Task Force on Climate-Related Financial Disclosures

Climate Change – Related Disclosures

ARUP UK PENSION SCHEME

August 2021

Contents

1 Introduction

TCFD framework

The TCFD released its final recommended framework for climate-related financial disclosure in June 2017 with four key recommendations outlined below.

Figure 1: TCFD Framework

The recommendations are in four key areas:

Governance
The organization's governance around climate-related risks and opportunities

Strategy
The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning

Risk Management
The processes used by the organization to identify, assess, and manage climate-related risks

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities

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TCFD Statement

This report outlines how the Trustees have established and maintained oversight and processes to satisfy that the climate-related risks and opportunities, which are relevant to the Scheme, are appropriately considered by all stakeholders involved in the day-to-day management of the Scheme.

The Trustees support the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCDD) as a best-practice framework to manage and report on the actions being taken to identify climate change related risks and incorporate climate change risk management into investment processes. For the avoidance of doubt, this report does not fully comply with the requirements set out in the forthcoming Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 and supporting Statutory Guidance. The Scheme does not fall under the requirements of the Regulations at least until 2023, subject to further guidance coming into force.

The Trustees are, on behalf the Scheme's members, a long-term investor. It is therefore in the interests of members that the market is able to effectively price climate-related risks and that policy makers, and other market participants, are able to address these risks and avoid market failure. The Trustees believe that TCFD-aligned disclosure from asset owners, asset managers, and companies, is in the best interest of the Scheme's members.

3 Governance

The Trustees' governance oversight with respect to climate change-related risks and opportunities

Policy approach

The Trustees maintain a Statement of Investment Principles (SIP), which details the key beliefs, risks and approach to responsible investment (RI) and climate change. This is reviewed on an annual basis or more frequently as required. Further, the Trustees have developed a standalone Responsible investment beliefs policy which details the Trustees' position in matters such as ESG integration, stewardship and climate change; this policy is appended to the SIP and periodically reviewed.

Oversight of climate change risks

The Trustees have ultimate oversight in respect of climate change exposures and their potential impact on the Scheme. Decision making in respect of investment aspects is delegated to the Investment Sub-Committee with oversight from the Trustees. The Trustees, and their Investment Sub-Committee, meet at least quarterly and receive quarterly performance reports from their investment consultant, which include ESG ratings for relevant investment mandates. The ESG ratings reflect the investment consultant's view on the extent to which environmental, social and corporate governance and active ownership practices (voting and engagement) are integrated into the manager's investment process and decision making across asset classes, including an assessment of how managers are taking climate change into consideration. This reporting includes a comparison of manager ESG ratings against their peer group. In the majority of cases to date, the Scheme's investment managers have had better results than the average for their respective peer groups.

In the first quarter of 2021, the Trustees engaged with the investment managers in respect of exposures within the Scheme's investments to companies that derived revenue from coal-based power generation and coal extraction. As part of this, the Trustees challenged investment managers in relation to specific strategy holdings where the percentage of revenue derived from coal was considered material, and in respect of the investment managers' policies on such holdings.

Training and climate competency

The Trustees receive relevant training on responsible investment, including climate change, as required. Responsible investment topics may also form stand-alone agenda items at meetings. The Trustees' investment managers are also asked to explicitly cover ESG and climate issues when presenting to the Trustees or the investment sub-committee. In the year under review, the Trustees undertook investment training provided by their investment consultant on responsible investment which covered ESG factors, stewardship, climate change and ethical investing. Training provided over the year included sessions covering:

- Implementing a sustainable equity allocation, in May 2020;
- The integration of ESG factors in different asset classes (besides equities) in November 2020 and in March 2021.

The investment consultant's approach to climate change and how these are integrated into its advice and services is assessed as part of the selection and monitoring process.

Day-to-day implementation

The Trustees have given appointed investment managers full discretion in evaluating ESG factors, including climate change considerations, and exercising voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code. This includes monitoring and engaging with relevant persons (including issuers of debt of equity, investment managers or other relevant stakeholders) about relevant matters concerning the issuer of debt or equity (Including their performance, strategy, capital structure, management of actual or potential conflicts of interest, risks, social and environmental impact and corporate governance).

From this year onward, the Trustees will publish their Engagement Policy Implementation Statement detailing how they have implemented their approach to Responsible Investment and climate change considerations, as laid out in the SIP.

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Strategy

The Trustees’ approach to managing strategic climate change risks and opportunities

Climate change related-investment risks and opportunities over the short, medium and long term

The Trustees believe that climate change presents risks over the short, medium and long-term that the Scheme should understand and mitigate where possible. Investment action is an important area for the Scheme to further develop their approach, including collaborative engagement opportunities. The Trustees support the objectives of the Paris Agreement, and believe that keeping a global temperature rise this century to well below 2ºC relative to pre-industrial levels is entirely consistent with securing strong financial returns.

As a long-term investor the Trustees recognise the risks and opportunities arising from climate change are diverse and continuously evolving.

The Trustees have considered the following short (next 3-5 years), medium (5-20 years) and long-term (20+ years) drivers of investment risk:

- Short term risks may present themselves through rapid market re-pricing as:
  - Scenario pathways become clearer. For example a change in the likelihood of a 2°C scenario occurring.
  - Market awareness grows. For example, the implications of the physical impacts of climate change become clearer to markets.
  - If policy changes catch markets by surprise. For example, if a carbon price is introduced across key markets to which the portfolio is exposed, at a sufficiently high price to impact behaviour.
- Over the medium term, risks associated with the transition to a low carbon economy are likely to dominate. These include the development of technology and low carbon solutions. Policy, legislation and regulation are likely to also play a key role at the international, national and subnational level. Technology and policy changes are likely to produce winners and losers both between and within sectors and lead to stranded asset risks.
- Over the long term, physical risks are expected to come to the fore. This includes the impact of natural catastrophes leading to physical damages through extreme weather events. Availability of resources is expected to become more important if changes in weather patterns (e.g. temperature or precipitation) affect the availability of natural resources such as water.

Strategic actions undertaken to manage climate risk

The Trustees continuously consider approaches to further manage climate change risks and opportunities in their investment strategy. In the year under review the following actions were taken:

- In Q3 2020, the Scheme fully transitioned from the Newton Real Return Fund into its sustainable version Newton Sustainable Real Return Fund.
- During the second and third quarter of 2020, the Trustees discussed and implemented a switch of the Scheme's equity exposure in order to improve the ESG and carbon footprint characteristics of the portfolio. This involved disinvesting the Legal and General Investment Management (LGIM) Synthetic Equity holdings and investing in an ESG focused equity mandate (LGIM Future World Global Equity 50% GBP Hedged portfolio).
- The Trustees conduct topic focused assessments from time to time. In the Q4 2020, the Trustees assessed the potential impact of climate change on investment returns, through a climate change scenario analysis undertaken by the investment consultant. More detail on the results is provided below under the 'Strategy' section.
- The Trustees agreed to changes to the management of their corporate bond mandate at LGIM in order to better align with their ESG and climate change beliefs (the changes were implemented subsequently to the year in question):

    a) LGIM shall target Climate Alignment Objectives that are consistent with the successful realisation of the Paris Agreement goal.. In particular, the portfolio targets:
        a. a weighted average portfolio temperature score of 2.6ºC or below in the short term;
        b. a 2ºC or lower score by 31 December 2029;
        c. a lower Green House Gas emissions intensity score year-on-year.

    b) A range of restrictions preventing investment in, inter alia, securities listed under LGIM's Controversial Weapons Policy, tobacco securities, securities from issuers with revenue greater than 10% generated from thermal coal, securities listed under the LGIM Climate Change Policy and securities listed under the LGIM Future World Protection List.

Investment strategy climate change scenario analysis

In the fourth quarter of 2020, the Trustees commissioned a strategic climate change scenario analysis on the Scheme's strategic asset allocation to assess the potential implications of climate change. The investment consultant produced this scenario modelling for the Scheme's portfolio, which estimated a 'climate impact on return' and focused on three scenarios for increases in global temperatures.

- 2ºC scenario, a low-carbon economy transformation aligned with successful implementation of the Paris Agreement's ambitions and the greatest mitigation of physical damages.
- 3ºC scenario, a coordinated policy response, as per the current Paris Agreement commitments, but a failure to meet the 2ºC objectives and meaningfully mitigate anticipated physical damages.
- 4ºC scenario, a fragmented policy pathway where current commitments are not implemented and there is a serious mitigation failure of anticipated physical damages

This modelling helped the Trustees understand the exposures within the investment portfolio to climate risks, and informed consideration of further mitigating actions.

Key findings from the analysis were as follows:

- The Scheme was positioned to capture the “low carbon transition premium” under a 2ºC scenario to 2030 and demonstrated robustness with respect to the potential impact of climate change under the more damaging 3ºC and 4ºC scenarios.

- The decision to move to ESG-tilted equities and a sustainable diversified growth fund was expected to improve outcomes under a 2ºC scenario, with no additional downside under 3ºC and 4ºC scenarios.

- The impact at the sector level was expected to be more significant, and while the equity portfolio at the time was underweight utility and energy stocks, the buy and maintain credit mandate had a material allocation to utilities (19%) some of which could be significantly impacted by climate-related policies and low carbon technologies.

The Trustees have also committed to producing a carbon foot-printing assessment as they intend to build a picture of the evolving carbon footprint of their portfolio over time, which will help inform decision making and potential targets for decarbonisation.

Funding Level Scenario Modelling and Integrated Risk Management

Over the next 12 months the Trustees expect to consider in more detail the potential impact of climate change scenarios on their funding strategy. This will explore the potential impact of climate change on the funding level as a result of potential changes in government interest rates and on longevity. In addition, it will consider the potential impact of climate change on the covenant to allow the Trustees to integrate funding, investment and covenant risk considerations.

5 Risk Management

The processes used by the Trustees to identify, assess and manage climate change-related risks and integrate them within the overall risk management approach

Processes for identifying and assessing climate change related risks

The Trustees seek to identify and assess climate change related risks from both a top down and bottom up perspective. The climate change scenario modelling (described above) provides a top down strategic assessment of climate change risks at the total Scheme, asset class and sector level.

From a bottom up perspective the Scheme's investment managers have been asked to provide carbon foot-printing metrics consistent with TCFD recommendations. This analysis helps identify key sources of company and sector-level carbon risks.

As the Trustees rely on third party investment managers to manage their assets, the day-to-day assessment of climate change related risks has been delegated to them. They in turn are regularly assessed using the investment consultant's ESG ratings.

Where relevant, investment managers are invited to present to the Trustees to explain their approach to climate change risk management, amongst other topics.

The Trustees will engage with investment managers where they are perceived to be lagging their peers in terms of ESG integration or active ownership, including where this relates to climate change risks.

Processes for managing climate-related risks

The Trustees manage risk by prioritising those risks that they believe may be most financially material over the Scheme's anticipated lifetime. These risks are identified in the Statement of Investment Principles and include climate change.

The Trustees' approach to climate change risk management is guided by climate change scenario modelling, carbon foot-printing and an assessment of managers' ability to integrate ESG issues, including climate change considerations, into their investment processes using the investment consultant's ESG ratings.

The Trustees recognise that active ownership by the investment managers will continue to be a very important part of the Scheme's approach to managing these risks. The Trustees have agreed to assess investment managers' approaches to stewardship and engagement on an annual basis and summarises their findings in the Engagement Policy Implementation Statement. The Trustees expect companies in their portfolio to manage climate change risks. Stewardship activities can help hold companies to account and ensure they are taking a meaningful approach in this area.

The Trustees delegate stewardship engagement activity to the underlying investment managers.

The Trustees recognise the challenges with various metrics, tools and modelling techniques used to assess climate change risks. The Trustees aim to work with their investment consultant and investment managers to improve their approach to assessing and managing risks over time.

Integration of climate change related risks into the overall risk management approach

Both climate change-related risks and wider investment risks are considered by the Trustees. Where possible, climate change and wider investment risks are treated in a holistic manner by recognising they are often interrelated. Climate change and ESG risks are included alongside other material risks in the Statement of Investment Principles.

The climate change scenario analysis is strategic in nature and has therefore been incorporated into wider investment strategy discussions and considerations.

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Metrics and Targets

The metrics and targets used to assess and manage relevant climate change-related risks and opportunities, in line with strategy and risk management

Key metrics for climate change related risks

For the listed equity, diversified growth portfolio and corporate bonds, together representing 55% of the Scheme's total strategic allocation (the majority of the remaining assets being government bonds (31%), alternative credit (9%) and property (5%)), the Trustees have decided to initially focus on carbon foot-printing analysis as a key metric for assessing risk; this analysis was performed in Q3 2021, covering the 12 months period to 31 March 2021. This is a way of assessing historical carbon emissions volume/intensity, which is an indicator for the relative risk of carbon pricing increases as part of the transition to a low-carbon economy.

Different methodologies can be used to calculate a portfolio's carbon footprint. The key methodology applied is the Weighted Average Carbon Intensity (WACI) and measures the number of tonnes of carbon dioxide equivalent per USD million in revenues. Further to this, the Trustees analysed the number of tonnes of carbon dioxide equivalent per USD million invested and the absolute emissions in tonnes of carbon dioxide (including Scope 1 & 2 emissions only). In future, the Trustees are looking to report on additional metrics and have requested information from the managers to assess their ability to report on other metrics.

Carbon foot-printing metrics aid the Trustees in assessing the potential climate change related risks to which the Scheme is exposed, and identifying areas for further risk management, including company engagement and investment manager monitoring.

The ability to determine appropriate and reliable climate change risk metrics is limited by the availability of consistent and comparable data.

Carbon foot-printing summary

The initial carbon foot-printing analysis was undertaken shortly after the year covered by this report. In summary:

- The report focused on LGIM equity, Newton and Nordea mandates. However, the table overleaf provides a summary for all of the Scheme's investment managers in place as at 31 March 2021.
- Over the 12 months period to 31 March 2021, the portfolio's carbon intensity decreased by c.-32.8% (versus -8.2% for MSCI World), while the absolute emissions and carbon footprint decreased, respectively, by c.-9.4% and c.-23.2% (versus -13.8% for MSCI World carbon footprint).

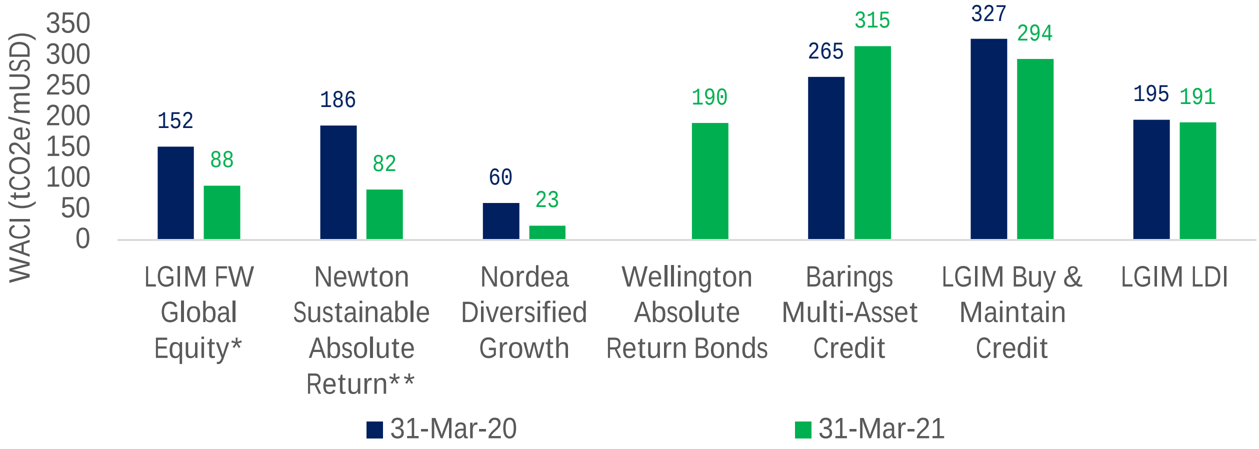
- The Scheme's transition to LGIM Future World Global Equity and Newton Sustainable Absolute Return (from synthetic equity and real return, respectively), were the main drivers for the significant improvement over the year and ahead of the benchmark improvement.
- All of the Scheme's mandates reported a lower WACI and Carbon intensity coverage than their respective benchmarks (where available), with the exception of the LGIM Buy & Maintain Credit mandate. The utilities sector is the main contributor to the higher WACI of the credit mandate.
- With the exception of Barings, all of the Scheme's investments improved its WACI over the 12 months period to 31 March 2021.

Figure 2: Comparison of Weighted Average Carbon Intensity

Mandate	WACI ($tCO_2e/mUSD$)		Carbon intensity coverage	
	Fund	Benchmark	Fund	Benchmark
LGIM Future World Global Equity[1]	88	158	99%	100%
Newton Sustainable Absolute Return[1]	82	158	78%	100%
Nordea Diversified Growth[1]	23	158	99%	100%
Wellington Absolute Return Bonds	190	-	88%	-
Barings Multi-Asset Credit[2]	315	355	35%	80%
LGIM Buy & Maintain Credit[3]	294	198	59%	-

Source: Arup UK Pension Scheme investment managers.
Notes: All data as at 31 March 2021. WACI is measured in tonnes of CO_2 (or equivalent "greenhouse gas" emissions, e.g. methane) per million USD of revenue. Carbon intensity coverage is the proportion of a mandate for which carbon intensity data is available.
Property mandates with PATRIZIA and Schroders have been excluded provided that they do not have the type of metrics shown in the table above available in their reporting production and given the tenant based approach of this type of asset class.
Wellington is not managed to a specific benchmark and a comparator is not available.
[1] Benchmark used is MSCI ACWI, for illustrative purposes.
[2] Benchmark used is ICE BofA Non-Financial Developed Markets High Yield Constrained.
[3] Benchmark used is iBoxx Non-gilt index.

Figure 3: Weighted Average Carbon Intensity Progression Over Time



Source: Arup UK Pension Scheme investment managers.* As at 31 March 2020, figure shown for LGIM Synthetic Equities, since the transition from Synthetic Equities to Future World Global Equity happened over the year to 31 March 2021. ** As at 31 March 2020, figure shown for Newton Real Return, since the transition to the sustainable vehicle happened over the year to 31 March 2021.
Wellington was not able to provide 2020 WACI.

Targets used to manage climate change-related risks and opportunities

The Trustees have not set specific climate change targets for the Scheme but this remains an area for ongoing review in conjunction with the new regulatory requirements due to come into force.

Suitability of additional metrics

The Trustees will assess the suitability of the proposed climate change metrics forming part of upcoming regulations and incorporate them into next year's report. The Trustees and the investment consultant will work on improving disclosure with its investment managers in future assessments.