PRI Principles for Responsible Investment

PUBLIC CONSULTATION RESPONSE

TCFD CONSULTATION ON METRICS, TARGETS, TRANSITION PLANS AND PORTFOLIO ALIGNMENT

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THE PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

This consultation questionnaire represents the view of the PRI Association and not necessarily the views of its individual members.

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PRI'S RESPONSE

The Principles for Responsible Investment welcomes the TCFD's new consultation. Metrics and targets are integral to decision-useful climate-related reporting. The proposed new guidance on climate-related metrics, targets, and transition plans represents a timely contribution from the TCFD and are a significant step forward in the Taskforce's guidance to preparers. The PRI particularly supports and welcomes the:

- Proposed cross-industry set of metrics that should be disclosed by all preparers, which would help investors who have diversified portfolios get a clearer overall view of risk and opportunities.
- The distinction between climate-related metrics and climate-related financial impact metrics.
- Inclusion of transition plans and Paris Agreement alignment of financial portfolios, as well as updated guidance on target setting in line with key regulator developments and investor industry initiatives since 2017.
- Flexibility on how investors should measure and disclosure portfolio alignment.

Yet, in discussion with investor signatories[1], we have identified some areas where the guidance could be made more effective as well as responses to key consultation questions.

1. **Improving the comparability of disclosures (1)**. The proposed new guidance would increase the quality and usefulness of disclosures, yet it is less clear how the Taskforce proposes to improve the comparability of TCFD reporting. From a users' perspective improving the comparability of climate metrics and targets is a high priority, as such PRI recommends:

Metric / target	Non-financial companies	Financial companies
Disclosure of industry benchmarks for carbon intensity metrics	Company emission intensity disclosed alongside the average for its GICS industry group	The WACI or Implied Temperature Rise of a portfolio should be compared to a market performance benchmark (e.g., the MSCI World, FTSE 100, STOXX 500).
Adding a target setting template to the new TCFD guidance	Should include the scopes covered, reference scenario used assumptions about negative emissions and offsets. See page 11 for a suggested template	Should include the scopes covered, methodology used, assumptions about negative emissions and offsets. See page 11 for a suggested template

[1] PRI is grateful to UN Net-Zero Asset Owner Alliance, members the UK Climate-Financial Risk Forum, PRI's Global Policy Reference Group and UNEP-FI for their feedback on the TCFD consultation.

The guidance calls for targets to be "quantified and granular" yet without a common template for climate targets, it is unclear as to how this would be realised. A suggested template is provided on page 11.

3. **Improving the comparability of disclosures (2).** Since the Taskforce published its recommendations in 2017, it is not only market practice on climate-related disclosure that has evolved but also understanding of climate science, notably through the IPPC's Special Report on 1.5°C. Yet, the language in the TCFD on relevant scenarios remains unchanged since 2017 and refers to 2° and 1.5° interchangeably through the phrase – "2 degrees or lower".

   However, for preparers use of scenario analysis or target setting and users understanding of these disclosures, the difference is significant. The global carbon budget for 1.5° in the IPCC's 1.5°C report is approximately half that of commonly used 2°C scenarios like the IEA's SDS and NGFS' orderly and disorderly scenarios[2]. The difference with IEA's 2DS scenario is even larger still.

   In parallel, an increasing number of governments have made net-zero by 2050 commitments and, in the case of European countries published 2030 emission reduction policy frameworks. As such, there is a business case for organisations operating in or with these markets to assess their strategic resilience to a 1.5 degree pathway. The PRI recommends revising the guidance on relevant climate scenarios from "including 2 degrees or lower scenario to "including a scenario where emissions reach net zero by 2050 in relevant jurisdictions**". Use of this scenario should be reviewed if governments stop trying to achieve this outcome.**

4. **Internal carbon pricing.** The inclusion of internal carbon pricing in the cross-industry metrics is welcome. It will help provide users with information about assumptions companies and other preparers make on the pricing of carbon, as well as stimulating debate and regulatory preparedness within TCFD report issuers, especially in countries where carbon pricing has yet to be established, on what their disclosure should be**.**

   Since experience and market understanding of carbon pricing varies considerably across regions, the PRI recommends the guidance references in the annex on page 81 key publications where information on the levels of carbon pricing across different scenarios can be found. These include:

   - Report of the high-level commission on carbon prices by J. Stigiltz and N. Stern (2017) https://www.carbonpricingleadership.org/report-of-the-highlevel-commission-on-carbon-prices
   - Table 2.2 on CO^2 pricings for energy production, page 53 IEA Net Zero Roadmap https://www.iea.org/reports/net-zero-by-2050

5. **The importance and challenge of Scope 3 reporting.** The updated footnote states "TCFD has determined that data and methodologies have matured sufficiently such that Scope 3 disclosure is appropriate for all sectors". PRI notes the emergence of PCAF, which provides an

[2] See table 4 on page 30 of this report a comparison of commonly used scenario's global carbon budgets.

accounting methodology for absolute financed emissions, yet the underlying GHG protocol on scope 3, on which PCAF is based, has not changed with its long-standing boundary issues between and within scopes, since the Taskforce recommendations were published in 2017. The aggregation and double accounting issues are particularly challenging for asset owners, which would be subject to this new guidance.

Nonetheless, as the proposed guidance notes, scope 3 is important for a number of key sectors, including finance. Thus, striking a balance between catalysing the improvements of scope 3 reporting and recognition of the methodological challenges in the new guidance is recommended. The table below summarises the suggested revisions to scope 3 guidance by type of preparer.

Preparer type	Suggested guidance
Non-financial groups	Disclosure of the most relevant scope 3 GHG emissions categories for the company's sector,
Banks	Disclosure of the most relevant scope 3 GHG emissions categories for the company's sector,
Asset owners	Disclosure of downstream scope 3 emissions for the most relevant industry sectors. Financed (Scope 3) greenhouse gas emissions byproduct comprised of scope 1 and 2 emissions of investee companies plus scope 3 emissions of investee companies where these are significant compared to other sources of emissions in MtCO2e
Asset managers	Disclosure of downstream scope 3 emissions for most relevant industry sectors. Financed (Scope 3) greenhouse gas emissions byproduct comprised of scope 1 and 2 emissions of investee companies plus scope 3 emissions of investee companies where these are significant compared to other sources of emissions in MtCO2e

6. **Addressing systemic risk from climate change and an organisation's contribution to the transition.** As the Financial Stability Board has noted[3], climate change is a potential systemic risk. Yet, in our view, this is not captured by the new Taskforce guidance (see table below). An organisation could be "Paris aligned", have published and implemented a transition plan with emission reduction targets, yet still be caught out by the systemic risks of climate change should there be a failure by governments and society more broadly to achieve a net-zero transition.

The different use cases for climate metrics

[3] The Implications of Climate Change for Financial Stability (2020), Financial Stability Board

Use case	Description	Covered in the proposed TCFD guidance?
The risk and opportunities to the portfolio / firm	The resilience to physical and transition risk / identification of new market opportunities.	✓
Portfolio alignment with climate goals	To track progress against climate goals	✓
Addressing systemic risk / contribution towards an orderly transition	To understand an issuers' contribution / impact on reducing system-wide climate-related risks.	×

As such, we believe, investors will also need forward-looking metrics that go beyond the organisational level to monitor and measure systemic risk and an organisation's contribution to an orderly transition. Whilst this is an emerging area, examples of this include:

- Schroder's Climate Progress Dashboard provides a temperature rating to 12 categories across political change, business & finance, technology solutions, carbon-intensive industries.
- % of / or investments in hard-to-electrify sectors
- Outcomes focus to investor – company engagement.
- Public positions on climate policy

7. **A grace period for implementing the updated guidance.** The proposed guidance represents a substantial, yet valuable update to the TCFD. Since it is expected to be October before any new guidance is approved and published, this would leave preparers who report in Q1 of 2022 little time to adapt and incorporate the new guidance into their reporting.

   Moreover, data from investor reporting to PRI indicates that only a small number of investors (less than 2% of the 2,700+ reporting base) are currently disclosing emission reduction targets or other alignment metrics. Allowing for a one-year grace implementation period could reduce the cost and challenge of implementing the new guidance as well as provide time for investors (and other preparers) to build the necessary internal capacity.

8. **Consider how Taxonomies could be used to support the proposed metrics.** Many of the metrics listed in Table C1 use concepts that also underpin Taxonomies currently in use or under development. For example, reporting on the proportion of assets, operating, investing or financing activities aligned to categories of climate-related risk and opportunity are conceptually aligned to turnover, expenditure and/or portfolio reporting against the EU Taxonomy.[4]

[4] Activities which cause significant harm to climate change mitigation or adaptation under the Taxonomy framework may be understood as broad proxies for transition and physical risk. Similarly, activities which make a substantial contribution to climate change mitigation and adaptation can indicate climate-related opportunities.

Feedback on the Portfolio Alignment Technical (PAT) Supplement

The PRI welcomes the flexibility in the PAT top-line recommendation, which allows for investors to utilise different approaches to measure and disclose portfolio alignment. We also agree with the report's recommendation that the standardisation of methodologies would be valuable for investors. The PRI does, however, recommend:

9. **Use of neutral language to describe each of the three alignment options.** Care should be taken to ensure that the description of the three alignment options is consistent with the non-prescriptive top-line guidance. Table 1 Portfolio Alignment Tool Evaluation, for example, on page 18 (and copied below), shows a clear preference towards the ITR. The table omits relevant information, such as the outputs of ITR may be easy to understand, but the inputs are not transparent, absolute emission reduction targets are not necessarily binary[5], it is also not clear how they "ignore the science on carbon budgets". The statement on page 5, that says ITR is the "most sophisticated" is another example here. Revising these instances in the table below and throughout the report is recommended.

   Also, changing the name given to the first category from "Binary Measurements" to "Absolute emission targets" is recommended.

[5] See for example the UN Net Zero Asset Owner Alliance target setting protocol.

PAT report table 1: Portfolio Alignment Tool Evaluation

Evaluation Criterion	Binary Measurement	Benchmark Divergence	ITR
Simple to use	Simplest to use, no additional technical skills needed	Complex to use, requiring facility with accessing and manipulating climate scenarios, designing and interpreting benchmarks, and creating forward-looking company performance projections	Most complex, requiring all the skills and resources needed to build a benchmark-divergence model, with the addition of basic physical science awareness to translate outputs into temperature scores
Transparent	Difficult to interpret — no information about degree of alignment/ misalignment	Some complexity in interpreting and communicating output — e.g., output is technical (divergence from a benchmark) and highly sensitive to scenario benchmark choice, construction method, and company emissions projection approach	Output is easy to interpret and communicate relative to benchmark-divergence models, also provides a measure of consequences of misalignment, unlike other approaches. Is subject to an additional layer of assumptions that further complicate comparability
Science-based	References science-based targets for assets but ignores science on carbon budget	Benchmark-divergence models can use a range of approaches, some more technically robust than others. So a model's robustness will depend on design choices	ITR tools can use a range of methods, some more technically robust than others. So a model's robustness will depend on design choices
Broadly applicable	Binary target measurements can be applied to any asset type, but data restrictions exist (e.g., targets need to exist and be disclosed)	There are substantial restrictions on the data currently available for both benchmark generation and company-emission baselining and projection	There are substantial restrictions on the data currently available for both benchmark generation and company-emission baselining and projection
Aggregable	Difficult or impossible to aggregate from company level to portfolio level (e.g., no way to account for companies without targets)	The aggregability of results from a model depends on the methods it uses. The more detailed the benchmarks, the more difficult it becomes to aggregate scores to the portfolio level, as different companies are more likely to be evaluated using different units	By making temperature the common unit, results can be easily aggregated from company level to portfolio level
Incentive optimal	This approach bases its measurement entirely on forward-looking target data, and does not allow for evaluation or validation of progress based on or weighted by real-world performance. Consequently, it risks misidentifying activities to which capital needs	Simple benchmark-divergence models penalize portfolios that finance geographic regions or economic sectors that need to decarbonize more slowly than the world economy average. Adopting such a tool widely could limit the field of viable investment/lending strategies for actors that want to be Paris-aligned, and could increase the cost of capital for geographies or sectors that need to decarbonize more slowly than the global economy as a whole	ITR models resolve the incentivization issues in binary-measurement and simple benchmark-divergence models. ITR models may, however, introduce other negative incentives, which should be addressed through careful design, just like complex benchmark-divergence models (see Part 2)

10. **Distinguishing between the different use case of the portfolio alignment options.** On page 6 of the report it states:

"*Asset owners and managers: Portfolio-alignment tools can inform the decisions needed to manage a portfolio towards a specific climate target. This could take the form of decisions about engagement (e.g., determine what expectations should be communicated to counterparties about how they behave in order to drive necessary real-economy changes), or decisions about portfolio allocation and optimization"*

Not all of the alignment options presently have the same use case. An ITR score is a powerful communication tool, particularly for non-specialised users. Yet, as is documented in the forward-looking metric consultation guidance by the TCFD and in research by other bodies,

such as The Alignment Cookbook[6], the absence of the transparency of inputs and a common methodology between providers, at present, limits its ability to track progress towards climate goals. As such, **it is premature for ITR to be used to inform target setting, portfolio allocation and optimisation**.

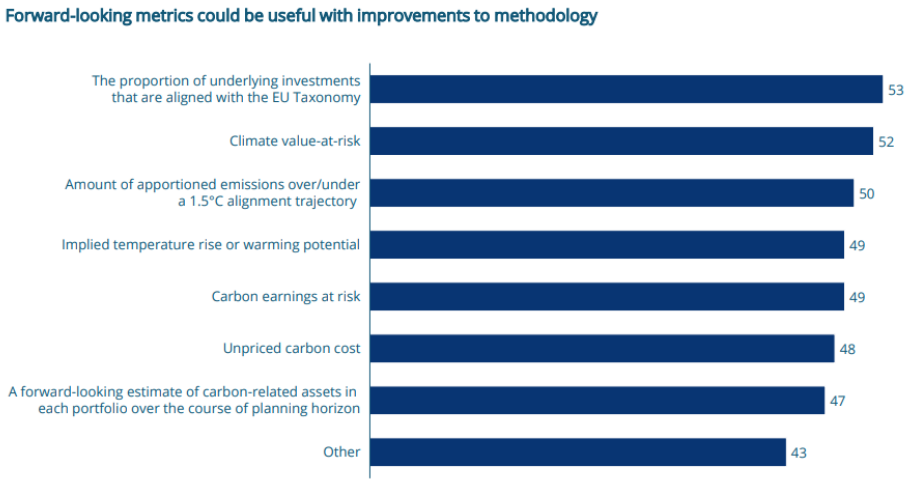
Moreover, PRI shares the concerns of Transition Pathway Initiative (TPI), that a requirement to measure and disclosure ITR, before the underlying methodological issues are address, could have perverse implications for investors and make it difficult for investors to hold carbon intensive companies that have been responsive to the investor engagement and have set net-zero targets.

At present, absolute and intensity-based emission metrics are the primary choices for investor and company climate target setting[7]. Revising the report to acknowledge the current use by investors and maturity of these alignment options is recommended.

11. **Absolute vs intensity measures.** On page 29, the PAT report states "Judgement 3: we recommend choosing emissions intensity as our benchmark units". As the paper rightly notes, there are pluses and minuses of absolute vs intensity metrics. If the objective, is to compare a company against a benchmark, then intensity-based metrics are well suited to this task. However, if the objective is to measure reductions in emissions and the progress towards net-zero, then absolute emission metrics are needed.

    The choice of which approach to use (absolute vs intensity) is not binary, investors will need to use both for these two different purposes. **As such, revising judgement 3 to "we recommend the use of both absolute and emission intensities for alignment benchmarks" is recommended.**

12. **Are there only three options for portfolio alignment?** In addition, to the three portfolio alignment options in the PAT report, there is also a role for sub-portfolio tools, such as taxonomies, to inform the carbon performance of the next investment decision. Indeed, the aggregate responses to the TCFD's consultation on forward-looking metrics, saw comparatively high response rates for the uses of taxonomies (in this case the EU taxonomy).



[6] The Alignment Cookbook (2020) The Alignment Cookbook : A Technical Review of Methodologies Assessing a Portfolio's Alignment with Low-Carbon Trajectories or Temperature Goal - Green and Sustainable Finance : Green and Sustainable Finance (institutlouisbachelier.org)

[7] As per the UN Net-Zero Asset Owner Alliance and Paris Aligned Investment Initiative

Source: TCFD Forward-Looking Financial Metrics Consultation: Summary of responses

Given the PAT report is designed around three options, PRI suggests keeping this focus, but acknowledging in the introduction, that as per the results of the TCFD forward looking metrics consultation, other options, including taxonomies, are being used by investors.

13. **Adding a Judgement 10: influence on the real economy.** A major challenge that investors face is seeking to realise the 1.5° aligned portfolio whilst investing in a 3~4° world. Decarbonising a portfolio will not in itself eliminate climate-related financial risk, as this risk moves from inside to outside the portfolio and the investor will still be exposed if there is a failure to transition. In short, what is needed is a net-zero economy, rather than only a net-zero portfolio.

    Thus, an assessment of the real-world impact, as well as the degree of alignment or other of the portfolio's main markets with the Paris Agreement, is also recommended. As noted above, examples of this could include:

    - Schroder's Climate Progress Dashboard provide a temperature rating to 12 categories across: political change, business & finance, technology solutions, carbon-intensive industries.
    - % of / or investments in hard-to-electrify sectors
    - Outcomes focused to investor – company dialogue

Annex 1: Target setting template[8]

GHG target disclosure template		
Target ID		
Overall number of active GHG emissions targets:		Include interim targets in the count
Target number:		
Target type:		Indicate whether this is aboslute or relative
Date the target was set:		
Target Information		
Scope(s) covered		For scope 2 emissions, indicate if calculations are location- or market-based. For scope 3 emissions, indicate the GHG protocol categories that are covered.
Organisational boundary		Describe the accounting boundary (e.g. operational/equity) on which the target is set. This should be consistent with its historical emissions and production/sales disclosures. Note additional exclusions if any (e.g. regional basis).
Percentage of in-scope emissions covered by the target :		
Base year:	Base year emissions:	For intensity targets, provide activity measure (e.g. tCO2e/Mwh or tCO2e/tonne of cementitious product)
Target year:	Target year projected emissions:	
Targeted reduction from base year (%)		
Targeted reduction from current year (%)	Current emissions:	Please indicate the most current year for which emissions data is available.
Target Methodology		
Verified by a independent third party?		If yes, please indicate the name of the independent third party that verified the target
Name of the reference scenario used		
Source describing how the percentage of in-scope emissions covered by the target has been calculated		Please indicate the title(s) of publicly available documents and relevant page numbers where information can be found.
Source describing transition plan outlining how this target will be met.		Please indicate the title(s) of publicly available documents and relevant page numbers where information can be found.
For Scope 3 targets, source describing the methodology used to calculate the Scope 3 emissions covered by the target.		
Indicate the % of the target to be achieved through offsets and provide a source specifying their type and the offset provider.		
For intensity targets, source describing the methodology used to calculate the carbon intensity.		

[8] PRI is grateful to the London Stock Exchange Group for providing the basis for this template