



Department
for Work &
Pensions

Climate and investment reporting: setting expectations and empowering savers

Consultation on policy, regulations and guidance

October 2021

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Ministerial foreword

We are proud that DWP and UK occupational pensions schemes have been at the forefront of tackling climate change risk. The UK was the first country in the world to put into law recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). By the end of 2022, the climate change risk to £1.33 trillion of pension savings will be assessed and, in time, published for the benefit of savers.

We are committed to ensuring our department does all it can to support trustees to limit climate risk to their members and set out clearly how they are doing so. We signalled our intention to consult on a requirement for trustees to measure and report their schemes' alignment to the Paris Agreement. However, we were unable to include this measure in our original package as more work was needed to refine methodologies and ensure consistent, comparable, and robust reporting. This has now been completed. TCFD published updated guidance on 14 October recommending that financial institutions describe the Paris alignment of their activities.

We are therefore bringing forward proposals and draft amending regulations to require relevant trustees to measure - as far as they are able - and report on their investment portfolios' Paris alignment. Together with existing climate governance and disclosure requirements, this will help inform trustees' investment decisions, stewardship and voting. Our proposals reflect industry calls for methodological flexibility and trustees will be supported with updates to statutory guidance.

We understand we are asking a lot of occupational pensions schemes and wish to thank trustees for showing great leadership. We want to support trustees in their climate disclosures and hope we can count on the same constructive relationship with industry to help ensure these measures help trustees and savers.

To get the best possible outcomes for members, we must prioritise stewardship. Building on the recommendations of the Taskforce on Pension Scheme Voting Implementation, we are also consulting on new statutory and non-statutory guidance which seeks to provide the clarity trustees have requested around stewardship, including voting and engagement, as well as to lessen reporting burdens.

These proposals are intended to support pensions schemes to play their part in tackling climate change and protect their members' savings from environmental, social and governance risks.



Thérèse Coffey MP, Secretary of State for the Department of Work and Pensions and Guy Opperman MP, Minister for Pensions and Financial Inclusion

Introduction

This consultation seeks views on policy proposals to require trustees of larger occupational pension schemes, authorised master trusts and authorised schemes providing collective money purchase benefits to measure and report on the Paris alignment of their investment portfolios.

It is proposed that the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 are amended to require trustees subject to those Regulations, to calculate and disclose a portfolio alignment metric describing the extent to which their investments are aligned with the goal of limiting the increase in the global average temperature to 1.5°C above pre-industrial levels. This document therefore also consults on the draft Occupational Pension Schemes (Climate Change Governance and Reporting) (Amendment, Modification and Transitional Provision) Regulations 2022, and draft amendments to statutory guidance.

The consultation also seeks to address deficiencies in scheme governance in relation to stewardship and voting by proposing new draft guidance which sets out stewardship and ESG best practice in relation to the Statement of Investment Principles, and DWP's expectations across the Implementation Statement.

About this consultation

Who this consultation is aimed at

- pension scheme trustees and managers;
- pension scheme members and beneficiaries;
- pension scheme service providers, other industry bodies and professionals;
- civil society organisations; and
- any other interested stakeholders

Purpose of the consultation

This consultation seeks views on the policy proposals with regards to Paris alignment reporting, as well as the accompanying draft Regulations and the extent to which these achieve the stated policy intent. It also seeks views on new draft statutory guidance.

This consultation is intended to satisfy the Secretary of State's consultation duty under section 120(1) of the Pensions Act 1995.

The consultation also seeks views on draft non-statutory guidance explaining best practice in relation to the Statement of Investment Principles and draft statutory guidance explaining our expectations across the Implementation Statement.

Scope of consultation

This consultation applies to Great Britain. Occupational pensions are a devolved matter for Northern Ireland and it is envisaged that Northern Ireland will make corresponding provisions.

Duration of the consultation

The consultation period begins on 21 October 2021 and runs until 6 January 2022. Please ensure your response reaches us by that date as any replies received after that date may not be taken into account.

How to respond to this consultation

Please send your consultation responses by email to:

Anne Kennedy, Melanie Jarman, Emma Walmsley, Tom Rhodes, Mark Rogers and Vanessa Calvache

Climate Change and Responsible Investment Team

Email: pensions.governance@dwp.gov.uk

Government response

We will aim to publish the government response to the consultation on the [GOV.UK](https://www.gov.uk) website. Where consultation is linked to a statutory instrument, responses should be published before or at the same time as the instrument is laid.

How we consult – Consultation principles

This consultation is being conducted in line with the revised [Cabinet Office consultation principles](#) published in March 2018. These principles give clear guidance to government departments on conducting consultations.

Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator, 4th Floor, Caxton House, Tothill Street, London, SW1H 9NA

Email: caxtonhouse.legislation@dwp.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the

consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team:

Email: freedom-of-information-request@dwp.gov.uk

The Central Fol team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the [Freedom of Information Act](#).

Equality Act

Under the Equality Act 2010, public bodies have a duty to give due regard to the needs of people with 'protected characteristics'. The Equality Duty covers the protected characteristics of:

- Age;
- Disability;
- Gender reassignment;
- Pregnancy and maternity
- Race;
- Religion or belief;
- Sex;
- Sexual orientation; and
- Marriage and civil partnership – in respect of eliminating unlawful discrimination only

Paying 'due regard' means that, in our roles as policy makers, we are required to consciously think about the three aims of the Equality Duty:

- eliminate unlawful direct or indirect discrimination, harassment and victimisation and other conduct prohibited by the Act;
- advance equality of opportunity between people who share a protected characteristic and those who do not share it; and
- foster good relations between people who share a protected characteristic and those who do not share it.

Chapter 1: Measuring and reporting Paris alignment

1. This chapter sets out proposals to require schemes to calculate and report a metric setting out the extent to which their investments are aligned with the Paris Agreement goal of pursuing efforts to limit the global average temperature increase to 1.5°C above pre-industrial levels.
2. The background section gives a brief explanation of the Paris Agreement and the need for trustees to both assess the climate risks associated with the transition to a low carbon economy and communicate them clearly to their members. Additionally, it summarises the work carried out so far by the DWP, the Task Force on Climate-related Disclosures (TCFD) and the Financial Conduct Authority (FCA), in relation to measuring and reporting on portfolio alignment.
3. The remaining sections explain our policy proposals in detail before concluding with a summary of our proposals.

1.1 Background

Trustees' duty to consider climate risk

4. As set out in our August 2020 consultation *'Taking action on climate risk: improving climate governance and reporting by occupational pension scheme'*¹ climate change poses a material financial risk to pension schemes.
5. In order to ensure trustees were fully considering this risk and acting in the best interests of pension scheme beneficiaries, we subsequently embedded the recommendations of the TCFD into UK law by making the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021² ("the Climate Change Governance and Reporting Regulations").
6. The Regulations came into force on 1 October 2021, and impose requirements on trustees of larger occupational pension schemes, and all authorised schemes, for the identification, assessment and management of climate-related risks and opportunities. This includes requirements relating to governance, strategy and risk management, and requirements to select and calculate climate-related metrics and to set and measure performance against targets.

¹ [Taking action on climate risk: improving governance and reporting by occupational pension schemes \(publishing.service.gov.uk\)](https://publishing.service.gov.uk)

² [The Occupational Pension Schemes \(Climate Change Governance and Reporting\) Regulations 2021 \(legislation.gov.uk\)](https://legislation.gov.uk)

The Paris Agreement

7. In December 2015, 195 countries committed in the Paris Agreement³ to holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels (Article 2.1(a)). The Agreement also aims to make financial flows consistent with low Green House Gas (GHG) emissions and climate-resilient development (Article 2.1(c)). It states that in order to achieve the long-term temperature goal, the Parties aim to reach peaking of global GHG emissions as soon as possible, and to undertake rapid reductions thereafter in accordance with best available science (Article 4.1).
8. In order to meet the 1.5 degrees global warming goal in the Paris Agreement, global carbon emissions need to reach Net Zero in 2050⁴. This transition will lead to a fundamental transformation of the global economy, affecting all types of pension schemes regardless of their investment portfolios. UK pension schemes' investments are internationally diversified, with overseas investment being a key element of the investment strategy, especially in relation to equities⁵ and so are acutely affected by a global transition.

Portfolio alignment metrics and climate risk

9. Forward-looking metrics will be key to managing the risks associated with the transition to a low carbon economy, as they will help trustees understand how the companies they are invested in are placed to weather that transition.
10. They can also support trustees' target setting processes and inform stewardship and voting activities where they highlight particular investee companies whose businesses are not well-placed to benefit from the transition or who are exposed to particular risks.
11. With the evidence also suggesting that financial returns will suffer in higher warming scenarios, trustees may wish to consider whether concepts such as universal ownership⁶ should inform their approach to stewardship and voting.

³ The United Nations Framework Convention on Climate Change dealing with greenhouse-gas emissions mitigation, adaptation and finance signed in 2016 - <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>

⁴ <https://www.ipcc.ch/2018/10/08/summary-for-policymakers-of-ipcc-special-report-on-global-warming-of-1-5c-approved-by-governments/>

⁵ Estimates vary between 70 and 80% of quoted equity investments are invested overseas. See figure 7.5 of [The Purple Book 2020 \(ppf.co.uk\)](http://ppf.co.uk) [DB schemes] and figure 23 of [UK pension surveys: redevelopment and 2019 results](#) [direct holdings of equities across all schemes]

⁶ See for example Urwin, Roger, Pension Funds as Universal Owners: Opportunity Beckons and Leadership Calls (June 1, 2011). Rotman International Journal of Pension Management, Vol. 4, No. 1, pp. 26-33, 2011, Available at SSRN: <https://ssrn.com/abstract=1829271>

12. An increasing number of UK occupational pension schemes are recognising these risks through the voluntary adoption of Net Zero targets: approximately 85% of defined contribution (DC) pension savers are now in a scheme with a Net Zero target.⁷ More than 10 of the UK's largest defined benefit (DB) pension schemes have also set Net Zero targets, including the two largest - Universities Superannuation Scheme⁸ and the BT Pension Scheme.⁹
13. A number of schemes are also voluntarily signed up to the 'Net Zero Investment Framework',¹⁰ launched by the Institutional Investors Group on Climate Change (IIGCC) in March 2021. The Framework is designed to ensure that investment portfolios are aligned with Net Zero emissions.¹¹ Several other pension schemes have signed up to the Net Zero Asset Owners Alliance¹² which requires similar Net Zero commitments.
14. Irrespective of whether schemes have sought to align their portfolio with Net Zero, a portfolio alignment metric may be a valuable tool for both assessing and communicating a scheme's transition risk and for identifying and communicating the priorities for scheme engagement, voting or ultimately divestment by highlighting firms which are furthest from alignment with climate goals or which make the biggest contributions to climate change.

Member engagement

15. It is now well established that the majority of pensions scheme members care about climate change and the impact it will have on their savings, the environment and wider society. The Defined Contribution Investment Forum's 2020 survey¹³ on responsible investment found that 70% of members have now declared an interest in responsible investment up from 61% just two years earlier, with 73% declaring they feel strongly about environmental issues and 87% feeling businesses have wider societal responsibilities beyond making a profit.

⁷ DWP internal research based on public commitments made by schemes

⁸ https://www.uss.co.uk/news-and-views/latest-news/2021/04/05042021_uss-announces-net-zero-ambition

⁹ <https://www.btpensions.net/news/bt-pension-scheme-sets-2035-net-zero-goal-for-its-entire-55bn-portfolio>

¹⁰ https://www.parisalignedinvestment.org/media/2021/03/PAll-Net-Zero-Investment-Framework_Implementation-Guide.pdf

¹¹ The list of UK pension schemes and pension providers already known to be drawing on the Framework is: Avon Pension Fund, Brunel Pension Partnership, Church of England Pensions Board, Cornwall Pension Fund, Devon County Council Pension Fund, Environment Agency Pension Fund, Lloyds Banking Group Pensions Trustees Limited, National Grid UK Pension Scheme, Nest, Northern LGPS (the collective asset pool for the Greater Manchester, Merseyside and West Yorkshire local government pension scheme funds), Oxfordshire County Council Pension Fund, and Scottish Widows.

¹² <https://www.unepfi.org/net-zero-alliance/>

¹³ The Key to Unlocking Member Engagement, Defined Contribution Investment Forum.

https://dcif.co.uk/wp-content/uploads/2020/07/the_key_to_unlocking_member_engagement.pdf

16. We believe that Paris alignment reporting can facilitate this engagement further and has the potential to be a particularly powerful tool for communicating a scheme's progress in managing the transition to Net Zero to members. By providing a reasonably simple representation of a complex concept, portfolio alignment metrics can provide scheme members with a more straightforward way to understand the scheme's progress in becoming Paris aligned and potential exposure to transition risk.

Work carried out by the DWP

17. DWP first signalled its intention to consult on a portfolio alignment metric in August 2020 in the consultation that set out our intention to mandate TCFD-aligned disclosures¹⁴. At the time we deferred proposals to mandate this measure until methodologies were more standardised, given concerns that existed around the accuracy and decision usefulness of existing tools.
18. We were aware of a substantial amount of work being undertaken by the TCFD and the Portfolio Alignment Team (PAT)¹⁵ to review and assess these methodologies measuring portfolio alignment. We anticipated that this work would lead to a better understanding of the existing approaches and further developments in the sophistication of the tools available to trustees of pension schemes.
19. The TCFD's updated guidance¹⁶ has now, amongst other things, recommended that financial institutions should describe the extent to which their activities are aligned with a well-below 2°C scenario (i.e. with the goals of the Paris agreement).
20. We are therefore seeking to broadly align with the TCFD's updated guidance in this area, and codify such a requirement for UK occupational pension schemes, as we did when aligning trustee reporting with TCFD's 2017 recommendations. The TCFD's recommendations remain a key part of the UK Government's international focus and engagement ahead of the UN Climate Change Conference for COP26, which will take place in Glasgow in November 2021.
21. In developing these proposals for public consultation DWP have also conducted considerable informal engagement with a range of industry stakeholders.

¹⁴ [Taking action on climate risk: improving governance and reporting by occupational pension schemes \(publishing.service.gov.uk\)](#)

¹⁵ Formed by the UN special envoy for climate and finance, Mark Carney, to respond to growing investor and lender interest in measuring portfolios' relative alignment to the objectives of the Paris Agreement, and to advance industry efforts to promote widespread adoption of consistent, robust, and decision-useful approaches.

¹⁶ [2021-TCFD-Implementing_Guidance.pdf \(bbhub.io\)](#) – see page 41 for asset owners

Work carried out by the TCFD and PAT

22. In their 2019 status report¹⁷, the TCFD identified specific areas it intended to explore to support implementation of its disclosure recommendations (published in June 2017¹⁸). A particular area of focus was the TCFD's supplemental guidance¹⁹ for the financial sector, which encouraged asset managers and asset owners to disclose to their clients or beneficiaries, respectively, the metrics they use to assess climate-related risks and opportunities as well as other metrics they believe are useful for decision-making.
23. Citing an evolution of disclosure practices since 2017 - including the availability of new research, tools, and resources for assessing climate-related risks and opportunities and an increasing interest in forward-looking climate-related information to inform financial decision-making - the TCFD held a public consultation from October 2020 to January 2021²⁰ on decision-useful, forward-looking metrics to be disclosed by financial institutions.
24. The TCFD followed this up with a further public consultation which ran from 8 June 2021 to 18 July 2021 and proposed changes to their supplemental guidance on climate-related metrics, targets and transition plans.
25. Its proposals included recommending that asset owners "measure and disclose the alignment of their portfolios consistent with a 2°C or lower temperature pathway (e.g. Paris-aligned), and incorporate forward-looking alignment metrics into their target-setting frameworks and management processes." The consultation also included a TCFD-commissioned technical report produced by the PAT with best practice recommendations for measuring the alignment of portfolios with the Paris Agreement.
26. The updated TCFD supplemental guidance for asset owners now recommends that they describe the extent to which assets they own and their funds and investment strategies, where relevant, are aligned with a well below 2°C scenario, using whichever approach or metrics best suit their organizational context or capabilities. Asset owners should also indicate which asset classes are included.

Work carried out by the Financial Conduct Authority (FCA)

27. Government acknowledged in its TCFD Roadmap²¹ that increasing the flow and quality of data through the investment chain is vital to trustees being able to

¹⁷ [TCFD - 2019 Status Report](#)

¹⁸ Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017). <https://www.fsb-tcf.org/publications/final-recommendations-report/>

¹⁹ [TCFD - Implementing the Recommendations of the TCFD - June 2017](#)

²⁰ [TCFD: Forward-Looking Financial Metrics - Consultation](#)

²¹ [UK joint regulator and government TCFD Taskforce: Interim Report and Roadmap - Published 9 Nov 2020](#)

embed effective climate risk governance. This of course extends to trustees' ability to measure portfolio alignment against climate goals, for the purposes of such governance.

28. It is therefore significant that the Financial Conduct Authority (FCA)'s consultation on TCFD-aligned rules for asset managers²² between June and September 2021 proposed to update their rules²³ to require disclosure of portfolio alignment metrics by fund managers on a 'best efforts' basis. This reflects the fact that portfolio alignment metrics are less established, inherently forward-looking, and with the methodologies still evolving – but still likely to be decision-useful to clients and consumers.
29. Subject to the outcome of that consultation, the FCA has proposed that final rules will be published by the end of 2021 and come into force in 2022, which aligns with the timing of our own proposals for mandating the measurement and reporting of portfolio alignment (see paragraph 60).

1.2 Proposals on mandatory portfolio alignment measurement and reporting

A 4th Climate metric

30. Metrics and targets are a crucial step towards embedding the TCFD recommendations which provide a framework for trustees to consider, and manage, the risks and opportunities posed by climate change. This is reflected by the requirements in paragraphs 15-24 in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations, which came into force on October 1 2021.
31. As countries increasingly legislate for Net Zero, trustees will need to identify the risks and opportunities associated with the transition to a net zero economy. There is also a clear imperative to communicate to beneficiaries the extent to which their investments are aligned to climate change goals. Following the TCFD's recommendation that financial institutions describe the alignment of their portfolios, we propose that pension schemes report a portfolio alignment metric. We agree with the PAT technical report that, alongside purpose-built tools such as climate scenario analysis, portfolio alignment tools can be used for quantifying transition risks and supporting management and engagement decisions concerning emissions reductions,²⁴ including at an individual investment level.

²² [CP21/17: Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers](#)

²³ See Annex B – ESG 2.1.7.

²⁴ See recommendations 3 and 4 of the PAT Technical Supplement

32. Our proposed approach is to put the measurement and reporting of a portfolio alignment metric on a statutory footing, mandating it as a 4th metric to be included in schemes' TCFD Reports by amending the Climate Change Governance and Reporting Regulations and Statutory Guidance published alongside those Regulations. We are proposing that schemes be required to measure and report on portfolio alignment in addition to the existing requirements under those Regulations.
33. We are proposing that pursuing efforts to limit the global average temperature increase to 1.5°C above pre-industrial levels be the baseline that trustees must measure and report against when considering their degree of Paris alignment. This recognises, the global and economy-wide shift from focus on the Paris agreement's climate goal of holding the global average temperature increase to well below 2°C, to its 1.5°C goal (which requires net zero emissions by 2050). This shift reflects improvements in the scientific consensus around the impact of climate change, as set out in the IPCC's report on Global Warming of 1.5°C, and has seen the mobilisation of 733 cities, 31 regions, 3,067 businesses and 173 of the biggest investors under the Race to Zero campaign.

What measures will be permitted

34. The PAT's 'Measuring portfolio alignment: Technical Considerations' commissioned by the TCFD states that financial institutions should use whichever portfolio alignment tool best suits their institutional context and capabilities, describing 3 main types of portfolio alignment metrics. Our proposals adhere broadly to the PAT's descriptions as follows:
- **Binary target measurements:** This tool measures the alignment of a portfolio with a given climate outcome based on the percentage of investments or counterparties in that portfolio that (a) have declared net-zero/Paris-alignment targets and (b) are already net zero/Paris aligned.
 - **Benchmark divergence models:** These tools assess portfolio alignment by comparing the forecasted emissions performance of investments or counterparties in the portfolio against one or more benchmarks
 - **Implied temperature rise (ITR) models:** These tools translate an assessment of alignment/ misalignment with a benchmark into a measure of the consequences of that alignment/misalignment in the form of a temperature score.
35. During the consultation process the TCFD received criticism about a perceived favouring of the ITR model as a more robust metric, with several stakeholders citing its methodological opacity and potentially superficial results. Further, there is a potential for "model shopping" for metrics offering lower ITR scores. In our engagement with the COP26 Private Finance Hub and other stakeholders, all stressed the usefulness and validity of all three models. The final PAT report avoids promoting ITR over other models.

36. We are keen to provide trustees with complete methodological flexibility in our proposed measures given that the market has not yet coalesced around a single approach, and methodological standardisation is yet to emerge.
37. We do not seek to encourage the use of one portfolio alignment measure over another, nor do we necessarily agree that the tools sit on a spectrum of methodological sophistication with an automatic improvement from the binary measure through benchmark divergence to ITR.
38. Some have suggested that portfolio alignment metrics would drive specific investment decisions such as wholesale divestment from high-emitting assets, regardless of the extent to which they are showing genuine progress in their attempts to transition. We would disagree. Indeed, pension schemes are already reporting emissions and emissions intensity metrics which show that they are a long way from Net Zero. These arguments ignore the opportunity that trustees have to explain to beneficiaries the role of the engagement they, or others on their behalf, are undertaking with firms who are further from Net Zero.
39. In particular, high-emitting sectors need not be penalised by metrics which can compare a high-emitting asset to the relevant sector benchmark. This benchmark would define the specific rate of decarbonisation needing to be achieved by companies in the sector, recognising that the unique mix of technological options available to the sector may mean this rate may differ from that applicable to other sectors.
40. It is the Government's position that portfolio alignment metrics are tools to be used for measuring and communicating Paris alignment. It should be noted that Government continues to believe blanket divestment from certain assets is the wrong approach – engagement with high-carbon companies, when done effectively, can reduce the climate risk to which the scheme is exposed. Trustees retain complete primacy over any investment decisions they make as a result of this assessment and through their TCFD Reports can explain their rationale for those decisions.
41. Measuring the percentage of investments that have declared net zero/Paris-alignment targets provides a simple way to track net zero progress across a portfolio. Tracking this will be supported by free tools such as the Science Based Targets Initiative's Portfolio Coverage Tool for Financial Institutions. We hope that all UK investee companies will have declared net zero/Paris-alignment targets as quickly as possible.
42. As more organisations have declared net zero/Paris-alignment targets, it will also become increasingly important to measure the percentage of investments that have already reached net zero. Declared targets do not necessarily mean that entities are on track to meeting targets and not all targets will be of the same standard. Being on track to being net zero/Paris-aligned today is not the same as being already net zero/Paris-aligned today.
43. We understand that open source tools to measure the percentage of companies in a portfolio that are already net zero/Paris-aligned will be released by the UK Centre for Greening Finance & Investment (CGFI), and by 2 Degrees Investing

Initiative (2DII) through their Paris Agreement Capital Transition Assessment (PACTA) methodology and tool. CGFI will also establish a working group to support the development of these 'net zero today' tracking methodologies and tools for portfolios.

44. Open source tools are also available for benchmark divergence metrics (for example through PACTA) and implied temperature rise (SBTi's Temperature Scoring Tool for Financial Institutions is an open source example of this type of tool).
45. Our proposals allow trustees autonomy to select a portfolio alignment tool which reflects their specific circumstances, including their investment strategy and governance capacity. We believe that while no methodological standardisation between portfolio alignment metrics currently exists, this is the most appropriate approach.

Data availability

46. Improving the accessibility, coverage and quality of the underlying data required to effectively assess climate risk is undoubtedly a key challenge. It is a challenge which Government has acknowledged when consulting on our TCFD reporting proposals, and one which extends to measuring and reporting Paris alignment.
47. However, as we have made clear with our Climate Change Governance and Reporting Regulations, not having full data does not prevent schemes from taking steps now to start to assess their exposure to climate risk. Nor does it preclude building relevant capability to ensure that, as data disclosures improve, pension trustees can benefit immediately.
48. In relation to measuring Paris alignment specifically, concerns over the flow of data to trustees from their asset managers should be alleviated by the FCA's proposal to update their rules to require disclosure of portfolio alignment metrics by fund managers on a 'best efforts' basis.
49. Nevertheless, we recognise that it is currently the case that trustees might not be able to obtain the full underlying data necessary to measure the Paris alignment of their entire portfolio. The PAT readily acknowledge that at present only a small proportion of companies have disclosed decarbonisation targets, as well as comprehensive emissions data. They also highlight the disclosure discrepancy between public and private markets and other alternative asset classes which may have "non-transparent footprints."
50. Ascertaining companies' transition plans (or lack thereof) will be much easier in some assets (for example equities – especially listed equities - and corporate debt) than others (such as property or commodities). We have proposed amendments to the Statutory Guidance to explain the approach trustees should take when measuring their portfolio's Paris alignment, to account for these challenges.

51. To mitigate these challenges, trustees might decide to opt for portfolio metrics that are less complex in execution and less dependent on emissions data (eg, binary target measurement).

‘As far as they are able’

52. As with the existing metrics requirements in the Climate Change Governance and Reporting Regulations, the ‘as far as they are able’ principle²⁵ will address the anticipated data gaps faced when calculating a portfolio alignment metric.

53. By ‘as far as they are able’ we mean that trustees should request data from their asset managers and make reasonable and proportionate efforts to obtain the data. We do not propose that trustees should be expected to pay disproportionate sums for access to the data and nor do we anticipate they will have to. This principle is explained in more detail on pages 8-9 of the current Statutory Guidance.

Schemes already using a portfolio alignment metric as an additional metric

54. We acknowledge that, by virtue of their scheme year cycle, trustees already in scope of the Climate Change Governance and Reporting Regulations may choose to select a portfolio alignment metric as their additional climate change metric for the part of the scheme year that falls ahead of 1 October 2022. However, from 1 October 2022 onwards, trustees would need to select a further additional climate change metric to remain compliant with the Regulations, since under our proposals the portfolio alignment metric would fall into a separate category and would therefore no longer be regarded as an additional climate change metric for the purposes of the Regulations.

55. If, following this consultation, we proceed with the proposed changes to the Regulations we consider it would be appropriate for trustees of schemes who are faced with this scenario to undertake a review of their metrics in accordance with paragraph 16 of the Schedule to the Regulations. Due to the amendments which would be forthcoming, we expect trustees would naturally be led to determine (in accordance with paragraph 17 of the Schedule) that it is appropriate to select an alternative additional climate change metric to calculate alongside their chosen portfolio alignment metric.

Extending the range of additional climate metrics

56. In addition to setting out their methodological criteria for calculating portfolio alignment metrics, the TCFD have also updated their existing guidance to create

²⁵ See paragraph 25 of the Schedule to the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

a standalone Metrics, Targets, and Transition Planning document²⁶. This includes a range of new climate-related metrics:

- Carbon price(s) (external and shadow/internal);
- Proportion of assets and/or operating, investing, or financing activities materially exposed to physical risks, based on key categories of commonly accepted risks;
- Proportion of assets and/or operating, investing, or financing activities materially exposed to transition risks, based on key categories of commonly accepted risks;
- Proportion of assets and/or operating, investing, or financing activities aligned toward climate-related opportunities, based on key categories of commonly accepted opportunities;
- Amount of senior management remuneration impacted by climate considerations; and,
- Amount of expenditure or capital investment deployed toward climate risks and opportunities.

57. We are not proposing to mandate any other requirements in the TCFD guidance at the present time. However, paragraph 15(c) in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations requires that trustees must select a minimum of one other metric relating to climate change (“additional climate change metric”) to calculate for the scheme. The Statutory Guidance²⁷ for these Regulations states that trustees should select one or more of three listed additional climate change metrics – ‘data quality’, ‘climate VaR’ and ‘portfolio alignment’.

58. As our proposals around portfolio alignment would mandate that metric, we propose to update the Statutory Guidance to add the ‘Additional Climate Change Metrics’ listed in paragraph 56 and remove portfolio alignment. Through informal stakeholder engagement we are aware that some schemes are already using a portfolio alignment metric as their additional climate metric, therefore adding to this list will – as well as aligning with the TCFD guidance – give trustees a greater suite of metrics from which to select their additional climate change metric, beyond the remaining options of ‘data quality’ and ‘climate VaR’. Using the TCFD guidance as a guide we have sought to explain these new metrics for pension schemes in the draft amendments to the Statutory Guidance.

59. Trustees will retain the existing option to select an alternative additional climate change metric to the ones set out in the Statutory Guidance, but would be expected to explain why they have done so in their TCFD Report.

²⁶ [Task Force on Climate-related Financial Disclosures Guidance on Metrics, Targets, and Transition Plans](#)

²⁷ [Governance and reporting of climate change risk: guidance for trustees of occupational schemes \(publishing.service.gov.uk\)](#) – Pages 42-43.

Consultation Question

Q1. We propose to amend the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 to require trustees of schemes in scope to measure and report their scheme's Paris-alignment by adding a requirement for them to select and calculate a portfolio alignment metric and to report on that metric in their TCFD report.

Do you agree with this policy proposal?

1.3 Timing and Scope

Scope

60. We propose the new requirement will apply to all trustees who are subject to the Climate Change Governance and Reporting Regulations.

61. As explained during the consultation on those Regulations, trustees of these schemes can be expected to have the resources in place to allow them to implement and report on the range of governance and assessment measures set out in the TCFD recommendations to a high standard, with a high probability of overall benefit to both the members of defined contribution schemes and the members and employer sponsors of defined benefit schemes.

Timing

62. We are not proposing a phased rollout.

63. Instead, we propose that all trustees who are subject to the Climate Change Governance and Reporting Regulations must comply with the new requirements from 1st October 2022. This would include trustees of a trust scheme which has relevant assets equal to, or exceeding, £5 billion on the first scheme year end date which falls on or after 1st March 2020²⁸, trustees of a trust scheme which has relevant assets equal to or exceeding £1 billion on the first scheme year end date which falls on or after 1st March 2021²⁹ and trustees of all authorised master trusts and authorised collective defined contribution schemes³⁰.

²⁸ See regulation 3(1) of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

²⁹ See regulation 3(2) of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

³⁰ See regulations 4(1) and 5(1) of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

64. This decision is informed by a number of factors. Firstly, with the Climate Change Governance and Reporting Regulations having now come into force schemes should already be putting the necessary climate risk governance frameworks in place. Schemes will already be required to collect climate data as part of the requirements.
65. Secondly, the urgency of the threat climate change presents is well-documented and in particular the need to transition to a low carbon economy has been made all the starker by the findings presented in the UN's Intergovernmental Panel on Climate Change (IPCC) August 2021 report³¹. Forward-looking metrics will be key to investors robustly assessing and reporting their portfolios' alignment with climate goals, and may help address exposure to transition risk.
66. Thirdly, this will make it much more simple for trustees to understand what they are required to do, when they need to do it and when they need to report it.
67. We have given the schemes who would be in scope notice both by signalling our intentions to bring forward a policy on Paris alignment reporting in August 2020 and also by consulting on draft Regulations approximately a year before it is proposed the requirements would come into force. In addition, as with the existing metrics requirements, trustees would not need to report on their portfolio alignment metric until after the scheme year which is underway on 1 October 2022 has ended, because they must produce and publish their TCFD report within 7 months of the end of the scheme year³². Indeed, some schemes are already using portfolio alignment tools and others have already been considering it as their 'additional metric'.

Schemes already in scope

68. We are aware that the proposed coming to force date of this new requirement - 1 October 2022 – will be part-way through a scheme year for some trustees who are subject to the Climate Change Governance and Reporting Regulations ahead of that date (for example trustees of schemes with £5bn or more in relevant assets on their first scheme year end date to fall after on or after 1 March 2020, or master trusts authorised before 1 October 2022). To account for this, we propose that the requirement to select a portfolio alignment metric would apply in the part scheme-year that runs from the 1 October 2022. Trustees would also be required to calculate the metric in that part scheme year and in each scheme year thereafter in which the trustees are subject to Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations.
69. Therefore, trustees of all schemes in scope are subject to the requirement from 1 October 2022 and will have to report against the metric within 7 months of end of

³¹ 'Climate Change 2021: The Physical Science Basis' (Summary for Policymakers) [IPCC AR6 WGI SPM.pdf](#)

³² See regulation 6 of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulation s2021.

the scheme year which is underway on 1 October 2022. The alternative, of waiting for a full scheme year to be subject to the requirement, would result in some schemes with £1bn-£5bn in assets being required to report a portfolio warming measure earlier than schemes with £5bn+ in assets.

70. For TCFD reports relating to scheme years ending before 1 October 2022, there would be no requirement to report on a fourth metric on the basis that trustees would not have been required to select and calculate that metric.
71. We also propose to extend the existing easement in paragraph 21 of the Schedule to the Regulations. We propose that trustees who become subject to the portfolio alignment requirements partway through a scheme year will be able to rely on data obtained, calculations performed and identification and assessment of climate-related risks and opportunities undertaken in that same scheme year, but before 1 October 2022. For example, for a scheme with a scheme year running from 1 January to 31 December 2022, trustees would be able to rely on work between 1 January and 30 September 2022 in addition to any work done from 1 October 2022 to 31 December 2022. This is consistent with our previous policy when introducing the wider TCFD measures.

Falling out of scope

72. We propose that, as with the existing metrics requirements, the requirements to select and calculate a portfolio-alignment metric and to report on that metric would cease in accordance with regulations 3(5), 4(3), 4(5), 5(3) and 5(5) of the Climate Change Governance and Reporting Regulations. That means all climate change governance requirements – including those relating to the portfolio alignment metric - would cease to apply with effect from any subsequent scheme year end date on which the scheme has relevant assets of less than £500 million and, in the case of an authorised scheme, only if authorisation has ceased.
73. In summary, our proposed conditions in relation to falling out of scope is as below.

The condition	Portfolio Alignment requirement	Disclosure Requirements
<i>If</i>	<i>Trustees must calculate a portfolio alignment metric requirement</i>	<i>Trustees must publish the metric findings in a TCFD report</i>
On scheme year end date falling after 1 October 2022 The scheme has relevant assets <£500m and is not an authorised scheme.	End with immediate effect	Must be met within 7 months of the end of the scheme year [†]

<p>After 1 October 2022 the scheme ceases to be an authorised master trust</p> <p>Or</p> <p>ceases to be an authorised scheme providing collective money purchase benefits</p> <p>And</p> <p>Has relevant assets < £500m on either the scheme year end date immediately before authorisation ceased or on a subsequent scheme year end date</p>	<p>End with immediate effect</p>	<p>End with immediate effect where the relevant assets were < £500m on the last scheme year end date before authorisation ceased, but must otherwise be met within 7 months of the end of the scheme year[†]</p>
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[†] unless scheme's relevant assets are zero on the scheme year end date

Consultation Question

Q2. We propose that:

(a) trustees who are subject to the requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations on or after 1 October 2022 (including trustees to whom the requirements are re-applied in accordance with regulation 3(4), 4(4) or 5(4)) will be required to select, calculate and report on a portfolio-alignment metric and to publish the findings in their TCFD report within 7 months of the relevant scheme year end date in the same way as they are for other metrics. This will apply to:

- trustees of a trust scheme which had relevant assets equal to, or exceeding, £5 billion on their first scheme year end date which falls on or after 1st March 2020, and who remain subject to the requirements in Part 1 of the Schedule on 1 October 2022;
- trustees of a trust scheme which has relevant assets equal to, or exceeding, £1 billion on a scheme year end date which falls on or after 1st March 2021; and
- trustees of all authorised master trusts and authorised collective defined contribution schemes.

After 1 October 2022

(b) trustees will cease to be subject to the requirements to select, calculate and report on a portfolio alignment metric in accordance with regulations 3(4), 4(3), 4(5), 5(3) and 5(5) of the Climate Change Governance and Reporting Regulations, in the same way as they would be for other metrics:

- trustees of a scheme with relevant assets of less than £500m on a scheme year end date which falls after 1 October 2022 will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must still report on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless the relevant assets on the scheme year end date were zero;
- trustees of an authorised scheme which ceases to be authorised after 1 October 2022 (a “formerly authorised scheme”) and which had relevant assets of less than £500m on the scheme year end date immediately preceding the scheme year in which authorisation ceased, will cease to be subject to the requirements to select, calculate and report on a portfolio alignment metric with immediate effect;
- trustees of a formerly authorised scheme which has relevant assets of less than £500m on a scheme year end date after authorisation ceased, will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must still report on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless the relevant assets on the scheme year end date were zero.

Do you agree with these policy proposals?

1.4 Disclosure and Penalties

74. We made clear in our August 2020 consultation ‘Taking action on climate risk: improving governance and reporting by occupational pension schemes’ the significant merits of schemes disclosing their climate governance activities. It recognises the growing government, regulatory, industry and public interest in the sustainability and wider socio-economic value of investment practices.
75. Paris alignment reporting specifically has the potential to be particularly impactful when communicating a scheme’s progress in transitioning to Net Zero. This will be especially true as methodologies standardise, variability reduces and outcomes become more comparable. The market power of the largest pension schemes that would be subject to this new requirement, and the methodological transparency a requirement to report on Paris alignment will foster, could act as key drivers towards greater standardisation of methodologies and the input judgements that underpin them.
76. We therefore propose that calculating the portfolio alignment metric would form part of the governance activities that trustees who are subject to the Climate Change Governance and Reporting Regulations must undertake, and would be reported as part of the scheme’s TCFD report.

77. Consequently, Paris alignment measuring and reporting would be subject to the compliance regime set out under Part 3 of those Regulations and not to any separate enforcement provisions.
78. That means that in relation to mandatory and discretionary penalty notices issued, the penalty amount would be determined by TPR, but that the minimum fine they can issue for a mandatory penalty (for a failure to publish any report on a publicly available website, accessible free of charge) would be £2,500³³. Following our previous consultations, we concluded that this is proportionate when taking into account the scale of the risk posed to member outcomes by climate change, and when considering that the requirements will only fall on trustees of schemes with the largest governance resources.
79. The maximum fine for a penalty issued for the breach of any of the climate change governance and reporting requirements, which we propose to now apply to the portfolio alignment metric requirements, cannot exceed £5,000 for an individual trustee, or £50,000 in any other case³⁴.
80. High quality climate governance and disclosures by occupational pension schemes is a strategic priority for both DWP and TPR, and therefore there is a strong expectation that schemes seek to comply fully as soon the Paris alignment requirements are introduced.
81. Since, under our proposals, trustees would be required to include information about the portfolio alignment metric in their TCFD report, the requirements in the Register of Occupational and Personal Pension Schemes Regulations 2005³⁵ and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013³⁶ relating to TCFD reports would also apply, as would the trustee knowledge and understanding requirement which is prescribed in relation to the Climate Change Governance and Reporting Regulations³⁷.

Consultation Question

Q3. We propose to incorporate the requirements to measure and report a portfolio-alignment metric into the existing Climate Change Governance and Reporting Regulations so that the requirements are subject to the same disclosure and enforcement provisions as the other metrics requirements.

³³ See regulation 9(4)(b) of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021

³⁴ See regulation 9(4)(a) of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

³⁵ See regulation 3(1)(k) and (l).

³⁶ See Schedule 3, Part 5, paragraph 34A, schedule 4, paragraph 10, Schedule 5, Part 2, paragraph 6A and Schedule 6, Part 1, paragraph 5C.

³⁷ See the Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021, regulation 2.

1.5 Regulations and statutory guidance

Draft amendments and modifications to the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021

82. In our draft Occupational Pension Schemes (Climate Change Governance and Reporting) (Amendment) Regulations 2022, regulation 2(2)(a) would amend paragraph 15 of the schedule to the “Principal Regulations”³⁸ to require trustees to select a portfolio alignment metric in the first scheme year in which the requirements of Part 1 of the Schedule apply and any first scheme year of re-application³⁹.
83. Regulation 2(2)(b) would insert new paragraph 19A into the Schedule to the Principal Regulations. Paragraph 19A(a) would require that trustees must in each scheme year, as far as they are able, obtain the data required to calculate their selected portfolio alignment metric. Paragraph 19A(b) would require trustees to, as far as they are able, use the data obtained to calculate that metric in relation to the scheme’s assets. Paragraph 19A(c) would require trustees to, as far as they are able, use the portfolio alignment metric they have calculated to identify and assess the climate-related risks and opportunities which are relevant to the scheme.
84. Regulation 2(2)(c) of the draft amending Regulations would amend paragraph 21 of the Schedule to the Principal Regulations to extend the easement in that paragraph to include the portfolio alignment metric. This would mean that where the first scheme year in which the requirements of Part 1 of the Schedule apply to trustees is a part scheme year, the trustees may rely on data obtained, metric calculations performed and climate-related risks and opportunities identified and assessed in that same scheme year, but before the date from which the requirements apply, for the purposes of complying with the portfolio alignment metric requirements. This would ensure that the portfolio alignment metric is treated in the same way as the other metrics which trustees are required to select and calculate.
85. Regulation 2(2)(d) of the draft amending Regulations would amend the definition of an “additional climate metric” so that a portfolio alignment metric could no

³⁸ This is defined in regulation 1(c) of the draft amending Regulations to mean the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

³⁹ See paragraph 26 of the Schedule to the Principal Regulations.

longer be selected as an additional climate change metric. It would also insert a separate definition of a portfolio alignment metric.

86. The definition is as follows:

“portfolio alignment metric” means a metric which gives the alignment of the scheme’s assets with the climate change goal of limiting the increase in the global average temperature to 1.5 degrees Celsius above pre-industrial levels.

87. Regulation 2(3) of the draft amending Regulations would amend paragraph 27(n) in Part 2 of the Schedule to the Principal Regulations to require trustees to describe in their TCFD report the portfolio alignment metric they have calculated and, if the trustees have not been able to obtain data to calculate the metric for all of the assets of the scheme, to explain why this is the case.

88. Regulation 3(1) of the draft amending Regulations modifies the application of paragraphs 15 and 21 of the Schedule to the Principal Regulations in respect of trustees who, by virtue of regulation 3(1), 4(1) or 5(1) must comply with requirements in Part 1 of the Schedule before 1 October 2022, and who remain subject to the requirements on that date.

89. Regulation 3(2) is to address the issue which would arise with paragraph 15 in the Schedule to the Principal Regulations which requires trustees to select their metrics “in the first scheme year in respect of which the requirements of [Part 1 of the Schedule]” apply. For trustees who are already subject to those requirements on 1 October 2022, that first scheme year may have already passed. The effect of the modification in regulation 3(2) is therefore to provide that, for the purposes of the requirement to select a portfolio alignment metric, paragraph 15 is to be read as if the requirement were to select the portfolio alignment metric in “the scheme year which is underway on 1st October 2022”.

90. For the purposes of the portfolio alignment metric requirements which would be introduced by regulation 2(2)(b) and (c) of the draft amending Regulations, regulation 3(3) modifies paragraph 21 in the Schedule to the Principal Regulations so that it would be read as if it applies in relation to “the scheme year which is underway on 1st October 2022” – i.e. the first scheme year in which the portfolio alignment metric requirements will apply to the trustees. This would ensure that trustees to whom the requirements in Part 1 of the Schedule apply before 1 October 2022 can benefit from our proposal to extend the easement in paragraph 21 to include the portfolio alignment metric.

91. Regulation 4 of the draft amending Regulations is included to make clear that the requirement to include information about a portfolio alignment metric in the TCFD report – which would be introduced by the amendment made in regulation 2(3) – does not apply in respect of a scheme year which ends before 1 October 2022. This is to ensure that where trustees produce or publish a TCFD report after 1 October 2022, which relates to a scheme year that ended before that date, they are not required to report on a portfolio alignment metric.

Draft amendments to the Statutory Guidance

92. We propose to update the metrics section of the *‘Governance and reporting of climate change risk: guidance for trustees of occupational schemes’* in order to provide further clarity and support for trustees when complying with the requirement to measure and report their schemes’ Paris alignment. The proposed amendments set out further information and guidance in relation to trustees’ compliance with the proposed paragraphs 15(ba), 19A and amended 27(n) of the Schedule to the Regulations. This includes, amongst other information, guidance on:

- the types of portfolio alignment and additional climate metrics trustees should or could select, calculate and report;
- the level of granularity – portfolio, section, fund, asset class – at which the selected metrics should or may be calculated and reported
- the management and reporting of data gaps.

93. The excerpt of proposed new statutory guidance is published in draft alongside this consultation.

Consultation Question

Q4.

(a) Do you have any comments on the draft amendments to the Regulations?

(b) Do you have any comments on the draft amendments to the Statutory Guidance?

Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter.

We particularly welcome comments on the definition of “portfolio alignment metric” and whether respondents think it reflects the policy intent?

1.6 Review and Impacts

Review

94. Government has already committed to reviewing the effectiveness of the Climate Change Governance and Reporting Regulations and Statutory Guidance for schemes in scope, including the identification of any barriers, gaps and inconsistencies; assessing whether the Regulations remain appropriate; and whether or not they should be extended to smaller schemes.

95. An assessment of our Paris-alignment measures will therefore be included in that review, as will the additional climate metrics we propose adding to the Statutory Guidance.

Impacts

96. Trustees adhering to their fiduciary duty should already have effective systems of governance, strategy and risk management of all financially-material risks, including climate change.

97. The main activities driving costs of implementing the full TCFD requirements are the requirements on trustees to undertake Scenario Analysis activities and the production of Metrics & Targets¹.

98. Based on our research and informal engagement with industry stakeholders we do not anticipate that an additional requirement to measure portfolio alignment will add significantly to the annual ongoing costs to meet the existing requirement to produce and publish a TCFD report⁴⁰.

99. The unit costs for any of the available metrics are low because the portfolio alignment data is normally sold as part of a wider data package, which many of the consultant service providers have already bought to meet the TCFD requirements, and as a result, have access to anyway.

100. The anticipation is that costs will continue to be driven down with a lot of tools both available and in development that are non-commercial and open source. Free tools currently available that would meet the regulatory requirements include SBTi⁴¹ list of signatories, SBTi ITR calculations, TPI⁴² and PACTA⁴³.

101. However, we expect there would be some minor transition costs associated with trustees of schemes in scope familiarising themselves with the requirements, and accompanying amendments to small section of the statutory guidance.

Consultation Question

Q5. Do you have any comments on the new regulatory burdens to business and benefits of requiring schemes to measure and report their Paris alignment?

⁴⁰ These costs were assessed in our [‘Impact Assessment on Climate Change Risk – Governance and Disclosure \(TCFD\) Requirements’](#)

⁴¹ <https://sciencebasedtargets.org/>

⁴² <https://www.transitionpathwayinitiative.org/>

⁴³ [PACTA / Climate Scenario Analysis Program - 2DII \(2degrees-investing.org\)](#)

Protected groups and other comments

102. Government is required under the Equalities Act 2010 to have due regard to the needs of people with protected characteristics⁴⁴. As part of this consultation we are seeking any views and evidence of the impact of our proposals on protected groups and the protected characteristics of age and disability in particular – and how any negative effects may be mitigated.
103. In particular, we would welcome evidence on existing provisions made by trustees of occupational pension schemes in response to requests for information in alternative accessible formats, specifically in relation to the protected characteristics of age and disability.
104. We also welcome any other comments respondents may wish to offer about other proposals in this document which are not specifically consulted on elsewhere.

Consultation Question

Q6. Do you have

- a. any comments on the impact of our proposals on protected groups and/or how any negative effects may be mitigated?**
- b. any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats.**
- c. any other comments about any of our proposals?**

⁴⁴ Set out in section 4 of the Equality Act 2010.

Chapter 2: Stewardship and the Implementation Statement

2.1 Background and introduction

1. Stewardship – which includes shareholder voting and individual and collaborative engagement with issuers and asset managers – is a key tool by which pension scheme trustees can improve investment returns, by encouraging, developing, and supporting behaviours and practices that ensure long-term value for savers⁴⁵.
2. Nevertheless, it is widely misunderstood. Like environmental, social and governance (ESG) considerations a few years ago, some trustees believe that it is not a key part of their work, that they are unable to carry out any stewardship activity due to the way they invest, or do not believe that the cost and governance burden involved add material value. ESG considerations have not consistently permeated smaller schemes either – as recently as the first quarter of last year, only 43% of schemes in The Pensions Regulator’s Defined Contribution schemes survey took account of climate change in their investment strategies, although those that did accounted for 95% of pension scheme savers⁴⁶.
3. Government already requires trustees of pension schemes with 100 or more members to publicly state their policy on the exercise of the rights attaching to their scheme’s investments, and on undertaking engagement activities in respect of those investments. They must do this via the Statement of Investment Principles (SIP). Schemes subject to these requirements account for more than 99% of savers. Trustees are also required to report on how and the extent to which they have followed this policy and on their most significant votes, via an annual published Implementation Statement (IS).
4. In addition, defined contribution schemes – and hybrid schemes with a defined contribution section – must publish a wider IS covering how and the extent to which they have followed all of the policies set out in their SIP.
5. TPR have not published any guidance on expectations around the IS. Whilst interim guidance by trade bodies has been welcome, this has been produced independently of Government. Stakeholders have told us that a lack of clarity about expectations for inclusion or for target readership means that sometimes it

⁴⁵ The [FRC](#) defines stewardship as “the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society”. Although the definition of stewardship is quite broad, DWP’s draft Guidance focuses primarily on voting and engagement.

⁴⁶ [Defined Contribution trust-based pension schemes research summary \(thepensionsregulator.gov.uk\)](#)

has been difficult to avoid the IS becoming a tick-box exercise, rather than a positive tool for verifying and demonstrating trustees' actions.

6. Therefore, DWP has produced draft SIP and IS Guidance (see Annex 1), on which it is consulting. The specific objectives of that Guidance are covered in section 2.4 below, but it focuses particularly on the areas where existing policies and reporting are weakest – stewardship, and to a lesser extent consideration of financially material environmental, social and governance factors (including but not limited to climate change) and non-financial factors.

7. Accordingly, this chapter covers:

- Government's view on stewardship in relation to pension trustee duties;
- current challenges in UK pension stewardship;
- a consultation on draft Guidance to clarify Government expectations around the SIP and the IS, including but not limited to stewardship reporting.

8. The Department published a Call for Evidence in March 2021 to seek views on the effectiveness of occupational pension scheme trustees' current policies and practices in relation to social factors⁴⁷. DWP is analysing those responses with a view to issuing a Government response in 2022. Therefore, the draft Guidance we are consulting on here largely uses examples of environmental and governance issues.

2.2 Trustees' stewardship duties

2.2.1 Trustees' fiduciary duty and stewardship

9. The Pensions Climate Risk Industry Group (PCRIG)⁴⁸ sums up trustees' fiduciary duty as follows:

- exercising investment powers for their proper purpose – trustees must exercise their investment powers for the purposes for which they were given.
- taking account of material financial factors – trustees should always take into account any relevant matters which are financially material to their investment decision-making, whatever their source. This includes whether a particular factor is likely to contribute positively or negatively to anticipated returns, or will increase or reduce risk.
- acting in accordance with the 'prudent person' principle – trustee investment powers must be exercised with the care, skill and diligence that "a prudent

⁴⁷ [Consideration of social risks and opportunities by occupational pension schemes - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/consideration-of-social-risks-and-opportunities-by-occupational-pension-schemes)

⁴⁸ [Aligning your pension scheme with the TCFD recommendations - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/aligning-your-pension-scheme-with-the-tcfd-recommendations)

person would exercise when dealing with investments for someone else for whom they feel morally bound to provide”.

10. Research suggests that stewardship of firms by investors has the capacity to significantly enhance investment returns. A literature review by Kolbel et al⁴⁹ showed that shareholder engagement emerges as the most reliable empirically demonstrated mechanism for investors enhancing investment returns.
11. The authors assessed five empirical studies that analysed the extent to which companies comply with shareholder engagement requests.⁵⁰ Taking different approaches and relying on different data, each study reports the success rate of shareholder engagement requests as part of its analysis. The results show that while shareholder engagement requests do not always succeed, there is a reasonable probability that they do, ranging from 18% to 60% per cent.
12. Two papers – Barko et al., and Dyck et al – also found that shareholder proposals are associated with subsequent increases in the ESG ratings of targeted companies, providing evidence that shareholder engagement can lead to changes in company activities that are detectable in data. Whilst trustee duties are to manage investment opportunities and the risks to the benefits that beneficiaries are expecting to receive rather than to drive impact, such impacts can develop to be financially material to savers.
13. This body of research suggests that carrying out stewardship will:
 - assist in delivering on the purpose of the trust (the provision of pension benefits);
 - contribute positively to anticipated returns, and support the reduction of risk;
 - constitute a prudent course of action, as part of their scheme’s risk management framework.
14. Therefore, it is DWP’s view that stewardship is an integral way by which trustees can seek to improve investment returns, and therefore fulfil their fiduciary duty. It is for this reason that we made the development of a stewardship policy for occupational pension schemes mandatory, rather than optional, in our 2018 Regulations⁵¹.

⁴⁹ [Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact.](#)

Kölbel, Julian F., Florian Heeb, Falko Paetzold, and Timo Busch.

⁵⁰ Dimson E, Karakaş O, Li X. 2015. Active Ownership. *Review of Financial Studies* 28(12): 3225–3268, Hoepner A, Starks LT, Sautner Z, Zhou X, Oikonomou I. 2016. [ESG shareholder engagement and downside risk](#); Barko T, Cremers M, Renneboog L. 2017. [Shareholder Engagement on Environmental, Social, and Governance Performance](#); Dimson E, Karakaş O, Li X. 2018. [Coordinated Engagements](#); Dyck A, Lins KV, Roth L, Wagner HF. 2019. Do institutional investors drive corporate social responsibility? International evidence. *Journal of Financial Economics* 131(3): 693– 714

⁵¹ [The Occupational Pension Schemes \(Administration and Disclosure\) \(Amendment\) Regulations 2018.](#)

15. The law is clear that assets must be invested in scheme members' and beneficiaries' best interests. This is widely understood to be their financial best interests but the law is sufficiently flexible to allow other non-financial concerns to be taken into account, subject to a 2-stage test being met:⁵²

- Trustees should have good reason to think the scheme members would share the concern; and
- The decision should not involve a risk of significant financial detriment to the fund.

16. DWP's draft Guidance clarifies that trustees may want to consider both financial and non-financial matters in their stewardship activities. Non-financial matters can include members' and beneficiaries' ethical views, their views on social and environmental impact matters, and their present and future quality of life. The draft Guidance encourages trustees to explain how their stewardship policies are in scheme members' and beneficiaries' best interests in the SIP. The draft Guidance expects trustees to consider how engagement activities and voting behaviour is in members' and beneficiaries' best interests in the IS.

2.2.2 Existing stewardship requirements

Fig.1 reporting requirements and different expectations of DC or hybrid and DB only schemes.

Reporting requirements	Relevant Scheme (DC or hybrid)	DB only
A description of any review of the SIP during the period covered by the Statement, including an explanation of any changes to the SIP.	Y	X
Details of how and the extent to which, in the opinion of the trustees, the SIP has been followed during the scheme year.	Y	Y (in relation to voting and engagement only).
Description of voting behaviour (including "most significant" votes by, or on behalf of, the trustee) and details of a proxy voter during the scheme year.	Y	Y

17. The reporting requirements can be broken down further, both for all schemes in scope and especially for DC and Hybrid schemes, which must report on all aspects of the SIP.

⁵² [2018 Government consultation response](#), page 18, paragraph 28.

Corresponding regulations reference being reported on	The Implementation Statement Reporting Requirement
ALL SCHEMES IN SCOPE	
Disclosure regs, Schedule 3, para 30(1)(ca)(i) and (f)(i) ⁵³	Set out how, and the extent to which, in the opinion of the trustees, the policy on exercise of the rights and undertaking engagement activities has been followed during the scheme year.
Disclosure regs Schedule 3, para 30(1)(ca)(ii) and (f)(v)	Describe the voting behaviour by, or on behalf of, trustees (including the most significant votes cast by trustees or on their behalf) during the scheme year and state any use of the services of a proxy voter during that scheme year.
DC / HYBRID SCHEMES	
Investment regs ⁵⁴ Reg 2(1)-(2)	The SIP must be reviewed at least every 3 years and without delay after any significant change in investment policy. Before preparing or revising the SIP, trustees must consult with the employer and obtain written advice. Regulation 2 relates to <i>how</i> trustees produce the SIP, not the content of the SIP.
Disclosure regs Sch 3, para 30(1)(f)(i)	How and the extent to which, in the opinion of the trustees their policy for securing compliance with the requirements of section 36 of the Pensions Act 1995 (choosing investments) has been followed during the scheme year.
Disclosure regs Sch 3, para 30(1)(f)(i)	How and the extent to which in the opinion of the trustees, their policies in relation to: (i) the kinds of investments to be held; (ii) the balance between different kinds of investments; (iii) risks, including the ways in which risks are to be measured and managed; (iv) the expected return on investments; (v) the realisation of investments; have been followed during the scheme year.
Disclosure regs Sch 3, para 30(1)(f)(i)	How and the extent to which, in the opinion of the trustees, their policy in relation to financially material considerations over the appropriate time horizon of the investments, including how those considerations are taken into account in the selection, retention and realisation of investments has been followed during the scheme year.
Disclosure regs	How and the extent to which, in the opinion of the trustees, their policy in relation to the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments, has been

⁵³ [The Occupational and Personal Pension Schemes \(Disclosure of Information\) Regulations 2013 - S.I. 2013/2734.](#)

⁵⁴ [The Occupational Pension Schemes \(Investment\) Regulations 2005 – SI 2005/3378](#)

Sch 3, para 30(1)(f)(i)	followed during the scheme year.
Disclosure regs Sch 3, para 30(1)(f)(i)	How and the extent to which, in the opinion of the trustees, their policies in relation to: (i) how the arrangement with the asset manager incentivises them to align their investment strategy and decisions with the trustees' policies; (ii) how arrangement incentivises asset manager to make decisions based on assessments about medium to long-term financial and non-financial performance of an issuer of debt or equity and to engage with issuers to improve their performance in the medium to longer term; (iii) how the method (and time horizon) of the evaluation of the asset manager's performance and the remuneration are in line with the trustees' policies; (iv) how trustees monitor portfolio turnover costs incurred by the asset manager, and how they define and monitor targeted portfolio turnover or turnover range; and (v) the duration of the arrangement with the asset manager have been followed during the scheme year.

2.3 Background to our proposals on stewardship

2.3.1 Challenges in UK pension stewardship

18. We are seeing increasing evidence of occupational pension schemes making asset allocation decisions and investment implementation decisions which take account of risks and opportunities, including environmental, social and governance (ESG) considerations.⁵⁵

19. To date, we have seen less action in relation to stewardship. Many SIPs make only high-level statements about delegating engagement and voting to asset managers, despite the Occupational Pension Schemes (Investment) Regulations 2005 (“the Investment Regulations”) also requiring the SIP to cover trustees’ policies in relation to engagement with the asset managers themselves⁵⁶ and how they monitor their performance against relevant matters. Market share of asset managers who are poorly rated by independent analysis on stewardship remains high⁵⁷. At the same time, managers are innovating to create climate-tilted and thematic funds. This suggests that trustees are choosing managers for their product offerings – and probably other features, such as price – and giving less weight to their stewardship record.

⁵⁵ [ESG funds defy havoc to ratchet huge inflows | Financial Times \(ft.com\)](#)

⁵⁶ The Occupational Pension Schemes (Investment) Regulations 2005, regulation 2(3)(c)(ii).

⁵⁷ Compare, for instance, ratings in [Share Action's point of no returns](#), and asset managers appointed to run large DC schemes – e.g. Annex of [Growing pains: master trusts beyond auto-enrolment](#) – asset managers rated D or E by Share Action feature particularly often.

20. Partly this is a consequence of the structural features of the market. The UK has a particularly fragmented pensions system, with 8,500 pension schemes accounting for the £1.8tn of assets in the UK market – something Government action elsewhere is seeking to address⁵⁸.
21. In addition, most asset managers have one “house” stewardship policy for pooled funds, which they require trustees to follow, irrespective of the product they are invested in⁵⁹. In effect, the asset manager’s voting and engagement is compulsorily bundled with their stock selection. Only a proxy voting service launched in February, by AMX and DWS⁶⁰, allows individual investors to execute votes in alignment with their voting policy in the pooled funds they invest in. Whilst some asset managers allow trustees to set their own voting policies in “segregated mandates” – dedicated funds where trustees are the only investors – these are more expensive, and for many schemes would require other costly infrastructural changes, such as moving off platform and investing directly.
22. Some commentators have suggested that trustees should accept the compulsory bundling of stock selection and stewardship and simply select managers whose stewardship and voting policies align with their own. However, research by the Association of Member-Nominated Trustees notes that many asset manager voting policies are vague and unambitious⁶¹. Whilst some asset managers have policies of supporting certain shareholder resolutions, few mainstream asset managers have a policy of actually requisitioning climate resolutions. Research by AMNT also shows that 20 major fund managers failed to even mention climate change in their voting policies⁶². Moreover, historic voting records are a regulatory requirement for managers, but these provide no explanation of how those managers will respond to future critical climate votes or resolutions relating to other ESG matters.
23. It is in this context that the Occupational Pensions Stewardship Council - which is scheme-led and independent of DWP – was launched in July 2021 to build trustee stewardship capability, strengthen the asset owner voice in their engagement with service providers, and develop best practice.
24. Additionally, in December 2020, the Minister for Pensions established a Taskforce on Pension Scheme Voting Implementation to look at solutions to voting system issues, to seek to increase the number of asset managers who are prepared to engage with their clients’ voting preferences, and to recommend

⁵⁸ See [Improving outcomes for members of defined contribution pension schemes](#) and [Future of the defined contribution pension market: the case for greater consolidation](#) for defined contribution. DWP also intends to bring forward proposals for defined benefit “superfund” consolidator schemes in due course.

⁵⁹ [Bringing shareholder voting into the 21st Century - The Association of Member Nominated Trustees \(amnt.org\)](#)

⁶⁰ [AMX and DWS develop new pooled funds service that allows pension schemes to express stewardship preferences | AMX \(theamx.com\)](#)

⁶¹ See [AMNT review into fund managers' voting policies and practices](#)

⁶² [AMNT-report-on-obstacles-to-trustee-voting-3-Nov-2020.pdf](#) p.11.

measures to ensure the convergence of asset managers' and trustees' voting policies.

25. We cover these in the following sections.

2.3.2 The Occupational Pensions Stewardship Council

26. The Occupational Pensions Stewardship Council, (“the OPSC”) was launched by the Department for Work and Pensions in July 2021.⁶³ The Council comes out of Recommendation 16 of Investing with Purpose⁶⁴, a report published by HMT’s Asset Management Taskforce. The report recommended that a “dedicated council of UK pension schemes should be established to promote and facilitate high standards of stewardship of pension assets.”

27. Coordinated by DWP, in partnership with the Department for Levelling Up, Housing and Communities (DLUHC)⁶⁵ and supported by the Financial Reporting Council (FRC), the OPSC is open to all UK occupational pension schemes with the exception of master trusts sponsored by firms who sell asset management services to other schemes, the Local Government Pension Scheme (LGPS), pools and in-house investment teams. The OPSC is a collective forum for UK pension schemes to promote and facilitate high standards and shift the dial on stewardship.

28. When the Council launched in July 2021, 28 schemes – with a combined £550 billion in assets under management – signed up. Members range from very large schemes, including the BT Pension Scheme, to much smaller schemes for example, Cushon Master Trust⁶⁶. The Council is a forum for sharing experience, best practice and research on stewardship, and providing practical support. Since launch, the Council membership has expanded to 32 schemes, representing over £575 billion in assets under management.

29. Members of the Council are expected to progress work on stewardship within their organisation, including working towards future UK Stewardship Code signatory status and, once achieved, to take action aligned with the Code’s principles.

30. The Council creates a stronger overall voice of trustees and scheme managers within the market, especially in relation to service providers. The forum also provides opportunities for schemes to learn more about undertaking effective stewardship and to share knowledge and approaches with each other, collaborate on stewardship activities, and signpost to other collective engagement initiatives.

⁶³ [Occupational Pensions Stewardship Council - GOV.UK \(www.gov.uk\)](https://www.gov.uk)

⁶⁴ [Asset Management Taskforce_proof7.pdf \(theia.org\)](#)

⁶⁵ DLUHC is responsible for overseeing local government pension schemes (LGPS).

⁶⁶ BT Pensions has £57.2bn of assets and Cushon Master Trust has £0.3bn.

31. The Council Secretariat – provided by DWP – works closely with key regulators, including the authors of the UK Stewardship Code, the FRC, who have helped Council members understand how to report against the UK Stewardship Code.
32. One of the OPSC’s projects for 2021-22 is to streamline reporting processes. Members of the Council raised concerns that regulatory expectations around the IS could be clearer. DWP’s proposals in response to these concerns are covered in section 2.5.

2.3.3 Responding to the Taskforce on Pension Scheme Voting Implementation

DWP’s response to the recommendations

33. DWP has publicly welcomed the recommendations of the Taskforce⁶⁷. We address recommendations 1-7 in the consultation document, or in the draft Guidance we are consulting on. The draft Guidance encourages trustees to take ownership of voting policies (recommendation 1); take account of voting and engagement policies in their appointment and ongoing monitoring of investment managers (recommendation 4); and, report more effectively on how votes relating to their investments were cast (recommendation 5). The draft Guidance also provides examples of “good” voting policies (recommendation 7).
34. Recommendation 3 states that “DWP should publish guidance on the ability of trustees to set an expression of wish over their own voting policy in pooled funds”. We are broadly supportive of recommendation 3. We see no problem with trustees setting an expression of wish over their own voting policy in pooled funds, if that is what trustees wish to do, provided that in doing so they adhere to their fiduciary duty to act in the best interests of their members and subject to any relevant contractual arrangements with their fund manager.
35. On recommendation 6, the Investment Consultants Sustainability Working Group’s⁶⁸ engagement template has not yet been published in a final form, so our conclusion is that it would be premature to promote it either here or in draft Guidance. Nevertheless, we are supportive of measures which help trustees distinguish between different levels of engagement and their effectiveness, so we would welcome views.

Consultation Question

Q7. Should DWP include a vote reporting template in its implementation statement guidance which trustees are expected to use? If so, should such a template be based on the PLSA’s vote reporting template? What changes, if any, would be needed to the PLSA template if it were to be adopted?

⁶⁷ “Taskforce [tackles](#) pension scheme governance”, DWP 20 September 2021.

⁶⁸ [ICSWG-US Steering Committee](#)

What are your views on the adoption of an engagement reporting template? Should it be separate from any vote reporting template or integrated with it, so that – in relation to equities – both voting and engagement activities are described for the same set of assets?

2.4 Objectives of our proposals

36. The proposed Guidance aims to meet the following four objectives:

1	<p>Improve the quality of SIP policies:</p> <p>The Guidance aims to clarify DWP’s intention that boilerplate statements in the SIP (e.g. “we delegate ESG / voting / engagement to our asset managers”) are insufficient. In line with the Regulations, trustees need to explain what consideration they give to these matters. The proposed Guidance aims to encourage trustees to explain how the policies in the SIP are in savers’ interests.</p>
2	<p>Develop best practice for IS reporting:</p> <p>In the IS, trustees must report on how and the extent to which, in their opinion, the SIP was followed during the scheme year. The draft Guidance is intended to help trustees understand what good practice looks like in relation to reporting engagement activities, voting behavior and most significant votes</p>
3	<p>Clarify how schemes may use disclosures from other frameworks:</p> <p>The guidance aims to provide clarity around schemes using sections of other disclosures, e.g. UK Stewardship Code reporting. This will make the IS process more efficient for schemes to complete.</p>
4	<p>Improve consistency across schemes’ reporting and practice:</p> <p>For example, by clarifying what is meant by key terms such as “most significant vote”, indicating which information Government anticipates being most useful for members, and clarifying the target audience for the IS.</p>

2.5 Summary of our proposals

37. The proposed Guidance is intended to be a combination of Statutory Guidance and non-statutory Guidance. The draft Guidance relating to the SIP is intended as “best practice” and is not intended to be Statutory Guidance. The draft Guidance in relation to the IS, including “most significant votes” is proposed to be Statutory Guidance to which trustees must have regard.

2.5.1 Cross-cutting proposals

38. The draft Guidance explains DWP's intentions in relation to the SIP, and sets out expectations across the IS in relation to the audience and ownership. In addition, it indicates in relation to the IS that trustees may use information also used for other reports, such as the UK Stewardship Code disclosures, providing that the information meets the legislative requirements in relation to the IS.
39. **Audience** – As with other mandatory disclosures, there has been confusion amongst stakeholders about the target audience for the SIP and IS. In our draft Guidance we make clear that the IS should be presented in such a way that would allow a reasonably engaged and informed member and also The Pensions Regulator to be able to interpret and understand the trustees' disclosures, and raise concerns or queries where appropriate. In addition, the proposed Guidance on the SIP encourages trustees to take the same member-focused approach.
40. We referred in our June 2018 consultation to “a role for engaged scheme members to hold trustees accountable for the investment decisions made”⁶⁹. However, we also referred to other audiences including other schemes, commentators, researchers and civil society organisations. We are now making clear that, whilst it is possible to write statements in such a way that they are informative and useful for more than one audience, key audiences are engaged scheme members and the Regulator.
41. **Who owns the report** – many stakeholders have continued to tell us that the SIP and the IS are documents that are primarily owned and produced by their advisers. This should not be the case – the trustees have responsibility for both documents. Prior to preparing or revising a SIP, trustees must obtain and consider the written advice of a person reasonably believed to be qualified and to have the appropriate knowledge and experience of the management of the investments of such schemes. However, trustees own the policies and they do not need to obtain or consider the advice of an adviser in preparing their IS. Trustees may choose to do so, but it is their choice.
42. **In members' interests** - the Asset Management Taskforce's report “Investing with purpose”, which recommended the establishment of an Occupational Pensions Stewardship Council⁷⁰, also suggested that UK pension schemes should be required to explain how their stewardship policies and activities are in scheme members' best interests⁷¹. We broadly agree with this principle, and it is aligned with the audience proposals set out above. We encourage trustees to reflect on how the policies in the SIP are in members' best interests. We expect trustees to consider how the stewardship activities reported in the IS are in members' best interests.

⁶⁹ [Consultation on clarifying and strengthening trustees' investment duties \(publishing.service.gov.uk\)](#)

⁷⁰ [Asset Management Taskforce - Investing with purpose – recommendation 16](#)

⁷¹ Recommendation 15 of the same report.

43. **Use of other disclosures** – the streamlining disclosures working group of the Occupational Pensions Stewardship Council, chaired by David Russell of the Universities Superannuation Scheme, have highlighted the challenges for occupational pension schemes which have also signed up to voluntary disclosure initiatives including the UK Stewardship Code and the Principles for Responsible Investment (PRI). Whilst this affects a relatively small number of schemes at the moment, we do not wish to discourage schemes from signing up to either initiative. As reporting requirements under PRI are set to be reviewed in 2022 and 2023, we have focused on overlaps with the UK Stewardship Code and identified under each section of the draft guidance where our expectation is that material from Stewardship Code disclosures can usefully be included in the IS.

Consultation Question

Q8. Do you have any comments on our cross-cutting proposals for the Guidance on Statements of Investment Principles and Implementation Statements, in particular that:

(a) they are written for members?

(b) the Guidance reiterates that these are trustees' statements, not their consultants'?

(c) Implementation Statements should set out how the approach taken was in savers' interests?

(d) trustees should be able to include material from voluntary disclosures, such as Stewardship Code reporting, as long as they meet the requirements in the Regulations?

2.5.2 Stewardship: engagement and significant votes

44. **Regulation 2(3)(c) of the Investment Regulations**, requires the scheme's SIP to be in writing and cover policies relating to both the exercise of the rights (including voting rights) attaching to the investments; and undertaking monitoring and engagement with relevant persons about relevant matters.

45. "Relevant persons" includes (but is not limited to) companies, asset managers, and other investors. "Relevant matters" includes (but is not limited to) matters concerning an issuer of debt or equity⁷².

46. Under **paragraphs 30(1)(ca)(i) (for Defined Benefit schemes) and 30(1)(f)(i) (for Defined Contribution and Hybrid schemes) of Schedule 3 to the Occupational and Personal Pension Schemes (Disclosure of Information)**

⁷² This includes their performance, strategy, capital structure, management of actual or potential conflicts of interest, risks, social and environmental impact and corporate governance

Regulations 2013 (“the Disclosure Regulations”), the IS must set out how, and the extent to which these stewardship policies have been followed during the scheme year.

47. Additionally, the IS must describe, under paragraphs **30(1)(ca)(ii) (Defined Benefit schemes) and 30(1)(f)(v) (Defined Contribution and Hybrid schemes) of Schedule 3 to the Disclosure Regulations**, the voting behaviour by, or on behalf of, trustees (including the most significant votes cast by trustees or on their behalf) during the scheme year and state any use of services of a proxy voter during that year.

48. The Guidance is needed to clarify what DWP’s expectations are around stewardship policies and stewardship reporting, including significant votes.

Main points proposed in the draft Guidance

In respect of the SIP, we have produced draft non-statutory Guidance which encourages trustees to not simply report that they have delegated stewardship to their asset managers. Instead, trustees are encouraged to identify what the schemes’ stewardship priorities are and set out their own stewardship policy in relation to those priorities if they have one, or that of their managers if they do not. The stewardship policy must cover both voting and engagement⁷³.

The draft Guidance also explains that there are several ways trustees can remain proactive in relation to the scheme’s stewardship policy, in the context of pooled funds where it has traditionally been seen as more difficult for trustees to remain involved.

Data shows that a number of asset managers continue to abstain or vote against climate critical resolutions because of ongoing engagement with the company – there is a view that if the company is already engaging, then other engagement approaches like filing or supporting a shareholder resolution are unnecessary⁷⁴. The draft Guidance clarifies that effective engagement includes both individual and collaborative approaches.

The draft Guidance includes example summary-level voting policies in relation to certain topics.

In respect of the IS, the draft Statutory Guidance seeks to make clear:

- that trustees should report on how and the extent to which voting carried out on behalf of the scheme reflects the policies they have adopted;
- that where trustees have their own policy but voting is exercised on their behalf by another person, they should explain whether that person has agreed to follow it;

⁷³ The Occupational Pension Schemes (Investment) Regulations 2005, regulation 2(3)(c).

⁷⁴ [Voting-Matters-2020.pdf \(shareaction.org\)](#)

- that trustees must report all of the most significant votes within the IS itself, and should also report the considerations by which the trustees selected significant votes;
- how trustees should report when asset managers are unable to give them details of significant votes in time for the publication of the IS;
- that information on significant votes should be collected from any third party making voting decisions on the trustees' behalf (the PLSA's Vote Reporting template is one example of a template trustees may find useful);
- that the details of any proxy adviser should be disclosed.

Finally, for trustees who are signatories of the UK Stewardship Code, the draft Statutory Guidance identifies Stewardship Code reporting material which may usefully be included in the IS.

Consultation Question

Q9.

(a) Do you have any comments on our proposed Guidance on stewardship policies?

(b) Do you have any comments on our proposed Guidance on most significant votes?

2.5.3 Prior to preparing, reviewing and updating a SIP

49. **Regulation 2(1) and (2)** of the Investment Regulations requires trustees to review the SIP at least every three years and, before doing so, to obtain and consider the written advice of a person who is reasonably believed by the trustees to have the appropriate knowledge and experience of the management of the investments of such schemes, as well as – subject to certain exemptions - consulting the employer.

50. Under paragraph 30(1)(f)(ii)-(iv) of Schedule 3 to the Disclosure Regulations, trustees of DC and hybrid schemes are required to describe any such review undertaken during the scheme year, explain any change made to the SIP and the reason for it and give the date of the last review if no review took place within that scheme year.

Main points proposed in the draft Statutory Guidance

- The draft Statutory Guidance seeks to clarify that the information included in the IS to meet the obligations in paras 30(1)(f)(ii), (iii) and (iv) of Schedule 3 to the Disclosure Regulations is sufficient to describe the review that has taken place, including consultation with the employer and consideration of the written advice of a person with appropriate knowledge and experience. While trustees do need to state the extent to which the SIP and the policies set out within it have been

followed, no further explanation is required on the preparation and review of, and consultation on, the SIP under para 30(1)(f)(i) of Schedule 3.

- It sets out our expectation that only key headlines about the review and the changes which were made need be included in the IS.

Consultation Question

Q10. Do you have any comments on our proposed Statutory Guidance on the information to be included in the Implementation Statement with regard the requirements under the Disclosure Regulations, Schedule 3, paragraph 30(1)(f)(i)-(iv)?

2.5.4 Compliance with requirements on choosing investments

51. Section 36 of the Pensions Act 1995 sets out requirements that trustees must meet when choosing investments. This includes ensuring that proper advice is taken prior to investment.

52. **Regulation 2(3)(a)** of the Investment Regulations requires that trustees cover in the SIP their policy for securing compliance with these requirements.

53. Para 30(1)(f)(i) of Schedule 3 to the Disclosure Regulations requires the trustees of DC and hybrid schemes to explain in their IS how and the extent to which, in their opinion, the SIP has been followed during the scheme year, this includes the trustees' policy for securing compliance with the requirements imposed under section 36 of the 1995 Act on choosing investments. The draft Statutory Guidance sets out our proposals on how this obligation should be met.

Main points proposed in the draft Statutory Guidance

The draft Statutory Guidance seeks to clarify that:

- The IS should include a statement as to whether the investments were chosen in line with section 36 of the Pensions Act 1995.
- We would expect that for most schemes this would be an affirmation that investments were chosen in line with those requirements.
- Where this is not the case, trustees should state the reasons why and explain what action, if any, it is proposed to take or has already been taken to remedy the position.

Q11. Do you have any comments on our proposed Statutory Guidance on meeting the Implementation Statement requirements in the Disclosure Regulations relating to choosing investments?

2.5.4 Investment strategy

54. The requirement for trustees to cover in their SIP their policies relating to the kinds, balance, risk, expected return and realisation of investments is set out in **regulation 2(3)(b)(i) to (v)** of the Investment Regulations.

55. Trustees of DC and hybrid schemes are required by paragraph 30(1)(f)(i) of Schedule 3 to the Disclosure Regulations, to set out in their IS how and the extent to which, in their opinion, the SIP has been followed during the scheme year, this includes these policies.

Main points proposed in the draft Guidance

- The draft non-statutory Guidance on the SIP does not seek to set out the content of the SIP policies on balance, risk, return and realisation, but it does explain our expectation that substantive policies are provided and do not simply report delegation to asset managers.
- The draft Statutory Guidance on the IS sets out that trustees should state whether these policies have been adhered to and, where this is not the case, the reasons why, including explaining what action, if any, it is proposed to take or has already been taken to remedy the position. Trustees have to explain how the policies have been followed. Trustees are expected to explain the extent to which this is in members' interests.
- For trustees who are signatories of the Stewardship Code, the draft Statutory Guidance identifies Code reporting material which may usefully be included in the IS.

Consultation Question

Q12. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to investment strategy?

2.5.6 Financially material considerations (including ESG and climate change)

56. **Regulation 2(3)(b) (vi)** of the Investment Regulations requires that trustees set out their policy in relation to financially material considerations over the appropriate time horizon of the investments, including how those considerations are taken into account in the selection, retention and realisation of investments.

57. In the Regulations the definition of financially material considerations includes (but is not limited to) environmental, social and governance considerations (including but not limited to climate change), which the trustees of the trust scheme consider financially material.

58. Trustees of DC and hybrid schemes are required by paragraph 30(1)(f)(i) of Schedule 3 to the Disclosure Regulations, to set out in their IS how and the extent to which, in their opinion, the SIP has been followed during the scheme year, this includes these policies.

Main points proposed in the draft Guidance

- The draft non-statutory Guidance on the SIP sets out that processes should be in place for ESG issues to be integrated into trustees' investment decisions. This may include – for example – that tenders and mandates contain requirements to integrate ESG into investment decisions, minimum standards for tendering firms and trustee commitments on monitoring and reviews.
- The draft Statutory Guidance on the IS sets out that trustees should not report simply delegating all these matters to asset managers.
- The IS should explain any outcomes of work relating to ESG carried out by the trustees or others on their behalf. Trustees are expected to explain how this is in members' interests.
- For trustees who are signatories of the Stewardship Code, the draft Statutory Guidance identifies Code reporting material which may usefully be included in the IS.
- The Guidance will also suggest further engagement with asset managers to ensure the most complete information is available to members.

Consultation Question

Q13. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to financially material considerations (including ESG and climate change)?

2.5.7 Non-financial matters

59. **Regulation 2(3)(b)(vii)** of the Investment Regulations requires that the SIP must cover the trustees' policy on the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments. Non-financial matters means the views of the members and beneficiaries⁷⁵.

60. Trustees of DC and hybrid schemes are required by paragraph 30(1)(f)(i) of Schedule 3 to the Disclosure Regulations, to set out in their IS how and the extent to which, in their opinion, the SIP has been followed during the scheme year, this includes these policies.

Main points of Proposed Guidance

- For the SIP, the draft non-statutory Guidance sets out that trustees of defined contribution and hybrid schemes may find it helpful to have a mechanism by which members and beneficiaries of DC sections can express their view on investments made, including both self-select options and any default arrangements. Trustees are encouraged to explain how they consider member views.
- For the IS, the draft Statutory Guidance sets out that trustees should explain what actions – if any - they have taken as a result of views expressed by members and beneficiaries of defined contribution and hybrid schemes. Trustees are expected to explain how this is in the members' interest.
- For trustees who are signatories of the Stewardship Code, the draft Statutory Guidance identifies Code reporting material which may usefully be included in the IS.

Q14. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to non-financial matters?

2.5.8 Arrangements with asset managers

61. Under **regulation 2(3)(d)(i) -(v) of the Investment Regulations**, the SIP must include – on a “comply or explain basis” – the trustees' policies in relation to their arrangements with any asset manager, and how they: incentivise managers to align their investment strategy and decisions with the trustees' policies; and to make decisions based on medium to long term performance of issuers and to engage with those issuers.

62. It also requires trustees to set out: how the method (and time horizon) of asset manager performance evaluation and remuneration are in line with trustees' policies; how they monitor portfolio turnover costs incurred by asset managers,

⁷⁵ The views of members and beneficiaries include (but are not limited to) their ethical views and their views in relation to social and environmental impact and present and future quality of life of the members and other beneficiaries of the scheme – regulation 2(4) of the Investment Regulations.

and how they define and monitor targeted portfolio turnover or turnover range; and the duration of arrangements with asset managers.

63. Trustees of DC and Hybrid schemes must set out in the IS how and the extent to which, in their opinion, the SIP has been followed during the scheme year, this includes these policies (see paragraph 30(f)(i) of Schedule 3 to the Disclosure Regulations).

Main points proposed in the draft Guidance

The draft non-statutory Guidance explains that in their SIP trustees must explain:

- Any arrangements they have for incentivising the asset manager to align its investment strategy and decisions with the trustees' policies mentioned in regulation 2(2)(b) of the Investment Regulations – this can include monitoring and review, as well as financial incentives.
- How the trustees monitor transaction costs – and, if they have a targeted portfolio turnover, what that is.
- It also encourages trustees to explain any policies on retention and replacement of asset managers

In relation to the IS, the draft Statutory Guidance sets out that:

- Trustees should confirm whether they followed the policies set out in the SIP – if not, trustees should state the reasons why and explain what action, if any, it is proposed to take or has already been taken to remedy the position.
- Trustees should explain very briefly how - if at all - they have ensured the design and award of mandates include requirements to integrate stewardship and investment to align with the investment time horizons of clients and beneficiaries and how they have monitored asset managers to ensure that assets have been managed in line with their policies.
- For trustees who are signatories of the Stewardship Code, the draft Statutory Guidance identifies Code reporting material which may usefully be included in the IS.

The draft Statutory Guidance explains that trustees may also cover in their IS:

- any performance fees or other incentives paid to asset managers over the previous year, and a short description of what the managers did to achieve these.
- any target portfolio turnovers and whether these were achieved, including the portfolio turnover rate for the main sections of schemes and popular defaults, with

links to chair's statement for the costs of these arrangements.

- how long the current managers of main sections and popular defaults have been managing these sections.

Finally, trustees are expected to explain how these arrangements were in members' interests.

Consultation Question

Q15. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to arrangements with asset managers?

Annex: Summary of questions

Chapter 1 – Measuring and Reporting Paris Alignment

Q1. We propose to amend the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 to require trustees of schemes in scope to measure and report their scheme's Paris alignment by adding a requirement for them to select and calculate a portfolio alignment metric and to report on that metric in their TCFD report.

Do you agree with this policy proposal?

Q2. We propose that

(a) trustees who are subject to the requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations on or after 1 October 2022 (including trustees to whom the requirements are re-applied in accordance with regulation 3(4), 4(4) or 5(4)) will be required to select, calculate and report on a portfolio-alignment metric and to publish the findings in their TCFD report within 7 months of the relevant scheme year end date in the same way as they are for other metrics. This will apply to:

- trustees of a trust scheme which had relevant assets equal to, or exceeding, £5 billion on their first scheme year end date which falls on or after 1st March 2020, and who remain subject to the requirements in Part 1 of the Schedule on 1 October 2022;
- trustees of a trust scheme which has relevant assets equal to, or exceeding, £1 billion on a scheme year end date which falls on or after 1st March 2021; and
- trustees of all authorised master trusts and authorised collective defined contribution schemes.

After 1 October 2022

(b) trustees will cease to be subject to the requirements to select, calculate and report on a portfolio alignment metric in accordance with regulations 3(4), 4(3), 4(5), 5(3) and 5(5) of the Climate Change Governance and Reporting Regulations:

- trustees of a scheme with relevant assets of less than £500m on a scheme year end date which falls after 1 October 2022 will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must still report on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless the relevant assets on the scheme year end date were zero;
- trustees of an authorised scheme which ceases to be authorised after 1 October 2022 (a "formerly authorised scheme") and which had relevant assets of less than £500m on the scheme year end date immediately preceding the scheme year in

which authorisation ceased, will cease to be subject to the requirements to select, calculate and report on a portfolio alignment metric with immediate effect;

- trustees of a formerly authorised scheme which has relevant assets of less than £500m on a scheme year end date after authorisation ceased, will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must still report on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless the relevant assets on the scheme year end date were zero.

Do you agree with these policy proposals?

Q3. We propose to incorporate the requirements to measure and report a portfolio-alignment metric into the existing Climate Change Governance and Reporting Regulations so that the requirements are subject to the same disclosure and enforcement provisions as the other metrics requirements.

Do you agree with this policy proposal?

Q4. (a) Do you have any comments on the draft amendments to the Regulations?

(b) Do you have any comments on the draft amendments to the statutory guidance?

Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter.

We particularly welcome comments on the definition of a portfolio alignment metric and whether respondents think it reflects the policy intent?

Q5. Do you have any comments on the new regulatory burdens to business and benefits of requiring schemes to measure and report their Paris alignment?

Q6. Do you have

(a) any comments on the impact of our proposals on protected groups and/or how any negative effects may be mitigated?

(b) any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats?

(c) any other comments about any of our proposals?

Chapter 2 – Stewardship and the Implementation Statement

Q7. Should DWP include a vote reporting template in its implementation statement guidance which trustees are expected to use? If so, should such a template be based on the PLSA's vote reporting template? What changes, if any, would be needed to the PLSA template if it were to be adopted?

What are your views on the adoption of an engagement reporting template? Should it be separate from any vote reporting template or integrated with it, so that – in relation to equities – both voting and engagement activities are described for the same set of assets?

Q8. Do you have any comments on our cross-cutting proposals for the draft Guidance on Statements of Investment Principles and Implementation Statements, in particular that:

(a) they are written for members?

(b) these are trustees' statements, not their consultants'?

(c) Implementation Statements should set out how the approach taken was in savers' interests?

(d) trustees should be able to include material from voluntary disclosures, such as Stewardship Code reporting, as long as they meet the requirements in the Regulations?

Q9. (a) Do you have any comments on our proposed Guidance on stewardship policies?

(b) Do you have any comments on our proposed Guidance on significant votes?

Q10. Do you have any comments on our proposed Statutory Guidance on the information to be included in the Implementation Statement with regard the requirements under the Disclosure Regulations, Schedule 3, paragraph 30(f)(i)-(iv)?

Q11. Do you have any comments on our proposed Statutory Guidance on meeting the Implementation Statement requirements in the Disclosure Regulations relating to choosing investments?

Q12. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to investment strategy?

Q13. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to financially material considerations (including ESG and climate change)?

Q14. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to non-financial matters?

Q15. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to arrangements with asset managers?