as climate change. In these conversations, we encourage companies to be transparent about their ESG risks, and to adopt good corporate governance and operational practices. We engage because we believe it improves companies' long-term performance, and is part of our roles and responsibilities as stewards of our clients' assets. Climate change is among our highest engagement priorities.

In a study conducted by the University of Virginia,[2] researchers found that engagement is an effective long-term decarbonization strategy. The study also found evidence that portfolios more exposed to climate transition risk earn higher-risk adjusted returns. By staying invested in carbon-intensive companies, and driving them toward decarbonization over the long term through engagement, we can positively influence the transition to a low-carbon economy without sacrificing the fulfillment of our mandate to our clients.

REDUCING FINANCED EMISSIONS VS. FINANCING REDUCED EMISSIONS

Addressing systemic risks such as climate change requires scenario analysis, planning, and thinking at the total portfolio level, as well as integration at every level of the investment decision-making process. BCI strongly believes that through investing in and engaging with high-emitting companies and sectors, we can contribute to real, absolute reduction in greenhouse gas (GHG) emissions across the broader economy.

Financed emissions are emissions attributed to individual investors based on how much of a company they own (e.g., if an investor owns five per cent of a company, they own five per cent of the company's emissions). When an investor sells an asset purely based on emissions intensity, the main outcome is a decrease in financed emissions and, on paper, a less carbon-intensive portfolio. However, there is no effect on the absolute GHG emissions produced by that company. In fact, according to a study commissioned by Glasgow Financial Alliance for Net Zero (GFANZ),[3] in recent years there have been prominent examples of increases in GHG emissions from real assets after they have been sold. Overall, the study argues that the divestment movement may result in more GHG emissions in the global economy as high-emitting assets are transferred to companies and/or countries that are less sensitive to decarbonization pressures. This is aligned with our belief that divestment simply transfers the problem to other investors that may be less interested in reducing emissions or supporting the global goal of achieving net zero by 2050. Hence,

[1]Source: **Global Divestment Commitments Database.** Data as of March 23, 2023
[2]Source: **"Decarbonizing Institutional Investor Portfolios,"** University of Virginia, 2022
[3]Source: **"The Managed Phaseout of High-emitting Assets,"** GFANZ, 2022

divestment fails to align with BCI's objective to manage systemic financial risks posed by climate change through real reductions in total emissions.

By staying invested in the fossil fuel industry, BCI can retain the ability to urge a company's management and their board of directors to reduce real emissions and therefore hold companies accountable. Technological breakthroughs and business model adaptation, which have been proven to be crucial in achieving emissions reduction,[4] require capital. Conversely, divestment deprives high-emitting industries of the financial resources necessary for finding solutions that will allow them to make the transition to a low-carbon economy. We are seeing this unfold now with the European energy crisis, which has highlighted both the need to transition to a low-carbon economy as fast as possible and the lack of viable alternatives. This is evidenced by the reality that global demand for fossil fuels is expected to see only a very gradual drop through to 2050, based on projections by the International Energy Agency (IEA).[5]

In the short and medium term, the world will still require fossil fuel sources while transitioning to a low-carbon economy.

Therefore, engaging with high-emitting companies allows us to drive the transition to a low-carbon economy. In addition, engagement requires more time than divestment, which aligns with our long investment horizon and allows us to actively reduce risk in our portfolio over time.

PUTTING THEORY INTO PRACTICE

BCI has a well-developed shareholder engagement program that we have been using to actively engage both portfolio companies and regulators on climate issues for many years. While our policy submissions cover the wide ESG spectrum, numerous submissions have been related to climate change, including 18 in the past five years.[6] We are proud of the progress we have made on all the climate-related metrics we are tracking, such as the number of companies providing responses to the CDP questionnaire,[7] setting climate-related targets, and using an internal price on carbon. However, we see an opportunity to further strengthen our commitment to climate change engagement. BCI's Climate Action Plan includes our specific engagement goals to ensure that by 2030 at least 80 per cent of BCI's most carbon-intensive investments have set mature net-zero-aligned commitments or are subject to engagement.

To achieve these engagement commitments, BCI has committed to:

- Engage the most carbon-intensive companies in our portfolio and drive action towards net-zero
- Encourage companies to develop action plans that include short- and medium-term targets for emissions reductions
- Broaden engagement and advocacy activity into additional global jurisdictions to support achieving net-zero by 2050
- Deepen climate engagements in high-emitting sectors and the financial sector
- Expand on engagement escalation strategies for non-responsive companies through voting and shareholder proposals
- Influence the development of the next phase of Climate Action 100+ (CA100+) and CDP's campaign to promote the Science-Based Targets Initiative (SBTi)
- Increase our expectations and set minimum standards of external managers and investment partners on climate risk
- Support the Transition Pathway Initiative (TPI)
- Encourage disclosure aligned with the Task Force for Climate-Related Financial Disclosures (TCFD) recommendations across all our investments

[4]Source: **"Decarbonizing Institutional Investor Portfolios,"** University of Virginia, 2022
[5]Source: **World Energy Outlook 2022**, International Energy Agency
[6]See BCI's **2021 ESG Annual Report** for more details (p. 50)
[7]CDP's **climate change questionnaire** collects climate-related data from the world's largest companies on behalf of over 590 institutional investor signatories with a combined US$110 trillion in assets

> “Through engagement, BCI is a part of the solution.

Although engagement is our first course of action, BCI may selectively divest if our evaluation of a company, inclusive of our ESG assessment, reveals that the risk-return characteristics are no longer appropriate for our clients. This could include cases where we have identified critical ESG issues that we believe impair the long-term value proposition of a company, and the company is either not responsive or has offered insufficient solutions to address material business risks.

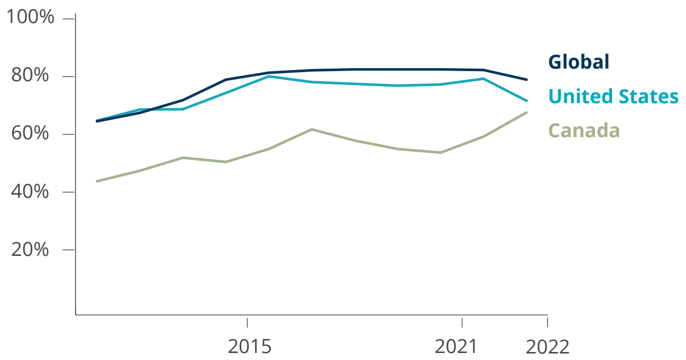
BCI has been engaging on climate for over a decade and there has been significant progress over the years. In 2012, 64 per cent of all CDP questionnaire respondents outside of the U.S. and Canada disclosed that they had set climate targets. For the U.S. and Canada, this number was 65 per cent and 45 per cent respectively. By 2022, these numbers had increased to 78, 71, and 68 per cent, which is a significant increase in the number of companies committing to reducing their emissions (Figure 1).

As expectations for transition plans increase, BCI has started engaging companies on setting Science Based Targets (SBT) aligned with the SBTi. Over one year, the number of companies committing to net-zero and setting SBTs has increased significantly (Figure 2). In addition, we have seen several fossil fuel companies strengthen their climate-related targets over the years through the commitment to include Scope 3 in their emissions reduction plans.[8] This is where most fossil fuel companies' emissions are generated. With the number of companies committing to net zero growing quickly, it is prudent that BCI and other investors communicate our expectations and encourage the adoption of credible targets and plans so companies can work towards decarbonization. Through engagement, BCI is a part of the solution.

Figure 1

CDP respondents with climate targets

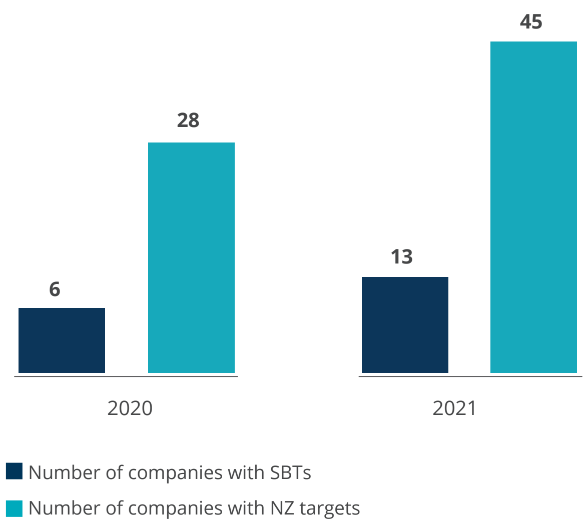
Number of CDP-reporting companies



The slight decrease in the proportion of global and U.S. companies setting climate targets was caused by the increase in the number of companies that were invited to respond to the CDP questionnaire.

Figure 2

Highest-emitting companies held by BCI with NZ and/or SBT



[8]Scope 3 emissions are characterized as the emissions created indirectly by a company through its value chain.

Marathon Petroleum Corporation – Scope 3 Engagement Outcome

BCI has co-led the engagement with Marathon Petroleum Corporation since the launch of Climate Action 100+ in 2017. Marathon operates the largest refinery network in the United States with 13 refineries, as well as midstream (processing) and downstream (retail) operations, making climate change transition risk a concern for shareholders. We have led multiple interactions with the company. Our objectives included establishing emissions reduction targets, a clear transition plan for the long-term health of the company, and alignment of lobbying activity with the goals of the Paris Agreement. Marathon announced in February 2022 an absolute reduction target of Scope 3 emissions of 15 per cent by 2030, using a 2019 baseline, demonstrating a meaningful commitment to absolute reductions and real-world outcomes.

ExxonMobil – The Power of Proxy Voting

Investor concerns over ExxonMobil's lack of action on climate change resulted in a new investment firm, Engine No.1, putting forward four board candidates with energy transition expertise at the 2021 annual general meeting. BCI assessed the candidates' backgrounds and met with ExxonMobil representatives. The failure of the ExxonMobil board to meet with the dissident nominees, combined with the lack of progress on engagement, unresponsiveness to shareholders, and poor financial performance, resulted in BCI supporting all four dissident candidates. Three were elected to the board.

Over the last five years, the number of shareholder proposals submitted at companies in Canada and the United States has grown significantly, with climate change becoming a key topic.[9] In 2022, the number of climate-related proposals BCI voted on increased from 44 to 79, and we supported 62 per cent of those proposals. Proxy voting is an effective channel to drive change as shareholders can offer to withdraw the proposals in exchange for more robust commitments and emissions reduction targets. Withdrawn proposals reached a record high in 2022.[10] For proposals that go to a vote, shareholders can also engage with companies to implement the request in the proposal even if it did not pass but received significant support. Proxy voting as an engagement tool continues to evolve; therefore, engagement in general must also evolve. Collectively, investors can improve engagement efforts by focusing on achieving and reporting actual outcomes. BCI strives to maintain a world-class engagement program that encompasses all channels of influence at our disposal as responsible owners.

[9]"Shareholder Proposal Developments During the 2022 Proxy Season," Gibson Dunn, 2022
[10]ibid.

ACTING AS RESPONSIBLE STEWARDS FOR OUR CLIENTS

Acting in the best interests of our clients is paramount at BCI. BCI performs in-depth climate risk and opportunity analysis on all our investments, both ahead of deploying capital into any new investment as well as for existing holdings. BCI uses a comprehensive engagement strategy with companies, governments, and regulators to ensure we participate constructively in the energy transition, helping to drive real-world solutions to climate challenges, rather than removing ourselves from the sector and losing our influence.

Glossary

Broad-based divestment: Removing an entire group of companies from the investment universe, most often based on their business activities.

Carbon footprint: A carbon footprint is the total greenhouse gas emissions caused directly and indirectly by an individual, organization, event, or product. It is calculated by summing the emissions resulting from every stage of a product or service's lifetime (material production, manufacturing, use, and end-of-life).

Climate Action 100+: An investor-led initiative, involving 700 investors responsible for over $68 trillion in assets under management, that aims to ensure that the world's largest corporate greenhouse gas emitters take necessary action on climate change.

Climate change: Long-term shifts in temperatures and weather patterns caused by human activities, primarily the burning of fossil fuels like coal, oil, and gas.

CDP: A not-for-profit charity that runs the global disclosure system for investors, companies, cities, states, and regions to manage their environmental impacts.

Decarbonization: Reduction or elimination of greenhouse gas emissions from a process such as manufacturing or the production of energy.

ESG: Refers to any environmental, social, or governance factor that could positively or negatively affect the risk or return of an investment, sector, or fund.

Greenhouse gas emissions: Greenhouse gas (GHG) emissions are produced when hydrocarbons, such as natural gas and oil, are burned. GHGs include carbon dioxide (CO2), methane, nitrous oxide and ozone, all of which contribute to climate change.

High-emitting assets: Investments that produce high volumes of greenhouse gas emissions relative to production output.

Internal price on carbon: An internal carbon price is the value a company voluntarily sets to internalize the economic cost of its greenhouse gas emissions.

Net-zero: An economy that has reduced its greenhouse gas emissions to as close to zero as possible, and offsets any remaining emissions through actions that support re-absorption from the atmosphere (for example, through tree planting or carbon capture technologies).

Proxy voting: The process by which shareholders of publicly traded companies cast their votes to approve or reject important decisions affecting the operations and governance of the business.

Science-based targets (SBT): Science-based targets provide a clearly-defined pathway for companies and financial institutions to reduce greenhouse gas emissions, helping prevent the worst impacts of climate change and future-proof business growth. Targets are considered 'science-based' if they are in line with what the latest climate science says is necessary to meet the goals of the Paris Agreement and limit global warming to 1.5°C above pre-industrial levels.

Science-Based Targets Initiative (SBTi): A partnership between CDP, the United Nations Global Compact, World Resources Institute (WRI), and the World Wide Fund for Nature (WWF) that defines and promotes best practices in emissions reduction and net-zero targets, and provides technical assistance, expert resources, and independent assessment and validation to companies who set science-based targets in line with the latest climate science.

Shareholder proposal: A recommendation formally submitted by shareholders to a company that asks for a specific course of action to be voted on by shareholders.

Systemic risk: Risk of collapse or severe disruptions to an entire financial system, market, or sector.

Task Force on Climate-Related Financial Disclosure (TCFD): 31 members from across the G20, representing both preparers and users of financial disclosures, brought together by the Financial Stability Board to develop recommendations on the types of information that companies should disclose around risks related to climate change.

Transition Pathway Initiative (TPI): An independent repository of research and data into the progress being made by the financial and corporate world in making the transition to a low-carbon economy.

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