

Proposed amendments to the Statutory Guidance - Governance and reporting of climate change risk: guidance for trustees of occupational schemes

Note to reader:

This draft statutory guidance is intended to add to the existing statutory guidance. Under our proposals, portfolio alignment will be removed from the additional metrics section of the existing statutory guidance.

Paragraphs 117-119 form part of the existing statutory guidance but have been edited to now include reference to the proposed requirement to select, calculate and report a portfolio alignment metric. Paragraphs 173 and 174 also form part of the existing statutory guidance - see paragraphs 155, 156 and 158 of that guidance – but again have been edited in light of the proposed portfolio alignment metric requirements. It is intended that paragraph 157 of the existing statutory guidance be deleted, as it duplicates the content of paragraph 119.

Metrics

117. For trustees, metrics can help to inform their understanding and monitoring of their scheme's climate-related risks and opportunities. Quantitative measures of the scheme's climate-related risks and opportunities, in the form of emissions, portfolio alignment and non-emissions based metrics should help trustees to identify, manage and track their scheme's exposure to the financial risks and opportunities climate change poses.

118. Trustees must select and report on a minimum of one absolute emissions metric, one emissions intensity metric, one portfolio alignment metric and one additional climate change metric, and must review their metric selections from time to time as appropriate to the scheme. Where following a review, trustees determine that a selected metric should be replaced, they must select a replacement metric of the same type. For the additional climate metric trustees may select a replacement metric of a different nature to their previous additional climate change metric – for example carbon price to replace data quality.

119. Metrics should be calculated, as far as trustees are able, for each popular DC arrangement and for all DB sections (see Part 2, paragraph 19-25 of this Guidance). However, different metrics may be selected for different parts of the portfolio - for example for different asset classes or different sections of the scheme.

The Paris Agreement and Net Zero

155. The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties, on 12 December 2015. It aims to strengthen the global response to the threat of climate change by holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C.

156. According to the IPCC¹, in order to keep warming to 1.5°C, emissions must reach “net zero” by 2050. The “net” in net zero means that the amount of greenhouse gases released into the atmosphere must not exceed the amount that is removed from the atmosphere. In practice, this will mean that any residual emissions from hard-to-abate industries must be removed from the atmosphere through technology or nature-based solutions.

For a country, company or investor, a “Net Zero” goal or target means ensuring that their own emissions (or, for an investor, the emissions attributable to their assets under management) reach “net” zero by 2050.

Portfolio Alignment

157. A portfolio alignment metric means a metric which gives the alignment of the scheme’s assets with the climate change goal of limiting the increase in the global average temperature to 1.5 degrees Celsius above pre-industrial levels.

158. Portfolio alignment metrics are forward-looking metrics that can provide an indication of the exposure of a scheme to climate-related transition risks and opportunities. They can be applied to a wide range of industries, sectors, and asset classes.

Which portfolio alignment metrics?

159. Trustees should calculate, “as far as they are able”, and report one of the 3 types of portfolio alignment metric listed below² in respect of the assets of their scheme:

- **Binary target measurements** – This tool measures the alignment of a portfolio with a given climate outcome based on the percentage of investments in that portfolio that (a) have declared net zero/Paris-aligned targets and (b) are already net zero/Paris aligned. Science Based Targets initiative (SBTi)’s Portfolio Coverage Tool for Financial Institutions is an open source example of a tool that tracks the percentage of companies in a portfolio that have declared net zero/Paris aligned targets³.
- **Benchmark divergence models** – These tools assess portfolio alignment by comparing the performance of investments in the portfolio against one or more benchmarks based on climate scenarios. Transition Pathway Initiative (TPI)’s carbon performance scores and Paris Agreement Capital Transition Assessment (PACTA) are examples of open source tools which can be used for this purpose.
- **Implied temperature rise (ITR) models** – These tools translate an assessment of alignment/misalignment with a benchmark into a measure of the consequences of that alignment/misalignment in the form of a temperature

¹ IPCC Special Report on Global Warming of 1.5°C

² https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf

³ It is understood that open source tools to measure the percentage of companies in a portfolio that are already net zero/Paris-aligned will be released by the UK Centre for Greening Finance & Investment (CGFI) and 2 Degrees Investing Initiative (2DII) through their Paris Agreement Capital Transition Assessment (PACTA) methodology and tool.

score. SBTi's Temperature Scoring Tool for Financial Institutions is an open source example of this type of tool.

160. Trustees should ensure they understand the basic methodological decisions and assumptions that will affect the results of portfolio alignment metrics. For example, where binary metrics measure the percentage of companies in a portfolio that have declared net zero/Paris aligned targets, percentage scores will be dependent on the stringency of the targets against which companies are measured.

161. Trustees should, where possible, choose a tool which includes consideration of Scope 3 emissions for sectors where these are significant.⁴

162. Trustees may choose to analyse and report their selected portfolio alignment metric by asset class, sector or geography. Where they take this approach, trustees should also report the percentage of the portfolio as a whole that falls within each category. For example, in reporting on the percentage of their listed equities which have a net zero target, trustees should also disclose the percentage of their portfolio invested in these equities.

163. In the interest of consistency, trustees should endeavour to use the same portfolio alignment metrics (calculated using the same methodology and assumptions) across their portfolio where possible. If this is not possible, or where there is a good reason for diverging from this principle, trustees may choose to measure and report different portfolio alignment metrics for different asset classes, sectors or geographies. They should, however, explain the approach taken, and their reasoning in their TCFD report.

164. Trustees should not aggregate fund level portfolio alignment data provided by their asset managers or third party data providers unless a consistent methodology has been used.

165. **For sovereign bonds**, trustees should measure and report on alignment by reference to the issuer's net zero, or other emissions reduction, target.

166. Trustees should treat **corporate and sovereign green bonds** in the same way as other bonds from the same issuer, unless trustees can provide a reasoned explanation for a different approach.

167. For **collateralised buy-in contracts**, the alignment of the assets designated to ensure the insurer can meet their liabilities under the contract should be used. For **other buy-in contracts**, trustees should use the insurer's calculation of the alignment of the assets backing their UK pensions bulk annuity book or, where this data is not available, use the insurer's net zero target.

168. Where trustees have gained synthetic exposure to a particular market index through a **derivative** instrument – for example a synthetic Exchange-Traded Fund (ETF), they should “look through” to the alignment of the underlying assets.

⁴ This is subject to paragraph 19 of the Schedule to the Climate Change Governance and Reporting Regulations, which provides that in the first scheme year in respect of which the requirements of Part 1 of the Schedule apply, trustees are not required to obtain the scope 3 emissions attributable to the scheme's assets.

169. We recognise that there will be challenges for trustees calculating portfolio alignment metrics for derivatives at the current time and, likewise, for **real estate or infrastructure** assets. However, trustees are required to calculate a portfolio alignment metric for these assets only “as far as they are able”.

Data gaps – Populating missing data

170. Trustees may be able to use the portfolio alignment metrics reported by their asset managers, which it is anticipated will go some way to populating data gaps. Where there are gaps in this reporting, trustees may choose to seek alternative third party sources of data or portfolio alignment tools to fill the gaps which in the trustees’ view are likely to be most material.

171. It is not meaningful for trustees to try to measure alignment for sections of the portfolio they do not have data for. Where issuers have not disclosed carbon reduction targets trustees should report on the basis of business as usual.

172. To support the effectiveness of the “as far as they are able” approach, trustees must explain any missing data that does not allow them to calculate a portfolio alignment metric for all of the assets of their scheme – as set out in Part 2, paragraphs 19-25 of this Guidance.

Additional climate change metrics

173. Trustees must also select and report on a minimum of one additional climate change metric. Trustees should select one or more of the following additional climate change metrics. They may select an alternative additional climate change metric to those listed, but they should explain why they have done so in their TCFD report.

- **Climate value at risk (VaR)** – this measure aims to measure the size of the loss attributable to climate-related risks a portfolio may experience, within a given time horizon, if a particular scenario unfolds⁵.
- **Data quality** – this measure aims to represent the proportions of the portfolio for which the trustees have high quality data. Trustees should calculate the proportion of the portfolio for which each of Scope 1-2 emissions (and from the second scheme year onwards Scope 3) emissions are verified, reported, estimated or unavailable. For the portion of the portfolio in the “estimated” category, trustees may also calculate the proportions estimated to different degrees of certainty.
- **Carbon price(s) (external and shadow/internal)** – shadow carbon pricing may be implemented to assess potential climate-related financial impacts that could arise from carbon pricing or restrictions. Trustees should ensure carbon price(s) are sourced from credible, reputable scientific research on the carbon price necessary to meet climate goals; are consistent with prices implied by the organisation’s climate-related targets; increase over time to reflect a diminishing carbon budget; are recalculated frequently to account for climate action or lack of action; and incorporate geographic or sectoral granularity.

⁵ Task Force on Climate-related Financial Disclosures: Forward-Looking Financial Sector Metrics Consultation <https://www.fsb.org/wp-content/uploads/P291020-4.pdf> .

- **Proportion of assets materially exposed to climate-related physical risks, based on key categories of commonly accepted risks⁶** – this measure aims to analyse, assess and estimate the potential proportion of assets with material exposure to climate-related physical risks, such as stranding of assets or reduction in value due to economic disruption or weather-related damage (which is particularly relevant for property assets). The proportion of assets vulnerable to climate-related physical risks will be specific to the geography where these are located and their likely exposure to the risk.
- **Proportion of assets materially exposed to climate-related transition risks, based on key categories of commonly accepted risks⁷** - this measure aims to analyse, assess and estimate potential proportion of assets or financial activities exposure to climate-related transitional risks, such as change in demand for products or services. The proportion of assets vulnerable to climate-related transition risks will be specific to company and industry-specific climate risks.
- **Proportion of assets aligned toward climate-related opportunities, based on key categories of commonly accepted opportunities⁸** - this measure aims to provide insight into the proportion of assets aligned to climate-related opportunities for the relevant industry. Existing frameworks already provide some specific sector guidance for this. For example, SASB’s Construction Material Standard asks companies to report the percentage of products that qualify for credits in sustainable building design.
- **Amount of senior management remuneration impacted by climate considerations**– this measure aims to assess the extent to which executive compensation is linked to climate-related performance for the companies in which the portfolio invests.
- **Amount of expenditure or capital investment deployed toward climate risks and opportunities** – this measure aims to provide an indication of the extent to which the companies in which the portfolio invests are investing in the technologies, infrastructure or products needed to manage climate-related risks and opportunities.

Disclosure of metrics

174. Trustees must describe in their TCFD report the metrics which they have calculated – a minimum of one absolute emissions metric, one emissions intensity

⁶ Table 1 (p. 10) of the 2017 TCFD Final Report and Tables D2 and D3 (pp. 13–14) of the 2020 Guidance on Risk Management Integration and Disclosure provide examples of “key categories of commonly accepted risk.” Assets and business activities may be directly or indirectly exposed.”

⁷ Table 1 (p. 10) of the 2017 TCFD Final Report and Tables D2 and D3 (pp. 13–14) of the 2020 Guidance on Risk Management Integration and Disclosure provide examples of “key categories of commonly accepted risk.” Assets and business activities may be directly or indirectly exposed.”

⁸ Table 2 (p. 11) of the 2017 TCFD Final Report provides examples of “key categories of commonly accepted opportunities” as well as types of investment and financing opportunities and climate-related financial impact.

metric, one portfolio alignment metric and one additional climate change metric. If they have been unable to obtain data to calculate the metrics for all of the assets of their scheme, they must explain why this is the case.