Responsible Investment Report 2017

Including TPT's 2017 climate-related financial disclosures

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CIO’s statement

Welcome to our 2017 Responsible Investment (RI) Report. It is now almost five years since the Trustee Board signed off our first RI policy. During that time we have become increasingly confident that our RI framework provides us with a more holistic and long-term lens through which to view our investment strategy, and the underlying managers we use to implement it.

We believe that our interpretation of RI is fully consistent with the principles of fiduciary duty set out by The Pensions Regulator, in that it supports our ability to manage certain downside risks and on occasion to identify attractive investment opportunities that may enhance returns.

Following the external recognition we received in 2016 for Best International Climate Disclosure Report, both our Chair of Trustees and Chair of the Investment Committee have publically committed to reporting in line with the recommendations set out by the Financial Stability Board’s (FSB’s) Task Force on Climate Related Financial Disclosures (TCFD). Therefore, we have included updated information in this report which summarises TPT’s approach to managing climate risk across the portfolio.

This year we have been using our RI ‘lens’ to help identify investments that not only meet the risk-adjusted returns traditionally sought by pension funds, but that also demonstrate positive economic, social and environmental outcomes. We continue to monitor our allocation to these types of ‘Sustainable Investments’ using an internally developed framework, recognising that there is still much debate as to what can and should be classified as ‘sustainable’ although this may soon be addressed by some of the policy initiatives seeking to establish standards and taxonomies for ‘Sustainable Investments’.

Whilst our RI focus to date has largely been on DB, in 2018 we will turn our attention to DC. TPT’s DC funds now represent a material proportion of total assets and as part of a DC strategy review TPT will explore the feasibility of incorporating its Responsible Investment Policy into the investment strategy of its Target Date Funds (TDFs), the default option for DC members.

You will find in this report three sections. The first section sets out our framework for ensuring RI is taken account of in portfolio management, the second one provides information on climate related disclosures and the third section provides an update on our engagement activities.

We hope that you enjoy reading this report and welcome any feedback.

Cliff Speed

Chief Investment Officer, TPT Retirement Solutions
April 2018

Our Responsible Investment Framework

TPT aims to provide best-in-class, cost-efficient investment solutions to pension schemes across the Defined Benefit (DB) and Defined Contribution (DC) markets. As part of its investment decision-making TPT has adopted a Responsible Investment and Climate Change framework to help mitigate the impact of Environmental, Social and Governance (ESG) risks[1].

The overarching framework we use is set out in TPT's Responsible Investment and Climate Change policy, with the Investment Committee (IC) and the Investment Management Team (IMT) responsible for its implementation. Progress is monitored through TPT's RI dashboard and this is reviewed on a regular basis by both Trustees and TPT's Senior Management Team.

Investment strategy

As at 31 December 2017, TPT's assets under management (AUM) were £9.4bn. The split between DB growth, DB liability focused and DC assets is shown in the pie chart below.

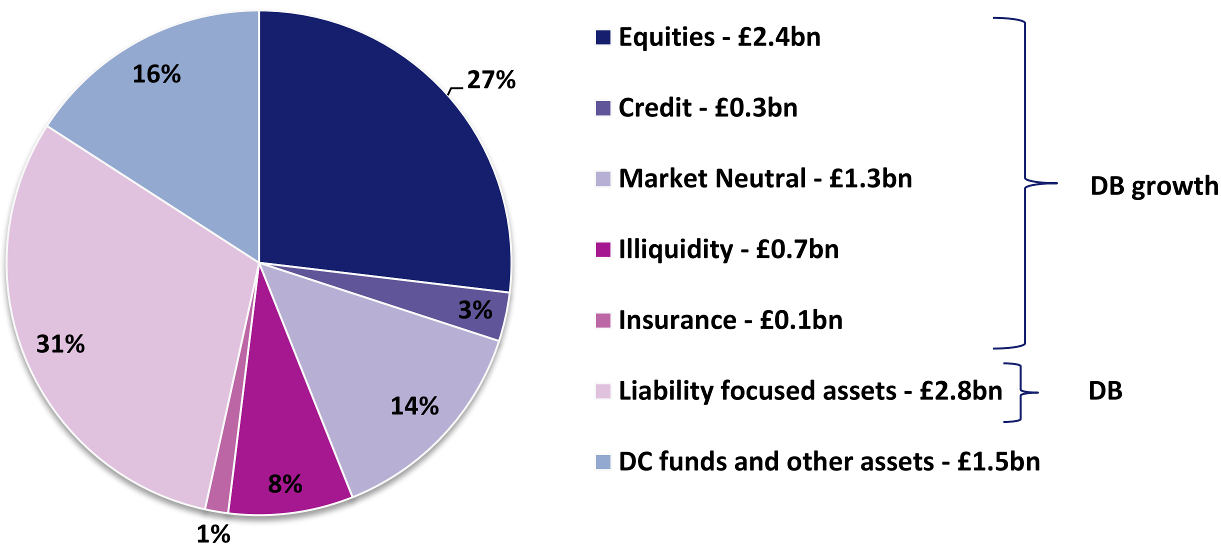

Figure 1: Chart showing TPT's assets split by type (DB, DC and breakdown of sub-portfolio)

With DB assets accounting for the significant majority of AUM, we have primarily focussed on how our Responsible Investment Framework applies to the growth portfolio. Since 2013, TPT has been focussed on diversifying sources of return in the growth portfolio away from equities, and increasing its exposure to a broad range of alternative investments, such as infrastructure, risk sharing and insurance-linked securities.

[1] Please see our website for further information on our overall approach to investment, including links to TPT's Statement of Investment Principles and Investment Beliefs, which both reference our commitment to RI.

Manager selection and appointment

The diversification strategy has required TPT to extend its governance process to oversee a broader and more complex range of asset classes. We outsource day-to-day investment decision making to external fund managers, which makes selecting and appointing the right fund managers fundamental to the success of the investment strategy.

We have an internal process that defines the key attributes we look for in a manager, such as preferred business models, appropriate remuneration structures, long-term mind sets, low portfolio turnover, strong risk management, and decision-making processes that embed ESG.

All of the managers selected and appointed by TPT are required to undergo a thorough interview process followed by detailed operational and legal due diligence, with both stages including an examination of capabilities from an RI perspective. All of the legal contracts we put in place with new managers reflect our expectations on RI with the specific criteria tailored according to the asset class and investment strategy in question.

Case Study – Applying our RI framework to new asset classes

Risk sharing

The opportunity in risk sharing has largely been driven by changes in regulation that require banks to hold more capital on their balance sheet and by the insufficient profitability of certain lending activities, such as corporate lending. 'Risk sharing' transactions allow banks to free up and recycle some of their capital to higher return areas of business.

In 2017, the IC agreed to make an allocation to Risk Sharing, an asset class not previously invested in by TPT but an emerging area of interest for institutional investors seeking income streams uncorrelated with equities and other traditional risk factors.

In December 2017, TPT appointed Chorus Capital ('Chorus'), a specialist manager in the risk sharing space. Chorus had not yet formalised an ESG policy when we first met them, but during the interview and due diligence process we discussed how ESG was relevant to our investment strategy.

We clearly set out our RI expectations in the legal contracts governing our mandate and since our first conversations with Chorus we have been impressed with the progress they have made.

Chorus are now on-boarding an ESG data-services provider and have upgraded their reporting to include an ESG summary. They have plans to formally publish an ESG policy that will describe how they are working to embed ESG in their investment process from loan underwriting and sponsor due diligence through to portfolio management.

Manager monitoring

As part of TPT's investment governance the IMT meets with all of its investment managers on at least an annual basis. The discussions with our managers are an opportunity to receive updates on the firm's overall business, its people and the investment process and these meetings are used to inform two ratings, an overall rating and an RI rating.

TPT's manager ratings are formally reviewed by the Trustees and TPT's Senior Management Team on at least a quarterly basis via our Manager Dashboard. The total number of managers with an A, B, C or D rating for RI is shown in the chart below.

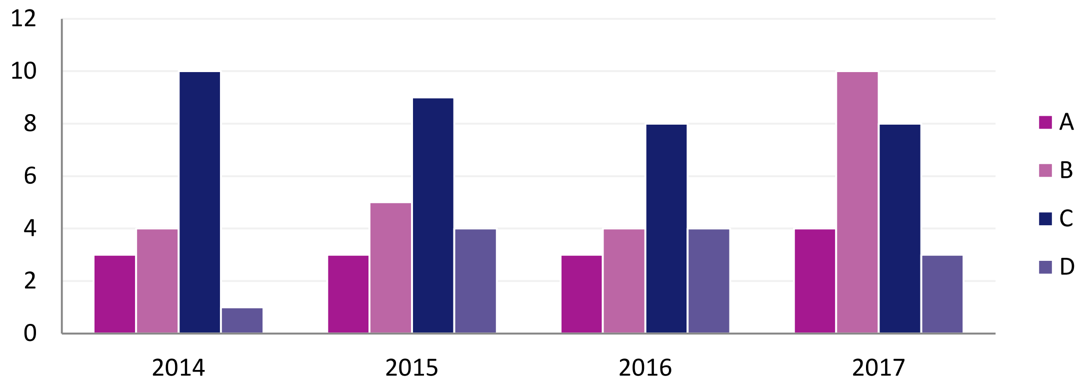

Figure 2: Summary of RI Manager Ratings (as at 31.12.17)

Over time we have increased the proportion of managers that are A, B and C rated and we estimate that as at the end of December 2017 more than 80% of the value of the growth portfolio was managed by A-C rated managers. We continue to work with D rated managers to improve their scores, acknowledging that it is harder for certain managers to fulfil our criteria given the way some mandates are implemented, or because of the particular underlying investments.

DC investment strategy

Whilst our RI focus to date has largely been on DB, in 2018 we are turning our attention to DC. In 2016 The Pensions Regulator published guidance for trustees of DC schemes on how to consider ESG in investment decisions. It now looks likely that the UK government will go further and introduce legislation in 2019 that legally requires trustees to demonstrate the extent to which they have considered ESG as part of their fiduciary duty.

TPT has an obligation to offer members an appropriate and well-governed default investment strategy that delivers long-term value. TPT believes that ESG factors can have a material impact on the financial value and performance of assets, particularly over the time horizon DC members are entrusting TPT with their savings.

Climate change disclosure

TPT is committed to reporting in line with the recommendations for asset owners set out by the FSB TCFD[2].

Governance and Strategy

The governance of climate change risk is set out in our Responsible Investment and Climate Change Policy and further details can be found in the Climate Disclosure Report 2016. As part of the 2016 investment strategy review, the IC undertook a formal analysis of the potential financial impact of climate change on our DB investments, using a multi-asset climate change scenario tool. The circle charts below show the results for TPT's investment portfolio in 2016 and also a 'Best Ideas'[3] portfolio.

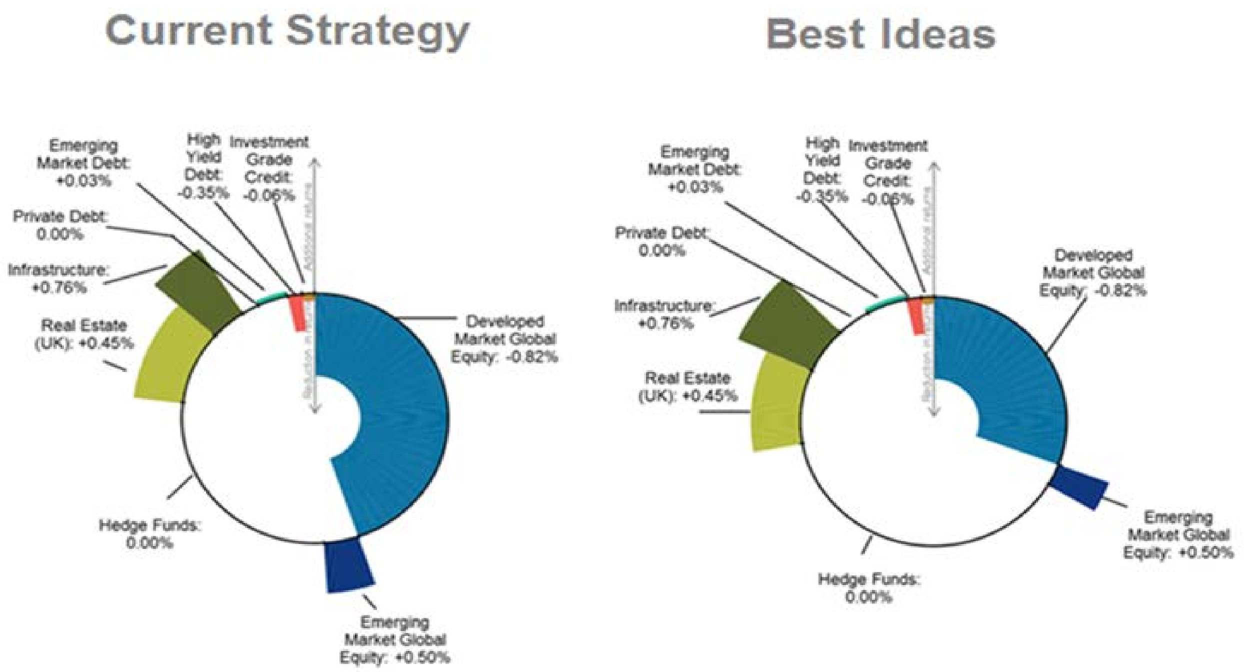

Figure 3: Figure Portfolio Analysis under a 2 degrees Scenario, Source: Mercer

Three results stand out from the analysis:

1. **A material negative impact on returns from global equities** - The blue shading inside the circle shows the potential quantum of impact on development market equities under a two degrees scenario. Mercer's model suggests that in this scenario equities could negatively be impacted by as much as 0.82% or 82 basis points per annum on a ten year horizon.

2. **Enhanced returns in real assets** - The green shading (both light and dark green) shows how infrastructure and real estate can positively impact upon returns, with a potential addition of 0.76%p.a. and 0.45%p.a. respectively over 10 years, to 2025.

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[2] In line with this commitment we have completed the Climate Disclosure Framework being trialled as part of the 2018 PRI Survey.

[3] The Best Ideas Portfolio broadly represents the asset allocation we have targeted through the implementation of our long-term investment strategy.

3. **Lower risk in the 'Best Ideas' portfolio** – The lower risk in this portfolio can be attributed to reduced exposure to developed market equities, and higher allocation to real assets (both real estate and infrastructure).

The review has led us to prioritise the following objectives over a 3-5-year time frame:

Objective 1: Monitor and manage climate risk in equities

As we continue to de-risk the investment strategy and move towards an asset allocation more in line with the 'Best Ideas' portfolio we are reducing TPT's overall exposure to global equities. Over the last 12 months we have reduced our exposure to global equites from around 60 percent of our growth assets to c. 40 percent which decreases the overall risk generated through this asset class. Equities will remain a significant component of our growth assets however, so we continue to monitor our exposure to carbon risk using a number of tools and metrics.

In 2017, we used both scenario and carbon footprint analysis, fully recognising that there are currently limitations to both methodologies. We therefore seek to collaborate with other investors to help widen the availability and usefulness of such tools in portfolio analysis.[4]

[4] For further information on the limitations of models used by TPT to assess climate related risks please see our Climate Disclosure Report.

Scenario analysis

We have used the 2° Investing Initiative (2°ii) scenario analysis[5] to look closer at how well aligned our global equity portfolio is with a two degrees scenario[6] over a five year time frame. The analysis from 2°ii looks at the key technologies and energy sectors that will be critical in delivering the two degrees pathway, covering around 30 percent of global equity exposure.

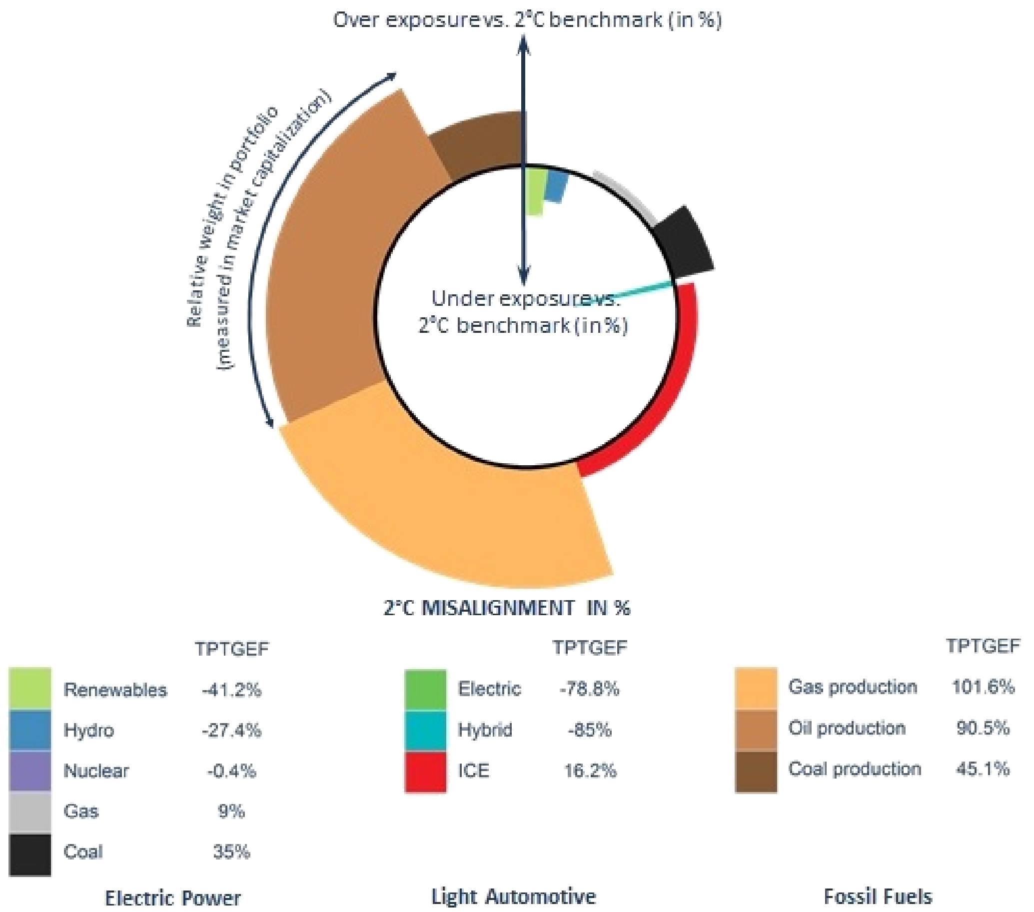


Figure 4: TPT's Global Equity Fund's alignment with 2 degrees Scenario, Source: 2°ii 7 as at 30. 6.17

At a high level the results indicate an overweight position in carbon intensive technologies (see the brown coloured segments), most notably the production of fossil fuels. This overweight position in carbon intensive technologies reflects the weighting of these sectors and companies in TPT's passive equity and factor funds. Whilst we have not for the moment set targets to align the investment strategy with a two degrees scenario, we are reviewing whether the addition of climate tilts in passive equity could mitigate carbon risk, whilst continuing to meet the funds' liquidity and other requirements.

[5] 2°ii's model allows investors to understand the deviation of their portfolio from an optimally diversified portfolio in terms of energy and technologies under the two degrees pathway as defined by the International Energy Agency (IEA). 2°ii *methodology uses third-party data, including Bloomberg, WardsAuto/AutoForecast Solutions & Global Data.*

[6] The European Parliament recommends that asset owners use scenario analysis to understand the extent to which their portfolio is aligned with a two degrees pathway.

Our active managers are typically underweight in the most carbon intensive sectors on a long-term basis, and we continue to monitor how they take climate into account through fundamental company research and portfolio construction.

The 2°ii analysis also finds that the portfolio is underweight in low carbon technologies, such as electric vehicles and renewables although we do have exposure to these technologies through private markets. In 2017, we appointed two new infrastructure managers, one of which specifically targets green-field investment opportunities in technologies aligned with the transition to a lower-carbon economy.

Carbon Footprint Analysis

As signatories to The Montreal Pledge, TPT is committed to measuring the carbon footprint of its portfolio. Carbon foot-printing is one of the metrics that can help us understand the relative carbon intensity of our underlying funds, which can also be useful to inform corporate engagement. In order to cover a greater percentage of the portfolio, corporate bonds were included in the analysis for the first time in 2017. The results, which are shown in the chart below, indicate that our aggregated global equity allocation has a slightly lower carbon intensity than our benchmark, the MSCI ACWI.

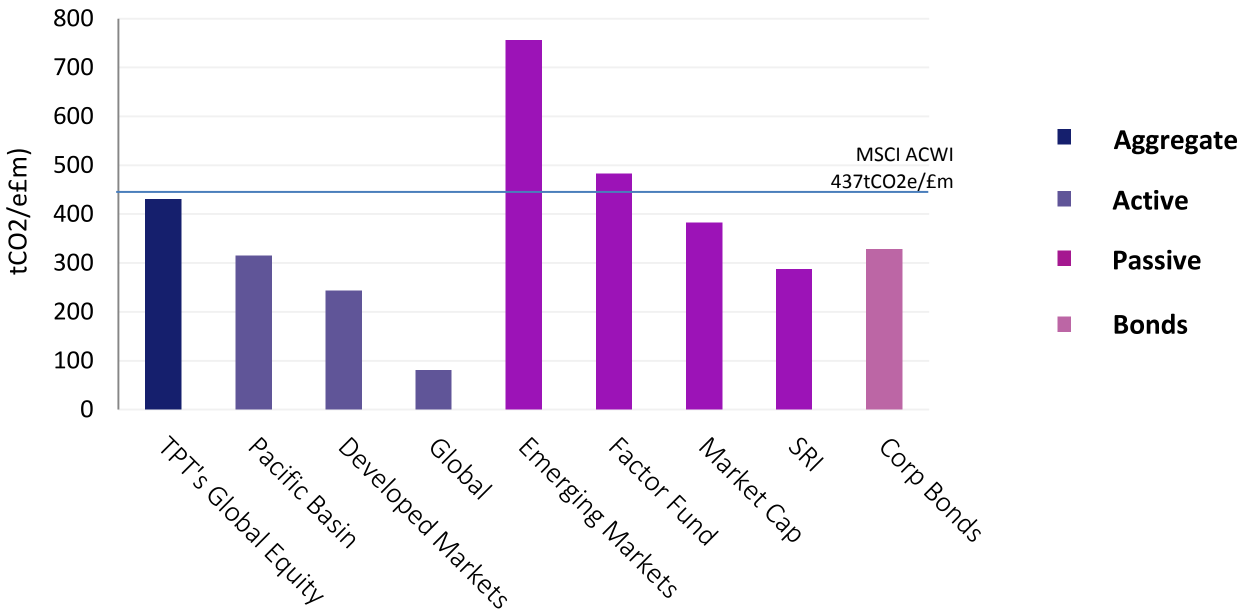


Figure 5: Carbon Intensity of TPT's Equity and Corporate Debt as at 30.06.17

It is also clear from the analysis that the carbon intensity of the emerging markets portfolio should be an area of focus. Since the date of this analysis TPT has moved the EM allocation from a passive to an active equity manager. We believe this is a better way to capture the opportunities presented by these markets whilst also addressing the higher carbon intensity of EM portfolios.

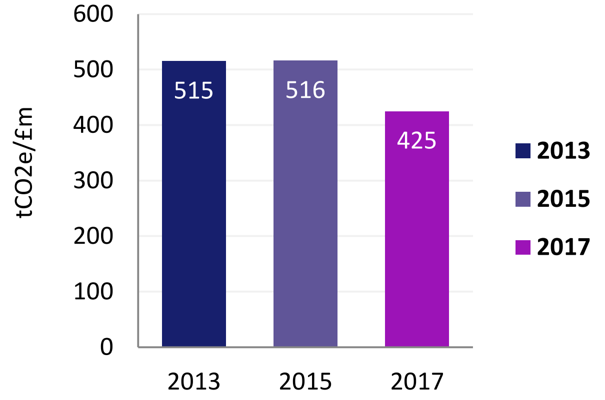


Figure 6: TPT Global Equities Carbon Footprint over time

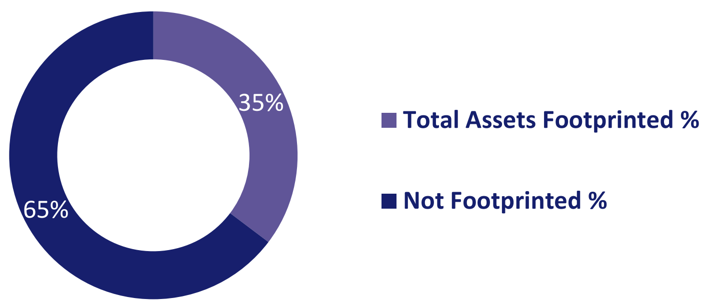


Figure 7: 2017 - % of total assets footprinted

The results from the evaluation indicate that the carbon intensity of the aggregate global equity portfolio has reduced over time, from 515 tCO2e/£m in 2013 to 425 tCO2e/£m in 2017, although we noted a significant increase in the carbon footprint of our Emerging Markets (EM) fund in the 2017 analysis.

Limitations of carbon footprints

As we focus on improving climate related disclosures it is important to note that in our view carbon foot-printing has a number of limitations. The analysis is backward-looking and does not inform investors about the potential impact of stranded assets or physical risks such as extreme weather events. Indeed the results of carbon footprints may support decision-making, but a wider range of metrics is required to understand the nature of the risks.

Objective 2: Quantifying climate risk in alternatives

TPT continues to monitor the progress of our managers on measuring and reporting carbon risk for a range of alternative assets, but in most cases this is still in early stages of development. These alternatives make up an increasing proportion of our portfolio although we have seen methodologies for carbon footprint analysis being developed by our infrastructure managers.

In September 2017, TPT joined a workshop alongside a number of other UK and European pension funds to examine the availability of carbon metrics for alternative asset classes. The conclusions from the workshop have been published in a report and will be fed back to the TCFD as part of a broader industry-wide consultation on the recommendations.

Objective 3: Allocating to sustainable investments

TPT continues to monitors its exposure to assets which deliver positive social, environmental and economic returns using an internally developed framework. We estimate that our exposure to Sustainable Investments is c.16% of the growth portfolio, through the following investments:

- **ESG Equities:** TPT's allocation to equity managers employing ESG strategies such as Ownership Capital and FTSE4Good

- **Environmental and social infrastructure**: An increasing exposure to environmental and social infrastructure through our infrastructure funds

- **Environmental finance**: TPT has increased its allocation to insurance-linked securities (ILS). This asset class helps provides insurance for both residential and commercial property in the event of natural and environmental catastrophes.

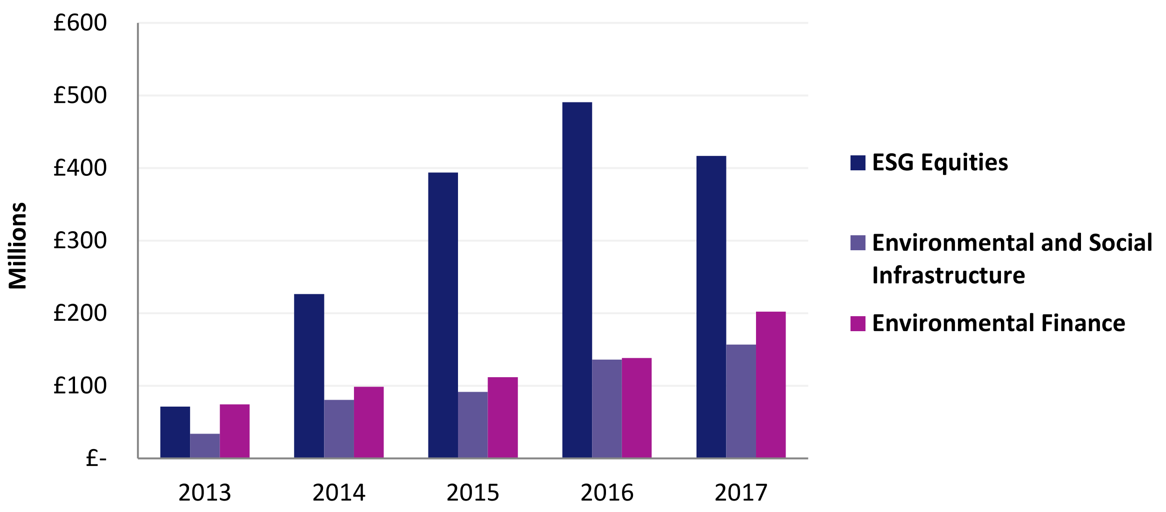


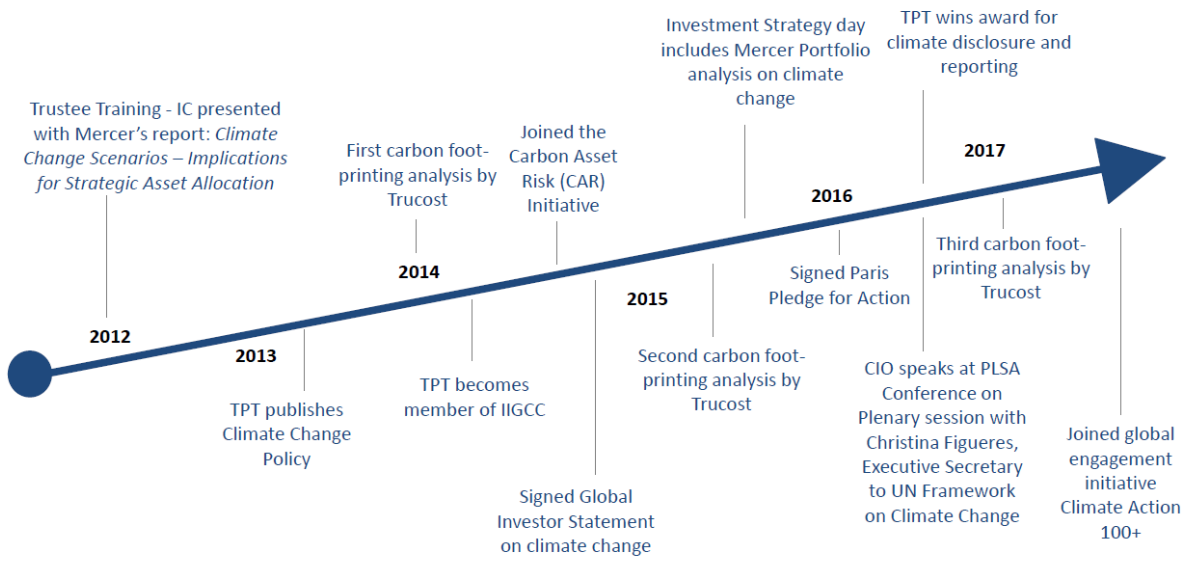
Figure 8: Allocation to Sustainable Investment

In 2017 we appointed two new infrastructure managers. Most noteworthy for our allocation to sustainable investments is the green-field mandate which follows an investment strategy developing assets supportive of the transition to a lower carbon economy.

Whilst the majority of our funds with this manager are yet to be drawn down, we expect this allocation to make a meaningful difference to TPT's total allocation to sustainable investments in 2018 and beyond. We look forward to providing an update on the investments in this portfolio in our next report.

Industry & corporate engagement

TPT recognises the importance of participating in industry initiatives and collaborative engagements that further its aims related to RI and that support the widespread adoption of best practice within the industry. The timeline below shows some of the actions and initiatives that have been supportive of implementing our climate change policy.



TPT remains an active member of the Institutional Investors Group on Climate Change (IIGCC). Jennifer Anderson, Investment Manager at TPT, sits on the Board of Directors and is actively involved in its Investor Practices programme.

In 2017 TPT was also involved in the following engagement initiatives:

1. In May TPT added its name to a collaborative investor statement made at the Shell AGM. This statement asked the Board to consider a clearer timeline for incorporating greenhouse gas emissions targets in its remuneration scorecard.

2. In October 2017, TPT joined the Climate 100+ Initiative alongside 256 other large institutional investors representing assets of $28 trillion. Climate Action 100 aims to co-ordinate international engagement with the world's largest emitters.

3. TPT continues to support the Living Wage Campaign, which is co-ordinated by ShareAction. 2017 was a promising year for the campaign with over one-third of the FTSE 100 companies now accredited Living Wage employers, with six companies accrediting with the Living Wage Foundation in 2017.

External validation of TPT's RI strategy

TPT has been awarded the following scores by the Principles for Responsible Investment (PRI) for the RI Framework it has put in place to manage its investments.

Category	2014	2015	2016	2017
TPT Strategy and Governance	B	A	A	A
TPT Listed Equity	A	A	A	A
TPT Sovereign Debt			A	A
TPT Corporate Debt			A	A
TPT Property	D	C	A	A
TPT Infrastructure	D	C	A	A

Priorities for 2018

TPT continues to be committed to evolving its thinking on RI as it relates to our investments. In 2018 we have plans to:

1. Update TPT's RI manager rating system

Over the last five years, we have gleaned many insights as to how Responsible Investment can be effectively applied to a wide range of investment strategies and assets classes. We believe that it is now appropriate to update the 'RI manager rating system' to reflect our learnings and to better define the key attributes we look for in both manager selection and on-going monitoring.
As part of this update we also plan to incorporate requirements that we expect to be driven by regulatory and policy developments. For example, we will establish whether our existing managers are intending to report climate related information in line with the recommendations set out by the FSB Taskforce on Climate Change.

2. Continue to manage and monitor carbon risk across the portfolio

Following the external recognition TPT received in 2016 for Best International Climate Disclosure **Report**, both our Chair of Trustees and Chair of the Investment Committee have publically committed to reporting in line with the recommendations set out by the Financial Stability Board's (FSB's) Task Force on Climate Related Financial Disclosures (TCFD).

We will continue to engage with industry initiatives seeking to develop guidance for best practice reporting in line with these recommendations.

3. Implement TPT's RI framework in DC

TPT's DC funds now represent a material proportion of its total assets and, as part of its 2018 DC strategy review TPT will explore the feasibility of incorporating its RI policy into the investment strategy of its Target Date Funds (TDFs), the default option for DC members.

We look forward to updating you on our progress in the next RI Report. If you have any questions regarding the content of this report then please contact:

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