



Dotting your i's and crossing your TCFDs:

LGIM's 5-step checklist for pension schemes'
climate reporting

The Task Force on Climate-related Financial Disclosures (TCFD) is an initiative established by the Financial Stability Board (FSB) developing best practice guidance for climate reporting in different sectors.

Its recommendations are structured around climate risks and opportunities in four thematic areas: governance, strategy, risk management, and metrics and targets.

LGIM was the world's largest asset manager to publicly endorse the TCFD recommendations when they were first released in 2017. In 2020, the UK government published a roadmap towards mandatory climate disclosures.¹ Commencing in 2021 with the largest listed companies and financial institutions, this will be rolled out in stages, with relevant schemes required to report in line with TCFD recommendations as early as October 2021 for schemes with over £5 billion in assets. LGIM was proud to take part in the governmental cross-industry working group that produced **detailed guidance** for schemes, launched in January 2021.

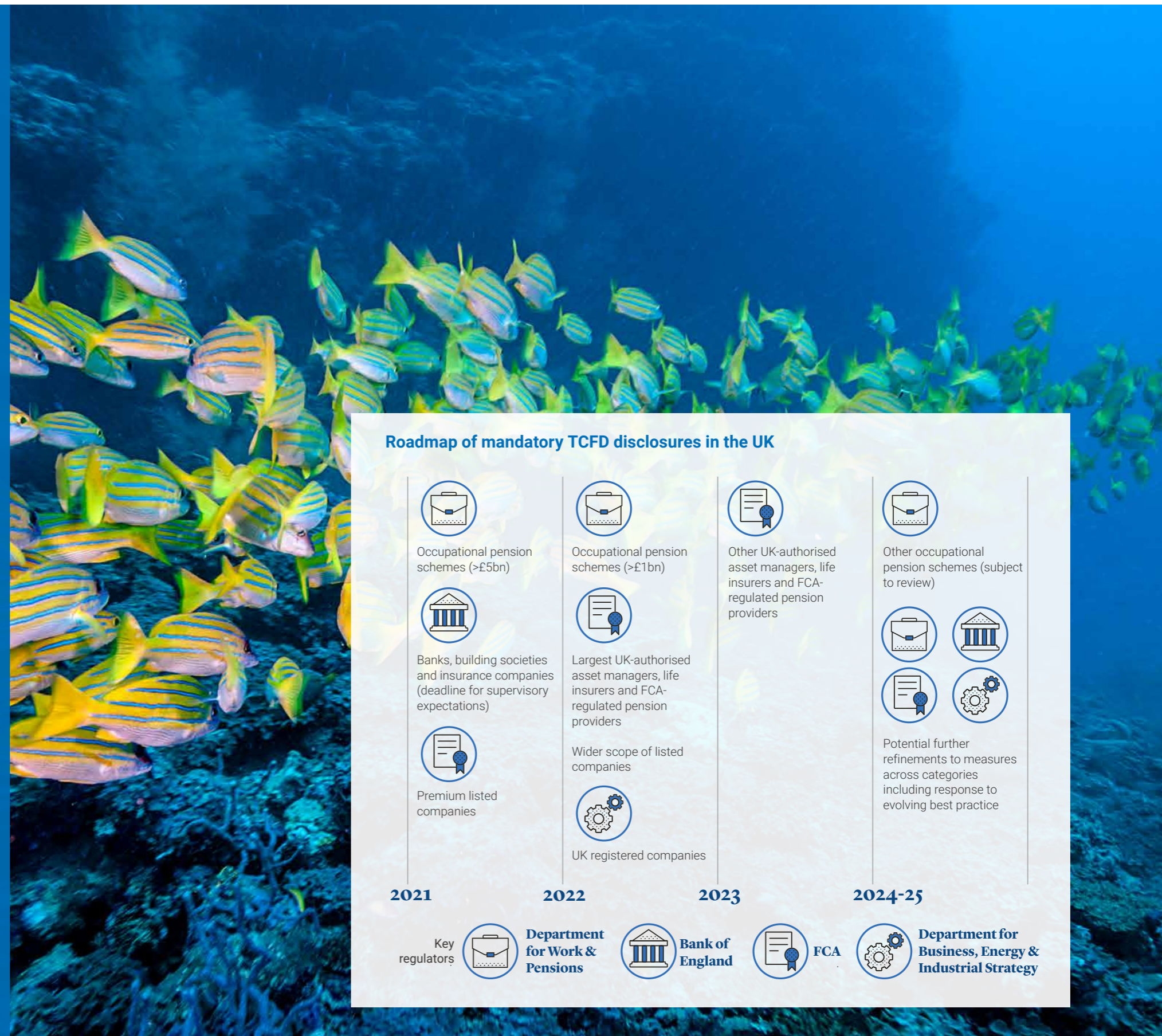
In this article, in addition to explaining how we provide support, we provide a five-step checklist which aims to help pension schemes take action today to prepare for these additional TCFD disclosure requirements:

1. Define your scheme's climate change beliefs
2. Measure your portfolio's carbon exposure
3. Analyse climate risks and opportunities affecting key companies, sectors and regions in your portfolio
4. Act: embed climate considerations into your trustee governance, ensure climate change is accounted for in manager selection and investment choices
5. Report on your approach, in line with the new TCFD disclosure requirements

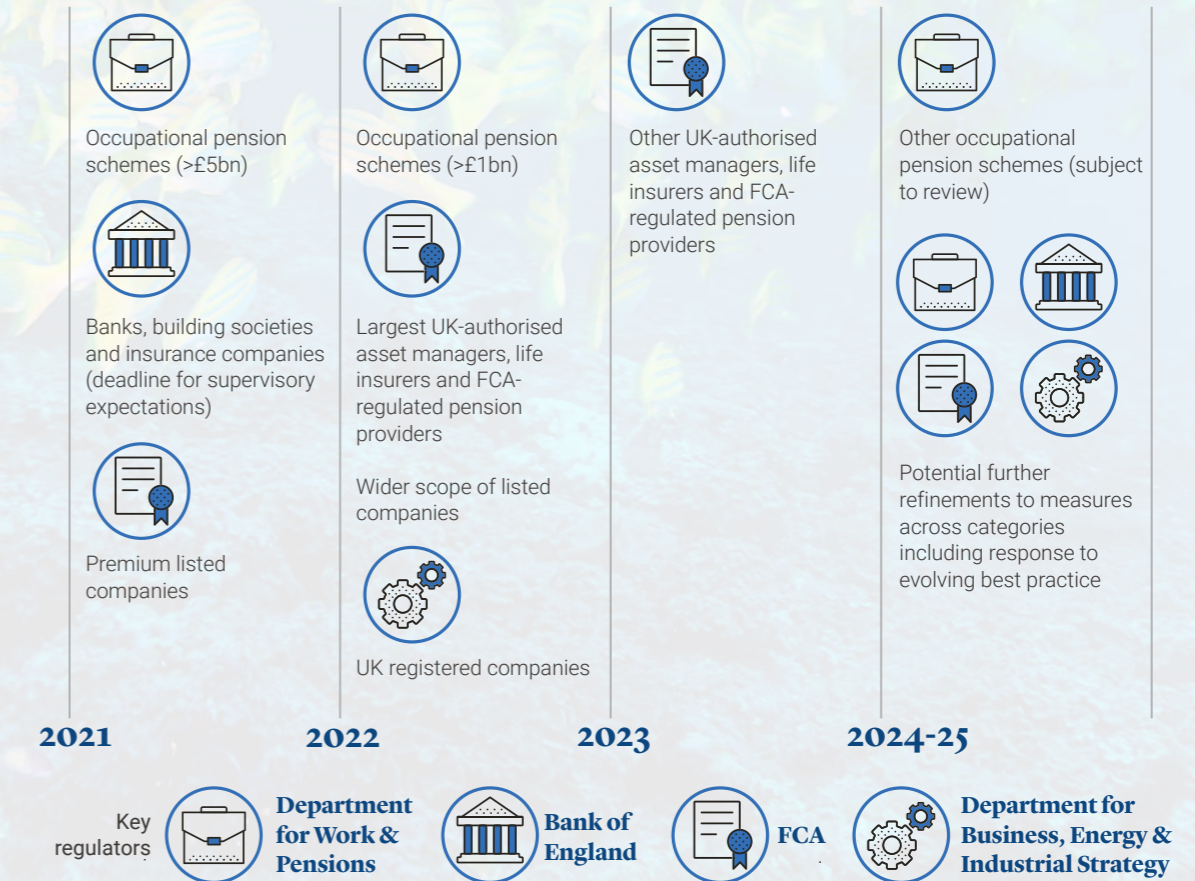
We realise many pension schemes rely on significant support from their asset managers - we also address the government's recommended 10 questions for trustees to ask their asset managers, and explain LGIM's responses.

1. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933783/FINAL_TCFD_ROADMAP.pdf

The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.



Roadmap of mandatory TCFD disclosures in the UK

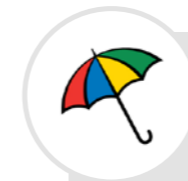


1. Define your scheme's climate change beliefs

Trustees are expected to define (or refine) their investment beliefs around climate change and relevant time horizons – what are the climate-related risks that the scheme is going to aim to incorporate, and to what extent will this affect what the portfolio invests in? The 2021 Pension Schemes Act encourages trustees to consider:

- the direct investment implications of a changing climate (so-called 'physical risks', e.g. losses in value to coastal real estate from flooding)
- the indirect implications of the response to climate change (so-called 'transition risks', e.g. losses in value to a coal power plant from government emissions limits or from cheaper, cleaner energy)

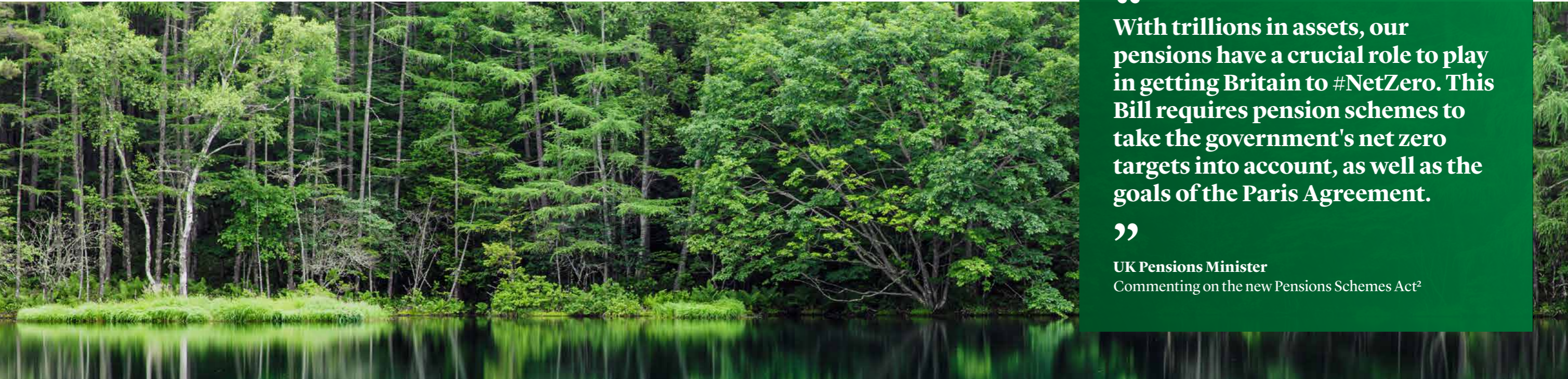
In our view, some sectors (for example renewables and electric vehicles) and assets (such as green infrastructure) and individual companies are well-placed to benefit from the transition to a low-carbon world, while others are likely to struggle (which may also present issues for the covenants of defined benefit schemes). We believe defining or refining your scheme's climate change beliefs is a crucial first step in making coherent and effective decisions that may help to position your portfolio for a greener future.



How LGIM can help

We issue regular educational materials on climate change, including:

- [thought leadership](#)
- [regular blogs](#)
- [checklists](#) for investors
- training sessions for trustees
- [webinars](#) and [podcasts](#)



“
With trillions in assets, our pensions have a crucial role to play in getting Britain to #NetZero. This Bill requires pension schemes to take the government's net zero targets into account, as well as the goals of the Paris Agreement.
 ”

UK Pensions Minister
 Commenting on the new Pensions Schemes Act²

2. <https://twitter.com/guyopperman/status/1351549045811138561>

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10 questions to ask asset managers - adapted from government guidance:³



1. Do asset managers know, and disclose, their exposure to fossil fuel assets?



2. Do they commit to providing trustees with appropriate climate metric data?

2. Measure your portfolio's carbon exposure

In order to implement your beliefs, it is important to calculate your portfolio's starting point. A natural first step for many trustees is to review their exposure to high-carbon stocks and industries. One of the 10 questions that the government recommends schemes ask their managers is disclosure around exposure to fossil fuel assets³. Other things being equal, high emissions may be a proxy for higher carbon risk. In practice, however, things are often not equal: two oil companies might have the same emissions today, but if one is linking their executives' pay to reducing emissions, whilst the other is tying pay to the growth of oil and gas production, their risk profiles may diverge. Past emissions performance is not a guarantee of future emissions.

Government recommendations recognise the value of forward-looking metrics, suggesting that trustees look beyond just emissions. Specifically, statutory guidance⁴ suggests trustees choose:

- Two emissions-based metrics (such as carbon footprint and total greenhouse gas emissions), and
- One additional climate metric (such as a measure of temperature alignment, climate value-at-risk, or a measure of data quality)

3. Questions are adapted from guidance available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/956378/aligning-your-pension-scheme-with-tcfd-recommendations-part-2-quick-start.pdf

4. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/991958/statutory-guidance-final.pdf



How LGIM can help

For several years, LGIM has been **providing data on carbon emissions and fossil-fuel reserves** on select fund factsheets in our Future World fund range*, and we are expanding this capability to capture more funds and 'green' revenues.

Our **Climate Impact Pledge** ratings are intended both to help our clients better understand the evolution of companies in their portfolio, and to help companies address gaps in their strategies and disclosures. We have compiled Climate Impact Pledge ratings for c. 1000 large companies and have made them publicly available on our website.

LGIM provides **an annual report of the progress made by companies on key climate metrics** (for example, improvements in their emissions targets and emissions performance), as well as details of climate-related sanctions.

Below are the metrics LGIM aims to report on for trustees to support their alignment with best practice:

- **Carbon footprint** – a measure of a company's carbon emissions relative to its size - total carbon emissions/ EVIC (enterprise value including cash)
 - **Temperature alignment** - a measure of the global warming temperature outcome implied by companies' activities and targets
 - **Quarterly climate-related engagements** associated with relevant funds
 - **Total carbon emissions** – a measure of absolute emissions associated with a given investment – carbon footprint multiplied by investment size
 - **Weighted average carbon intensity** – a measure of carbon 'efficiency', i.e. how much carbon companies emit to generate a unit of revenue – the weighted average of companies' emissions relative to sales
- We will also seek to provide trustees with information on the coverage of metrics and **data quality**, and work to address limitations in coverage and analysis in different asset classes. As with all data, we believe the value of a quantitative approach is maximised when combined with qualitative insights from our ongoing engagement with investee companies.

LGIM Climate Impact Pledge dashboard

Orsted A/S

Sector: Utilities
Region: Europe ex UK
ISIN: DK0060094928

LGIM Climate Impact Pledge dashboard

The company's performance against key indicators is shown in a 'traffic light' system below. LGIM encourages companies to address any highlighted gaps in their disclosure and strategies, and will sanction companies falling short of its minimum standards. Aggregate ratings against 5 categories are shown for comparability only.

Scores are updated bi-annually. This rating was last updated 15/02/2021.

Have questions about the data? >

88 _{/100} Governance See scoring metrics >	50 _{/100} Scenario Analysis See scoring metrics >	100 _{/100} Metrics & Targets See scoring metrics >	77 _{/100} Risks & Opportunities See scoring metrics >	88 _{/100} Strategy See scoring metrics >
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The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested. For illustrative purposes only. Reference to a particular security is on a historic basis and does not mean that the security is currently held or will be held within an LGIM portfolio. The above information does not constitute a recommendation to buy or sell any security. *Reference to specific products is for illustrative purposes only.

3. Analyse climate risks and opportunities



Just as with individual companies, so with entire portfolios; similar levels of overall emissions may nevertheless be associated with different levels of climate risks. In our view, trustees should supplement high-level carbon reporting with an understanding of how climate dynamics may vary across companies, sectors and regions.

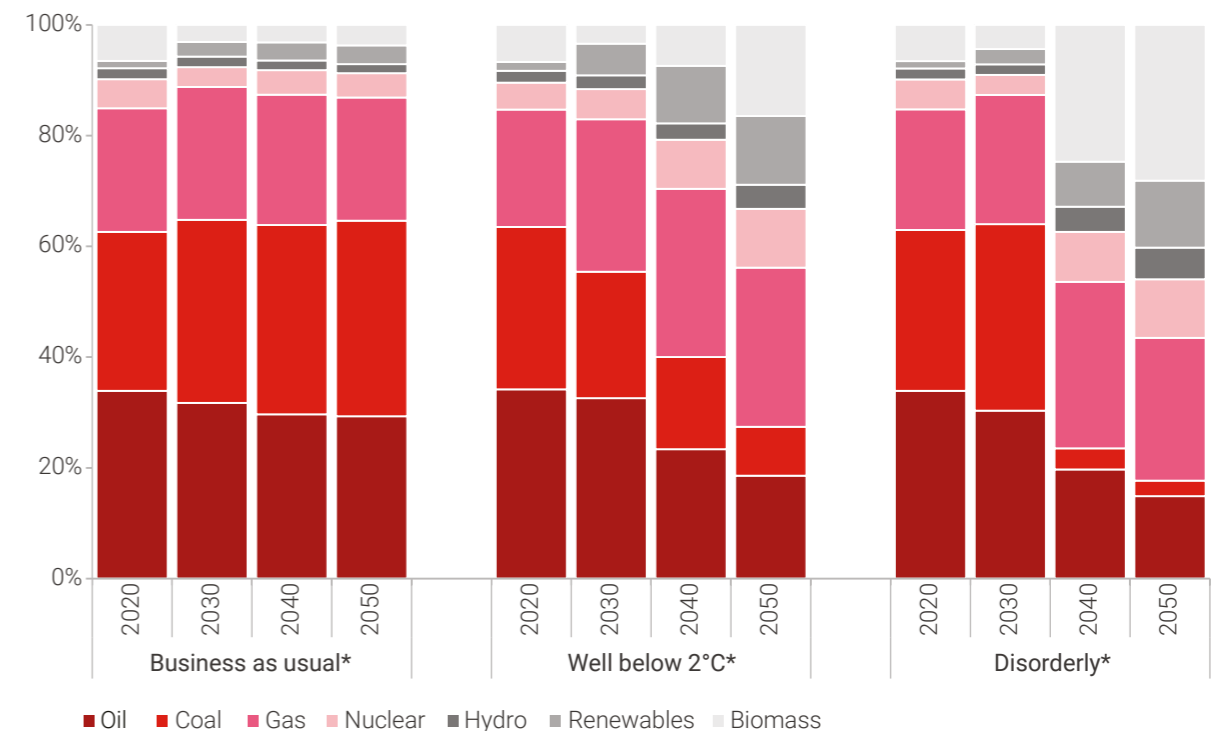
We have developed a number of tools to help assess these implications at different levels of analysis, including our LGIM Destination@Risk model, which looks at the implications of different climate change scenarios across the global economy.

10 questions to ask asset managers



3. Do they commit to disclosing climate-related scenario analysis?

Evolution of the global primary energy mix in different scenarios



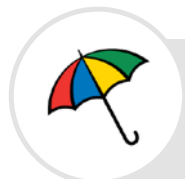
Source: LGIM Destination@Risk and LGIM analysis, as at March 2021. *See table on page 11 for definitions.

The government guidance recommends trustees conduct scenario analysis 'as far as they are able', as a lack of data or resources may pose limits in certain asset classes or portfolios.

Whilst 'bottom-up' analysis starting with individual

securities may not always be feasible for pension schemes, the guidance also recognises that trustees may still benefit from conducting more qualitative, top-down analysis of the macro-economic impacts of climate change, with a particular focus on the evolution of the energy mix of the future. This is an issue on which we have regularly presented to our clients, both directly and through guidance materials, podcasts etc.

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How LGIM can help

Looking in more detail at our investment process, we have evolved our investment process in the following areas:



Sectors

Industry specialists from our Investment, Real Assets and Investment Stewardship teams have established working groups to assess the evolving materiality of climate and ESG factors across different sectors, from energy to consumer goods, and to better unify our engagement efforts.



Portfolios

Voting and engagement remains a cornerstone of our approach to climate risk mitigation across **index funds**. We have helped design indices to reduce exposure to high-carbon sectors and/or increase exposure to companies generating 'green' solutions, across both equity and debt. Across our **actively managed funds**, climate considerations are incorporated through bottom-up research as part of the security selection process.



Countries

We have developed scores that aim to capture countries' exposure to climate change, air quality, water stress, vulnerability to natural hazards, and food security. In a [recent article](#), we outlined how our emerging market debt team uses data on climate vulnerability to navigate the investment risk associated with government bonds.

"..Scores on food security and high vulnerability to climate change led us to reduce our position despite the bond's scarcity and attractive relative value.."



Asset allocation

Our multi-asset fund managers incorporate climate factors into their analysis for strategic asset allocation and risk management, utilising informed metrics to understand this key long-term challenge.

Under our partnership with a leading external consultancy to co-develop 'LGIM Destination@Risk' – we have modelled the transitional and physical risks of climate change over the next 30 years. We have conducted **scenario analysis** around three main energy pathways:

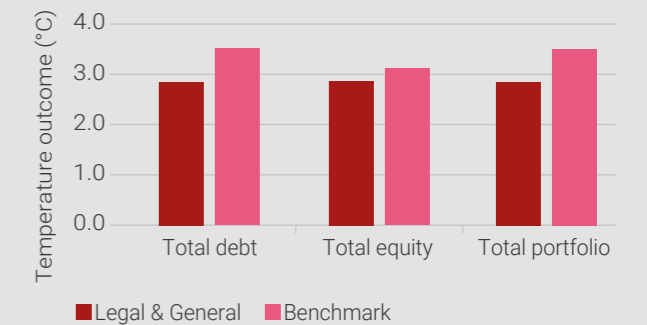
Scenario	Description	Outcome
Business as usual (BAU)	World fails to act to make the necessary changes to address climate change.	Global average temperature rise of 3.5°C or more by 2100
Well below 2°C	World takes early, definitive, joined-up policy and investment actions. Company and consumers align their behaviour with a carbon neutral economy.	Below 2°C
Disorderly	Collective action to achieve climate outcomes is delayed to 2030, resulting in a more abrupt transition	

Our modelling is used to derive two key metrics:

- **Temperature alignment** – a measure of the global warming scenario implied by the emissions trajectory of a portfolio's holdings
- **Climate Value-at-Risk** – a measure of the estimated climate impact on bond and equity values

We are also developing our ability to produce quantitative climate reporting for our portfolios to help our clients with this step.

Temperature portfolio alignment



For illustrative purposes only. Source: Legal & General Group TCFD report 2021.

10 questions to ask asset managers



4. How do they undertake top-down research and analysis related to climate-related risks?



5. Do they consider climate risks across asset classes and investment strategies?





4. Act: embed climate considerations in governance, and ensure climate change is accounted

After measuring carbon exposure and 'looking under the bonnet' to see climate implications across sectors, there are a range of actions trustees can take. First and foremost, given the regulatory October 2021 deadlines, is to embed the oversight of climate risks into regular **governance** processes. This can involve:

- Clearly delineating and documenting the responsibilities between the trustee board, the investment committee (if applicable) and the designated asset manager
- Implementing regular monitoring and reporting

Moving from governance to **strategy**, a second important stage is to include climate competence in manager selection, review and monitoring. Some pension schemes may find that their existing governance and manager arrangements are sufficient, whilst others may find the need for further strategic actions, such as:

- adjusting allocation to certain assets and sectors
- adopting low-carbon benchmarks (for index funds)
- changes to investment objectives and restrictions (for active funds)
- reviewing default and self-select funds (for DC schemes)

Such actions can be further strengthened through **targets**, such as a reduction of the carbon footprint (or temperature alignment) associated with the portfolio. We recognise this is still a nascent area; fortunately, trustees are not alone, as a growing number of organisations – such as the UN-backed Net Zero Asset Owner Alliance or the Paris-Aligned Investment Initiative⁵ – are developing guidance and the tools for asset owners to collaborate when approaching targets. LGIM is an active collaborator with investor networks developing best practice guidance to support clients.

5. <https://www.parisalignedinvestment.org/>; <https://www.unepfi.org/news/industries/investment/net-zero-asset-owner-alliance-publishes-final-target-setting-protocol/>

10 questions to ask asset managers



6. Do they support shareholder resolutions on climate change?



7. What is their escalation policy when engagement is unsuccessful?



8. Do they conduct public policy advocacy on climate change?



How LGIM can help

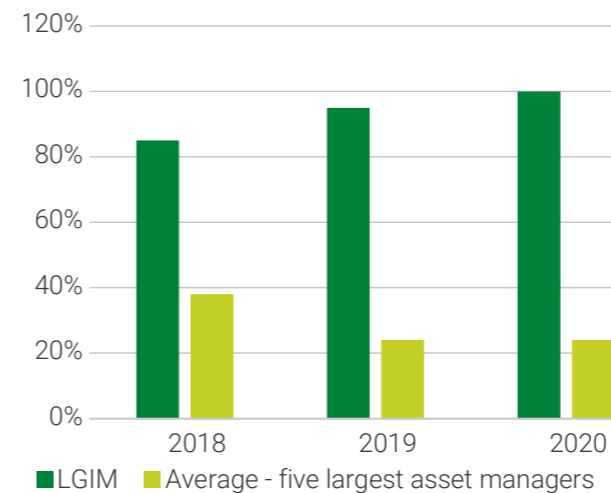
At LGIM, we have been **staunch advocates of sustainability** in our engagements with companies and policymakers.

- In 2020, **LGIM was ranked highest among asset managers** for our approach to climate change in a review by NGO ShareAction⁶ with the UN-backed Principles for Responsible Investment (PRI) also selecting us as part of **its 'leaders group' on climate change**.

Escalation is a key part of our engagement approach, alongside:

- **supporting** (or co-filing) shareholder proposals on climate change,
- **voting** against directors or even **divesting** from companies,
- **public pressure** in the media, and
- **collaboration**.

Support for 'climate-critical' shareholder proposals



Source: LGIM, Majority Action, as at December 2020

www.reuters.com

Investor Legal & General to vote against Exxon chair re-election over climate

www.legalandgeneral.com

Legal & General calls on urgent government to take urgent action to reduce emissions from the built environment

Under the Net Zero Asset Manager Initiative, LGIM has committed to work with clients to help them go further along this journey and to develop net-zero-aligned solutions. Having pledged to increase the proportion of assets under management under a net zero target:

- At the end of 2020, LGIM's Real Assets team published a roadmap to help achieve its commitment to net-zero emissions by 2050 or earlier
- In early 2021, by L&G Workplace Pensions and L&G Mastertrust* set out a roadmap to net zero for all auto-enrolment default options

Further announcements are expected ahead of the crucial COP26 climate conference later in 2021.

6. <https://shareaction.org/research-resources/point-of-no-returns/point-of-no-returns-part-iii-climate-change/>
*Reference to specific products is for illustrative purposes only.

5. Report


Bringing it all together, trustees are expected to communicate the details of their approach in TCFD-aligned disclosures, which are to be made publicly available, mentioned in the annual benefit statement and incorporated into other member communications (where appropriate).

Many trustees will naturally seek to incorporate elements of regular reporting from their asset managers – for example, around their voting record or managers’ own TCFD reporting.⁷

New climate disclosure requirements are growing across the capital structure, from asset owners to companies. At the nexus between the owners and beneficiaries of capital, asset managers can play a key role in accelerating the transition to a sustainable future.

10 questions to ask asset managers

- 9.  Are they transparent regarding all their voting activity?
- 10.  Have they produced a TCFD report?



How LGIM can help

LGIM issues **regular reporting** to help clients meet their obligations, including:

- **voting disclosures** the day after shareholder meetings, and
- **quarterly and ad-hoc** communications.

Both LGIM and L&G Group have issued **TCFD-aligned reporting**.



7. LGIM’s active ownership report provides a high-level overview of our alignment with the TCFD recommendations. For more detailed TCFD-aligned reporting, please see [LGIM’s PRI report](#). Legal & General Group Plc’s TCFD report is also available [here](#). LGIM’s active ownership report provides a high-level overview of our alignment with the TCFD recommendations. Voting disclosures with rationales for key votes are available [here](#).



“
Our responsible investment strategies are already channelling capital towards low-carbon solutions; we are accelerating our efforts to help our clients set and meet decarbonisation goals for their portfolios. As we invest in many of the world’s largest companies, we continue to hold them to account. Delivering the net-zero ambition requires substantial change across the global economy and LGIM will be at the heart of these efforts.
 ”

Michelle Scrimgeour
 CEO, LGIM

Authors



Caroline Ramscar
 Head of Sustainability Solutions



Iancu Daramus
 Senior Sustainability Analyst

Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM representative



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