THE BRITISH STEEL PENSION SCHEME

CLIMATE CHANGE REPORT FOR THE YEAR TO MARCH 2024

CONTENTS

INTRODUCTION

This Climate Change Report provides information about how the Trustee has considered climate-related risks and opportunities and how these have been managed.

This is the Scheme's third Climate Change report covering the 12-months to the Scheme year end date of 31 March 2024 (the first report covered the Scheme year to 31 March 2022). There have been significant changes to the investments of the Scheme since March 2022 culminating in the Scheme fully insuring all benefits with Legal & General Assurance Society (LGAS) on 17 May 2023. From that date, the Trustee's role as stewards of the Scheme's assets is limited to the insurance policies with LGAS with a modest portfolio of cash and gilts to meet the on-going running costs of the Scheme. The Trustee has taken steps to ensure that the chosen insurance provider has a climate change strategy that is coherent with the Scheme's climate ambitions.

The act of securing benefits with insurance policies has reduced the risks (including climate risks) of the Scheme having insufficient assets to provide members' benefits as far as possible. We have therefore taken a pragmatic and proportionate approach to producing this report. While the purpose of this report has historically been to inform future strategy, the insurance policies are such that no change to future strategy is likely.

This report follows the framework to provide disclosures in four broad categories:

- **Governance:** the arrangements that have been put in place to maintain oversight of the climate-related risks and opportunities relevant to the Scheme
- **Strategy:** consideration of the potential impact of climate-related risks and opportunities on the Scheme's investment strategy and funding strategy
- **Risk management:** how the processes used to identify, assess and manage climate-related risks are integrated into the Scheme's overall risk management approach
- **Metrics and targets:** the metrics and targets used to assess and manage climate-related risks and opportunities.

GOVERNANCE

The Trustee is ultimately responsible for decisions on all investment matters, which includes ensuring climate-related risks and opportunities were given appropriate consideration when determining the strategic objectives of the Scheme and are properly integrated into the Scheme's risk management framework.

As described in section 3, the Scheme has a proportionate Integrated Risk Management (IRM) Policy which sets out how the residual risks to which the Scheme is exposed are assessed and managed.

The Trustee expects its insurance policy provider and its investment manager to have integrated Sustainable Investment considerations (including climate change risks and opportunities) into their investment analysis and decision-making processes.

In May 2023 the Trustee completed its fourth and final insurance transaction with LGAS taking the percentage of Scheme assets invested in annuity insurance policies to 97% (see appendix). LGAS's climate risk management practices, as assessed by LCP, were considered before transactions with LGAS as discussed in section 5.

Over the year, following the execution of the buy-in transaction with LGAS the Trustee outsourced the management of most of the residual Scheme assets (i.e., the remaining assets following the payment of the insurance premium) to Legal and General Investment Management (LGIM). LGIM's Sustainable Investment capabilities, including climate risk management, as assessed by WTW, were considered when appointing LGIM.

The Trustee has received advice or assistance on governance and risk management activities from a range of providers including WTW (Scheme Actuary and investment consultant), LCP (settlement transactions and risk management adviser) and Penfida (Covenant adviser). The Trustee has ensured that its professional advisers consider climate-related risks and opportunities within the support provided to the Scheme.

The Trustee, through engagement with these providers, is satisfied that they take account of climate-related risks and opportunities, where relevant to the advice or assistance being provided. The Trustee formally reviews the service it receives from all providers on an annual basis, and the providers' continued ability to take account of climate-related risks and opportunities forms part of these reviews.

The Trustee has embedded climate considerations within the Scheme's wider integrated risk management framework, which is aligned with the regulatory direction of travel set by The Pension Regulator.

STRATEGY

Since the establishment of the new BSPS in 2018, the Trustee's strategic objective has been to secure liabilities in full with an insurance company and this was achieved on 17 May 2023.

The Trustee undertook scenario analysis during the Scheme year ending 31 March 2022, being the first year in which the Climate Change regulations applied to the Scheme. This analysis, which was described more fully in the 2022 report, considered four separate scenarios for the potential impact of climate change on both the Scheme's assets and liabilities at that time and hence the future progression of its funding level. In conducting the analysis the Trustee considered the potential effects of climate change over a range of time horizons. As part of this, the Trustee has also identified the different elements of climate change risk (i.e., transition risk, physical risk). The approach taken in the two prior years is consistent with the regulatory requirements and with the statutory guidance for pension schemes published by the Department for Work & Pensions.

The overarching aim of the analysis was to assess the likely impact on the achievement of the Trustee's ultimate objective, which was to fully secure the liabilities through the insurance market. At the time of the analysis, the Scheme's funding level was around 93%, with a central expectation that it would take around 11 years to achieve the ultimate objective.

Under most of the scenarios considered, there would be a negative impact on the expected timeframe to achieving the objective. The most significant impact occurred under the 'Global Coordinated Action' scenario, where the expected timeframe extended to beyond 15 years. In the case where investment markets suddenly price in the impacts of climate change, the Scheme could have experienced a drop in funding level of up to 8%. In considering this analysis, the Trustee recognised that proceeding to a full buy-out of the liabilities as quickly as possible would be the most effective way of mitigating these risks.

As required by the regulations, the Trustee reviewed this initial scenario analysis during 2022-23 and considered whether it would be appropriate for the analysis to be updated. The Trustee took into account changes in the circumstances of the Scheme since the initial analysis was undertaken and considered whether updated analysis would usefully inform Trustee strategy or investment decisions.

When considering whether the scenario analysis should be updated for the purposes of the 2023 Report, the Trustee had already insured 59% of the liabilities and was awaiting a quotation for securing the remaining liabilities, with an expectation that it would have sufficient assets to proceed with a final transaction. Against a background of strong improvements in overall market conditions and after dynamically deploying a range of tactical and strategic de-risking measures, full funding on a buyout basis was achieved during the first half of 2023.

The Trustee’s view was that completing the final transaction would provide the best way for the Scheme to manage the various risks it faces, including the impacts of climate change. Consequently, the Trustee concluded that reassessing the risks and opportunities presented by climate change would not impact the decision to proceed with the transaction, nor would it be feasible to take action to mitigate any risks or exploit any opportunities identified by the analysis, within the relevant timeframes. As such, the Trustee concluded in 2023 that updating the scenario analysis would not help inform strategic or investment decisions.

Now that the Scheme is fully insured and holds the vast majority of its assets as either insurance policies or cash or gilts, the Trustee has again concluded that updating the scenario analysis will not inform future strategy or investment decision making.

Given the size and composition of the Scheme’s investment holdings, the Trustee does not expect to be required to produce a Climate Change Report after 31 March 2024.

RISK MANAGEMENT

Integrated Risk Management (IRM)

Having largely mitigated the key investment, funding and covenant risks by means of insuring liabilities in full, the Trustee operates a proportionate IRM framework which identifies the key residual risks to which the Scheme is exposed and for the most important risks, sets out how the risks are defined, measured, mitigated and monitored.

The Scheme's objectives and key risks are reviewed annually. All key risks and residual controls are reviewed and reported to the Board on a quarterly basis.

A full review of the interaction between key investment, funding and covenant risks is completed at each triennial valuation (or sooner if significant changes impacting the Scheme takes place). The next triennial valuation is due as at 31 March 2024.

Consideration of risks of insurance policies with LGAS

Fully insuring the liabilities of the Scheme with LGAS brings significant risk management benefits, which includes the management of climate risks.

The Trustee has taken advice from Penfida on the financial strength of LGAS as a counterparty for the Scheme's annuity insurance transaction. They advised LGAS were a suitable counterparty for the following reasons:

- LGAS's Solvency II ratio as at 31.12.22 was 207%, improving to 209% at 31.12 2023, of the minimum required (the minimum is designed to cover a 1-in-200 year stress)
- They have strong credit ratings and a strong approach to risk management
- Transferring to an insurance company provides additional regulatory protections including the Financial Services Compensation Scheme should LGAS fail, protection against any acquisition/transfer of business and protection against excessive shareholder pay-outs.

The insurer bears any climate related losses out of solvency capital and shareholder funds so the above factors all mitigate the risk that members' benefits will be adversely impacted by climate related losses on the insurer's underlying investments.

The Trustee has also taken advice from LCP on the responsible investment and climate risk management capabilities of LGAS for the investments backing their annuities business. LGAS is LCP's highest rated annuity provider for responsible investment and LGAS's investment process involves considering climate risks and opportunities at both an asset class level and within individual securities.

Covenant Risks

The Scheme's sponsor, TATA Steel UK Limited (TSUK), operates in an energy-intensive sector meaning that climate risks are skewed to the downside.

In September 2023, TSUK and the UK Government announced a joint agreement on a proposal to invest in a state-of-the-art Electric Arc Furnace steelmaking at the Port Talbot site with a capital cost of £1.25 billion inclusive of a grant from the UK Government of up to £500 million, subject to relevant regulatory approvals, information, consultation processes and finalisation of detailed terms and conditions. The project would bolster UK's steel security and would be the first step towards decarbonisation of the local steel industry, reducing direct emissions by 50 million tonnes over a decade. With a high degree of circularity, it would leverage strategic, domestically available scrap steel and promote local value addition within the UK.

Whilst the proposed project would ensure continuity of steel making in Port Talbot after the transition and transform TSUK into a sustainable, capital-efficient and profitable business, it exposes TSUK to a number of additional short-term risks during the transition period. As the BSPS has insured liabilities in full, the insurer is effectively providing a second covenant to the Scheme, which is arguably stronger than that of the sponsoring company especially with regards to climate risks.

METRICS AND TARGETS

The Trustee must select and report on a minimum of the following metrics:

- one absolute emissions metric,
- one emissions intensity metric,
- one portfolio alignment metric and
- one additional climate change metric

The following metrics were selected by the Trustee in its 2022 and 2023 reports, copies of which can be reviews at Library – The British Steel Pension Scheme (bspspensions.com).

- **Absolute GHG emissions**
- **Weighted Average Carbon Intensity**
- **Climate Value-at-Risk**
- **Warming Potential**
- **Exposure to Green Bonds/Revenues**

These metrics were previously calculated based on the Scheme's holdings of corporate bonds and equities at the time. These asset classes are no longer held. No emissions were attributed to the other asset classes held by the Scheme for the following reasons.

- The industry is yet to formalise an approach for calculating the carbon emissions associated with gilts and insurance policies. As such, we have disregarded the proportion of the portfolio that is invested in gilts and the LGAS buy-in insurance policies – this approach is aligned with the industry practice.

- The quality and breadth of data is lower for private companies and the coverage across different asset classes varies significantly, particularly within less liquid mandates. As such, we have excluded the property and private equity exposure from the calculation of these metrics.

Because of the change in scheme investment holdings, all the metrics previously calculated now register zero scores. The Trustee has no direct influence on the environmental policies associated with 98.4% of the investments (insurance policies and gilt) and has effectively passed on the climate related risks to LGAS. The remaining illiquid assets are expected to be sold for cash during 2024.

The previous carbon journey plan to be net-zero by 2050 has been superseded by the transfer of climate risk to the insurer. Details of L&G's sustainability strategy, including its Climate and Nature Report 2023, can be found at Sustainability l Legal & General (legalandgeneral.com).

INSURER’S CLIMATE CHANGE CREDENTIAL

In selecting LGAS to insurer the Scheme’s benefit liabilities, the Trustee reviewed their climate risk management credentials and have reviewed updated reports subsequently. We reported last year that the Trustee had selected the highest rated insurer for risk management of their underlying investments according to advice from LCP.

LCP updated their analysis in Feb 2024 and L&G continues to be the only bulk annuity insurance provider to achieve LCP’s highest rating.

The Trustee has taken advice from WTW on LGAS’s approach to ESG which has confirmed that LGAS is highly rated both on a standalone basis and relative to its peers.

APPENDIX - ASSET ALLOCATION

As at March 2024, the fund's investments were valued at £7.17 billion and the split between different asset categories is set out in the table below:

Asset Allocation	31-Mar-24		31-Mar-23		31-Mar-22	
Asset Category	**£'m**	**%**	**£'m**	**%**	**£'m**	**%**
LGAS Inisurance Policies	6,525	97.2%	4,290	58.6%	498	5.0%
Corporate Bonds	0	0.0%	1,481	20.2%	5,785	58.3%
Gilts	82	1.2%	739	10.1%	1,637	16.5%
Property	65	1.0%	463	6.3%	1,202	12.1%
Listed equity	2	0.0%	2	0.0%	448	4.5%
Private Equity	7	0.1%	33	0.5%	52	0.5%
Cash and other	34	0.5%	314	4.3%	307	3.1%
Total Fund Value	6,715	100.0%	7,322	100.0%	9,929	100.0%

APPENDIX - GLOSSARY

Net Zero target
Firm's targets to make Net Zero carbon emissions by a specific date, at which point having sought to reduce the emissions as much as possible, any carbon dioxide which continues to be released into the atmosphere is balanced by an equivalent amount being removed by offsetting through carbon removals.

Scope 1, 2 and 3 emissions

Scope 1 carbon emissions are those directly occurring from sources that are owned or controlled by the institution.

Scope 2 carbon emissions are "indirect emissions generated in the production of electricity consumed by the institution".

Scope 3 carbon emissions encompass all other indirect emissions that are "a consequence of the activities of the institution but occur from sources not owned or controlled by the institution" such as commuting; waste disposal; embodied emissions from extraction, production, and transportation of purchased goods; outsourced activities; contractor-owned vehicles; and line loss from electricity transmission and distribution".

As per the GHG Protocol, Scope 3 carbon emissions can be classified into two broad categories:

- Upstream Scope 3 emissions: defined as indirect carbon emissions related to purchased or acquired goods and services; and
- Downstream Scope 3 emissions: defined as indirect carbon emissions related to sold goods and services.

Carbon Emissions - Scope 1+2+3 Intensity (t/USD million sales)

Carbon emissions are classified per the Greenhouse Gas Protocol (the GHG Protocol) and include:

1. Carbon Dioxide (CO2)
2. Methane (CH4)
3. Nitrous Oxide (N2O)
4. Hydrofluorocarbons (HFCs)
5. Perfluorocarbons (PFCs)
6. Sulphur Hexafluoride (SF6)
7. Nitrogen Trifluoride (NF3)

A carbon dioxide equivalent or CO2 equivalent, abbreviated as CO2e, is a metric used to compare the emissions from various greenhouse gases based on their global-warming potential (GWP), by converting amounts of other gases to the equivalent amount of carbon dioxide with the same global warming potential.

This figure represents the company's most recently reported or estimated Scope 1 + Scope 2 + Scope 3 greenhouse gas emissions normalised by sales in USD, which allows for comparison between companies of different sizes. The carbon intensity figures for each holding in the portfolio are averaged using the portfolio weights.

Green Bonds
A green bond is a bond specifically earmarked to be used for climate and environmental projects. These bonds are typically asset-linked and backed by the issuer's balance sheet, and are also referred to as climate bonds.

Sustainability
All activities can be considered as taking account of profit, people and the planet (also known as the 'triple bottom line'). A more formal definition is "meeting the needs of the present without compromising the ability of future generations to meet their needs".

Task Force on Climate-related Financial Disclosures
The Financial Stability Board created the TCFD to improve and increase reporting of climate-related financial decision useful information.
Governments are encouraging firms to make disclosures aligned to the TCFD framework to enable investors to compare them and allocate capital accordingly. The UK Government made TCFD reporting mandatory for all listed companies and large asset owners in 2022.

The **Climate VaR** metric provides investors with *an estimation of how the value of their investment portfolios could be impacted* (up or down) by climate policy risk, technology transition opportunities and extreme weather (physical climate risks). A company's Climate VaR, expressed as a percentage change from its current market valuation, is derived from financial modelling of potential future costs and profits associated with climate-related risks and opportunities.
TFCD requires that asset owners run climate scenario analyses in accordance with Paris Agreement.
Base case: holding the increase in the global average temperature to 2°C above pre-industrial levels by 2100.
Worst case: using a greater than 2°C scenario to account for physical effects due to extreme weather change.
Best case: pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, with net zero by 2050.

The **Warming Potential** metric provides investors with an indication of *how the projected business activities undertaken by companies in their investment portfolios align to pathways corresponding to global temperature targets*. Given the same business activities, the Warming Potential of two companies, expressed in degrees Celsius (°C), should be similar regardless of other factors that may affect their exposure to climate-related risks such as differences in their policy environment, exposure to weather hazards or market valuations.