

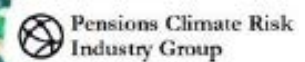


Aligning your Pension Scheme with the TCFD Recommendations

Part II - Trustee governance, strategy and risk management: how to integrate and disclose climate related risks

January 2021

The Pensions Climate Risk Industry Group



Aligning your pension scheme with the TCFD recommendations

Part II - Trustee governance, strategy and risk management: how to integrate and disclose climate-related risks

January 2021

The Pension Climate Risk Industry Group

Contents

1. Defining climate-related investment beliefs.....	5
2. Setting scheme investment strategy and manager selection, review and monitoring	7
3. The trustees' approach to stewardship on climate issues.....	22
4. Additional points for defined benefit schemes.....	29
5. Method of reporting and member communication.....	33
Appendix 1 - Enquiries to make of asset managers.....	37
Appendix 2 - Guide for assessing climate competency of Investment Consultants	40

This section covers:

- How to define investment beliefs in relation to climate change
- Identifying climate risks and integrating them into the investment strategy and wider risk management processes
- Asset manager selection, review and monitoring
- Ensuring climate risk management processes influence:
 - investment mandates
 - portfolio construction
 - strategic asset allocation
- Ensuring climate risk is used to influence the selection of asset managers and investment consultants, ultimately shaping fiduciary management
- Trustees' role in terms of climate stewardship including steps smaller schemes can take.
- Supplementary information for DB schemes
 - Implications for sponsor covenant
 - DB funding issues
- Approaches to member communication and disclosures

Each Chapter in Part II includes a summary table showing the suggested actions and disclosures for that chapter and the relevant TCFD disclosure recommendation. A guide to interpreting these table is below:

Figure 1: Guide to Summary Tables

Suggested trustee actions (and recommended disclosures)	UK	TCFD
1. Consider, document and disclose whether (and if so, the processes and frequency by which) the trustees (and/or relevant sub-committee) consider climate issues when setting the scheme's investment strategy.	Schedule Part 1 – 2 Schedule Part 2- 21 (a), (b), (f)	G(a)(ii)
Additional actions/disclosures for those seeking to demonstrate leadership		
[]. Disclose details of any carbon-footprinting undertaken in respect of the scheme and how this is used to assess climate-related risks and opportunities in relation to eth scheme's investment strategy.	Schedule Part 1 – 14, 15 Schedule Part 2 – 21 (n)	M(b)(iv)

1. Defining climate-related investment beliefs

Key considerations

- Investment beliefs can help focus trustees' investment decision-making and make it more effective. Climate change should be considered as part of these beliefs.
- Trustees should allow appropriate time and ongoing training to ensure that they have a sufficient understanding of climate change to define their investment beliefs.
- Trustees should consider the roles and responsibilities within the trustee board (and, where applicable, any sub-committees and/or individuals/organisations providing executive support to the trustees) for climate-related issues.

1.1 Investment beliefs

1. Trustee boards may find it helpful to develop and maintain a set of beliefs about how investment markets function and which factors lead to good investment outcomes.¹ Investment beliefs, developed by reference to research and experience, can help focus trustees' investment decision-making and make it more effective. Viewed as a statement of intent, investment beliefs should be reviewed regularly in order to maintain relevance. Climate change should be considered as part of these beliefs and, when documented, be integrated within them. Trustees' investment beliefs should not be confused with their personal (i.e. ethical or moral) beliefs.
2. Trustees should define their climate-related investment beliefs (e.g. about potential future climate change scenarios, how to manage their impacts, both through the integration into the investment process and through acting as effective stewards, and take climate-related opportunities). Beliefs should take into account practical circumstances (e.g. scheme size/resources, internally/externally managed assets and preference for an active/passive investment approach).
3. Trustees may wish to consider including the following in their investment beliefs:
 - Trustees should consider how their overarching strategic aims and investment objectives will influence incorporation of climate change into their frameworks
 - Trustees should consider the balance between engagement, voting and/or divestment as appropriate tools to manage climate-related risks

¹ See TPR Investment Guidance for DB and DC Schemes - <https://www.thepensionsregulator.gov.uk/en/trustees/managing-db-benefits/funding/investment> ; and <https://www.thepensionsregulator.gov.uk/en/trustees/managing-dc-benefits/investment-guide-for-dc-pension-schemes->

- Trustees should understand what their collective investment beliefs mean for the portfolio and how they will shape member engagement
 - Trustees should ensure that their beliefs are actionable and they should consider any potential consequences that they could result in, as well as impacts to the investment budget
4. Trustees should consider the internal consistency of their investment beliefs. For example, trustees of defined contribution schemes who believe in the efficacy for the scheme’s default fund of a pure passive market-cap weighted fund with no flexibility to reduce allocations selectively should consider how this will reconcile with strong beliefs in relation to the impact of climate change on markets during the time horizon of the scheme’s members. Likewise, trustees who believe in the ability of asset managers to identify and exploit asset mispricing should consider how this reconciles with a view that climate-related risks alone have been adequately “priced in” to company valuations.

1.2 Trustee climate competence: knowledge and understanding required to define investment beliefs

5. Where trustees identify a lack of sufficient understanding of climate-related financial risks to define their investment beliefs on the issue with confidence (or that there has previously been insufficient time allocated on board agendas to it), they should allocate specific time at a future board meeting or an investment strategy session dedicated to climate-related risk issues.² Trustees should ensure that they allow adequate time to look at the issue in sufficient depth to ensure that they are meeting their legal duties. This might include more detailed sessions on:
- The latest evidence on the investment impacts of climate change and views from investment consultants, asset managers, independent experts and other advisers on how climate-related risks and opportunities have the potential to affect different investment portfolios.
 - The trustees’ legal obligations to consider and act on climate-related issues (and the extent to which the trustees’ policies need to be disclosed or reported on).
 - In a defined benefit scheme, the potential impact of climate-related risks on the scheme sponsor’s covenant.
 - The range of possible actions that might be taken to help manage climate-related risks (and capture the opportunities), including case studies of good practice actions across the investment community. Trustees may also wish to consider the potential impacts if there is an active decision to ‘do nothing’.

² See World Economic Forum (in collaboration with PWC), How to Set Up Effective Climate Governance on Corporate Boards; Guiding principles and questions (January 2019) http://www3.weforum.org/docs/WEF_Creating_effective_climate_governance_on_corporate_boards.pdf.

Investment beliefs - Suggested trustee actions (and recommended disclosures)	Proposed requirements in the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations	TCFD
1. Identify, document and disclose the relevant climate-related investment beliefs and policies of the trustee board, whether these are set by the trustees or a sub-committee (e.g. investment sub-committee) and the frequency of their review.		
2. Consider, document and disclose the processes and frequency by which the trustee board (and, where applicable, any sub-committees and/or individuals/organisations providing executive support to the trustees) are informed about, assess and monitor climate-related risks and opportunities (including any training received) and how these influence the setting of the trustees' investment beliefs.	Schedule Part 1 – Paras 1, 2 Schedule Part 2 – Para 21 (a), (b), (c)	G(a)(i) G(b)(iv)
3. Identify, define and disclose the roles within the trustee board (and, where applicable, any sub-committees and/or individuals/organisations providing executive support to the trustees) that have oversight, accountability and/or manage responsibilities for climate-related issues.	Schedule Part 1 – Paras 1, 2 Schedule Part 2 – Para 21 (a), (b), (c)	G(b)(i)
<u>Additional actions/disclosures for those seeking to demonstrate leadership</u>		
4. Disclose details of commitments or involvements in wider initiatives, such as UN-backed PRI, IIGCC, Climate Action 100+, Transition Pathway Initiative etc.	n/a	n/a

2. Setting scheme investment strategy and manager selection, review and monitoring

Key Considerations

- Trustees should consider how different investments and investment strategies could be affected by the transition to a low carbon, climate-resilient economy and under different future climate scenarios.

- Scenario analysis and modelling are helpful tools to use in considering climate risks in setting the scheme's investment strategy.
- Trustees should consider their risk appetite and time horizons in the context of their scheme and their current investment strategy, noting the need for well-defined risk management processes to ensure climate related-risks are effectively measured and managed.
- Trustees should consider how climate risks may affect different asset classes and sectors in which the scheme has invested and the investment approaches in each portfolio.
- Having determined their overall strategic asset allocation, trustees should consider the mandates set for each asset class and the method by which investments are made; and they should identify strategic actions to reduce exposure to climate-related risks, as well as options for investment in climate-related opportunities.
- Climate competence should be factored into both manager selection, review and monitoring to execute agreed mandates for each asset class and method of investment.
- Trustees must be able to assess the potential size and scope of risks, which pose the most significant potential loss and which are the most likely to occur. This process of assessing risk can be multi-tiered, taking place at various levels of risk at the scheme, portfolio or asset-level
- Trustees should make use of the expertise of their investment consultants and advisers but should not be overly reliant on them to set the agenda. Trustees should challenge advisers and set objectives for them to factor climate-related risks into their advice. Climate competence should be considered when reviewing advisers.

2.1 Investment (and investment adviser) objectives

6. Trustees should set clear investment objectives for their scheme (and their advisers) and identify how and when they should be achieved. A scheme's investment strategy (and any adviser objectives to support that strategy) should support and be consistent with the trustees' objectives, taking account of the trustees' view of climate-related risks in the circumstances of the scheme and allowing for the fact that the objectives may evolve over time.
7. Trustees should distinguish between strategies for defined benefit and defined contribution schemes. In a defined benefit scheme, this will involve considering the scheme's funding levels and employer covenant as part of an integrated risk management (IRM) approach.³ In a defined contribution scheme, trustees should

³ See Pension Regulator's DB code of practice and IRM guidance, including guidance on assessing and monitoring employer covenant - <https://www.thepensionsregulator.gov.uk/>

consider the risk/return profile appropriate to the membership and in particular the design of the default investment strategy. This will involve consideration of the needs of the scheme's members, and how these might change in the future.⁴

2.2 Considering risk appetite

8. Considering risk appetite can help trustees determine whether their current investment strategy is appropriate. Trustees should consider how different investments and investment strategies could be affected by the transition to a low-carbon economy and/or the physical impacts of climate change under different scenarios and whether implementing an alternative strategy may be more likely to achieve the scheme's objectives. Trustees should also consider their risk appetite for capitalising on investment opportunities connected with the transition to a low-carbon economy and, if applicable, their belief that they should help to fund investments that are needed to achieve the low carbon transition.
9. Adequate risk management depends on having the right processes and the right metrics in place. However, it is worth reiterating that climate change represents a negative externality that carries potentially very high and costly market-wide risks which may be largely unpriced or mispriced. The scale and complexity of climate change and its resulting impacts requires strong and well-defined risk management processes to ensure that the risks are being measured and managed.

2.3 Considering time horizons

10. Trustees need to understand how climate-related issues may affect the scheme's investment strategy and, where relevant, funding strategy over the short, medium and long term. They should set out what they consider to be the relevant short, medium and long term time horizons for their scheme.
 - Trustees should describe the relevant short and medium term time horizons; longest horizons.
 - In DB schemes, the longest time horizon to be considered will be the time over which the benefits will be paid to their members from the scheme.
 - In DC schemes, the longest time horizon to be considered will be the time over which members' money will be invested via the scheme.
11. It is up to trustees how they determine their time horizons, but trustees could approach this by thinking about their shorter horizons relative to their longest horizon. For example, If the longest time horizon is less than 10 years, trustees may decide to only have a short and a long time horizon. Trustees should

[/media/thepensionsregulator/files/import/pdf/guidance-assessing-monitoring-employer-covenant.ashx?la=en&hash=62D096BB6BEB41B17ACA8F6CFE2EF450F669D045](https://www.thepensionsregulator.gov.uk/media/thepensionsregulator/files/import/pdf/guidance-assessing-monitoring-employer-covenant.ashx?la=en&hash=62D096BB6BEB41B17ACA8F6CFE2EF450F669D045)

⁴ see Chapter 4 of TPR DC Code: Designing investment arrangements (including default arrangements) - Understanding your membership - <https://www.thepensionsregulator.gov.uk/en/trustees/managing-dc-benefits/investment-guide-for-dc-pension-schemes->

consider the time horizons which would be most suitable based on the range of climate-related risks and opportunities that the scheme may face.

2.4 Use of scenario analysis

12. Trustees should:

- undertake climate scenario analysis and/or modelling, considering the scenarios to be used, how the impacts are calculated and the output of the analysis (by asset class, sector, strategic asset allocation etc.)
- consider how they use scenario analysis (including the impact of different scenarios on different types of assets, sectors and investment approaches within each portfolio) to manage climate related risks and opportunities, including how the analysis has been interpreted and acted on and any future plans.

13. See Part III of this guidance for further details on scenario analysis.

2.5 Considering climate-related risks as part of strategic asset allocation

14. Trustees should consider how climate-related risks may affect the different asset classes the pension scheme is invested in over time.

15. The proportion of different types of growth, matching and other assets held will vary by scheme (depending in a defined benefit scheme on the maturity of the scheme, its funding levels and employer covenant). In a defined contribution scheme a default fund may have a pre-determined process by which assets are transitioned from higher growth to lower volatility as a member approaches retirement age.

16. Growth assets are generally expected to be more sensitive to climate-related risks than matching assets⁵ but trustees should consider the impact of different climate change scenarios on all asset classes (see Part III of this guidance). This should be factored into investment decision-making as part of a scheme's strategic asset allocation – i.e. a top-down integration instead of employing a case-by-case bottom-up approach to climate change.

17. The consideration of climate-related risks, using scenario analysis, may prompt trustees to make changes in their overall strategic allocations to different asset classes or the timeframe over which an agreed transition from growth to matching assets will occur. Trustees may also wish to consider whether certain asset classes and sectors may be expected to benefit from the low carbon transition and may wish to make positive allocations to these and/or make changes to the scheme's strategic allocation targets (e.g. set targets to increase exposure to

⁵ Mercer, Investing in a Time of Climate Change, the Sequel (2019) - <https://www.mercer.com/our-thinking/wealth/climate-change-the-sequel.html>

certain types of infrastructure, real estate, private equity, etc. within a set timeframe).

18. Trustees may also wish to consider how agreed asset allocation targets and ranges may be impacted by climate change and whether it is necessary to increase ranges around existing asset class allocations to provide more leeway for significant moves towards the upper and lower boundaries during times of high volatility.

2.6 Determining how climate-related risks are incorporated within investment mandates and portfolio construction

19. Having determined their overall strategic asset allocation, trustees must consider the mandates they intend to set for each asset class and the method by which the investments will be made.
20. Because trustees generally do not choose specific investments themselves,⁶ they will usually delegate this power to authorised asset managers.⁷ Whilst some larger pension schemes may invest through a manager who will manage a segregated portfolio of assets on behalf of the trustees, in many cases trustees will invest via pooled funds.
 - **Actively managed pooled funds** - In relation to the selection of an actively managed pooled fund (or the appointment of an active manager in relation to a segregated mandate), trustees should carefully consider the investment objectives and restrictions under which the manager will make investment decisions. Trustees should identify funds and managers which adopt an investment approach which is aligned with the trustees' investment beliefs (including engagement and, where applicable, voting policies – see chapter 3). Manager capabilities should be considered carefully (see [2.7] below).
 - **Passively managed pooled funds** - In relation to passively managed funds, trustees should consider the indices that might be suitable to track. To date, market-capitalisation weighted indices have been used by the majority of pension trustees (particularly in defined contribution schemes). However, these indices usually reflect business-as-usual scenarios and as allocation guidelines for sector diversification, such indices may tend to overweight high carbon sectors (e.g. oil and gas). Trustees may wish to consider the use of alternative indices if they wish to maintain a passive approach. However, in doing so care should be taken as ESG or climate tilted indices may suffer from the same flaw by maintaining overall sector allocations (going overweight for some oil and gas firms to compensate for being underweight in another).

⁶ Most day-to-day investment activities carried out on behalf of an occupational pension scheme are regulated activities: see TPR, 'Investment Guidance for Defined Benefit Pension Schemes (March 2017)', 5; see further: Financial Services and Markets Act 2000, s 22 and sch 2, para 6; Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI 2001 No 544, art 37.

⁷ See Pensions Act 1995, s 34(2); under section 47(2) of the Pensions Act 1995, where an occupational pension scheme has assets including investments, an asset manager must be appointed.

21. Where applicable, trustees may consider a number of strategic actions to reduce identified exposure to risks and/or take advantage of opportunities. These might include:

- making positive allocations to certain assets and sectors that may benefit from the low-carbon transition;
- reducing exposure to certain assets and sectors that may be harmed by the low-carbon transition;
- making changes to the scheme's strategic allocation targets (e.g. set targets to increase exposure to certain types of infrastructure, real estate etc. within a set timeframe);
- changing the timeframe over which an agreed transition from growth to matching assets will occur (DB schemes);
- a shift in passive investments to low carbon benchmarks rather than tracking a market-capitalisation weighted index (which have tended to reflect 'business as usual' scenarios);
- making use of funds which take other "factor-based" approaches reflecting climate-related risks rather than tracking an index;
- changes to the investment objectives and restrictions under which a manager will make investment decisions in actively managed pooled funds or a segregated mandate;
- engagement with asset managers and investee companies on climate-related risks (more about this in chapter 2.7-2.8), collaborating with trustees of other schemes as appropriate and other managers, investors or campaign groups;
- replacing existing asset managers to ones better aligned with trustees' concerns and ambitions on climate change;
- collaborating with other investors as appropriate on climate-related risks e.g. through shareholder coalitions, shareholder resolutions etc.;
- accelerating funding plans e.g. if trustees are less confident about longer-term covenant support in light of climate risks;
- amending the assumed future investment returns due to a revised assessment in light of climate impacts;
- putting in place contingent funding arrangements to offer protection against adverse transition developments for covenant;
- reviewing the design of the scheme's DC Default funds; and
- revising the range of self-select funds for DC schemes and communicating to members on this.

22. Trustees should establish their preferred approach(es) and consider and document any changes to the trustees' strategy over time. These should be embedded into the trustees' governance, investment strategy, risk management and reporting processes.

23. Trustees may also wish to consider the potential strategic options for investing in climate-related opportunities and agree priority areas for further research (including the extent to which the trustees expect their investment consultants or asset managers to investigate and present opportunities in these areas).

2.7 Factoring climate-related risk management capabilities into the selection, review and monitoring of asset managers

24. Having decided upon the mandates they intend to set for each asset class, as well as the method of investment, trustees must consider the process and requirements for the selection, review and monitoring of managers to execute these mandates. This may begin with a review of the climate policies of existing or prospective managers. However, it also requires rigorous due diligence on how these are executed. An assessment of an asset manager's governance of climate issues and the broader integration of climate impacts into their business strategy is recommended. Appendix 2 provides a number of suggestions for trustees to help them carry out due diligence of asset managers' capabilities and approach to climate-related risk management.
25. Climate competence should therefore be factored into the choice of managers. Challenging asset managers over their current practices will prevent greenwashing; engaging with them will promote better understanding of climate related issues. The fund manager should be capable of explaining underlying carbon-risk exposures, as well as demonstrating that environmental considerations have been considered during portfolio construction and engagement activities.
26. Where schemes invest through a segregated portfolio, whether active or passive, trustees should seek to ensure that their existing managers take an approach to climate which largely aligns with the trustee's investment beliefs. Where trustees carry out a tender exercise for the appointment of a new manager trustees may wish to consider in addition the prospective managers' broader investment offering and approach and potentially the expertise, capability and track record of the manager to work with the trustees to develop and deliver solutions aligned with their investment beliefs around climate change.
27. For those schemes investing via pooled funds, whether active or passive, trustees should assess the integration capabilities of managers and approach taken for that fund/strategy; these should cover a range of approaches.
28. For active (and factor-based) strategies, it is important to consider how the asset manager applies climate research, data and beliefs to enhance their fundamental analysis (or factor-based approach), and how this is reflected in and complemented by stewardship activities and voting policies (see chapter 3). Trustees should consider the extent to which the approach aligns with their investment beliefs on climate-related issues and delivers on the pension scheme's strategy. Trustees should assess manager performance against any climate-related mandates, performance benchmarks, or targets set by trustees and consider asking managers for examples of recent cases where climate factors have influenced buy/hold/sell investment decisions.

29. For passive strategies, trustees will need to have considered the suitability of market-cap based solutions, against alternative index offerings. When selecting an asset manager to provide these, trustees should in all cases rigorously assess the stewardship activities and voting policies of asset managers. When selecting climate indices, they should seek to ensure that the manager's approach to climate more broadly, and in particular its stewardship activities, complement the index solutions on offer.
30. In their monitoring and review of existing managers, trustees may also consider the following strategic actions to hold managers to account on their management of climate-related issues:
- Assess quality of climate-related disclosure provided by managers, preferably against the TCFD recommendations.
 - Assess quality of climate-related voting and engagement practices by managers (see chapter 3).
 - Require managers to perform and report back on climate scenario analysis on their holdings (see Part III).
 - Require managers to undergo periodic climate-related assessments (such as carbon auditing or stranded assets).

2.8 Investment consultants (and fiduciary management)

31. In practice, many trustees will rely heavily on their advisers and consultants to provide strategic advice about investment strategies, asset allocation and asset manager selection. Increasingly, trustees will rely on other consultant and adviser services, including manager research and analysis and reporting on asset manager performance. Although trustees will usually have ultimate responsibility for making decisions on these issues, investment consultants' advice will often be highly influential.⁸
32. Where trustees have legal duties to consider and address climate risk, consultants will need to have regard to these when providing their advice. However, trustees retain ultimate responsibility to effectively monitor and oversee their advisers.⁹ Trustees are also required to set objectives for their investment consultants.¹⁰
33. Trustees should consider setting specific objectives for their investment consultants to:

⁸ Financial Conduct Authority. Asset Management Market study: Interim Report (November 2016), 140–170 - <https://www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf>

⁹ TPR, 21st Century Trusteeship - <https://www.thepensionsregulator.gov.uk/en/trustees/21st-century-trusteeship/2.-d.-clear-roles-and-responsibilities> See also – Managing DC benefits, Scheme management skills - <https://www.thepensionsregulator.gov.uk/en/trustees/managing-dc-benefits/scheme-management-skills-guide-for-dc-pensions/#f5c80ed475614021af1eb07874c56c1d>

¹⁰ The Investment Consultancy and Fiduciary Management Market Investigation Order 2019, Article 12 - https://assets.publishing.service.gov.uk/media/5cfdfa86e5274a090f9eef8e/Order_investment_consultants.pdf

- advise so as to help trustees develop climate-related strategies (and processes to manage risk) that are aligned with trustees’ investment beliefs on climate-related issues;
- address climate-related risks and opportunities material to the scheme in their investment advice, adapting their core services accordingly (including demonstrating a robust track-record that shows the adviser’s capacity to assess and address the issues); and
- assess the climate-related performance (and resilience to climate related risks) of the schemes’ asset managers and funds and to proactively suggest alternative approaches where these are not aligned with the trustees’ investment beliefs on climate-related issues.

34. Where trustees delegate both the consultancy and implementation of investment strategy to a fiduciary manager, trustees should apply the principles relating to both asset managers and consultants as set out above. Trustees should agree with the fiduciary manager where responsibility lies in relation to each of the actions set out below, depending on the extent to which investment strategy decisions are delegated by the trustees to the fiduciary manager.

35. The Investment Consultants Sustainability Working Group (ICSWG) have produced a helpful “Guide for assessing climate competency of Investment Consultants” which can be found in Annex 2.

Investment strategy Suggested trustee actions (and recommended disclosures)	Proposed requirements in the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations	TCFD
Overall strategy		
1. Consider, document and disclose whether (and if so, the processes and frequency by which) the trustees (and/or relevant sub-committee) consider climate issues when setting the scheme's investment strategy.	Schedule Part 1 – Para 1 Schedule Part 2- Para 21 (a)	G(a)(ii)

<p>2. Consider, document and disclose how the trustee board (or relevant sub-committee) will identify climate-related risks/opportunities. Trustees may wish to consider:</p> <ul style="list-style-type: none"> - what information is needed to evaluate climate-related risks and opportunities, and where can it be sourced; - which risks/opportunities could be material (including existing and emerging regulatory requirements related to climate change); - what process will the trustees adopt for determining size/scope of risks/opportunities at total fund/strategy level, and individual asset class-level. Risks and opportunities should be considered in absolute terms and in relation to the risk appetite of the scheme; - how the trustees have assessed the materiality – the likelihood and impact – of climate-related risks (and opportunities) - e.g. by sector and/or geography, as appropriate; and - the role of the trustee’s investment consultants in bringing climate-related risks/opportunities to the trustees’ attention (and their capacity and expertise to do so). 	<p>Schedule Part 1 - Paras 3, 4, 11 Schedule Part 2 – Para 21 (d), (e), (k)</p>	<p>S(a)(iii) R(a)(i) R(a)(ii) R(a)(iii)</p>
<p>3. Identify, document and disclose the extent (consistent with the trustees’ investment beliefs) to which and how the trustees intend to factor climate-related risks and opportunities into relevant investment strategies - both at total fund/strategy level, and individual asset class-level.</p>	<p>Schedule Part 1 – Para 5 Schedule Part 2 – Para 21 (f)</p>	<p>S(b)(i) S(b)(ii) S(b)(iv)</p>
<p>4. Identify, document and disclose what the trustees consider to be the relevant short-, medium-, and long-term horizons, taking into account:</p> <ul style="list-style-type: none"> - in a defined benefit scheme, the likely time horizon over which members' benefits will be paid from the scheme; and - in a defined contribution scheme the likely time horizon over which members' monies will be invested in the scheme to and through retirement. 	<p>Schedule Part 1 – Paras 3, 4 Schedule Part 2 – Para 21 (d), (e)</p>	<p>S(a)(i)</p>

<p>5. Identify, document and disclose the climate-related issues for each time horizon (short, medium, and long-term) that could have a material financial impact - whether transition or physical risk. Examples of risks to cover may include: increased pricing of greenhouse gas emissions; substitution of existing products and services with lower emission alternatives; successful/unsuccessful investments in new technology; moves to more efficient buildings and infrastructure; litigation risk; extreme weather risk.</p>	<p>Schedule Part 1 – Paras 3, 4 Schedule Part 2 – Para 21 (d), (e)</p>	<p>S(a)(ii)</p>
<p>6. Consider, document and disclose the resilience of the scheme's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario and how this informs the design of strategies.</p>	<p>Schedule Part 1 – Paras 6-10 Schedule Part 2 – Para 21 (g)-(j)</p>	<p>S(c)(i)</p>
<p>7. Consider, document and disclose how the trustees' processes for identifying, assessing, and managing climate-related risks are integrated into the scheme's risk register and/or integrated risk management approach. Trustees may wish to consider:</p> <ul style="list-style-type: none"> - their processes for managing climate-related risks, including how they make decisions to mitigate, accept, or control those risks; - their processes for prioritising climate-related risks, including how materiality determinations are made; and - the role of the trustee's investment consultants in advising on the integration of climate-related issues within an integrated risk management approach. 	<p>Schedule Part 1 – Paras 11-13 Schedule Part 2 – Para 21 (k), (l), (m)</p>	<p>R(b)(i) R(b)(ii) R(c)(i)</p>
<p>8. Identify, document and disclose the extent (if at all) to which climate-related issues are included in the trustees' investment consultant's strategic objectives.¹¹ Trustees may wish to consider (but need not disclose) any similar requirements incorporated into consultants' investment service agreements.</p>	<p>Schedule Part 1 – Para 2 Schedule Part 2 – Para 21 (c)</p>	<p>G(b)(i)</p>
<p>Asset allocation and defining asset manager / pooled fund mandates</p>		

¹¹ Note that trustees are obliged to document their investment consultant's strategic objectives under Article 12 of the Investment Consultancy and Fiduciary Management Market Investigation Order 2019.

<p>9. Identify, document and disclose how the trustees consider that climate change may impact the scheme's growth, matching and other portfolios (including the default fund in a DC scheme), taking into account the short-, medium-, and long-term horizons the trustees have identified as relevant. This should include identifying and taking account of areas where the scheme's (or default fund's) asset allocation ranges and portfolio structure are expected to evolve in the future.</p>	<p>Schedule Part 1 – Paras 3, 4 Schedule Part 2 – Para 21 (d), (e)</p>	<p>S(a)(ii)</p>
<p>10. Identify, document and disclose the extent (if at all) to which climate-related risks are embedded/included in strategic asset allocation decisions (and detail any changes resulting from scenario analysis into strategic asset allocation decisions).</p>	<p>Schedule Part 1 – Para 5 Schedule Part 2 – Para 21 (f)</p>	<p>S(b)(i) S(b)(iii) S(b)(iv)</p>
<p>11. Consider, document and disclose how scenario analysis is used as a relevant factor in informing asset allocation and decisions to invest in specific asset classes.</p>	<p>Schedule Part 1 – Paras (5)-(10) Schedule Part 2 – Para 21 (f)-(j)</p>	<p>S(b)(iii) S(c)(ii)</p>
<p>12. Consider, document and disclose how the scheme's growth, matching and other portfolios are positioned in relation to the transition to a lower-carbon economy. Trustees may wish to consider:</p> <ul style="list-style-type: none"> - within different asset classes, the scheme's exposure to those sectors that are particularly sensitive to transition risk (energy, utilities, materials); and - in relation to passive funds, the extent to which low-carbon transition risks and opportunities are part of the index and whether the trustees have considered any reallocation to alternative index funds or factor-based funds with climate-related weightings. 	<p>Schedule Part 1 – Paras 5-10, 12 Schedule Part 2 – Para 21 (f)-(j), (l)</p>	<p>S(b)(i) S(c)(i) R(b)(iii)</p>

<p>13. Consider, document and disclose how climate-related risks may impact funds with higher exposure to economic sectors that are concerned with physical assets or natural resources, such as real estate, infrastructure, timber, agriculture and tourism (being the most vulnerable to physical risks of climate change). Trustees may wish to consider:</p> <ul style="list-style-type: none"> - TCFD's focus sectors (i.e. Energy; Materials and Buildings; Transportation; and Agriculture, Food, and Forest Products); - regional and sectoral mix to identify and capture the areas where the greatest climate transition is expected to occur; and - exposure to and management of stranded assets. 	<p>Schedule Part 1 – Para 5 Schedule Part 2 – Para 21 (f)</p>	<p>S(b)(i)</p>
Asset manager selection, review and monitoring		
<p>14. Identify, document and disclose how the trustees' process for the selection, review and monitoring of the scheme's asset managers takes account of climate change issues. Trustees may wish to consider:</p> <ul style="list-style-type: none"> - the role of the trustee's investment consultants in rating asset managers, how such rating process takes climate change issues into account, and how such rating process is understood and reviewed by the trustees; - how the trustees ensure that the weighting attributed to climate change issues within manager selection, review and monitoring is appropriate to the trustees' investment beliefs and the scheme's investment strategy in relation to climate issues; - how frequently the selection, review and monitoring process is reviewed in relation to climate change issues; and - if selection and monitoring of asset managers is delegated to a fiduciary manager, what oversight processes are in place on their integration of climate considerations. 	<p>Schedule Part 1 – Para 2(b) Schedule Part 2 – Para 21 (c)</p>	<p>G(b)(i)</p>

<p>15. Identify, document and disclose how the trustees evaluate the alignment of their asset managers' investment strategy (or the investment objectives of any pooled funds) with the trustees' climate-related investment beliefs and the scheme's investment strategy and objectives in relation to climate issues. Trustees may wish to consider:</p> <ul style="list-style-type: none"> - the role of the trustee's investment consultants in advising the trustees on the alignment of the managers' investment strategy; - how (if at all) the manager is incentivised to align its investment strategy; and - how the method (and time horizon) of the trustees' evaluation of the asset manager's (or pooled fund's) performance and the remuneration of the manager are in line with the trustees' climate-related investment beliefs and support the scheme's investment strategy and objectives in relation to climate issues. 	<p>Regulation 2 – Investment) Regulations 2005)¹²</p>	
<p>Additional actions/disclosures for those seeking to demonstrate leadership</p>		
<p>16. Disclose details of any carbon-footprinting undertaken in respect of the scheme and how this is used to assess climate-related risks and opportunities in relation to eth scheme's investment strategy.</p>	<p>Schedule Part 1 – Paras 14, 15 Schedule Part 2 – Para 21 (n)</p>	<p>M(b)(iv)</p>

¹² See regulation 2(3)(c) of the Occupational Pension Schemes (Investment) Regulations 2005

<p>17. Disclose details of any specific decarbonisation target adopted by the scheme, such as alignment with specific climate objectives e.g. below 2°C / alignment with the Paris Agreement / net zero by an earlier date (including methodology used) and how the trustee board (or relevant sub-committee) monitors and oversees progress against this. Trustees may wish to consider whether such targets or objectives:</p> <ul style="list-style-type: none"> - should aspire to lower greenhouse gas emissions by exclusion of sectors or companies from a scheme’s portfolio over time as opposed to engagement with those sectors or companies leading to a reduction of greenhouse gas emissions by such sectors or companies; - will apply across all assets (or for example be limited to listed equities); - are absolute or intensity based; - are based on real-life vs portfolio outcomes (for example, would a scheme investment in, say, EU carbon credits, or wind farms, be allowed to reduce the associated emissions of a portfolio elsewhere?) 	<p>Schedule Part 1 – Paras 17, 18 Schedule Part 2 – Para 21 (o)</p>	<p>R(b)(iii) M(c)</p>
<p>18. Consider steps taken to reduce the pension scheme’s own operational impact e.g. use of renewable energy sources, business travel and use of off-sets and adaptation measures to reduce climate impact.</p>		

3. The trustees' approach to stewardship on climate issues

Key Considerations

- Stewardship sits alongside the integration of long-term factors into investment decision-making, governance and processes.
- It is therefore important that trustees consider how they fulfil their stewardship role (including both engagement and voting) on climate change issues to create “long-term value for...beneficiaries” and disclose their activities in this respect.

3.1 Why stewardship forms a key part of an integrated approach to climate-risk

36. The UK Stewardship Code¹³ defines stewardship as “the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.”
37. There is a growing body of evidence¹⁴ which demonstrates the benefits of active ownership, or good stewardship, to corporate performance. Engagement activity with investee companies (including through appointed managers) can help to encourage better practices and corporate behaviours related to climate-related risks as well as improving disclosures by those companies to enable better assessment of climate-related risks by asset owners. It should therefore form a key part of the integration of climate issues into trustee investment processes.
38. Although there is only one specific TCFD recommended disclosure on stewardship or engagement, it is difficult for trustees to have a meaningful and effective governance and decision-making framework – for instance regarding investment beliefs, or use of metrics, or in disclosing their approach on climate change – without consideration of how they fulfil their stewardship role. Good Stewardship can also be an effective form of post-investment risk management.

3.2 Principles for effective climate stewardship

39. What good stewardship looks like will vary for each trustee board, depending on the scheme's resources and the trustees' investment beliefs. However, in all cases trustees should be clear on how stewardship fits within the scheme's

¹³ The UK Stewardship Code 2020 - https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf

¹⁴ This includes *Active Ownership* (Dimson, Karakas and Li, 2012) or *Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach* (Flammer, 2013).

investment strategy and how it helps meet the trustees' climate-related investment objectives.¹⁵

Manager delegated approach¹⁶

40. In many cases, trustees will delegate stewardship activities to the scheme's asset managers. Where this is the case, trustees should:
41. Familiarise themselves with their asset manager's stewardship policies in relation to climate-related issues (seeking to influence them where appropriate). This should include talking to their advisers and asset managers about how climate-related risks and opportunities are currently built into their engagement and voting policies and, where applicable, how they sit alongside measures taken to reflect climate-related risks within investment portfolios. Trustees should have a clear understanding of what 'success' by their asset managers on climate issues looks like.
42. Ensure that asset managers' climate approaches are in line with the trustees' climate-related investment beliefs and support the scheme's investment strategy and objectives in relation to climate issues.
43. Hold their asset managers to account in relation to their engagement activities and voting record on climate issues. Agreeing a schedule for monitoring and reviewing outsourced stewardship activities would be good practice and will assist trustees comply with their own requirements to produce an annual statement in the scheme's report and accounts setting out how the trustees' voting and engagement policies have been implemented during each scheme year (see 3.2(C) above).
44. When appointing new asset managers, using due diligence and the asset manager appointment process to gain a clear understanding of how the prospective manager considers and integrates climate factors in their engagement and voting behaviour (including, the asset manager's approach to securities lending).
45. Where asset managers outsource activities on climate stewardship, explicitly setting out expectations for such outsourced activities on climate stewardship and approaches in legal documents. This could include in documents such as the Investment Management Agreement (IMA) or side letters to pooled fund documentation.
46. Encourage your asset managers to be active participants in climate-related initiatives. For example, the Institutional Investors Group on Climate Change (IIGCC), Transition Pathway Initiative (TPI) and Climate Action 100+.

¹⁵ Further details on building a stewardship, engagement and voting policy across issues including on climate change can be found in the PLSA's *Stewardship Guide and Voting Guidelines 2020* - <https://www.plsa.co.uk/Policy-and-Research/Document-library/PLSA-Stewardship-Guide-and-Voting-Guidelines-2020>

¹⁶ Engaging the Engagers: A practical toolkit for schemes to achieve effective stewardship through their managers' - <https://www.plsa.co.uk/Policy-and-Research/Document-library/Engaging-the-engagers-A-practical-toolkit>

Scheme's own strategy

47. Some trustees may have strategies to carry out their own engagement and/or voting. In this case, trustees should articulate a clear process and policy for voting on climate issues. This should identify what issues will be taken into account when deciding how to cast their vote and also set out their approach to exercising voting rights, having a clear understanding of what 'success' on climate issues looks like. Key issues to consider could include:

- How to make systematic use of all voting powers at trustees' disposal to support the highest standards of climate governance and approach at investee companies.
- Under what circumstances the trustees will seek to support climate-related resolutions. Key issues for consideration would include: whether the resolution conflicts with other climate resolutions; whether it is supported by management; whether the resolution is binding or non-binding; whether the solution sought is appropriate and consistent with the business' long-term success.
- Where scheme investments are held in pooled arrangements, the extent to which the scheme's asset manager policies enable the casting of client votes.
- Developing an engagement strategy beyond listed equity to include assets such as fixed income, real estate, bonds and infrastructure.

48. In addition to the above, trustees might also like to consider the following as part of their overall stewardship approach:

- **Joining collective or collaborative engagement efforts.** The 2012 Kay Review noted that greater collective engagement could address concerns about fragmented and disparate ownership of companies. Collaborative engagement may be particularly appropriate for those trustees with fewer resources for specific engagement activities and who can maximise their influence by joining their voice with those of others. Trustees of these schemes can work within membership bodies such as the PLSA and UKSIF to press for stronger co-ordinated actions. Schemes can also collaborate and join with industry groups promoting Paris alignment, including the IIGCC's Paris Aligned Investment Initiative, the Net Zero Asset Owners Alliance and Transition Pathways Initiative.
- **Influencing the public policy debate on climate.** Investor stewardship takes place within a policy and regulatory framework which is shaped by various forces including governments, political parties, membership associations, campaign groups and public opinion. If trustees feel that the legislative framework does not sufficiently support them in acting as good stewards of their assets, they should seek to influence policy and regulatory initiatives.
- **Aiming to follow and engage with the UK Stewardship Code**, including becoming a signatory where possible.

- **Agreeing a policy and approach for communication of stewardship activities and outcomes to stakeholders.** As well as reporting duties under statutory requirements around engagement (see [3.2] above), stewardship should also be communicated with beneficiaries. Trustees could consider a standalone stewardship or responsible investment report, additional information on members’ annual benefit statements or, for defined contribution schemes, content in the Chair’s Statement.

Smaller schemes

49. Amendments to the Investment regulations¹⁷ taking effect in October 2019 required all schemes to have a stewardship policy. Trustees should therefore already have considered their approach in some detail.
50. Whilst larger schemes are better placed to undertake direct engagement individually or through collaboration with other large investors, smaller schemes should still be able to demonstrate that they have engaged effectively with an asset manager both at appointment and through ongoing monitoring to implement this on their behalf. They should also ensure that their consultants give weight to asset managers’ track records in climate change stewardship – and stewardship more broadly - in shortlisting and recommendations.
51. Trustees of such schemes should refer to Appendix 1 at the end of this section which provides a list of questions aimed at obtaining detailed information from asset managers, which will help them identify a manager to deliver their stewardship policy effectively.

3.3 Holding investee companies to account on TCFD

52. The TCFD recommendations apply not just to asset owners, but to intermediaries such as asset managers, and the investee companies themselves¹⁸. Trustees should be working with their advisers and managers to ensure a joined-up approach on TCFD which extends through to these companies. This should include engagement and, where necessary, applying a voting sanction to company boards which are not effectively monitoring, assessing and providing oversight of the company’s approach to managing the risks and opportunities from climate change.
53. Some of the largest companies are already reporting using TCFD. This can either be done in a separate Sustainability Report or integrated throughout the Annual Report – which is the approach many investors prefer. Although trustees should make allowances for smaller firms in their use of specific third-party frameworks

¹⁷ Occupational pension schemes (investment) regulations SI 2005/3378 – as amended by SI 2018/988.

¹⁸ Premium listed companies will be required to report against the TCFD recommendations from 2021 see: [FCA– PS20/17 - <https://www.fca.org.uk/publications/policy-statements/ps20-17-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing> https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf See also FCA consultation CP20/3: [Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations: https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing](https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing)

like TCFD, there should be evidence that all companies are at least broadly considering their approach to climate risk in terms of governance, strategy and risk management – and which are also making use of appropriate metrics and scenario analysis.

54. Trustees should look for the following as signs of good corporate behaviour:

- **A discussion of climate change in terms of strategic, financial and operational factors.** The potential impact of different scenarios – including reactions from policymakers and regulators – on value creation in the long-term should be clearly discussed. There should also be a clear link to risk management at the executive level and risk oversight at the board level. The impact of climate risk and opportunities on the firm’s strategy over the short-, medium- and long-term should be clearly outlined.
- **Clear climate-related governance and oversight structures and processes.** This includes climate change expertise at board level, identification of which Director is accountable for climate issues and management’s role in assessing and managing climate-related risks and opportunities. Every Director should demonstrate an understanding and awareness of the potential range of impacts which climate change may have on the company¹⁹.
- **A proactive approach both to identifying and managing climate risks (and opportunities) and providing sufficient disclosures on climate change.** Although at this stage this does not need to include reporting using the TCFD framework, there should already be evidence that companies are considering the issue of climate change across the high-level TCFD areas of governance, risk management, strategy, metrics and targets, and scenario analysis.
- **Active consideration and discussion in reporting of both the expected physical impacts of climate change and transition impacts.** In terms of physical impacts of climate change, the resilience of assets and supply chains in the face of, for example, changing weather patterns and rising sea levels should be considered as relevant. Companies also need to demonstrate consideration of the potential impact of changes in public policy and regulation around the transition to a low carbon economy.
- **Clear reference in the Annual Report and Accounts to, and use of, credible industry climate reporting metrics.** This should include reference to the Task Force on Climate-Related Financial Disclosures, SASB (Sustainability Accounting Standards Board) CDSB (Climate Disclosures Standards Board), or other established third party frameworks. Companies should provide explanations as to the rationale for their choice of framework and the extent to which, if at all, relevant metrics have been “blended” with others. *Please note:* smaller and medium sized companies should be allowed

¹⁹ We acknowledge that this understanding may change owing to developments in the available data as well as technological, regulatory and scientific developments.

some discretion and flexibility regarding their choice of framework and timescales.

- **References in disclosures mention the Paris Agreement and mention Net Zero.** Companies should disclose whether or not they have assessed whether their business model is compatible with global commitments to mitigate temperature increases and, where they do not feel this is currently the case, have outlined a process – complete with relevant timescales – under which they hope to achieve compatibility.

This should include a discussion of the metrics which the company has chosen to assess climate-related risks and opportunities in line with its strategy and risk management. These metrics could include Scope 1, 2 or (where relevant) Scope 3 greenhouse gas emissions.

- **Financial disclosures include transparency on the underlying assumptions used to calculate balance sheet valuations and earnings.**²⁰

Many key valuation and profit measures disclosed by companies depend on assumptions about future returns. Investors may wish to challenge the calculations and/or substitute alternative assumptions in their own financial analysis should there be concern that these may rely on the Paris Agreement not being delivered in practice. In order to be open to such discussion, companies should be transparent on the assumptions underlying their calculations.

- **A company's political donations and membership of trade associations are aligned with their stance on climate change.** Investors have become increasingly concerned about corporate support for organisations and individuals whose lobbying activities and objectives are considered to frustrate climate change mitigation. Such support may take the form of political donations, trade association membership, or the establishment of charitable or educational trusts that undertake lobbying against progressive climate legislation²¹.

55. Asset owners should describe, where appropriate, engagement activity with investee companies (including through appointed managers) to encourage better disclosure and practices related to climate-related risks to improve data availability and asset owners' ability to assess climate-related risks.

²⁰ A useful resource for trustees to consider is Principles for Responsible Investment initiative 'Accounting for Climate Change' <https://www.unpri.org/sustainability-issues/accounting-for-climate-change>

²¹ We encourage investors to consider the recommendations from the Institutional Investors Group on Climate Change (IIGCC) on *European Investor Expectations on Corporate Lobbying on Climate Change* (2018) which outlines what positive company engagement with public policymakers on the transition to an orderly transition to a low carbon economy might look like.

Stewardship Suggested trustee actions (and recommended disclosures)	Relevant legislation to consider	TCFD
<p>1. Consider, document and disclose the trustees' policy²² setting out the processes by which the trustees engage with investee companies (including but not limited to issuers of debt or equity, investment managers or another holder of debt or equity) on climate-related issues. Trustees should consider:</p> <ul style="list-style-type: none"> - the methods by which, and the circumstances under which, the trustees would monitor and engage with investee companies on climate-related issues; - their approach to exercising rights (including voting rights) attaching to the scheme's investments in relation to climate-related issues; - the extent to which responsibilities for stewardship are delegated by the trustees to third parties or sub-committees and/or individuals/organisations providing executive support to the trustees; - where trustees delegate stewardship activities to the scheme's asset managers, the processes by which the trustees familiarise themselves (and seek to influence) the manager's stewardship policies in relation to climate-related issues and how the trustees evaluate the alignment of the managers' stewardship policies with the trustees' climate-related investment beliefs and the scheme's investment strategy and objectives in relation to climate issues. 	<p>Regulation 2 – (Investment) Regulations 2005)</p> <p>Schedule 3 (para 30) – (Disclosure Regulations 2013)</p>	R(a)(iv)
<p>2. Disclose how, and the extent to which the trustees' engagement policy on climate-related issues has been followed during the year.²³ Trustees should consider:</p> <ul style="list-style-type: none"> - outcomes of any collaborative engagement/other engagement initiatives in which the trustees have taken part; - the voting behaviour by, and on behalf of, the trustees (including the most significant votes cast by the trustees or on their behalf) during the year; - use of the services of a proxy voting advisory service during the year. 	<p>Regulation 2 – “(Investment) Regulations 2005)”</p> <p>Schedule 3 (para 30) – “(Disclosure Regulations 2013)”</p>	
<u>Additional actions/disclosures for those seeking to demonstrate leadership</u>		
<p>3. Disclose the Stewardship Code signatory status of the scheme.</p>	n/a	n/a

²² This can be set out in the trustees' policy on stewardship required to be included in their Statement of Investment Principles, see regulation 2(3)(c) of the Occupational Pension Schemes (Investment) Regulations 2005

²³ This can be set out in the trustees' implementation statement prepared under regulation 12 of the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 in accordance with paragraphs 30(ca) or 30(f) (as applicable) of Schedule 3 to those regulations.

4. Additional points for defined benefit schemes

Key Considerations

- Trustees need to take an integrated risk management (IRM) approach to DB scheme funding and investment, looking at how climate-related risks around the employer covenant, funding, and investment strategy may be linked and inter-dependent.
- Scenario testing can help trustees and their covenant advisers assess risks to investments, funding and covenant arising from climate change.

4.1 Assessing the impact of climate-related risks on sponsor covenant

56. For DB schemes, the sponsor covenant is the extent of the employer's legal obligation and financial ability to support the scheme now and in the future. TPR has previously set out in guidance its view of how the sponsor covenant should be assessed.²⁴

57. As with any other risk, trustees need to consider risks from climate change on the sponsoring employer when assessing the strength of the current covenant.²⁵ Trustees should take independent external advice where they lack the objectivity or expertise required to perform an appropriate assessment.

58. All sponsoring employers will be exposed to climate-related risks and opportunities to some extent, although their nature and magnitude will vary considerably. Trustees of schemes with direct exposure to fossil fuels companies should be aware that their scheme will likely have above-average exposure to climate-related risks through the scheme's sponsor covenant. However, climate-related risks may be more difficult to identify where they are longer-term in nature or primarily arise through indirect routes such as supply chain exposure.

59. There are various routes through which climate-related risks can affect businesses, with both direct and indirect effects on their financial strength. For example:²⁶

²⁴ <https://www.thepensionsregulator.gov.uk/en/document-library/regulatory-guidance/assessing-and-monitoring-the-employer-covenant>

²⁵ See press release from the Employer Covenant Practitioners Association ("ECPA") (July 2019): "it's vital that DB covenant assessments consider potential implications of climate change on sponsors' businesses" <https://ecpa.org.uk/docs/20190717-news-climate.pdf>

²⁶ Examples taken from Institute and Faculty of Actuaries, Resource and Environment Issues for Pensions Actuaries: Supplementary Information on Resource and Environment Issues and their Implications for Sponsor Covenant Assessments - <https://www.actuaries.org.uk/system/files/field/document/Covenant%20report%20-%20July%202019%20updates.pdf>

- Cost and availability of inputs – due to interaction of supply and demand, possibly affected (positively or negatively) by government intervention.
- Valuation of company assets – e.g. fossil fuel reserves (stranded assets), high carbon infrastructure, buildings on flood plains.
- Legislative and regulatory change – mechanisms may be market-based (e.g. carbon taxes, emission trading schemes, renewable subsidies) or non-market-based (e.g. vehicle emission limits, bans on certain chemicals, water quality standards).
- Technological change and product evolution – e.g. rapid advances in renewable energy technology is reducing costs and threatening the cost-competitiveness of fossil fuels.
- Changes in customer demand and social norms – prompted by environmental concerns, either voluntarily, or in response to, or anticipation of, policy changes.
- Reputational damage – caused by failing to meet public expectations and/or legislative requirements.
- Shareholder sentiment – businesses that are seen as environmentally risky or inconsistent with a low carbon future may become unpopular with investors (e.g. high profile campaigns are encouraging divestment from fossil fuels).
- Business disruption – e.g. caused by damage to business premises, infrastructure or the transport network, affecting the business directly or its suppliers and customers.
- Fines and litigation risk – climate change is a new source of litigation risk as people affected by climate change, or organisations campaigning on their behalf, seek compensation.

60. As schemes rely on sponsor contributions for many years into the future, trustee assessments of their sponsor covenant should be forward-looking, taking account of the impact of potential medium and long-term climate scenarios on the employer business (considering both transition and physical risks) and the market in which it operates.

61. Trustees should consider their sponsor's business resilience in the face of future uncertainties. This might involve exploring the employer's risk management processes, including how it identifies emerging risks and factors them into long-term business planning. Where applicable, trustees may wish to consider the appropriateness of the sponsor providing information to the trustees (or their professional covenant assessors) in line with the TCFD recommended disclosures.

62. Emphasis should also be placed on qualitative information, including information about the employer values and culture in relation to climate issues and risk management.

63. Trustees may wish to consider raising the following questions with their sponsoring employer²⁷:

- What are the main climate-related risks faced by the business over the short, medium and long-term?
- How does the company identify, assess and mitigate these risks?
- What climate-related risks might affect business viability over the term of the scheme's recovery plan and long-term funding target?
- How does the company seek to achieve a resilient business model which is robust to a wide range of potential climate scenarios?

4.2 The role of the covenant adviser

64. In selecting a covenant advisor, trustees should ensure that the prospective adviser demonstrates an understanding of the issues and the possible impact that climate change could have on the sponsor. Ideally, they would also be able to demonstrate tools to incorporate these risks into their assessment of covenant, and suggestions for how risks might be mitigated.

65. Potential advisors should be able to demonstrate an ability to work with management teams to source and interpret information. As always in DB pensions, it is crucial that advisers are able to provide advice which can be integrated into a scheme's investment, funding, legal and administration advice.

66. Trustees of larger schemes should ensure that such skills and knowledge are held within their proposed delivery team and not drawn purely from 'specialists' who will not be part of core services.

4.3 Taking account of climate issues in DB funding

67. As for any area of risk, the funding implications of climate issues on DB schemes are affected by the covenant and investment implications and vice versa. For example, a scheme that is actively managing climate-related risks to its investments and has a sponsor with relatively low exposure to climate-related risks, may conclude that no adjustments are needed to the current financial assumptions.

68. Conversely, scheme actuaries may want to suggest a more prudent funding approach in schemes where mitigation of climate-related risks is not explicitly addressed in the trustees' investment strategy or where climate-related risks are a major source of covenant risk.

69. More broadly, scheme liabilities may be affected through wider financial and mortality assumptions:

- Actuaries use market yields when setting financial assumptions, and compare the resulting value of liabilities with a market value of assets. Where markets

²⁷ Taken from Institute and Faculty of Actuaries, Resource and Environment Issues: A Practical Guide for Defined Benefit Pensions Actuaries (April 2017) - <https://www.actuaries.org.uk/practice-areas/resource-and-environment/resource-and-environment-practice-area-practical-guides>

are not pricing climate-related risks correctly (or are underestimating the downside risks) this may have a knock-on effect on financial assumptions.

- Current mortality rate assumptions are affected by environmental factors such as cold winters and poor air quality, and these effects are reflected in the data used to construct base tables and initial rates of mortality improvement. Assumptions may, however, be impacted by climate-related issues. This may go wider than the direct effects of rising temperatures and more extreme weather events. Other factors may have an effect such as increasing energy prices and a resource-constrained economy. Conversely efforts to reduce air pollution and greenhouse gas emissions may improve health.²⁸ All of these effects are difficult to quantify, however and impacts may vary by age and location.

70. Given the uncertainty surrounding these effects, trustees may wish to consider asking their actuaries to illustrate a range of possible financial assumptions and mortality improvements in their advice, taking into account different potential climate scenarios.²⁹

71. Buy-out funding targets for schemes may also be affected as insurers start to price in climate impacts, although anecdotal evidence suggests that there has been little, if any, impact on annuity pricing to date.

DB covenant and funding Suggested trustee actions (and recommended disclosures)	Proposed requirements in the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations	TCFD
1. Identify, document (and disclose where applicable ³⁰) the extent to which (and how) the trustees factor climate-related risks and opportunities into their assessment of the sponsor covenant. Trustees may wish to consider: <ul style="list-style-type: none"> - the trustees' (or their covenant assessor's) processes for determining which climate-related risks and opportunities could have a material impact on the sponsor's covenant including how materiality determinations are made; - what the trustees (or their covenant assessors) consider to be the relevant short-, medium-, and long-term horizons and the climate- 	Schedule Part 1 – Paras 1, 3, 4, 6, 10, 11, 12, 13 Schedule Part 2 – 21 (a), (d), (e), (g), (h), (i), (k), (l), (m)	G(a)(ii) S(a) S(c)(i) R(a)(iii) R(b)(ii) R(c)(i)

²⁸ For further examples see Resource and Environment Issues for Pension Actuaries: Implications for Setting Mortality Assumptions (October 2017) -

<https://www.actuaries.org.uk/system/files/field/document/Mortality%20report%20-%20July%202019%20updates%20%28final%29.pdf>

²⁹ An IFoA risk alert, dated May 2017, states that “Actuaries should ensure that they understand, and are clear in communicating, the extent to which they have taken account of climate-related risks in any relevant decisions, calculations or advice” - <https://www.actuaries.org.uk/documents/risk-alert-climate-related-risks>

³⁰ It is recognised that some information which trustees rely upon in forming a view of the scheme sponsor's covenant may be confidential and or market-sensitive and that accordingly, disclosures may be limited to a description of the trustee processes rather than providing substantive information in relation to the sponsor.

<p>related issues for each time horizon that could have a material impact on the sponsor - whether transition or physical risk; and</p> <ul style="list-style-type: none"> - the resilience of the scheme's sponsor, taking into consideration different climate-related scenarios, including a 2°C or lower scenario and how this informs the design of strategies. 		
<p>2. Identify, document and disclose how climate-related risks are included in the actuary's assessment of the scheme's liabilities. Trustees may wish to consider the extent to which:</p> <ul style="list-style-type: none"> - changes to longevity / mortality assumptions and asset performance assumptions are made to take account of climate issues; - margins for prudence are included to allow for mitigation of climate-related risks not explicitly addressed in the trustees' investment strategy or climate-related risks in relation to the sponsor covenant; and - a different approach is adopted in assessing technical provisions and long-term funding targets. 	<p>Schedule Part 1 – Paras 5, 12 Schedule Part 2 – 21 (f), (l)</p>	<p>S(b)(ii) R(b)(i)</p>

5. Method of reporting and member communication

Key Considerations

- Trustees should seek to inform members of actions taken to manage climate-related risks and opportunities across their portfolios.
- Trustees should consider how best to provide a compelling, accessible narrative which not only demonstrates to members that the trustees are appropriately managing climate-related issues.

5.1 Disclosure

72. Preparing for public reporting in line with the TCFD recommendations may help trustees meet other existing and forthcoming regulatory disclosure requirements around climate change.

73. Subject to consultation and Parliamentary approval, Government regulations will come into force from 1 October 2021. Trustees can consider the following approaches to publishing TCFD-aligned disclosures based on whether or not they are in scope of the requirements:

Starting out (not in scope of 2021 legal duties)	<ul style="list-style-type: none"> • Publish a standalone TCFD report, potentially in summary form. • Incorporate the report into the Annual Report, or Chair’s statement/ implementation statement (for defined contribution schemes required to produce one).
Good Practice (legal minimum for schemes in scope)	<ul style="list-style-type: none"> • Publish a TCFD report on a publicly available website and make it accessible free of charge • Reference the report from the scheme’s Annual Report • Tell members via the annual benefit statement (and the annual funding statement for DB schemes) that the information has been published and where they can locate it.
Best Practice	<ul style="list-style-type: none"> • Publish a TCFD report on a publicly available website and make it accessible free of charge • Reference the report from the scheme’s Annual Report • Tell members via the annual benefit statement (and the annual funding statement for DB schemes) that the information has been published and where they can locate it. • Incorporate TCFD-aligned disclosures into one or more other forms of member communication (such as member newsletters or a responsible investment report).

74. Regardless of which of the above approaches are used for disclosure, the TCFD recommends that climate-related financial disclosures should be subject to appropriate governance processes “that are the same or substantially similar to those used for financial reporting.”³¹

75. The TCFD offers further guidance on how to make the 11 recommended disclosures, noting that “When used by organisations in preparing their climate-related financial disclosures, these principles can help achieve high-quality and decision-useful disclosures that enable users to understand the impact of climate change on their organisations”. Trustees should consider the following principles when deciding upon and reviewing their climate-related financial disclosures:

³¹ TCFD Final Report. Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017), p.18. - <https://www.fsb-tcf.org/publications/>

Principles for Effective Disclosures³²

1	Disclosures should present relevant information specific to the potential impact of climate-related risks and opportunities on the scheme avoiding generic or boilerplate disclosures that do not add value to members' understanding of issues.
2	Disclosures should be specific and sufficiently complete to provide a thorough overview of the scheme's exposure to potential climate-related impacts and the trustees' governance, strategy and processes for managing climate-related risks and opportunities.
3	Disclosures should be clear and understandable showing an appropriate balance between qualitative and quantitative information.
4	Disclosures should be consistent over time to enable scheme members to understand the development and/or evolution of the impact of climate-related issues on the scheme.
5	Disclosures should ideally be comparable with other pension funds of a similar size and type.
6	Disclosures should be reliable, verifiable and objective.
7	Disclosures should be provided on a timely basis. The TCFD recommends annual disclosures for organisations. However, pension funds starting out may consider triennial disclosures.

Auditing

76. The reasonable level of assurance provided by the auditors in their audit report relates only to the financial statements included with a company's Annual report, not to the Annual report as a whole. With limited exception³³ the auditor does not, in their audit of the financial statements, provide an assurance opinion on the 'Other Information'³⁴ included in the Annual Report.

77. Therefore, trustees do not need to secure additional auditors assurance as a result of including the disclosures in the Annual Report. However, Trustees may still wish to ask to have their TCFD reports audited to provide further confidence that they are both accurate and complete.

5.2 Member communication

78. Communicating clearly with members on how climate-related risks and opportunities are being managed can also help build trust and public confidence, especially as members' interest in climate change continues to escalate. The UK

³² Adapted from the TCFD Final Report, Annex: Implementing the Recommendations of the TCFD (June 2017) Part F - <https://www.fsb-tcfid.org/publications/final-implementing-tcfid-recommendations/>

³³ Certain elements of a quoted companies' director's remuneration report are subject to audit.

³⁴ ISA (UK) 720 (Revised November 2019) Paragraph 12(c)

Stewardship Code also requires signatories to communicate the activities and outcomes of their stewardship and investment (see chapter 3).

79. In addition to public reporting, trustees can consider including more tailored member communication on climate change in the following:

- Regular newsletters.
- Online content including social media.
- Member events and representative programs.

80. Trustees interested in improving their member communications on important topics like climate change are encouraged to read ShareAction’s report, “Pensions for the Next Generation: Communicating What Matters”.³⁵ Trustees should also read PLSA’s “Implementation Statement Guidance for Trustees”³⁶ which includes a specific chapter on how to produce clear, effective and meaningful disclosures on voting behaviour in the Implementation Statement.

Review process, monitoring and reporting	Proposed requirements in draft regulations	TCFD
Suggested trustee actions (and recommended disclosures)		
1. Consider the communication routes used to provide assurance to beneficiaries and other stakeholders on climate-related activity and whether disclosure to members adheres to the UK regulatory requirements, TCFD recommended disclosures and underpinning principles for effective disclosure.	Schedule Part 2 para 21 - Climate Change Governance and Reporting Regulations Regulation 4 – Miscellaneous Provisions and Amendment Regulations	n/a
<u>Additional actions/disclosures for those seeking to demonstrate leadership</u>		
2. Provide an overview of the climate related queries or communications from beneficiaries and other stakeholders	n/a	n/a

³⁵ ShareAction, Pensions for the Next Generation: Communicating What Matters (March 2018) - <https://shareaction.org/resources/pensions-for-the-next-generation-communicating-what-matters/>

³⁶ PLSA, Implementation Statement Guidance for Trustees (July 2020) - www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2020/PLSA-Implementation-Statement-guidance-for-trustees-July2020.pdf

Appendix 1 - Enquiries to make of asset managers

Trustees should be careful to ensure that the products and services they buy are genuinely managing climate risk. They need to be able to identify and avoid greenwash.

As with any other investment or governance issues, they should not be afraid to dig deeper, keep asking questions and challenge what they hear. They should also be willing to move the discussion onto their own territory. How do the managers' strategies and outcomes reflect the trustees' own investment beliefs, stewardship and investment policies? Rather than allow fund managers to pick their own case studies, what engagement and voting do they carry out in relation to the firms chosen by the trustees.

In line with their fiduciary duty, trustees should rigorously assess the capabilities and approach to climate management of new and existing managers. Below we have included a 'Top 10' list of questions to prioritise when assessing asset managers, and a list of further questions structured in line with the TCFD recommendations.

Top 10

1. Has the manager produced a TCFD report which outlines their governance of climate related issues? (Governance)
2. Will the manager share climate-related scenario analysis undertaken as part of their investment process? (Strategy)
3. Do they support shareholder resolutions on climate change - if so, how many, which ones, and what was the rationale for their decision? (Strategy)
4. Are they transparent regarding all their voting activity? (Strategy)
5. What is the manager's escalation policy when engagement is unsuccessful? Can they give an example of when they have escalated, how they did so, their rationale for doing so, and the outcome? (Strategy)
6. Does the manager support and/or play a leading role progressive public policy initiatives on climate change, e.g. decarbonisation of transport, agriculture? (Strategy)
7. How does the manager undertake top-down research and analysis related to climate-related risks? (Risk Management)
8. Does the manager demonstrate that the implications of climate-related risks are considered across different asset classes and investment strategies? (Risk Management)
9. Do they know, and disclose, the exposure to fossil fuel assets? (Risk Management)

10. Does the manager commit to providing trustees with appropriate (and fund specific) climate metric data required to permit the trustees to meet their own disclosure obligations? (Metrics and Targets)

Additional questions

Governance

11. If not, is there clear evidence that governance structures and responsibilities are in place/have been updated to ensure appropriate oversight of climate-related risks and opportunities?
12. Does the manager report climate change data annually?

Strategy

Integration into the investment process:

13. Does the manager integrate climate-related risks into their investment process i.e. valuation and construction process?
14. How does the manager perform in league tables that compare managers' approach to climate change (e.g. <https://aodproject.net/managers/>)
15. Is the manager a signatory to the Stewardship Code?
16. Is the manager a PRI signatory? Does their PRI Reporting include voluntary information, as well as mandatory information? Do they provide private transparency reports on request?

Engagement and voting:

17. Are your rights to hold companies to account exercised?
18. How does the manager vote per region?
19. How often do they vote against company resolutions?
20. In what circumstances – and how often – do they vote against (re)appointments of chairs on climate grounds?
21. Do they propose their own shareholder resolutions?
22. Does the manager have custom voting policies?
23. Is their voting materially different from large proxy voting providers?
24. How do they manage internal conflicts of interest?³⁷
25. Who internally decides on the way in which the asset manager votes?
26. Does the manager abstain from voting?

³⁷ This is a reference to *stewardship* conflicts which is different to firm-level conflicts. Annex 5 of PLSA's 'Vote Reporting Template for Asset Owners' provides further background on conflict - identification <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2020/IS-Asset-Owners-template.pdf>

27. Do your managers speak for your beneficiaries?
28. Is the manager a member of and actively involved in key selected climate-related initiatives (such as PRI, CDP, CA 100+)? - If the manager is a PRI member – How have they decided where and on what to lead? Does their PRI Reporting include voluntary information, as well as mandatory information? Do they provide private transparency reports on request?
29. Does the manager have examples and successes from leading collective engagement?

Client education

30. Does the manager seek to understand client needs and views on climate?
31. Are managers able to demonstrate how they are helping their clients, and ultimate beneficiaries, to act on climate change?
32. How does the manager inform their clients about the future risks and opportunities that are not fully recognised by the market?
33. How does the manager communicate the impact they have had to their clients?
34. Is the reporting detailed, standardised, and cover the whole of the portfolio?
35. Are they articulating the 'value add' of their engagement on climate change?
36. Can the manager share worked examples of the impact they have had?

Public policy

37. Does the manager challenge companies that fund anti-climate lobbying through affiliates and trade associations?
38. Does the manager push for better standards in regulation, listing rules and other oversight?
39. Does the manager collaborate with others to promote continued improvement of the financial markets?

Product development

40. Does the manager have a comprehensive low-carbon offering across asset classes? Do they offer a bespoke service for clients?
41. Is the manager's approach to product development and low-carbon offerings aligned with its broader climate strategy/approach?

Risk Management

Macro-economic and thematic research

42. Does the manager demonstrate that this feeds into considerations of sector analysis and asset allocation?
43. Has the manager estimated the potential risk of assets becoming stranded in a 2°C climate scenario? If not, are they willing to undertake this exercise?

44. Is climate-related risk considered in the assessment of sovereigns?

Micro-economic/company research

45. Does the manager demonstrate how top-down and bottom-up analysis of climate-related risks are integrated into investment decision-making, including fundamental analysis (active) and index strategies (passive)?

46. Does the manager measure the carbon footprint, including reserves, of its portfolios? Have they clearly reported this on an annual basis?

47. Has the manager considered the risks of physical impacts of climate change on the portfolio?

ESG engagement for all clients and markets

48. Is the manager able to demonstrate how engagement activities are linked up to the consideration of climate-related risks within investment analysis/portfolios?

49. Is the asset manager able to demonstrate engagement in assets other than listed equity?

50. Are there any other activities or initiatives that the manager is involved in to mitigate the risk of climate change?

Appendix 2 - Guide for assessing climate competency of Investment Consultants

The guide sets out five themes against which trustees should expect their Investment Consultants to demonstrate their climate competency. Examples of positive and best practice indicators are included against each theme to help judge competency. The indicators are deliberately stretching with the aim of raising investment consultants' standards and it should be acknowledged that some of these indicators will be aspirational.

As with assessing asset managers, trustees should ask their Investment Consultants for evidence of action to support their reported competencies. Trustees should test the depth of application and integration of these climate competencies in the services they receive from their Investment Consultants. This guide is not exhaustive.

This guide has been prepared by the Investment Consultants Sustainability Working Group (ICSWG), with helpful input from independent parties including ShareAction, The Pensions Regulator and the UN PRI. The ICSWG is a collaboration between 17 firms formed in 2020 taking action to support and accelerate sustainable investment initiatives in the UK. The ICSWG members are:

Aon	Cambridge	LCP	Momentum	SEI
Barnett	Associates	Mercer	Redington	Willis Towers
Waddingham	Cardano	MJ Hudson	River and	Watson
bfinance	Hymans	Allenbridge	Mercantile	XPS Investment
Buck	Robertson			

ISIO

Competency theme	Positive indicators	Best practice indicators
<p>Firmwide climate expertise and commitment</p>	<ul style="list-style-type: none"> ▪ Clear governance structure and responsibilities stated to ensure appropriate oversight of climate-related factors into client services ▪ Assigned senior leader (partners / board member) responsibility for the oversight of climate-related issues ▪ Firm-wide strategic response to manage climate-related risks and opportunities and steward an orderly transition <u>which is publicly available</u> (for example, in line with the recommendations of the Taskforce on Climate-related Financial Disclosures) ▪ Specialists with depth of climate expertise ▪ UN PRI signatory ▪ Signatory to the UK Stewardship Code 2020 (from mid-2021) ▪ Conflicts policy which addresses potential conflicts related to advice on climate as a result of differences between the investment consultant's commercial interests and the trustees' climate objectives, or business relationships between the investment consultants and the asset managers or trustees 	<ul style="list-style-type: none"> ▪ Performance assessment of the investment consulting firm's consultants and senior leaders is aligned with helping clients achieve their climate-related objectives ▪ Signatory of (or affiliated to) other climate related initiatives ▪ Produce climate risk management thought pieces ▪ Inclusion of climate-related issues in regular client communications ▪ Demonstrate an awareness of climate justice, including a just transition
<p>Individual consultant climate expertise</p>	<ul style="list-style-type: none"> ▪ All investment consultant colleagues receive regular and appropriate climate-specific training by both internal and external experts ▪ Seek to understand client needs and views on climate change, and where relevant educate clients on climate-related risks to their investments ▪ Able to identify and assess climate-related risks and opportunities ▪ A working understanding of how to apply and disclose against the recommendations of the Taskforce on Climate-related Financial Disclosures 	<p>Demonstrable record of helping clients:</p> <ul style="list-style-type: none"> ▪ develop climate related beliefs and understanding of key issues ▪ shape voting policy to include explicit guidance on climate-related voting, including policies on shareholder proposals, and influencing asset managers to accept these. ▪ develop climate-related targets (such as Paris alignment, decarbonisation and other targets) in line with recommendations of the Taskforce on Climate-related Financial Disclosures. ▪ develop climate-related policy frameworks

Competency theme	Positive indicators	Best practice indicators
		<ul style="list-style-type: none"> ▪ integrate climate-related considerations across all asset classes ▪ shape their investment strategy, incorporating climate-related risks, pricing opportunities and climate-related impacts ▪ with practical recommendations to reduce their climate-related risk exposure and/or develop strategies to steward an orderly transition to a net zero and resilient economy ▪ with guidance on climate-related reporting ▪ fully integrate climate considerations into manager selection and monitoring ▪ keep abreast of and meet regulatory expectations
Tools and software	<ul style="list-style-type: none"> ▪ Have a database of climate metrics for investments covering for example: <ul style="list-style-type: none"> ○ Carbon intensity ○ Carbon emissions ○ Alignment with goals of the 2015 Paris climate agreement and implied temperature rise ○ Climate Value at Risk ○ Exposure to ‘green’ revenues ▪ Help clients monitor climate-related metrics ▪ Use freely available tools such as PACTA or PRA stress test data to help clients assess climate risk ▪ Help clients set and monitor appropriate climate-related targets 	<ul style="list-style-type: none"> ▪ Capability to conduct scenario analysis for assets, liabilities and sponsor covenant to help clients understand how climate change might affect investment returns and value at risk over the short, medium and long-term. ▪ Consideration of an orderly transition, disorderly transition and failed transition scenario with their associated direct transition and physical risks as well as systemic risks that could arise ▪ Where relevant, help clients consider real world impacts on climate change of their investment choices
Thought leadership and policy advocacy	<ul style="list-style-type: none"> ▪ Encourage better standards of corporate governance of climate-related risks, for example through positive contributions to public consultations on guidance and regulation of climate-related risks ▪ Supportive of public policy initiatives on climate change 	<ul style="list-style-type: none"> ▪ Engage with regulators on latest climate-related policies ▪ Engage with the developers of climate reference scenarios ▪ Contribute meaningfully to system decarbonisation and achieving the goals of 2015 Paris climate agreement

Competency theme	Positive indicators	Best practice indicators
	<ul style="list-style-type: none"> ▪ Collaboration as part of climate industry groups 	<ul style="list-style-type: none"> ▪ Active monitoring of related developments, for example, nature-related financial risks such as biodiversity loss
<p>Assessment of investment managers and engagement with them</p>	<ul style="list-style-type: none"> ▪ Engage with investment managers about their climate practices (eg integration into investment decisions, voting and engagement) ▪ Climate change is integrated into manager research and a topic of discussion at research meetings ▪ Provide assessment of investment managers' firmwide approaches to climate change risk management, including through both asset allocation and stewardship 	<ul style="list-style-type: none"> ▪ Provide assessment of investment managers' fund specific approaches to climate change risk management ▪ Disclose details of methodologies and framework for assessing investment managers' approaches to managing climate-related risks and opportunities ▪ Investment managers' approaches to managing climate-related risks and opportunities feed into the consultant's ratings of investment managers ▪ Prepared to exclude fund recommendations on sustainability criteria ▪ Encourage improvement in investment managers' climate competencies including on stewardship, and set expectations on best practice ▪ Encourage investment managers to become signatories to the UK Stewardship Code 2020