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ERAFP's fossil fuel policy

Background

The latest scientific publications[1] confirm the reality of global warming. The latest IPCC report indicates that the decade between 2011 and 2020 was the hottest in 125,000 years, mainly as the result of human activities. According to this report, global warming will reach 1.5°C above pre-industrial levels by the early 2030s, regardless of immediate efforts to reduce global CO_2 emissions. In addition, IPCC projections indicate that under current policies, global warming is expected to increase from 2.4°C to 3.5°C by the end of the century, with a median value of 3.2°C. By comparison, it is estimated that the Earth's average temperature during the last ice age was only 5°C lower than it is today.

In 2019, the concentration of CO_2 in the atmosphere reached its highest level in 2 million years. As a result, the energy sector has become critically important due to its contribution to the increase in greenhouse gas emissions through the combustion of fossil fuels. In 2019, fossil fuels accounted for 81% of the global energy mix. The majority of CO_2 emissions originated from the combustion of fossil fuels: 39% from coal, 30% from oil and 19% from natural gas. In this context, Article 29 of France's Energy and Climate Act (LEC), adopted on 8 November 2019 and applicable to both the management companies in the portfolio and to ERAFP, requires "*a gradual phasing out plan of the use of coal and non-conventional fossil fuels, specifying the chosen exit schedule and the proportion of total investments managed or held by the entity covered by these policies*".

For this purpose, ERAFP has reviewed the main scenarios limiting warming to 1.5°C by 2100. Both the IEA and the IPCC agree on the need to reduce coal production in the short, medium, and long term. Regarding oil and gas, the IEA recommends, in its 1.5°C scenario, limiting investments to maintaining existing production from oil and natural gas fields already in operation. Furthermore, the IEA recommends refraining from initiating any new oil and gas exploration or development projects beyond those already committed by the end of 2021. Additionally, the IEA discourages the exploitation of any fresh oil or gas field.

1,5°C by 2100

ERAFP's policy is therefore consistent with the objectives announced by the French government in its energy and climate strategy and with the COP28 Agreement to reach carbon neutrality by 2050.

Climate targets

Willing to reduce its greenhouse gas emissions, ERAFP joined the Net-Zero Asset Owner Alliance (AOA) in March 2020. As part of this commitment, , ERAFP will set itself interim targets every five years, with the aim of achieving carbon neutrality by 2050. Targets covering the 2019-2024 period are summarised in ERAFP's climate policy.

Given the importance of the energy sector in the fight against climate change, ERAFP decided to develop an investment policy for the fossil fuel sector, which includes both conventional fossil fuels (coal, oil and natural gas) and non-conventional fossil fuels[2].

1_ See in particular: IEA, Net Zero by 2050, May 2021 et 2018 Special Report on Global Warming of 1.5°C, and the «mitigation» chapter of the Sixth Assessment Report 2021-2022, IPCC 2021

2_ Shale oil and gas, oil sands and shales, hydrocarbons extracted from sensitive areas such as the Arctic or ultra-deep drilling.

This Fossil fuel policy describes how ERAFP will use the four main levers for action within its socially responsible investment policy (Best in Class; Shareholder Engagement; Voting rights; Exclusions) to engage with companies involved in the conventional and non-conventional oil and gas sectors, at pre and post-investment phase, where those companies do not meet the eligibility thresholds or align their businesses with 1.5°C scenario pathways.

SRI framework

Prior to the investment decision, ERAFP assesses the companies, projects, and countries in which it invests based on ESG criteria, in accordance with its SRI framework, using specific criteria defined in its best-in-class approach. This assessment applies to 100% of ERAFP's assets.

Within the environmental pillar, the criterion "Limit greenhouse gas emissions and contribute to the energy transition" includes indicators aimed at assessing energy sector companies and ultimately encouraging them to reduce or stop production of thermal coal and conventional and unconventional fossil fuels.

The ESG ratings of all portfolios are regularly monitored and ERAFP pays particular attention to the exposure of its assets to conventional and unconventional fossil fuels, as disclosed in its Sustainability Report since 2021.

ERAFP's SRI framework is based on revised eligibility criteria for the following three fossil fuel energy sources:

Thermal coal

Unconventional fossil fuels

Conventional fossil fuels

Shareholder engagement and voting policy specific to issuers in the fossil fuel sector

ERAFP is determined to support, on a long-term basis, those organisations in which it invests, by exercising its responsibilities as a shareholder or stakeholder in such a way as to sustainably promote, within these entities, practices that comply with the values it supports.

To this end, ERAFP has adopted an active engagement approach towards issuers in which it invests or is likely to invest, either directly through collaborative engagement initiatives such as Climate Action 100+ or through its management companies.

The voting policy is one of the pillars of ERAFP's engagement and energy transition approach. Each year, ERAFP publishes its shareholder engagement guidelines on its website, setting out its approach to all matters relating to voting. When applying these guidelines through the exercise of voting rights, ERAFP pays particular attention to the complementarity of its engagement strategy and the non-financial criteria of its SRI framework vis-à-vis companies involved in the fossil fuel sector.

This policy includes specific elements for companies operating in sectors with a high climate impact, including fossil fuels, and may result in ERAFP voting against resolutions such as the election or re-election of a nominee director or chair of the board, or executive compensation, if certain criteria are not met. Such elements may include the consideration given to climate issues, establishing GHG emissions reduction targets, assessing emissions progress and engagement outcomes.

Expectations for fossil fuel companies

This policy outlines the expectations that ERAFP has for companies operating in the fossil fuel sector.

- cease development of any new capacity related to thermal coal (mines, power plants, transport or storage infrastructure, etc.);
- align with 1.5°C scenarios, which entails a complete phase-out of coal-fired power generation by 2030 in OECD countries and by 2040 globally;
- shut down sites instead of selling them, while considering the principle of a just transition, especially for affected employees.

Companies involved in conventional or unconventional oil and gas activities are expected to:

- cease the development of new oil and gas exploration or production capacities, in priority for unconventional fossiel fuels;
- align with 1.5°C scenarios, which entails a reduction of the overall volume of oil and gas production and a target of carbon neutrality by 2050;
- minimise fugitive methane emissions;
- align lobbying activities with pre-defined climate objectives;
- shut down sites instead of selling them, while considering the principle of a just transition, especially for affected employees.

Implementation rules

The following implementation rules for ERAFP's fossil fuel policy apply to mandates and dedicated funds investing directly in companies or infrastructure projects.

The "1.5°C scenarios" referred to should be understood as GHG emission scenarios limiting global warming to 1.5°C by 2100, with no or limited overshoot.

Positions and investment policy regarding thermal coal

ERAFP has included the following proposals in a timetable that aims for rapid disengagement while preserving energy security and ensuring a just transition:

a. Planned exit from thermal coal by 2030 in OECD countries and 2040 worldwide.

This timetable is consistent with the main international recommendations.

b. Companies that generate more than 5% of their revenue from thermal coal-related activities as of January 1, 2024 are excluded from the portfolio, both in terms of existing holdings (excluding bonds) and new investments. This threshold will be reduced to 1% of revenue from January 1st, 2026.

Under this criterion, companies that generate more than 5% of their revenue from activities related to thermal coal will be ineligible.

c. Any company developing new thermal coal capacities is excluded from the portfolio

ERAFP prioritises the cessation of all thermal coal capacity development, as stated in the exclusion condition. This includes activities such as mine development, coal-fired power plant construction, dedicated infrastructure, and other related activities.

d. These exclusions do not apply to companies with a credible exit plan from thermal coal that is aligned with the exit dates referred to in a) above, or to green bonds issued by companies that do not yet meet the threshold referred to in b) above.

e. A systematic in-depth annual follow-up will be conducted out with the asset managers on the evolution of these companies and their exit plans. This will also help to determine any associated engagement actions to be taken.

If exit plans are not followed, a case-by-case review will be conducted, which may lead to divest the position in the best interests of ERAFP.

Positions and investment policy regarding unconventional fossil fuels

ERAFP aims to divest from companies whose strategies primarily focus on unconventional fossil fuels or that are not committed to energy transition and with whom there is no prospect of productive dialogue:

a. Companies that generate more than 30% of their revenue from activities related to unconventional fossil fuels are excluded from the portfolio, both in terms of existing holdings (excluding bonds) and new investments.

b. New investments in the debt of companies that derive more than 5% of their revenue from unconventional fossil fuels are excluded.

To support the energy transition, investments in green bonds and bonds issued by companies with a credible strategy of alignment with a 1.5°C temperature scenario interest will remain eligible.

c. Systematic monitoring of positions and climate policy developments of companies in the sector will be carried out, together with enhanced engagement actions to ensure that exit plans are implemented

Where a company is not aligned with a 1.5°C temperature increase scenario, a case-by-case review will be conducted, which, after failed engagement efforts, may lead to divest the position in the best interests of ERAFP.

It should be noted that ERAFP is keen to maintain enhanced shareholder dialogue with other companies in the sector, so as to encourage them to align their strategy with a scenario conducive to a successful energy transition.

Positions and investment policy regarding conventional fossil fuels[3]

ERAFP aims to incorporate scientific recommendations while acknowledging the need to use fossil fuels in the medium term, especially considering energy security concerns. The following measures will be taken to achieve this:

a. From 2030 onwards, investments in the debt of companies developing oil and gas exploration or production projects will be excluded.

This measure aims to ensure that ERAFP no longer participate in the financing of new oil and gas exploration and extraction projects after 2030, which has been identified as a key criterion for limiting global warming.

In order to support the energy transition, investments in green bonds and bonds issued by companies with a credible strategy aligned with 1.5°C scenarios will remain eligible.

b. Systematic monitoring of positions and climate policy development of companies in the sector will be carried out, together with enhanced engagement actions.

This position reflects ERAFP's desire to engage in enhanced and demanding shareholder dialogue to encourage these companies to align their strategies with 1.5°C scenarios.

Where a company is not aligned with a 1.5°C temperature increase scenario, a case-by-case review will be conducted, which, after failed engagement efforts, may lead to divest the position in the best interests of ERAFP.

Governance

As a reminder, the Board of Directors defined ERAFP's SRI framework and oversees it internally.

In accordance with Article 24 of Decree 2004-569 relating to the French public sector additional pension scheme, the investment policy monitoring committee (CSPP) is responsible for preparing the Board of Directors' decisions on general guidelines of the SRI policy, monitoring its implementation, assessing its effects on the Scheme, ensuring compliance with the principles of the SRI Charter and preparing any updates thereto.

Within this framework, the CSPP has validated the publication of this fossil fuel policy and will review it with the Board of Directors every two years from its effective date. It will monitor and evaluate the follow-up and engagement actions specified for the three fossil energy sources.

3_ Crude oil and natural gas.