ALIGNING YOUR PENSION SCHEME WITH THE TCFD RECOMMENDATIONS

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2 July 2020

A Guide for Trustees on Integrating Climate-related Risk Assessment and Management into Decision Making and Reporting – comments in response to your consultation

Pinsent Masons LLP

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Introduction

We are extremely supportive of this guide and what it is trying to achieve. It is essential, in our view, for trustees to engage with this issue.

For that reason, it is critical to make sure that the guide is written in a way that makes it easy for trustees to engage. In the case of an issue such as climate change, engagement is as much about winning hearts and minds as it is about making a case for compliance. And in practice it is the trustees and not just their advisers who need to be convinced. All trustee boards are conscious of costs and many are, rightly, very pro-active in their management of adviser fees. Professional advisers can find it very difficult, in practice, to raise ''new'' issues with trustees when trustee meetings are long on business and short on time and advisers are conscious of being perceived as creating work for themselves.

What follows are our thoughts on how the guide might be simplified to make it more accessible to trustees, especially those who are not well-versed in this area. As currently drafted, it is a long and, at times, confusing read even for those who are interested in this area. Note that, although the Quick Start guide is helpful, it would be preferable, in the interests of making things easier for trustees, not to have this separate guide and, instead, to revise the content in the summary boxes in the various chapters in place of the Quick Start guide. In general we think that the function of the summary boxes should be to draw attention to the key points that trustees need to understand – and which will make them feel that they need to read the rest of the chapter.

We recognise that a great deal of work and thought has gone into this guidance and we trust that these suggestions will be taken in the spirit in which they are intended – i.e. as constructive comments designed to ensure, as far as possible, that all trustees engage in this key issue.

We have prepared a separate PowerPoint document setting out the suggested commentary to be included in the summary boxes in Part I, to illustrate how these could be used. The PowerPoint document also includes a flowchart to help trustees understand the connections between the information in Chapters 5, 6 and 7.

At the end of this response, we also address the question of the extent to which the guide is relevant to all pension schemes (irrespective of size or type) and how trustees can adopt a proportionate approach to implementation.

PART I - Introduction

Chapter 1: How to use this guide

Suggested wording for the summary box is in the PowerPoint document

Beyond the text in the summary box, the only text needed in Chapter 1 is an explanation of why the framework is based on TCFD – i.e.

- TCFD represents the most widely-accepted standard for organisations to disclose the risks and opportunities presented by climate change
- large asset owners will be expected to comply with TCFD by 2022
- the recommended TCFD disclosures provide an appropriate framework within which all pension scheme trustees can assess the impact of climate change and how best to manage its risks

The summary tables at the end of each of the Chapters in Part II are self-explanatory, except for the references in the TCFD column in each of those tables. However, those references are not explained in Chapter 1 in any event. It would be better to delete the explanation of the summary tables from Chapter 1 and to make some amendments elsewhere in the guidance to cross refer to Appendix 1.

2. Introduction – Understanding climate change as a financial risk to pension schemes

There is no need to use the word ''Introduction'' in this heading.

See the PowerPoint for the suggested text for the summary box. The summary box should be used to draw out the key points from this chapter which illustrate that climate is a financial risk to pension schemes. This will help trustees to understand why they need to act.

3. The legal requirements on trustees to consider climate-related risks

See the PowerPoint for the suggested text for the summary box

4. The TCFD recommendations

See the PowerPoint for suggested wording for the summary box

In addition it would be helpful to explain more clearly what Appendix 1 is. We suggest amending the final sentence in paragraph 53 to read – *Appendix 1 sets out TCFD's guidance on how to comply with each of these recommended disclosures*''

PART II

This part of the guidance is about how trustees can integrate consideration of climate-related risks into what they do and, therefore, it would be helpful to demonstrate how the contents of the various chapters in this part are linked together. A flow chart, such as that at the end of the PowerPoint document, would be helpful at the beginning of Part II

5. Defining climate-related investment beliefs

The third bullet point in the summary box is not something that is expanded upon in Chapter 5. It would be helpful to explain this further in the main text, including why it is important from a governance point of view.

In the table at the end of the chapter, the entries in the TCFD column are confusing without further explanation. It would be clearer if the heading to the TCFD column were to read *''TCFD (see Appendix 1)* - and for this to be replicated in the tables in later chapters.

6. Considering climate-related risks in setting scheme investment strategy and manager selection, review and monitoring

It would be helpful to have a closer link between the contents of this Chapter and the recommended disclosures. We believe that it would help trustees navigate this chapter if the headings used in the Chapter were to reflect the main headings used in the table of actions and disclosures at the end of the Chapter.

We have not commented further on the drafting of individual chapters. The comments made up to this point should give enough of a flavour of our thoughts. Some more general comments follow.

Application of the guide to schemes of different types and sizes

Although there is no clear definition of what constitutes a large asset owner from a pension scheme perspective, the guide is relevant to all schemes (irrespective of size and type), given the Government's Green Strategy, Paris Agreement and proposed amendments to the Pension Schemes Bill. Climate change risk is a key risk for schemes to mitigate and one that is not going away.

It would be helpful for the guide to flag more clearly that trustees need to approach TCFD in a proportionate way depending on scheme size, budget, type of benefits provided and maturity of scheme. One way of doing this may be to include a table on suggested minimum steps for schemes, depending on size and type (e.g. over £1 billion / £250m+ / below £250m), so that trustees can easily see what is expected of them as a minimum and implement some targets and strategic goals in the short-term. It is preferable to give some clear parameters, rather than leave it to trustees to decide.

For example, there are several practical steps that all trustees (irrespective of the scheme) could implement now:

- Consider roles and responsibilities within the trustee board (and executive support/sub-committees) for climate-related issues – oversight and accountability
- Recognise difference in approach to active/passive mandates and different asset classes
- Consider how different investments and strategies could be affected by the transition to a low carbon, climate-resilient economy
- Require managers to perform and report back on climate scenario analysis on their holdings
- Review investment consultant objectives so that investment advisers assess climate-related performance of asset managers and funds and help trustees develop climate-related strategies that are aligned with trustees' investment beliefs on climate-related issues
- Consider adoption of an off-the-shelf voting policy (e.g. AMNT Red Lines)
- Clarify the trustees' position around balance between engagement, voting and divestment as appropriate risk management tools
- In terms of stewardship – where there is a manager delegated approach, review asset manager's stewardship policies in relation to climate-related issues

- For DB schemes, trustees need to take an integrated risk management approach to DB funding and investment and look at how climate-related risks around the employer covenant, funding and investment strategy may be linked and inter-dependent

And then there are some steps that may be more appropriate for larger schemes, or schemes with a more immature membership or return-seeking investment portfolio:

- Consider the extent to which trustees consider market prices reflect climate-related risks

- Assess quality of climate-related disclosure provided by managers against TCFD recommendations

- Require managers to undergo periodic climate-related assessments – e.g. carbon auditing or stranded assets

- Embed climate change risk across governance and internal control frameworks as part of an integrated risk management framework

- Use free tools such as the Transition Pathway Initiative and PACTA (the TPI tool allows pension schemes to review carbon management quality and carbon performance for key companies within high risk sectors)

- Ask asset managers or investment consultants for details of any climate scenario analysis they have carried out and actions taken

- Start to carry out high-level scenario planning in the following scenarios: orderly transition (2°C or lower); an abrupt transition (2°C or lower); and no transition, pathway to 4+°C scenario

- Start with qualitative scenarios and develop more quantitative analysis over time.

- Request data from asset managers on carbon footprinting, engagement and exposure to carbon-related assets

- Choose metrics for assessing climate change risk exposure and understand difference between outcome metrics and process metrics

Please contact Carolyn Saunders (carolyn.saunders@pinsentmasons.com) if you have any questions about this response.