

15th July 2021

Dear Sir/Madam,

Re: TPI Response to the TCFD Forward-Looking Financial Sector Metrics Consultation

We are responding to your consultation on two documents: *Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans* and the associated *Measuring Portfolio Alignment: Technical Supplement*. We do so as Asset Owner members of the Transition Pathway Initiative (TPI) an initiative we established as asset owners to serve the needs of asset owners in understanding the transition to a low carbon economy aligned to the Goals of the Paris Agreement.

Please note that a more detailed technical submission will be made by the TPI technical team to the technical aspects of the consultation. This letter focuses on the concerns of asset owners regarding TCFD's proposals on portfolio assessment and portfolio alignment¹.

The Transition Pathway Initiative has been a long-standing supporter of TCFD and of initiatives that support TCFD (e.g. Climate Action 100+). We recognise the important role that TCFD has played in framing and driving corporate and investor climate change disclosures and in putting climate change on the agenda for company and investor leadership teams. We also see that TCFD has now achieved the status of a *de facto* standard-setting body on climate-related disclosures; that is, if TCFD recommends disclosure of an indicator or other information, that recommendation is treated in a similar manner to a disclosure request from a regulatory agency.

In preparing this submission, we have consulted extensively with other asset owners, we have carefully reviewed the two consultation documents and we have had a detailed discussion with the TCFD Team and other members of the COP26 Private Finance Hub.

Our conclusion from those discussions can be summarised as follows:

- There remain significant gaps and technical weaknesses in the two consultation documents which mean that the recommendations in the report relating to portfolio

¹ We also wish to note that we agree with many of the specific elements of the consultation. For example, we welcome the proposals to develop a specific list of climate metrics and targets which are essential to enable the climate transition (the TPI technical submission provides further commentary on this point), the emphasis on climate opportunities as well as risks, and the focus on decarbonisation strategies.

assessment and portfolio alignment are not supported by the information presented in the reports. We also note the similar concerns expressed by the Bank of England in its May 2021 paper: *Options for greening the Bank of England's Corporate Bond Purchase Scheme*².

- We disagree with the positioning of implied temperature rise as a more sophisticated – and, in turn, more relevant - metric. We acknowledge that calculating implied temperature rise is a complex calculation than other methods presented, but this does not mean that it is a more robust or decision-useful measure.
- The adoption of portfolio alignment metrics will have a series of undesirable consequences for asset owners potentially forcing them to breach their fiduciary duties, imposing significant additional costs on asset owners. We remain concerned that the TCFD's proposals seem to have been developed without consideration of the feasibility and cost versus the benefits for pension funds or asset owners. We see the attraction of the TCFD's proposals for fund managers looking to develop and market green products, but do not see the same benefit for asset owners that have very different duties, interests and responsibilities.
- Our most fundamental concern remains that the TCFD's proposals will drive decisions that could undermine wider efforts to transition to a low carbon economy. In particular, the implied temperature metric has the potential to create wide misunderstanding and to drive the carbon washing of portfolios. It would become increasingly difficult to hold a portfolio of transitioning assets in high carbon intensive sectors, even if those very same companies had been responsive to investor engagement and made credible and independently verified net zero aligned targets that were consistent with the transition. Given that these are the companies and assets we need to transition, such an outcome seems perverse and, presumably, not the intention of the TCFD's proposals.

In order to support asset owners as effectively as possible we have offered to work with TCFD to map out the steps that need to be taken to develop an implied temperature metric, to define the data needed to construct such metrics and to understand how these metrics might be used in investment decision-making. We think that this work will provide the robust foundations needed to support the development of robust portfolio alignment metrics and address the concerns we have outlined.

² See <https://www.bankofengland.co.uk/-/media/boe/files/paper/2021/options-for-greening-the-bank-of-englands-corporate-bond-purchase-scheme-discussion-paper.pdf?la=en&hash=9BEA669AD3EC4B12D000B30078E4BE8ABD2CC5C1>

Below, we set out our views in more detail, providing:

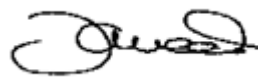
- A brief overview of the Transition Pathway Initiative's (TPI's) experience in this area and of our current and future priorities.
- Our general views on the state of play on portfolio alignment metrics.
- Our views on the two TCFD reports.
- A summary of how we might make progress.

We trust that you will find these comments and proposals helpful. We look forward to hearing from you.

Yours sincerely,



Adam C.T. Matthews
Chair
Transition Pathway Initiative (TPI) &
The Church of England Pensions Board



Faith Ward
Member TPI Steering Committee &
Brunel Pension Partnership



David Russell
Member of TPI Steering Committee &
USS



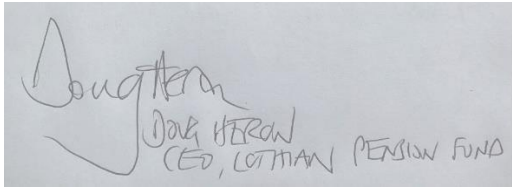
Bess Joffe
Member of TPI Steering Committee &
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Chandra Gopinathan
Member of TPI Steering Committee
RPMI – Railpen



Rachel Ewell
TPI Asset Owner Member
Border to Coast Pensions Partnership



Doug Heron
Doug HERON
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Lothian Pension Fund



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1. **Background: The Transition Pathway Initiative and portfolio alignment metrics**

The Transition Pathway Initiative (TPI) is a global initiative led by Asset Owners and supported by Asset Managers. Established in January 2017, TPI now has 105 investor supporters with over \$29 trillion combined Assets under Management and Advice. TPI's supporters have committed to using the tool and its data in a range of ways, including to inform their investment research, in engagement with companies and in tracking managers' holdings.

Using publicly disclosed data, TPI assesses the progress that companies are making on the transition to a low-carbon economy, supporting efforts to mitigate climate change. The TPI is in line with the recommendations of TCFD and provides data for the Climate Action 100+ initiative. All TPI data are published via an open-access online tool: www.transitionpathwayinitiative.org

TPI has – with its supporters and in partnership with various investor initiatives– pioneered, and continues to pioneer, the development of portfolio assessment and portfolio alignment tools. In partnership with our research partner (the Grantham Institute at the London School of Economics) and our data partner (FTSE Russell), these include the development of:

- Carbon performance assessment tools, using the sector decarbonisation approach, for a range of high impact sectors including electricity, oil and gas, mining, transport, steel, food and chemicals.
- Net zero standards for the oil and gas sector (forthcoming, July 2021) and for the diversified mining sector (forthcoming, late 2021).
- Sector transition pathways and frameworks for various sectors. We are currently working on electricity and steel, and expect to complete these as well as transport by the end of 2021.
- Carbon performance assessment frameworks for corporate fixed income, sovereigns (the ASCOR project) and banks.
- An assessment framework for responsible climate change lobbying (forthcoming, Sept 2021).

2. **Our Position and Perspective**

We think it is important to start with a summary of our position:

- We – both through our leadership role within TPI and through our individual organisations – strongly support the principle of portfolio alignment as demonstrated through our work with and active support of, amongst others, the Paris Aligned Investing Initiative (PAII). We have been long-standing supporters of TCFD. We have used TCFD to structure our own climate change reporting, we have aligned the TPI with TCFD, we have encouraged companies (directly and through collaborative engagement such as CA100+) to align their reporting with TCFD, and we have supported policy proposals to introduce TCFD into legislation.

The Bank of England's Perspective

We note that the Bank of England drew similar conclusions – both about the relevance of the implied temperature metrics and about the hierarchy of different assessment methodologies - in its May 2021 paper: *Options for greening the Bank of England's Corporate Bond Purchase Scheme*³

In relation to forward-looking metrics it noted: “Implied temperature rise (ITR) metrics have a particularly appealing intuition. But the current generation of measures remains very sensitive to assumptions, complicating their use in operational decision making. Methodologies for these types of measures are, however, improving... Nonetheless, some issues are inherent to ITR metrics, and may not be eliminated entirely by methodological improvements. For example, they require a large number of assumptions about the nature and credibility of constituent firms' future emissions paths, and can be sensitive to small changes in these assumptions.

Therefore, in parallel to this ongoing support, the Bank and others are exploring simpler and more transparent approaches to forward-looking metrics. This includes looking directly at corporate decarbonisation plans, rather than incorporating them into ITR metrics, to avoid the range of assumptions needed.”

- These initiatives – TPI, AOA, PAII, TCFD – have made many important contributions in terms of data, metrics and tools. However, assessing portfolio alignment – in particular, using the more complex metrics such as implied temperature rise – remains very much a work in progress. There are many data and methodology issues that need to be resolved before such metrics can be considered ready for widespread adoption. We have attached our October 2020 submission to TCFD which sets out some of these issues.
- We are concerned that what we see as the rush to adopt portfolio alignment metrics – in particular those which reduce this to a single metric – will have a series of undesirable consequences for asset owners. In particular, we are concerned that:
 - Asset owners will be forced to make investment decisions that compromise the duty that they owe to their beneficiaries.
 - We create incentives for asset owners to divest from high impact sectors rather than to stay invested and encourage, challenge and support company management to decarbonise their business and achieve net zero.
 - The utility of the proposed metrics for decision-making has not been fully demonstrated; we risk requiring asset owners to do a significant amount of work that provides no benefit either to them as investors, to their beneficiaries or to wider society.
- The status of TCFD means that it is now a *de facto* standard in many jurisdictions and an actual standard in an increasing number of jurisdictions. Therefore, any changes, even if apparently modest, need to be properly scrutinised and reviewed before they are adopted.

³ See <https://www.bankofengland.co.uk/-/media/boe/files/paper/2021/options-for-greening-the-bank-of-englands-corporate-bond-purchase-scheme-discussion-paper.pdf?la=en&hash=9BEA669AD3EC4B12D000B30078E4BE8ABD2CC5C1>

This is not a call to preserve TCFD as it is for all time but, rather, an acknowledgement that the evolution of TCFD needs the same level of scrutiny and governance as domestic legislation. That is, the benefits and the costs of any changes to TCFD need to be clearly documented and discussed.

3. Comments on the TCFD reports

Turning to the two TCFD reports (*Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans* and *Measuring Portfolio Alignment: Technical Supplement*), we would like to offer the following comments:

- We recognise the importance of both documents and support their general aims.
- We are however concerned that they risk hard-wiring inappropriate reporting requirements into TCFD, at a point when those technical requirements are a long way from being properly developed, meaningful, decision-useful or even cost-effective to apply (again, see our October 2020 submission to TCFD).
- We are concerned that both documents draw conclusions that are not supported by the analysis within the reports. As we discussed in our meeting, the reports do not set out – for example – the core steps that need to be followed to produce an implied temperature metric. As a consequence, assertions in the report (e.g. ‘Additionally, only ITR tools provide the ability to translate degree of misalignment of a given company with a benchmark into consequences for a desired climate goal,...’ (p. 6)) are simply not supported by the analysis in the report.

4. Moving Forward

As we discussed, there is a strong interest and desire on our part to advance this agenda at pace, and to support TCFD in its efforts. There are two areas where we think progress can be made:

- Rewording the TCFD recommendations so that additional reporting requirements are introduced for asset owners only at the point when such reporting is practical, cost-effective and generates decision-useful information.
- Developing a more rigorous approach to and understanding of portfolio alignment metrics and measures. We outline each of these briefly

4A. TCFD Recommendations

- We refer to the Asset Owner related recommendation on p. 69 (which states: “Asset owners should measure and disclose the alignment of their portfolios consistent with a 2°C or lower temperature pathway (e.g., Paris-aligned), and incorporate forward-looking alignment metrics into their target-setting frameworks and management processes.”)
- Our view – reflecting the comments above - is that this wording is both overly prescriptive and not reflective of current practice, and therefore needs to be changed. We also recognise that there is a need to create pressure for action in this area so that robust, decision-useful tools and metrics are developed.

- We therefore suggest the following wording: “As the data and tools to assess portfolio alignment are not, as yet, sufficiently developed, asset owners should plan to measure and disclose the alignment of their portfolios consistent with a 2°C or lower temperature pathway (e.g., Paris-aligned), and incorporate forward-looking alignment metrics into their target-setting frameworks and management processes. Asset owners should also report on the efforts they have taken and intend to take to produce the data and tools necessary to conduct a full portfolio alignment assessment.”

4B: Portfolio alignment metrics and measures

The narrative in the Technical Supplement about implied temperature rise metrics is essentially a black box discussion. It is asserted that the approach is relevant but with no substantive explanation of what the approach involves (i.e. how is the metric constructed), the data needed to construct the metric or the decision-usefulness of the metric or the underlying calculations.

We have therefore suggested to the TCFD Team that we work with them to conduct an analytical exercise that has three elements:

- A mapping of the steps that need to be taken to develop an implied temperature metric or other measure of portfolio alignment.
- For each step:
 - Identify the data needed for the step [noting that there may be more than one approach or that different data sets may fill the same need].
 - Assess whether the data sets exist or whether there are gaps.
 - Identify the actions needed to fill these gaps.
- For each step:
 - Explain what inferences/conclusions could be drawn if complete data sets were available.
 - Explain what inferences/conclusions could be drawn using current data sets.
 - Define the decisions that can be made based on the information.

This analysis will require further consideration on an asset class by asset class basis and will also need an explicit discussion of uncertainties (in data, in methods, in decision-making).