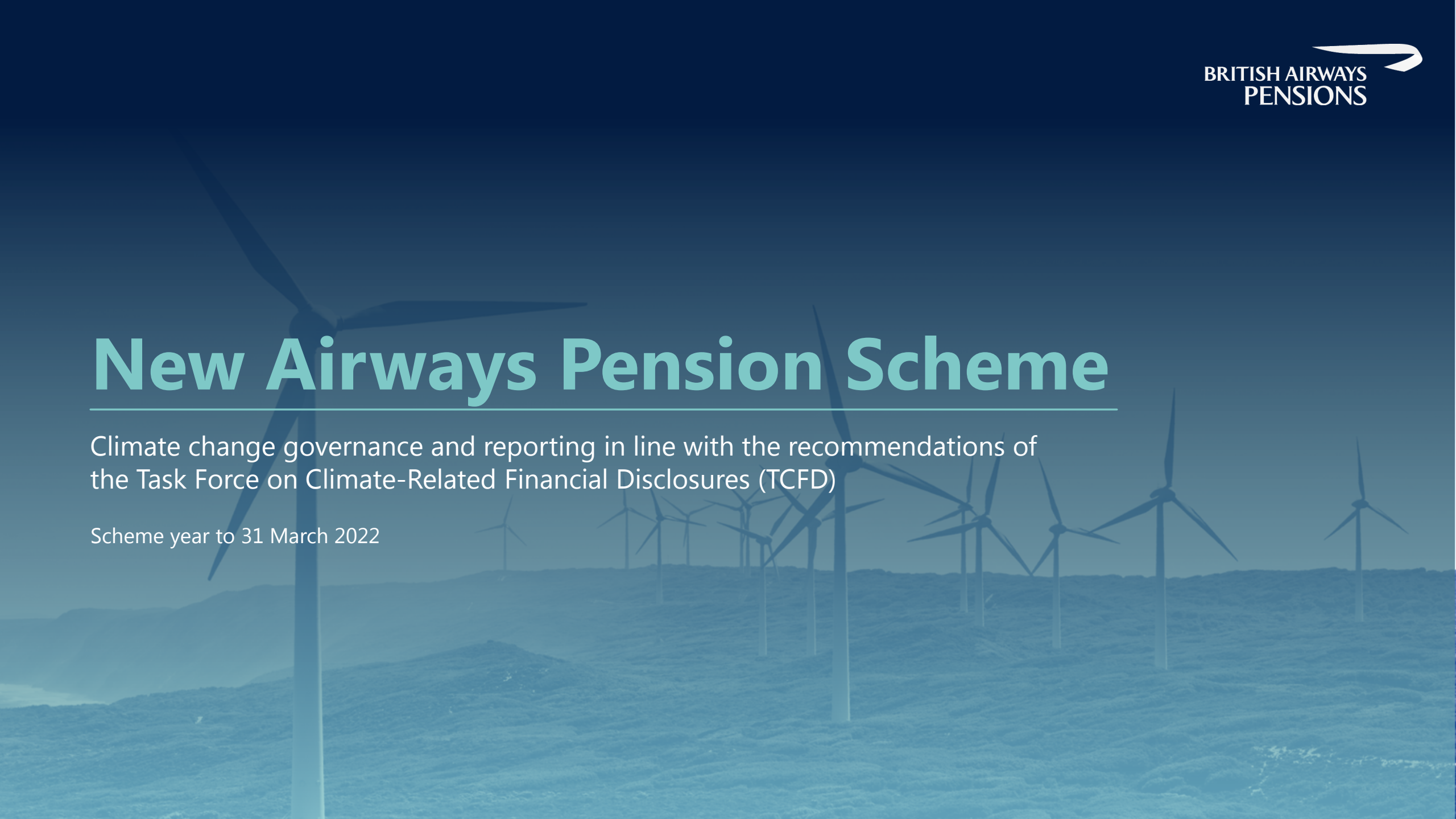
BRITISH AIRWAYS PENSIONS

# New Airways Pension Scheme

Climate change governance and reporting in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD)

Scheme year to 31 March 2022



# 1 Summary

# Executive Summary

This report has been prepared in line with the recommendations of the Taskforce on Climate-Related Financial Disclosure (TCFD), as required by regulation. The TCFD developed a framework to help public companies and other organisations disclose climate-related risks and opportunities.

This report covers the Scheme year dating from 1 April 2021 to 31 March 2022 and describes the activities and approach taken by the Trustee to understand the climate-related opportunities and reduce the risks to the Scheme related to climate change across the investments, the liabilities and the sponsor's (British Airways) covenant. The following points are a summary of the detailed report that follows:

- We have revisited our investment beliefs in relation to Environmental, Social & Governance (ESG) issues and climate change specifically.
- We used these beliefs to update our Responsible Investment (RI) Policy in November 2021.
- We have established a governance structure to identify specific roles, responsibilities and oversight regarding climate risks.
- We work closely with, monitor, and challenge our investment manager, BlackRock, to ensure ESG considerations are fully integrated into all investment decision making and evidenced back to the Trustee.
- We have carried out scenario analysis to consider how the climate-related risks and opportunities might affect the funding and investment strategy and the British Airways' covenant.
- As part of the 2021 actuarial valuation, the Trustee is considering the impact of climate risk on any updates that may be made to the investment and funding strategy.
- We have updated the Scheme's risk management process to include consideration of climate change risk.
- We have chosen three climate-related metrics to monitor through time, namely carbon footprint, carbon intensity and data quality.
- We have set an initial climate target on the listed equity portfolio of reducing the carbon exposure by 45% over the period to 2030.
- We have changed our passively managed public equity mandate to one that tracks an index with an in-built target of reducing carbon intensity by 7% per year.
- We strongly believe in the role of engagement and working with invested companies, via the investment manager, as a way to facilitate real world decarbonisation.

The next slide summarises some of the results of our analysis.

Finally, this is a developing area of financial and risk analysis, and the Trustee will continuously review its approach and take appropriate advice from its professional external advisors.

# Executive Summary

**Potential impact on 31/03/2022 portfolio from different warming pathway scenarios, based on available data[1]**

| Temperature rise scenario | | Funding ratio change[2] |
|---|---|---|
| Orderly Transition[1] (Transition Risk model) | 1.5 - 2.0°C | -4.6% |

| Estimated Impact on Assets [1] | Equities | Private Equity | Corporate Bonds | Liability Hedging Portfolio |
|---|---|---|---|---|
| Orderly Transition | -2.6% | -4.3% | -1.2% | 5.5% |

| Temperature rise scenario | | Funding ratio change[2] |
|---|---|---|
| High Emissions[1] (Physical Risk model) | 3.2 - 5.4°C | -1.9% |

| Estimated Impact on Assets [1] | Equities | Private Equity | Corporate Bonds | Liability Hedging Portfolio |
|---|---|---|---|---|
| High Emissions | -8.9% | -9.1% | -0.8% | -0.9% |

## What does this tell us?

In the context of the scenario analysis undertaken, the Trustee believes that the current funding and investment strategies are resilient to climate-related risks.

Although there is climate-related risk associated with the public equity portfolio, it serves a purpose in the portfolio and will reduce over time. The exposure to gilts will increase over time which means the Scheme will have exposure to the UK's transition and physical risks.

BlackRock's climate scenario analysis helps in understanding risks and opportunities.

The Trustee understands that climate change risks could be material for the sponsor, and this is taken into account, along with other factors, in the assessment of the strength of the sponsor covenant by the covenant advisor and the potential impact on the funding strategy.

The Trustee will continuously review its approach.

[1] Based on data for a proportion of the assets in the portfolio - unlisted/private market assets have been excluded. Orderly Transition is a transition risk scenario. High Emissions is a physical risk scenario. These only capture some of the likely effects on the Scheme in each case. Temperature rise relative to pre-industrial levels.
[2] The estimated impact on the Scheme's LTFT funding ratio as a result of adjusting the present value of its current assets and liabilities.
Source: BlackRock, March 2022. Readers are directed to the Disclaimers related to the scenario analysis on page 48.

# Executive Summary

## Climate-related target and progress

The Trustee aims to reduce the carbon intensity of the listed equity allocation by at least 45% from 31 March 2021 baseline levels by 2030

| | |
|---|---|
| **Change over the year to 31 March 2022** | **-68%** |

## Emissions data

| **Carbon emissions[1]** | | **Data coverage** |
|---|---|---|
| Liability Matching emissions | 1,594,000 | 77% |
| Rest of portfolio emissions | 362,222 | |

## Decisions taken over the year to 31 March 2022 in relation to climate-related target[2]

The climate-related target was reached due to actions taken over the year:

- Following the appointment of BlackRock from 1 June 2021, the listed equity mandate was restructured to be a global mandate with an active/passive split. The passive equity mandate became an ESG optimised index to incorporate a reduction in carbon emissions intensity relative to its parent index;
- From 1 June 2021 the active listed equity strategies incorporated BlackRock's baseline ESG screens; and
- The Trustee actively decided to transition to the updated methodology in February 2022 for the MSCI ACWI ESG Enhanced Focus passive equities mandate. This change ensures alignment to the EU's climate transition benchmark requirements. The new methodology achieves a minimum of 7% p.a. reduction in weighted average carbon emissions.

## Next steps for target setting[2]

- Review the appropriateness of the climate-related target for future years and in light of any wider investment strategy changes;
- Consider rebasing the baseline start date of the climate-related target to 31 March 2022, given the original target has been reached;
- Consider possibly covering the credit mandate under a future target; and
- Include a Paris Agreement alignment metric in the next TCFD report.

[1] Total portfolio emissions are split out between the Liability Matching Portfolio (i.e. sovereign bonds) and the remainder of the portfolio due to a difference in calculation methodology

[2] These lists are not intended to be exhaustive.

# 2 Introduction

# Introduction

**Dear Members**

The Trustee of NAPS believes that climate change represents a long-term systemic risk to the Scheme. It recognises that climate risks are financially material and need to be managed as the Scheme has a long-term payment horizon.

Identifying, assessing and managing climate-related risks and opportunities for the Scheme are strategic priorities carried out by the Trustee, with support from the British Airways Pensions internal teams, the Trustee's investment manager and the Trustee's external advisors:

- Investment manager – BlackRock
- Actuarial advisor – LCP
- Investment advisor – Mercer
- Covenant advisor – PwC
- Legal advisor – CMS

The Trustee implements its investment strategy using an Outsourced Chief Investment Officer (OCIO) model, in which the investment manager, BlackRock, is also the stewardship provider. The Trustee believes it is important to ensure that the investment manager promotes the TCFD's recommendations and considers climate-related risks and opportunities within its investment decision making process.

The Scheme's partnership with BlackRock is key in this process. We are reassured that BlackRock supports the low carbon transition in the way it invests and in the way it votes and engages with the underlying companies and issuers.

We have set out this report according to the framework suggested by the TCFD, covering the following key areas:

- **Governance**

  This section outlines the Scheme's governance structure regarding climate-related risks and opportunities, including a breakdown of roles and responsibilities, implementation and oversight.

- **Risk management**

  This section summarises the processes used by the Trustee to identify, assess, and manage climate-related risks.

- **Strategy**

  This section covers the potential impacts of climate-related risks and opportunities on the Scheme's investment and funding strategy.

# Introduction

- **Metrics**
  This section summarises the climate-related metrics which the Trustee has chosen to report for the Scheme and provides data for the investments held as at 31 March 2022.
- **Targets**
  The climate-related target chosen by the Trustee, and progress over the reporting period, is provided in this section of the report.
- **Technical Section and Additional Information**
  There is a great deal of technical information required for climate analysis and reporting, and in order to keep the report accessible and relevant, we have included the more granular detail in the technical section of the report.

The NAPS Trustee believes the approach outlined in this report is consistent with its fiduciary duty to the beneficiaries of the Scheme. Further, this report fulfils the requirements of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, which are themselves designed to align with the recommendations of the Taskforce on Climate-Related Financial Disclosure.

Further information about the Scheme, including the Statement of Investment Principles (SIP) and Responsible Investment Policy, can be found on the Scheme's publicly accessible website: www.mybapension.com/naps

A list of acronyms used in this report can also be found on the same website: www.mybapension.com/naps/documents/responsible-investment

**Roger Maynard**

Chair of the Trustee
New Airways Pension Scheme

# 3 Governance

# Governance

**Trustee Board**

The Trustee Board has ultimate responsibility for all aspects of the management and strategy of the Scheme including climate change governance and reporting.

Climate risk is not just an investment-related issue: there are wider implications covering both risks to the covenant of the sponsor and risks around the liabilities. The Trustee maintains a Statement of Investment Principles (SIP), which details the key objectives, risks and approach to considering ESG factors, such as climate change, as part of its investment decision making. The document is reviewed on at least an annual basis.

**Investment Committee (IC)**

The Trustee Board has delegated the regular monitoring of climate risks, to the IC. The IC also undertakes to review annually the Scheme's Responsible Investment (RI) Policy including the approach to managing climate-related risks, with advice from the Scheme's investment advisor to ensure it remains aligned with best practice.

To ensure that the IC is fulfilling its duties adequately, the Trustee maintains a 'Terms of Reference' setting out the IC's responsibilities and delegations, including ESG and RI issues. The Terms of Reference are subject to annual review by the Trustee Board.

**Ongoing Governance Activity**

Climate change has and will continue to form an explicit agenda item at Trustee Board meetings at least annually and is covered as an ad-hoc regular agenda item at IC meetings. It will also be discussed within other agenda items as part of wider discussions on funding or investment strategy, or as part of the investment manager appointment and review discussions.

The Trustee is satisfied that the amount of governance time spent is reasonable and will allocate more time at future meetings if any analysis or wider industry research requires additional Trustee review and consideration. The Trustee and IC questioned the information provided to them and, where appropriate, challenged BlackRock or advisors in the course of conducting its governance activities.

**Investment Advisor**

The Trustee's investment advisor, Mercer, provides ongoing advice on the investment strategy for the Scheme. This includes advice on managing and monitoring investment-related risks, including climate change. Mercer works closely with the Scheme's appointed investment manager, BlackRock, to understand the impact of any strategic asset allocation changes on the Scheme's exposure to climate-related risks and opportunities, questioning and challenging where required. Mercer representatives attend IC meetings (held at least quarterly) and Trustee Board meetings when necessary. Mercer has provided the Trustee with training on climate change and the various components of TCFD during the Scheme year.

# Governance

**Investment Manager**

The investment manager, BlackRock, is responsible for the day-to-day implementation of the Scheme's investment strategy and RI Policy.

The investment manager provides quarterly and annual reporting to the in-house team and the IC, detailing the stewardship, engagement and voting activity conducted on behalf of the Trustee.

The Trustee has mandated that the investment manager must include consideration of ESG factors, including climate-related risks, when making investment decisions, and the IC receives regular updates that includes consideration of ESG factors in the investment process.

BlackRock provides the Trustee with climate scenario analysis for the investments and liabilities of the Scheme on an annual basis. BlackRock also provides climate-related metric data at least annually.

**Independent Investment Expert (IIE)**

An IIE attends IC meetings to provide support, expertise and input to the discussions of the IC, including in relation to climate change matters.

**Scheme Actuary**

The Scheme Actuary analyses and monitors the risk of climate change on the Scheme's funding strategy, including in respect to any potential effects on the mortality assumptions within the Scheme's liability measures.

**Covenant Advisor**

The Trustee incorporates the climate risk of the Scheme's sponsor, British Airways, into its review and analysis of overall climate risk. The Trustee has appointed PwC as its covenant advisor. PwC provides covenant advice during the triennial valuation process, as well as quarterly covenant monitoring. PwC has incorporated climate risk into its analysis.

**In-house Team**

On behalf of the Trustee, the in-house Funding and Investment team performs the day-to-day oversight function, challenging advisors and BlackRock and raising issues to the IC and Trustee Board, where appropriate.

**Advisor Review**

In order to ensure that its advisors, including the investment, actuarial and covenant advisors, are taking adequate steps to identify and assess climate risks, the Trustee sets objectives for its advisors, including ESG-related objectives where appropriate, and reviews these annually.

With regard to the investment manager, the in-house team conducts a monthly review meeting with BlackRock, and the Trustee performs an annual review.

# Governance

**Implementation**

Day-to-day implementation of climate risk management, and the wider NAPS RI Policy is delegated by the Trustee to the investment manager, BlackRock. BlackRock is responsible for:

- Portfolio management, including individual decisions on the purchase, retention and/or sale of investments;
- The integration of climate change and other ESG risks when making investment decisions as required by the RI Policy, including conducting specific climate-related analysis where appropriate;
- Stewardship, including engagement with held or prospective companies intended to protect and/or enhance the value of the Scheme's assets. Where appropriate this will include ensuring that investee companies have appropriate climate-related policies and strategies in place;
- Annual climate-related scenario analysis to inform strategic decisions by the Trustee; and
- Production of annual ESG and climate specific reporting for the Trustee including portfolio metrics and analytics (such as emissions data) for monitoring and regulatory purposes.

**Oversight**

Oversight of the implementation of the Scheme's RI Policy is carried out, on behalf of the Trustee, by the in-house team. Tasks include:

- Regular liaison with the BlackRock Strategic Client Delivery Team and the various BlackRock Investment Stewardship and Responsible Investment teams;
- Reviewing data/analysis/reporting outside of the regular reporting cycle;
- Ensuring sufficient reports and analysis are available to meet the Trustee's climate-related obligations and objectives; and
- Reviewing any developments in industry practice, and changes in legislation and regulation.

# Governance

**Training**

Over the past two years, the Trustee has received a number of training sessions from Mercer and BlackRock on various topics, including:

- Climate-related risks and opportunities;
- The recommendations and requirements of TCFD reporting; and
- Climate-related metrics, scenario analysis and setting climate targets.

Several of these sessions included advisor recommendations, discussion, debate and ultimately resulted in key decisions being made, which feature in this report. The in-house team attending the meetings received the same training, in addition to joining industry events and with relevant staff keeping up to date with CPD requirements.

**ESG beliefs**

During the Scheme year, an interactive Trustee session on ESG beliefs was conducted by the Scheme's investment advisor. The outcome of the discussion was to review the Scheme's RI Policy to ensure the policies remain consistent with the Trustee's ESG beliefs.

The session included a survey of the full Trustee Board, including questions around ESG themes and priorities, the sponsor's policies on sustainability, member views, and voting and engagement.

**Responsible Investment Policy**

A number of changes were adopted by the Trustee as part of a revision of the Scheme's RI Policy.

These changes included a strengthening of the wording around voting and engagement, and an update of the Trustee's mission statement:

> **"Environmental (including climate change), social and governance ("ESG") issues are multifaceted and represent long-term systemic risks.**
>
> **We recognise that ESG risks are financially material and need to be managed as we have a long-term payment horizon. We therefore seek to integrate ESG considerations into our decision-making and reporting processes across all asset classes.**
>
> **Where consistent with our fiduciary duties, and applicable to our investment strategy, we will require our investment managers to actively engage and utilise their voting rights/engagement to drive up ESG standards in the organisations in which we invest."**

# 4 Risk Management

# Risk Management

**Processes for identifying, assessing and managing climate-related risks and integration within the Trustee's overall risk management of the Scheme**

A key part of the Trustee's role is to understand and manage risks that could have a financially material impact on both the Scheme's investments and 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 climate-related risk management processes and activities of the Trustee Board and its sub-committees. These help the Trustee understand the materiality of climate-related risks, both in absolute terms and relative to other risks that the Scheme is exposed to.

The Trustee Board and its sub-committees prioritise the management of risks primarily based on the potential impact to the security of members' benefits.

The Trustee also ensures that it is kept up to date with the latest developments regarding climate-related risks and opportunities, and undertook multiple climate focused training sessions during the Scheme year to 31 March 2022.

BlackRock uses its risk tools and provides outputs and outcomes of using those tools to the Trustee, as required.

**Governance**

The Trustee has documented its approach to ESG, including climate risk, into Scheme documents such as the **Statement of Investment Principles (SIP)** and the **Responsible Investment (RI) Policy**, both of which are reviewed at least annually and set out how investment climate-related risks are managed and monitored.

The Trustee maintains a **risk register** to monitor and mitigate financially material risks to the Scheme. A specific RI risk is included: "*Identification, assessment and management of environmental (including climate-related), social and governance factors on the Scheme's assets, liabilities and investment strategy and regulatory compliance.*" The Trustee Board has delegated ongoing monitoring of the risk register to the Governance and Operations Committee, which meets at least quarterly.

In addition to the risk register, the Scheme also has an **Integrated Risk Management (IRM)** framework, which looks at funding, investment and covenant risks holistically, including climate risk.

The Trustee has received Mercer's Responsible Investment Total Evaluation (RITE) analysis, which provides an evaluation of how well the Trustee is integrating ESG considerations, including climate change, into its overall investment process and allows the Trustee to monitor progress over time.

**Strategy**

The Trustee's advisors are required to take climate-related risks and opportunities into account as part of the wider strategic advice provided to the Trustee. This includes highlighting the expected change in climate-risk exposure through proposed asset allocation changes. BlackRock will be required to carry out climate scenario analysis and monitor the progress of the investment strategy against climate related metrics.

Climate scenario analysis for the investments of the Scheme will be reviewed at least triennially or if there has been a material change to either the strategic asset allocation or the scenario modelling approach. A summary of the Trustee's latest climate scenario analysis is included in the next section of this report and is the primary tool to help the Trustee understand the materiality of climate-related risks that could impact the Scheme over time.

# Risk Management

**Reporting**

In order to fully understand climate risks, the Trustee has worked with BlackRock to obtain a regular delivery of a suite of climate-related reporting which is considered each quarter by the Investment Committee.

Following the Trustee's choice of metrics, BlackRock receives climate-related data on the portfolio and delivers a report to the Trustee on an annual basis.

As the Trustee has established a target based on a specific metric, going forwards, BlackRock will provide regular detail on how the portfolio is progressing towards that target.

The Trustee, via the in-house team, monitor BlackRock's stewardship (voting and engagement) programme for the Scheme's assets. On a quarterly basis, the in-house Team meets with BlackRock to discuss the voting and engagement activity for the period in question, and provides challenge where necessary. On a semi-annual basis, the stewardship reporting is also presented to the IC, considered and challenged where necessary.

# Risk Management

BlackRock provides the Trustee with its **Stewardship Annual Report**, which includes:

- Details of its Investment Stewardship Global Principles;
- Its firm-wide Voting Guidelines.
- Current themes and topics, including environmental and climate risk concerns;
- The voting records, including breakdowns by subject and geographical categories; and
- Details of where BlackRock has voted against management on proposals.

Under the *Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019*, the Trustee is required to produce an Annual Implementation Statement, setting out how the voting and engagement policies described in the Scheme's Statement of Investment Principles have been followed. These statements include detailed example case studies of BlackRock's engagement activity.

Current and previous implementation statements are included on the Scheme's public website: www.mybapension.com/naps/home/index

# Risk Management: Asset Manager Review

**Asset Manager Review**

BlackRock's conviction is that sustainability risk – and climate risk in particular – is investment risk. As such it has identified a Climate Focus Universe of companies which are potentially exposed to climate-related risks.

The BlackRock Investment Stewardship team engages with companies to assess how material sustainability-related factors impact a company's ability to generate long-term shareholder returns.

In 2021, BlackRock expanded its focus universe to over 1,000 carbon-intensive public companies that represent 90% of the global scope 1 and 2 GHG emissions of their clients' public equity holdings with BlackRock.

As an extension of this programme, BlackRock has also developed the **Heightened Scrutiny Framework** for Climate Risk. BlackRock expects that the issuers they invest in on their clients' behalf to be adequately managing the global transition towards a net-zero economy. While many companies are energetically preparing for this evolution, others that are not adequately prepared present a risk to their clients' portfolios. The Framework covers companies which have:

- **High carbon intensity today**
- **Insufficient preparation for the net zero transition**
- **Low reception to our investment stewardship engagement**

Where BlackRock does not see enough progress, and in particular where there is a lack of alignment combined with a lack of engagement, BlackRock may use its vote against management and will flag holdings for targeted review and engagement where they believe they may represent a risk to performance.

Conversely, BlackRock believes companies that distinguish themselves in terms of their emissions trajectory, transition preparedness and governance will often represent opportunities.

The Scheme has no exposure to companies covered within BlackRock's "Heightened Scrutiny Framework" for its active public equity mandates.

Just over 30% of the Scheme's public equity portfolio as at 31 March 2022 was invested in companies that are part of the Climate Focus Universe. Between 31 May 2021 and 31 March 2022 BlackRock engaged with 255 individual companies from the Climate Focus Universe held by NAPS. Management of climate-related risk was raised and discussed with those companies on 337 separate occasions.

**Scheme specific risk management action:** Over the year the decision was made to transition to the updated methodology for the MSCI ACWI ESG Enhanced Focus passive equities mandate. This change ensures alignment to the EU's climate transition benchmark requirements. The new methodology achieves a minimum of 7% p.a. reduction in weighted average carbon emissions each year, increasing the weighting to green revenue companies and those with credible reductions targets. As the global passive equity mandate is segregated the move was not automatic and the Trustee made an active decision in this regard.

# Risk Management: ESG Integration Examples

**ESG Integration**

The integration of ESG factors and specifically climate risk is fundamental to how the Trustee perceives risk within the investment portfolio.

To support the implementation of this risk management, BlackRock regularly provide examples of ESG integration to the Investment Committee.

The following examples from the property portfolio detail the efforts made to ensure that climate risk from the development of properties is minimised.

**Windsor Dials**

Two buildings in Windsor totalling 68,500 square feet were acquired in March 2019, with planning secured in December 2019 to add an extra floor, extend reception areas and other changes.

The team commissioned an assessment of the carbon that would be embodied under the renovation and renewal plan, relative to "demolish and rebuild" scenarios. Embedded carbon under the renovation and renewal plan was estimated to be around ⅓ of a demolish and rebuild approach.

Construction completed in Q4 2021 delivering nearly 88,000 square feet to Windsor town centre.

The renovation and rebuild saved c.8,100 tonnes of $CO_2$ equivalent compared with the Industry Average for New Builds.

This is equivalent to 6,191 one-way flights from London to New York!

**Warrington Distribution Unit**

Construction of a 246,000 square foot distribution unit with a whole life net zero carbon commitment.

**Environmental**

- Energy Use Intensity and Embodied Carbon targets of 40% improvement over best practice standards
- Photovoltaic panels to generate on site electricity
- 22% recycled steelwork

**Social**

- Access to daylight: improved occupant productivity and reduced artificial lighting energy
- Increased ventilation to improve air quality and comply with Covid-19 guidance
- Three schools engaged for site visits

**Governance**

- EPC A Rated
- BREEAM Very Good
- Zero Carbon Ready Building in line with UKGBC Framework

# Risk Management: Transition Risks and Physical Risks

**Climate Risks and Opportunities**

The effects of climate change will be felt over many decades. The Trustee has 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. In order 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)
- 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.

# 5 Strategy

# Strategy: Time Horizons

**Strategy**

ESG issues, including climate change, are multifaceted and represent long-term systemic risks. The Trustee recognises that ESG risks are financially material and need to be managed as the Scheme has a long-term payment horizon. The Trustee therefore seeks to integrate ESG considerations into its decision-making and reporting processes across all asset classes. ESG considerations are integral to the development of the Scheme's investment strategy. As a core part of this the Trustee has reviewed scenarios for future development in climate change and their potential impact on the Scheme's assets and liabilities. We recognise this is a first iteration, it is useful data for the Trustee and it will be developed further through time.

**Time Horizons**

The Trustee has set its time horizons as follows:

**Short-term: 2024**

In line with the next actuarial valuation

**Medium-term: 2030**

In line with the current Long-Term Funding Target (LTFT);
In three actuarial valuations' time; and
Close to the projected peak level of liabilities.

**Long-term: 2050**

When liabilities are projected to have significantly run-off.

**Short Term (Now to 2024)**

- Transition risks are greater than physical risks with moderate asset re-pricing risk driven by:
  - Increases in private sector net zero commitments and clearer decarbonisation plans;
  - Perceived or real increased pricing of greenhouse gas emissions/carbon; and
  - Exposure to developing economies which have longer time horizons for country level phase down of fossil fuel usage.

**Medium Term (2024 to 2030)**

- Transition risks continue to dominate with heightened asset re-pricing risk driven by:
  - Future warming pathways become clearer;
  - Market awareness grows and is better priced into asset valuations; and
  - Unexpected policy changes that surprise markets.

**Long Term (2030 to 2050)**

- Physical risks become increasingly important:
  - Development of technology and low carbon solutions; and
  - Policy, legislation and regulation likely to also play a key role at the international, national and subnational level.



*Readers are pointed to disclaimers for the scenario analysis found in the Technical Section*

# Strategy: Impacts and Opportunities

**Short Term (Now to 2024)**

The Scheme is exposed to climate-related risks through its allocation to public equity. BlackRock's climate scenario analysis helps the Trustee understand which equity market sectors are most exposed to climate-related risks and which are positioned best to transition to a low carbon economy.

**Medium Term (2024 to 2030)**

The climate-related focus over the medium-term will turn towards risk-reducing assets, such as credit, as the Scheme continues its de-risking journey. Over this time period, bond investments where the issuer of the debt has made minimal effort to support the low carbon transition may lead to a potential 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. Exposure to this market volatility is expected to reduce over time and the resilience of the funding strategy to climate-related risks is subsequently expected to improve.

While the Scheme's allocation to BlackRock's Strategic Alternative Income Fund (SAIF) does not have a direct climate or mandate, the Fund's managers leverage the expertise of BlackRock's Renewable Power Team and currently has significant investments in renewable energy including on- and off-shore wind and solar.

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**Long Term (2030 to 2050)**

As the Scheme matures, the Trustee aims to reduce investment risk with a view to providing the greatest security possible for members' benefits. A typical low-risk investment strategy would invest in high quality corporate bonds, government bonds and cash, all of which the Trustee sees as suited to a transition to a low carbon economy due to being more resilient to climate-related risk.

Physical risks are also expected to increase over the long-term without sufficient actions being taken, which may lead to investment opportunities in industries supporting the transition to a low-carbon economy. However, physical and transition risks could impact mortality and the Trustee will need to be aware of any potential impact on its ability to transfer risk to the insurance market.

# Strategy: Climate Scenarios

Given the uncertainty around the timing and impact of climate-related transition and physical risks, the Trustee has considered a range of possible climate scenarios modelling different risks to test the resilience of the Scheme's investment strategy and funding strategy. The purpose of scenario analysis is to better understand the risks and opportunities posed by climate change to the Scheme and to inform the Trustee's strategy and investment decisions accordingly. They are hypothetical constructs, not forecasts, predictions or sensitivity analyses. The scenarios model the investment strategy in place as at 31 March 2022 and assume this is static over all time horizons.

This report summarises two of these scenarios which present different trajectories:

1. **"Orderly Transition"** – this models **transition risk only** and the global average temperature increase is 1.5°C above pre-industrial levels.
   - The Trustee has chosen this as it:
   - Meets the requirement of modelling a scenario of a temperature increase within the range of 1.5°C - 2°C above pre-industrial levels;
   - Is in line with the Paris Agreement, a global government pact signed in 2015, designed to keep global warming below 2°C;
   - Is based on a Network for Greening the Financial System (NGFS) representative scenario; and
   - Represents a plausible pathway for the Trustee assuming the Orderly Transition mitigates physical risks over the long term.

2. **"High Emissions"** – this models **physical risk only** and the global average temperature increase is 3.2°C - 5.4°C above pre-industrial levels (i.e. likely warming above 4°C).
   - The Trustee has chosen this as it represents a scenario that breaches the 2°C global average temperature increase; and
   - It is based on a scenario from the Intergovernmental Panel on Climate Change (IPCC), which is the United Nations body for assessing the science related to climate change;
   - This scenario assumes that some corrective actions are taken in line with current policies. The impact of physical risk increases over time as emissions accumulate in the atmosphere.

| 31 March 2022\ | Change in Surplus | Change in Funding Ratio* |
|---|---|---|
| **Orderly Transition** | -£918m | -4.6% |
| **High Emissions** | -£374m | -1.9% |

**The present value of the estimated impact on the LTFT funding ratio*

Based on the data available, the **Orderly Transition** scenario has a **moderate expected impact** on the Scheme's funding position. It reflects the world taking aggressive but orderly actions towards reaching Net Zero by 2050 and high-carbon emitting sectors seeing an immediate decline in company profitability.

The **High Emissions** scenario has a **modest expected impact** on the Scheme's funding position. In the near term, it is likely that physical risks are concentrated in certain geographies, particularly impacting assets in Asia Pacific and Emerging Markets. Over the longer term, more countries face significant damage to their economies from higher temperatures and extreme weather events.

*The modelling may understate or overstate the true level of risk due to uncertainty around future economic impacts of climate change. In particular, it would not be appropriate to add together the impacts of a transition risk scenario and a physical risk scenario due to these being different models. Although the Trustee has evaluated the impact of transition and physical risk separately, it is conscious that it should take both into account. Analysis is developing in this area and the Trustee will review its scenarios in future reporting periods. The Technical Section of this report provides more detail on the modelling approach, along with the assumptions and limitations of the scenario analysis.*

***Source: BlackRock, March 2022. Readers are directed to the Disclaimers related to the scenario analysis on page 48.***

# Strategy: Climate Scenario 1 – Orderly Transition

**Overview:** BlackRock's "Orderly Transition" scenario is based on the "Net Zero by 2050" pathway developed by the NGFS. Global warming is limited to c.1.5$^{o}$C through stringent climate policies and innovation, with $CO_2$ emissions reaching "net zero" relative to pre-industrial levels in c.2050.

**Risk Factors:** Transition risk factors are the focus.

**Narrative:** The main features of this scenario are higher carbon prices and taxes, higher end user energy prices and a changing energy mix (out to 2050). Those companies which rely heavily on energy, utility and basic materials are most severely affected. The financial model also incorporates changing consumer behaviour, which impacts demand for goods and services.

The impact of the Orderly Transition on the Scheme's funding level has been considered over a single timespan over the lifetime of the scenario modelled. The model considers the impact of transition risk factors to 2050, covering the Scheme's short, medium and long-term time horizons.

**Outcome:** There is a large estimated change in the Scheme's liabilities that occurs under this scenario, where higher carbon prices and an increase in government investment drives higher inflation (UK inflation is around 1.9% higher, peaking in 2026). The Scheme's index and active equity portfolios are less exposed to transition risk than the standard MSCI global all country index. This is predominantly due to differences in their exposure to energy and materials stocks versus the index. This analysis has been conducted on listed assets only. Unlisted, private market assets, other than private equity via a proxy, have been excluded, therefore the summary below will be underestimating the impacts on the overall strategy. The table below shows the estimated impact on the Scheme of the Orderly Transition scenario.

| | Assets* | Liabilities** | Surplus (Deficit) | Funding Ratio | Change in Surplus | Change in Funding Ratio |
|---|---|---|---|---|---|---|
| **Base, 31/03/2022** | £19,646m | £19,298m | £349m | 101.8% | | |
| **Orderly Transition** | £20,008m | £20,577m | (£569m) | 97.2% | -£918m | -4.6% |

** Includes a negative adjustment of £160m for the value of the Scheme's AVCs.*
*** The Scheme's liabilities have not been adjusted for changes in longevity.*
*Source: BlackRock, March 2022. The Technical Section contains more information about the scenario modelled as well as the assumptions and limitations.*

# Strategy: Climate Scenario 2 – High Emissions

**Overview:** BlackRock's "High Emissions" scenario is based on the IPCC's RCP 8.5 pathway which assumes that some corrective actions are taken, but that $CO_2$ emissions only stabilise at around 940 ppm by 2100, i.e. temperatures rise by 3.2 - 5.4°C in 2100 relative to pre-industrial levels.

**Risk Factors:** Physical risk factors are the focus.

**Narrative:** All sectors of the economy are impacted by higher average temperatures. Most impacted however are agriculture, mining and transportation as well as those which rely heavily on physical labour or physical capital. Although some geographies see a material increase in physical risk before 2030, over the longer term, more countries face significant damage to their economies from higher temperatures and extreme weather events. The most important driver of financial impact is the expected change in each countries' gross domestic product (GDP).

The impact of the High Emissions scenario on the Scheme's funding level has been considered over a single timespan over the lifetime of the scenario modelled. The model considers the impact of physical risk factors to 2050, covering the Scheme's short, medium and long-term time horizons.

**Outcome:** The Scheme's index and active equity portfolios are more impacted by physical risk than transition risk, which generally has a higher impact across all sectors of the economy. The impact on UK macro-economics from physical risks is fairly modest over most timeframes. The impact is felt most severely in geographies vulnerable to extreme temperatures, precipitation and sea-level rise, as well as companies with operations in those areas. This analysis has been conducted on listed assets only. Unlisted, private market assets have been excluded therefore the summary below will be underestimating the impacts on the overall strategy. The table below shows the estimated impact on the Scheme of the High Emissions scenario.

| | Assets* | Liabilities** | Surplus (Deficit) | Funding Ratio | Change in Surplus | Change in Funding Ratio |
|---|---|---|---|---|---|---|
| **Base, 31/03/2022** | £19,646m | £19,298m | £349m | 101.8% | | |
| **High Emissions** | £19,158m | £19,184m | (£26m) | 99.9% | -£374m | -1.9% |

** Includes a negative adjustment of £160m for the value of the Scheme's AVCs.*
*** The Scheme's liabilities have not been adjusted for changes in longevity.*
*Source: BlackRock, March 2022. The Technical Section contains more information about the scenario modelled as well as the assumptions and limitations.*

*Note: Totals may not sum due to rounding*

# Funding Strategy - Covenant

**Impact of Climate-Related Risks for the Covenant of British Airways (BA)**

Climate change risks are an increasingly important consideration in assessing the employer covenant strength and longer-term outlook for BA.

The impact of climate change will be significant to BA and is complex. The aviation industry is heavily reliant on fossil fuels to maintain operations and therefore more exposed to climate risk than other industries. Current forecasts expect fundamental changes to aircraft and carbon capture technology from 2035, which may require significant capital expenditure investment with unknown cost implications. This aviation industry expectation aligns with the Trustee's long-term time horizon of 2030-2050, when the Trustee expects the Scheme to have reduced its reliance on the employer substantially and to have moved to a lower risk investment strategy.

BA, and its parent IAG, have taken significant steps towards understanding its climate risks and setting a climate strategy known as "BA Better World". The strategy aims to achieve Net Zero by 2050 and consists of three pillars:

**Sustainable Aviation Fuel (SAF)**

- BA has partnered with Velocys to build a commercial plant to convert household waste into jet fuel by 2025.
- BA has partnered with LanzaJet to secure SAF supply from late 2022.
- BA has committed to powering 10% of all flights with SAF from 2030.

**Carbon Offsets / Removal**

- BA's domestic flights have been carbon neutral since January 2020.
- For international flights, BA has partnered with Pure Leapfrog to allow all customers to make their flight carbon neutral. 10% of customers are expected to pay the carbon neutral offset by 2025.
- BA expects more sophisticated carbon removal technologies will be available from 2035.

**New Hydrogen Aircraft**

- BA expects hydrogen powered aircraft to support short haul operations from 2035 without significant aircraft engineering changes.
- The technology required for long haul hydrogen aircraft is not expected until 2050 onwards.

In considering the long-term strategy of the Scheme, the Trustee considers the impact of climate risk on both the strength and visibility of the covenant. As per earlier sections, the risks of climate change have been broken into two categories; transition risks and physical risks.

# Funding Strategy - Covenant

**Transition Risks**

Transition risks arise from the transition to a decarbonised global economy to limit warming. For BA the following are relevant considerations:

- **Business travel** could decrease as businesses seek to meet their own Net Zero and ESG targets. In the **short-term** this is more likely to be dominated by post-pandemic behaviour changes, with climate-driven changes over the **medium-term.**
- **Consumer demand** and changing behaviour to reduce carbon footprint could result in the loss of market share, especially if BA is not at the forefront of adopting new technologies as it targets Net Zero. In the **short-term** demand is expected to be driven by pent-up post-pandemic demand, with climate-driven changes and uncertainty more of a factor over the **medium-term** as consumer consciousness of individual carbon footprints rises.
- **Regulatory pressure** could increase, particularly over the **medium-term**:
  - The speed at which airlines need to transition to Net Zero and regulation on non-$CO_2$ impacts;
  - Requirements to comply with CORSIA (market-based emission offset program) on all international flights; and
  - Certain airports could adopt greenhouse gas emission or climate-related goals and requirements.
- **Innovation requirements** will drive opportunities over the **medium to long-term**, but the costs to develop and roll out new low/negative carbon technologies, electrification and hydrogen fuel technologies will be a significant financial burden.
- **Investor pressure** could negatively impact share price over the **medium-term** if institutional investors increase their focus on ESG metrics and challenge performance.
- **Technology** to deliver Net Zero is not yet commercially developed or widely available. Uncertainty remains as to what technologies will be delivered to supply sustainable, affordable fuel and/or carbon reducing fleet and supporting assets. BA will need to make strategic decisions regarding future technology and energy sources in the medium-term to ensure it is well-placed to deliver longer term.

There are also **Transition Opportunities**, which BA is well positioned to take advantage of given it is part of a world-leading airline group.

- **Short and Medium-Term:**
  - Carbon offsets and pricing.
  - Strong position at London Heathrow.
  - Strong brand, broad customer base and valued loyalty programme.
- **Long-Term:** Ability to become a market leader in new technologies:
  - Commercial hydrogen technologies – aircraft and supporting infrastructure.
  - Sustainable Aviation Fuel to replace kerosene.
  - Carbon capture and storage.
  - Electrification and improving efficiency.

# Funding Strategy - Covenant

**Physical Risks**

Physical risks stem from how changing climate could impact the business, and for BA could lead to the increased severity and frequency of extreme weather impacting operations and fuel production.

**Monitoring Climate-Related Covenant Risks and Opportunities**

The Trustee's covenant advisor, PwC, has modelled various scenarios, including changes in the mix of business/leisure travel and wider impacts on the economy. The Trustee continues to keep this under review and will:

- Engage with BA and IAG Sustainability teams to request updates on the progress of the Net Zero strategy.
- Monitor key climate-related risks and metrics, such as:
  - CO2/km fuel efficiency against sustainability targets;
  - Group access to new technologies and the capital to enable this change;
  - Where ESG assets go in the Group; and
  - Results of consumer and customer surveys related to sustainability sentiment on air travel.

## Conclusion

The Trustee understands that climate change risks could be material for the sponsor, and this is taken into account, along with other factors, in the assessment of the strength of the sponsor covenant by the covenant advisor and the potential impact on the funding strategy.

# Funding Strategy - Actuarial

**Impact of Climate-Related Risks on the Liabilities of the Scheme**

The modelling carried out by BlackRock under the Scenario Analysis considers the impacts on the liabilities* by applying consistent stresses to those applied to the assets. However, BlackRock's model currently makes no allowance for the potential impact of climate change on life expectancy and so the Trustee has worked with its actuarial advisor, LCP, to further consider this risk.

**Longevity Assumptions**

The Trustee makes an assumption about how long Scheme members will live, and therefore how long pensions will be paid for, when assessing the amount of assets the Trustee requires to meet future benefit obligations. If a member lives longer, the Scheme pays the member's pension for longer and therefore needs more assets to make the payments. Typically, the Trustee will review its assumption for future life expectancy every three years as part of the formal actuarial valuation.

**Climate-Related Impact**

The impact of climate change on life expectancy is highly uncertain. The Trustee has considered at a high-level what the potential impacts of climate change might be on members' life expectancies under its two chosen scenarios over the three timescales described in this report. This identified drivers that could result in either an increase or decrease in future life expectancies.

For example, in the High Emissions scenario, the continued use of fossil fuels should lead to higher temperatures, reducing cold-related deaths in winter and thus increasing life expectancies. However, this effect could be offset by less prosperous economic conditions, which may limit the funding available for healthcare and therefore reduce life expectancies. The extent to which these factors outweigh each other will determine whether life expectancies increase or decrease.

Currently the Trustee does not explicitly allow for the possible effects of climate change when making assumptions about life expectancy for the Scheme's actuarial valuation. However, it does consider uncertainties associated with life expectancy and the sensitivity of the valuation results to the assumptions made, and considers that those arising from climate-related factors are within the range of impacts it already considers. It will keep this area under review and consider it further as part of its strategic planning, risk management frameworks and at the next actuarial valuation as at 31 March 2024.

** The liabilities modelled by BlackRock will differ slightly from those modelled by the Scheme Actuary due to differing model approaches and assumptions.*

# Strategy: Summary

**Summary of Orderly Transition scenario**

This transition risk scenario has a moderate impact on the Scheme's funding position with a 4.6% reduction in funding level on the LTFT basis, based on the data available. This is the present value of impacts over the modelled timeframe.

There is a large estimated change in the Scheme's liabilities that occurs under this scenario, partially offset by the movement of the assets supporting the liability matching portfolio, where higher carbon prices and an increase in government investment drives higher inflation. Longevity changes have not currently been built in quantitatively to this analysis.

The Scheme's equity and private equity holdings reduce the most in this scenario as they have negative exposure to transition risks. However, the Scheme's index and active public equity portfolios are less exposed to transition risk than the standard MSCI global all country index. It is in the best interests for members to target an orderly transition.

**Summary of High Emissions scenario**

This physical risk scenario has a modest impact on the Scheme's funding position with a 1.9% reduction in funding level on the LTFT basis, based on the data available, showing the Scheme is reasonably resilient. This is the present value of impacts over the modelled timeframe.

The Scheme's index and active public equity portfolios are more impacted by physical risk than transition risk, which generally has a higher impact across all sectors of the economy. The Scheme's public equity and private equity holdings reduce by c.9% in this scenario. Physical risk is quite material in certain geographies (Asia Pacific, Emerging Markets) and intensifies over time. Longevity changes have not currently been built in quantitatively to this analysis.

| | Change in Surplus | Change in Funding Ratio |
|---|---|---|
| **Orderly Transition** | -£918m | -4.6% |
| **High Emissions** | -£374m | -1.9% |

**BlackRock's climate scenario analysis helps the Trustee to understand the climate-related risks and opportunities for the Scheme. In the context of the analysis undertaken, the Trustee believes that the Scheme's current funding and investment strategies are resilient to climate-related risks. The Trustee will keep this under review.**

Since the analysis date of 31 March 2022, the Trustee has rebalanced the portfolio and removed its allocation to active public equity. Over the Medium-Term and Long-Term the allocation to index public equity and private equity is planned to reduce under the de-risking framework, improving resilience in funding level under both scenarios. As the return-seeking assets reduce under the de-risking framework, the liability-matching assets will increase, and interest rate and inflation hedging will rise. This will increase the resilience in funding level under both scenarios from changes in interest rates and inflation. De-risking may also increase exposure to credit-based assets (transition risk exposures).

Over the Long-Term the Trustee plans to increase the funding level of the Scheme such that it is less reliant on contributions from the Scheme's sponsor, BA, and therefore the exposure to BA's covenant and the transition risks posed by climate change to BA.

# 6 Metrics

# Metrics: Introduction

This report presents data analysis for the Scheme's assets as at 31 March 2022, where available.

The Trustee has chosen to present three climate-related metrics in this report. These climate-related metrics help the Trustee to:

- Understand the climate-related risk exposures and opportunities within the Scheme's investment strategy; and
- Identify areas for further risk management, which may include additional due diligence of the investment manager and its voting and engagement activity and priorities.

Following advice and training from Mercer on the range of metrics that are available, the Trustee chose the following metrics at a strategy day held in Autumn 2021:

Absolute Emission Metric: Total Greenhouse Gas (GHG) Emissions

Emissions Intensity Metric: Carbon Footprint

Additional Metric: Data Quality

The Trustee recognises the challenges associated with the various metrics, tools and modelling techniques used to assess climate risk. The Trustee will work with BlackRock to continuously improve the approach to assessing and managing risks over time as more data becomes available.

The Technical Section of this report sets out the data limitations and assumptions used in collating these metrics.

# Metrics: Absolute Emissions Metric – Total GHG Emissions

**"Total GHG Emissions"** measures the total Green House Gas (GHG) emissions associated with a portfolio. It attempts to calculate the amount of carbon emissions the Scheme "owns" (or finances) as a consequence of its holdings. Total GHG Emissions are measured in tonnes of $CO_2$ equivalent ("$tCO_2e$") based on the Kyoto Protocol covering seven main GHGs[1,2].

Scope 1 and 2 carbon emissions data has been calculated for all asset classes where data is available. Proxies have been used for asset classes where data is not available, where BlackRock believes that to be an appropriate approach. **Data coverage is 77%, excluding the proxied Private Equity emissions. Allowing for the proxies used, the Trustee is reporting on 88.9% of the portfolio.** Scope 3 emissions are not included due to low availability and comparability of company reported Scope 3 data.

The emissions data helps the Trustee to see the breakdown of where the emissions come from, to understand the exposures to climate-related risk within the investment strategy. The largest allocation for the Scheme is to the Liability Matching Portfolio and therefore this makes up the largest proportion of the Scheme's total carbon emissions (based on available data). These hedging assets provide good protection against changes in interest rates and inflation and therefore the Trustee expects the allocations to these assets to increase over time as the funding level improves. The majority of this portfolio is invested in UK Government bonds and so will be aligned with the UK Government's climate-related targets. Currently, the UK is targeting emissions reductions of 78% by 2035 relative to 1990 levels. The Trustee has very limited ability to influence these carbon reduction targets set by the UK Government. The methodology for the Liability Matching Portfolio (i.e. sovereign bonds) and the remainder of the portfolio is different.

| 31/03/2022 | Allocation (%) | GHG Emissions ($tCO_2e$)[2] | Comments |
|---|---|---|---|
| **Equities - Global Active** | 6.0 | 5,345 | |
| **Equities - Global Passive** | 8.5 | 76,264 | |
| **Private Equity** | 7.1 | 83,053 | Proxied using listed benchmark |
| **Property** | 9.1 | 6,268 | Data effective 31/12/2021 |
| **Alternatives** | 3.5 | - | Data/proxies not available |
| **DII**[3] | 6.4 | - | Data/proxies not available |
| **Corporate Bonds** | 10.2 | 191,292 | |
| **Liability Matching Portfolio** | 48.0 | 1,594,000 | Technical Section has further details |
| **Tactical Asset Allocation (TAA)**[4] | 0.4 | - | Data/proxies not available |
| **Cash**[4] | 0.8 | - | Data/proxies not available |

*1) Seven main GHGs: carbon dioxide, methane, nitrous oxide, nitrogen trifluoride, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride.*
*2) Total GHG Emissions figures assume no contribution from holdings for which there is no reported or estimated carbon emissions data. Totals are lower (less conservative) than they would otherwise be.*
*3) DII includes: ABS, CLO, SAIF, Legacy Floating Rate Funds, Secure Income Assets and Real Assets.*
*4) All FX forwards are included in Cash*
*Source: BlackRock, MSCI, Bloomberg. All data is as at 31 March 2022 unless otherwise noted.*

# Metrics: Emissions Intensity Metric – Carbon Footprint

**"Carbon Footprint"** calculates the carbon intensity of each asset class by dividing the total GHG emissions of each portfolio by the size of the portfolio in pounds sterling. Carbon Footprint is measured in tonnes of $CO_2$ equivalent per £ million invested.

Scope 1 and 2 carbon emissions data has been calculated for all asset classes where data is available. Proxies have been used for asset classes where data is not available where we believe that to be an appropriate approach. **Data coverage is 77% excluding the proxied Private Equity emissions. Allowing for the proxies used, the Trustee is reporting on 88.9% of the portfolio.** Scope 3 emissions are not included due to low availability and comparability of company reported Scope 3 data.

The Liability Matching Portfolio and the Corporate Bond holdings show the highest emissions intensity of the data available. However, there is an investment case for including these within the strategic asset allocation as these assets provide liability matching income streams and good protection against changes in interest rates and inflation. The Trustee expects the allocations to these assets to increase over time as the funding level improves. There are limited levers available to influence the intensity figure for government bonds within the Liability Matching Portfolio.

| 31/03/2022 | Allocation (%) | Carbon Footprint ($tCO_2e/£m$)[1] | Comments |
|---|---|---|---|
| **Equities - Global Active** | 6.0 | 8.4 | |
| **Equities - Global Passive** | 8.5 | 45.9 | |
| **Private Equity** | 7.1 | 59.2 | Proxied using listed benchmark |
| **Property** | 9.1 | 6.1 | Data effective 31/12/2021 |
| **Alternatives** | 3.5 | - | Data/proxies not available |
| **DII**[2] | 6.4 | - | Data/proxies not available |
| **Corporate Bonds**[3] | 10.2 | 117.2 | |
| **Liability Matching Portfolio** | 48.0 | 167.7 | Technical Section has further details |
| **Tactical Asset Allocation (TAA)**[4] | 0.4 | - | Data/proxies not available |
| **Cash**[4] | 0.8 | - | Data/proxies not available |

*1) Carbon Footprint is calculated only for securities where BlackRock has either reported or estimated carbon emissions data. Carbon intensity is higher (underestimated) than it would otherwise be.*
*2) DII includes: ABS, CLO, SAIF, Legacy Floating Rate Funds, Secure Income Assets and Real Assets*
*3) Enterprise value data is not available for c.14.5% of the corporate bond portfolio. Where that's the case, securities are excluded from both Total GHG Emissions and Carbon Footprint.*
*4) All FX forwards are included in Cash*
*Source: BlackRock, MSCI, Bloomberg. All data is as at 31 March 2022 unless otherwise noted.*

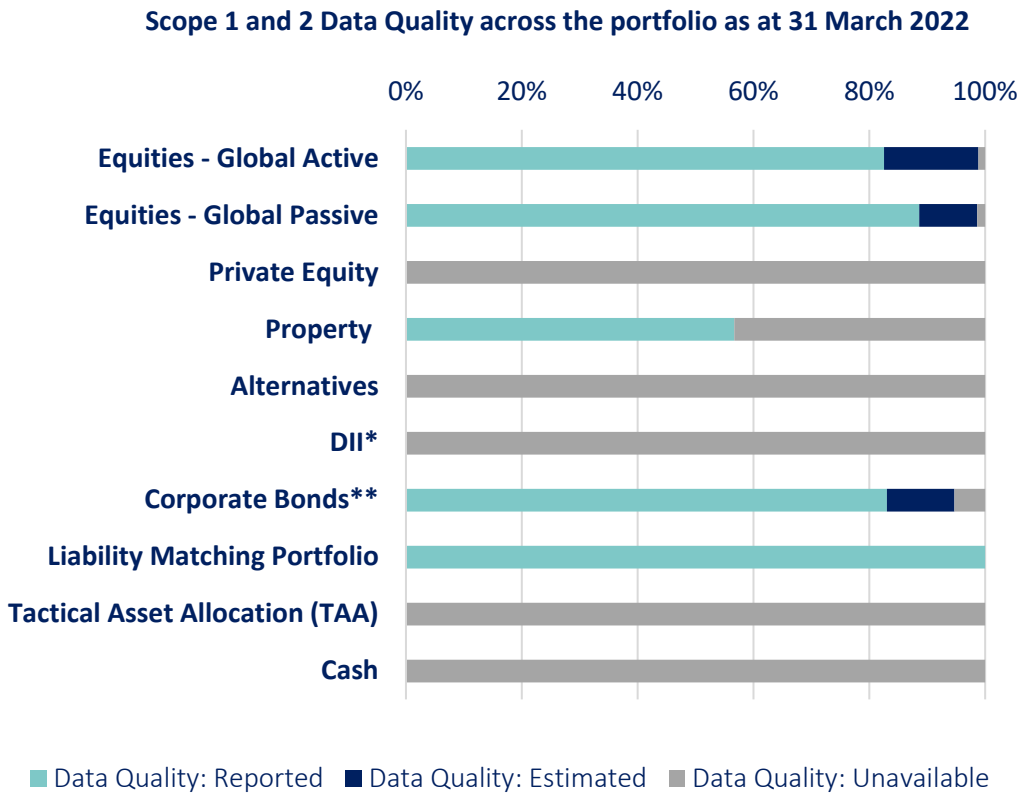
# Metrics: Additional Metric – Data Quality

**"Data Quality"** will – over time - help the Scheme evaluate the reliability of the information they are collecting. The measure aims to represent the proportions of the portfolio for which the Trustee has high quality data. This is based on four factors which consider what proportion of the data is verified, reported, estimated or unavailable. Note that BlackRock have been unable to source a breakdown between reported data that is verified or unverified. Therefore, the carbon emissions data shown is classified as "reported", "estimated" or "unavailable".

For the equity and corporate bond mandates the level of reported data is reasonably high with only a small proportion unavailable or estimated. For property the data quality is good for non-developmental projects but data is unavailable for the developmental. The largest mandate, the liability matching portfolio, has 100% reported carbon emissions data.

Where reported, the data quality is generally high giving the Trustee comfort in the figures and the ability to use the data to assess climate-related risks and opportunities. However, there is still some way to go to improve overall data quality in the portfolio and across the industry particularly in unlisted assets.

This covers Scope 1 and 2 emissions. Scope 3 emissions are not included due to low availability and comparability of company reported scope 3 data.




*Note that even where carbon emissions data may be available, other data points essential for certain calculations may not be available. The data quality figures shown reflect the availability of emissions data only.*
**DII includes: ABS, CLO, SAIF, Legacy Floating Rate Funds, Secure Income Assets and Real Assets.*
***Enterprise value data is not available for c.14.5% of the corporate bond portfolio. These securities are excluded from both Total GHG Emissions and Carbon Footprint*
*Private Equity has been proxied using a listed benchmark. The data for property is effective 31 December 2021. Data or proxies are not available for Alternatives, DII, TAA and Cash. All FX forwards are included in Cash.*
*Source: BlackRock, MSCI, Bloomberg. All data is as at 31 March 2022 unless otherwise noted.*

# 7 Targets

# Targets: Trustee's Climate- Related Target

The Trustee initially decided to set a climate-related target for the listed equity mandate only relating to the Carbon Footprint metric. As at 31 March 2022, the equity mandate consisted of one segregated passive portfolio and two segregated actively managed portfolios. The aggregate for all three listed equity portfolios will be used for measuring the target.

The Trustee's target is:

*To reduce the carbon intensity of the listed equity allocation by at least 45% from 31 March 2021 baseline levels by 2030**

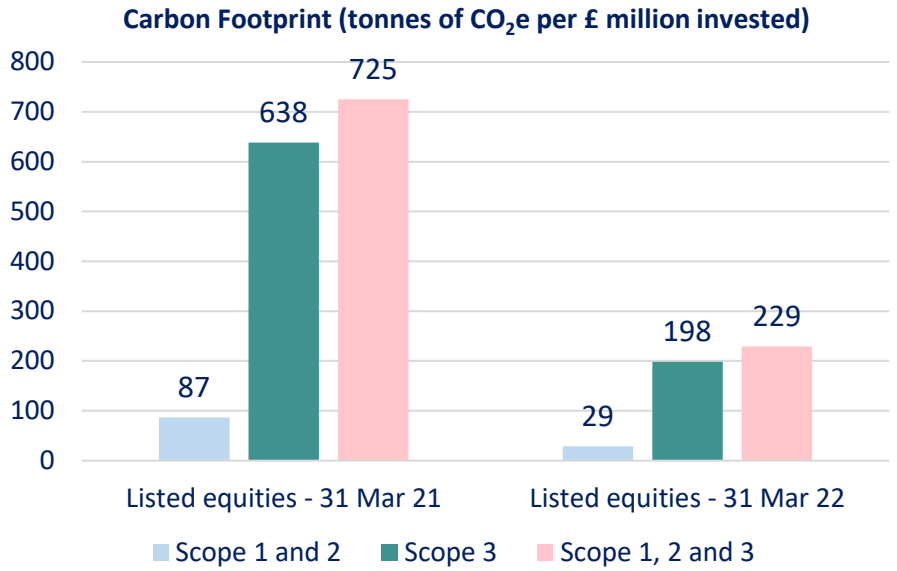
The Target includes Scope 1, 2 and 3 to align the Target with the Scheme's benchmark, which aims to reduce Scope 1, 2 and 3 carbon intensity.

A summary of the progress to date against this target is shown opposite. It can be seen that the targeted reduction in carbon intensity of the equity portfolio has been achieved in the last year, eight years ahead of schedule.

In June 2021 the management of the Scheme's assets, including the equity portfolio, transferred to BlackRock. As part of this transition the Trustee selected a new ESG Enhanced Focus MSCI All Country World benchmark for the passively managed equity portfolio which makes up c.60% of the total equity portfolio. In February 2022 the Scheme opted in to an updated index construction methodology which includes a decarbonisation target.

At the time of writing, the Trustee is in the process of rebalancing its equity portfolio and will consider the appropriateness of this target for future years.

| | Equity Portfolio | |
|---|---|---|
| **Date** | **31 March 2021** | **31 March 2022** |
| **Data Coverage**** | 77% | 98% |
| **Carbon Footprint (tonnes of $CO_2e$ per £m invested)** | 725 | 229 |
| **Change** | | -68% |




*As measured by the carbon footprint and Scope 1, 2 and 3 emissions, where available. Due to low availability of company reported Scope 3 data, MSCI estimates Scope 3 across the 15 GHG Protocol stated categories based on its internally vetted model. There is no distinction made between reported and estimated data for Scope 3 assets.

** Much of the improvement in the data coverage over the year is because the Scheme's previous asset manager, BAPIML, held ETFs at 31/03/2021, which are no longer held by BlackRock.

Source: BlackRock, March 2022 and MSCI

# Targets: Rationale for Setting the Target

***To reduce the carbon intensity of the equity allocation by at least 45% from 31 March 2021 baseline levels by 2030****

In setting its target, the Trustee worked closely with its investment manager and investment advisor to establish what data was available for each of its asset classes, what the quality of that data was, and how practical it would be to set a target around that data. Highlights of the various asset-level considerations are shown opposite.

The 2030 date is aligned with the IPCC's target date for global emissions to half and meets the TCFD requirement to set a target within the next 10 years.

The 45% figure assumes around 7% p.a. reduction over 8 years, which is consistent with underlying objective for the passive equity index.

The Trustee has decided to use 31 March 2021 as a baseline. This is consistent with the Scheme year end and is just prior to the transition of the investment management to BlackRock.

**Property, Alternatives and Diversified Illiquid Income:** The data availability is currently poor.

**Private Equity:** Metric data has been proxied with a listed equity index and therefore is not representative of the actual exposures in the portfolio. It is also challenging to drive climate-related targets for legacy private equity investments reaching maturity.

**Liability Driven Investments:** Metric data coverage is excellent however, any targets set against an LDI portfolio will be aligned predominantly with the UK Government's climate-related targets. Currently, the UK is targeting emissions reductions of 78% by 2035 relative to 1990 levels. In addition, levers to control progress against target are very limited.

**Equity:** Metric data coverage is good. The passive equity mandate has an index with a decarbonisation objective embedded. Active equity mandates have significantly lower carbon footprints than the standard market index.

**Credit:** Metric data coverage is reasonable. Challenges centre around how to implement a climate-related target without requiring unnecessary portfolio turnover. Use of engagement and stewardship are key to driving climate-positive outcomes.

**As measured by the carbon footprint and Scope 1, 2 and 3 emissions, where available, noting that Scope 3 data is limited and less reliable.*

# 8 Technical Section

# Technical Section – Supporting Information for Scenario Analysis

| Gilt Factors | Rationale | Catalysts | Calibration |
|---|---|---|---|
| Orderly Transition | • A transition to Global Net Zero by 2050 is achieved via immediate and smooth policy responses<br>• Carbon taxes are channelled back to the economy via government investment | • UK sees up to 2% p.a. GDP gains peaking in 2027 (50% of carbon tax assumed to be reinvested into the economy)<br>• UK inflation around 1.9% higher peaking in 2026, largely driven by repricing of carbon prices<br>• Price of carbon rises to over 800 $/ton by 2050. | • The UK yield curve falls modestly as growth accelerates and the UK risk premia falls.<br>• Higher inflation drives most of the impact on UK LDI assets and pension liabilities<br>• Assumed no central bank response to higher inflation. |
| High Emissions | • Some corrective action to reduce emissions is taken but temperatures rise by 3.2°C to 5.4°C in 2100 relative to pre-industrial levels | • Physical changes such as higher temperatures, sea-level rises and hurricanes impact GDP.<br>• The impacts are largely felt from 2050 onwards | • The UK yield curve is relatively unchanged with high degree of uncertainty given expected higher risk premia could be offset by central bank response |

| BlackRock: Scenario Analysis Limitations | |
|---|---|
| Modelling | • The climate models used focus separately on transition risk or physical risk. A holistic view of climate-related financial risks should take both into account<br>• The climate models used do not predict the abrupt or irreversible changes that may result from reaching critical climate thresholds or "tipping points"<br>• The economic models used may not adequately predict feedback loops and will therefore underestimate the chance of systemic failure in parts of the global economy<br>• Models also do not include the social or political impact of mass migration<br>• The current framework incorporates first order impacts on companies' revenues and costs. It does not capture second order effects such as supply chain disruption<br>• Based on prior economic and financial crises, it can be hard to predict the scale of monetary and fiscal policy responses. The models' assumptions about changes in financial valuations may therefore be incorrect.<br>• They also do not include the impact of other shocks that might occur such as recessions, conflicts or pandemics. |
| Data | • BlackRock have been able to provide scenario analysis for assets equalling nearly 80% of the total<br>• There are a number of portfolios for which there is not have adequate information on the underlying holdings to provide quantitative scenario analysis. These are: Private Equity, Property, Alternatives, and DII.<br>• Where BlackRock have a benchmark that they can use as a proxy for the asset class, they have done so<br>• Where BlackRock believe this could be misleading they have marked the estimated impact as N/A<br>• Tactical asset allocation positions and cash are not included in this analysis |

| Note on Liabilities | |
|---|---|
| | • The Liabilities shown are on the Trustee's Long Term Funding Target (LTFT) basis.<br>• The liabilities modelled by BlackRock will differ slightly from those modelled by the Scheme Actuary due to differing model approaches, assumptions, and due to the cashflows provided to BlackRock being primarily for the purpose of maintaining the liability hedging portfolio. |



*Source: BlackRock, March 2022*

# Technical Section – Supporting Information for Scenario Analysis

*Source: BlackRock, March 2022*

| Description | Type | Climate Scenario[1] | Economic Model[1] | Financial Model[1] | Temperature Rise | Climate Policy Assumptions |
|---|---|---|---|---|---|---|
| **Orderly Transition** | Transition risk only | NGFS Net Zero by 2050 | BlackRock Climate Change | BlackRock Discounted Cash Flow Model | 1.5°C | Immediate and co-ordinated |
| **High Emissions** | Physical risk only | IPCC RCP 8.5 | Climate peril damage functions | | 3.2 – 5.4°C | Current policies only |

| Data Coverage | Equities | Corporate Bonds | Liability Hedging Assets | Total |
|---|---|---|---|---|
| **Orderly Transition** | 94% | 71% | 100% | **69%** |
| **High Emissions** | 97% | 78% | 100% | **70%** |

| Estimated Impact on Assets | Equities | Private Equity[2] | Alternatives | Property | Corporate Bonds | DII | Liability Hedging Portfolio | TOTAL[3] |
|---|---|---|---|---|---|---|---|---|
| **AUM at 31/03/2022** | £2,869m | £1,409m | £701m | £1,809m | £2,020m | £1,247m | £9,502m | **£19,797m** |
| **Orderly Transition** | -2.6% | -4.3% | n/a | n/a | -1.2% | n/a | 5.5% | **1.8%** |
| **High Emissions** | -8.9% | -9.1% | n/a | n/a | -0.8% | n/a | -0.9% | **-2.5%** |

BlackRock's climate models are intended to highlight the potential impact of climate policies and outcomes on the economy and on financial markets. Although they provide some insight into where the Scheme may face risks or have opportunities, modelling financial risks requires making a number of assumptions which may not be correct.

The scenario assessments BlackRock has considered should be taken independently. Physical risks and transition risks are however linked. Scenarios with increased transition risk in the short to medium term are likely to have lower physical risks in the long term (and vice versa). The DWP's guidance for Occupational Pension Schemes does however note that considering transition and physical risk separately may be helpful.

BlackRock's transition models use the Network for Greening the Financial System's scenarios as a starting point. The implications of each scenario are modelled at an economy-wide, sector, issuer and asset level by BlackRock. The models focus on the most likely direct impact of climate policy measures, evolving consumer trends, and technological innovation on corporate prospects. BlackRock's transition risk models are used to calculate the impact on corporate equity and corporate credit portfolios. The impact of transition risk on sovereign bond portfolios and UK pension scheme liabilities has been modelled separately in Aladdin through calibration of user specified stress tests intended to be consistent with the climate scenarios shown.

BlackRock's physical models use the Intergovernmental Panel on Climate Change's scenarios as a starting point. The implications of each scenario are modelled by BlackRock at an economy-wide, sector and company level. The models focus on forecasting the impact of climate perils on the economy and on individual corporates. The impact of physical risk on sovereign bond portfolios and UK pension scheme liabilities has been modelled separately in Aladdin through calibration of user specified stress tests intended to be consistent with the climate scenarios shown.

This analysis has been conducted mainly on listed assets. Unlisted, private market assets, other than private equity via a proxy, have been excluded, therefore the impact figures will be understated.

*1) BlackRock's equity and corporate bond models forecast the impact of the various scenarios and look forward 30 years, or for corporate bonds a shorter time period relevant to their individual maturities. The climate and economics models look further out, for example the physical models currently run to 2090, but there is a limit of what is relevant to the current valuation of financial securities.*

*2) Estimates for private equity use the Scheme's performance benchmark as a proxy for the actual assets held, this is a customised benchmark of 80% US Equity S&P 500 (Gross TR) and 20% FTSE World Eurobloc (Gross TR).*

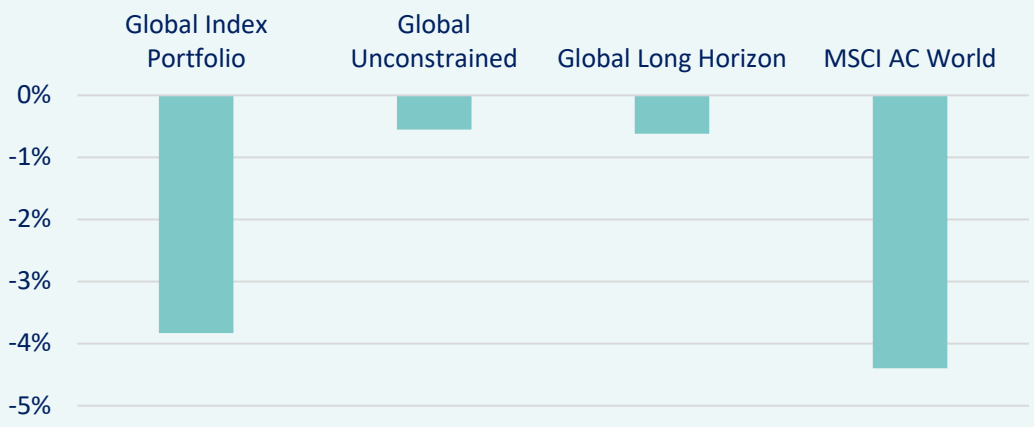
*3) Includes £240m of cash and other*

# Technical Section – Supporting Information for Scenario Analysis

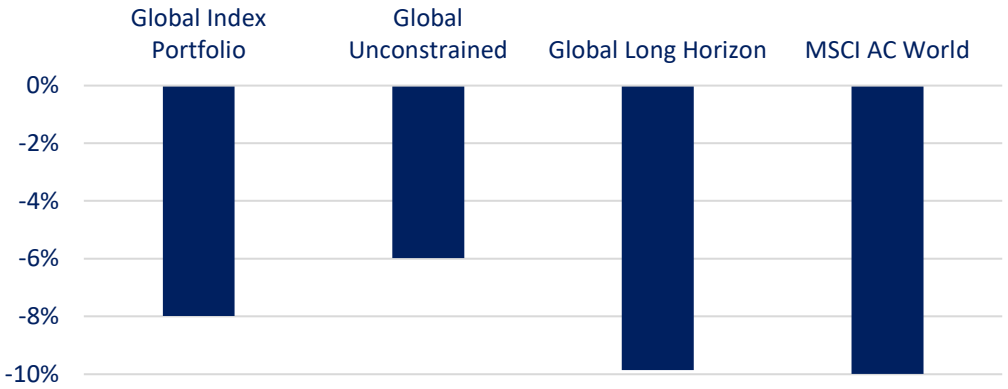
## Climate Related Risks: Equities as at 31 March 2022

The Scheme's index and active equity portfolios are estimated to be less exposed to transition risk than the standard MSCI global all country index. This is predominantly due to differences in their exposure to energy and materials stocks versus the index. All three mandates are more impacted by physical risk than transition risk, which generally has a higher impact across all sectors of the economy.

**Transition risk: Orderly Transition**




**Physical risk: High Emissions**

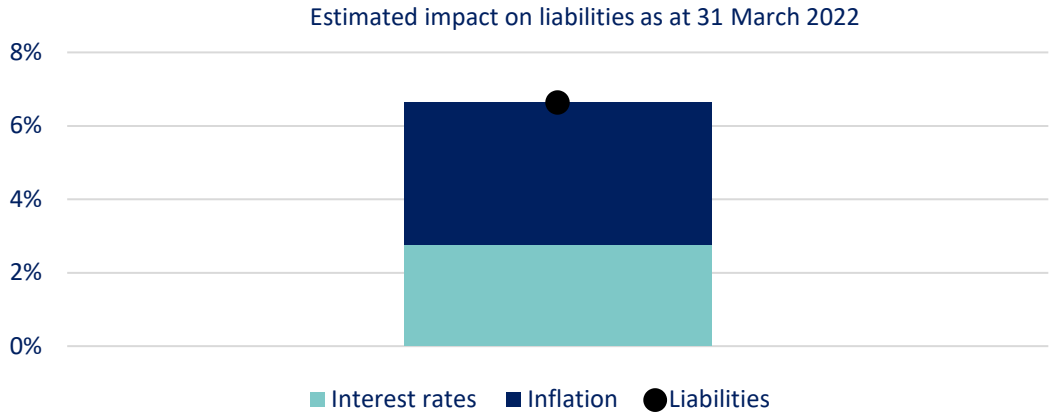



*Source: BlackRock, March 2022*

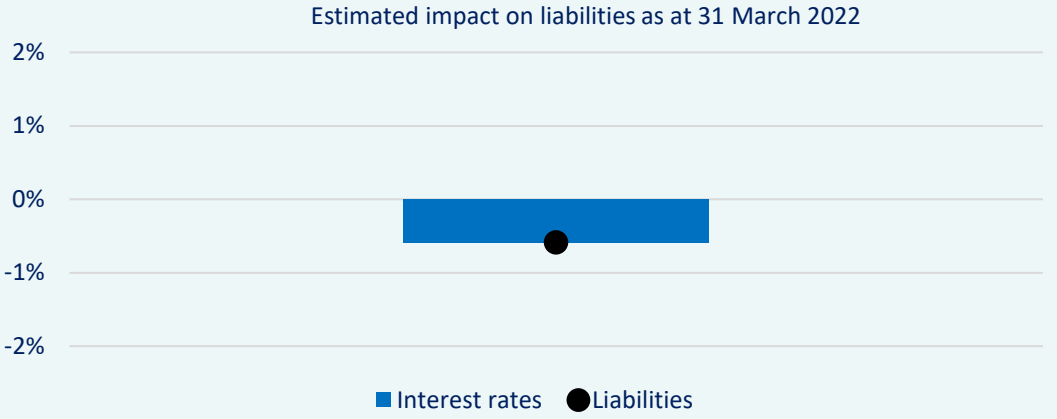
## Climate Related Risks: Liabilities as at 31 March 2022

The largest estimated change in the Scheme's liabilities occurs under the orderly transition scenario, where higher carbon prices and an increase in government investment drives higher inflation.

**Transition risk: Orderly Transition**




**Physical risk: High Emissions**



# Technical Section – Supporting Information for Metrics

**Benchmark proxies**

Estimates for the Absolute Emission Metric: Total Greenhouse Gas (GHG) Emissions and Emissions Intensity Metric: Carbon Footprint for the actual assets held in the Private Equity holdings have been proxied using the Scheme's performance benchmark. This is a customised benchmark of 80% US Equity S&P 500 (Gross TR) and 20% FTSE World Eurobloc (Gross TR).

## Liability Matching Portfolio approach

Physical gilts, gilt repo and gilt Total Return Swaps (TRS) have been included. Interest rate and inflation swaps have been excluded from the calculation.

Total emissions is calculated as follows:

- Metrics tonnes of $CO_2$ and equivalents per country multiplied by (value of gilts in the portfolio / public debt).

This is based on the following inputs:

- The GHG emissions for the UK as 401,263,933 tons of $CO_2$ equivalent *(sourced at the most recent date)*
- Public debt in GBP as £2,940,722m (*sourced as at end December 2021)*

| | |
|---|---|
| **Total emissions $tCO_2e$** | For physical gilts: 1,587,000 tons $CO_2$ and equivalents |
| | For green gilts: 2,000 tons $CO_2$ and equivalents |
| | For gilts TRS: 5,000 tons $CO_2$ and equivalents |

The Emissions footprint figure is arrived at by dividing the above through by the portfolio NAV.

| | Total in Liability Matching Portfolio |
|---|---|
| **Physical gilts excluding green gilts** | £11.6bn |
| **Green Gilts** | £18m |
| **Gilt TRS** | £33.8m |
| **Portfolio NAV** | £9.5bn |

*Source: BlackRock, MSCI, Bloomberg. All data is as at 31 March 2022 unless otherwise noted.*

# Technical Section – Supporting Information for Metrics

**Definition of Scope 1, 2 and 3 emissions**

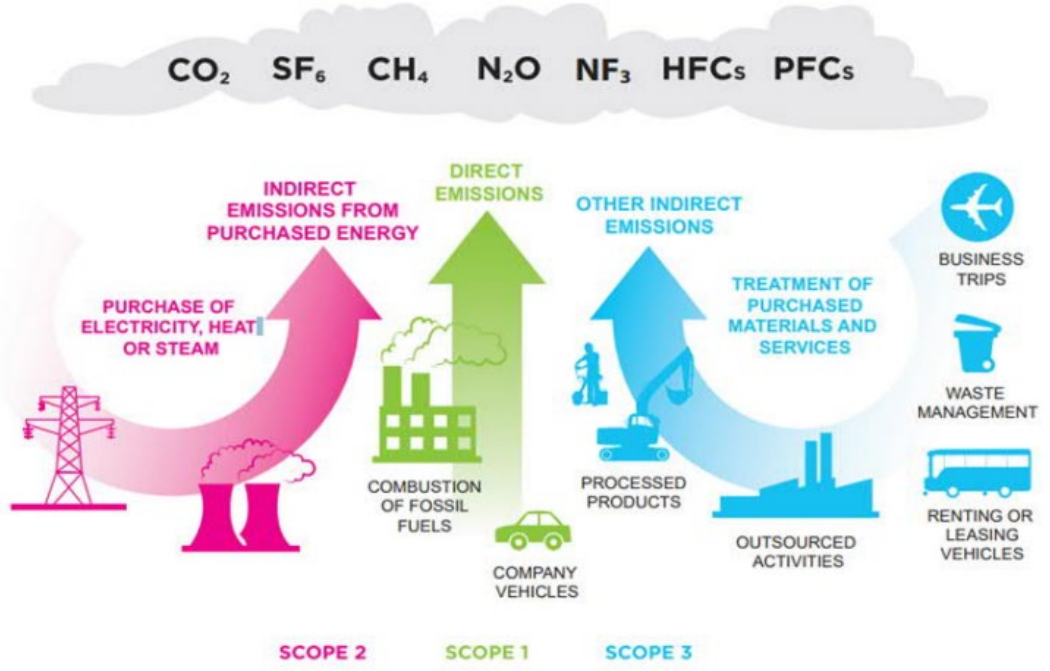
Scope 1,2 and 3 emissions are as defined by the GHG protocol. The GHG Protocol Corporate Standard classifies a company's GHG emissions into three 'scopes'.

- Scope 1 emissions are direct emissions from owned or controlled sources.
- Scope 2 emissions are indirect emissions from the generation of purchased energy.
- Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

**Definition of Greenhouse Gases (GHGs)**

The Kyoto Protocol sets out the seven main GHGs as follows:

- Carbon dioxide, $CO_2$
- Sulphur hexafluoride, $SF_6$
- Methane, $CH_4$
- Nitrous oxide, $N_2O$
- Nitrogen trifluoride, $NF_3$
- Hydrofluorocarbons, HFCs
- Perfluorocarbons, PFCs



# 9 Additional information

# Scheme Information

**Scheme overview**
NAPS is a predominantly Defined Benefit (DB) arrangement which opened in 1984 and since closed to new entrants in 2003 and closed to future accrual in 2018.

Access to key documents for the Scheme is available using the following website: www.mybapension.com including a copy of the Member's Handbook which succinctly explains the key features of the Scheme rules and options available to members. The full details can be found in the Trust Deed and Rules also available via the website.

NAPS contains several sub-schemes most notably the British Caledonian pension scheme (BCal) which merged with NAPS in 1988; and the Dan Air pension scheme (DADN) which merged with NAPS in 1994. DADN is made up of two distinct sub-sections Dan Air and Davies and Newman.

All analysis has been carried out at Scheme-level.

# Asset Allocation

| Assets as at 31 March 2022 | Value (£m) | Allocation (%) |
|---|---|---|
| **Return Seeking Assets** | **7,017.0** | **35.2%** |
| **Total Equity** | **2,977.9** | **14.9%** |
| Active Equity | 1,183.8 | 5.9% |
| Passive Equity | 1,685.5 | 8.5% |
| Equity FX Hedge | -35.9 | -0.2% |
| Equity (Futures) | 144.5 | 0.7% |
| **Total Illiquid Assets** | **4,039.1** | **20.3%** |
| Property | 1,907.3 | 9.6% |
| Private Equity | 1,448.7 | 7.3% |
| Alternatives | 683.1 | 3.4% |
| **Liability Matching Assets** | **12,927.4** | **64.8%** |
| **Total Bonds** | **11,416.0** | **57.2%** |
| UK Corporate Bonds | 2,019.7 | 10.1% |
| Liability Hedging Portfolio | 9,502.4 | 47.6% |
| Overseas Govt Bond (Futures) | -106.1 | -0.5% |
| **Diversified Illiquid Income** | **1,253.5** | **6.3%** |
| **Real Assets** | **444.8** | **2.2%** |
| **Total Floating Rate** | **500.4** | **2.5%** |
| Floating Rate (Legacy) | 402.4 | 2.0% |
| ABS Portfolio | 49.8 | 0.2% |
| CLO Portfolio | 48.7 | 0.2% |
| **Total Index Linked (Legacy) including SAIF** | **308.4** | **1.5%** |
| **Cash & FX**** | **257.9** | **1.3%** |
| **Total Assets** | **19,944.4** | **100.0%** |

*Note: values shown above sourced from BlackRock as at 31 March 2022, taken from the 31 March 2022 Quarterly Investment Report. Figures slightly differ to elsewhere in this report as the above table captures post month end adjustments whereas those used in the report used a static Net Asset Value.*

# Disclaimers

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- The BlackRock data, models and methodologies rely on comparatively new analysis and there is limited peer review or comparable data available.
- To the extent that the BlackRock's scenario analysis includes third party-data, BlackRock uses the data as provided by such third-party and is not liable for inaccuracies or omissions therein.

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