One year on – TCFD reporting for pension funds

IMPACT LENS

PENSIONS FOR PURPOSE

REDINGTON

Contents

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1 Executive summary

Executive summary

This Impact Lens research paper shares insights on how pension funds use the output from their **Task Force on Climate-related Financial Disclosures** (TCFD) reports, what challenges they face and which metrics they favour.

GOVERNANCE

- Pension funds gather data for their report from three main sources:
  - Low-cost solution – *ask your investment manager.*
  - Data integrity option – *ask a data specialist (for example, Trucost or MSCI).*
  - Data with interpretation – *ask your investment consultant.*

Insight: most funds are using their investment consultant.

STRATEGY

Investment strategy

- Concern from funds about using TCFD report output to influence their investment strategy because:
  - Data is still unreliable,
  - Reporting is still in its infancy – need trend data.
  - Does the fund want to green the world or the fund?

Insight: most funds are not yet using their reports to inform and drive strategy.

Carbon offsets

- Only a minority of pension funds mentioned offsets in their reports, with only one accounting for it.
- The credibility of carbon offsets was questioned.

Insight: most funds are not yet including carbon offsets in their TCFD reports.

Scenario analysis

- A valuable tool but some scepticism - main use was to identify biggest risks.
- 75% of funds interviewed referenced liabilities in their scenario analyses.
- Questions over the validity of assumptions.

Insight: most funds see scenario analysis as useful but with a limited application at present.

RISK MANAGEMENT

Material risks

- Several funds mentioned concerns about the materiality of risks.
- Time spent analysing climate risk was disproportionate to mitigation efforts.

Insight: TCFD reporting fails if it becomes overly complicated.

Estimations or omissions

- Mixed views about whether it is better to estimate or omit data.
- Disagreement over whether to use scope 1, 2 and 3.
- Embarking on the journey, even if imperfect, is valuable.

Insight: data quality remains a key challenge for pension funds.

Assurance

- Most schemes felt data was too inadequate to warrant independent assurance.
- A focus on data assurance of the provider may be necessary, however.

Insight: independent assurance is needed but unsuitable today given data limitations.

METRICS AND TARGETS

Metrics

- Data lacks consistency.
- Conflicted views on scope 3.
- Concern over unintended results.

Insight: climate data remains a challenge for pension funds.

Science-based targets versus implied temperature rise

- **Science-based targets (SBTs) – positives**
  - Focuses on the medium- and long-term outcomes.
  - Validation by climate experts reassuring.
  - Less time consuming to calculate. Climate data remains a challenge for pension funds.

- **Science-based targets (SBTs) – negatives**
  - Speed of data dependent on SBTi's resources.

- **Implied temperature rise (ITR) – positives**
  - Allows for investment in opportunities as well as mitigation.
  - Engaging and accessible for members.

- **Implied temperature rise (ITR) – negatives**
  - No standardisation in methodology.
  - More difficult to compare between pension funds.

MEMBER ENGAGEMENT

- Mixed views.
- Some funds add a more accessible summary to the first two to three pages of their report to make it more member friendly.
- Unsure if members are downloading the report.
- Most funds use other forms of outreach; for example, taking output from the report and sending emails to fund members.

Insight: few funds use TCFD reports to improve their member engagement.

2 Overview

Overview

Overview of the research

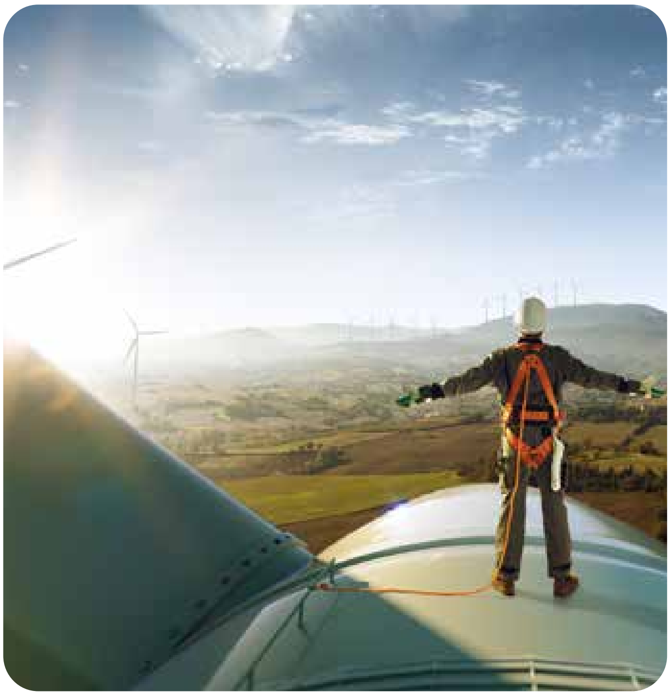
Pension funds are at the vanguard in tackling the complexity and nuance of the newly imposed TCFD regulations. This white paper shows there is ambiguity around pension funds' views on how reports should be compiled. We are not necessarily highlighting what Pensions for Purpose believes is best practice but will provide our insights and perspectives, alongside Redington's, throughout the paper.

This research was conducted to provide insights for pension funds yet to undertake TCFD reporting, as well as allowing funds who are already statutorily reporting to compare their approach with other funds.

The themes shared in the report were drawn from interviews with mixed stakeholders from corporate pension funds, both defined benefit (DB) and defined contribution (DC), Local Government Pension Schemes (LGPS), investment consultants and asset managers, as well as findings from a Pensions for Purpose Paris Alignment Forum all-stakeholder event in Q4 2022.

The quantitative data presented in our report was drawn from an analysis of published TCFD reports and aims to understand how schemes approach the reporting regulations.

A list of contributors to the research has been provided in Appendix 3 of this report.



The report's research themes correspond to the headings used in the TCFD regulations: Governance, Strategy, Risk Management, and Metrics and Targets.

Finally, we are grateful to our sponsor, Redington, for their support in delivering this research and for their expert input into the findings.

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3 Governance

Governance

Training

Many funds emphasised the importance of educating and training the board. One trustee interviewed mentioned that the regulations encourage trustees to understand what their service providers are discussing. As this topic is quite technical, training is required which investment consultants may be best placed to deliver.

Who to approach for help with data collection and interpretation

Insight: most funds are using their investment consultant.

Pension funds are using three routes to pull together and interpret the data for their TCFD reports:

- The low-cost solution - one public sector DC fund, for example, said they went to their asset managers for most of the data required for their report. They recommended other funds do the same. Given asset managers should be carrying out this work, anyway, leveraging their help is a cost-efficient solution. This fund then pulled the data together and interpreted it in-house. It was mentioned, however, that this was resource-intensive for the pensions team.

- The data-integrity option - other pension funds said they went straight to the source data providers, for example MSCI or Trucost. This solution has the benefit of allowing the pension fund to compare standardised results across different managers and to access the data provider's estimated data where this was not available for underlying investments.

The efficacy of estimated data is referred to in the 'Risk Management' section, on page 15.

- The data-interpretation option - the majority of pension funds interviewed were using their investment consultants to gather data for their TCFD reports. Larger funds tended to use the consultant to pull together data from different asset classes and data sources, and to present the information in a consistent format. Smaller funds additionally used the consultant to help them interpret the data. 75% of the funds interviewed used an investment consultant to prepare their TCFD report.

HOW REDINGTON TRAIN TRUSTEES

In our experience well-trained trustee boards are more empowered to make meaningful decisions, can focus on what matters and move through the TCFD process at pace. What we have found works best in training our clients on climate change and TCFD reporting is to start early, to do little but often, and to remain adaptable to a changing narrative. The understanding of climate change in an investment context is developing rapidly. Everything we know about methodologies and approaches now might change very quickly and so learning material can rapidly become outdated. Using materials from multiple sources such as industry initiatives, academics and NGOs helps to keep trustees up to date on important developments.

Recognising the governance strain TCFD puts on trustee boards, we use a combination of methods for delivering training – apart from the usual in-person interactive meetings we like to deliver pre-reading materials, pre-recorded videos for Trustees to watch at their leisure, and a curated weekly newsletter outlining key developments in the sustainable investing world to keep them well informed.

> “While it may be cheaper to get data from providers, it is about helping funds to frame and put their data into context as well as how to move forward.”

INVESTMENT CONSULTANT

> “We outsource to our consultant because they are the only ones that can do it and put it into context.”

PENSION FUND REPRESENTATIVE

One pension fund pointed out it may be difficult to get consistent and comparable results, where the company had both a DB and a DC scheme, each using a different consultant with a different model, because this led to inconsistent output. In this case, it was important to get the two consultancy firms to discuss their approaches from the outset.

We have also been made aware of data licensing challenges with funds publishing data. Some data providers charge extra fees for publishing any data which has already been provided to management. This is clearly an issue in the case of statutory TCFD reporting which are public documents.

PENSIONS FOR PURPOSE’S PERSPECTIVE

- Agree in advance whether this is something you wish to do.
- Look at reports by others to see what works well.

Fiduciary duty

Insight: concern around fiduciary duty remains with differing opinions. Clarity from government on this would be beneficial.

Climate change has raised questions about fiduciary duty. Some argue that risk-adjusted returns should be the primary focus of trustees, but others argue there are wider questions about what the state of the world will be in 40 years’ time that need to be addressed by trustees. This, of course, is a much stronger argument for DC schemes whose younger members will see the full effects of climate change in their pension funds at retirement. Despite this, the statutory requirement to report on climate risk as investment risk within the TCFD regulations has answered some of these questions.

Speaking at Pensions for Purpose’s all-stakeholder discussion on TCFD reporting in November 2022, keynote speaker Jeremy Hughes, from the Local Government Pensions Scheme Advisory Board, felt it would be beneficial to have more guidance from the government on the contours of fiduciary duty for the LGPS.

4 Strategy

Strategy

How are the findings from the report influencing investment strategy?

Insight: most funds are not yet using their reports to inform and drive strategy.

Some pension funds are seeing TCFD as an opportunity to integrate climate risk and decarbonisation more efficiently into their investment strategy. For example, scenario analysis has helped one fund calculate a series of metrics at both the stock and portfolio level. This allows them to identify and highlight high-risk assets. Another fund mentioned that their scenario models helped validate any recommendations to the board and investment committee, for example to transition away from equities to renewable infrastructure. In this way, TCFD reporting is the disclosure at the end of the process of climate integration.

Pension funds that had already integrated climate risk and decarbonisation into their investment strategy, however, have seen TCFD reporting as a compliance obligation, rather than helping them with their climate approach. Some larger DB schemes also noted they are less affected by climate risk because of their shorter timelines, as their schemes are closed to new members.

The original motive for introducing the regulation was most likely to influence investment behaviour but we have identified three reasons why many schemes do not yet see it in this way:

- **Data reliability**
  Without reliable data, the fruits of this work will remain on the tree. If funds are unable to rely on the accuracy of emissions data, they are less willing to take action with companies identified as climate laggards.

> “We’re uncomfortable setting emissions targets until the data is higher quality.”
>
> CORPORATE PENSION FUND

Over time, however, data quality should improve as measurement and disclosure from all sides gets better. *Data issues will be referred to more thoroughly in the 'Metrics and Targets' section, on page 18.*

- **TCFD reporting is still in its infancy**
  This means schemes can't see data trends from previous years. Although initially these tendencies may be unreliable due to changes in data quality, trend data may be important in the medium to long term to show how investments are progressing along a transition pathway. This will identify hotspots for engagement and, in the case of recidivism, potential divestment.

- **Greening the world not the fund**
  The stakeholders we interviewed felt the regulations are not always addressing the pension fund’s wider role in the global low-carbon transition. Several interviewees felt the rules placed too much emphasis on positioning the fund and not enough focus on company climate transition plans. For pension funds to have an impact on global warming, they need to influence the companies they engage with to encourage action on reducing emissions. However, if the pension fund is only measuring carbon emissions at the total portfolio level, or at the asset class level, this does not give them the information they need to bring about real change.

> “Equity investments don’t produce carbon, companies do.”
>
> CORPORATE PENSION FUND

Despite this, data quality and coverage are likely to improve over time and pension funds, especially those who have set themselves goals to improve data quality, will help to drive this. Hopefully, in the medium to long run, TCFD can help funds spot further opportunities for engagement. It is possible to position a pension fund as net zero aligned within the TCFD reporting recommendations simply by selling off a few high-emitting assets but – as many schemes have noted – the world needs greening, not the pension fund.

> "How you get to net zero is as important as getting there."
>
> CORPORATE PENSION FUND

PENSIONS FOR PURPOSE'S PERSPECTIVE

- Plan ahead – how much trend data will you need and how will you ensure improvements in data quality?.
- Be clear what you are trying to achieve – greening the fund or the world?

Climate opportunities – emissions offset and avoided

Insight: most funds are not yet including carbon offsets in their TCFD reports.

A minority of pensions funds in our research have written about the treatment of emissions offsets in their TCFD reports, with one interviewee going further and accounting for emissions and carbon avoided. With questions raised about the utility of carbon offsets on the route to global net zero, we asked these funds about their approaches to offsets and avoided emissions.

The schemes noted that the credibility of carbon offsets has been called into question. However, one pension fund interviewed had already incorporated offsets into their carbon accounting process. They saw this as a positive and something they should do for their forestry assets, for as long as they hold them.

Other schemes are hesitant to introduce offsets, as they believe they should focus efforts on emissions reduction.

PENSIONS FOR PURPOSE'S PERSPECTIVE

- Carbon offsetting may be necessary as pension funds move further along their climate action path – think about how you will reach your goal by reducing emissions first.
- Prepare to potentially use carbon offsets by understanding how they work, how they can be used in a pension fund and how they can be sold.
- We expect the carbon offset market to improve over time – but pension funds can help shape this.

> "Offsets may be necessary but more at the tail end of meeting net zero. There's a lot more low-hanging fruit to capture first."
>
> CORPORATE PENSION FUND

One scheme included their renewables' investments in their carbon accounts because they felt it was valuable information. However, they did not think avoided carbon emissions should be included in carbon accounting in order to reach net zero.

In such cases, pension schemes could have a separate section referring to their investment in climate solutions. There are ways to convey a commitment to investing in renewables, for example, within a TCFD report, that don't involve emission statistics.

Scenario analysis

Insight: most funds see scenario analysis as useful but with a limited application at present.

It is important to bear in mind that scenario analysis is a range of possible outcomes, not a forecast, and an analysis on how the fund would be impacted from a risk, return and liquidity standpoint.

It was noted that scenario analysis is a valuable way to help funds identify risk. However, there was scepticism about whether this could be condensed into a single number. Creating a narrative around the biggest risks in the portfolio can provide pension funds with insights into what needs to change first.

A good way to identify material risks is to create a heat map of the pension fund's portfolio. Pinpointing the managers and asset classes that need attention is where the value lies in scenario modelling, according to interviewees. As mentioned previously, one fund representative used scenario modelling to recommend to the board and investment committee a move away from equities towards renewable infrastructure.

> "It should be that scenario analysis is built to guide investment strategy and the rest of the information in the TCFD report is disclosure."
>
> CORPORATE PENSION FUND

Despite the strategic utility of scenario analysis in identifying the highest risk areas in a pension fund's portfolio, it also recognised that modelling at the asset class level was unhelpful for engaging with underlying investments. Asset class modelling may be the most useful area for identifying risk and, as a result, informing investment strategy. However, for impact and to meet emissions targets, it is more useful to identify specific underlying climate laggards. It was also mentioned that standardisation of methodologies is needed for scenario modelling.

At Pensions for Purpose's Paris-Alignment Forum discussion on TCFD reporting, in November 2022, Brendan Walshe from The Pensions Regulator (TPR) observed that some of the scenario models do not make sense in the real world.

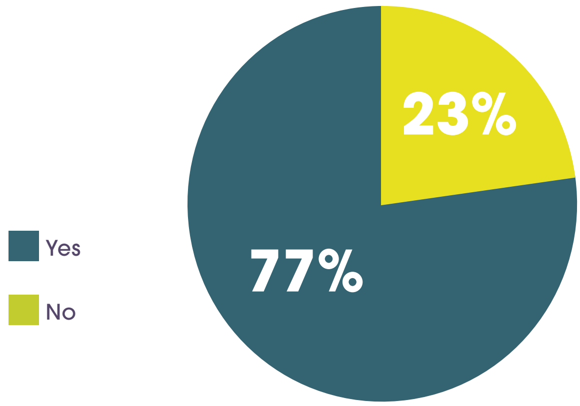
> "When you get the results from your scenario analysis, think about what they actually mean in practice. There's one scenario, in particular, for a four-degree warmer world, in which the outcome is portrayed as 'business as usual' with a slight reduction in expected returns which doesn't seem plausible. A four degree-warmer world is not 'business as usual'. You'd have resource wars, mass migration, mass dislocation so to think that may take 10 to 20 basis points off the expected returns doesn't seem right."
>
> BRENDAN WALSHE, TPR

Brendan Walshe also warned that the number of potential warming scenarios is narrowing with time, as the world continues to fall behind on decarbonisation.

It is important to recognise climate change could significantly affect mortality causing consequences for DB schemes' liabilities and their total funding levels. The reporting requires funds to build up their scenario analysis sequentially to understand investment, liability and covenant to come to a holistic understanding of what these signs are pointing towards.

Figure 1 shows how many schemes have referenced liabilities in their scenario analysis.

Figure 1 | Number of schemes that have referenced liabilities



PENSIONS FOR PURPOSE'S PERSPECTIVE

- Understanding scenario analysis may require training and time.
- Pension funds should think about how they plan to use the output to inform strategy.

REDINGTON'S THOUGHTS ON SCENARIO ANALYSIS

Performing climate scenario analysis is required in the TCFD process but this is the area where methodologies are still in their infancy. A lot of work has been done on climate shocks and investment stress tests but not nearly as much on how they interlink. As a result, the industry's ability to translate climate pathways into investment analysis is still underdeveloped. Furthermore, methodologies are not standardised and continue to evolve.

While this can be viewed as a positive to avoid group think, trustees need to understand limitations of the stresses to truly interrogate what is going on. Depending on the modelling, the quantitative results may look underwhelming. We've found it helps to focus on understanding the narratives of the scenarios alongside the practical implications.

Scenario analysis sits within the strategy element of TCFD for a reason – the point is to help identify how climate change may impact a scheme's strategy – and yet current practices are not doing a great job at being decision useful. Integrating outputs from scenario analysis when changing an SAA can help identify ways of mitigating climate risk strategically.

However, long-term forecasts showing small reductions in future expected returns regardless of temperature trajectories are unlikely to push trustees and investment committees to act. We've recently updated our scenario modelling based on the Network for Greening the Financial System (NGFS) models but continue to monitor industry developments keenly.

5 Risk Management

Risk Management

Highlighting material risks

Insight: TCFD reporting fails if it becomes overly complicated.

The question of the materiality of risks was raised by several interviewees. For example, one pension scheme pointed out that the large efforts to calculate climate risk were disproportionate compared to the minimal efforts to mitigate climate risk. However, one asset manager felt that the calculation of risk was too complicated. Schemes should focus on their biggest material risks to define their risk management efforts.

> "If you can't find the bit in there which describes what the biggest material risks that you face are, then (TCFD reporting) fails. Sometimes people over complicate it… even if it's just 'here's our top three material risks and we'll have a look in a year's time to see if it's the same', then that will help the report to be used for something, rather than sitting on a shelf."

ASSET MANAGER

PENSIONS FOR PURPOSE'S PERSPECTIVE

- Consider materiality – be clear where your main risks lie.
- Decide how to mitigate risks effectively and review annually.

Estimations versus omissions

When asked whether estimations or omissions were recommended for pension funds, one investment consultant responded that pension funds should aim to measure everything, even if it meant estimating data.

One asset manager explained that, currently, listed equities are drawing coverage in the 90% to 100% range for scope 1 and 2, with scope 3 coverage ranging from 60% to over 80%. Listed assets are easier to

calculate accurate data for, as attempting to measure everything would require the use of proxies for many asset classes, particularly in private markets. Gilts' emissions are harder to measure as there is no industry-wide accepted standard.

While poor quality data will ensure that drawing any meaningful conclusions from the numbers in the next few years would be limited, by trying to measure everything, interviewees felt pension schemes could still get a better idea of the strategic direction for their climate action plans.

> "Once we build up that bank of data, we can start drawing some conclusions and get a bit more conviction in investment strategy over time."

INVESTMENT CONSULTANT

Funds may believe using proxies for certain asset classes where data is unavailable may cause reputational risk, because their emissions may increase as data quality improves. As a result, it is imperative to communicate this estimated data in the fund's TCFD report. Many asset owners are concerned about issues arising from poor or estimated data, particularly the LGPS who are subject to a greater level of public scrutiny.

One LGPS, despite measuring two-thirds of investee companies' emissions using estimates, stated:

> "Estimates are inherently flawed."
>
> LGPS

As a result, this fund had implemented data quality assessments to help communicate the issue and to use it as:

> "Part of a defence mechanism to protect us against – frankly – ill-informed activist lobbying."
>
> LGPS

PENSIONS FOR PURPOSE'S PERSPECTIVE

- Spend time agreeing your fund's stance on estimation versus omission.
- Agree measurement criteria to assess data quality and estimation levels over time.
- Qualify progress on climate action by including data limitations.

How data improvements may potentially skew the emissions calculations is referred to more thoroughly in the next section 'Metrics and Targets', on page 18.

Independent assurance or audit

Insight: independent assurance is needed but unsuitable today given data limitations.

With regard to the audit of findings of TCFD reports, most of the schemes interviewed felt that the data is at this stage not good enough to warrant auditing.

Notwithstanding this, funds are aware that independent assurance on the TCFD report may be appropriate and one fund we interviewed highlighted its importance. Another fund referred to their focus on investigating the assurance process of their data providers.

> "The challenge is in the reliance on their data being robust. You're taking for granted that an oil and gas company's reported emissions, for example, are coming through. How much rigour has that gone through? So, we spent a bit of time asking our third party what assurance they undertake to be happy with the emissions. In our case, they get it from the accounts and then play it back to the company to ask if it's correct."
>
> CORPORATE PENSION FUND

PENSIONS FOR PURPOSE'S PERSPECTIVE

- Agree measurement criteria to assess data quality/estimation levels over time.
- Engage with your data providers on this topic.
- Decide when and how you will use independent assurance.

6 Metrics and Targets

Metrics and Targets

Data issues

Insight: climate data remains a key challenge for pension funds.

As alluded to previously, data is the primary issue when using TCFD reports. Funds just are not receiving the coverage or the quality of data that allows them to identify accurately the focal points within their portfolio. A multitude of themes around data were raised in our interviews, as listed below:

- **Consistency of data**
  Often, inconsistency in emissions calculations between asset classes. There are frequently issues comparing data from different asset managers, making it difficult to calculate the whole portfolio's emissions consistently.

> "It's about having the tools; we don't have a holistic portfolio management look-through so we're having to bolt together the different asset classes."
>
> CORPORATE PENSION FUND

When asked what the biggest challenge has been in providing data to clients for their TCFD reports, one asset manager stated being able to compare 'apples for apples' between asset classes, given that both the format and time frames for emissions calculations vary, particularly with listed assets versus more illiquid assets.

> "It's not the voracity of the data and I'm not even sure it's the clarity of the data, it's just having the right data in the right format."
>
> ASSET MANAGER

- **Scope 3**
  There are conflicting views in the industry on whether to calculate scope 3 emissions or not. Some funds view scope 3 data as too inaccurate and unreliable at present. Calculating the data is useful only if it is meaningful.

> "The (scope 3) data is so much weaker that trying to make decisions based on it would be foolish."
>
> LGPS REPRESENTATIVE

Despite these challenges, one LGPS pool commented that not calculating scope 3 emissions may mask climate risk materiality in the underlying company holdings.

> "Discarding scope 3 can reallocate carbon risk along the value chain."
>
> LGPS POOL

For a fund embarking on the TCFD reporting process, calculating your scope 3 emissions is something to consider immediately, rather than in the second year because you will need to understand how good practice is evolving.

- **Skewed emissions data**
  Many funds have expressed worries/concerns over improvements in data quality and how improvements

in coverage may actually increase the reported carbon intensity of their portfolio, unrelated to any changes in the underlying investment strategy. This possibility opens funds up to a level of reputational risk which can only be mitigated through effective communication of the issues currently faced with data quality and coverage. Some funds are using data quality metrics, whereas others have written sections in their reports highlighting this possibility.

There is also a problem with market-value-based emissions intensity metrics. As market-values go down, the financed emissions may increase according to such metrics, through no change in investment strategy or reduction in the emissions of underlying assets. This may skew emissions data making it seem as if the portfolio is being decarbonised.

> “There’s too much focus on saying ‘we’ve decarbonised our portfolio by X’ but, in reality, the data is moving significantly. It’s about aligning the portfolio to get to net zero rather than worrying about X carbon emissions.”
>
> INVESTMENT CONSULTANT

Equally, rolling back the data may alter the data because the further back a fund goes, to set a baseline, the more gaps in the data exist. This makes using 2019 as a baseline year less effective. Many funds are using 2019 as a baseline year because it avoids the distortion of emissions during the COVID-19 pandemic. However, multiple stakeholders in the Paris Alignment Forum event explained that sticking with the current year as a baseline seems to work best.

- **Data quality metrics**
  As mentioned, many interviewees stressed that data quality will improve over time, which could skew emissions numbers making a portfolio appear to have increased its emissions through no fault of poor investment strategy or a lack of company engagement. Data quality metrics (for example, accuracy, coverage and consistency) are one way to illustrate this issue.

> “The data quality metric is massively important because it gives us leverage. It’s part of a defence mechanism, particularly for LGPS who are subject to activists.”
>
> LGPS REPRESENTATIVE

- **Data targets**
  Although one investment consultant emphasised the role of underlying companies in transparency and the responsibility of government to regulate disclosure, pension funds still have an important part to play in arguing for improved data. One fund we spoke to believed that all stakeholders should be pushing for more accurate data:

> “The responsibility lies with all of us.”
>
> CORPORATE PENSION FUND

As a result, this particular fund has set a data quality target to focus their efforts on improving the data before setting a net-zero target. They clearly believe that setting ambitious net-zero targets is not necessarily the right thing to do, at present.

> “People who’ve set aspirational net-zero targets don’t know how they are going to do it. We’re only going to set a net-zero target once we can see how we’d achieve this.”
>
> CORPORATE PENSION FUND

The debate on setting targets is referred to more thoroughly in the ‘Which targets should you set?’, on page 22.

PENSIONS FOR PURPOSE’S PERSPECTIVE

- Be clear about how, when or if you will include scope 3 data.
- Understand the implications of including or excluding scope 3.
- Be aware of how the metrics can skew the data, for example WACI.
- Qualify any public statements about carbon data of the pension fund.

Selected metrics (statutory schemes)

Schemes that are statutorily required to produce TCFD reports are choosing different metrics to explain the emissions their portfolio’s investments make.

Appendix 1 shows a table of the metrics used by the schemes that have contributed to this research paper.

Schemes are required to include one non-emissions-based metric. While some have opted to measure data quality, others have chosen to calculate forward-looking metrics to see how their fund and its investments fit in the climate transition. Going forward, however, all schemes will be required to use a forward-looking calculation.

Forward-looking metrics

We asked our interviewees which forward-looking metric they preferred and why. Table 1, below shows the two most popular metrics.

Selected targets (statutory schemes)

Each scheme must select a mandatory target. The objectives chosen by the contributors to this paper are outlined in Appendix 2. While some funds have set decarbonisation and net-zero goals, other funds have opted to set milestones for improvements in their data quality or data coverage to help map their road to net zero before setting their target. Some funds are targeting improvements in their forward-looking metrics:

- 21% of funds have absolute emissions targets.
- 42% of funds have emissions intensity goals.
- 16% of funds have targets for their forward-looking metrics.
- 21% of funds have data quality/coverage targets.

Figure 2 | Schemes setting net-zero targets that have produced TCFD reports

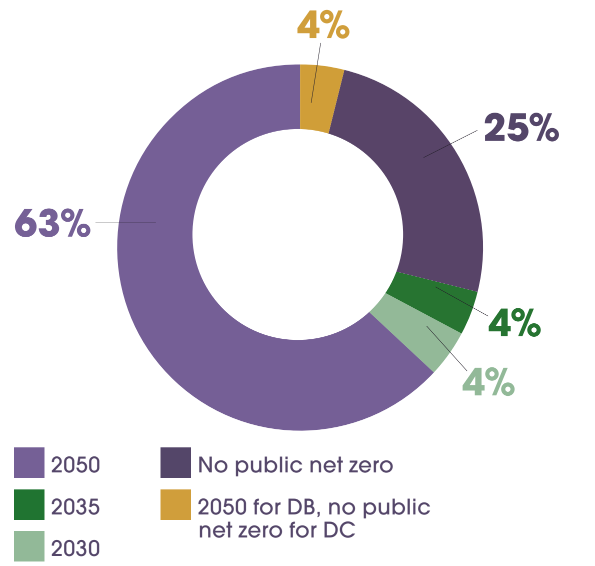


Table 1 | The two most popular metrics

ITR positives	ITR negatives
It shifts the emphasis away from emissions today, allowing for investment in opportunities such as renewable energy which may be carbon-intensive at the outset but which offer climate solutions in the medium to long term.	As data improves, the ITR of the pension fund's portfolio could look very different despite the investment strategy not changing.
ITR is the most engaging and accessible metric for members' understanding (including Member Nominated Trustees).	Comparison between pension funds is not helpful due to variations between data providers and no standard methodology.
It is easier to highlight the magnitude of the challenge, presented by global warming, on the pension fund's investments.	It relies on measuring companies' transition plans. Again, there is no standard methodology.
	ITR is slower to account for progress on stewardship and engagement.

SBT positives	SBT negatives
It shifts the emphasis away from emissions today, allowing for investment in opportunities such as renewable energy which may be carbon-intensive at the outset but which offer climate solutions in the medium to long term.	There are limitations around SBTi's resources. As a result, how quickly SBTi can get data through is restricted.
Using metrics that are validated by climate experts gives the results credibility. The science-based element is encouraging in this respect.	
You need your investments signed up to net-zero in order for the fund to reach it.	
SBTs require less governance resources to calculate than ITR.	

21%

of funds have absolute emissions targets

42%

of funds have emissions intesity goals

16%

of funds have targets for their forward-looking metrics

21%

of funds have data quality/coverage targets

Which targets should you set?

As referred to earlier, some funds are uncomfortable setting net-zero goals at this stage because of data quality issues and coverage. It is worth mentioning that some funds have set net-zero targets without a plan of how they are going to achieve them. In this case, it is better to try to improve the data so trustees can then see a path to net zero.

Setting ambitious net-zero targets may also not be the right thing to do. The pension fund's role in global net-zero is to steer their investments towards net-zero, as the underlying companies are creating the emissions. Therefore, setting an ambitious net-zero objectives may limit a pension fund's investment options and make them unachievable, as one LGPS referred to when they said:

> “Don't make kneejerk decisions. We've ended up with an aggressive net-zero target because of a decision made in a committee meeting. We've had a lot of learning about how not to go about these things. It's going to be an albatross around our necks. We can't go back on the decision but can only acknowledge the difficulty in achieving it.”

LGPS REPRESENTATIVE

But also, it may be counterintuitive to the fund's engagement efforts. As one corporate pension fund mentioned:

> "People think that, by putting an earlier date, they're being proactive, but they're putting more grit in the wheels, because you need everybody to be aligned to the same date to get the world to change. If I'm running a company and you're telling me you want 2030 and someone else is telling me they want 2040, then I don't know what to do. So, it's a bad policy, this idea that everyone's trying to outdate everyone else."
>
> CORPORATE PENSION FUND

Pension funds with closed DB funds may not exist in 2050, making setting net-zero targets a lower priority for those firms.

REDINGTON'S VIEW ON DATA AND METRICS

Trustees are often wary of using climate metrics and integrating them into investment decisions due to concerns around the robustness and quality of the data. While we think it's good to recognise imperfections and omissions, we advise clients to not let this halt progress. The key is to understand what each metric means and what it measures.

Some metrics measure sources of risk in the portfolio while others look at the portfolio's contribution to changes in the real world. Understanding the drivers of each metric helps in understanding what's being measured and what changes truly signal.

The most frequently used climate metrics are emissions-based – these are inherently backward-looking. They can be helpful for understanding where risks may be concentrated but acting heavily on these can lead to unintended consequences. They also don't give an accurate picture of important investor levers like stewardship. This is why we are supportive of bringing forward-looking metrics such as portfolio alignment into the process early on as it provides a more complete picture. When setting targets, we advise our clients to focus on what matters, and attempt to move the dial using what they have the most control over given their constraints and levers of influence.

8 Member engagement

Member engagement

Member engagement

Insight: few funds are using TCFD reports to improve member engagement.

Given the significant resourcing funds are allocating to completing their TCFD reports, we are interested in how funds are using their report findings to encourage greater member engagement around their climate impact.

Length of report (statutory schemes)

The length of the report is important as it shows whether funds are trying to make their reports concise or not, to help with member engagement. We found there was a wide range in the length of these publications.

Interviewees' TCFD reports ranged from 18 to 71 pages. While 42 pages was the average length, see figure 3 *(below)* for full details.

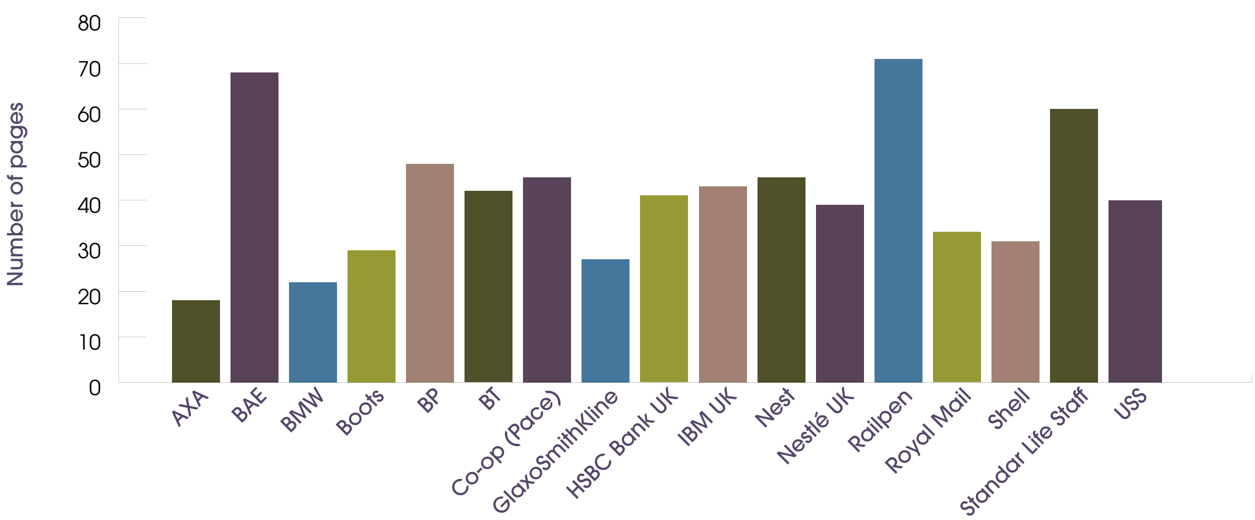
Supplementary member engagement

A few funds spoke to us about their plans to make the first couple of pages of their TCFD reports more member-facing, with an executive summary friendly to laypeople, getting the main points across in a non-technical and easy-to-understand format.

What our interviewees reflected, however, is that members are simply not downloading these reports.

> “We've had 732 people download our TCFD report, but I've got a funny feeling 730 of those are either consultants or people who have to produce a TCFD report themselves.”
>
> CORPORATE PENSION FUND

Figure 3 | Length of report



More pension funds were instead turning to other forms of outreach to share the findings of their TCFD reports. This seemed to encourage greater member engagement. Typically, pension funds were using figures from the report in member mailouts. One fund had created an app to show how their members' pension investments are impacting society and the environment. Another is creating an animated video summarising their report findings, as they have discovered video content communicates well with their membership.

Several schemes have found case studies on the fund's investments in climate solutions, are a good way to make members aware of the fund's climate impact, rather than an explanation of the approach being taken. For example, showing why engagement is more effective than divestment.

> "From our point of view, (communicating investment in climate solutions) is a better way of communicating how we're addressing the issue than the fund's emissions and the fact that we've still got some holding in Shell."
>
> LGPS REPRESENTATIVE

Reports ranged in length from **18-71** pages

The average length was **42** pages

PENSIONS FOR PURPOSE'S PERSPECTIVE

- Agree in advance whether member engagement with TCFD output is something you wish to do.
- Look at others' reports to see what works well.

8 Conclusion

Conclusion

To reiterate, the purpose of this white paper is not necessarily to advise on best practice. Because the TCFD reporting regulations are nascent, best practice is still under review. Instead, the purpose of this paper was to give the perspectives of pension funds that have taken on the reporting process, to share insights on challenges and issues being faced and to explore how output is being used by funds.

For governance, it is important to provide training to trustees, as well as ensuring the right choice is made with respect to data collection and interpretation by using experts to maximise efficiency.

For strategy, the data output of TCFD is not yet influencing investment strategy for most funds. Scenario analysis has also not yet evolved to have more than a limited application. Investments in climate solutions with carbon offsets need to be communicated but are being kept out of accounting measures at present.

It has been pointed out that risk management is not proportional to the efforts being undertaken to calculate risk. Highlighting material risks to funding is something that pension funds can certainly consider. Pension funds should also compare the risk of omitting portfolio emissions data versus the risk of estimating it. In our view, the risk of omitting far outweighs the potential for inaccuracy that comes with estimation. Finally, although it has been limited thus far, it may be valuable to seek assurance from data providers.

In the metric and targets section, there are clearly issues with data quality and coverage. However, an important element is targeting forward-looking metrics to assess how a fund fits into a net-zero world. Funds should ensure they consider the pros and cons of the different forward-looking metrics.

Member engagement with the TCFD report is likely to be limited given they are often long documents restricting the capacity for lay understanding. Funds are more likely to increase member engagement around climate action if they extract insights from their TCFD reports and communicate these in other ways.

REDINGTON'S COMMENT

With TCFD, as with other investment decisions you make, it is important to focus on what matters, and attempt to move the dial using what you have most control over given your constraints and levers of influence. Plan the time line of the process with your advisors, work on data gathering early on, request training – ideally little and often, meaning short sessions covering specific areas you need to make decisions on and do this across the whole plan period. Then think about what levers you will pull to act on the information you are receiving - will you engage your managers more robustly, change your mandates or think about tilting out of risks. Look for actionable data and advice in this area, don't let it become an expensive box-ticking exercise.

9 Appendices

Appendices

Appendix 1 | Metrics (statutory schemes)

Pension scheme	Absolute emissions metric	Emissions intensity metric	Non-emissions-based metric
AXA	Total GHG emissions	Carbon footprint ● By enterprise value including cash (EVIC). ● By revenue (WACI).	Warming potential. Green investments. Exclusions. Environmental score. Coverage.
BAE	Total GHG emissions	Carbon footprint WACI	Asset-side climate value-at-risk of the asset portfolios.
BMW	Total GHG emissions	Carbon intensity	Data quality: % of asset base where carbon data is available.
Boots	Total GHG emissions	Carbon footprint	Data quality: a measure of the proportion of the portfolio that the trustee has high quality (verified and estimated) data for.
BP	Total GHG emissions	Carbon footprint	Data quality: % of portfolio included within portfolio alignment model.
BT	Total GHG emissions	Carbon footprint WACI	Portfolio alignment (%). Data coverage (%). Company reported data (%).
Co-op (Pace)	Total GHG emissions	Carbon footprint WACI	ITR for DB and DC Portfolio alignment: SBTs % for DB only
GlaxoSmithKline	Total GHG emissions	Carbon footprint WACI	DB: % of portfolio holdings with corporate targets aligned with less than 2’C. DC: portfolio Implied Temperature Rise (ITR).
HSBC Bank UK	Total GHG emissions	Carbon footprint WACI	Portfolio alignment: Transition Pathway Initiative. Management quality score.
IBM UK	Total GHG emissions	WACI	Share of portfolio held at year end for which engagement or voting on climate-related risk & opportunities has been a substantive topic.
NatWest	Total GHG emissions	Carbon footprint	Portfolio alignment: science-based targets.
Nest	Total GHG emissions	Carbon footprint	Data quality.
Nestlé UK	Total GHG emissions	Carbon footprint	Data quality: % coverage of company reported emissions.
Railpen	Total GHG emissions	Carbon footprint	Portfolio alignment. Company engagement (%).
Royal Mail	Total GHG emissions	Carbon intensity	Data coverage (%). Portfolio alignment: science-based targets.
Shell	Total GHG emissions	Carbon footprint	Data quality: % coverage of company reported emissions.
Standard Life Staff	Total GHG emissions	Carbon intensity	DB: engagement. DC: data quality.
USS	Total GHG emissions	Carbon footprint	Portfolio alignment: decarbonisation trajectory.

Source: public TCFD reports online

Appendix 2 | Targets (statutory schemes)

Pension scheme	Net-zero target	Statutory target	Additional targets
AXA	2050	Interim target is a 27% reduction in emissions by 2031.	Target 1.5°C warming potential by 2050 and interim 2°C by 2030. Target a green investment in line with the UN PRI by 2025. Actively exclude investments considered controversial. Maintain and incrementally improve the integrated environmental score.
BAE	2050	Aim to reduce the financed scope 1+2 emissions of listed equity and listed corporate credit by 50% by 2030, compared to the Scheme's 2021 baseline.	Not applicable.
BMW	2050	Reduce the scheme's carbon intensity by 50% by the year 2030 (relative to 2019).	The Trustee has opted to set their reduction target using the carbon intensity measure to avoid any impacts from asset value changes over time.
Boots	No	Improve data quality over the next five years.	The data coverage targets have been set to collate carbon emission data across scopes 1 and 2. The Trustee will consider an appropriate target to set covering the scope 3 emissions in its next disclosure report. The Trustee recognises that the data coverage and quality for equities is already strong. It therefore plans to ensure reporting remains over 95% in future years.
BP	No	Increase % of investments (by market value) for which preparatory portfolio alignment analysis has been undertaken from 27% (31/12/2021) to 42% (31/12/2022).	Not applicable.
BT	2035	At least 25% reduction in carbon footprint for equity and corporate credit investments by 2025.	At least 25% reduction in WACI for equity and corporate credit investments by 2025. At least 50% increase in portfolio alignment for equity and corporate credit investments by 2025.
Co-op (Pace)	2050	50% reduction in emissions by 2030 – DB measured using absolute emissions DC measured using WACI.	Net-zero emissions by 2050 – DB measured using absolute emissions, DC measured using WACI.
GlaxoSmithKline	2050	50% reduction in carbon emissions associated with the portfolio by 2030.	Net-zero emissions by 2050.
HSBC Bank UK	2050	Real economy emissions reduction interim target of 50% by 2030 or sooner for equity and corporate bond mandates.	Net-zero emissions by 2050. Ambition for all corporate bond and equity investments (DB and DC assets) to be Paris aligned by 2030. Enhancing engagement and stewardship efforts through the scheme's asset managers.
IBM UK	No	Reduce the Plan's WACI by 20% under scope 1 and 2 over the short-term horizon of three years from 31 December 2021.	The Trustee aspires to but has not yet committed to a net-zero target due to the quality of data. The Trustee will be exploring net-zero target setting over the next 12 months and is working with its investment managers to improve the quality of data.
NatWest	2050	57% of portfolio (excluding gilts and cash) aligned with SBT by 2030.	100% of portfolio (excluding gilts and cash) aligned with SBT by 2040. 100% of portfolio (excluding cash and gilts) has net-zero emissions by 2050.

▸▸▸continued

Appendix 2 | Targets (statutory schemes) *continued*

Pension scheme	Net-zero target	Statutory target	Additional targets
Nest	2050	35% reduction in carbon intensity by 2025 (relative to 2019).	50% reduction in carbon intensity by 2030 (relative to 2019)
Nestlé UK	No	Minimum 10% improvement (weighted by portfolio weight) over 2022 in terms of scope 1, 2 and 3 emissions data disclosed and calculated by the companies and subject to MSCI verification.	Not applicable.
Railpen	2050	Carbon footprint: 25-30% reduction by 2025.	50% carbon footprint reduction by 2030. Net-zero emissions by 2050. Portfolio alignment: 100% AUM in material sectors to be 'aligning' or 'fully aligned' to net-zero pathway by 2040. Company engagement: 70% financed emissions under engagement (or already aligned to net zero) rising to 90% by 2030.
Royal Mail	2050	Reduce emissions by 50% in corporate bonds and equities (relative to 2015).	Net-zero emissions by 2050.
Shell	2050	Increase coverage metric from 75% (31/12/2021) to 79% (31/12/2022).	SCPF has set a 2050 net-zero target. However, for the purposes of the statutory target under TCFD reporting, they set a data coverage target. Over the next 12 months, SCPF will work on net zero and will report more details on its net-zero plan in its next Climate Change Report in mid-2023.

Source: public TCFD reports online

Appendix 3 | List of contributors to the research

Corporate pension scheme	LGPS/Pools	Asset managers	Investment consultants
AXA	Border to Coast	Baillie Gifford*	Barnett Waddingham*
BAE	LPFA*	J.P. Morgan Asset Management*	Redington*
BMW	London CIV*		
Boots*	South Yorkshire Pensions Authority*		
BP	Wiltshire*		
BT	Worcestershire	.	
Co-op (Pace)*			
GlaxoSmithKline			
HSBC Bank UK			
IBM UK			
NatWest*			
Nest*			
Nestlé UK			
Railpen			
Royal Mail*			
Scottish Widows*			
Shell			
Smart*			
Standard Life Staff*			
USS			

* *Contributors were interviewed.*
Information about the firms (without an asterisk), was sourced from their public TCFD reports, available online.

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