Introduction

Founded in 1996, PineBridge Investments is a private, global asset manager with a focus on active, high-conviction investing across traditional and alternative asset classes. The consideration of ESG criteria in our investment business dates back to 2006, when PineBridge was part of the former asset management arm of American International Group (AIG), the first U.S. insurer to issue a policy statement on environmental and climate change. Today as a UN Principles for Responsible Investment (UN PRI) signatory and a supporter of the Global Investor Statement to Governments on Climate Change, PineBridge continues to build on its legacy by welcoming the recommendations of the Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosures (TCFD). By incorporating the evaluation of environmental impacts in portfolio construction, our investment framework remains closely aligned with the Sustainability Accounting Standards Board's (SASB) financial materiality guidance. It has deepened our sustainability dialogue with corporate issuers while also providing a reference benchmark in public policy settings. One recent example is our participation in the discussion surrounding the energy performance of investments during the 2019 G20 Environmental Ministerial meeting in Japan. This contribution to the SASB ESG Integration Insights series highlights how PineBridge promotes the application of SASB standards to effectively incorporate the outcomes of the TCFD recommendations in investment management with the goal of returning climate-resilient portfolio performance to our clients.

TCFD: From Disclosure Recommendations to Portfolio Outcomes

Since their launch in 2017, the TCFD recommendations have provided reference guidance to promote the integration of climate-related information in mainstream financial filings of public companies. Today, they also serve as a critical stepping stone for investors’ due diligence. Meanwhile, although SASB standards are in their early stages of implementation, the standards are already providing corporate reporters and investors with foundational metrics that facilitate the flow of TCFD-aligned financial disclosures.

In recognition of both the direct and indirect impacts of climate change in investment portfolios, we investigate the positive effect of TCFD-compliance across portfolio allocations in developed credit markets. Specifically, through the lens of our proprietary Key Risk Indicators (KRIs), we define how the longer-term trends of ESG factors, aligned with the SASB’s
financial materiality sector guidance, affect the portfolio exposures in scenarios where “climate stress” is applied to varying degrees on the availability, consumption, and production cycle of natural resources (Figure 1).

Figure 1: TCFD Implementation: From SASB Standards to PineBridge’s Key Risk Indicators (KRIs)

<table>
<thead>
<tr>
<th>TCFD Core Elements:</th>
<th>Governance</th>
<th>Strategy</th>
<th>Risk Management</th>
<th>Metrics and Targets</th>
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<tbody>
<tr>
<td>Scope of Disclosure:</td>
<td>Oversight of firm’s practices around climate-related risks and opportunities in strategic planning</td>
<td>Impact of climate-related risks and opportunities in strategic planning</td>
<td>Identification, analysis and management of climate-related risks</td>
<td>Selection of financially material metrics and targets</td>
</tr>
</tbody>
</table>

| Investor’s Eye on SASB Guidance | Discussion of materiality | Strategic planning/goal setting vs. materiality | Gap analysis (processes, data, skill) | Sector-relevant standards |

| PineBridge’s KRIs | Board-level oversight factor (multi-year TPI trend) | Management accountability factor (multi-year TPI trend) | Internal carbon pricing assessment | Issuer carbon intensity vs. peer group |

Source: 2018 TCFD Status Report; PineBridge Investments and Transition Pathway Initiative (TPI)

Note: For illustrative purposes only. We are not soliciting or recommending any action based upon this material.

We find that the primary benefits of overlaying the SASB materiality framework in the analysis of climate risk in the context of TCFD/climate-readiness compliance are twofold:

- the ability to define top-down, sector-specific climate-related scenario parameters that prioritize the financially material outcomes of environmental risks—including both direct and indirect impacts of climate change, and
- the ability to provide an actionable roadmap for portfolio outcomes in line with the de-carbonization efforts of asset owners at the individual holding level by addressing transition risk as a function of time vs. cost associated with viable mitigation alternatives.

Step 1. Define Sector-Specific Climate-Related Scenarios

To incorporate the Governance and Strategy core elements of the TCFD recommendations (Figure 1) in our investment process, we have added a TPI3 inspired Governance Indicator (TPIg) to our portfolio risk framework. It evaluates multi-year trends in both management accountability and board oversight of climate-related impacts by corporate issuers in our investible universe. The TPIg is introduced as a momentum indicator to uncover reputational risks surrounding the possible divergence of corporate commitments vs. corporate behaviors with respect to climate risk. Not surprisingly, the more climate-conscious issuers exhibit a positive TPIg momentum as investors are willing to reward the alignment between longer-term corporate commitments and near-term operational awareness. To the evaluation of potential red flags in the Governance and Strategy core elements of issuers (bottom-up analysis), we have added an internal carbon pricing (ICP) assessment at the aggregate portfolio level to determine a baseline for what a climate-stress scenario may produce as a performance outcome for our portfolios should a carbon tax/abatement cost to cut emissions emerge in the near future (Figure 2). The impact of the ICP assessment in terms of potential erosion of risk-adjusted performance of the portfolio captures the direct, near-term impact of climate change as well as its indirect, longer-term outcomes. Fluctuations in crop yields are a common example of the direct impact of climate stress on agricultural production that are eventually passed on to the consumer as a “carbon cost” of production. On the other hand, shifts in agricultural land use result in longer-term indirect costs of climate stress that may not be readily captured by traditional measures of economic output.

Figure 2: TCFD Core Elements and Climate-Related Scenarios

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3 Transition Pathway Initiative and the Grantham Research Institute on Climate Change and the Environment
Step 2. Analyze and Mitigate Transition Risk

After defining the climate-stress scenarios that are most likely to impact our portfolio allocations, we are able to derive an internal “price” for sector-specific climate-risk exposures and add the potential financial severity of environmental risks to traditional risk-adjusted portfolio metrics. By employing reference trajectories for technology development and deployment that affect carbon-emitting sectors such as the Paris Agreement Capital Transition Assessment (PACTA), we are able to compare the environmental performance of financing the transition of carbon-producing assets vis-à-vis their greener alternatives over a medium to longer-term time horizon. This is particularly relevant in the context of comparing the green bond framework of issuers, and both the economic and environmental fit of newly issued green-labeled instruments to our existing portfolio. The alignment of the carbon intensity reference metrics we utilize in our KRI approach with the SASB guidance for corporate disclosure remains instrumental as we compare the use of proceeds of green-labeled offerings to the broad funding strategy of the issuer in terms of overall financial materiality.

Looking Ahead

We expect continued support for the adoption of the TCFD recommendations as well as the application of SASB reference metrics across a wide spectrum of financial services activities. The proactive alignment of TCFD-compliant investment portfolios is likely to put pressure on a more standardized use of climate risk assessment tools to deliver upon the de-carbonization efforts of global asset owners. Inevitably, setting higher standards for investors’ involvement in governance-level dialogue on the topic of climate risks calls for renewed cooperation in public policy engagement on environmental issues as well.

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