



Leonardo Helicopters Pension Scheme

Climate-related disclosures

2023 TCFD report



1. Introduction

1.1 Foreword

The Trustee of the Leonardo Helicopters Pension Scheme (“the Trustee”, “the Scheme”) is pleased to share its first climate-related disclosures report for the scheme year ending 5 April 2023 in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (“TCFD”).

The Trustee recognises climate change (defined by the United Nations as the long-term shifts in temperatures and weather patterns) as a material long-term systematic risk to pension schemes. The Intergovernmental Panel on Climate Change estimated in 2018 that human activities have already caused circa 1 degree Celsius of warming above pre-industrial levels. The Trustee is supportive of the goals of the Paris Agreement, to limit global warming to “well below” 2 degrees Celsius compared with pre-industrial levels and pursuing efforts to limit warming to 1.5 degrees, and recognises the relevance of this goal under their obligations of fiduciary duty to their members.

The warming of the planet poses significant risks in the form of both Physical and Transition risks:

- **Physical risks** stem from more frequent or severe weather events such as hurricanes, floods and droughts
- **Transitional risks** increase as the world shifts towards a low-carbon economy and could manifest as changes in policy, regulation or consumer preferences.

New UK Regulations require trustees of certain pension schemes to meet climate governance requirements and publish an annual TCFD-aligned report on their scheme’s climate-related risks. Greater transparency and reporting on climate risks should lead to better-informed decision making by investors and increased accountability.

1.2 Scheme background

The Leonardo Helicopters Pension Scheme is a defined benefit pension scheme created in June 2002. It closed to new entrants in October 2007 and will close to future pension accrual in April 2024. It has a total of 4,925 members and assets of £1,230m as at 5 April 2023. The estimated funding level is 94% on the Low-Dependency basis and 107% on the 2020 Technical Provisions basis as at 31 March 2023.

1.3 Structure of this report

This report contains four sections which directly align with the TCFD requirements:

- **Governance** – the Trustee’s governance and oversight processes regarding climate-related risks and opportunities (“CRRO”)
- **Strategy** – the actual and potential impacts of climate-related risks and opportunities on the Scheme’s strategy
- **Risk management** – the processes used to identify, assess and manage climate-related risks
- **Metrics & targets** – the metrics and targets used to assess and manage relevant climate-related risks and opportunities.

1.4 Key findings

The key findings of the report are as follows:

- The Trustee recognises climate change as a significant risk to the Scheme.
- In preparing for this first TCFD report there has been major progress in the quality of the research and data that is available to the Trustee Board to understand climate related risks and opportunities. For example we are able to monitor carbon intensity of much of our portfolio and see progress in reducing this.
- Modelling of potential funding impacts has been conducted based on three scenarios that the transition to the Paris Agreement goals are met on an orderly or disorderly basis as well as them not being met. This is a new area of study and, while all of the scenarios have negative impacts on Scheme funding, it is clear that an orderly transition would be in the best interests of Scheme members.

- The Trustee believes that its use of a fiduciary manager, Schroder Solutions, is helpful to maximise positive impacts through the pooling of assets with other schemes and the greater influence they are likely to have in engaging managers to achieve net zero.
- The Trustee has set a goal of achieving net zero by 2050, in line with the target set by Schroders across its investment portfolios.
- The main climate risks identified are in the growth portfolio. In this context it is helpful that the Scheme funding is strong and a significant proportion of the assets are in off-risk assets (with low carbon intensity).
- Climate risk has also been considered in relation to the covenant of Leonardo as the sponsor of the Scheme. Risk is found to be low over the time horizon of the funding strategy.
- The environment is one of the three ESG pillars of responsible investment. The Trustee supports Schroders engagement blueprint in this area and, in addition to Climate Change has identified Human Rights and Corporate Governance as its engagement priorities.

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Martin Flavell

Chair, Leonardo Helicopters Pension Scheme (Trustee) Limited

2. Governance

2.1 Trustee investment beliefs

In 2023 the Trustee formally identified the following key investment beliefs:

- It is important to consider ESG for the Scheme as it will have a positive societal impact,
- All issues within ESG require equal consideration,
- The Trustee is supportive of the goal to achieve net zero global emissions by 2050.

In addition the Trustee has agreed three engagement priorities, which are as follows:

- **CLIMATE CHANGE** | Engaging with companies to encourage positive change by transitioning their business models to a net zero or 1.5 degree pathway and adapt to a changing climate (e.g. understanding climate risk, decarbonising and minimising emissions, adaptation, carbon capture and removal, just mitigation of social effects),
- **HUMAN RIGHTS** | Protecting human rights and reducing the negative impacts companies have on workers, communities and consumers (e.g. child labour, ethical supply chains, indigenous rights, basic access to products and services, modern slavery),
- **CORPORATE GOVERNANCE** | Ensuring transparency of voting and shareholder resolutions, particularly around climate and diversity issues (e.g. shareholder rights, executive and board compensation).

These beliefs and engagement priorities are going to be documented in the Statement of Investment Principles (“SIP”) and this is reviewed annually (or sooner in the event of a significant change in investment policy).

The Trustee believes the most appropriate way of implementing its investment beliefs taking into account its governance structure is via a fiduciary management arrangement, where day-to-day investment decisions are delegated to an investment manager and greater impact may be available through the pooling of assets with other pension schemes. The Trustee currently uses Schroders Solutions as its Investment Adviser and Fiduciary Manager (“FM”); however it acknowledges that the responsibility for managing climate risks ultimately rests with the Trustee.

The engagement priorities noted above are aligned with those of Schroders, as set out in their [Engagement Blueprint](#). The Trustee (and Schroders) have set a net-zero target by 2050 for the Scheme’s investment portfolio in line with the Paris Agreement.

2.2 Scheme governance of CRRO

2.2.1 Role of the Trustee Board

The Trustee is collectively responsible for the governance and oversight of all strategic matters related to the Scheme. The Trustee Board makes strategic decisions with implementation delegated to an Investment Sub Committee (“ISC”) that has authority to change the specific approach taken within the investment strategy. This includes matters relating to environmental, social and governance (“ESG”) and climate-related risks and opportunities. The Trustee meets at least 4 times a year, alongside quarterly meetings of the Investment Sub Committee (“ISC”), with ESG and climate change regular topics of discussion particularly within the ISC. The Trustee also has a training day once a year, at which time can be devoted to training on climate risks. Trustee Board and ISC activity is co-ordinated by an internal Pensions Management team.

The Trustee receives regular training on climate related issues from its advisers, details of which are set out in section 3.3. The Trustee expects its advisers to bring important and relevant climate-related issues and developments to the Trustee’s attention in a timely manner. Detail on how the Trustee board ensures the Trustee is taking adequate steps to identify and assess CRRO is included in section 3.4.

Climate risk has been an agenda item for the ISC at least once per year since 2021, in particular, to discuss climate metrics and scenario analysis, along with reviewing whether adequate steps have been taken to identify, assess, and manage CRRO, through consideration of feedback from the Trustee sub-committees. Further detail on each sub-committee is detailed below.

2.2.2 Role of the Investment Committee (“IC”)

The Trustee has delegated oversight and ongoing monitoring of investment related climate risks to the ISC who meet at least 4 times a year. The ISC seeks to ensure any investment decisions appropriately consider CRRO within the context of the Scheme’s wider risk and return requirements and are consistent with the Scheme’s SIP.

The key activities of the ISC, with support of the Trustee’s investment adviser, include:

- Ensuring strategic investment proposals consider the impact of CRRO
- Reviewing the ESG and TCFD climate metrics of the portfolio through quarterly monitoring reports
- Reviewing climate scenario analysis on an annual basis
- Monitor the FM’s activities in relation of management of climate-related risks and in seeking investment opportunities which enhance the ESG and climate characteristics of the Scheme’s portfolio
- Reviewing the FM’s annual ESG report
- Reviewing the FM and underlying managers’ voting and engagement activity on an annual basis with focus on the Trustee’s priority engagement themes which includes climate change.
- Engaging with the FM as required to understand or challenge its approach to managing CRRO, and in ensuring the FM is undertaking stewardship activities of its own relating to climate over the underlying managers in the portfolio

The ISC feed back to the Trustee on a quarterly basis and ensure the Trustee are informed of any material climate-related developments as required.

2.3 Trustee knowledge and experience

The Trustee board ensures it possesses the relevant knowledge and understanding to govern climate-related risks and opportunities effectively. The Trustee board has undertaken 1.5 hours of training regarding ESG and climate risks in the Scheme Year, with the ISC and the DC investment committee having received additional training on ESG and climate risks.

This training covered:

- How climate-related risks and opportunities have the potential to impact Scheme assets and liabilities now and in the future
- The Trustee’s legal and regulatory obligations to consider and report on climate-related risks and opportunities
- How climate risks could impact the sponsor covenant
- Actions taken by the FM on the Trustee’s behalf in the Scheme’s investment portfolio to identify and manage climate-related risks and opportunities
- How to set appropriate climate metrics and targets and monitor progress against them.

2.4 Role, assessment and credentials of Trustee advisors

Our advisors:

- **Schroders Solutions** is our Fiduciary Manager and strategic investment advisor. They provide assistance with considering, understanding, managing and monitoring the impacts of climate change on our investment portfolio
- **Rob Watkin of Isio** is our Scheme Actuary, who provides input on the potential impact of climate change on the Scheme's liabilities and funding assumptions
- **Cardano** is our covenant advisor, and considers the potential impact of climate change on the Scheme's sponsor
- **Burges Salmon** is our legal advisor, which advises the Trustee on remaining compliant with all legal and regulatory requirements in relation to climate change risk
- **LCP** provides independent oversight of the Scheme's fiduciary management arrangement

The Trustee is supported by specialist advisors in all necessary areas such as investment, funding, covenant and legal. The Trustee expects their advisors to have the adequate skills, experience, tools and knowledge to sufficiently assist them in these areas. The Trustee carries out an annual review of its investment advisor to satisfy itself that they are adequately supporting the Trustee in all relevant tasks.

LCP provided an in-depth independent review of the Scheme's investment strategy and fiduciary management arrangement in 2019; facilitated a competitive retender for fiduciary management in 2020 and provided a reflection on the liability driven investment crisis in 2023. They continue to provide independent oversight of the performance of the Scheme's FM on an ad-hoc basis which may include an assessment of the FM's approach to identifying and mitigating ESG and climate-related risks within the investment strategy.

Further detail on the approach taken to assess the credentials of the investment adviser, Scheme actuary and covenant adviser is detailed below:

Investment Adviser

As the Trustee's FM and investment advisor, Schroders Solutions work with the Trustee on a regular basis to identify, understand, manage and monitor climate-related risks and opportunities in the Scheme's investment portfolio. This includes, for example, the provision of TCFD climate metrics on a quarterly basis, annual review of climate scenario analysis, annual FM ESG report including progress against the net zero target, and ad-hoc updates on the latest developments regarding CRRO as required. The Trustee challenges Schroders on the output received and queries where relevant to ensure the Trustee is correctly interpreting the nature of the CRRO the Scheme is exposed to. The Trustee has also reviewed the FM's own ESG policies and are satisfied the FM's investment approach is aligned with its beliefs and objectives. In addition, the Trustee has specified the consideration and integration of ESG risks (including climate risks) and stewardship within Schroders Solutions' objectives as investment consultant and reviews the services received each year against them.

Actuary

In their role as Scheme Actuary, Isio work with the Trustee to assess and manage CRRO in the Scheme's liabilities. Isio advises the Trustee on its long-term funding strategy and monitors progress against this through the provision of regular valuations of the Scheme's liabilities. This includes the presentation of quarterly funding reports at Trustee meetings. As Scheme Actuary, Isio make long-term assumptions about the future by analysing past trends and considering the potential impact of future developments. The potential impact of CRRO is reflected implicitly in every assumption Isio make about the future. Through

the discussion of Isio's advice at Trustee meetings, the Trustee receives and challenges this advice and ensures that its own view on CRRO is appropriately reflected in the Scheme's funding strategy.

Covenant Adviser

Cardano provide a monitoring report every six months to the Trustee concerning the covenant of Leonardo UK and the wider Leonardo Group. This includes consideration of how the covenant is expected to be impacted by the key climate risks identified in the scenario analysis, thereby allowing the impact on the Scheme's covenant and investments to be considered in parallel. Additionally, the evolution of the covenant is assessed over similar timeframes to those considered by Schroders Solutions.

The Trustee is satisfied with its advisers for the year to 5 April 2023.

The Trustee is also committed to regularly reviewing its own approach in terms of climate risks.

3. Strategy

3.1 Description of risks over relevant timeframes

The Trustee is required to identify and consider how its investment and funding strategies could be impacted by Physical and Transition risks, as defined in the Introduction of this report, over the short, medium and long-term. The Trustee has set these time horizons as shown in the table below.

These timeframes have been determined by taking into account the climate outlook, membership demographics, funding position and objectives. The Trustee will review the chosen timeframes on a regular basis and assess the extent to which it believes the Scheme will have sufficient assets to meet expected future payments over its journey. The Scheme is closing to accrual in April 2024 and is now expecting to buy out the Scheme's liabilities with an insurer within the next 15-20 years. As a result, the Trustee has chosen to assess climate risks over a time horizon of no more than 20 years.

There are a number of climate related risks and opportunities the Trustees are aware of over these timeframes. In particular, in the short-term we expect transition risks in general to be greatest, however, in the long-term, physical risks will ramp up and could become increasingly dominant especially if climate change mitigation actions are not undertaken.

	Short-term (0-5 years)	Medium-term (5-10 years)	Long-term (15-20 years)
Investment Horizon	Triennial strategy review cycle	Low Dependency Objective	Significantly mature
Climate Horizon	UN PRI Inevitable Policy Response Improvement in data quality	Interim 2030 targets Stronger focus on transition - mitigation Alignment with UN Sustainable Development Goals	Transition becomes increasingly difficult – focus on adaptation over mitigation Physical risks become more prevalent
Risk to Assets	Transition risks such as carbon pricing and regulation affect asset values	Continued transition risks Physical risks such as extreme weather events and sea level rises increasingly affect asset values	Physical risks dominate
Risks to Liabilities	Changes to long dated yields and/or implied inflation (as per assets) are more dominant in short to medium terms with changes to longevity expectations more dominant in medium-longer terms due to rising physical and transition risks. For example in the long-term physical and transition risks may both impact on the provision and quality of healthcare.		
Risks to Sponsor	The ability of the sponsor to adapt to low-emissions supply chains (i.e. reducing scope 3 emissions) and the physical risk of climatic events to global operations.		

The next section identifies and demonstrates the potential impact of CRRO on the Scheme's specific investment and funding strategies.

3.2 Climate risks and opportunities

3.2.1 Overview of CRRO within the Investment Strategy

In relation to the investment strategy, the Scheme invests via a fiduciary management arrangement where the Trustees agree the overall strategic allocation across a number of investment 'building blocks' as detailed in the table below:

Building Block	Sub Asset Class	Allocation %
Growth Assets	Equities, Property, Return Seeking Credit, Alternatives	30%

Buy & Maintain Credit (“B&M”)	Investment grade credit	10%
Active Structured Equity (“ASE”)	Equity derivative instruments, UK Gilts	15%
Liability Hedging	UK Gilts, Cash	45%
Total		100%

The day-to-day investment decisions, including the identification and management of CRRO, are delegated to the FM who invests via a number of different underlying mandates in seeking to achieve the Scheme’s objectives. Within the Growth allocation, the FM can invest across a range of asset classes and third-party pooled-fund managers and can alter the underlying investments between asset classes regularly to take account of market conditions including its view on emerging climate risks and opportunities. In particular, the FM incorporates a climate risk screen within the Scheme’s core equity and return-seeking credit portfolios where it has direct influence over security selection, and otherwise rates all of the underlying mandates on an annual basis on the extent of ESG and climate integration within the investment processes. Managers who score lower are prioritised for engagement by the FM. Climate was a particular topic of engagement with the core credit manager over 2022 as the FM identified some high emitting securities and the FM fed back its progress to the Trustee through the FM’s annual ESG report.

In relation to climate opportunities, the FM is actively seeking to pursue positive climate solutions in order to contribute to the net zero by 2050 target and is currently reviewing climate-themed active equity managers to sit alongside the core equity portfolio. Over 2022, the FM invested in a renewable infrastructure mandate on the Scheme’s behalf and in late 2021 invested in green gilts as part of the Scheme’s LDI portfolio.

Given the fiduciary management approach adopted, the Trustee, as part of its stewardship obligations, reviews and monitors the activities of the FM in how they select asset classes and underlying managers and take account of ESG factors including climate changes. The FM has also supported the Trustee in assessing the impact of CRRO at a strategic asset allocation level as set out in the table below.

3.2.2 Overview of CRRO within the Funding Strategy

In relation to the funding strategy, with support of the Scheme Actuary and Covenant Advisor, the Trustee has considered the impact of climate change on financial assumptions (e.g. gilt yields and market implied inflation) and demographic assumptions (e.g. life expectancy) used in valuing the liabilities (including the long-term funding objective), the employer covenant and the balance between employer contributions and investment returns.

The Scheme Actuary monitors the implicit impact of climate change on the Scheme’s funding strategy at least annually in formal actuarial reports presented to the Trustee. As part of these reports the Scheme Actuary considers changes since the previous year in financial markets (mainly long-term gilt and credit markets, both nominal and inflation linked), in member experience and emerging research on future changes in life expectancy. Whilst it is often not possible to isolate the impact of climate change and therefore quantify the financial impact of CRRO, these are implicitly considered alongside other risk areas

The impact on liabilities due to changes to interest rates and expected inflation rates is mitigated through a high level of liability hedging (90% of the Low-Dependency liabilities). The Trustee is not currently hedging longevity risk and therefore remains exposed to the risk of climate change resulting in an increase in longevity. The Trustee monitors opportunities to mitigate longevity risk with the support of the Scheme Actuary.

The Regulations require the Trustee to consider the resilience of the funding strategy within different warming scenarios. Covenant is viewed as an integral part of a plan’s funding strategy and therefore to address this requirement this report considers the resilience of the employer covenant to various climate scenarios.

The Trustee’s assessment, carried out by Cardano, has been focussed on Leonardo S.p.A., including all subsidiaries and associated undertakings (“Leonardo” or the “Group”) rather than the Scheme’s UK sponsor, given the more complete information available at Group-level, noting the integration present within the Group and the covenant. The climate scenario analysis is based on identifying and assessing relevant transition and physical risk impact across five transmission channels below:

Transmission channel	Key feature
Supply chain	Leonardo's supply chain is extensive and global, with over 11,000 suppliers around the world. Key commodities that go into the products include aluminium, titanium, nickel and steel. Helicopter engines are sourced from a range of companies including Pratt & Whitney, GE, Safran and Rolls Royce
Operations	The two main segments for Leonardo are Electronics (e.g. radar and sensors) and Helicopters (e.g. military and civil). The majority of the operating sites are based in Italy, but other key sites are located in UK, USA and Poland
Competition	Primary competitors in the Electronics space include BAE systems, Thales and Saab while the Helicopter business competes with companies such as Airbus, Bell and Sikorsky
End-market	The end buyers of Leonardo's products include sovereign bodies such as the Italian Air Force, UK MoD, US Air Force and the Polish Armed Forces, as well as politically sensitive markets like Saudi Arabia. Corporates such as Airbus, Boeing and Northrop Grumman are also large customers
Macro-economic conditions	Macro-economic conditions could impact on Government defence spending; although the Italian Government (which is Leonardo's single largest shareholder) views Leonardo as a strategic asset and Leonardo has stated in disclosures that "in periods with high financial and economic instability the Italian Government might dispose of certain assets to support public expenditure in... strategic [sectors]". The group is also reliant on external financing and has sustainability-linked debt in place

3.2.3 Summary of the impact of CRRO on the investment and funding strategies

The Trustee, in conjunction with its advisers, has used a Red, Amber, Green rating scale to illustrate the likely magnitude of the potential impacts of CRRO across the different timeframes agreed, where:

- Red denotes a high level of financial exposure to the risk
- Amber denotes a medium level of financial exposure to a risk
- Green denotes a low level of financial exposure to a risk (or it is hedged)

	Time	Growth – Equity / ASE	Growth – Return-Seeking Credit	Growth – Property	Growth - Alternatives	Buy & Maintain Credit	Liabilities (LDI)	Liabilities (demographic)	Sponsor
Transition	Short	Red	Green	Amber	Amber	Green	Green	Green	Amber
	Medium	Red	Green	Amber	Amber	Green	Green	Green	Amber
	Long	Red	Green	Red	Amber	Green	Green	Green	Amber
Physical	Short	Amber	Green	Green	Green	Green	Green	Green	Green
	Medium	Amber	Green	Amber	Amber	Green	Green	Green	Green
	Long	Red	Amber	Red	Red	Green	Green	Green	Red
Expected change	Allocation	↓	↓	↓	↓	↑	↑		

Over the next 10 years, the Scheme is expected to de-risk its investment strategy materially and hold lower allocations to Growth with higher allocations to the Buy & Maintain investment grade credit mandate, gilts and other contractual assets. In the longer term (15-20 years), the Scheme is expected to transact a buyout, which will transfer the transition and physical risks inherent in the Scheme's assets and liabilities to an insurer, and at that point in time removes in full any further risks associated with the Sponsor.

As highlighted in the table above, the most significant assessed impacts of CRRO on the Scheme's funding strategy are to future investment returns. For this reason we make prudent assumptions regarding future investment returns in our funding strategy. This in turn has the impact of tilting the balance from investment returns towards employer contributions in our funding strategy.

Another potential CRRO impact in the longer term is a change in life expectancy. There is currently considerable uncertainty regarding the long-term impact of climate change on life expectancy for UK citizens. However this

is assessed as a less significant risk to the Scheme than the risk to investment returns since many of the predicted impacts may be negative to life expectancy (e.g. extreme weather, poor air quality, reduced food security) and therefore not a risk to the funding strategy.

3.3 Climate scenario analysis

3.3.1 Scenarios considered

Under the TCFD framework, the Trustee is required to carry out scenario analysis under at least 2 scenarios to identify the potential impact of climate change on the Scheme, and hence to understand the resilience of the Scheme’s strategy.

Our FM, Schroders Solutions, have partnered with Ortec Finance, a climate risk modelling specialist, to carry out this analysis on the Scheme’s investment strategy. The analysis undertaken by the Trustee considers the projection of the Scheme’s funding progression under three climate scenarios modelled are set out below:

Scenarios:	Failed Transition	Paris Orderly Transition	Paris Disorderly Transition
Paris Agreement outcome	Paris Agreement goals not met.	Paris Agreement goals met.	Paris Agreement goals met.
Global warming	Average global warming reaches 3.8 degrees Celsius by 2100, compared to pre-industrial levels.	Average global warming stabilises below 2 degrees Celsius above pre-industrial levels.	Average global warming stabilises below 2 degrees Celsius above pre-industrial levels.
Transition risks	<p>Limited transition impact:</p> <ul style="list-style-type: none"> Economies follow business-as-usual track continuing low carbon policies and technology trends No additional new policy measures 	<p>Large transition impact:</p> <ul style="list-style-type: none"> Ambitious low carbon policies High investment in low-carbon technologies Substitution away from fossil fuels to cleaner energy sources and biofuel 	<p>Large transition impact:</p> <ul style="list-style-type: none"> Ambitious low carbon policies High investment in low-carbon technologies Substitution away from fossil fuels to cleaner energy sources and biofuel
Physical risks	Severe physical impacts occur increasing over time as temperatures rise – both gradual physical changes such as agricultural and worker productivity, as well as more frequent and severe extreme weather events	Moderate physical impacts occur up to 1.5/2 degrees which are greater than today but still much less than under a Failed Transition	Moderate physical impacts occur up to 1.5/2 degrees which are greater than today but still much less than under a Failed Transition
Impact on GDP	Global GDP is significantly lower than the climate-uninformed scenario in 2100. US GDP expected to be 60% lower than the climate-uninformed scenario by 2100.	Global GDP is lower than the climate-uninformed scenario in 2100. US GDP expected to be 3% lower than the climate-uninformed scenario in 2040.	In the long term, Global GDP is slightly worse than in the Paris Orderly Scenario due to sentiment shock.
Financial market impacts	Markets price in physical risks up to 2050 by end of this decade. A second repricing occurs in the period 2036-2040 as investors factor in the	Transition is assumed to occur as smoothly as possible. Market pricing-in dynamics of transition & physical risks occur smoothed out over	Transition has disruptive effects on financial markets with repricing of assets followed by a sudden sentiment shock to the financial system in 2025.

severe physical risks post-2050. 2021-2025 period respectively.

Source: Ortec Finance

The analysis on the liabilities undertaken by the FM only considers the impact of financial assumptions on the liabilities. However this is considered a reasonable approach by the Scheme Actuary given that the impact of climate change on demographic assumptions is considered less material and may even be to the benefit rather than detriment of the Scheme’s funding strategy.

In order to understand the resilience of the funding strategy, the Trustees have also undertaken scenario analysis on the employer covenant with support of the Covenant adviser.

The analysis carried out by Cardano considered the covenant exposure to below three climate change scenarios which are broadly aligned to the scenarios used by Ortec Finance above:

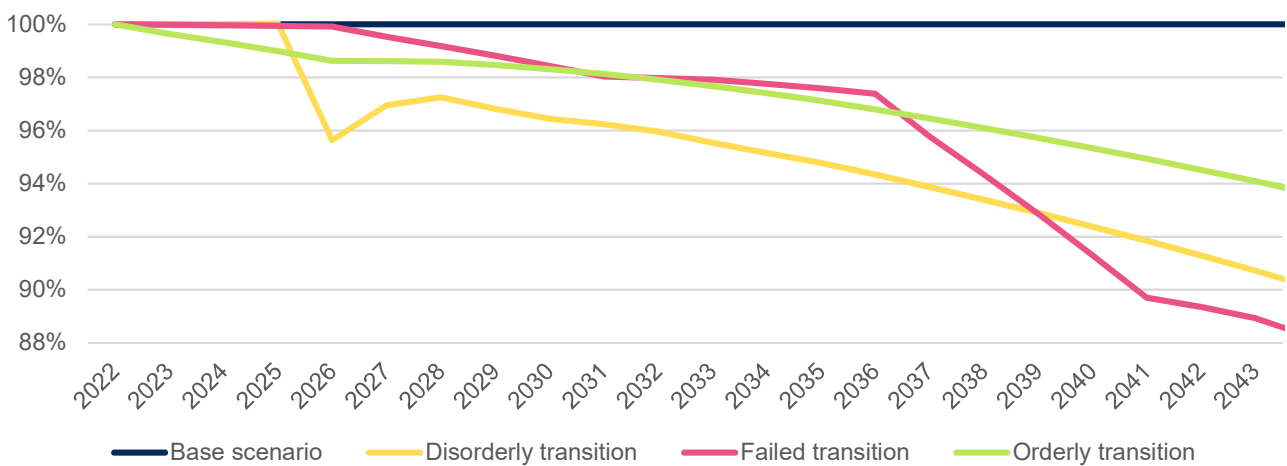
Selected scenarios	Orderly Transition 1.5°C scenario	Disorderly Transition 1.5°C scenario	Failed Transition 3-4°C scenario
Scenario outline	Global decarbonisation starts now , so policies intensify gradually but immediately. Large transition changes will happen quickly	The key difference between this scenario and Orderly transition is that financial markets react belatedly to the transition (assumed to be 2025)	No new transition policies above existing commitments lead to continued increase in GHG emissions and rise in global temperatures
Physical risks	Long-term physical risks are reduced but deviations from the present climate are still expected	Long-term physical risks are reduced but deviations from present climate still expected	More pronounced physical risks – particularly over the longer-term
Transition risks	Highest in the near-term as policies are implemented immediately	Highest in the near-term , but macro-risks delayed until medium-term	Limited transition risks over above existing commitments and policies
Macro-economic impact	Overall longer-term impact on GDP growth muted , with assumed long-term benefit from green tech investment offset by physical impacts	Compressed nature of financial market adaptation causes more abrupt market impacts	UK and global GDP growth permanently lower with that impact increasing over time. Macroeconomic uncertainty rises
Alignment with advisers	Aligned to Ortec’s Orderly Transition	Aligned to Ortec’s Disorderly Transition	Aligned to Ortec’s Failed Transition scenario

3.3.2 Results of scenario analysis

The three scenarios outlined above were run using Scheme-specific asset and liability information as at 31 March 2023. The result was a projected impact on the progression of the Scheme’s funding level compared to a baseline ‘climate uninformed’ scenario. This base scenario assumes the Scheme follows its projected journey plan and achieves its target investment return uniformly, with no impact from climate change. The other scenarios have been projected relative to this base scenario; therefore the funding deterioration experienced as a result of a climate change may in fact be a scenario where the funding position has improved in absolute terms, but has deteriorated relative to the scenario where climate risks had not had any impact.

Additionally, no de-risking has been allowed for in these projections and it is assumed that the Scheme’s current investment strategy will be retained indefinitely. The long-term evolution of the Scheme’s investment strategy is currently being reviewed by the Trustee, and it is expected this will be taken into consideration when carrying out this modelling in next year’s report.

Ratio of projected Funding Level relative to base scenario



Source: Schroders Solutions, Ortec Finance, 31 March 2023.

The key conclusions of the analysis on the assets/funding progression were:

- Over the long term, the Orderly Transition scenario provides the best outcome for the Scheme funding position and a Failed Transition the worst outcome.
- Given that the Trustee expects to buy out the Scheme’s liabilities with an insurer before 2040, the Failed Transition and Disorderly Transition Scenarios are approximately equivalent in detriment to funding position over that time horizon, with a Disorderly Transition having a more immediate impact on funding position.
- Over the short-term, the Disorderly Transition scenario has the least impact as governments and markets continue to function as they are.
 - Over the medium term, sudden impacts are felt as ambitious low-carbon policies are then implemented which has a material impact on GDP and asset class returns.
 - Over the longer term, there is some recovery as transition risks subside, although the overall impact on the funding progress remains worse than in an Orderly Transition scenario.
 - This poses a risk to the Scheme being able to buyout over this time horizon
- Under all scenarios, even Paris Orderly Transition, the impact from climate change is detrimental to the Scheme.
- The Trustee intends to de-risk materially over time, which will mitigate some of the longer-term impacts of climate change on the funding level, although the Trustee acknowledges that the Scheme may not be in a position to have de-risked meaningfully before the impacts of a Disorderly Transition are expected to begin feeding through to the funding position.
- The impact of climate change on mortality experience and expectations has not been accounted for in this modelling as this is considered likely to be of secondary importance and climate change may act to slow down currently assumed life expectancy improvements, which would support the Scheme’s funding strategy.

3.3.3 Scenario analysis for the employer covenant

From the climate scenario analysis undertaken by Cardano, it has been concluded that climate change presents a relatively low risk to the employer covenant over the time horizon of the funding strategy, particularly given the Scheme’s funding position.

Assessed potential business risk over time

	Near-term <i>Up to 2025</i>	Mid-term <i>2025 to 2031</i>	Long-term <i>2031+</i>
Orderly	Medium risk	Medium risk	Medium risk
Disorderly	Lower risk	Medium risk	Medium risk
Failed	Lower risk	Lower risk	Higher risk

Transmission channel exposure in Failed Transition scenario



In the near-term, transition risk relates to the Group’s direct emissions but the cost to potentially offset these does not appear to represent a material risk to Leonardo.

Over the mid-term, the main risk driver relates primarily to increasing cost of commodities and the risks associated with its scope 3 (supply chain) emissions in the Orderly and Disorderly transition scenarios.

Over the longer time horizon, the global operational and supply chain footprint represents material physical risk exposure to climatic events in a Failed transition scenario.

To address the risks detailed above, the Trustee has considered the recommendations from the covenant advisor in each of the following areas:

- Climate risks (e.g. global supply chain of underlying commodities, extreme weather events, renewable energy pricing, and carbon reduction targets etc.) will be integrated into the Trustee’s regular employer covenant monitoring framework, and;
- The Scheme’s long-term funding target should take account of climate risk, whether as part of necessary residual covenant support, should there be a delay in reaching buy-out (or alternative risk transfer solution).

3.3.4 Limitations

As with any model, there are some data and calculation limitations to be aware of:

- Asset projections are assumed to be in line with the current strategic allocation shown above. In reality this asset allocation will change over time and, in particular, the Trustee intends to de-risk the investment strategy over time which would limit the impact of climate change on the asset values.
- The 3 scenarios considered are medians from a range of possible outcomes.
- The data is modelled over very long time horizons and therefore the range of uncertainty around any projection is very wide.
- Modelling is done by asset class and does not allow for specific underlying holdings.
- Small changes to inputs can result in large changes at the output level.

4. Risk management

The Trustee has a risk management process for all risks, including climate risk. The Trustee recognises climate change as a material risk that could have real long-term impacts on the Scheme from a funding, investment and covenant perspective.

4.1 Process for identifying, assessing and managing climate-related risks

The Trustee incorporates ESG and Climate risk into the Scheme's integrated risk management framework in the following ways:

- **Training** – The Trustee has an annual ESG and Climate focused agenda item covering the investments. In addition supplementary training takes place through other advisors or attendance at industry events.
- **Advisers** – The Trustee reviews its adviser objectives to ensure they have appropriate climate capability, and bring important, relevant and timely-related issues to the Trustee's attention, including new and emerging climate-related risks.
- **Investment Strategy** – The Trustee has delegated the monitoring and management of climate-related risks to the ISC. This allows for more specialist knowledge to be built within the Trustee board and therefore for more effective oversight of ESG and Climate risk. The ISC undertakes the following processes:
 - The Trustee has been monitoring ESG and Climate risk for several years via the quarterly governance reporting received from the FM. These metrics highlight areas of key ESG or climate risk within the asset portfolio and are included in the 'Metrics and Targets' section of the report.
 - On an annual basis the Trustee undertakes climate scenario analysis to identify the potential impact of various climate scenarios on the funding position of the Scheme. This process also helps inform the potential impact of climate risks on the Scheme's liabilities.
 - On an annual basis, the ISC reviews the FM's annual ESG report detailing the specific actions being taken to integrate and manage climate risks within portfolio management, and reviews the FM's stewardship activities. Further detail on the Trustee's stewardship approach is detailed in the next section.
- **Covenant** - On a biannual basis the Trustee undertakes a review of the strength of the Sponsor covenant, during which the covenant advisor will monitor the highlight key climate risks identified above. The Trustee ensures any covenant advice received adequately incorporates climate-related risk factors where they are relevant and material.
- **Actuarial** – As part of the triennial actuarial Valuation process, the Trustee ensures the funding advice provided considers the potential impact of climate-related risks.
- **Scheme documentation** – ESG and Climate risks are recorded in the Risk Register, Statement of Investment Principles and Integrated Risk Management policy. These documents are reviewed on a regular basis.

During the Scheme year, examples of risk-management activity included:

- As part of their governance processes for identifying and managing climate risks, the Trustee wrote to all key Scheme advisers setting out their approach to integrating climate-related risks into their overall risk-management framework. This included a request that when undertaking scheme governance activities, or when advising or assisting the Trustee with respect to scheme governance activities, that the advisers take steps to identify, assess and manage any climate-related risks and opportunities which are relevant to the activities being undertaken.
- Selecting metrics and setting targets in relation to climate risks.
- Introducing monitoring of climate-related risk factors within the biannual covenant reporting.
- Dedicated training sessions on ESG and climate-related risks on an integrated basis across the areas of Scheme management.
- The Trustee identified three key priorities for voting and engagement.

4.2 Stewardship and engagement

The Trustee acknowledges the importance of voting and engagement with underlying companies and investment managers in order to manage climate risks. The Trustee has delegated responsibility for engagement with underlying managers (who also hold voting rights within equities) to the FM, but the Trustee reviews the stewardship policies and ESG integration approach of the FM from time to time to ensure they are aligned with the Trustee's priorities and beliefs.

The FM, Schroders Solutions, has set 'Climate' as one of its key engagement priorities for the coming years, which covers themes such as Greenhouse Gas Emissions, Net Zero, Physical Risks and Renewable Energies. Natural Capital and Biodiversity is also a key engagement priority and is relevant in the management of climate-risks given climate change and biodiversity loss are inter-linked.

The Trustee has also identified Climate Change, Human Rights and Corporate Governance as key priorities for voting and engagement.

The FM reports back to the Trustee on voting and engagement activity on an annual basis in the annual ESG report and the Implementation Statement (IS). The IS is publicly available for members to review examples of engagements with companies and underlying investment managers which took place on the Trustee's behalf during the year.

5. Metrics and Targets

5.1 Overview

Greenhouse gas (GHG)-related metrics and targets play a key role in measuring exposure to climate risk and progress being made towards reducing these risks. The Trustee has agreed on the following 4 metrics which are produced and recorded on a Scheme-specific basis annually:

Metric	Description	Unit of measurement
Total GHG emissions (Absolute emissions)	Absolute greenhouse gas emissions associated with a portfolio for Scope 1, 2 and 3 emissions	Tons of CO ₂ e
Carbon footprint (Emissions intensity)	Total carbon emissions for a portfolio normalised by the market value of the portfolio	Tons of CO ₂ e / \$M invested
Data coverage (Additional climate metric)	Proportion of portfolio for which data is available	%
Implied Temperature Rise (Portfolio alignment metric)	A forward-looking metric which translates the projected GHG emissions of the portfolio into an equivalent average global temperature rise which can be compared to the Paris Agreement Goal of keeping warming this century to well below 2°C	°C

The three classifications of GHG emissions are defined below:

- **Scope 1:** direct emissions from sources owned by a company (e.g. burning of fuel)
- **Scope 2:** indirect emissions from purchased energy (e.g. electricity used in company buildings)
- **Scope 3:** other indirect emissions that are produced across the whole supply chain of a company, both upstream (e.g. from suppliers) or downstream (e.g. from customers).

Scope 3 emissions are often the largest proportion of an organisation's emissions but they are also the hardest to measure due to the complexity and global nature of the supply chains. Scope 3 emissions have been shown to the extent the data is available but this should be considered alongside the data coverage statistics shown below. Where data is not available, no assumption has been made about the emissions of those assets.

In addition, at the current time, emissions data is currently extremely limited for certain asset classes including Alternative investments, Sovereign bonds and illiquid investments. The Trustees expect data coverage to improve over time and as industry-standard emissions methodologies for non-traditional asset classes are issued. However, this may mean that as data coverage improves, the Scheme's absolute emissions and carbon footprint may increase in the coming years due to additional data coming available, rather than due to a real-world increase in GHG emissions.

While data coverage is an industry-wide issue, the Trustee does engage with the FM to understand its actions to support its clients in this area including its own monitoring of climate-risks in managing the Scheme's assets. For example, regarding the LDI mandate which the FM manages in-house, Schroders Solutions have confirmed they are awaiting further guidance on the preferred methodology for measuring emissions of sovereign holdings from the Partnership for Carbon Accounting Financials (PCAF). The FM expects to be able to report emissions on the LDI mandate by the end of this year. In addition, the FM is a member of the UK's Investment Consultants Sustainability Working Group (ICSWG) which seeks to improve best practice in the industry and engages with investment managers' regarding their ESG reporting.

5.2 Metrics

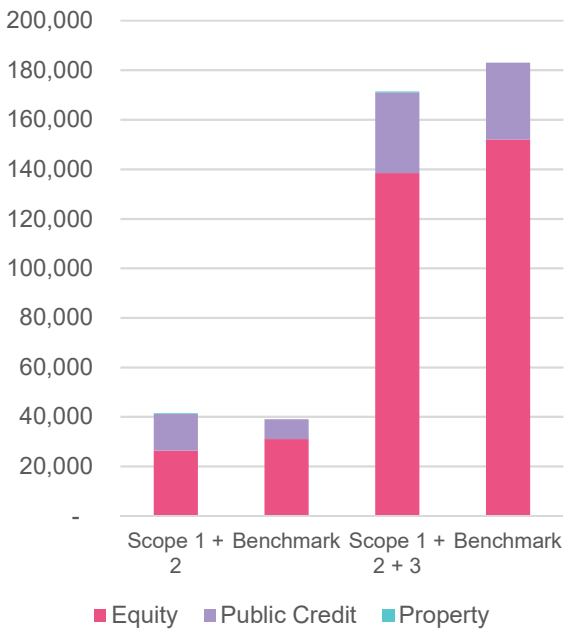
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The Trustee has worked with its FM to calculate the metrics as at 31 March 2023. The FM uses MSCI ESG Research in order to obtain data required for listed equity and credit holdings, with other asset classes requested directly from the underlying managers. These are summarised below.

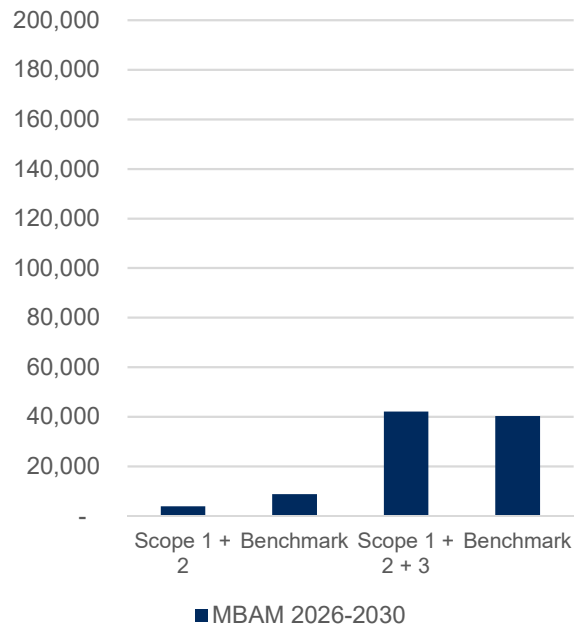
Please note that the Trustee is not currently able to publish this data for members due to MSCI licencing requirements. Accordingly some information is redacted below. The Trustee has reviewed the metrics and is satisfied that the portfolio is meeting expectations. It intends to publish an un-redacted version once this licencing requirement has been resolved.

Absolute Emissions (GHG emissions in metric tonnes)

Growth Portfolio

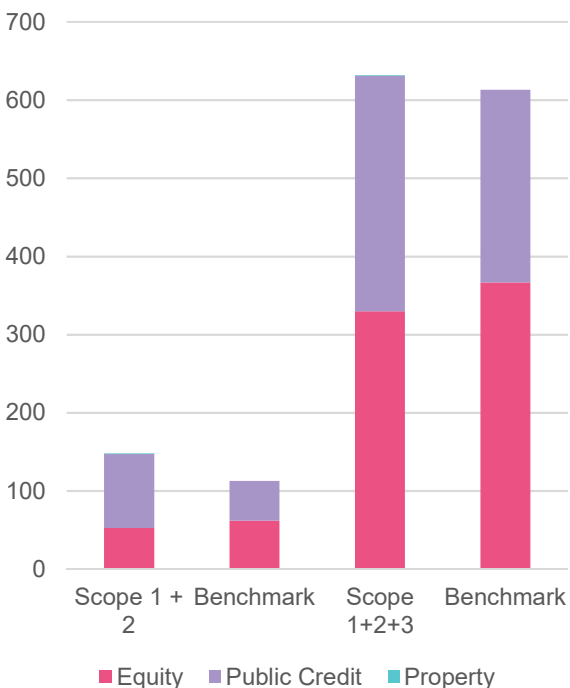


Buy & Maintain Credit

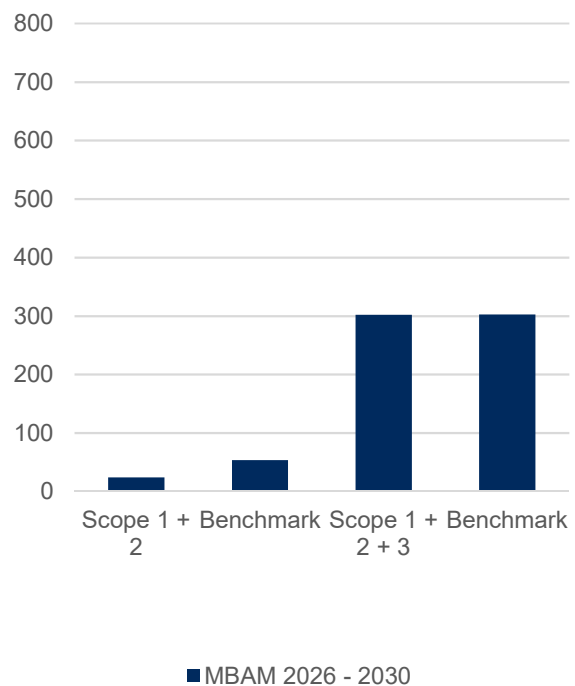


Carbon Footprint (GHG emissions in metric tonnes per \$m invested)

Growth Portfolio



Buy & Maintain Credit



GHG Emissions Data Coverage

		Portfolio	Benchmark
Scope 1+2	Equity	99%	99%
	Public Credit	58%	62%
	Property	85%	0%
	Total Growth	48%	40%
	Buy & Maintain Credit	69%	75%
Scope 1+2+3	Equity	73%	70%
	Public Credit	34%	42%
	Property	85%	0%
	Total Growth	37%	27%
	Buy & Maintain Credit	60%	60%

Implied Temperature Rise

Implied Temperature Rise (“ITR”) estimates the global temperature rise associated with the greenhouse gas emissions of a single entity or a group of entities, such as those in an investment portfolio, and is expressed as a numeric degree rating. It takes into account current GHG emissions and assumptions about expected future emissions, and translates this into a projected increase in global average temperature in the year 2100 relative above preindustrial levels. The ITR metric is expressed in a single temperature unit or range, such as 1.5°C or 2°C, that is comparable to widely understood potential climate outcomes.

At 31 March 2023 the Scheme’s ITR (based on growth assets, where data is available) was 2.68 degrees Celsius, versus a benchmark figure of 2.59 degrees Celsius.

Source: Schroders Solutions, MSCI ESG Research, 31 March 2023.

Carbon Footprint Scope 1+2 represents the company’s most recently reported or estimated Scope 1 + Scope 2 greenhouse gas emissions (if available). Scope 1 emissions are those from sources owned or controlled by the company, typically direct combustion of fuel as in a furnace or vehicle. Scope 2 emissions are those caused by the generation of electricity purchased by the company.

Carbon Footprint Scope 3 represents the company’s Scope 3 greenhouse gas emissions, as reported. Scope 3 emissions include an array of indirect emissions resulting from activities such as business travel, distribution of products by third parties, and downstream use of a company’s products (i.e. by customers). Most reports of Scope 3 emissions include only some portion of these.

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Benchmark figures above relate to the strategic central benchmark for the Growth Assets and a credit benchmark for the Buy & Maintain Credit.

A comparison of how these metrics have evolved within the Growth Assets over the past year is summarised below. Implied Temperature Rise is not included as this metric has only been monitored by the Trustee from 31 March 2023 onwards.

Metric	31 March 2022		31 March 2023	
	Scope 1+2	Scope 1+2+3	Scope 1+2	Scope 1+2+3
Total GHG emissions	27,638	149,596	41,489	171,351
Carbon footprint	167	644	148	632
Data coverage	45%	31%	48%	37%

Source: Schroders Solutions, MSCI ESG Research.

While absolute emissions have increased over the past year, the intensity metric (carbon footprint) has decreased, indicating that assets are now being invested in a less carbon-intensive manner. Additionally, there has been a significant increase in the level of data coverage, so it is likely that absolute emissions were as high or higher last year but were not being fully captured due to less data availability. Data coverage has improved as a result of increased engagement with underlying managers, including successful engagement with property managers for the first time.

5.3 Targets

The Trustee has set an overarching goal to achieve Net Zero carbon emissions on its portfolio by 2050. In order to measure progress against this goal most effectively, the Trustee has decided to set a target in relation to the forward looking metric shown above, Implied Temperature Rise. In doing this, it has decided to align with those targets set by the Scheme's FM, Schroders Solutions. Schroders' [Climate Transition Action Plan](#) details their net zero framework and timescales and targets in place as a firm.

Specifically, they have set science based targets to align Schroders' clients' investment portfolios (including FM clients) at an overall level to a 2.2°C pathway by 2030 and 1.5°C by 2040. This is consistent with a net zero emissions by 2050 goal. Schroders' targets have been formally validated by the Science Based Targets Initiative (SBTi).

Therefore, in line with this, the Trustee has set a long-term goal of achieving a 1.5°C portfolio by 2040 with an interim target of 2.2°C by 2030.

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