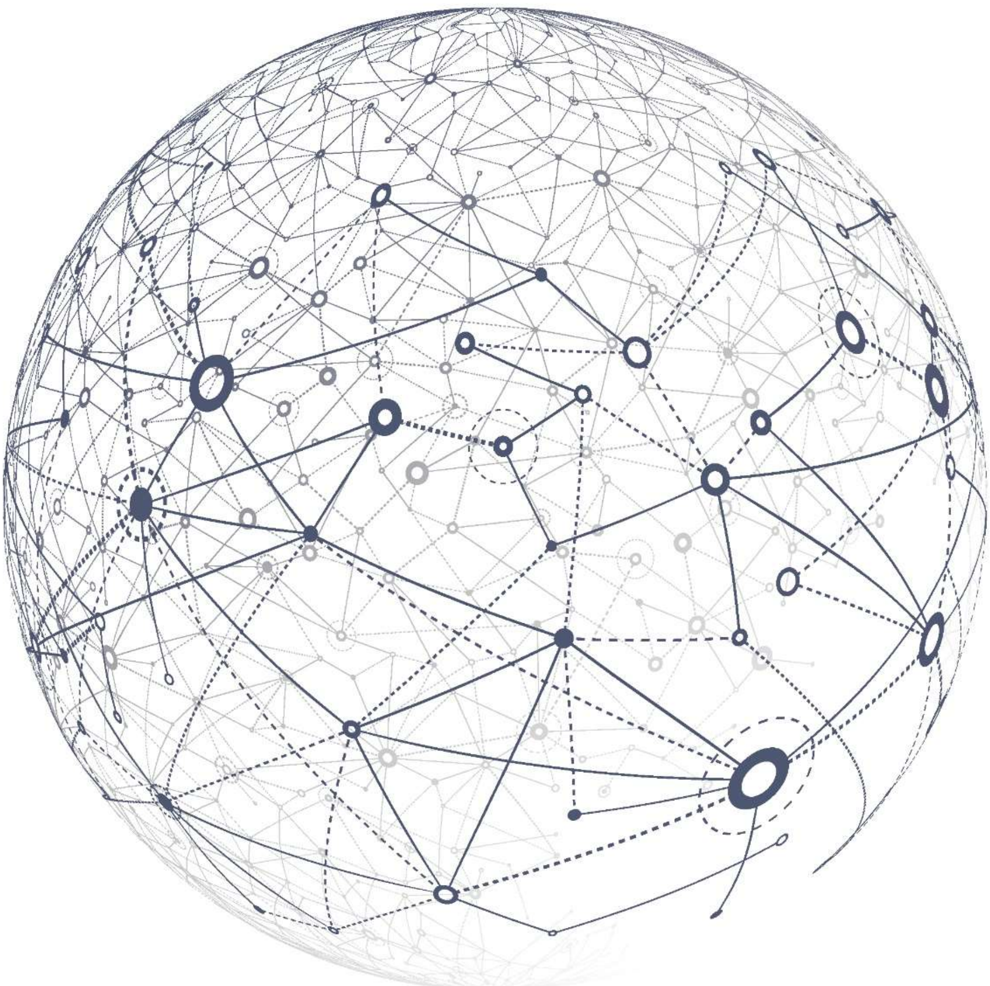
DWP TCFD Consultation

Russell Investments

January 2021

Response to consultation



Executive Summary

As a global asset manager with approximately £236.8bn[1] assets under management, Russell Investments is continually evolving techniques to incorporate climate-related risks and opportunities into our investment portfolios. In our experience, this is an investment topic that can lack transparency and consistency. As such, we welcome the DWPs proposal to improve climate risk governance and reporting by occupational pension schemes.

We have been a supporter of the TCFD since 2019 and have actively taken steps to meet the 11 recommendations of the TCFD. In addition to developing a climate risk policy, we have created a working group to develop and integrate climate risk modelling and assessment throughout our investment process. We have also started incorporating climate-related metrics into our standard equity portfolio reporting and anticipate expanding to other metrics and asset classes.

Before responding to specific questions in the consultation, we note several high-level observations.

- We are supportive of mainstreaming climate-related risks and opportunities and see this proposal, to implement the TCFD recommendations into the practices of pension schemes, as a step in the right direction
- Whilst it is widely recognized that there will be gaps in data, and especially so when looking at total portfolio level metrics, we agree that schemes should start somewhere and look to close those gaps as data availability improves. These gaps also extend to robust modeling which we expect will improve as data and capabilities of modelling such complex risks further develop.
- We believe that the assessment of climate related risk on liabilities is still underdeveloped and this will require further investigation.

We elaborate on several of these points in the consultation responses that follow. We have limited these responses to the questions that were relevant to us and where we had a comment. We have also limited our comments to reflect our opinions in relation to defined benefit trust schemes as we do not have a money purchase business in the UK.

We welcome the opportunity to discuss any of these further.

[1] As at 31 December 2020, Source: Russell Investments

Question 1

Scope and Timing

Do you have comments on the proposals to change the “reference date” used for the purposes of determining whether a scheme is in scope, or the arrangements made for schemes which obtain their audited accounts later than 1 October 2021, or 1 October 2022?

Do you have comments on the draft regulations on scope and timing?

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

We agree with the approach taken by the regulator in amending the reference date. We believe using the valuation date as March 2020, for assessing the obligations of a pension scheme, would give more clarity to trustees and leave enough time to prepare a satisfying TCFD report in line with the regulation. Furthermore, we welcome the proposal to provide 7 months from scheme year end date, in order to be fair to the schemes under scope.

Question 2

Trustee Knowledge and Understanding

a) Do you have any comments on the draft regulation on trustee knowledge and understanding?

b) Do you have any comments on the draft guidance?

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

We agree with the way the draft regulation on trustee knowledge has been written. In fact, we believe the draft is flexible enough to avoid being too detailed at this stage, ahead of further improvements on TCFD reporting, but at the same time outlines the trustee’s responsibility on climate change consideration both for risk management and investment opportunities.

Moreover, we are supportive of the creation of a non-statutory guidance for trustees.

Question 3

Governance

a) Do you have any comments on the provisions on governance in the draft regulations?

b) Do you have any comments on the draft statutory guidance on governance?

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

We believe that the new draft regulation and draft statutory guidance clearly state the responsibilities of the trustee in setting the Climate governance framework. We agree with the new definition relating to "individual or organization who undertake governance activities" as it better defines the duties of concerned players including investment advisory, fiduciary managers, and others.

Despite the greater clarity on governance, the regulator should strive to further clarify the role of asset managers operating in the form of partial FM, specifically with 5bn+ scheme. We would also recommend clarifying the climate obligations of fiduciary managers when selecting underlying funds and managers.

Question 4

Strategy

a) Do you have any comments on the draft regulations on strategy?

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

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

We believe that the strategy chapter explains the obligations of the trustee well with regards to the different aspects including sponsor's covenant, time horizons, data availability and liabilities.

Overall, we have a positive view of the draft regulation on the strategy however we would note a specific point:

- Climate risk on liabilities will be challenging to assess considering the nature of longevity estimates. However, we do believe that a detailed liability assessment would be possible with enhanced climate data in the next few years. Therefore, we would suggest the regulator reviews the high level liability obligations in 24 months.

Question 5

Scenario Analysis

a) Do you have any comments on the provisions on scenario analysis in the draft regulations?

b) Do you have any comments on the proposal that all assets of the scheme, including relevant contracts of insurance, are within scope for scenario analysis?

c) Do you have any comments on the draft statutory guidance on scenario analysis?

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

We support the new approach taken by the regulator in extending the mandatory frequency of the scenario analysis to every three years whilst defining factors that might trigger an annual review.

Although we believe that it is fair to assess the covenant position under different climate scenarios, we believe that it may be challenging to implement this recommendation; especially so, for very diversified sponsor companies. Therefore, a qualitative, high-level approach is the maximum that the regulator should require on “as far as they can” basis.

We welcome the approach of not excluding any asset classes as this would encourage trustees to take into consideration the entire multi-asset spectrum. It should, however, be recognized that it will be harder to estimate climate risk for less vanilla assets (eg. VIX futures) during the first review cycle in 2022.

Question 6

Risk Management

a) Do you have any comments on the draft regulations on risk management?

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

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

We believe that Stewardship and Engagement on climate topics should be at the top of trustees’ agendas as a mean to further understand and mitigate the climate risk of specific firms. Underlying asset managers should strive to perform these essential activities on behalf of pension funds whilst educating trustees on how to enhance their Stewardship and Engagement policies.

Question 7

Metrics

a) Do you have any comments on the draft regulations on metrics?

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

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

We greatly support the decision of the regulator to allow different GHG metrics for different asset classes and have more flexible rules on portfolio aggregation metrics at this stage. We also support the change made in the draft regulation regarding the frequency of GHG metrics disclosure to be made annually and not quarterly; and we consider a total of 3 climate metrics (absolute, intensity, other) to be reasonable. However, this standard will be much more difficult to obtain for some asset classes versus others, as noted. This is the main source of concern, and we note that expecting trustees to take “all steps as are reasonable and proportionate in the particular circumstances, taking into account the costs incurred, or likely to be incurred” is still vague. In early stages, it must be recognized that acquiring data, even when that data is available from an ESG data provider, needs to be balanced against the quality and reliability of that data, not simply a matter of cost.

While we do not agree with the recommended use of carbon footprint over WACI (page 96), and note that this does not agree with the TCFD recommendations themselves, there appears to be sufficient flexibility that investors can choose their desired metric.

Question 8

Targets

a) Do you have any comments on the draft regulations on targets?

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

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

We welcome the new frequency period defined by the regulator. Annual frequency is more appropriate for measuring metrics target compared to the initial proposal for quarterly review.

Question 9

Disclosure

a) Do you have any comments on the draft regulations on disclosure?

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

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

We are supportive of the regulator's mission of making the TCFD report widely available and transparent to all members. We share the same concern that a full TCFD report might not be easy to interpret for some members and that trustees should strive to provide a qualitative update, along with the firm's website address and location for the full TCFD report, in the annual benefit statement and the annual funding statement.

Moreover, we do agree that TCFD climate disclosures should be performed on top of current ESG reporting obligations as it contains a significant strategy and risk management scope too.

Question 10

Penalties

Do you have any comments on the draft regulations on penalties?

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

We are supportive of the regulator's approach of applying automatic penalties only in cases of non-compliance with the publishing rule for the TCFD report. We do think that TCFD is still in its infancy and we would discourage applying hard penalties on the quality of the reporting at this stage.

Question 11

Impacts

In relation to the policy changes we have made, do you have any comments on the regulatory burdens to business and benefits, and wider non-monetised impacts which are estimated and discussed in the draft impact assessment?

No further comments.

Important information