Consultation Document: Developing a TPI Framework for Corporate Fixed Income

Summary

TPI is proposing to extend its analysis of management quality and carbon performance to corporate fixed income.

Our proposal is that the methodology for assessing management quality and carbon performance will be the same as for equity issuers. In the attached note, we provide some background information on TPI and we describe TPI's approach to assessing management quality and carbon performance.

This Consultation Document is seeking your feedback on this proposal, and your views on whether there are any specific issues that we need to consider in applying the TPI methodology to corporate fixed income. In addition, if you have already used TPI data or the TPI framework in assessing your fixed income portfolios, we would be very interested in hearing more about this.

Based on the feedback received, we will prepare a short report summarising the proposed TPI methodology for corporate fixed income, explaining how we will address the technical and other issues raised in this consultation, and setting out how we intend to take this work forward.

We request that you provide your comments to Joanne Lewis (Secretariat to the Transition Pathway Initiative (TPI) at joanne.lewis@unpri.org by 14 May 2020. To simplify the process of collating and analysing responses, we encourage you to complete Table 1 overleaf. We are, however, also happy to receive comments by email.

Thank you for your contribution to this project

Faith Ward and Rory Sullivan

Acknowledgements:

This project is being funded by Brunel Pension Partnership and being chaired by Faith Ward (the Co-Convenor of TPI). Chronos Sustainability (Dr Rory Sullivan) is the technical lead on this project.

Developing a TPI Framework for Corporate Fixed Income

Key Questions

Name:
Position:
Organisation:
Date:

No	Question	Yes/No	Comments/Notes
1	Do you think TPI should develop a framework for evaluating corporate fixed income issuers?		
2.	Do you agree with the proposal that TPI should use its existing management quality and carbon performance frameworks for assessing corporate fixed income issuers?		
3.	Do you have any specific comments on the suitability or relevance of the TPI management quality indicators (see Section 4 below) for assessing corporate fixed income issuers? Note: We are particularly interested in whether you think any indicators are less relevant to fixed income issuers, or whether additional indicators are required.		
4	Do you have any specific comments on the suitability or relevance of the TPI carbon performance framework for assessing corporate fixed income issuers? Note: As the TPI carbon performance measures are based on carbon intensity per unit of activity or production (rather than financial measures such as turnover), we think that these measures can be directly applied to fixed income issuers. We welcome your views on this assumption.		
5	If TPI extends its coverage to fixed income, are there priority sectors, issuers or universes that TPI should focus on? Note: We are also interested in the question of sequencing (i.e. which should be done first). Note: We would also welcome your views on whether/how we might apply the TPI methodology to the finance sector.		
6.	Are there any other issues we should consider in the development of the TPI framework for corporate fixed income issuers? For example: • How might TPI treat specialist bond issuances (e.g. Green Bonds)?		

	• How might TPI assess different parts of the corporate capital structure? • How might TPI assess bonds with different timeframes? • How might TPI assess/treat use of proceeds? • How might TPI treat covenants that relate to carbon performance?		
7.	Have you used TPI in assessing the climate change performance of your fixed income portfolios?		

Supplementary Information

- Section 1: About TPI
- Section 2: About the TPI Management Quality Framework
- Section 3: About the TPI Carbon Performance Framework
- Section 4: The TPI Management Quality Indicators

Section 1: About TPI

The Transition Pathway Initiative (TPI) is a global investor initiative which assesses companies' preparedness for the transition to a low-carbon economy. The London School of Economics' (LSE) Grantham Research Institute is the TPI's academic partner, developing the methodology behind the tool and hosting it online. The data partner is FTSE Russell, and the administrative partner is the Principles for Responsible Investment (PRI).

Using publicly disclosed company information sourced and provided by TPI's data partner, FTSE Russell, TPI:

- Evaluates and tracks the quality of companies' management of their greenhouse gas emissions and of risks and opportunities related to the low-carbon transition;
- Evaluates how companies' planned or expected future carbon performance compares to international targets and national pledges made as part of the Paris Agreement.
- Publishes the results of its analysis through an open online tool hosted by the Grantham Research Institute on Climate Change and the Environment at the London School of Economics (LSE): http://www.transitionpathwayinitiative.org.

TPI focuses on those sectors that contribute most significantly to greenhouse gas emissions. To date, over 300 publicly-listed companies across 14 high carbon sectors have been analysed (see Table 1).

Table 1: TPI sectoral coverage and Carbon Performance measures

Sector	No. of companies assessed on Management Quality	No. of companies assessed on Carbon Performance	Carbon Performance measure
Oil and gas	50	50	Carbon intensity of primary energy supply
Electricity utilities	62	59	Carbon intensity of electricity generation
Coal mining*	23	-	-
Automobiles	22	22	New vehicle carbon emissions per kilometre
Airlines	22	22	Carbon emissions per revenue-tonne kilometre
Shipping	13	13	Carbon emissions per tonne kilometre

Cement	22	22	Carbon intensity of cementitious product
Steel	24	24	Carbon intensity of crude steel production
Aluminium	15	8	Carbon intensity of aluminium production
Paper	18	18	Carbon intensity of pulp, paper and paperboard production
Chemicals	21	-	-
Oil and gas distribution	6	-	-
Services	6	-	-
Consumer goods	9	-	-
Other basic materials	4	-	-
Other industrials	18	-	-
Total**	332	238	

*TPI published a discussion paper on the Carbon Performance of diversified mining companies in March 2020.

**Companies assessed in more than one sector are counted once.

The TPI's Methodology and Indicators Report provides the technical background to TPI's assessments of Management Quality and Carbon Performance, with a particular focus on Management Quality[1].

The following high-level principles guide TPI's approach assessing companies:

- Company assessments should be based solely on publicly available information.
- Indicators should be objectively assessable.
- Indicators of Management Quality should be relevant to all companies in all sectors covered by TPI.
- Carbon Performance benchmarks should be sector-specific.
- TPI's outputs should be useful to asset owners as they engage with companies and with asset managers.
- Indicators should link to, or build on, existing initiatives and disclosure frameworks (e.g. the FSB Taskforce on Climate-related Financial Disclosures or TCFD) as far as possible.
- Indicators should be pitched at a high level of aggregation and apply to the corporation as a whole.

Section 2: About the TPI Management Quality Framework

TPI's Management Quality describes companies' carbon management practices, in other words their governance of greenhouse gas emissions and the risks and opportunities arising from the low-carbon transition.

TPI's Management Quality framework is currently based on 19 indicators, each of which tests if a company has implemented a particular carbon management practice (Yes/No), such as formalising a policy commitment to action on climate change, disclosing its emissions, or setting emissions targets.

[1] Dietz, S., Jahn, V., Nachmany, M., Noels, J. & Sullivan, R. (2019), *Methodology and Indicators Report. Version 3.0. June 2019* (Transition Pathway Initiative, London, UK), https://www.transitionpathwayinitiative.org/tpi/publications/38.pdf?type=Publication

These 19 indicators (described in detail in Section 4) are then used to map companies on to five levels, shown in Box 1. Companies need to be assessed as 'Yes' on all of the questions pertaining to a level before they can advance to the next, with the exception of Level 0. Companies that have been assessed as 'Yes' on all Level 4 questions (and thus all questions in the framework) are described as 4* companies. The data underpinning the indicators are provided by FTSE Russell on the basis of companies' public disclosures.

Box 1.1. TPI levels of Management Quality

- ***Level 0*** – *Unaware of (or not acknowledging) climate change as a business issue*.
- ***Level 1*** – *Acknowledging climate change as a business issue*: The company acknowledges that climate change presents business risks and/or opportunities, and that the company has a responsibility to manage its greenhouse gas emissions. This is the point at which companies adopt a climate change policy.
- ***Level 2*** – *Building capacity*: The company develops its basic capacity, its management systems and its processes, and starts to report on practice and performance.
- ***Level 3*** – *Integrating into operational decision-making*: The company improves its operational practices, assigns senior management or board responsibility for climate change and provides comprehensive disclosures on its carbon practices and performance.
- ***Level 4*** – *Strategic assessment*: The company develops a more strategic and holistic understanding of risks and opportunities related to the low-carbon transition and integrates this into its business strategy decisions.

Section 3: About the TPI Carbon Performance Framework

TPI's Carbon Performance assessment translates emissions targets made at the international level under the 2015 UN Paris Agreement on climate change (and through other international forums) into benchmarks against which the performance of individual companies can be compared. TPI takes a sector-by-sector approach, recognising that different sectors of the economy face different challenges arising from the low-carbon transition, including where emissions are concentrated in the value chain and how costly it is to reduce emissions. Table 1 above lists the Carbon Performance measures used in each sector we cover. These measures are intended to cover the majority of lifecycle emissions, while taking into account issues of data availability.

TPI's Carbon Performance assessment is based on the Sectoral Decarbonization Approach (SDA), which translates greenhouse gas emissions targets made at the international level (e.g. under the Paris Agreement to the UN Framework Convention on Climate Change) into appropriate benchmarks, against which the performance of individual companies can be compared. The SDA is built on the principle of recognising that different sectors of the economy (e.g. oil and gas production, electricity generation and automobile manufacturing) face different challenges arising from the low-carbon transition, including where emissions are concentrated in the value chain, and how costly it is to reduce emissions.

Applying the SDA involves first setting a global carbon budget which is consistent with international emissions targets. This global carbon budget is then allocated across time and to different regions and industrial sectors, usually allocating emissions reductions by region and by sector according to where it is cheapest to reduce emissions and when (i.e. the allocation is cost-effective). In order to compare companies of different sizes, sectoral emissions are normalised by a relevant measure of sectoral activity (e.g. physical production, economic activity). This results in a benchmark path for emissions intensity in each sector:

TPI uses companies' own data to calculate their recent and current emissions intensity and estimates their future emissions intensity based on the emissions targets they have set for themselves. Together these establish emissions intensity paths for companies.

TPI then benchmarks these emissions in most sectors against three scenarios that are derived from modelling by the International Energy Agency (IEA)[2]:

- *Paris Pledges*, consistent with the emissions reductions pledged by countries as part of the Paris Agreement in the form of the first set of Nationally Determined Contributions (NDCs).[3] These are insufficient to limit global warming to 2°C or below.
- *2 Degrees*, consistent with the overall aim of the Paris Agreement to hold "the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels", albeit at the low end of the range of ambition.
- *Below 2 Degrees*, consistent with a more ambitious interpretation of the Paris Agreement's overall aim.

Further details of how the Carbon Performance methodology is applied in specific sectors can be found in TPI's occasional Methodology Notes, all of which are available on the TPI website[4]. 16

Section 4: TPI Management Quality indicators

	Level 0: Unaware of (or not Acknowledging) Climate Change as a Business Issue
Question 1	Does the company acknowledge climate change as a significant issue for the business? [If the company does not acknowledge climate change as a significant issue for the business, it is placed on Level 0]
Notes	Companies are assessed as Yes if they: • Recognise climate change as a relevant risk and/or opportunity for the business (Q2); or • Have a policy or an equivalent statement committing them to take action on climate change (Q3); or • Have set greenhouse gas emission reduction targets (Q4); or • Have published information on their operational greenhouse gas emissions (Q5).
	Level 1: Acknowledging Climate Change as a Business Issue

[2] The usual source of data for these scenarios is the modelling of the International Energy Agency (IEA), via its biennial *Energy Technology Perspectives* report.[9] However, for some sectors it is necessary to draw upon other modelling. For example, TPI has used the modelling of the International Council on Clean Transportation (ICCT) in the automobile manufacturing sector.
[3] Note that in 2020, all signatories to the Paris Agreement will have to submit new NDCs.
[4] See https://www.transitionpathwayinitiative.org/tpi/publications

Question 2	Does the company recognise climate change as a relevant risk and/or opportunity for the business?
Notes	Companies are assessed as Yes if they demonstrate recognition of climate change as a relevant risk and/or opportunity to the business, or if they have incorporated at least two of the following, more advanced management practices, namely they: • Have a process to manage climate-related risks (Q12); • Have set long-term quantitative targets for reducing their greenhouse gas emissions (Q14); • Incorporate climate change performance into remuneration for senior executives (Q15); • Incorporate climate change risks and opportunities in their strategy (Q16); • Undertake climate scenario planning (Q17); • Disclose an internal price of carbon (Q18); • Ensure consistency between their climate change policies and the positions taken by trade associations of which they are members (Q19).
Question 3	Does the company have a policy (or equivalent) commitment to action on climate change?
Notes	Companies are assessed as Yes if they have a published policy or commitment statement on climate change that commits them to addressing the issue, or to reducing or avoiding their impact on climate change (e.g. to reduce emissions or improve their energy efficiency).
Level 2: Building Capacity	
Question 4	Has the company set greenhouse gas emission reduction targets?
Notes	Companies are assessed as Yes if they have greenhouse gas emissions reduction targets. These targets may cover Scopes 1, 2 and/or 3, and they may be quantified or unquantified. This question is less demanding than Questions 7 and 13, which require companies to have set quantified targets and for those quantified targets to be long-term, respectively. Companies that are assessed as Yes on Question 7, or Yes on Questions 7 and 13, are automatically assessed as Yes on Question 4.
Question 5	Has the company published information on its operational (Scope 1 and 2) greenhouse gas emissions?
Notes	Companies are assessed as Yes if they report on their Scope 1 and 2, or their Scope 1, 2 and 3 emissions. Companies that only report Scope 1 emissions are assessed as No.
Level 3: Integrating into Operational Decision-Making	
Question 6	Has the company nominated a board member or board committee with explicit responsibility for oversight of the climate change policy?
Notes	Companies are assessed as Yes if they provide evidence of clear board or board committee oversight of climate change, or if they have a named individual/position responsible for climate change at board level.
Question 7	Has the company set quantitative targets for reducing its greenhouse gas emissions?
Notes	Companies are assessed as Yes if they have set quantified targets to reduce greenhouse emissions in relative or absolute terms (Scopes 1, 2 and/or 3). This question is more demanding than Question 4, as companies must have set quantitative targets to reduce emissions. This question differs from Question 13, which asks whether companies have set quantified targets for reducing greenhouse gases over the long term (i.e. targets that are more than 5 years in duration). Companies that are assessed as Yes on Question 13 are automatically assessed as Yes on this question.

Question 8	Does the company report on Scope 3 emissions?
Notes	Companies are assessed as Yes if they report on Scope 3 emissions separately, either in total or in one or more categories, or if they provide a total for Scope 1, 2 and 3 emissions.
Question 9	Has the company had its operational (Scope 1 and/or 2) greenhouse gas emissions data verified?
Notes	Companies are assessed as Yes if their operational greenhouse gas emissions have been independently verified by a third party, or if they state the international assurance standard they have used and the level of assurance.
Question 10	Does the company support domestic and international efforts to mitigate climate change?
Notes	Companies are assessed as Yes if they demonstrate support for mitigating climate change through membership of business associations that are supportive, and if they have a clear company position on public policy and regulation.
Question 11	Does the company disclose its membership and involvement in trade associations engaged in climate issues?
Notes	Companies are assessed as Yes if they have disclosed their memberships of trade associations that engage on climate-related issues, and if they have disclosed their involvement in these trade associations.
Question 12	Does the company have a process to manage climate-related risks?
Notes	Companies are assessed as Yes if they have integrated climate change into multi-disciplinary company-wide risk management, or if they have a specific climate-related risk management process.
Question 13(applicable to some sectors only)	Does the company disclose materially important Scope 3 emissions?
Notes	Scope 3 emissions are diverse and many companies only disclose in a sub-set of categories. In some sectors, particular categories of Scope 3 emissions are materially important, in the sense of being a large share of lifecycle emissions. In these sectors, we require companies to specifically disclose emissions in the relevant category or categories. For example, in automobile manufacturing, coal mining, and oil and gas production, we ask: does the company disclose Scope 3 emissions from use of sold products?
Level 4: Strategic Assessment	
Question 14	Has the company set long-term quantitative targets for reducing its greenhouse gas emissions?
Notes	Companies are assessed as Yes if they have set quantified, long-term targets (i.e. more than 5 Years in duration) to reduce greenhouse emissions in relative or absolute terms (Scopes 1, 2 and/or 3). This question is more demanding than Question 7, as the targets must not only be quantitative, they must also be long-term.
Question 15	Does the company's remuneration for senior executives incorporate climate change performance?
Notes	Companies are assessed as Yes if executive remuneration incorporates climate change performance.
Question 16	Does the company incorporate climate change risks and opportunities in their strategy?
Notes	Companies are assessed as Yes if they detail how they incorporate climate change risks and opportunities in their strategy (mitigation, new products, R&D, etc.), and if they

	disclose the impact of climate change risks and opportunities on financial planning (OPEX, CAPEX, M&A, debt).
Question 17	Does the company undertake climate scenario planning?
Notes	Companies are assessed as Yes if they mention the 2 degrees scenario in relation to business planning or confirm they have conducted climate related scenario analysis, and if they describe the business impact of one or more climate scenario analysis.
Question 18	Does the company disclose an internal price of carbon?
Notes	Companies are assessed as Yes if they have and disclose their internal carbon price.
Question 19	Does the company ensure consistency between its climate change policy and the positions taken by trade associations of which it is a member?
Notes	Companies are assessed as Yes if they have a stated policy or commitment to ensure consistency between their climate change policy and the position taken by the trade associations of which they are members, and for responding appropriately in those instances where the trade association positions is significantly weaker than or contradicts that of the company.