

# The First Wave

Early TCFD reporting and what it can teach us



# Chair's foreword

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One of the reasons why the DC Investment Forum (DCIF) exists is to challenge thinking and practices as new areas evolve in the world of DC pensions. And what could be fresher and more evolving than TCFD reporting?

We were keen to see how master trusts had approached their first iterations of TCFD reports and asked Nico Aspinall to investigate on our behalf.

It is clear that master trusts have put a huge amount of effort and energy into these reports. We hope this report provides useful analysis to those master trusts, regulators, and the wider industry, as well as offering some suggestions as to how their next iterations could be improved.

Fundamentally, the recommendations from the second report in this two-part series echo the suggestions we made in the first.

Firstly, it would be really helpful for regulators to clarify who the intended audience is for TCFD reports, so that master trusts can tailor their work accordingly.

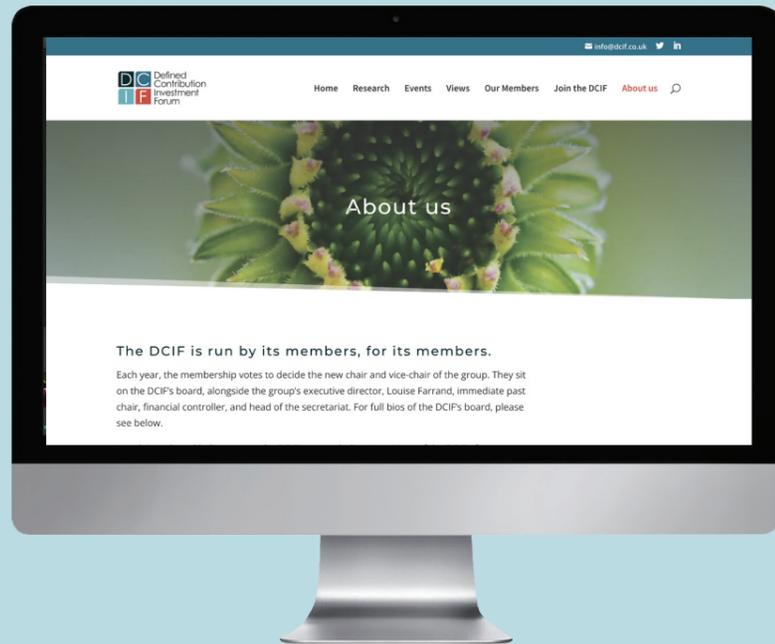
Second, as Nico observes, at present it is very difficult to draw comparisons between different schemes' approaches to the climate transition. The regulator should set out a common methodology for scenario analysis. At the moment, it is impossible to make meaningful comparisons between pension schemes.

Adapting to change is always a challenge. We'd like to applaud all the master trusts for producing their first TCFD reports. We hope the findings of this report are helpful and provide you all with some constructive comments which will help you to make them even better next time.



*Lorna Kennedy*

Lorna Kennedy,  
DCIF chair, July 2023



## Who are we?

We're a group of asset managers who believe that a well-designed and diverse investment strategy has an important role in delivering a comfortable retirement for millions of DC savers.

A not-for-profit organisation, we commission and publish research which shines a spotlight on DC investment issues. We hope the people who determine DC pension schemes' investment strategies will use it to inform their work.

We also arrange events. From virtual roundtables to in person gatherings, they're a great way to learn more about DC investment issues and meet a like-minded community of trustees, pensions managers, investment consultants and more.

To find out more about our work and explore membership options, please visit: [www.dcif.co.uk](http://www.dcif.co.uk)

## Our members

Our members shape the DCIF's direction and steer research projects. They are:



# Executive summary

This report contains quantitative analysis of the reports that 14 of UK DC master trusts have produced against the Taskforce for Climate-related Financial Disclosures (TCFD) requirements.

### The main findings are:

- Making comparisons between schemes of the metrics and scenarios is very difficult. It is not possible to use TCFD reporting in its current state to answer who is doing "better" or "worse" on climate change.
- Placing the responsibility to address climate change on trustee boards has been positive and has achieved much in starting schemes down the road of addressing climate change. Creating the requirement to disclose the outputs of TCFD processes without a consistent template for reporting to be used across the industry highlights the complexity and confusion the financial services sector feels in terms of how it should be acting on climate risk.
- It is unclear who benefits from these public reports. Internal non-executive and executive resources in the schemes, and at the asset managers preparing data for funds will have been pulled away from other issues, including acting on climate change.
- Schemes dedicated 25% of their reports to strategy (including scenario analysis), 19% to metrics and targets, 11% to risk management and 9% to governance.
- Few schemes use the governance section to describe how the sponsors and investment managers govern delegations they make to them around the development and implementation of climate risk management approaches to climate risk.
- A very wide range of time horizons are used in the strategy section. The longest time horizons tend to come from those schemes thinking about their members' time horizons, rather than government or internal planning horizons. Three schemes did not describe why they chose the horizons they used.
- There is a plethora of methodologies used in the scenarios analysis, making comparability between schemes almost impossible. Impacts ranged from the pessimistic (TPP – 50% damage to equities in a 3oC scenario) to the optimistic (NOW – 2% uplift to pots in a 3oC scenario).
- Scenarios are a key area for regulatory intervention in the form of explicit guidance of methodologies to make the disclosed impacts clearer and consistent between schemes.
- While 57% of schemes disclose a risk matrix in their risk management section, that leaves a substantial minority of those who did not.
- There is very wide variation in disclosed figures of carbon intensity between schemes in the metrics section. Partly this is because asset classes have such wide differences in carbon intensity with equities the lowest and short-dated corporate bonds potentially 35 times higher. This means schemes with better diversification in their portfolios will disclose higher carbon intensities. There is an additional factor of the range of outputs given by different data providers. These figures are not currently reliable.
- Ten schemes have set net zero goals and emissions reduction targets based on the figures in the targets section. No doubt these targets will need to be revised as data improves. Schemes not setting net zero targets cited their application to the wider COP process and set more meaningful short-term targets.

# Introduction



**This report is the follow up from our earlier work on TCFD where we interviewed stakeholders from around the DC industry on their progress in reporting against the TCFD requirements. In this report we analyse the TCFD reports of 14 of the top master trusts.**

The analytical approach we have taken in this report is quantitative in nature. This means extracting figures or asking constrained questions of the reports rather than assessing them for more subjective questions of being 'good' or 'bad'. In some areas, subjectivity in interpreting the documents does creep in. We will highlight as much as possible where this occurs. This approach means that the outputs are generally statistical rather than assessments of the quality of the reports or the climate strategies they describe.

The broad framework was to look at the documents overall, thinking about who might read them and analysing their size by counting pages in the pdfs and analysing the emphasis of the reports by seeing where the weight of pages in each report lies between the four sections of TCFD (governance, strategy, risk management and metrics and targets).

The regulatory guidance from the Pensions Regulator (TPR) splits two of the parts of the TCFD into four with scenario analysis given its own section, taking it out of strategy; and metrics and targets in different sections. We echo this structure when analysing the content of each TPR section in turn.

The results in this document are presented in the same way, in seven sections:



Overview



Governance



Strategy



Risk Management



Scenario Analysis



Metrics



Targets

We have drawn out preliminary conclusions in each section.

## Reports analysed and abbreviations

We have included 14 master trust reports in our analysis. The master trusts and the abbreviations we will be using for them in the report are as follows:

- Aviva Master Trust – Aviva
- Cushon Master Trust – Cushon
- Legal & General WorkSave Master Trust and Legal & General WorkSave Master Trust (RAS) – L&G
- LifeSight – LifeSight
- Mercer Master Trust – Mercer
- National Employment Savings Trust – NEST
- National Pensions Trust – NPT
- NOW: Pensions Trust – Now
- Scottish Widows Master Trust – ScotWid
- Smart Pension Master Trust – Smart
- The Aon Master Trust – Aon
- The Crystal Trust – Crystal
- The People's Pension – TPP
- The SEI Master Trust – SEI

# Overview

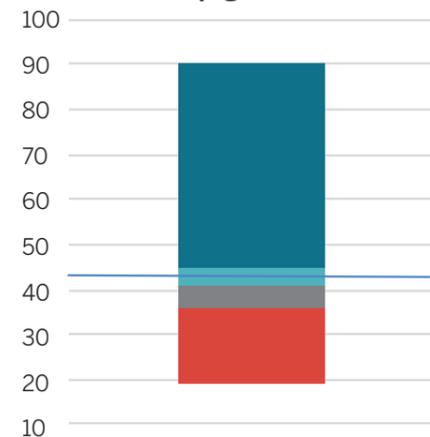


**In the first section of this report, we will give an overview of the reports. How long are they? What weights are given to the four different sections of TCFD reporting?**

## Length

There is significant variety in the lengths of the reports. At the longest end was 90 pages (Crystal) and the second longest was 85 pages (Aviva). At the other end of the scale, 19 pages (LifeSight) was the shortest report. TPP was the second shortest, with 23 pages. The average was 44 pages long.

## Total number of pages

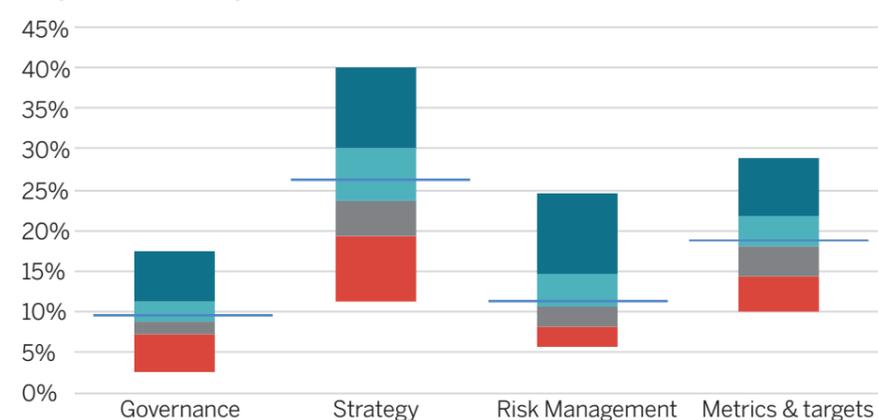


## Proportions of the report against each part of TCFD

Overall, the largest section of the reports was the strategy section, followed by metrics and targets, risk management and the smallest section was governance.

- The governance sections took up between 2.6% of the reports' pages (ScotWid) and 17.5% (NOW). The average was 9.6%.
- The strategy sections took up between 11.4% of the reports' pages (Smart) and 40% (Crystal). The average was 25.4%.
- The risk management sections took up between 5.7% of the reports' pages (L&G) and 24.4% (Crystal). The average proportion was 11.9%.
- The metrics and targets sections took up between 10.0% of the reports' pages (Crystal) and 28.9% (NEST). The average proportion was 18.9%.

## Proportion of the report dedicated to each section



## Conclusions

It is the variation in length which highlights the most in terms of the range of views as to the purpose of the document. In some cases, we were reminded of Cicero asking forgiveness for writing so long a letter because he had too little time to write a shorter one. Could the report have been bit "punchier"?

At the same time, the shorter reports were probably too short to show off much of master trusts' work on climate change. In many cases the real content on climate change sits outside of this report with references to the scheme's responsible investment and climate policies sitting outside of the scope of this analysis.

The critical question that remains is who are these reports written for? The conclusion one draws is that the implied purposes range from those who see this as a tick-box exercise few will read to those who see their TCFD reports as a showpiece document.

# The governance sections



In reviewing the governance sections of the TCFD reports, we were interested to see how the trustees had divided the climate change risk management responsibilities between their own sub-committees or made delegations to their sponsors and investment managers, coupled with their statements around how often the board would receive carbon emissions data. This was a complex area to analyse as there was limited consistency of coverage of these topics.

## Use of trustee sub-committees

The majority of reports did not describe any delegation to sub-committees (seven schemes, 50% of the sample). In these cases, either the trustee board is the only committee looking at climate risk or perhaps the trustees decided the description of the process was not necessary in the report. In some cases, we understand there are no sub-committees to delegate to, with all matters handled by the trustee board.

Five schemes (36% of the sample) described delegations of climate risks to one sub-committee which was always an investment sub-committee. NOW also included a delegation to its Audit, Risk and Compliance Committee who “establish and maintain processes to assess and effectively manage [climate risks] which are relevant to the Scheme.” In addition to their investment committee, Crystal also cites its Operational & Compliance Committee and their Development Committee as having roles in managing and communicating climate risk.

## Trustee Knowledge and Understanding (TKU)

Every scheme referenced the significant amounts of training they had carried out as a board over the last 12 months. There was not much differentiation between schemes on TKU worth highlighting in this report.



## Executive committees

Nine schemes (64% of the sample) described no executive committees receiving delegations on climate change. Five schemes (36% of the sample) mention one executive committee involved in climate risk management.

This is interesting. Seven of the schemes in the sample are sponsored by insurance companies, investment managers or investment consultants and have substantially delegated their considerations and development of their product’s responses to climate change to companies related to their sponsor, but only two of these (Mercer and L&G) hint at any governance structure backing these delegations. The remaining three of the five schemes naming executive committees were the “independents”

NEST, Smart and TPP.

While this is in keeping with the letter of the regulations, one might argue that best practice for a governance section is to be clear how delegations are managed. Without this clarity, the fear must be that delegations are not being managed.

The lack of named committees or job titles managing or implementing decisions on climate risk doesn’t mean that these delegations are not being respected by the sponsors, but as an external reader we would like to see some better description of how the people, processes and systems come together to develop and apply the trustee’s policies on climate risk.

## Data reporting

We were interested to see whether the

reports would tell us how often trustee boards or their delegated sub-committees were reviewing information on the portfolio’s carbon emissions and intensity. This was to understand how central these figures were, or were not, to the overall governance of climate risk to the schemes.

This was not well reported on, though again, not strictly a part of the regulated disclosures. In some cases, we have had to interpret the statements made by schemes to fit the questions.

## In terms of scope 1 and 2 emissions data:

- Nine schemes (64% of the sample) did not describe how often they review emissions data.
- Two schemes (NOW and NPT, 14.3% of the sample) reviewed emissions data every year.
- One scheme (NEST 7.1% of the sample) reviewed emissions data twice a year.
- Two schemes (Aviva and Crystal 14.3% of the sample) review emissions data every quarter.

## In terms of carbon intensity data:

- Ten schemes (71% of the sample) did

not describe how often they review carbon intensity data.

- One scheme (NPT 7.1% of the sample) reviews carbon intensity data every year.
- One scheme (NEST 7.1% of the sample) reviews carbon intensity data twice a year.
- Two schemes (Aviva and Crystal 14.3% of the sample) reviews carbon intensity data every quarter.

## In terms of scope 3:

- Eight schemes (57% of the sample) did not describe how often they review scope 3 emissions data
- Three schemes (Aon, Aviva and Crystal, 21% of the sample) specifically describe their exclusion of scope 3 data on the basis of its unreliability. This is something that will come into their process over the next few years.
- Two schemes (NOW and NPT, 14.3% of the sample) reviewed emissions data every year.
- One scheme (NEST, 7.1% of the sample) reviews scope 3 data twice a year.

## Frequency of reviewing climate data

Scope 1 & 2



Carbon intensity



Scope 3



■ Not disclosed ■ Excluded ■ 12 Months ■ 6 Months ■ 3 Months

## Conclusions

The two headline recommendations of TCFD itself are:

**1. Describe the board’s oversight of climate-related risks and opportunities.**

**2. Describe management’s role in assessing and managing climate-related risks and opportunities.**

Particularly in reference to the second recommendation, we would challenge whether the majority of reports are really achieving this. In our view it is important to demonstrate that delegations to management and advisors do not disappear into the ether and that there is attention to how these delegations are being operated; who is doing operating these delegations; and whether the processes are sufficient to mitigate climate risks to the levels intended. If a hoped-for outcome of TCFD reporting is clarity on how climate risk is being practically managed by schemes, few open up sufficiently for outside observers to learn from any best practice going on in the schemes.

No doubt this is unfair in terms of the actual work being done by boards and executives on their behalf. We would like tighter descriptions of these delegations to become the norm in future.

# The strategy sections



**In reviewing the strategy sections of the TCFD reports, we were interested to see evidence that schemes had made changes to their investment designs to react to climate risks; to analyse the time horizons used in their modelling and the reasons they were selected; and to understand whether climate risks affecting the employers participating in the trusts was incorporated into their approach.**

## Have investment changes been made in response to climate risk?

We have outlined four categories of investment response that might have been made. The first two are the trickiest to distinguish: making changes to allocations and making changes by altering weights.

With allocation changes, we looked for explicit climate-related objectives that might come into a top-level description of the allocation, potentially visible to members. Examples might include a 'low-carbon' fund or a 'renewable energy' fund. These might be expected to have different risk and return characteristics than other investments and so be seen as an allocation change.

With altering weights, we looked at whether some tilting mechanism might have been applied to an index with the intention to not to exacerbate tracking error against the original index or to remain sector neutral in comparison to that index.

Given the level of description in these reports and width of the "grey area" between these two descriptions it is entirely possible we have mis-categorised some responses here, but we hope the overall analysis remains useful.

- Six schemes (43% of the sample) provided evidence that they had changed allocations.

- With the exception of one scheme (L&G - 7% of the sample) all other schemes provided evidence that they

had altered investment weights.

- Nine schemes (64% of the sample) evidenced their exclusions. In terms of climate risks, this meant excluding thermal coal from their investments and, in many cases, tar sands or unconventional oil. This does mean that members of six schemes (Cushon, Crystal, L&G, Mercer, SEI) may be profiting from thermal coal, based on their TCFD reports.

- One scheme (Cushon - 7% of the sample) uses carbon offsetting.

## Employers / covenant

While some schemes are open to all, some might have particular focus on employers in industries which are threatened by climate risk to a greater or lesser degree. Given the DC pensions industry's increasing focus on making illiquid investments, having some assessment of the future liquidity of contributions might be appropriate. This research question looked for discussions of the employers' covenant or industry in the TCFD reports. However, no schemes discussed this topic at all.

## Time horizon

As a part of the TCFD requirements, schemes should outline the time horizons they have applied to their strategic views and decisions, split into the short-, medium- and long-term. Most disclosed the reasons why these decisions had been taken.

## Reasons for selecting time horizons

There appeared to be three major reasons for selecting time horizons:

- Seven schemes (Aon, Cushon, LifeSight, Mercer, NOW, SEI, Smart - 50% of the sample) linked their time horizons to their membership and lifestyle design.



- Three schemes (Crystal, NEST, TPP - 21% of the sample) linked their time horizons to the likely planning horizons of the government or the UN COP processes.

- One scheme (L&G - 7% of the sample) linked their time horizons to their own planning horizons.

- Three schemes (Aviva, NPT, ScotWid) did not disclose why they had chosen their time horizons, or it was not clear from their text.

## Short-term:

The assumption is that the short-term starts now and extends out to a point in time where the medium-term starts. So, taking the end of each period.

- The closest was three years away (three schemes, Aon, Aviva, TPP)

- The furthest was fifteen years (Crystal). It should be noted that they combine the short and medium-term periods here.

- Furthest out of those just looking at the short-term was ten years (five schemes: Cushon, LifeSight, Mercer, ScotWid, Smart)

- Average short-term was just over seven years

## Medium-term:

Again, looking at the point where the medium-term becomes the long-term:

- The closest was eight years away (TPP)

- The furthest was 25 years away (Mercer, Smart)

# Strategy



- The average was just under 16 years.

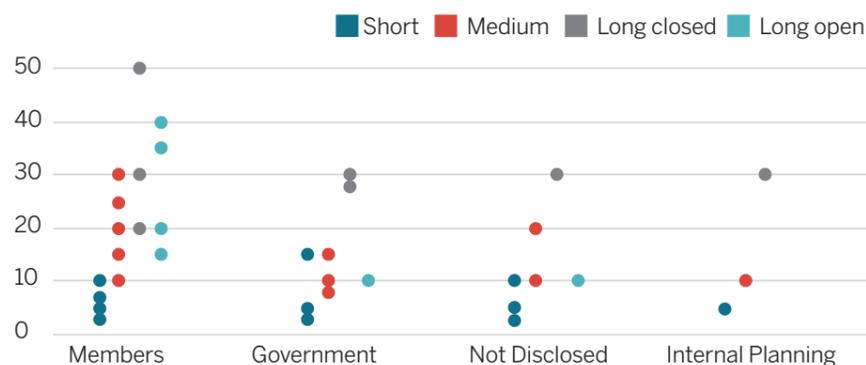
## Long-term:

With the long-term, we have a split between eight schemes (57% of the sample) who follow the same logic as above in that the long-term is a closed period and so they might have disclosed the long-term as being 20 – 25 years. Six schemes (43% of the sample) used an open period so might have disclosed that the long-term is periods after 20 years into the future.

For the eight schemes disclosing the long-term as a closed period, we looked at the end of that period:

- The closest was 20 years away (Aon). It should also be noted Aon actually had four time horizons including a “very long-term” which was >20 years.
- The furthest was 50 years away (Cushon)
- The average was 31 years away. For the six schemes using an open period:
- The closest was >10 years away (NEST)
- The furthest was >40 years away (Mercer)
- The average was 21.5 years away

## Time horizons by reason for selecting horizons



## Conclusions

Turning again to the TCFD recommendations themselves. Three apply to the strategy section:

1. Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.
2. Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.
3. Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

Following the regulatory guidance, much of the content outlined is dealt with in the next section on scenarios. The main use of this section should therefore be to set out how the schemes' strategic asset allocation is being altered to address climate risks and opportunities and to set out the time horizons these actions are intended to work over.

There is no right or wrong approach

to setting out your strategic time horizons, but it is interesting to see how the three major reasons the definitions of the medium and long-term. Schemes where the membership is the basis for determining time horizons generally look further into the future than those basing their time horizons on government or internal planning.

This difference could be quite stark. Schemes thinking about members might only start to define the long-term at 40 years out (Mercer) or take the long-term to mean up to 50 years away (Cushon). Schemes not thinking about members when setting their time horizons didn't consider more than 30 years out. When we come to analyse the scenarios, this will have major ramifications in terms of their comparability.

It would have been helpful if the three schemes had described why their time horizons were set at the points they were. While not within the regulatory requirements, this does feel like a simple and brief addition they could have considered which would have helped the external reader understand their process better. Schemes did in general outline how transition risks and opportunities are likely to occur earlier than physical risks with varying detail in this discussion, though we did not conduct any analysis on this part of their disclosures.

It was disappointing how difficult some of the evidence of investment strategy reactions to climate risks was to find. One scheme, well known to the researcher, had made progress on addressing climate risk in its investments but this was barely evidenced in the report. It is therefore possible that more action is being taken than disclosed in TCFD reports, as odd as that sounds.

# Risk management



**When reviewing the risk management sections of the TCFD reports, we were interested to see how the schemes were disclosing their risk considerations and in particular how they were preparing scenarios to assess the potential damage members might suffer as a result of climate risks.**

## Presentation of a risk matrix

There was a major split in the risk management section between those who provided some form of risk matrix (eight schemes, 57%) and those who do not. Those providing a risk matrix / risk description:

- At the lowest end two schemes only described two risks into their risk ma-

trix, the two risks of “physical risk” and “transition risk” (Aon, TPP).

- One scheme (The Crystal Trust) identified 32 sub-risks.
- The average number of risks identified by schemes who included a risk matrix was eight risks.

We had intended to analyse whether the risks were being managed or accepted, and whether controls around the risks were preventative, mitigative or detective, but unfortunately hardly any of the schemes provided this level of detail and there was limited sample for this analysis.

## Conclusions

Turning back to the original TCFD recommendations, three fall under risk management:

1. Describe the organization's processes for identifying and assessing climate-related risks.
2. Describe the organization's processes for managing climate-related risks.
3. Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.

These recommendations were not amenable to quantitative analysis, but in the view of this researcher, these recommendations are not well met. One would expect the process to identify and assess climate-related risks to either be “top-down” starting at asset allocation and then looking at individual asset classes; or “bottom-up” focussing on companies or sectors particularly exposed to climate risks or providing opportunities. This is not clear from the average report.

We would like to see more schemes providing more information on their risk management approaches by extracting more detail from their risk matrices where it relates to climate risks.

In general, it is hard to perceive how schemes are really thinking about managing climate risk as an investment problem.

# The metrics sections



In reviewing the metrics sections of the TCFD reports, we were interested to understand what choices were being made around defining emissions as an asset owner; how Scope 3 emissions were being treated; how intensity measures were being calculated; whether they were taking their own emissions into account; and how well the levels of data coverage and estimation were being reported.

In general, in this section, we have reviewed the main default's growth stage assets, where this was obvious, to try to be consistent. This is because figures were inconsistently shown in terms of equities, bonds and alternatives; their mixes across different lifestyles; the default and employer-designed defaults and self-select.

## Absolute emissions

Every scheme provided the absolute emissions measure all weighted by the Enterprise Value Including Cash (EVIC) as recommended by TPR guidance. The analysis was therefore around whether the emissions considered were just Scope 1 and 2 or whether Scope 3 emissions were also included. Many schemes discussed the problems of mapping EVIC onto sovereign debt holdings where GDP is a better denominator. Generally, emissions relating to sovereign debt were excluded from the measure.

Three schemes (NEST, NOW, Smart 21% of sample) included data on Scope 3 emissions as a second absolute emissions measure and report on these emissions separately. All these schemes have strong caveats around the limitations of this data in their reports.

NOW went further and separated Scope 3 emissions between "up-stream" and "down-stream" emissions. In other words, the emissions in the value chain of products bought by the company (up-stream) and the emissions from those using the company's products (down-

stream). While this adds complexity it does seem like a logical way to think about the emissions of any economic entity. Given its high exposure to derivatives, NOW also was the only scheme to include its analysis of emissions relating to derivative positions in its figures.

## Emissions intensity

TPR's guidance recommends a footprint measure which is a measure of the emissions financed per £m invested, but highlights that schemes might additionally want to provide the Weighted-Average Carbon Intensity (WACI). There are multiple factors that might provide the weighting but most commonly this is the revenue of the companies invested in.

Eleven schemes provided one emissions intensity measure, with two (Crystal, NPT - 14% of the sample) using the WACI measure. Three schemes provided both intensity measures (Aviva, Mercer, SEI 21% of the sample) with all of these schemes making WACI their primary measure of emissions intensity. This means that overall, five schemes have WACI as their primary measure of emissions intensity. This will become important when looking at their intermediate targets for emissions reductions.

All of the three schemes (NEST, NOW, Smart - 21% of sample) reporting Scope 3 absolute emissions also reported their emissions intensity measure based on Scope 3 emissions as a separate figure.

## Carbon footprint

Of the nine schemes disclosing carbon footprint as their primary measure, two schemes did not disclose an aggregate figure (LifeSight, NEST), for different reasons. LifeSight has created an emissions intensity index to track their reduction of this measure, but do not disclose its intensity. NEST discloses the intensity of each individual asset class but does not create the weighted sum of this figure. Without knowing the asset allocation at



the time of publication, it is not possible to create a comparable figure.

For those who did disclose their carbon footprint, there was a very large range of figures.

- The lowest carbon footprint was 24.1 tonnes CO<sub>2</sub>e/£m (Aon – Aon Managed Core Retirement Pathway Funds).
- The highest carbon footprint was 117.8 tonnes CO<sub>2</sub>e/£m (L&G - L&G PMC MULTI ASSET-FUND 3).
- The average carbon footprint was 73.3 tonnes CO<sub>2</sub>e/£m.

One of the schemes using WACI did not disclose an aggregate figure (SEI). Among the three that did there was a large range:

- The lowest WACI was 110 tCO<sub>2</sub>e / £M sales (Crystal – Target Date Fund 2044-2046).
- The highest WACI was 280.9 tCO<sub>2</sub>e / £M sales (Mercer – Mercer Growth Fund).
- The average WACI was 175 tCO<sub>2</sub>e / £M sales.

The wide ranges here suggest that there could be significant inconsistency in the data being received on different holdings, rather than that they have such dramatically different levels of emissions intensities. Indeed, TPP talk to the range of emissions data given to them by different providers, with asset classes like fixed income showing a 160% range from top to bottom.

The other reason for the wide range is

the surprising differences in emissions between asset classes. Looking at the NEST disclosures:

- Equities have an average footprint of 85 tonnes CO<sub>2</sub>e/£m.
- Short-dated investment grade bonds have a footprint of 2,983 tonnes CO<sub>2</sub>e/£m.

For short paper (i.e. cash) to have a carbon footprint 35 times greater than equities suggests these figures may not be that meaningful to begin with. Members would struggle to understand why this could be the case, whatever the technical explanation. Because equities have the lowest assessed footprint, any portfolio offering reasonable diversification will look to be worse in terms

of emissions intensity. In other words, improving risk-adjusted returns seems to increase footprint.

## Portfolio alignment

Trustees are required to report a "Portfolio Alignment" metrics "as far as they are able". Seven schemes (Aon, Cushon, NEST, NOW, ScotWid, SEI, TPP - 50% of the sample) did not report portfolio alignment metrics. The reasons discussed for this were around the lack of confidence in the methodologies available to them.

## Seven schemes did publish portfolio alignment metrics:

- Five schemes (Aviva, L&G, Mercer, NPT, Smart 28% of sample) published Implied Temperature Rises as their metric.
  - Aviva's portfolio has a "warming potential" of 3oC by 2100.
  - L&G's portfolio has implied temperature alignment of 2.84oC according to their proprietary Destination@ Risk model
  - Mercer's implied temperature rise is 3oC
  - NPT's portfolio is predicted to produce 1.9oC.
  - Smart's portfolio implies a 2.3oC rise in temperatures.
- Two schemes (Crystal, LifeSight - 21% of sample) measured the adoption of Science Based Targets
  - Crystal had two categories: aligned 27%, not aligned 73% (the TDF Default fund).
  - LifeSight had three categories: aligned 28%, aligning 30% or not

# Metrics

aligned 42% (LifeSight Equity)

## Additional metrics

With the exception of Aviva and Mercer, all schemes published additional metrics. There are quite a few different approaches here. Metrics around improving data quality and data coverage were the most common with eight schemes (Aon, Cushon, L&G, NEST, NPT, ScotWid, Smart, TPP). Other metrics included:

- Climate VAR (Crystal)
- Number of engagements with investee companies that reference climate (L&G)
- Climate Transition VAR (proprietary measure); capital allocated to climate solutions; exposure to physical risk; manager assessments on ESG, voting and engagement – (LifeSight).
- Percentage of AUM in portfolios with explicit sustainability objectives - NOW
- Number of investee companies engaged on climate; number of climate action 100+ companies engaged; investee companies achieving climate milestones; voting on climate proposals (SEI)

Some of these measures, particularly CVaR, are also the way the scenarios are analysed. In some cases, these are also recorded as metrics, in some cases not.

## Metrics relating to the operation of the trust

No schemes analysed their carbon emissions resulting from their own operations.

However, special note must go to Crystal who stated their policies to reduce these emissions, holding more meetings virtually to reduce trustee travel emissions, looking at heating and lighting usage, looking at paper and plas-

tic usage, among eleven actions in total.

## Data coverage

The majority of schemes (twelve schemes - 86% of sample) reported on the coverage of emissions measure of the portfolio.

- The lowest coverage was 67.4% (L&G – though this rises to 86.2% when considering eligible coverage, so excluding alternatives in the weighting).
- The highest coverage was 99% (NOW – though this is only disclosed for equity, and it is not clear what proportion of growth assets this comprises. Also, as noted above, this includes in the coverage figure from derivatives in the portfolio).

- The average coverage was 89.9%.

## Estimation

It is likely that significant proportions of the emissions data of covered assets are in fact estimated.

A smaller proportion disclosed the amount estimated. Five schemes (Cushon, NEST, ScotWid, Smart, TPP) provided the proportion estimated.

- The lowest proportion estimated was 8% (ScotWid)
- The highest proportion estimated was 22% (NEST – There is a detailed table of estimations, but no aggregate figure. This is the proportion of global equities, and it is not clear what proportion of the fund this represents.)
- Average proportion estimated was 14%

## Conclusions

Two TCFD recommendations are metrics-focused:

**1. Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.**

**2. Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas (GHG) emissions and the related risks.**

TPR has effectively imposed further requirements on Implied Temperature Rise or Science Based Targets as far as it is able. Given the complexity of the different ways of presenting current emissions, comparability.

The main surprise was the wide variation in disclosed emissions intensity within and between asset classes, particularly different kinds of capital investment in essentially the same businesses. For short-dated lending to companies to carry 35 times the carbon intensity as equity ownership suggests more an artefact of reporting methodology is being highlighted, not a true assessment of emissions intensity.

This is unsatisfactory for any form of comparison between schemes. The industry should work together to come up with common disclosures of current emissions incorporating views on how different asset classes, data gaps and carbon offsetting should be approached quickly.

This should be a particular focus as these metrics are the basis for the targets set by schemes. We would like to see more schemes providing more information on their risk management approaches by extracting more detail from their risk matrices where it relates to climate risks.

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**In reviewing the targets set out in the TCFD reports, we were interested to see whether schemes were setting targets around carbon emissions reductions in their portfolios, particularly to achieve net zero dates, and what other targets were being set.**

### Net zero targets

Most schemes have set net zero targets. Four schemes (Cushon, NPT, SEIMT, TPP, 28% of the sample) have not. In general, this is because they are sceptical of a net zero target and they highlight that their objective is to be Paris-aligned, potentially revising this as and when the COP tightens future emissions pathways. They argue this is more appropriate in managing climate risk. This narrative is more or less explicit in different schemes without targets. In Cushon's case, there is the additional point that they use carbon offsetting to reduce the emissions of their portfolios to be net zero already.

Of the net zero targets set, all target 2050 with the exception of two schemes (Aviva and Smart) which target 2040.

### 2030 emissions reductions target

The regulatory guidance is that schemes must set at least one target, and this should not be more than ten years away. As such all the schemes with net zero targets in 2040 or 2050 have to set a target sooner, which acts as their "real" target for the purposes of the regulation.

Nine schemes have therefore set emission reduction targets for 2030:

- The lowest reduction target is 45% (Mercer)
- The highest reduction target is 60% (Aviva)
- All other schemes target a 50% reduction
- The average reduction targeted is 51% by 2030

Of the schemes with net zero targets, only Smart did not set a de-carbonisation target for 2030. Its target is sooner, a 50% reduction by 2025.

### Additional targets

Schemes without net zero and emissions reductions have set the following targets:

- Cushon – set itself the target of reducing the footprint of the legacy Salvus default by 20%. No date was set for achieving this, though the report also highlights that this will be achieved in the coming year when the strategy is consolidated with the Cushon Sustainable Investment Strategy which has a 44% lower footprint. In their next report they will set another target.
- NPT – is targeting alignment to the Paris agreement.
- SEI – has set three annual targets to engage companies on climate risk and for companies to pass climate milestones.
- TPP – has set the target of achieving 95% coverage for emissions data in the next three to five years. At this point the trustees will believe the emissions data to be robust enough to set targets with.

## Conclusions

The final recommendation from the original TCFD was:

### 1. Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

To some extent, the debate of how best to address climate change and whether emissions reduction and net zero targets are actually meaningful is simmering under the surface within these master trust TCFD reports. Three schemes in this sample have set targets around actions they are taking over the next year or three to engage companies and improve the data they receive regarding their portfolios. These are, in general, real, on the ground actions affecting actual companies in the economy.

Nine schemes have put in place emissions reductions targets for eight years away. While these schemes are generally committed to reporting pro-

gress against their targets annually, it could be that the emissions reductions they achieve are the result of a combination of divestment and offsetting, doing nothing to reduce real world emissions.

There is a second concern here around the variety of emissions data discussed in the previous section. Many of the baselines for the emissions reductions targets will be restated over coming years as data improves and methodologies start to harmonize between providers. We will also have the addition of scope 3 data next year which may require a further revision of baselines. Whether these revisions will mask failure by the schemes will be hard, if not impossible, to track.

While the schemes have not engaged with each other as to which approach might be better, placing these reports side-by-side is instructive in framing this debate.



# Overall conclusions



**We came to this exercise on the back of a series of interviews around the DC industry. One of the outstanding findings from this process was that TCFD reports were a solution in search of a problem. There is no doubt that legislation putting addressing climate risks within pension schemes on the trustee board table has been positive. Mandating that they follow a process to consider this risk was also positively received. However, mandating that the outputs of that process are disclosed has highlighted the subjectivity and early stage of the development of a response from the financial services sector to addressing climate risk.**

We based the analysis in this report as much as possible on the objective and quantifiable data disclosed, rather than trying to assess the processes themselves. This was necessary given the time available and the nature of the reports. We had hoped that the data contained in the reports might be comparable between schemes and highlight where schemes were acting more quickly or slowly on climate change. We do not believe it would be fair to draw this conclusion from the results we have derived.

Of particular concern is the variety of time-horizons; levels of focus on members; and mixture of different emissions reporting and scenario analysis methodologies. This makes TCFD reports a weak basis of comparison between schemes. The only possible basis for a comparison would be to receive the data on the underlying holdings across all schemes of interest

and to re-run the analysis the schemes have done on a single basis. This is outside of the scope of this report.

If the reports are not to generate comparisons between schemes, we come back to the question of what they are for. The level of language and expertise required to read many of these reports is higher than most members, and indeed most of the sustainable finance community, possess.

We have not reviewed the member summaries the regulations require except to the extent they are written into the main reports, but on basis of the reports they summarise we suspect most members would be disappointed to learn that understanding their scheme's reaction to climate requires detailed understanding which most do not have.

Trustee and executive time and attention has no doubt been drawn away from more general issues, including action on climate change, to prepare, review and sign off these reports. Investment managers have been pushed to provide data in inconsistent formats across their funds and holdings.

It is difficult to see what the purpose of publishing these documents are compared to the purpose of compelling trustee boards to have a response to climate risk. We must do better with future guidance in this area, particularly around scenario reporting, to increase the benefit of future reporting to members and the wider public.

This is the first year of TCFD reporting and so we must hope that more work is done across the industry to make future reports more consistent with each other and more digestible to an outside audience. More formal reporting standards should be developed, not to constrain strategies, but to better enable comparisons between strategies.

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