



The Universities Superannuation Scheme's Response to the Climate Emergency

A Report by DivestUSS

October 2022
divestuss.org





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Endorsed by:



Switch It



Catherine Howarth, Chief Executive ShareAction said:

"This report, written by scheme members of USS, asks pertinent questions about the progress being made on the scheme's climate targets. Net zero commitments made by UK pension schemes are highly welcome. Nevertheless, they merit the kind of scrutiny that pension schemes, as asset owners, are rightly applying to net zero commitments made by asset managers and companies. Recent disclosure requirements for UK pension schemes, introduced by DWP, have put information into the hands of pension savers. We applaud the empowerment of pension savers, many of whom are deeply concerned about climate risks and impacts."

Cover photo: Ben Wicks via Unsplash

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1. Summary

USS (the Universities Superannuation Scheme) is the largest pension fund in the UK by assets (approximately £90 billion).

Despite “long recognising the... risks” of climate change,¹ USS still has large investments in the industries responsible for the climate emergency. We recognise that USS has made plans to decarbonise its investment portfolio, and can see that this presents many complex challenges, in particular because much data is unavailable. However, even so, we consider there are fiduciary as well as moral duties to make deeper structural changes to their portfolio immediately. We do not have the time to wait for full data.

It is the view of many USS members that their pension scheme should urgently take further action, including divestment from fossil fuel companies.² Other major pension funds have taken this action (such as ABP, the huge Dutch public sector fund),³ as have the fund managers of many UK universities (around 100 of which have committed to fossil fuel divestment).⁴

USS's current position:

1. Its top 100 holdings include over £570m in fossil fuel companies;
2. Its list of all holdings includes 48 leading fossil fuel companies;
3. It has £18bn in pooled investment vehicles, which are not easily disaggregated into source investments;
4. It has holdings in banks/insurance companies that are significant lenders to, and underwriters of, fossil fuel producers with consequent carbon emissions;
5. It does not provide information on lending to fossil fuel companies, through the purchasing of bonds and similar investment vehicles;
6. It has committed to 'net zero' by 2050, with interim targets of a 25% reduction by 2025 and a 50% reduction by 2030 from 2019 levels for the emissions from the private companies across its public and private equity and debt portfolios.⁵ However, it reports that it has only achieved a 3.7% reduction between 2019-2021 for this element of its portfolio, so may struggle to achieve the 2025 target.⁶
7. It reports that the carbon footprint data on around half of its assets is unreliable or missing, and that only 12.5% of its assets can currently be stated to be consistent with the Paris Climate Agreement.⁷
8. The 2022 USS £5bn "climate tilt" – in one public equity portfolio only – does not cover the first year of the reductions required by their current policy, and covers less thereafter;
9. It provides no analysis of the credibility of its assumed carbon offsetting;
10. It claims that the policy of 'engagement' with companies such as Shell is leading to significant progress towards decarbonisation. However, its voting record on shareholder resolutions at AGMs tends to support the company directors' plans, rather than challenge them to take more urgent action;
11. It argues that its fiduciary duty to members' financial interests prevents divestment from fossil fuels. However, this takes no account of medium and long-term risks of such assets becoming stranded, and is inconsistent with their decision to divest from tobacco, thermal coal and unconventional weapons;
12. It has not published the results of the 2020 survey of active USS members (undertaken by Maastricht University) on their attitudes towards sustainable investment.

We recommend that:

1. USS should immediately stop purchasing bonds from those companies and supporting banks that explore for, and exploit, new fossil fuel reserves;
2. USS should conduct a more detailed assessment of the emissions impact of their current holdings, in particular the lending and underwriting of banks in which it invests, and an assessment of the emissions impact of the most cash rich companies in which USS is invested;
3. USS should publish full information on all its holdings;
4. USS should vote against the re-appointment of directors in companies that are not recognised, by external assessors, to have committed to a credible path towards zero emissions;
5. USS should divest from companies that have not committed to a credible path towards zero emissions, based on published criteria;
6. Given the systematic under-reporting of emissions by companies, the challenges of measuring the carbon emissions of an investment portfolio, and the evidence of accelerating climate change, USS should change its reductions commitments to 60% by 2030, and 100% by 2040;
7. USS should commit to absolute carbon reduction targets for its portfolio, not intensity reductions. Any missing of targets on this trajectory should be agreed to be made up for within the two subsequent years;
8. USS should commit to excluding from its climate emergency plans both carbon offsets and the financing of carbon capture technologies;
9. USS should press Maastricht University to publish the 2020 member survey results, and should itself conduct a more comprehensive survey, covering all members (active, deferred, and pensioner) in 2022-23, after consultation with members on the survey's design;
10. USS should consider making its ethical fund the default option in its Defined Contribution section, and seek members' views on this;
11. USS should implement regular meetings with members to explain the actions being taken on emissions reductions;
12. USS should invite USS member climate scientists to provide evidence and information sessions for USS Board members.

USS currently invests in 45 leading fossil fuel companies
(Photo: Ben Wicks via Unsplash)



2. Introduction

2.1 Urgency

At the launch of the third Intergovernmental Panel on Climate Change (IPCC) report in April 2022, the UN Secretary-General António Guterres said:

“This report of the Intergovernmental Panel on Climate Change is a litany of broken climate promises... We are on a fast track to climate disaster... Investing in new fossil fuels infrastructure is moral and economic madness”.⁸

His comments are based on the evidence that, to keep to the 1.5°C limit agreed at the UN’s 2015 climate change conference in Paris, global emissions cuts of 45% are required this decade.⁹ Current pledges actually amount to a 14% increase in emissions which will lead to much greater levels of warming and thus severe global environmental, social and economic disruption. Extreme climate events that were previously rare are now reported to be happening every year.¹⁰ As this report was being written, for example, it was found that areas of the Arctic are heating up at seven times the global average rate.¹¹ The interconnection with other elements of systems collapse, including the biodiversity crisis, global food insecurity and the emergence of global pandemics further accentuates the urgency and need for responsible and decisive action.

2.2 Where are carbon emissions coming from?

Emissions of carbon dioxide (CO₂) are the primary cause of human induced climate change, usually referred to as global warming, but emissions of other gases such as methane also make a significant contribution. Emissions of these other gases are often combined with those of carbon dioxide into an equivalent carbon dioxide, CO₂e. This is referred to as “carbon” here. The main contributor to carbon emissions is the burning of fossil fuels – oil, gas and coal. To avoid worsening the climate crisis it is essential to stop all new fossil fuel exploration, and cease the use from existing sources as quickly as possible, replacing them with renewable energy sources and reducing unnecessary energy use.¹²

Most major fossil fuel companies are reported to have large-scale on-going plans to further develop and sell their products;¹³ continuing investment in these companies is literally fuelling the on-going climate crisis. Moreover, investing in the banks and other financial institutions which support such fossil fuel companies is a significant contribution to the crisis, as most new financing for fossil fuels comes from bank lending and bond issues, not equity investments.¹⁴ Recent research has argued that the huge cash reserves of the world’s largest companies are reinvested into major sources of carbon emissions.¹⁵ Finally, it has been argued that the emissions which governments and companies self-report usually underestimate their real emissions.¹⁶

3. USS and past actions

3.1 Background

USS was established in 1974. It has around 500,000 members and covers university and higher education staff in the UK. It is the largest pension scheme in the UK by asset value,¹⁷ with over £90.8 billion under its management at 31 March 2022.¹⁸ Changes over the past decade or so have seen a shift in its provision, with a reduction in the Defined Benefit (“final salary”) component and an increase in the Defined Contribution (directly based on contributions) component of pension contributions and benefits. The Defined Benefit component covers the largest element of the investment portfolio and provides no choice for members of investment options; the Defined Contribution component provides members with some investment choices, including “ethical” funds, although an ethical fund is not the default, and many members appear unaware of the option to select a fund.¹⁹

3.2 Past fossil fuel investments

USS does not provide a complete breakdown of its investments, although it does provide more information than many UK pension funds.²⁰ This has included the value of its top 20 investments over the years 1996-2017 (in its Annual Reports), and, since 2011, the value of its top 100 investments (on its website), with a searchable index of all holdings by name, although not by amount. All information quoted here has been obtained from these publicly available, archived records.²¹

These sources suggest that USS has made major investments in fossil fuel companies for many years. In the twenty years up until 2019, for example, either Shell or BP were amongst the four largest holdings overall, and in eight of those years both were in the top four. The investment in Shell reached as high as £538m in 2019. Major banks such as HSBC, which research suggests is a significant financier of fossil fuels, also feature prominently, as do companies with large cash holdings such as Microsoft, Apple and Alphabet (Google). More broadly, USS invests in large numbers of significant fossil fuel companies;²² an average of 30 over the period 2010-20, for example.

3.3 Past investment policies

USS members have been voicing concerns about USS investments and policies for some time. The member group DivestUSS is more than ten years old.²³ Expressions of concern in 2018 and 2019 led to a formal complaint, arguing that USS was failing to consider the financial risks of climate change. This was considered by USS in August 2019 and not upheld, on the basis that the organisation's fiduciary duty was to act in the best financial interests of the members/beneficiaries of the scheme. USS stated that they might only take non-financial factors into account where there was good reason to think that members/beneficiaries would agree, and where such account would not involve a risk of significant financial detriment.

Given USS relies on this double basis to allow them to change, both analysis of alternative investment strategies to assess the risk of financial detriment, and regular assessment of members' views on divestment are very important.

In 2020, Maastricht University reported on its survey of active USS members' views on sustainable investment (active members comprise about 40% of the total, the remainder being deferred or retired members). The results have not been published, although USS shared some of them with DivestUSS.²⁴ USS confirmed that the results showed strong support amongst the 4,000 respondents for sustainable investment (even if this meant lower returns), with the majority of respondents supporting divestment from fossil fuels. This finding is supported by the fact that more than 60% of the UK's 154 public universities have committed to divesting from fossil fuels,²⁵ often citing the views of their staff as a reason for this decision, who are largely members of USS (the issues and views involved have been analysed in detail in relation to the University of Cambridge).²⁶

We have concerns about USS's interpretation of the concept of fiduciary duty.²⁷ Their response to our formal complaint appeared to show little consideration of the long-term financial risks of the climate emergency, though the pension scheme has to be able to make financial returns to members long into the future. USS needs to take a long-term approach to its investments: given the risks of economic chaos, achieving 'net zero' is in no way contrary to its fiduciary duty. As noted by a 2018 report by a House of Commons select committee on green issues in finance:

“Fiduciary duty is often misinterpreted as a duty to maximise short-term returns and... this could be particularly problematic when it came to the management of long-term pension funds”.²⁸

The insurance company Aviva told the committee how:

“Pension funds often rely on the advice of investment consultants when allocating capital. This gives investment consultants considerable influence over capital allocation. However, their fee and incentive structures too often drive a short-term outlook that overlooks long-term sustainability considerations”.²⁹

In June 2020, USS announced plans to cease investing in tobacco, thermal coal and unconventional weapons, without consulting members and without publishing an analysis of the financial impact. They stated that it was based on “*changing political and regulatory attitudes and increased regulation that USS Investment Management consider will damage the prospects of businesses involved in these sectors in the years to come*”.³⁰ This decision appears inconsistent with USS’s interpretation of fiduciary duty regarding fossil fuel holdings.

3.4 The response to the climate emergency

In May 2021, USS announced a “net zero ambition” to be carbon neutral by 2050.³¹ The proposal excluded the purchase of carbon offsets, although presumably allows their investee companies to use them given the inclusion of the word “net”. This was followed in February 2022 by an announcement of intermediate targets for carbon emission intensity reductions of 25% by 2025 (from the 2019 level), and 50% by 2030.³² Note that this excludes “Scope 3” emissions, which can constitute 85% of all emissions in some key sectors (see Section 4.2 below).

Alongside the fiduciary duty argument that USS has used against divestment, USS stresses that their policy is also one of “engagement” with companies to encourage them to move towards better climate policies and actions, claiming that “*We can’t divest our way to net zero*”.³³ While we would not expect to be given access to behind-the-scenes engagement with management, it is hard to find public evidence for the practice and efficacy of this policy. USS highlights its work with Shell, stating that “*The outcomes of these engagements have been ground-breaking*”,³⁴ in terms of Shell’s net zero commitments.

Others have been less convinced that ground has been broken. In March 2022 ClientEarth started legal action against Shell’s Board of Directors over its failure to properly prepare for the net zero transition.³⁵ ClientEarth argued a) that Shell has no short-term absolute emissions reduction targets; b) more than 90% of the emissions from which the company derives revenue are excluded from its only interim absolute emissions reduction target (that for 2030); and c) the vast majority of Shell’s capital

investment and plans remain devoted to the continued expansion and exploitation of fossil fuel reserves.³⁶ The last is in direct opposition to the conclusion of the International Energy Agency in May 2021 that addressing the climate crisis means that there can be no new investments in oil, gas and coal.³⁷

Shareholder voting records also show little evidence that USS takes a line in public which is different from the management of Shell, despite USS's claim that it "*typically supports the vast majority of climate change-related shareholder resolutions*".³⁸ In the five Shell Annual General Meetings (AGMs) up until 2020, USS voted every year in line with Shell's recommendations, against shareholder motions seeking Paris-aligned or related climate constraints.³⁹ Prior to the 2021 AGM, 405 USS members wrote to USS to urge them to support the Shareholder Resolution calling for Paris-aligned emissions targets.⁴⁰ 30% of shareholders voted against the Shell Board in support of the resolution however USS again voted with the Board.⁴¹ In 2022 the innocuous shareholder resolution 21, "*To request that the Company report on the strategy and underlying policies for reaching [greenhouse gas emissions]... targets*",⁴² was opposed by the company. USS, in perhaps an indicative change of approach, voted For, noting:

"We would welcome enhanced reporting of climate related risks and the adoption of greenhouse gas emissions reduction targets".⁴³

USS currently holds a 10% stake in Heathrow Airport
(Photo: Sebastian Grochowicz via Unsplash)



4. Current situation

4.1 Current investments

The September 2021 listing of USS investments is on its website.⁴⁴ This shows eight fossil fuel companies in the top 100 investments list (Table 1), with a total investment of over £570 million. Their total list of investments includes seven of the top ten US shale oil producers (Chevron, ConocoPhillips, EOG, ExxonMobil, Marathon, Occidental, Pioneer) and three of the world's four biggest fracking companies (Halliburton, Schlumberger and Baker Hughes).⁴⁵

Company	Investment (£m)
Royal Dutch Shell PLC	135.22
Glencore PLC	92.94
Lukoil PJSC	84.8
Vale SA	56.04
Total Energies SE	55.21
Exxon Mobil Corp	50.68
China Petroleum & Chemical Corp	49.52
LG Chem Ltd	46.95
Total	571.36

Table 1: Fossil fuel companies in USS top 100 investments⁴⁶

The listing of all investments does not give amounts, but it currently includes 45 fossil fuel companies overall, and this number has increased significantly in recent years (Table 2).⁴⁷

Date of list of investments	No. fossil fuel companies in list
June 2011	40
September 2012	37
December 2013	25
June 2014	21
March 2017	25
March 2020	29
September 2020	46
September 2021	45

Table 2: Number of USS fossil fuel company holdings

These holdings include companies that have not set any long-term targets for reducing greenhouse gas emissions (e.g. CNOOC, ConocoPhillips, Chevron, ExxonMobil).⁴⁸

USS additionally holds stakes in fossil-fuel intensive industries, such as a 10% holding in Heathrow Airport Holdings Ltd, which has a Regulatory Asset Base (a measure of its value) of £17.5bn.⁴⁹

An important feature of recent USS investments is the use of “Pooled Investment Vehicles”. USS now has over £18bn in these,⁵⁰ compared to the £29bn invested directly in public equities (publicly traded shares). These financial vehicles include unit trusts and managed funds, private equity funds and hedge funds. The use of these vehicles makes it unclear where funds are being invested, and thus the carbon emissions are difficult to calculate.

Financial institutions and cash-rich companies in which USS invests represent significant contributions to carbon emissions, through lending, purchasing bonds and underwriting or cash holdings (rather than equity investments). In the six years following the Paris Agreement, the world’s 60 biggest banks financed fossil fuels to the tune of \$4.6 trillion.⁵¹ Amongst their top 100 investments in Sept 2021, USS was investing over £500m in seven of these banks, which were responsible for \$143bn of fossil fuel support in 2021 (Table 3).⁵²

Institution	USS investment in their top 100 (£m)	Fossil fuel financing by institution (2021) (\$m)
China Construction Bank Corp	101.92	9,475
JP Morgan Chase	91.45	61,732
China Merchants Bank Co Ltd	80.54	10,645
Ping An Insurance Group China	64.0	10,004
HSBC Holdings PLC	60.7	17,976
Bank of America Corp	59.71	31,978
Lloyds Banking Group PLC	53.76	1,309
Total	512.08	143,119

Table 3: USS investment in the top 60 banks lending to the fossil fuel industry (as at Sept 2021)

4.2 Current policy

In 2022, USS made two major announcements. In January they announced a new “climate tilt” to its portfolio,⁵³ a change affecting just over £5bn of their assets. This will involve following an index that weights towards companies that are hitting suitable decarbonisation targets, ensures investment in sectors critical to the low-carbon transition, and weights against those ranking poorly on the four UN Sustainable Development Goals (SDGs) relating to environmental sustainability and climate impact. USS’s press release claimed that this “*will initially reduce emissions compared to the broad equity market by at least 30%, and further decrease its carbon intensity by 7% each year thereafter. This will include all Scope 1, 2 and 3 emissions from day one*”. (Roughly speaking, Scopes 1 and 2 emissions are those arising from sources controlled by an organisation, or arising from their use of energy such as electricity, whilst Scope 3 are emissions arising from activities that the organisation is indirectly responsible for, for example products or services they procure, or the use of their products or services by others.)

USS followed this in February by announcing a new £500m fund for decarbonisation technologies, complementary to its renewable energy strategy (at March 2021, USS held £1.2bn of investments in wind farms and green technology).⁵⁴

4.3 TCFD Report

In late July 2022, alongside its Annual Reports, USS released a Taskforce on Climate-Related Financial Disclosures (TCFD) report. Since October 2021 these reports are mandatory for UK pension funds with over £5bn in assets. They require funds to assess the carbon emissions and intensity of their portfolios and to set reduction targets in line with the Paris Agreement climate goals.

It is clear from the report that considerable efforts have been made by USS to clearly describe their climate impact, policies and targets, and the data these are reliant on. What is also clear is how little USS is able to find out about the actual carbon emissions of their investments. Just a few examples show this starkly:

First, USS only looks at Scope 1 and Scope 2 emissions, as the Scope 3 data is poor. USS state that “*Scope 3 is particularly important for some sectors, for example, in oil and gas it makes up approximately 85% of emissions*”,⁵⁵ and intend to report on this in their next TCFD. This is critical, as USS notes: “*For many asset classes, we have found that approximately 10 assets are usually responsible for roughly 75%*

to 80% of emissions".⁵⁶ These top ten are listed in the report, and include energy-intensive companies in the sectors of fossil fuels, cement, steel, and mining.⁵⁷ Second, USS finds that assessing the carbon emissions of sovereign investments, such as government bonds, is sufficiently problematic for them to report these separately, with strong caveats. This is important as around 36.9% of its holdings are sovereign investments.⁵⁸

These problems mean that, as USS states, 49% of its Defined Benefit carbon footprint data is unreliable or missing, and, of the other half, only 24% is aligned to "well below 2 degrees".⁵⁹ In summary, only about one-eighth of USS's assets can currently be stated to be consistent with the Paris Climate Agreement.

Much of this state of affairs is due to government inaction on climate change: the TCFD regulations were imposed on pension funds before the same rules were required to be implemented by companies and asset managers.⁶⁰ Hence much of the data required by the pension funds was unavailable or poorly researched.

Nevertheless, in the context of the urgency of climate action, this lack of reliable information means that decisions now about where to invest should focus on areas where emissions are clearly most significant. The fossil fuel companies, and those financing their continued exploitation, are the obvious starting points.

5. Our critique: are USS on track towards zero carbon?

5.1 Current commitments

Whilst the USS announcements of some actions, intermediate targets, and explicit data are welcome indications that steps are finally being taken, we think that there are critical elements missing from the current USS carbon strategy.

The first is clarity and transparency about the carbon reduction targets and pathway, and how these are consistent with international agreements. The Head of the UN is very clear on the essential target “*limiting warming to 1.5 degrees Celsius*”.⁶¹ In the introduction to their TCFD report, USS state that their aim is to “*limit global warming to below 2 degrees centigrade*”.⁶² There is a gulf between 1.5 and 2 degrees of warming in terms of the climate impact, and we consider that USS should commit unequivocally to the UN target, particularly given the likelihood of overruns elsewhere.⁶³

The USS TCFD report also notes that their “*interim targets for working with the companies we invest in to cut the intensity of the emissions they generate by 25% by 2025, and by 50% by 2030. These cuts are relative to our 2019 baseline, and on a CO₂e per £m invested basis. These interim targets cover all of our assets except sovereign debt*”.⁶⁴ Since sovereign debt makes up over a third of the portfolio, this omission is of concern.

Furthermore, it is the level of absolute emissions, not intensity, that drives climate change, and which should be the explicit target for reductions. A focus on emissions intensity (emissions per pound of asset value) may obscure this, as it is possible for intensity to fall as a fund grows, but for absolute emissions to rise at the same time. The USS TCFD report states that “*To achieve our ambition of Net Zero by 2050... we need to reduce the emissions intensity of our investments by between 4.7% and 6.1% a year*”.⁶⁵ It also states that “*Targets based on climate science, meaning what is needed to achieve Net Zero by 2050, would suggest we need to reduce emissions by 6% to 8% each year*”.⁶⁶ USS should explain how these statements are consistent with each other, clarifying the use of absolute versus intensity measures, and, importantly, showing how the resulting total emissions over the full period to net zero are consonant with the equivalent world carbon budget limit for the 1.5 degree warming target.

USS needs to appreciate that the carbon reduction path that is taken to net zero is a critical issue: larger reductions in emissions in earlier years will mean a smaller

overall total of emissions over the whole period (and smaller reductions in earlier years will mean a larger overall total). Thus, the pathway is critical to deriving the total emissions associated with the strategy and assessing it against external criteria such as the Paris Agreement, as well as evaluating annual performance against targets.

The second major issue with the USS carbon strategy is that the announcements made by USS so far on carbon reductions seem to us to be insufficient to meet their own stated ambitions. The recent “climate tilt” on £5bn of assets affects only around 5.5% of USS assets. If the investments being moved have some similarity to the overall portfolio, this means that the year one reduction will be about 1.8% of USS’s total emissions. The 7% reduction planned in subsequent years will represent about 0.4% of USS emissions.⁶⁷ This “climate tilt” gets USS nowhere near the required reduction in the first year and has essentially no effect in subsequent years. USS has not given any information about how they plan to make up these shortfalls.

On top of these issues of USS’s emissions reduction ambitions and pathways, a further, and increasingly crucial issue that is not addressed by USS in its current strategy, is its definition of net zero. The “net” means that some emissions continue but are offset, i.e., not counted. Carbon offsets are essentially paying someone else to promise to either reduce their future carbon emissions, or physically remove or store carbon, then claiming this as a reduction of your own. Reportedly less than 5% of offsets actually remove carbon dioxide from the atmosphere.⁶⁸ An independent survey last year of over 100 certified carbon-credit projects found that just 10% met its basic criteria (including that projects did not: inflate carbon savings, were not already planned, and did not violate human rights).⁶⁹ USS suggests that it will invest in carbon capture technologies,⁷⁰ but these are very unlikely to be able to remove atmospheric carbon on any significant scale.

Finally, and related to the above points, USS needs to clarify how the large investments into sovereign funds, pooled investment vehicles, and private equity funds, will be brought into their net zero strategy. These are large fractions of USS assets: sovereign funds alone are 38% of assets, as noted above. Even where the identity of some of these investments is known there are clear issues with carbon strategies. Consider, for example, the significant 10% stake USS has in Heathrow Airport. 97% of the emissions associated with Heathrow are from aircraft flights but the credibility of its net zero commitment is questionable: it has a highly qualified “*up to 15%*” cut in air-based emissions by 2030 with less than half of this from a mix of standard and cleaner fuels.⁷¹ The track record of the aviation industry’s emissions strategies has been criticised.⁷²

More widely, the USS carbon reduction path needs to take more account of climate justice. There are two directions to this. An inadequate response to the climate emergency risks inequality between USS members. Current retired members are able to enjoy securely funded pensions in part paid for by the carbon intensive industries which threaten the ability of USS to pay the pensions of newly joining members in the distant future. More broadly still, since developed nations have been responsible historically for the majority of emissions so far,⁷³ these nations, along with their domestic organisations like USS, should follow a higher ambition pathway than that of the world overall.

5.2 General Strategy

USS has a large and diverse portfolio. Understanding how to effect a long-term transition to net zero across this portfolio is not easy, and as noted above, this is compounded by the difficulties of getting clear and reliable data on all Scopes of emissions from a wide variety of companies, and significantly from investments into different financial instruments which are further removed from the emissions sources. Alongside understanding where the emissions are coming from, it is necessary to analyse the financial effects of any short and long-term portfolio changes on the fund and the resultant impact on projected pension provisions. Nevertheless, USS's 2022 TCFD report clearly indicates assets which are responsible for significant carbon emissions.

Divesting from fossil fuel industries and the institutions most involved in financing them is a clear and obvious option. The argument that "engagement" with these companies will lead them to change simply fails the test of time. After many years of such engagement, fossil fuel companies still only invest 5% of their capital expenditure on renewables,⁷⁴ and it has been argued that their net zero targets have been consistently contradicted by their actions.⁷⁵

This is not surprising – these companies simply cannot transition to renewables for the simple reason that their entire structure, and infrastructure, worth trillions, is tied up with the exploration, extraction, and sale of fossil fuels. They may spin off or buy profitable renewable subsidiaries but as their core business is required to shrink to zero on the timescales required to save our climate they will rapidly slide towards bankruptcy, with the consequent risks to investors. The risk of "stranded assets" like these is a major issue in the financial industry. A recent comprehensive study estimated that future fossil fuel losses would "*exceed \$1 trillion under plausible changes in expectations about the effects of climate policy*" and that "*the large exposure of pension funds remains a major concern*".⁷⁶

USS has previously argued against divestment from fossil fuel companies on the basis that this will have no positive effect in that it will just lead to someone else buying the shares, who may be less committed to climate.⁷⁷ This argument ignores the fact that divestment, along with increased investment in renewables, will help accelerate a transition by making it more difficult for fossil fuel companies to raise funds to continue business as usual, whilst making renewables more profitable and competitive at the same time.

The main argument used by USS against divestment is one of “fiduciary duty”, which is that “*if there are financial costs associated with doing so, USS cannot make investment decisions purely by screening on ethical or moral grounds and operating divestment policies*”.⁷⁸ This is increasingly untenable since the climate emergency presents a financial threat to USS and its members. In addition, USS’s own recent investment report shows that over the past three years the USS Ethical Growth Fund has had a return of 19% compared with 15% for the current default Growth Fund.⁷⁹ For the medium and longer term, we noted above how pension funds have been criticised by a government committee for narrow interpretations of this duty which ignore longer-term risks, such as “stranded assets”.⁸⁰ It is not even clear that investment in fossil fuels provides any benefits: the University of Cambridge study reviewed 118 years’ worth of historical evidence and found that, although there were good and bad periods, over that period fossil fuels performed in line with the market. It would not have affected returns if they had been excluded from portfolios. The exception was coal, which was the worst-performing sector in the UK over that period.⁸¹

Moreover, it is not at all obvious how this duty was applied in past divestment decisions affecting tobacco, thermal coal, and the manufacture of certain weapons, nor in this year’s “climate tilt”. There is also not such a clear-cut distinction in the issues. As the USS Investment Manager Simon Pilcher noted with regard to the recent USS divestment of over £400m of Russian assets, “*I think the two things overlap – morals drive finance*”.⁸² With the accelerating pace of climate change, the “morals” of preserving our environment are rapidly strengthening the financial case for divestment from the industries causing this crisis. As one of USS’s own Responsible Investment Analysts notes:

“Climate change is a financial risk to the returns generated by our assets”.⁸³

There are also legal risks: there has been a rapid growth in climate change litigation in recent years.⁸⁴ Pension funds that fail to divest may similarly find themselves facing increasing legal action for not protecting their members’ interests; USS has already been subject to action partly based on this.⁸⁵ Recent events in other fields

have demonstrated the potential for class actions and legal challenges against organisations whose actions impact on the health and wellbeing of the claimants.

There are many cases of major pension funds divesting from fossil fuels. For example, ABP, one of the world's biggest pension funds and Europe's second largest,⁸⁶ with assets under management of over €500bn, is currently selling its €15bn-worth of holdings in around 80 fossil fuel companies and is reported to have reduced the carbon footprint of its equity portfolio by 30% since 2015⁸⁷ (compared to USS's progress of less than 2% per year for 2019-2021). The chair of the company said "*We part with our investments in fossil fuel producers because we see insufficient opportunity for us as a shareholder to push for the necessary, significant acceleration of the energy transition at these companies*".⁸⁸ Raj Thamotheram, the former head of Environmental, Social and Governance at USS and now an independent adviser on ESG, commented that:

"Hopefully this will be a wake-up call to [USS] and all its peers to dramatically raise their game. Either be genuine forceful stewards or divest fully and quickly with a public announcement".⁸⁹

USS reports its 'appetite' for climate risks as cautious, yet it continues to repeat its position against divestment, and for its continued engagement with the companies that are causing the climate crisis. They acknowledge that they are behind schedule on their emission reduction targets but say "*most of the actions we have taken to date relate to engagement and stewardship activities, which are expected to reduce long-term emissions rather than short-term*".⁹⁰

But we have absolutely run out of road on "long-term" promises. Already we are witnessing frequent severe weather events around the world. The failure to take effective action in the past decades has meant that we need very high levels of reductions in the coming 5-10 years. The fact that we have reached this critical point now is the simplest and clearest demonstration possible of the failure of the strategy of "engaging" with companies whose financial interests are in continuing to sell the products causing the crisis. USS should get out of them, and those financing them, now. If the second biggest pension fund in Europe can do it, then so can they.

USS could divest from high carbon industries and instead fund more renewable energy
which would help to accelerate the transition to a low carbon economy
(Photo: Nicholas Doherty via Unsplash)



6. Recommendations

We recommend that:

1. USS should immediately stop purchasing bonds from those companies and supporting banks that explore for, and exploit, new fossil fuel reserves;
2. USS should conduct a more detailed assessment of the emissions impact of their current holdings, in particular the lending and underwriting of banks in which it invests, and an assessment of the emissions impact of the most cash rich companies in which USS is invested;
3. USS should publish full information on all its holdings;
4. USS should vote against the re-appointment of directors in companies that are not recognised, by external assessors, to have committed to a credible path towards zero emissions;
5. USS should divest from companies that have not committed to a credible path towards zero emissions, based on published criteria;
6. Given the systematic under-reporting of emissions by companies, the challenges of measuring the carbon emissions of an investment portfolio, and the evidence of accelerating climate change, USS should change its reductions commitments to 60% by 2030, and 100% by 2040;
7. USS should commit to absolute carbon reduction targets for its portfolio, not intensity reductions. Any missing of targets on this trajectory should be agreed to be made up for within the two subsequent years;
8. USS should commit to excluding from its climate emergency plans both carbon offsets and the financing of carbon capture technologies;
9. USS should press Maastricht University to publish the 2020 member survey results, and should itself conduct a more comprehensive survey, covering all members (active, deferred, and pensioner) in 2022-23, after consultation with members on the survey's design;
10. USS should consider making its ethical fund the default option in its Defined Contribution section, and seek members' views on this;
11. USS should implement regular meetings with members to explain the actions being taken on emissions reductions;
12. USS should invite USS member climate scientists to provide evidence and information sessions for USS Board members.

7. USS's response to this report

This report was sent to USS for comment on 26 September 2022. On 17 October 2022 USS replied with a 3-page response, which did not dispute any of the facts presented in the report. The full text of the USS's response is available on [our website](#). Below we highlight some of elements from it:

USS say: *“we strongly believe that engagement is the most effective way of driving positive change... 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”.*

USS also say: *“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”.*

We find it disappointing that this response does not reflect the urgent need to stop exploring for and exploiting new fossil fuel reserves (as the IPCC has demanded). No response is made to our specific recommendations. Instead USS continue with the claim that divesting makes no difference to carbon emissions and that engagement will lead to companies progressing to 'net zero' at sufficient speed. USS could choose to divest from high carbon industries and use their members' contributions to fund new, low carbon alternatives, which would help to accelerate the transition. Furthermore there appears to be no consideration of the need to bring forward the 'net zero' targets in response to the accelerating speed of global warming.

Thank you for reading. Please share this report with your colleagues and contact us with any questions or comments:

ussdivest@gmail.com
divestuss.org

Appendix: Lists of USS holdings

Below are links to the current/archived webpages listing USS's investments used to prepare this report.

The 'top 100 investments' pages provide simple lists; the 'equity holdings' pages provide a searchable index of all holdings, with the full list in the html source code.

- 30 June 2011, [USS top 100 investments](#) (Internet Archive)
- 30 June 2011, [USS equity holdings](#) (Internet Archive)
- 30 September 2012, [USS top 100 investments](#) (Internet Archive)
- 30 September 2012, [USS equity holdings](#) (Internet Archive)
- 31 December 2013, [USS top 100 investments](#) (Internet Archive)
- 31 December 2013, [USS equity holdings](#) (Internet Archive)
- 30 June 2014, [USS equity holdings](#) (Internet Archive)
- 30 September 2014, [USS top 100 investments](#) (Internet Archive)
- 31 December 2014, [USS top 100 investments](#) (Internet Archive)
- 31 March 2017, [USS equity holdings](#) (Internet Archive)
- 30 September 2017, [USS top 100 listed equities](#) (Internet Archive)
- 30 June 2019, [USS top 100 listed equities](#) (Internet Archive)
- 31 March 2020, [USS equity holdings](#) (Internet Archive)
- 30 September 2020, [Public Market investments](#) (Internet Archive)
- 30 June 2021, [Public Market investments](#) (Internet Archive)
- 30 September 2021, [Public Market investments](#) (USS website)

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- ¹ USS, 2022, [Taskforce on Climate-Related Financial Disclosures Report \(TCFD\)](#), p.2
- ² DivestUSS, 7 November 2021, [October Meeting with USS](#)
- ³ ABP, 26 October 2021, [ABP stops investing in fossil fuel producers](#)
See also: The Guardian, 26 October 2021, [One of world's biggest pension funds to stop investing in fossil fuels](#)
- ⁴ People & Planet, August 2022, [Universities committed to pursuing fossil fuel divestment](#)
- ⁵ USS, 14 February 2022, [USS announces interim targets to reaching Net Zero ambition](#)
- ⁶ USS, 2022, [TCFD](#), p.37
- ⁷ USS, 2022, [TCFD](#), p.36
- ⁸ United Nations, 4 April 2022, [Secretary-General warns of climate emergency](#)
- ⁹ Intergovernmental Panel on Climate Change, 2022, [Climate change 2022: mitigation of climate change: summary for policymakers](#), p.22
- ¹⁰ United Nations, 31 October 2021, [State of Climate in 2021: Extreme Events and Major Impacts](#)
- ¹¹ The Guardian, 15 June 2022, [New data reveals extraordinary global heating in the Arctic](#)
- ¹² BBC, 19 October 2017, [A brief history of the earth's CO2](#)
- ¹³ Production Gap Report, [2021 Production Gap Report](#)
- ¹⁴ T Cojoianu et al, April 2019, [The economic geography of fossil fuel divestment, environmental policies and oil and gas financing](#), SSRN Electronic Journal, p.30, table 1
See also: Carbon Bubble, 2021, [Wall Street's Carbon Bubble: The Global Emissions of the US Financial Sector](#)
- ¹⁵ The Carbon Bankroll, 17 May 2022, [The Carbon Bankroll Report](#), p.5
- ¹⁶ The Washington Post, 7 November 2021, [Countries' climate pledges built on flawed data](#)
See also: MSCI, 28/4/22, [Which Scope 3 Emissions Will the SEC Deem 'Material'?](#)
- ¹⁷ House of Commons Environmental Audit Select Committee, 4 June 2018, [Greening Finance: embedding sustainability in financial decision making](#)
- ¹⁸ USS, 31 March 2022, [Report & Accounts](#), pp.3,7
- ¹⁹ DivestUSS, 7 November 2021, [October Meeting with USS](#)
- ²⁰ Note that Australian pension funds are now required to publish full information on their holdings
- ²¹ Links to the data sources are in the Appendix
- ²² "Fossil fuel companies" here are defined as those in the top 50 carbon emitters listed in CDP, [Carbon Majors Report 2017](#), p.15, plus the top 200 owners of fossil fuel resources listed in the [Carbon Underground Top 200](#)
- ²³ Formerly Ethics for USS, now DivestUSS
- ²⁴ DivestUSS, 7 November 2021, [October Meeting with USS](#)
- ²⁵ People & Planet, August 2022, [Universities committed to pursuing fossil fuel divestment](#)
See also: Bright Green, 31 May 2022, [Campaigners celebrate as University of Leicester becomes 94th UK university to divest from fossil fuels](#)
- ²⁶ E Quigley, E Bugden & A Odgers, [Divestment: Advantages & Disadvantages for the University of Cambridge](#)
- ²⁷ "We are now developing a comprehensive strategy for delivering on the Net Zero ambition while remaining mindful of our fiduciary duties", USS, 2022, [TCFD](#), p.2
- ²⁸ House of Commons Environmental Audit Select Committee, 4 June 2018, [Greening Finance](#), para.21
- ²⁹ House of Commons Environmental Audit Select Committee, 4 June 2018, [Greening Finance](#), para.23
- ³⁰ USS, 1 June 2020, [USS to make first divestments after long-term investment review](#)
- ³¹ USS, 4 May 2021, [USS announces Net Zero ambition](#)
- ³² USS, 14 February 2022, [USS announces interim targets to reaching Net Zero ambition](#)
- ³³ USS, 20 June 2022, [Twitter](#)
- ³⁴ USS, 2020, [Responsible Investment Report 2019/20](#), p.9
See also: USS News, 16 April 2020, [Investors welcome net zero emissions commitment agreed with Shell](#)
- ³⁵ ClientEarth, 15 March 2022, [ClientEarth starts legal action against Shell's Board over mismanagement of climate risk](#)
- ³⁶ ClientEarth, 31 March 2022, [Investor briefing redirecting Shell: derivative claim against the Board of Shell PLC](#), pp.15-6,19
- ³⁷ International Energy Agency, May 2021, [Net zero by 2050: a roadmap for the global energy sector](#), p.160-165

See also: The Guardian, 18 May 2021, [No new oil, gas or coal development if world is to reach net zero by 2050, says world energy body](#)

³⁸ USS, 2022, [TCFD](#), p.25

³⁹ USS, [How we vote](#) (AGM: 2016 resolution 19; 2017 resolution 21; 2018 resolution 19; 2019 resolution 22; 2020 resolution 21; 2021 resolution 21)

See also: Shell, [Voting results of the 2021 AGM](#), and, [Notice of meeting of 2021 AGM](#) (resolution 21, p.6)

⁴⁰ DivestUSS, 28 April 2020, [USS, Climate and Shell AGM May 19th 2020 Resolution 21](#)

⁴¹ Shell, 2021, [Result of Annual General Meeting](#)

⁴² Shell, 2022, [Notice of meeting of 2022 AGM](#) (resolution 21, p.6)

⁴³ USS, 2022, [How we vote](#) (Shell AGM: 2022 resolution 21)

⁴⁴ USS, 30 September 2021, [How we invest](#)

⁴⁵ See lists of the [top ten shale companies](#) and the [big four fracking companies](#)

⁴⁶ USS is currently selling its remaining holdings in Lukoil, as a result of its decision to divest from Russian holdings, See: USS, 2022, [TCFD](#), p.34

⁴⁷ The data sources listed in the Appendix – ‘Fossil fuel companies’ as defined by [Carbon Underground Top 200](#)

⁴⁸ Transition Pathway Initiative, 2022, [CNOOC](#)

⁴⁹ Heathrow Airport Holdings, 2021, [Annual report & financial statements](#), p.53

See also: USS, 2022, [How we invest: case studies](#)

⁵⁰ USS, 31 March 2022, [Report and accounts](#), pp.65,71

⁵¹ Banking on Climate Chaos, 2022, [Fossil Fuel finance report 2022](#)

⁵² USS, 30 September 2021, [How we invest](#)

See also: Banking on Climate Chaos, 2022, [Fossil Fuel finance report 2022](#), pp.8-11

⁵³ USS, 14 January 2022, [USS makes steps towards net zero with carbon reducing investment benchmark](#)

⁵⁴ USS, 14 February 2022, [USS announces interim targets to reaching net zero ambition](#)

⁵⁵ USS, 2022, [TCFD](#), p.30

⁵⁶ USS, 2022, [TCFD](#), p.24

⁵⁷ USS, 2022, [TCFD](#), p.33

⁵⁸ 97% of USS assets are in USS’s Defined Benefit section, and 38% of these are in sovereign investments, See: USS, 2022, [TCFD](#), pp.35-6

⁵⁹ USS, 2022, [TCFD](#), p.36

⁶⁰ Corporate Adviser magazine, 29 July 2022, [Josephine Cumbo: TCFD’s green fudge](#)

⁶¹ United Nations, 4 April 2022, [Secretary-General warns of climate emergency](#)

⁶² USS, 2022, [TCFD](#), p.2

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⁶⁴ USS, 2022, [TCFD](#), p.5

⁶⁵ USS, 2022, [TCFD](#), p.37

⁶⁶ USS, 2022, [TCFD](#), p.30

⁶⁷ The £5bn “climate tilt” is 5.5% of USS total assets of £90.8bn; the 30% reduction in Year 1 of this 5.5% is then 1.65% of total assets, and the 7% reductions in the following years make up 7% of that 5.5% = 0.385%

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⁷¹ Heathrow Airport Holdings, 2021, [Annual report & financial statements](#), pp.32-3.

⁷² The Guardian, 10 May 2022, [Just one of 50 aviation industry climate targets met, study finds](#)

⁷³ Our World in Data, 2022, [CO₂ emissions](#)

⁷⁴ International Energy Agency, [World energy investment 2022](#), p.83

⁷⁵ The Guardian, 17 February 2022, [Oil firms’ climate claims are greenwashing, study concludes](#)

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- ⁸⁰ House of Commons Environmental Audit Select Committee, 4 June 2018, *Greening Finance*
See also: G Semieniuki et al, 16 May 2022, *Stranded fossil-fuel assets*, pp.532,537
- ⁸¹ E Quigley, E Bugden & A Odgers, *Divestment: Advantages & Disadvantages for the University of Cambridge*
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- ⁸² Professional Pensions, 1 March 2022, *USS divests from Russia*
See also: USS, 3 March 2022, *Russia-related investments*
- ⁸³ USS, 2022, *Stewardship Code Report*, p.44
- ⁸⁴ Grantham Research Institute on Climate Change & the Environment and the London School of Economics,
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- ⁸⁵ CrowdJustice, 2022, *Save university pensions, and save the planet*
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- ⁸⁸ ABP Press Release, 26 October 2021, *ABP stops investing in fossil fuel producers*
See also: The Guardian, 26 October 2021, *One of world's biggest pension funds to stop investing in fossil fuels*
- ⁸⁹ IPE News, 29 October 2021, *ABP fossil fuel exit: engagement at a crossroads*
- ⁹⁰ USS, 2022, *TCFD*, p.37