

BP Pension Fund's approach to TCFD reporting

At this Paris Alignment Forum asset owner event, *Redington* and *BP Pension Fund* discussed the challenges and outcomes of preparing Climate-related Financial Disclosures (TCFD) reports

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By Juan David Perez



The application of TCFD reports requires time and effort. This Paris Alignment Forum asset owner event discussed how these reports can be used to make more informed investment strategies. Renata Kostrzewa, Head of Responsible Investment at *BP Pension Fund*, and Alex Lindenberg, Managing Director at *Redington*, reviewed reporting requirements, and how data quality, scenario analysis and engagement can make reports more useful to trustees.

Q How have you dealt with data quality? In particular, how has the issue evolved from your first report to your second report?

A The *BP Pension Fund* is a defined benefit scheme with over £20bn of assets under management invested in a broad range of asset classes, including listed equities, corporate bonds, infrastructure, debt, direct lending and direct property. As *BP* is a bigger pension scheme, Renata acknowledged they do have internal resources available to work with specialist data providers. Yet she recognised data quality is still a challenging aspect of TCFD reporting, especially for smaller pension schemes.

The *BP Pension Fund* has worked with its data providers to understand what kind of data they provide, how they estimate data and what modelling assumptions they have. This led them to identify an inconsistency in the frequency of the data companies publish. The fund also engages with its asset managers to collect data on a more consistent, comparable basis. Renata highlighted the importance and relevance of informing the board of trustees of the assumptions underpinning the data. Trustees must be made aware that the data is imperfect: there are numerous estimations. By engaging with both asset managers

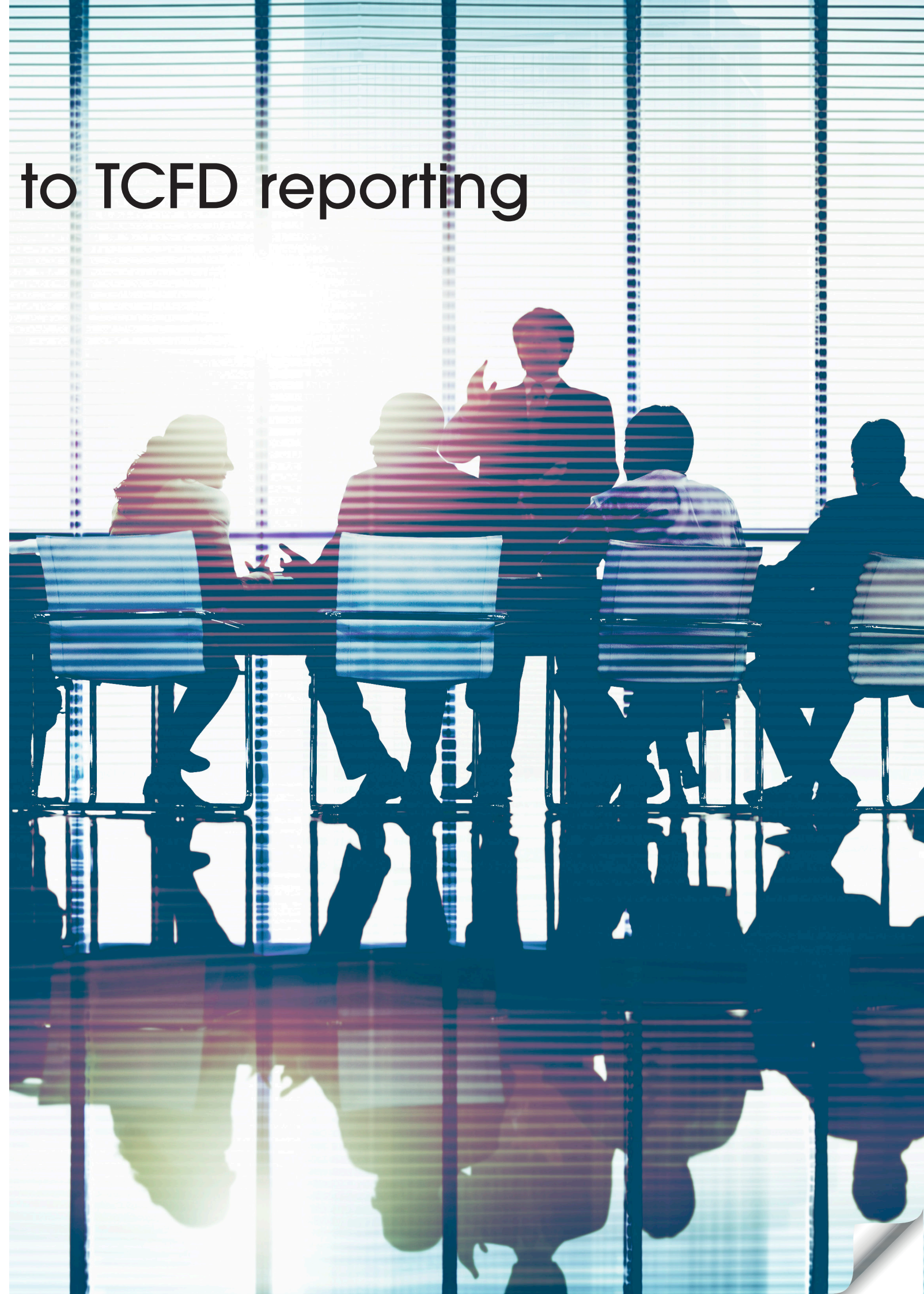
and data providers, *BP Pension Fund* has a good understanding of all the assumptions being used to provide the output in the metrics. Alex from *Redington* made a clear point that trying to include as much data as possible does not necessarily result in effective decision-making; large investors must also engage with data to improve quality over time.

Q How have you dealt with comparing results between your first and second year TCFD reports?

A The comparison between the 2021 and 2022 reports showed considerable differences, especially in some of the more carbon-intensive industries that have performed remarkably well. This is challenging to explain and put into context for readers. Emissions can fluctuate even before changes have been made to the portfolio's positions and asset allocation. *BP Pension Fund* and its asset managers look at data quality as much as they can, both internally and externally, for their reports. By comparing proportions of data published and estimated, they can draw conclusions on whether more data was reported or estimated. Explaining how the emissions change over time and what leads to these fluctuations is still complicated to narrow down, but by examining the positional differences and the data quality the different moving parts can be understood.

Q How have you integrated scenario analysis into investment decision making?

A Alex referred to the Institute and Faculty of Actuaries (IFoA)'s critical report, 'Emperor's new climate scenarios – a warning for financial services', which argues that the assumptions used in





many climate scenario analyses lack credibility. These studies suggest the financial impact of climate change is harmless even in a 4°C warmer world. Renata agreed the report was welcome and added they had not built their own climate scenario models. Instead, the fund worked with a specialist provider to run climate stress tests. It allows *BP Pension Fund* to understand the methodology and assumptions applied to scenario analyses and ask questions. She also felt, over time, as more robust models evolve, it will become harder to compare results from year to year. We can easily understand the numbers in a crisis if we have been faced with them before – for example, the financial crisis in 2008. Unfortunately, we do not have historic climate scenarios to reflect on, which makes the exercise more challenging.

Q & A Has your TCFD reporting exercise changed the way you interact with asset managers? What have you learned about them that you didn't already know?

A The engagement between asset owners and managers is important in producing TCFD reports and executing policies. Managers are incentivised to supply information to retain their mandate. The *BP Pension Fund* has quarterly meetings with its managers and an annual responsible investment meeting to discuss climate risk. The fund also uses an annual reporting template to cover stewardship engagement examples through climate metrics. Some managers have made more progress than others over the last two years, for example, on physical risk. Alex highlighted that one of the benefits of the TCFD report is to build more robust engagement with managers, which brings the opportunity to identify gaps in their process.

Q & A Have you changed your assessment of any of your managers as a consequence?

A The application of the TCFD has not led the *BP Pension Fund* to terminate any relationships with managers; however, it has led them to request more information about what actions managers are taking on climate risk and ask for real life examples of how investment decisions are made. The report has also allowed the pension fund to identify managers whose investments are not well aligned with the fund's mandate. Overall, the TCFD report has been helpful in pushing managers forward, but it has not represented a radical change.

Q & A Have wider considerations around biodiversity and the environment been factored into your investment strategy or your engagement with managers?

A *BP Pension Fund* requires managers to incorporate climate change into their investment strategy through the fund's responsible investment policy, which includes three stewardship themes: board diversity, human rights and climate change. All investment management agreements refer to this policy and managers are required to adhere to it. The pension fund seeks to add biodiversity to their stewardship themes, so it becomes as relevant as climate change. However, this is still work in progress.

Alex indicated that Redington's clients have begun recently to show more interest in natural capital and they are seeing new investment opportunities which can form part of a net-zero pathway. However, these asset classes do not always fit with the risk-return profile, which depends on the type of pension fund and its characteristics. Renata said it is essential to have discussions with managers to understand individual examples of natural capital and its impact. It allows the fund to see how these asset classes work, what they mean, and how they interconnect with climate and other issues.

Q & A What does net zero mean to you and how do you envisage putting it into practice?

A Setting a specific net-zero target has generated much debate among *Redington's* clients and the practical route to achieving these targets for pension schemes is ongoing. The *BP Pension Fund* considers and treats this topic seriously. Again, engagement with managers is crucial to encourage them to at consider frameworks towards net zero. Half of the fund's managers have net-zero goals,

which helps the pension fund understand how they can proceed in setting their own targets. Currently, the fund is working to establish a correct baseline across asset classes. This year, the team has had to estimate illiquid assets such as private equity. They aim to track the data for these estimations until they are confident in the results to make investment decisions based on the data. At present, the fund does not consider disinvestments. The priority is to work with the fund's policy and to engage with managers to reduce emissions and ensure an overall transition.

For its part, *Redington* emphasise to clients that achieving net-zero objectives is not all about portfolio decarbonisation. A fund can achieve a net-zero portfolio by selling the highest emitters, but that does not automatically improve the planet or improve the portfolio's efficiency.

Q & A How important is it to BP to educate and engage their membership, in particular on TCFD?

A The TCFD report is regulatory, complex and hard for members to understand. Even *The Pensions Regulator (TPR)* admitted it is a complicated topic and difficult for members to digest. This was also one of the conclusions from the *Pensions for Purpose* Impact Lens research 'One year on – TCFD reporting for pension funds', sponsored by *Redington*, pension funds found the document too technical to be aimed at members. *BP Pension Fund* includes in their TCFD report a synopsis providing a high-level description of the process and the essential findings under the executive summary.

Q & A How do you deal with government debt and ESG metrics? Do you look at government's policies and compare this with what they actually do?

A Classifying countries and governments is still quite challenging since many methodologies on climate change opportunities and risks exist. The *BP Pension Fund* is reviewing the Assessing Sovereign Climate-related Opportunities and Risks (ASCOR) project and its approach to see how the

fund extend its UK exposure. Classifying countries by climate action and their approach to ESG metrics is still complicated. Alex indicated that *Redington* has seen more disclosure on the sovereign side, highlighting that climate change's financial impact is their financial risk.

Q & A Are we approaching the point where there is increased standardisation in reporting?

A There have been many discussions regarding which metrics to use. The *BP Pension Fund* decided to follow the TPR's suggestions. Nowadays, total absolute emissions and emissions intensity metrics are more widely understood. It is impossible to condense the data to a single metric because it depends on the evaluated sector. The *BP Pension Fund* has spent significant time on understanding portfolio alignment metrics; they selected their climate metrics for the first TCFD report by analysing the alignment methodologies. For the second report, they have decided to choose a model from one data provider and understand all the assumptions underpinning that.

Q & A Where do you think we will be in a year's time?

A The risks and opportunities associated with climate change are fast-moving. More regulatory pressure on companies is necessary to produce high-quality and consistent data. There is still a long way to go towards having a systematised methodology and collecting the necessary data to generate reliable metrics for investment decisions. It requires strong engagement between asset managers, asset owners, stakeholders and data providers to get more standardisation.



Follow the link to read the original event post this article relates to.

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