

Summary of Climate risk policy, Carbon measurement and Carbon reduction

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Approved by APG AM Investment Committee (APG AM IC)
Owner APG AM IC
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Change log			
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Summary of Climate risk policy, Carbon measurement and Carbon reduction

As a fiduciary manager for Dutch pension funds whose goal is to provide their beneficiaries with a good retirement income that they can enjoy in a sustainable world, all our investment processes are geared towards ensuring they can deliver on this objective. Our fully integrated Responsible Investment Approach encompasses a comprehensive approach towards making a material positive social, economic and environmental contribution in the real economy by investing responsibly for the long-term.

The specific and diverse characteristics of the portfolio of assets we invest in on behalf of our clients require a clear overarching but also a customized approach to integrating responsible investing objectives for each asset class. Thereby we can ensure that they all contribute to the fullest extent possible to the overall objective of the Responsible Investment Approach.

This document describes the APG AM Approach to climate risk, carbon measurement & carbon footprint reduction and how it is implemented, applied¹ and maintained.

Global climate change is one the greatest challenges of our time. As a long-term investor we are acutely aware of the exposure of companies to the risks and opportunities associated with climate change, and subsequently to our investment portfolio, either through the physical consequences of global warming and/or through changes in government policy, technology and markets aimed at reducing global warming. It is therefore critical that companies adequately assess and manage climate risks and opportunities as part of their business strategies and risk management. We engage and have continuous dialogues with companies to communicate our expectations and understand how they deal with climate risks and opportunities from a low-carbon transition and how these affect their ability to create sustainable value.

APG is committed to contribute to the goal of the Paris Climate Agreement to keep global warming limited to 1.5 °C. We aim for a Net Zero emissions portfolio by 2050 or sooner.

APG has made a number of commitments to substantiate our commitment to the goals of the Paris Climate Agreement:

- APG is a signatory to the Climate Commitment of the Financial Sector (hereafter: Climate Commitment)² – Requiring disclosure of financed emissions of ‘relevant’ investments, including formulating action plans to decrease the impact of investments on climate change;
- APG is a signatory to the Net Zero Asset Manager (NZAM) initiative³ – Which is a commitment to achieving Net Zero emissions by 2050, and requires setting interim targets commensurate to the attainment of a Net Zero portfolio in 2050;

¹ We aim to apply the APG AM Climate Risk Policy progressively to all assets under management, methodological approaches permitting.

² <https://klimaatcommitment.nl/about/>

³ <https://www.netzeroassetmanagers.org/>

- APG is a supporter of the Task Force on Climate-related Financial Disclosures (TCFD)⁴ – A framework for enhanced climate-related corporate and investor disclosures.⁵

APG's overarching objectives regarding climate change are:

- to identify, assess, manage and disclose climate-related risks and opportunities in the portfolio;
- to take meaningful action to contribute to mitigating climate change in line with the commitments made by APG and its clients, and align the portfolio with the goals established in the Paris Climate Agreement – the climate targets established and instruments applied are described in detail in our Climate Action Plan⁶.

Principal Adverse Impacts

The Climate risk policy, Carbon measurement and Carbon reduction target consider a number of Principal Adverse Impacts (PAIs) as prescribed by SFDR, such as GHG emissions (PAI #1). Carbon footprint (PAI #2), GHG intensity of investee companies (PAI #3), Exposure to companies active in the fossil fuel sector (PAI #4), Energy consumption per high impact climate sector (PAI #6). GHG intensity of investee countries (PAI #15), and Exposure to energy-inefficient real estate assets (PAI #18).

In our annual principal adverse impacts (PAIs) statement, which can be found on the APG AM website, we provide further detail about the way we consider these PAIs by applying the Climate risk policy, Carbon measurement and the Carbon reduction target.

Climate Risk Policy

In 2019, APG AM adopted a formal climate risk policy and added climate risk to the risk taxonomy for investments overseen by the APG AM Risk Committee. The policy was approved by the Investment Committee of APG AM and entered into force on 1 January 2020.

The Climate Risk Policy describes the way APG AM defines, measures, manages and reports on climate-related risks and opportunities, both at the total client portfolio level as well as for specific investment strategies. It covers the entire investment process on behalf of our clients - from investment beliefs towards evaluation. Climate-related considerations are included in Strategic Asset Allocation, the mandating process, portfolio management, and in the Annual Mandate Review cycle. The implementation of the climate risk policy is dependent on the availability of tooling and measurements, and hence will evolve continuously.

Methodology and instruments

Measurement in Asset Liability Management (ALM) and Strategic Asset Allocation (SAA)

⁴ <https://www.fsb-tcfd.org/>

⁵ APG AM's annual TCFD report can be found on the APG AM website.

⁶ The APG Climate action plan can be found on the APG AM website.

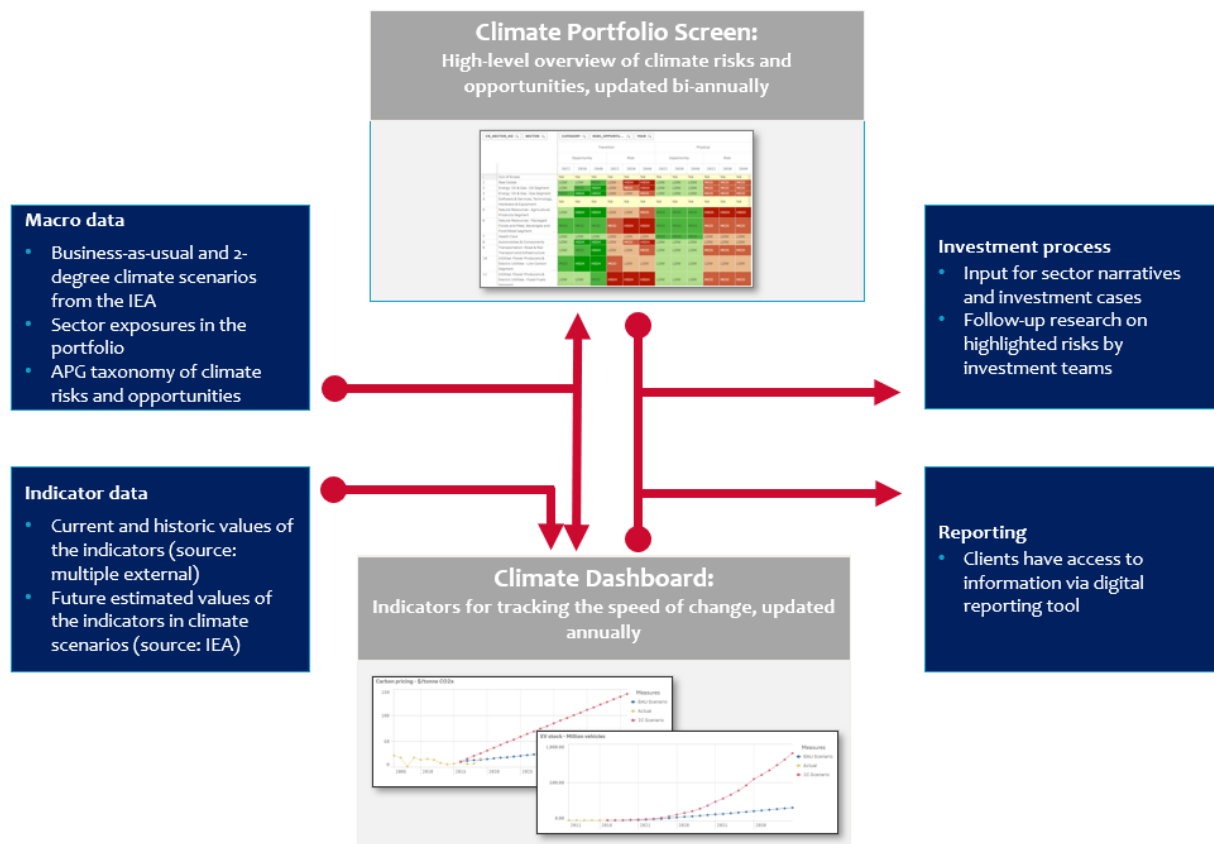
Deterministic climate scenarios are used in the periodic ALM studies performed for our clients with the aim of evaluating the sensitivity of client portfolios for these deterministic scenarios.

Climate stress tests are performed to evaluate the potential effects and implications for the Strategic Asset Allocation. Due to the multi-faceted and non-linear characteristics of climate risks, we do not apply a quantitative modelling approach. Instead, we use analogies based on situations in the past featuring physical destruction and heavy government intervention (e.g. natural disasters and wars). These analogous situations give us a rough sense of the range of possible impacts of climate change on asset classes.

Measurement at portfolio level

- Climate-related risks and opportunities are measured in the portfolio using the Climate Portfolio Screen (CPS). The CPS identifies sector-level climate risks and opportunities against external expert scenarios.
- We used a business-as-usual scenario (IEA Stated Policies Scenario, 3°C) and two climate scenarios with different levels of ambition (IEA Sustainable Development Scenario, 1.65°C, and IEA Net Zero Scenario, 1.5°C).
- Two external consultants have assessed climate risk of sectors evaluating the climate scenarios against the business-as-usual scenario using their proprietary methodology. The final APG AM sector ratings have been constructed by combining the ratings of both consultants, and calibrating them based on feedback of the APG investment teams.
- The results of the climate scenario analysis have been captured in the CPS, which creates insights into the most prominent climate-related risks and opportunities in 2025, 2030 and 2040. For each of the economic sectors, in each of the time horizons, the traffic light model depicts the assessed transition risk and opportunity as ‘high’, ‘moderate’ or ‘low’.
- A similar analysis has been done for sovereign bonds at country level. For each country we looked at physical risk (based on the Notre Dame GAIN database) and at transition risks (based on HSBC indicators). This resulted in a low-medium-high risk profiling of the sovereign bonds portfolios.
- Investments in areas with ‘high’ transition risk within the investment horizon, as indicated by the CPS, require further investigation into the nature of the risk/opportunity and the potential financial impacts by the investment teams.

The CPS is updated every two years in order to incorporate the latest developments in climate scenarios (last update was in 2021). On a more frequent basis, key signpost indicators and the overall speed of the low-carbon transition are tracked through the Climate Dashboard. As such, the Climate Dashboard provides an indication whether the world is leaning more towards a Business-as-Usual or a 2-degrees scenario, and it flags the areas in the portfolio where this may signal more immediate risks or opportunities.



Carbon footprint measurement

APG has been measuring the carbon footprint of the listed equity portfolio since 2013. Since then, carbon footprint measurement and disclosure has been expanded to other asset classes, including real estate, credits and private equity. We measure the carbon footprint on an annual basis.

APG aims to measure the carbon footprint of all relevant⁷ investments. We use the Global Standard developed by the Partnership for Carbon Accounting Financials (PCAF) as a basis⁸ for measuring the carbon footprint. In our Responsible Investment Report (pages 60-66) we report on the carbon footprint of APG’s investments, and provide a detailed explanation of how we measure the carbon footprint, including data sources used.

Carbon reduction target

APG aims to reduce the absolute carbon footprint of the listed equity and credit portfolios by 50 percent in 2030 (compared to 2019). The target considers direct and indirect emissions of a company’s own activities (scope 1 and 2). In line with our commitment to contribute to limiting global warming to

⁷ The APG AM Climate Action Plan lists the asset classes that are deemed to be relevant and that are in scope for phasing-in carbon footprint measurement.

⁸ In case no guidance from PCAF is available for a specific asset class, we use an equivalent definition and methodology. Please see the methodology document.

1.5 °C, we have used the 1.5 °C scenarios (with limited or no overshoot) developed by the International Panel on Climate Change (IPCC) and the International Energy Agency (IEA) to determine the reduction target for the listed equity and credits portfolios.

To achieve real world impact, we take a multi-pronged approach to reducing the carbon footprint of our portfolio through portfolio change (i.e. selling high-emitting companies in favor of low-emitting companies) and through emissions-reductions by portfolio companies. Therefore, a combination of the following instruments is applied to reduce the carbon footprint of our portfolio:

- Allocate carbon budgets per relevant investment strategy.
- Assess the investable (corporate) universe based on climate indicators.
- Perform stewardship activities, in particular engagement and voting.
- Invest in climate solutions.

The carbon footprint of applicable portfolios is calculated on a regular basis for the purpose of monitoring progress against the carbon reduction targets, and integrated into key portfolio management systems. Progress against the carbon reduction targets as established by APG's pension fund clients is monitored by the Investment Committee.

Governance of the Climate Risk Policy

The roles and responsibilities in relation to managing and controlling climate risks and opportunities are based on the "Three Lines of Defense" model.

The APG AM Climate Risk Policy has been approved by the APG AM Investment Committee (IC). The APG AM Climate Steering Group - which is composed of six Managing Directors (from Global Responsible Investment & Governance, Risk and Portfolio Management (4)) and chaired by the MD Global Responsible Investment & Governance (GRIG) - established the APG AM Climate Risk Policy. The Climate Steering Group is responsible for monitoring and ensuring coherence and continued development and oversees the implementation of APG AM's overall approach to climate-related risk management. In addition, the Climate Steering Group identifies, prioritizes and monitors research and development initiatives with respect to climate-related risk management and integration into the investment process.

The Global Responsible Investment (RI) & Governance team (part of portfolio management) is responsible for the development and maintenance of the overall APG AM RI framework at APG AM and acts as the secretariat of the APG AM Climate Steering Group. In this role, the RI team manages the implementation of the policy on a day-to-day basis and coordinates the periodic update and review of the climate risk policy. Initially the policy is reviewed on a yearly basis.

The IC, in its role as acting governing body of this policy, approves all RI related frameworks including the climate policy. In addition, the IC is overall responsible for the monitoring and managing of the risk and opportunity factors described in the policy over the full investment process and across the overall client portfolios. The AM Risk Committee will affirm the part of the APG AM climate risk policy related to the risk appetite when this can be explicitly defined and measured.

Portfolio Management (first line) is responsible and accountable for managing ESG risks and opportunities at the asset class level. Any applicable limits set as a result of this policy are managed by



PM and they report on a regular basis on climate-related risks and opportunities to the IC as governing body. Chief Financial Risk Officer/ Internal Risk Management is responsible for the second line measuring and monitoring of climate risk levels.

Fiduciary Management is responsible for advising clients on their mandates. They monitor and review the implementation of client policies and mandates in the portfolio, including climate risk.

Insight into impact on risk and return

APG AM is developing methods to assess the likely impacts of sustainability risks on the returns for its financial products and gain further insight into the impact of the various policy instruments, such as inclusion, exclusion, Sustainable Development Investments, and the Climate risk policy on the ability to meet risk and return targets. Our aim is to be able to measure and monitor any impacts on an ongoing basis, initially for liquid investments and extending it to other asset categories at a later stage.

Reporting

On an annual basis, APG AM reports on the APG AM website about climate-related risks and opportunities identified in the portfolio, the carbon footprint, and progress against climate targets.