

# Annual TCFD Report

Wood Pension Plan

Reporting to 31 December 2022

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## Executive Summary

The Taskforce for Climate-Related Financial Disclosures (“TCFD”) is an international body set up in 2015 by The Financial Stability Board which promotes a consistent and transparent approach to reporting the climate impact of organisations, with the goal of increasing available information and therefore better identifying a route to change and minimising the effects of global warming. The Taskforce has set out a list of recommendations for how organisations can best consider their impact on the climate.

From 1 October 2021, the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 and Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 introduced new requirements relating to reporting in line with the TCFD recommendations, to improve both the quality of governance and the level of action by trustees in identifying, assessing and managing climate risk. The Wood Pension Plan now falls within these guidelines.

In preparing this Report we have adopted a collaborative process between us, Wood Pensions Trustee Limited (“the Trustee”), our Investment Managers and our Investment Advisors. In assessing the impact of the Plan’s investments on climate change, this Report considers both the Defined Benefit and Defined Contribution sections of the Plan. For the Defined Contribution section, the Report covers the default investment options that are used by the overwhelming majority of Plan members.

This Report is a key deliverable, describing how we have identified the current impacts of the Plan’s investments on climate change. From the identified impacts, we can take appropriate actions to work to reduce the Plan’s carbon footprint, whether that is through the engagement of our Investment Managers with the companies in which they invest or by adopting investment strategies that reduce climate-related risks and maximise climate-related opportunities.

The Report outlines the steps we have taken to incorporate consideration of these Climate-Related Risks and Opportunities (CRROs) into the governance framework and the methods by which we will measure our impact and what we seek to achieve. To do this we have set ourselves some goals and methods of measuring our impact. These are referred to within the Report as ‘targets’ and ‘metrics’.

Although there has been widespread global support for the reduction of carbon emissions for many years, the required pace of change has often not met expectations. We have therefore also sought to identify the potential impact of several climate change scenarios on the funds used within the Popular Arrangements of the Plan.

The four areas covered are:

### Governance

- How we plan to maintain oversight and monitor climate-related risks and opportunities which are relevant to the Plan.
- The roles and responsibilities for managing climate-related risks and opportunities within the Plan.

### Strategy

- How we will identify climate-related risks and the definitions we will use for the short, medium, and long term and where these may differ between the Defined Benefit and Defined Contribution sections of the Plan.
- Consideration of the different climate-related scenarios we will use when assessing the Plan’s resilience to Climate Change.

## Risk management

- The Plan's processes for identifying and assessing climate-related risks.
- Describe the Plan's processes for managing climate-related risks, and how the management of climate-related risks is integrated into the Plan's overall risk management.

## Metrics & Targets

- The metrics used by the Plan to assess climate-related risks and opportunities in line with its strategy and risk management process, including where data is not available.
- Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
- The target used by the Plan to manage climate-related risks and opportunities and performance against targets.

We would remind members that this is the first report of its kind we have published, covering the calendar year 2022. We and our advisors therefore expect that the content of our subsequent TCFD reports will evolve in line with the availability of climate-related data and a growing momentum from companies as they transition their businesses to sustainable models.

## Governance

### Monitoring climate risk

Table 1 shows the metrics related to climate change that we will monitor.

Table 1: Reporting content and frequency

Reporting content	Frequency
Specific climate-related metrics	Annually
Scenario analysis	Annually
Progress toward net zero target	Annually
Adherence of the investment managers to the exclusion list relating to coal	Annually
Assessment of the investment managers' ESG and climate-related credentials	Annually
Any holdings/activity within the portfolio that require attention from a climate-related perspective	As required
Any notable stewardship activity related to climate risk within the portfolio	As required

### Overall Responsibility

We have the ultimate responsibility for ensuring the Plan's CRRO's are well governed. This report sets out the governance processes we have agreed to ensure that we have oversight of the climate-related risks and opportunities that are relevant to the Plan. We maintain a Statement of Investment Principles (SIP), which details the key objectives, risks, and approach to considering Environmental, Social and Governance (ESG) factors, such as climate change, as part of its investment decision making. The document is reviewed on at least an annual basis.

We believe that ESG issues may have an impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly require explicit consideration.

Our policy sets out where responsibility lies and how the framework is implemented It has been prepared in line with:

- the requirements of the Pension Schemes Act 2021
- the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 ('the Regulations')
- statutory guidance for climate governance and reporting of climate risks issued by the Department for Work and Pensions (DWP)
- the guidance prepared by The Pensions Regulator (TPR)
- the non-statutory guidance prepared by the Pensions Climate Risk Industry Group (PCRIG), and
- recommendations set out in the TCFD.

## Roles and Responsibilities

### a. Trustee

Our responsibilities when assessing the CRRO include, but are not limited to, the following:

- Setting and implementing a Climate Delegation Framework.
- Incorporating climate-related considerations into the Plan's ESG Policy (including investment beliefs), ongoing risk management (including risk register) and monitoring.
- Incorporating climate-related considerations into strategic decisions relating to the Plan's investments and funding arrangements.
- Allowing for climate-related considerations when assessing and monitoring the strength of the sponsoring employer's covenant.
- Reviewing climate-related sections of the Plan's risk register.
- Ensuring that the external advisors have clearly defined responsibilities in respect of climate risk, including documenting the extent to which the advisors' responsibilities are included in any agreements, such as service agreements with providers and the Investment Consultant's strategic objectives.
- Assessing how the external advisors have performed against their climate responsibilities.

We will, on a quarterly basis:

- Receive any relevant climate-related updates from the Investment Consultants and Fiduciary Manager (for the Defined Contribution section) potentially covering the investment managers' climate capabilities, progress on various climate workstreams and any relevant market or regulatory updates.

We will, on an annual basis:

- Review our Climate Delegation Framework and ESG Policy.
- Review our Task Force on Climate-Related Financial Disclosures (TCFD) reporting.
- Communicate clearly with members on how climate-related risks and opportunities are being managed.

We are responsible for assessing the impact of CRRO on Plan assets. Working with the Investment Consultants, provides oversight and manage ESG-related risks as they pertain to the Plan's assets, to help execute our strategy and enhance long-term, sustainable financial stability. We will ensure that sufficient time is allocated to consider and discuss the Plan's approach to responsible investment and climate change.

Our responsibilities include, but are not limited to, the following:

- Factoring climate-related risk management capabilities into the selection, review and monitoring of investment managers. This includes ensuring that the Plan's investment managers are managing the climate-related risks and opportunities associated with the Plan's investments;
- Identifying climate-related risks and opportunities for the Plan and setting and monitoring metrics and targets to conduct assessment and management;
- Undertaking analysis of various climate scenarios on a triennial basis, and for the two years following the latest scenario analysis, considering whether there is sufficient reason to carry out further analysis;

- Receiving updates on the Plan's investments from the Plan's Investment Consultants and Fiduciary Manager, including data on ESG metrics and progress against any targets set in relation to these metrics;
- Overseeing delivery of TCFD reporting;
- Working with the Investment Consultant to provide regular updates to the Trustee on the climate-related risks the Plan is exposed to and the results of other TCFD-related outputs, such as scenario analysis.

### **Trustee Knowledge and Understanding**

We undertake a range of activities to ensure we are sufficiently informed on climate change-related topics to be able to challenge assumptions, external advice, and the information we receive.

- Identifying regulatory developments relevant to the Scheme, including guidance from The Pensions Regulator and Department for Work and Pensions.
- Engaging with peer groups, industry bodies and advisors to compare the Scheme's position to peers or competitors.
- Managing reputational risks by identifying relationships between events and news, and business and financial impacts.
- Identifying and assessing physical and transitional risks over different time horizons.
- Considering the impact of physical and transitional, including operational, risk factors.
- Asking advisors to provide training on climate change-related topics.

We use our output from the activities listed above to help us consider climate change scenarios, risk management, metrics and targets. We explain these considerations throughout this report.

### **b. Investment Consultant**

The terms of reference for the Plan's Investment Consultants set out the roles and responsibilities of the Investment Consultants. Our advisors are reviewed annually against these terms.

The Investment Consultants' responsibilities include, but are not limited to, the following:

- Advising on the inclusion of climate considerations in the Plan's governance arrangements, investment strategy, risk management and monitoring, working with the Trustee, and its other advisors as appropriate.
- Advising on how climate-related risks and opportunities may affect the Plan's exposure to different asset classes over the short, medium, and long term, and the implications for the Plan's investment strategy.
- Assisting the Trustee in the selection and monitoring of appropriate climate-related metrics and targets for the Plan's investments, including engaging with the Plan's investment managers regarding the provision of the agreed metrics.
- Providing training and relevant updates to the Trustee and IC on relevant climate-related matters.

The Investment Consultants will, on an annual basis:

- Provide an ESG impact assessment report to monitor the extent to which the Plan's investment managers are integrating ESG considerations including climate change.
- Assist with the selection, collection, and presentation of climate-related metrics and targets.
- Assist with the preparation of the Trustee's annual TCFD report.

The Investment Consultant will, on at least a triennial basis:

- Assist with climate scenario analysis to determine the potential impact on the Plan's assets and liabilities under various climate-change scenarios, working with other advisors as required.

#### **c. Scheme Actuary**

The Scheme Actuary's responsibilities include, but are not limited to, the following:

- Assessing climate-related risks and opportunities in relation to the Plan's funding position over the short, medium, and long term and the implications for the Plan's funding and long-term objective.

#### **d. Covenant Advisor**

The Covenant Advisor's responsibilities include, but are not limited to, the following:

- Undertaking periodic reviews, at least triennially, of the extent to which climate-related risks and opportunities could affect the Plan's sponsoring employer over the short, medium, and long term.

#### **e. Legal Advisor**

The Legal Advisor's responsibilities include, but are not limited to, the following:

- Providing training to the Trustee on climate-related legal matters, including ensuring the Trustee is aware of its climate-related statutory and fiduciary obligations.
- Where requested, assisting in the documentation of the arrangements with the Plan's third parties with respect to climate-related matters.
- Assist with the preparation of the Trustee's annual TCFD report.

#### **f. Investment Managers**

The Investment Managers' responsibilities include, but are not limited to, the following:

- Identifying, assessing and managing climate-related risks and opportunities in relation to the Plan's investments.
- Exercising voting rights and engaging with portfolio companies in relation to climate-related risks and opportunities, on behalf of and in the best interests of the Plan's members.
- Providing the agreed climate-related metrics to the Plan's Investment Consultant in relation to the Plan's investments and focusing on increasing the quality and availability of these metrics.

As part of the investment manager selection and monitoring process, The Trustee consider the level and extent to which managers take into account ESG factors, including climate change, in their investment process and stewardship activities (such as voting and engagement with the companies or issuers they invest in).

#### **g. Fiduciary Managers**

Mercer Workplace Solutions (MWS) is the Plan's DC Fiduciary Manager. The responsibilities of the DC Fiduciary Manager include, but are not limited to, the following:

- Overseeing climate-related risks and opportunities of the Plan's DC investments
- The delegation of assessing and managing these climate-related risks in an effective way.

Table 2 shows the subgroups within the MWS alongside their responsibilities.

Table 2: Responsibilities within MWS

Subgroup	Responsibilities
<b>Mercer Workplace Savings Investment Governance Committee</b>	Responsible for ensuring climate-related and broader sustainability risks and opportunities are considered across the MWS investment arrangement.
<b>MWS Investment Team</b>	Translates Mercer’s thought leadership and best practice into policies and processes for the MWS investment arrangement.
<b>Mercer Investment Solutions / Mercer Global Investments Europe Limited (MGIE) Board</b> <i>(Investment Manager)</i>	Responsible for ensuring effective governance of climate-related and broader sustainability risks and opportunities across the investment management process.
<b>Global ESG Integration Committee</b>	Co-ordinates Mercer’s global approach to investing sustainably across the investment solutions business.
<b>Mercer Investment Solutions ESG Team</b>	Translates Mercer’s thought leadership and best practice into clear policies and processes, for implementation into portfolios, by various teams across the business.
<b>Mercer’s Global Sustainable Investment Consulting Team</b>	Consult with, and provide support to, both the MWS Investment Governance Committee and Mercer Investment Solutions / MGIE.

## Strategy

This section covers the actual and potential impacts of climate change-related risks and opportunities on the organisation’s businesses, strategy and financial planning.

### Time Horizon

The effects of climate change, and the actions or measures taken by governments, businesses or individuals, will be felt at different times in the future and to different extents.

In compliance with TCFD-aligned regulations, we have defined the periods over which climate risks will be identified. This varies between the Defined Benefit and Defined Contribution Sections of the Plan due to the differences in structure and liabilities between the Sections.

Table 3: Time horizons monitored by the Trustee.

	Defined Benefit Section	Defined Contribution Section
<b>Short Term</b>	Short term – 0-5 years. This allows sufficient time for climate-related decisions to be made, implemented and monitored.	10 years (Representative of a member approaching retirement age)
<b>Medium Term</b>	Medium term – 5-10 years. This is, broadly, in keeping with the Plan’s target to achieve 100% funding on a buy out basis.	25 years (Representative of a member in the mid-career stage)
<b>Long Term</b>	Long term – 10-17 years. At the upper end of the range this definition will broadly align with the duration of the Plan’s liabilities (which is c17 years).	40+ years (Representative of a member currently in the ‘early career’ stage)

### Climate Related Risks

We recognise the importance of identifying the impacts climate-related risk on the Plan’s assets.

- Physical risks refer to the potential adverse impacts on the Plan’s assets that arise from physical manifestations of climate change. These can be acute i.e., a sudden event that occurs over a relatively short timeframe such as an extreme weather event or natural disaster, or chronic i.e., arising from slow-onset changes in climate patterns and environmental conditions such as rising sea levels and temperature changes. These risks can impact the Plan’s assets directly or indirectly.
- Transition risk refers to the financial risk associated with the transition to a low-carbon economy. These can arise from changes in government policy and regulation, technology, reputation, and market risk factors when transitioning to a low-carbon economy. The extent of the impact of transition risk is minimised if the transition to a low-carbon economy is well-managed and smooth, or “orderly”.

- Short term
  - A significant climate-related exposure is through the public equity allocations. The climate scenario analysis and climate metrics help the Trustee to understand which equity market sectors are most exposed to climate-related risks and which are best positioned for the move to a low carbon economy.
  - The Defined Contribution Section is more exposed to this risk due to a higher allocation to equity assets relative to the Defined Benefit Section.
  
- Medium term
  - The greatest climate-related exposure remains with public equity allocation, particularly for the Defined Contribution Section where maintaining a sizeable equity allocation is typically appropriate given most members' long-time horizon up to and through retirement.
  - For the Defined Benefit Sections, the exposure is more towards the risk-reducing assets, such as public credit, where an issuer that has made minimal effort to support the low carbon transition may lead to a potential bond default or downgrade.
  - Market surprises due to unexpected policy changes related to climate change could lead to asset price volatility and therefore funding-level volatility.
  - As the funding level of the Defined Benefit Section improves over time, the resilience of the funding strategy to climate-related risks improves.
  
- Long term
  - Investment opportunities remain in investments linked with the development of technology and low-carbon solutions, which will be harnessed through the sustainable equity allocation in the Defined Contribution Section.
  - Additional policy, legislation and regulatory action post 2030 is likely to be inflationary. The Defined Benefit Section's liability hedging programme will reduce the impact of rising inflation on the funding strategy of the Plan.

## Scenarios

The Trustee will consider different climate-related scenarios to form a view on the resilience of the Plan's current strategy. The Trustee recognises that this needs to be undertaken within the first Plan year in which the Regulations apply.

Table 4 shows the climate scenarios considered in the climate scenario modelling for the DB and DC Sections. Regarding the DB Section, the scenarios represent four of the six designed by the Network for Greening and Financial System (NGFS) which provide a good overview of possible outcomes.

For added context, the NGFS scenarios explore the impacts of climate change and climate policy with the aim of providing a common reference framework. The scenarios used in the DC Section are strongly aligned to those of the scenarios used in the DB Section. We note there is no requirement for the scenarios to be exactly same however, a strong alignment provides consistency.

These scenarios were selected to test a broad range of feasible outcomes and the Fund's exposure to both transition and physical risks.

Table 4: Climate-related scenarios

Defined Benefit Section	Defined Contribution Section
<p><b>Disorderly 1.5°C</b> – Reaches net zero around 2050 but with greater costs due to divergent policies introduced across sectors (leading to varying carbon prices across sectors) resulting to a quicker phase out of oil use. This scenario is also known as “Divergent Net Zero”.</p>	<p><b>1.5°C Rapid transition</b> - A low-carbon economy transformation most closely aligned with both successful implementation of the Paris Agreement’s ambitions and the greatest chance of limiting physical damages.</p>
<p><b>Disorderly 2°C</b> – Assumes annual emissions do not decrease until 2030. As a result, there is higher transition risk due to policies being delayed or divergent across countries and sectors. For example, carbon prices are typically higher for a given temperature outcome. Strong policies are needed to limit warming to below 2°C. This scenario is also known as “Delayed Transition”.</p>	
<p><b>Orderly below 2°C</b> – As above, but more gradual increase in the stringency of climate policies, giving a 67% chance of limiting global warming to below 2°C.</p>	<p><b>2°C Orderly transition</b> – Some climate action but a failure both to meet the Paris Agreement 2°C objective and to meaningfully alleviate anticipated physical damages.</p>
<p><b>Hot House World 3°C</b> – Assumes that some climate policies are implemented in some jurisdictions, but globally efforts are insufficient to halt significant global warming.</p>	<p><b>4°C Failed transition</b> – Reflecting a fragmented policy pathway where current commitments are not implemented and there is a serious failure to alleviate anticipated physical damages.</p>

In designing scenario analysis, a fundamental decision is whether to assume that any climate impacts are priced in today. The analysis in this report is expressed relative to a ‘climate-informed’ baseline; the implication is that all return impacts are presented in terms of how they are different to what we are assuming is priced in today. Further detail on climate scenario narratives, including modelling limitations, is included in the appendix of this report.

Climate scenario modelling is a complex process. We are aware of the modelling limitations. In particular:

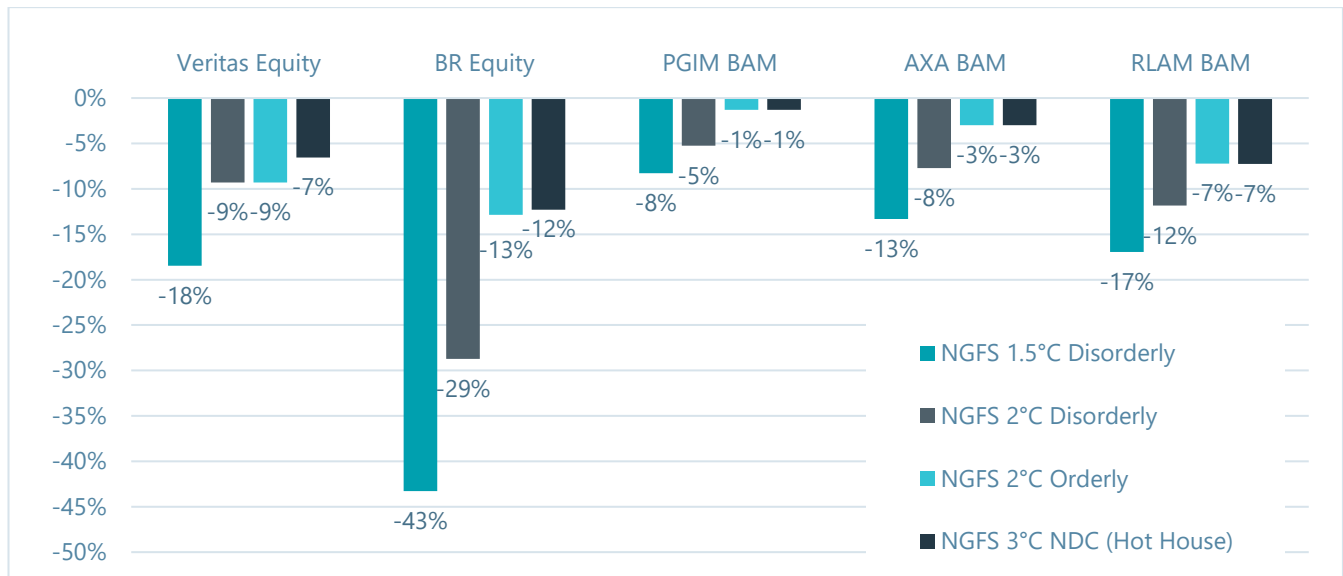
- The further into the future you go, the less reliable any quantitative modelling will be.
- There is a reasonable likelihood that physical impacts are grossly underestimated. Feedback loops or ‘tipping points’, like permafrost melting, are challenging to model particularly around the timing of such an event and the speed at which it could accelerate.
- Financial stability and insurance ‘breakdown’ are not modelled. A systemic failure may be caused by either an ‘uninsurable’ 4°C physical environment, or due to the scale of mitigation and adaption required to avoid material warming of the planet.
- Most adaptation costs and social factors are not priced into the models. These include population health and climate-related migration.

- New and emerging risks, such as the impact of climate change on biodiversity loss, will be integrated into climate scenario modelling over time once the supporting science and impact on econometrics and finance is better understood.

### Scenario Analysis on the Plan’s Assets – DB Section

Climate Value at Risk (VaR), a climate scenario modelling tool, provides a forward-looking and return-based valuation assessment to measure climate related risks and opportunities in an investment portfolio. It provides insights into the potential climate-stressed market valuation of investment portfolios and downside risk. The below chart shows the changes in portfolio value of each of the Plan’s funds under the scenarios broadly in line with the above.

Figure 1: Climate impact on the Plan’s DB assets



It is important to note that most of the risk existed in the BlackRock Equity and Veritas Equity which have been fully disinvested from in October 2022 as part of the Plan’s wider de-risking exercise.

A Disorderly 1.5°C scenario would present the greatest risk to the Plan’s asset valuation due to the significant transition risk embedded in this scenario. If this scenario played out these risks are expected to emerge in the short to medium term.

The narrative around the 2°C scenarios (Orderly and Disorderly) and Hot House world are more aligned to the medium and long-term timeframes defined by the Plan. The impact on the Plan’s assets under the Hot House World scenario appears to be lower compared to the orderly 2°C scenario. This is because Plan is expected to be more susceptible to transition risk as opposed to physical risk, based on its portfolio composition. A Hot House World scenario carries more physical risk as opposed to transition risk.

To mitigate these long-term risks we will engage more closely with current managers to identify the high-risk holdings or consider investing in funds or establishing segregated mandates that take more explicit account of forward-looking low carbon transition alignment with the same financial objectives.

The Plan has a high degree of interest rate and inflation hedging in place; while the value of liabilities could be impacted by changes in interest rates and inflation, the hedging policy means that the impact on the funding level is likely to be minimal. Based on analysis undertaken by the Scheme Actuary, our view is that the funding level

appears resilient in the scenarios considered, noting that some uncertainty exists in relation to life expectancy risk, which has not been assessed at this stage but is a risk to which the Plan remains exposed.

### **Factors that impact covenant (the Employers' and Guarantors' ability to support the Plan)**

The Plan is supported by certain companies ("Employers") in the John Wood Group plc group ("Group").

We receive analysis and advice in relation to the employer which includes the risks that the Group is exposed to, including climate-related risks.

This assessment assists us in considering these risks alongside mitigating actions taken by the Group, as well as the opportunities for the Group that arise from the transition to a low-carbon economy.

The Group is an engineering and consultancy group operating across energy and materials. A significant proportion of Group operations are related to activities within the energy sector, including the oil and gas industry. This means climate-related risks present a medium- to long-term risk to the employer covenant. The short-term risk to the covenant from climate-related factors is expected to be less significant due to the strength of the existing order book. The impact on Plan strategy of such covenant risks materialising will depend on the level of covenant reliance at that time.

The Group's strategy includes a focus on the opportunities presented by the transition to a low-carbon economy. Specifically, opportunities around decarbonisation and low-carbon solutions including hydrogen, carbon capture, renewables, and biofuels.

The Group has also set various sustainability targets including a carbon reduction target to reduce scope 1 and 2 emissions by 40% (compared with 2019 baseline) by 2030.

Having reviewed the analysis provided, we are currently satisfied that the Group is developing its strategy to address the anticipated risks and opportunities arising from climate change. Therefore, we see no reason at present to alter the Plan's funding strategy because of this covenant analysis. Instead, we will continue to review the approaches of the Group in light of the risks and opportunities the business is exposed to.

We also acknowledge that there may be scope to further develop covenant analysis in the future and will continue to review our covenant monitoring methodology to incorporate available relevant data.

### **Scenario Analysis on the Plan's Assets – DC Section<sup>1</sup>**

As previously mentioned, the scenarios used in the DC Section are broadly in line with those used in the DB Section. Figure 2 and Figure 3 show the expected climate impact on annualised expected return for the Mercer Growth Fund and Mercer Diversified Retirement Fund<sup>2</sup>. The sustainable allocations help reduce the climate impact in short to medium term across both the rapid and orderly transition scenarios.

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<sup>1</sup> Data and commentary regarding the Plan's DC assets have been provided by Mercer.

<sup>2</sup> Mercer's baseline assumes a composite scenario with the following weightings priced in: 40% Orderly Transition, 10% Rapid Transition, 10% Failed Transition, the remaining 40% represents low impact scenarios and the potential for the transition to have an overall positive impact.

Figure 2: Climate impact on the annualised expected return of the Mercer Growth Fund

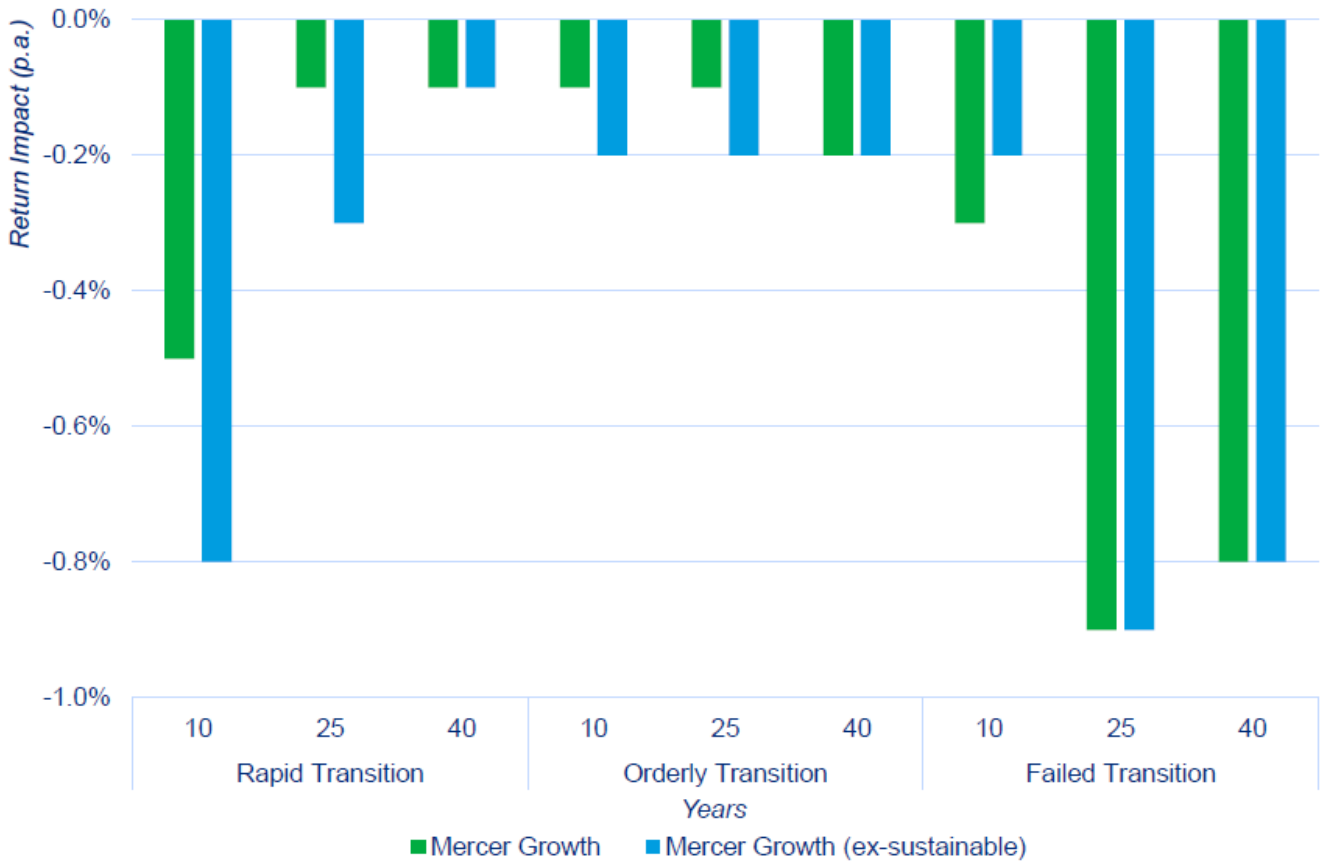
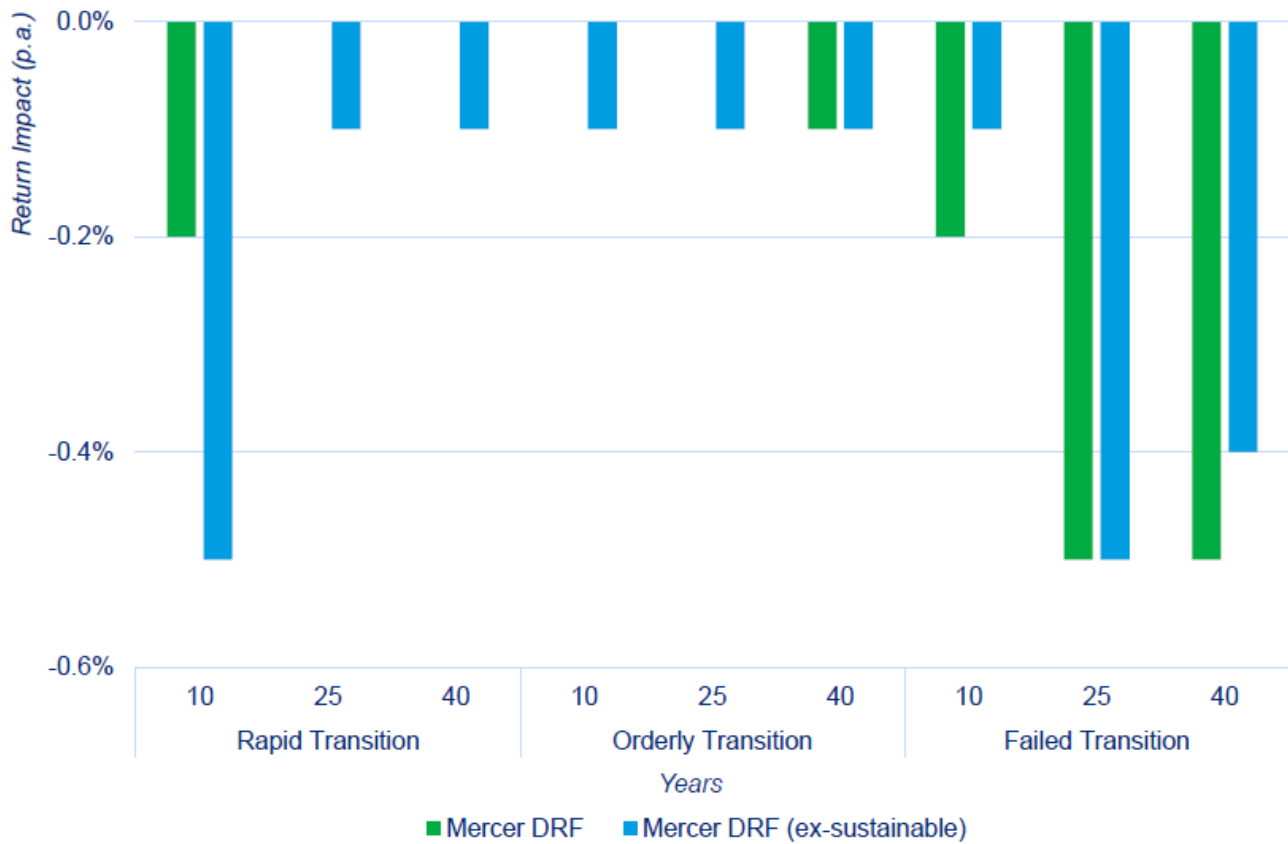


Figure 3: Climate impact on the annualised expected return of the Mercer Diversified Retirement Fund



Over the 10-year period, transition risks are the most significant, therefore the rapid transition is the most impactful. However, the failed transition becomes more impactful as future physical damages start to be priced in. The impact of the orderly transition is small on the basis that transition costs and impacts are smaller and largely priced in.

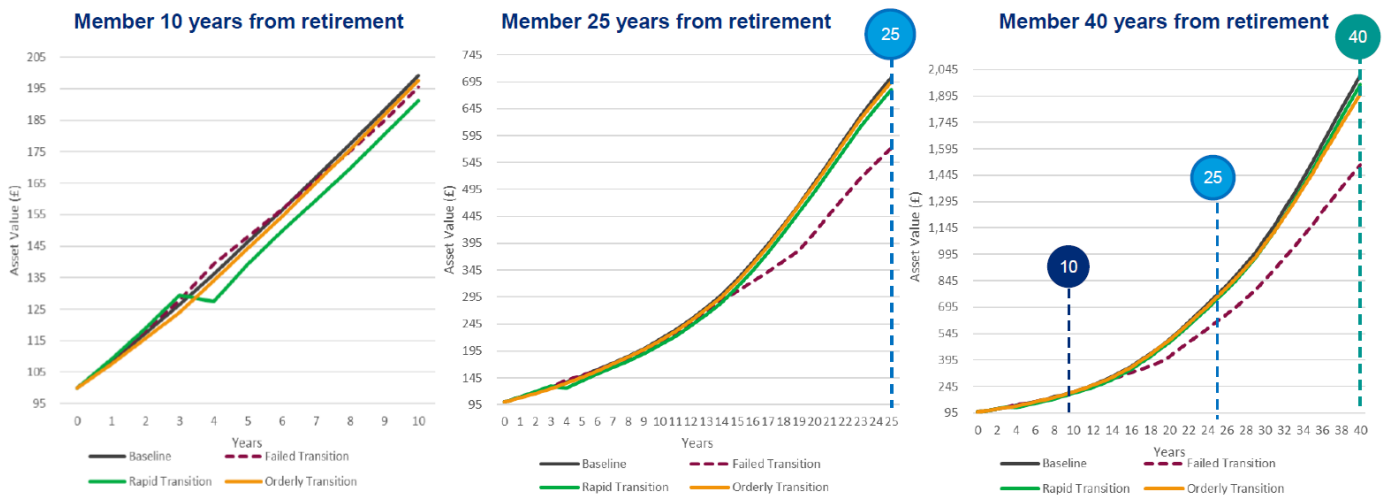
In contrast, over the 25-year period i.e., over the medium term, physical risks dominate, and the failed transition becomes the most impactful scenario.

Over the long term, physical damages are the dominant driver, and the failed transition is by far the worst scenario. Within an orderly transition we see the additional warming and the damage caused by this means it becomes a slightly more negative scenario compared to the rapid transition.

The charts below illustrate the projected impact on pot size projections for members at different stages on the glidepath for those in the Mercer SmartPath Targeting Drawdown<sup>3</sup>.

<sup>3</sup> The projections assume £100 as initial asset value, with the baseline following Mercer’s capital market assumptions’ return expectations. Mercer’s baseline assumes a composite scenario with the following weightings priced in: 40% Orderly Transition, 10% Rapid Transition, 10% Failed Transition, the remaining 40% represents low impact scenarios and the potential for the transition to have an overall positive impact.

Figure 4: Mercer SmartPath Targeting Drawdown - Projected pot size.



The above charts show that for members 10 years from retirement (short-term), transition risk dominates, which causes deterioration in the portfolio in year 4 under the rapid transition scenario. This is driven by the transition shock impacting the economy and investment markets, causing losses in equity and growth assets at earlier years.

For members 25 years from retirement (medium-term), physical impacts begin to dominate the transition risks. As a result, the greatest negative climate impact on returns over a 25-year time horizon for a member 25 years from retirement comes under the failed transition scenario. For members 40 years from retirement (long-term), physical impacts are most important, therefore the failed transition is the worst scenario, potentially reducing the value of portfolios (and therefore member benefits) by almost one third.

In summary, a failed transition is substantially worse in terms of long-term returns. This supports the view that long-term investors collectively trying to bring about an effective transition is aligned to their fiduciary duty to seek the best return within risk, liquidity and complexity restraints.

## Risk Management

### **Processes to identify and assess the potential impact of climate-related risks/opportunities.**

A key part of the Trustee's role is to understand and manage risks that could have a financially material impact on the Plan's investments and, for the Defined Benefit Sections of the Plan, on the wider funding position and strategy. Climate change is one of the risks that the Trustee considers alongside other financially material risks that may impact the pension outcomes for members.

This section summarises the primary CRRO risk management processes and activities we undertake. These help us, the Trustee, understand the materiality of climate-related risks, both in absolute terms and relative to other risks that the Fund is exposed to. We prioritise the management of risks primarily based on the potential impact to the security of members' benefits.

We recognise the importance of identifying and assessing the potential impact of climate change within the Plan's investments and have taken the following key actions:

#### **Governance**

- Our Statement of Investment Principles is reviewed at least annually and sets out our beliefs relating to climate change and how investment climate-related risks are managed and monitored.
- We maintain a risk register (covering all the Plan) and IRM framework to monitor and mitigate financially material risks to the Fund. The climate-related risks are reviewed annually to ensure the assessment of the likelihood and impact continue to remain appropriate for the Plan given the developing research and understanding on this subject.
- We will receive training regularly on climate-related issues, including market updates. The training allows the Trustee to better understand how climate-related risks and opportunities can have an impact on the Fund. The training allows us to challenge whether the risks and opportunities are effectively allowed for in our governance processes and wider activities, and to be able to challenge our advisors to ensure the governance support and advice adequately covers the consideration of climate-related risks and opportunities.

#### **Strategy**

We will take climate-related risks and opportunities into account as part of the wider strategic investment advice provided. This includes highlighting the expected change in climate-risk exposure through proposed asset allocation changes, both from the top-down level (via climate scenario analysis) and bottom-up (via climate-related metrics). It will also reflect any potential impact to our climate-related targets and progress to meet those targets.

Climate scenario analysis for the Plan's investments, and the funding strategy for the Defined Benefit Sections of the Plan, will be reviewed at least triennially, and more frequently if there has been a material change to the strategic asset allocation of an individual section or a material change/update to the scenario modelling approach. A summary of our first climate scenario analysis is included in this report and is the primary tool to help us understand the materiality of climate-related risks that could impact the Plan over time.

We have delegated the management of climate risk and opportunities (including stewardship of assets) to the investment managers. Therefore, responsibility for identifying and assessing climate-related risks has also been delegated to the investment managers. We have:

- Undertaken thorough due diligence to consider the capabilities of the investment managers to integrate climate change and broader ESG issues into the management of the Plan's assets.
- Undertaken an exercise to establish whether industry exclusions are appropriate, and if so, which industries should be excluded and at what threshold.
- Required the investment managers to report in sufficient detail on the carbon footprint of the investments with commentary or rationale for any movement in observations, including a periodic review of the climate change integration by investment managers and carbon footprint of the portfolio to the Trustee calendar.
- Required that the investment managers periodically undertake climate risk modelling and scenario testing to understand the risk exposure of the Plan's assets to various climate scenarios.
- Consulted with the sponsoring employer in relation to the climate-related risks to establish the potential impact on the employer, and therefore the potential impact on the Plan.

## Reporting

- We receive annual reports of climate-related metrics and progress against targets in respect of the assets held in the Fund. The Trustee may use the information to engage with the Fiduciary Managers and the investment managers.
- We receive an annual ESG monitoring report in respect of the Defined Contribution Section and a voting and engagement activity summary in respect of the Defined Contribution and Defined Benefit Sections. The reports summarise how the investment managers chose to vote and engage on climate-related issues (among other key engagement priorities). Key information and outcomes from the stewardship monitoring are summarised in the Trustee's annual Implementation Statement.

## Manager selection and retention

- We, with advice from our Investment Consultants, will consider an investment manager's firm-wide and strategy-specific approach to managing climate-related risks and opportunities when either appointing a new manager, in the ongoing review of a manager's appointment, or as a factor when considering the termination of a manager's appointment.
- Our Defined Contribution Fiduciary Manager rates investment managers on the extent of integration of ESG factors (including climate change) into their processes. A manager's stewardship process forms part of the rating assessment. This is considered at the firm level and at the investment strategy or fund level. The ratings are presented and are reviewed in quarterly investment performance reports. A downgraded ESG rating will (taking into account other factors) lead to an investment manager being the subject of closer scrutiny.
- A more detailed review of asset manager integration of ESG factors (including climate change) is carried out annually and is based on the Investment Consultant's investment manager research.
- The review can highlight gaps in a manager's approach relative to expected market practice and we request Investment Consultants liaise with investment managers to drive improvements. During 2022, the focus was on engaging with the asset managers to improve the disclosure of information to help with this assessment.
- We will set out a monitoring process to review how the underlying investment managers are assessing, managing, and mitigating climate risks including the portfolio's positioning in relation to the transition to a lower-carbon economy. This includes conducting scenario analysis to understand the resilience of the portfolio to various climate scenarios as far as practicable, noting that this type of analysis is still evolving.

## The integration of processes for identifying, assessing, and managing climate-related risks into the organisation's overall risk management

We recognise the importance of integrating the considerations which surround climate change within the Plan's overall risk management and have taken the following key actions:

- Explicitly documented climate change as a risk within the Plan's risk register and included detail on the steps taken to manage the risk.
- Climate change is considered alongside other risks (in terms of invested assets and the impact on the funding strategy).

We view the development of roles and responsibilities as an ongoing process, as approaches to understanding and integrating climate-related risks and opportunities continue to evolve over time. When reviewing the ESG Policy, the Trustee will consider whether the current delegations remain appropriate.

## **What are the climate-related risks and opportunities?**

The effects of climate change will be felt over many decades. The Trustee has again considered two types of climate-related risks and opportunities in its climate scenario analysis:

### **Transition risks and opportunities**

This covers the potential financial and economic risks and opportunities from the transition to a low carbon economy (i.e., one that has a low or no reliance on fossil fuels), in areas such as:

- Policy and legislation
- Market
- Technology
- Reputation

Risks include the possibility of future restrictions, or increased costs, associated with high carbon activities and products. There are also opportunities, which may come from the development of low-carbon technologies. To make a meaningful impact on reducing the extent of global warming, most transition activities need to take place over the next decade and certainly in the first half of this century.

### **Physical risks and opportunities**

The higher the future level of global warming, the greater physical risks will be in frequency and magnitude. Physical risks cover:

- Physical damage (storms; wildfires; droughts; floods; reduced productivity of labour and agriculture)
- Resource scarcity (water; food; materials; biodiversity loss)

Physical risks are expected to be felt more as the century progresses though the extent of the risks is highly dependent on whether global net zero greenhouse gas emissions are achieved by 2050.

There are investment opportunities, for example, in newly constructed infrastructure and real estate that are designed to be resilient to the physical impacts of climate change, as well as being constructed and operated in a way that have low or no net carbon emissions. There are also opportunities for investment in those companies or industries that focus on energy conservation and resource efficiency.

## Metrics

In relation to metrics the Trustee intends, as far as it is able, to take a consistent approach between the DB and DC Sections. However, the Trustee recognises that the availability of data may differ given the difference in underlying assets held by each Section.

### Core reporting

The Trustee will measure the following outcome metrics annually:

- i) Total carbon emissions (emissions-based absolute metric)
- ii) Weighted Average Carbon Intensity (WACI) (emissions-based intensity metric)
- iii) Implied Temperature Rise (ITR) (transition alignment metric)
- iv) 'Data quality', i.e., Share of portfolio held at year end for which climate-related metrics of an acceptable quality have been obtained (non-emissions-based process metric)

### Additional Reporting

In addition to the core minimum metrics, the Trustee will measure the below additional metrics in so far as possible depending on the availability of the data.

#### Outcome

- i) Carbon emissions as a proportion of the company's total market cap, total debt including cash (EVIC) normalised per £m invested (additional emissions-based intensity metric).
- ii) Exposure to Carbon-Related Assets exposure to the energy and utilities sectors as defined by the Global Industry Classification Standard (GICS) sector definitions.
- iii) Proportion of the Plan's assets invested in low carbon opportunities.
- iv) Proportion of companies held with climate change risk mitigation plans.
- v) Proportion of sovereign bonds held issued by countries with Net Zero 2050 commitments.
- vi) Proportion of the Plan's assets highly exposed to key indicators of physical climate risk e.g., extreme weather events, flooding risks etc.
- vii) Climate Value at Risk.

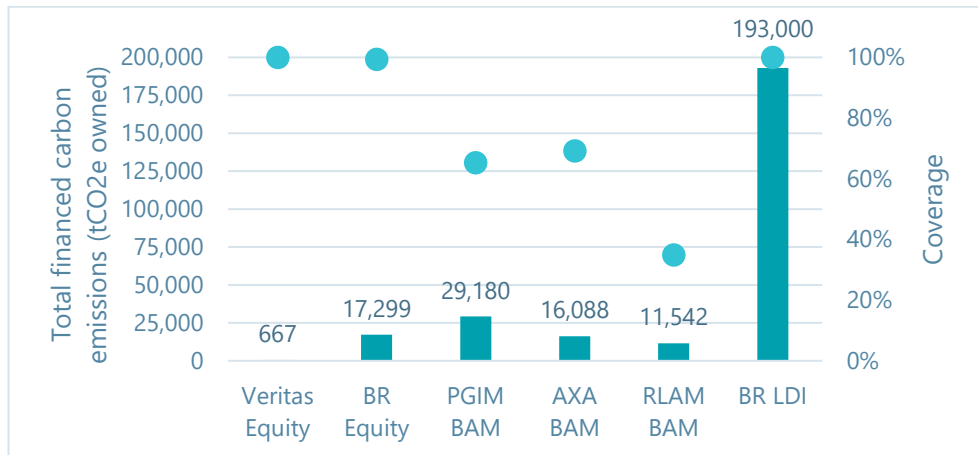
#### Process

- i) Share of portfolio held at year-end for which engagement or voting on climate-related risk and opportunities has been a substantive topic.
- ii) Share of board meetings per year in which climate-related issues have been a substantive agenda item.

## DB Section Metrics Dashboard

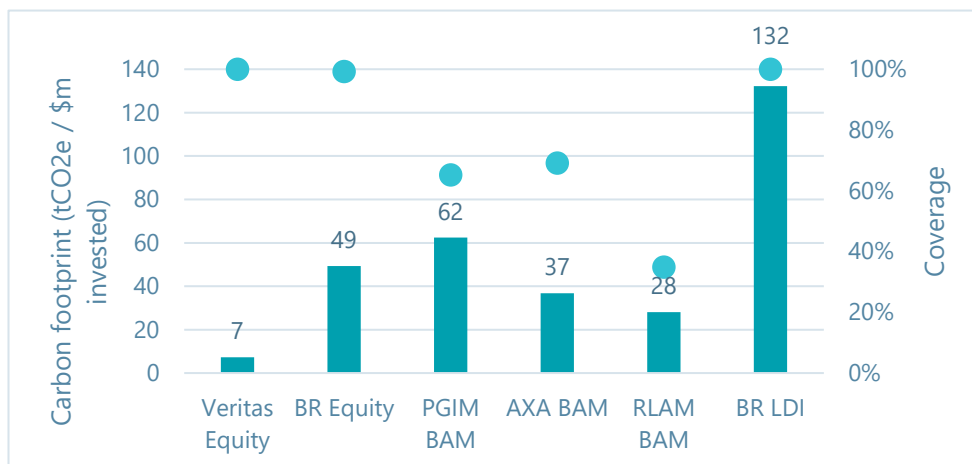
### Core Metrics

#### Total financed carbon emissions (tCO<sub>2</sub>e)



Total Financed Carbon Emissions, or absolute carbon emissions, represents the total tonnes of greenhouse gases attributable to the Plan's holdings based on the ownership of the underlying assets. It's clear that the majority of this comes from the Blackrock LDI mandate, corresponding to the carbon emissions associated with the UK government bond exposure, as this is the largest holding by value for the scheme.

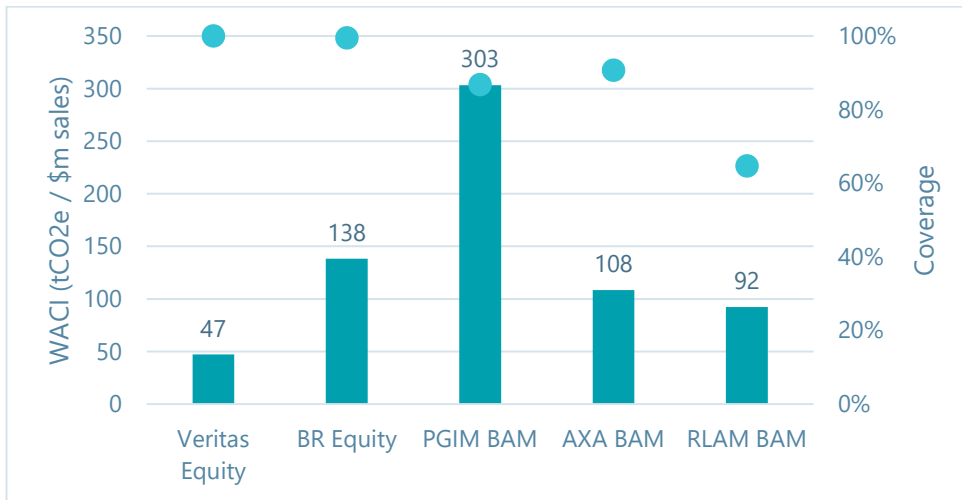
#### Carbon footprint (tCO<sub>2</sub>e / \$m invested)



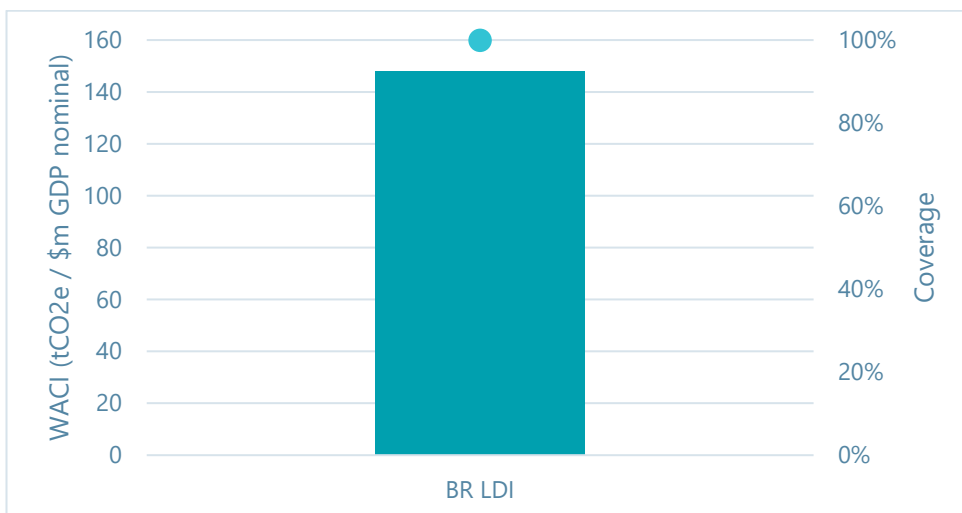
Carbon footprint is an intensity metric, showing the total carbon emissions normalised by the value of the investment. This is useful to show comparison of emissions intensity for portfolios of different sizes. The chart shows that the LDI portfolio (government bonds) are more carbon intensive than the equity or corporate bond assets. Of the other funds, the PGIM Buy and Maintain fund has the highest carbon footprint and therefore the trustees will engage with the manager to understand the key drivers of this.

<sup>4</sup> BAM refers to Buy and Maintain

## Weighted Average Carbon Intensity (tCO<sub>2</sub>e / \$m sales)

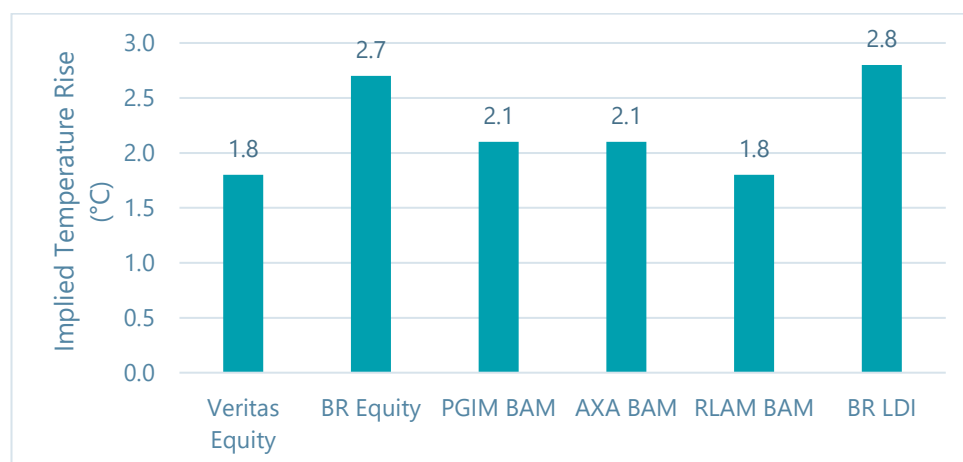


## Weighted Average Carbon Intensity – BR LDI



Weighted Average Carbon Intensity (WACI) is another intensity measure. We show two charts, as the WACI of companies (equity and buy and maintain funds) is based on emissions normalised by revenue, whereas for government bonds WACI is emissions normalised by GDP - and hence are not comparable. The WACI illustrates how efficient the investments held are with respect to their carbon emissions. It's clear again that the PGIM buy and maintain fund has the highest intensity figure, and therefore the Trustee will engage with PGIM to understand which companies are contributing to this and the rationale for their inclusion.

### Implied temperature rise (°C)



Implied Temperature Rise (“ITR”) is a measure of the alignment of the portfolio to a future increase in global temperatures above pre-industrial levels, to give an indication of whether the portfolio is in line with the delivery of the Paris Agreement. An ITR of 2°C or lower would indicate alignment with successful outcome under the Paris Agreement.

### Data quality for emissions measures

PCAF score	1 (best)	2	4	Average score
PCAF description	Verified	Unverified	Estimated	
Veritas Equity	-	99.8%	0.2%	2.00
BR Equity	-	94.1%	5.9%	2.12
PGIM BAM	-	89.6%	9.5%	2.17
AXA BAM	-	92.0%	7.6%	2.14
RLAM BAM	-	74.1%	24.0%	2.44
BR LDI	n/a	n/a	n/a	n/a

Notes regarding core metrics:

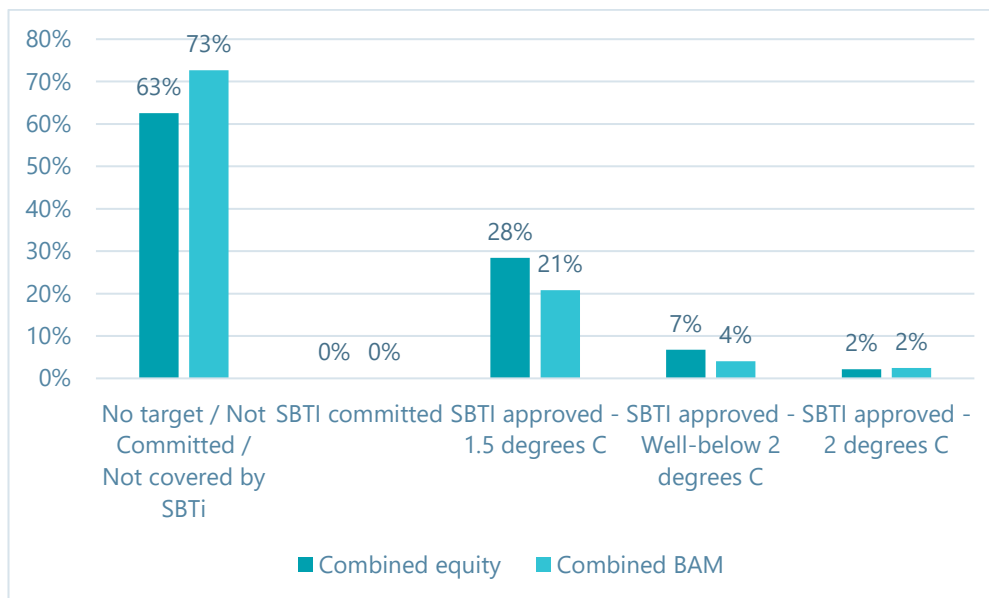
- Scope 1 and 2 carbon emissions shown. Availability of Scope 3 is limited and not required by TCFD.
- Metric results sourced from the MSCI ESG Manager tool for all funds apart from LDI, using underlying fund holdings provided by investment managers on 30 Sept 2022 for BlackRock and Veritas, and 31 December 2022 for PGIM, AXA and RLAM.
- Emissions figures and Implied Temperature Rise for LDI portfolio provided by Blackrock.
- WACI for LDI presented separately as this is measured in tCO<sub>2</sub>e / \$m GDP, in line with market practice for government bonds.
- Coverage indicates the proportion of the fund for which carbon data is available. For LDI this is calculated based on long exposure to gilts physically owned by the Plan.
- Where coverage is less than 100%, data provided has been re-normalised to reflect 100% of the funds (assumes unknown emissions data is equivalent to known data points).

## Additional Metrics

### Forward looking exposure to opportunities

	Exposure to low carbon solutions	Exposure to Green revenue
Veritas Equity	4.8%	2.3%
BR Equity	7.8%	4.7%
PGIM BAM	3.5%	4.8%
AXA BAM	4.7%	6.0%
RLAM BAM	4.0%	4.9%

### Forward looking commitments of investments



The chart illustrates the proportion of the fund underlying holdings which have verified Science Based Targets, according to the Science Based Targets initiative (SBTi). The SBTi is a global company which assesses the current emissions and green transition plans of companies and assigns a temperature alignment score (e.g. 1.5°C aligned) based on the credibility of the plans. It's clear that the majority of companies have not had their transition plans approved by SBTi, but that those who have are aligned to 1.5°C, which is encouraging.

## DC Section Metrics Dashboard

This metric scales the total carbon emissions of each underlying investee company by the amount of revenues generated by that company. At a total asset class portfolio level, this metric gives an indication of carbon efficiency. A lower WACI score shows better efficiency. For government debt, the WACI measure scales the Absolute Emissions of each country by the Gross Domestic Product (“GDP”) of the country. The methodology used to calculate the carbon intensity associated with government debt is likely to change and we will keep this under review.

### Core Metrics<sup>5</sup>

Metric	Measure	Mercer Growth Fund	Mercer Diversified Retirement Fund
WACI (listed assets)	Tonnes CO <sub>2</sub> e per \$m revenue	211.4	156.6
Carbon Footprint	Tonnes CO <sub>2</sub> e per £m invested	90.4	61.8
WACI (sovereign assets)	Tonnes CO <sub>2</sub> e per \$m GDP	430.0	353.9
Implied Temperature Rise	°C	2.8	2.5
Climate VaR	% return	-15.2	-12.9

### Mercer Growth Fund Data Quality (Scope 1 & 2)

Non-eligible	Sovereigns	Reported	Estimated	Not Reported
7.0%	8.5%	58.7%	21.8%	3.9%

### Mercer Diversified Retirement Fund Data Quality (Scope 1 & 2)

Non-eligible	Sovereigns	Reported	Estimated	Not Reported
12.7%	14.0%	54.1%	15.4%	3.9%

5

**Absolute emissions** represents each company’s reported or estimated greenhouse gas emissions, where available (includes scope 1 and scope 2 emissions).

**Weighted Average Carbon Intensity (“WACI”)** measures the carbon emissions (in metric tonnes) generated per million US dollars of revenue generated. For sovereign assets, this is normalised by Gross Domestic Product (GDP) rather than revenue.

**Carbon footprint** measures the carbon emissions (in metrics tons) per million £ sterling invested.

**Implied Temperature Rise** analyses the warming scenario that the investment is aligned with. As a reminder, the 2015 Paris Agreement was to keep global temperature rises to below 2°C above pre-industrial levels.

**Climate VaR** is an estimation of the impact related to climate change under a 1.5-degree scenario.

**Data Quality** measures the proportion of the company’s emissions data either reported by the company, estimated by the data provider, not reported, or estimated, or reported by a third party.

## Targets

As part of the TCFD requirements, we must set a target against one of the metrics chosen.

Target setting is flexible and can be:

- Set for certain asset classes.
- Applicable to only a portion of the Plan's assets

Targets should be:

- Based on recognised metrics
- Be quantified and regular.
- Have a clear baseline and timeframe.

Targets should be, Emissions, Transition based or can relate to "other metrics".

### DB Section

#### Data Quality metric

Our target is to increase average data quality relative to the prior year, based on PCAF (Partnership for Carbon Accounting Financials) score. We believe that intuitive and high-quality data are critical to enable better understanding of current risks. It will be applicable to all asset classes.

We believe that by first ensuring that the more direct climate metrics are reliable will allow us to target improving those metrics in the future.

### DC Section

For the relevant popular arrangements (as defined by the TCFD regulations) we will measure (as far as we are able) the performance of the Plan against a target for at least one of the metrics reported.

#### Emissions-based

The trustees have agreed to a Net Zero strategy within the DC popular arrangements. The funds have an overall Net Zero by 2050 target, and an interim target to reduce WACI by 45% by 2030, from 2019 base levels.

The Trustee works closely with its investment consultant to understand the actions that need to be taken by our delegated Fiduciary Manager to progress towards the Trustee's climate-related target. Examples of continued efforts to work towards the target are:

- Better integration of climate considerations in the manager selection process
- Pushing managers to enhance their voting and engagement practices.
- Continuing to identify and allocate to solutions which deliver return opportunities as well as emissions reductions targets.
- Continuing to monitor exclusions framework to ensure best outcomes for investors.

In addition, we may monitor and target an increase in the quality of carbon data available for the portfolio held at year end. The Data Quality metric measures the proportions of the portfolio for which we have high-quality data. Our Investment Consultants have considered whether the underlying emissions data has been verified by a third party, reported by the company, estimated by the data provider, or that it is unavailable. Data Quality also assists the Trustee in monitoring quality of reporting over time, as companies are expected to continually improve their reporting on climate-related metrics. As the quality of data improves, the climate metrics reported on the Plan's portfolio allow better-informed decision-making. In addition, our Fiduciary Manager can identify the companies in the portfolio that are not currently reporting emissions data and use this as the basis for engagement.

We will review the progress against our targets every year and review the target itself at least every three years. This is to ensure it remains consistent with the latest scientific thinking and is appropriately incentivising the economic transition that is needed.

Signed: 

For and on behalf of Wood Pensions Trustee Limited

Name: Mervyn Walker

Date: 23 October 2023

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