MEASURING PORTFOLIO ALIGNMENT: TECHNICAL REPORT

Summary of Responses

October 2021

Portfolio Alignment Team

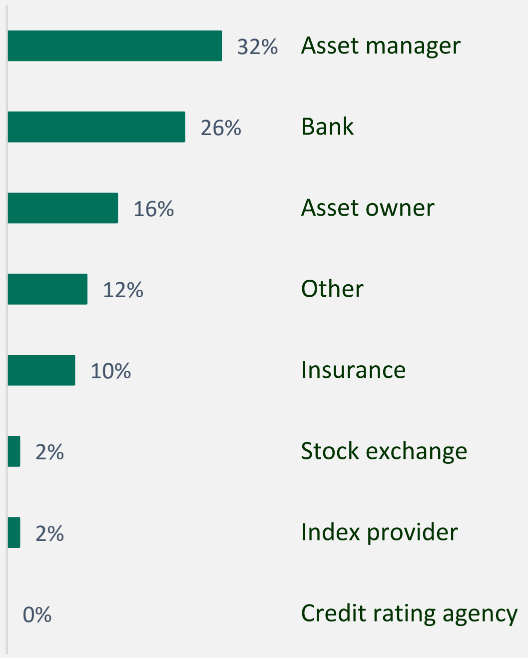
Key take-aways

- The June-July 2021TCFD consultation included questions on a draft technical report on portfolio alignment metrics, developed by an independent group of experts (the Portfolio Alignment Team) at the request of the TCFD.
- Respondents widely supported the proposed guidance (77%) that all financial institutions should describe the alignment of their activities with a well below 2C scenario, and to incorporate forward-looking metrics in their target-setting processes.
- However, respondents pointed to challenges in implementing tools, relating data (more than 80%) and scenarios (more than 70%).
- The final PAT report makes clear that financial institutions should use whatever approach suits best their institutional context and capabilities. It does not prescribe the use of implied temperature rise metrics.
- Some consultation participants provided targeted technical comments, which were taken into account in the final version of the PAT report.

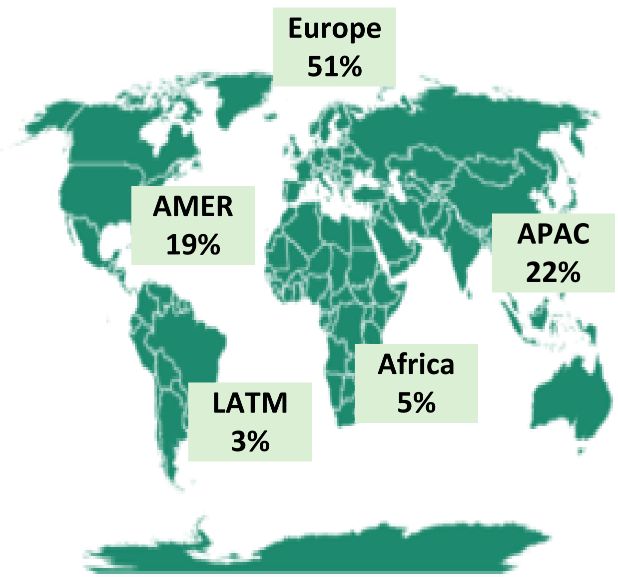
Overview of respondents*

110 financial institutions (FIs) participated in the TCFD consultation that included questions relating to portfolio alignment. Roughly half of these respondents were from organizations headquartered in Europe (including 29% from the United Kingdom). Most FI respondents roles included making decisions about sustainability.

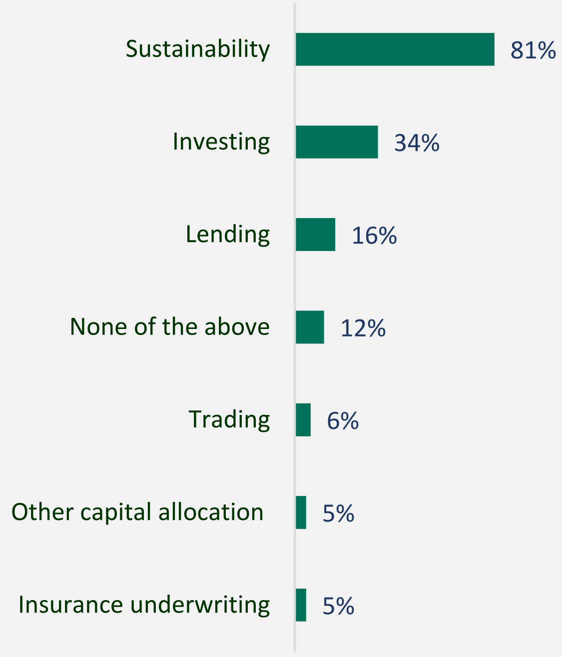
Organization type



Location of headquarters



Nature of role

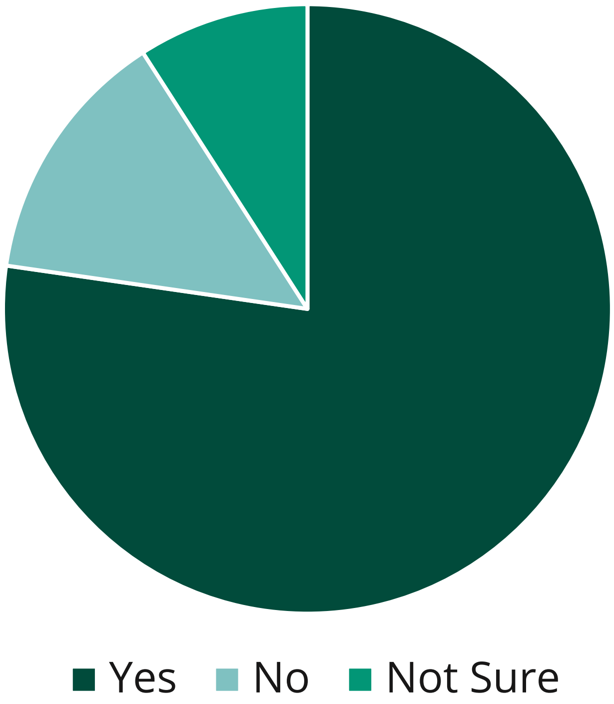


Q: Where is your organization headquartered?
Q: Please select your primary firm type from the list below
Q: In your role, are you responsible for making decisions in any of the following areas?

Portfolio Alignment Team

<u>More than three quarters</u> of financial institution respondents support the recommendation that all financial institutions should disclose alignment with the goal of the Paris agreement.

Should all financial institutions disclose alignment with the Paris agreement? *



Open Response Excerpts

- ***Bank:*** *“We don’t believe any one methodology for financed emissions or Paris Alignment has yet been road tested and critiqued enough to point to one particular methodology.”*
- ***Asset owner:*** *“We welcome efforts to assess & strengthen the use of the forward-looking metrics to measure the alignment of assets, that can support investors, to allocate capital.”*
- ***Data provider:*** *“From our own client base, which includes leading institutional investors, we observe a shift from using warming potential metrics for reporting purposes to using it as an input for portfolio construction. This illustrates that portfolio alignment tools have a value beyond mere reporting.”*

Q: All financial institutions should disclose alignment of their portfolios with the goals of the Paris Agreement and incorporate forward-looking alignment metrics into their target-setting framework and management processes. Please tell us whether your organisation supports the proposed changes.

Many respondents saw current and potential benefits from using portfolio alignment tools…

- **Users of portfolio alignment metrics reported the following benefits**:
  - Clear net zero contextualisation of portfolio performance.
  - Communicating clearly alignment with Paris agreement to clients, stakeholders, companies.
  - Better understanding transition risk across a portfolio.
  - Supporting better capital allocation.

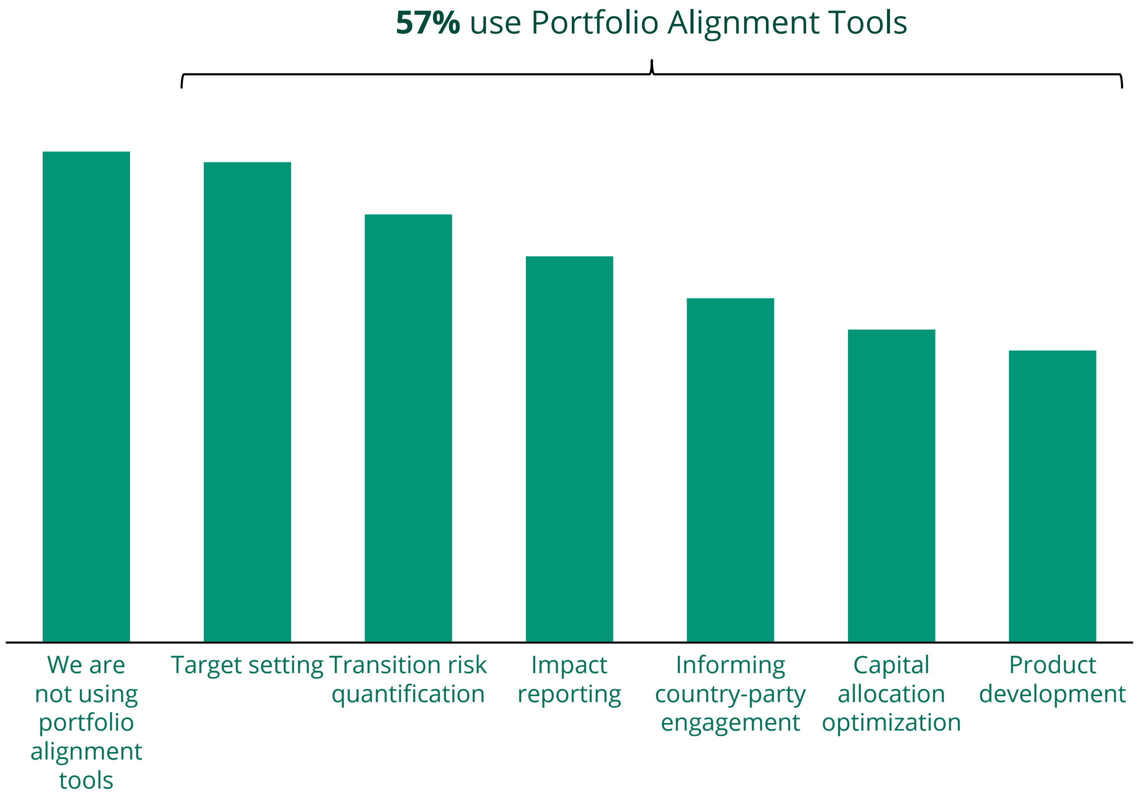
- **Respondents not currently using the tools expected similar benefits. They also highlighted:**
  - Target-setting and measuring progress towards net zero targets.
  - Better comparison with peers on alignment.

Q: What key benefits do you expect the use of portfolio alignment tools would have to your organization?
Q: What key benefits do you expect the use of portfolio alignment tools would have to your organization?

Respondents supported the concept of portfolio alignment but raised concerns around implementation

Organizations Using Portfolio Alignment Tools

Respondents could choose more than one option



Key Challenges

Respondents could choose more than one option

87% report challenges in **data availability**

86% report challenges in **data standardization**

86% report they have challenges in their **data quality**

77% report challenges specific of **Scope 3 emissions**

72% report challenges in **climate scenario development or application**

14% report **other challenges**

Q: Is your organization using portfolio alignment tools, and if so for what purposes? (n = 110)
Q: In your opinion, what are the key challenges that need to be addressed across climate data and analytics in order to support the usefulness and adoption of portfolio alignment tools?
Base: Financial sector respondents (n = 110)

Portfolio Alignment Team

As a result of long-answer consultation feedback, the PAT has made 12 key changes to the technical report (1/2)

1. We amended the introductory material of the report to explain more clearly why portfolio alignment tools should be used, emphasising the value of these tools in promoting company engagement and whole-economy transition.

2. We amended the section on portfolio alignment tool choice, adding an explanatory paragraph on why different financial institutions may decide to use different tool types for the management of their respective activities. A disclaimer now clarifies that the report is focused primarily on the use of emissions benchmarks and recognises the benefits of production-based alignment tools.

3. We amended our recommendations regarding tool choice to ensure these do not suggest that all institutions move towards ITR in the long-term, recognizing that different institutions have different needs / contexts that may be better suited for other types of portfolio alignment tools.

4. We also highlighted ongoing challenges that ITR methods face and clarified their pros/cons.

5. We updated our recommendations on benchmark type and emissions units as follows. There are two appropriate approaches. The first is to follow an absolute emissions "fair share carbon budget approach" for all sectors. The second is to use physical intensity-based convergence pathways for homogenous sectors, and absolute rate-of-reduction benchmarks for sectors where it's difficult to find physical intensity benchmarks.

6. We clarified that our recommendations to use particular units for portfolio alignment tools does not supersede or replace other reporting requirements, e.g. TCFD.

As a result of long-answer consultation feedback, the PAT made 12 changes to the technical report (2/2)

7. We added a suggestion that institutions use 1.5C scenarios for their alignment activities, and that institutions follow SBTI standards on scenario choice as minimum criteria. The team noted that there are additional emerging standards that may be complementary to, or expand on, these standards that institutions should follow including UNEP FI, NZAOA, NZBA, etc.

8. We added a sentence to the Scope 3 emissions suggestion to clarify that the available evidence on magnitude of double counting suggests it shouldn't impact the usefulness of including Scope 3 emissions.

9. We updated the recommendation on temperature score conversion to state that TCRE calculations can be used in the near-term; but that in the long term, we think that scenario interpolation method is ideal - scenarios need to evolve for that to be possible.

10. We strengthened the recommendation on aggregation methods (Judgement 9), to communicate that only the aggregated budget approach should be used for communicating alignment externally.

11. We amended the aggregation section of the report to note that measuring the alignment of a full portfolio is currently unlikely given data availability, so managers should indicate the alignment of the proportion of a portfolio for which data is available.

12. We added a recommendation that portfolio alignment disclosures include statements about uncertainties related to methodology, data, and scenarios, and the reasons for scores changing following methodological, data, or scenario improvements, which are expected to be substantial in the near term.