DISCUSSION PAPER

FORWARD LOOKING CLIMATE METRICS

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PRI Association

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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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SUMMARY OF PRI'S POSITION ON FORWARD LOOKING METRICS

2021 is set to be a critical year for climate-related disclosures. A number of countries have already committed to introducing mandatory reporting requirements for financial institutions and listed companies based on the TCFD recommendations, more may follow in the build-up to COP 26 in Glasgow. In the private sector, a growing number of initiatives are using TCFD as a basis for corporate engagement, alignment with climate goals and target setting.

Yet, TCFD is still a developing framework. Disclosure practice by financial institutions has evolved considerably since when the recommendations were published in 2017. Without greater specificity there is a risk of fragmentation in how the TCFD is implemented. In this context, PRI welcomes this timely consultation from the TCFD on forward looking metrics, which are critical to informing decision making by financial institutions on climate-related risks and opportunities. We recommend that future TCFD guidance focuses on:

1) **Clarifying on the purpose for which financial institutions would need to use forward looking metrics.** In addition to what financial institutions are reporting and plan to report, there is value in future TCFD guidance going back to first principles and clarifying the particular issues that forward looking metrics would seek to solve. Alignment with climate goals will be one, yet in our view, it will not be the only objective of climate-related reporting, there are other use cases for which forward looking metrics will be needed. PRI identifies three use cases to track:

Purpose	Description
The risk and opportunities to the portfolio	The resilience to physical and transition risk / identification of new market opportunities.
Portfolio alignment with climate goals	To track progress against climate goals
Systemic risk / contribution towards an orderly transition	To understand an issuers' contribution / impact on reducing system wide climate-related risks.

It is possible to have a 1.5 degree aligned portfolio in technology, health care or green infrastructure and yet the performance of the portfolio could still be impacted by the systemic risks of climate change, due to a failure of coordinated government policy to ensure a transition to a manageable level of warming. As such, a broader dashboard of KPIs and forward-looking metrics is likely to be needed.

2) **Distinguishing between the end users**. Similarly, the needs of users of financial institutions' TCFD reports will vary and it is helpful to distinguish between them. This could include:

User	Issuer objective
Supervisors and regulators	To respond to regulatory requirements
Clients (asset owners) and beneficiaries	To report to clients and end beneficiaries
Internal stakeholders	To inform internal decision making
Other external stakeholders, NGOs, employees etc	To respond to demand for enhanced climate disclosure.

Regulators, for example, could seek information on the results of climate stress-tests, whereas asset owner clients may seek information on high probability outcomes rather than tail risks and how to evaluate the exposure to climate-related risk and opportunities between portfolios. As with conventional financial metrics, different users will likely want different metrics.

3) **The use case for the Implied temperature rise (ITR) metric.** This is a powerful communication tool, particularly for non-specialised users. Yet, as is documented in the consultation guidance and in research by other bodies, such as The Alignment Cookbook[1], the absence of a 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 it to be used to inform target setting**.

   Moreover, as noted above, the performance of the portfolio may be impacted by indirect systemic risks from climate change. As such, sole reliance on the ITR metric is potentially mis-leading. It doesn't capture an issuer's exposure to systemic risks nor the stewardship value of owning high carbon assets that could be transitioned to clean energy solutions.

   Yet, it still has an important use-case as a KPI that can help internal and external stakeholders understand there is portfolio exposure to climate change. Guidance from the Taskforce should clarify the use-case of the ITR metric and also encourage the standardisation of methodologies among providers so to as to improve the comparability of outputs. The Guidance should also make clear that the ITR should not be used in isolation, and that investors and companies should use and disclose a variety of climate metrics inline with accepted practice in financial accounting.

4) **Alternative metrics.** As noted in the consultation paper, there are alternative metrics to ITR. Each have their own pluses and minuses for use as forward-looking portfolio metric.

[1] 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)

Summary of alternative forward-looking metrics

Metric type	Advantages	Limitations
Absolute emission reductions	- A direct measure of emission reduction. - A familiar and established metric	- Double counting of emissions - Data availability. Challenge of aggregation across asset classes (esp. private equity, derivatives, sovereign bonds)
Percentage alignment of portfolio with the EU taxonomy[2]	- A open-source environmental performance standard, enshrined in EU legislation - Several tools for transition financing within the taxonomy framework	- Availability of taxonomy compliant data -"Significant harm" criteria not yet widely used. - sector coverage. aviation, some shipping not covered by the EU taxonomy
Climate VaR	- A measure of the potential financial sensitivity of climate-related risks and opportunities	- Reliance on proxy data. A lack of transparency of inputs - Valuations of risk highly sensitive to modelling assumptions.
Projected amount or percentage of carbon related assets in the portfolio[3]	- Can be drawn from financial filings and management accounts	- Challenge of how to represent supply chain and financed emissions.

It is likely that financial institutions will use a combination of different metrics. The UN Net Zero Asset Owner Alliance, for example, recommends the use of absolute emission metrics, together with intensity metrics (for comparison within sectors) and corporate engagement metrics. Forthcoming regulation in the EU is expected to be a major driver of corporate and financial institution reporting, which will improve data availability and make it easier to aggregate Taxonomy compliant data at the portfolio level.

5) **Distinguishing between forward-looking metrics and targets**. Potentially any forward-looking metrics, which is disclosed, is also a target, even if it is not formally recognised as

[2] The current regulation requires Companies and Investors to disclose in line with criteria for making a "substantial contribution" to climate objectives (the "green" taxonomy). The EU Taxonomy also includes criteria which judge whether an activity is deemed to cause significant harm to climate objectives. However, there is no obligation to disclose against these yet.
[3] As proposed by ECB's 2020 consultation on climate-related and environmental risks.

such. Future TCFD guidance should look to clarify the distinction and interaction between the two.

The approach to established economic measures like inflation may provide a useful point of reference. Central banks may have a formal inflation target of 2% yet use a wide range of *indicators* to monitor where economy is relation to the target. Financial institutions may have a group wide emission target of net zero by 2050 yet use a range of KPIs to monitor progress towards it.

6) **Need for consistency with non-financial metrics**. Corporate disclosure is a vital input into financial institutions TCFD reporting. As such, consistency between corporate and financial institution metrics is essential to reduce implementation costs and improve the ease at which data can be aggregated, especially by asset owners which are at the end of the investment chain. As such, improving the availability and reliability of corporate GHG data (scope 1, 2 and 3) is a high priority for financial institutions and changes to the TCFD's guidance for non-financial metrics, should be consistent with updated guidance on metrics for investors, insurers and banks.

7) **Developing a TCFD metrics dashboard.** The consultation paper notes "no single climate-related metric can fully describe the position of a company, product, fund, or investment strategy in relation to climate"[4]. We would agree with this and propose that the TCFD develops guidance on a metrics dashboard for financial institutions consistent with the different purposes outlined above. In our view, a dashboard could usefully include the elements set out in the table below.

[4] TCFD consultation of forward looking metrics for financial institutions (2020) page 3

Dashboard of climate metrics for financial institutions

	Portfolio risk and opportunity	Alignment metrics	Systemic risk / Contribution to the transition
Present day	GHG exposure metrics Carbon-earnings at risk Operational loses due to weather related events	Percentage alignment with EU taxonomy[5] Baseline for absolute emission reduction target Sector / company scorecards	Collective shareholder / government engagement
Forward looking	GHG exposure Sector exposure (company scorecards / CA 100+ benchmark) Absolute portfolio emission targets Climate valuations of risk	Implied warming metric Progress towards absolute emission targets	Corporate Engagement outcomes Public advocacy

[5] Based on the criteria for making a "substantial contribution to climate change mitigation and adaptation".