LCP's response to the DWP consultation on taking action on climate risk

10 March 2021

I am writing on behalf of Lane Clark & Peacock LLP in response to the consultation document "Taking action on climate risk: improving governance and reporting by occupational pension schemes" issued on 27 January 2021.

Who we are

Lane Clark & Peacock LLP ("LCP") is a specialist consulting firm with over 800 personnel in the UK and Europe, including 135 partners, 214 qualified actuaries and 94 part-qualified actuaries in the UK. We have offices in London, Winchester and Ireland.

The provision of actuarial, investment, covenant and pensions administration advice, benefits, and directly related services, is our core business. About 90% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy. The remaining 10% relates to insurance consulting and business analytics. The firm is regulated by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Our view on the consultation

We support the Department for Work & Pensions' ("DWP") proposals, which we believe are necessary to help protect members' pensions savings from the impacts of climate change. The changes that DWP has made in response to the August 2020 policy consultation strike a broadly appropriate balance between addressing the practical concerns that we and others had identified and setting suitably high expectations for trustees' climate action.

We believe the draft regulations mostly achieve the stated policy intent and generally find the draft statutory guidance to be clear and appropriate. We have provided our comments on the draft regulations and guidance in the appendix, highlighting where we don't believe the stated policy intent is quite achieved, where further clarity is needed and – in a few places – where we think an alternative approach would be preferable.

Importantly, we believe the definition of a "popular default arrangement" is potentially unworkable in its current form, given DWP's guidance on bulk transfers without consent, whereby a default arrangement is created whenever workers' savings are moved without their consent. This can "accidentally" result in schemes having several default arrangements. Consequently, we have suggested this be changed to default arrangements that comprise an investment strategy intended for a member's entire DC pot (eg a lifestyle strategy) with at least 1,000 invested members.

In relation to climate change metrics, we feel the draft regulations and guidance are too prescriptive in places and would prefer a more flexible approach, given that many measurement aspects are at an early stage of development and likely to evolve rapidly. It is unclear currently how metrics should be calculated for certain asset classes (especially sovereign bonds and derivatives), so we request that either guidance is provided or an expectation set that trustees do not (yet) attempt to calculate metrics in respect of those particular asset classes.

We are happy for LCP to be listed as a respondent to the consultation, and for our comments, which represent the collective view of various individuals within the firm, to be attributed to LCP. We hope that our response is helpful. If you have any questions, or would like to discuss anything further, then please contact Claire Jones (claire.jones@lcp.uk.com, 01962 873373) or Ian Gamon (ian.gamon@lcp.uk.com, 01962 872718).

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About Lane Clark & Peacock LLP

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Question 1: Scope and Timing

a) 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?

We support the proposals to change the reference date.

Given that schemes must comply with the various ongoing requirements from the first day they are in scope, preparations for compliance will need to start well before that date. There may be practical difficulties for borderline schemes for which it is not immediately clear whether the asset threshold will be exceeded on the reference date, as they may not have long left to prepare once their asset value is confirmed. However, we expect such cases to be relatively rare and, in these cases, the asset value is likely to be known with a good degree of certainty fairly soon after the scheme year-end. Hence preparations for compliance can be made whilst the scheme accounts are being prepared. On the understanding that "the date on which the trustees obtain audited accounts" is the date on which the accounts are formally signed, we believe the proposed dates give sufficient time for preparation, even when the audited accounts are obtained later than 1 October (and so the scheme comes into scope on the day the accounts are signed).

b) 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 strongly support the relaxation of the proposed disclosure timings so that all schemes have a full seven months to publish their TCFD reports after the scheme year end.

We believe that the draft regulations on scope and timing meet the stated policy intent.

Regulation 2(1)[1] – we are surprised that "trust scheme" is used rather than using "occupational pension scheme", defined per Section 1(1) of Pension Schemes Act 1993, consistent with the title of the regulations.

Regulation 2(11)(i) definition of "relevant contract of insurance" – this might exclude bulk annuity contracts that insure only part of a members' pension promises under the scheme rules (ie not an exact match for the benefits "payable in accordance with the scheme rules") as currently drafted. This would cause problems because most (if not all) bulk annuity contracts do not exactly match the benefits payable under the scheme rules owing to discretionary benefits and/or simplifications in the insurance of complex pension increase rules. To address this, we suggest that the phrase "and which are, or will become, payable in accordance with the scheme rules" is deleted from sub-clause (i). We also suggest the phrase "(irrespective of financial conditions and demographic experience)" is inserted after "which are intended in all circumstances to fully meet the cost of specified benefits" to ensure that only "true" buy-in policies are captured, and not newer insurance arrangements where there is still recourse to the scheme or sponsor in some circumstances, which we understand is the policy intention.

Regulation 2(11)(j) definition of "scheme year" – we suggest cross referring to the definition of scheme year in Regulation 1(2) of The Occupational Pension

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[1] All references to the draft regulations relate to the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 unless otherwise stated.

Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (SI 1996/1975) as this is substantially the same and the regulations are already cited. If the current definition is retained, then we believe the reference in paragraph (ii) (bb) should be to paragraph (i) not (ii) (aa).

Question 2: Trustee knowledge and understanding

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

We support the proposal to include climate-related risks and opportunities in the prescribed matters on which trustees must have knowledge and understanding. However, the draft Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 do not seem to cover the full range of relevant risks and opportunities, as many of them do not arise from climate change itself. We believe that trustees should also have knowledge and understanding of principles relating to, inter alia, steps which might be taken to prevent climate change, technological change related to the effects/steps mentioned, and financial market reactions related to, or in anticipation of, the effects/steps mentioned. Whilst these may be implicit in the current wording, we would prefer them to be explicitly covered.

As managing climate-related risks and opportunities is already part of trustees' fiduciary duty, whatever the scheme size, we believe all trustees should have knowledge and understanding of this subject. We therefore suggest that this part of the regulations applies to all pension trustees and not just those to whom the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 will apply.

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 are supportive of this section of the draft guidance and have no significant comments.

Question 3: Governance

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

In our view, the climate-related governance system should be integrated into the scheme's overall system of governance. We suggest this is included in the Schedule to the regulations (similar to paragraph 13 relating to risk management).

In paragraph 2 of the Schedule, there may be some ambiguity regarding which governance activities are intended, ie whether it is any or all governance activities in relation to the scheme, or just the governance activities specified in these regulations. We believe it should be the former.

We do not think it is necessary or appropriate to exclude lawyers in paragraph 2(b) of the Schedule. Lawyers may be involved in "the way a scheme operates and the internal processes and controls in place to ensure appropriate oversight" (paragraph 11, p15 of statutory guidance) even if they're not advising on scheme-wide strategic decisions. Moreover, other advisers – such as communications or administration consultants – might similarly have scheme-wide roles for which climate-related risks and opportunities are not immediately relevant. Nonetheless we consider it appropriate that such advisers are within scope in case climate-related risks and opportunities become relevant to their role at some point. The phrase "relevant to the matters in respect of which they are advising or assisting" seems sufficient to achieve the policy intent.

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 note that paragraph 14 (page16) says that the climate-related governance processes may be separate, contrary to our preference stated above for them to be integrated.

We believe page 17 of the statutory guidance could be clearer on who needs to have "climate-related risk expertise and resources". Although we suggest above that paragraph 2 of the Schedule to the regulations should relate to all governance activities, the statutory guidance should clarify that climate-related expertise is only expected to the extent necessary for that person's role. Otherwise, it may create difficulties for employees and potentially some advisers who are taken on with limited scope to their role.

We note that paragraphs 21 and 23 on page 17 relate to "those governing the scheme", but also seem relevant to those advising or assisting with governance activities.

The proposed governance disclosures are very extensive and far more detailed than we have seen included in UK pension schemes' TCFD reports to date. We suggest that the disclosures in paragraphs 29 and 30 on page 19 are described as things that trustees "may" rather than "should" disclosure. We also suggest that paragraph 31 is made more general, covering the ways in which the trustees ensure that all involved in scheme governance (including the trustees themselves, and those advising and assisting) have adequate climate-related risk expertise for their role.

Question 4: Strategy

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

We are generally supportive of this section of the draft regulations. The one change we would suggest is including an explicit reference to sponsor covenant for defined benefit schemes. The draft statutory guidance includes covenant considerations in its definition of funding strategy, but it is not clear from reading the draft regulations in isolation that this is the intention.

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.

Our main comment is on the level of assessment for DC schemes, specifically the definition of popular default. We believe the definition of a "popular default arrangement" is potentially unworkable in its current form, given the interpretation by DWP in paragraph 53 of its April 2018 guidance on bulk transfers without consent that a transfer payment will itself constitute a contribution. This interpretation means that a default arrangement is created whenever workers' savings are moved without their consent. This interpretation already causes various problems for trustees since it can lead to default arrangements proliferating "accidentally" and discourage them from, say, switching members from one type of self-select fund into an equivalent fund that they consider offers better value for money. Layering further requirements for assessing **multiple** "popular default arrangements" may be disproportionate. Consequently, we suggest this be changed so that the requirements only apply to default arrangements that comprise an investment strategy intended for a member's entire DC pot (eg a lifestyle strategy or target date fund) and not to single-asset-class funds. We also suggest that the threshold number of members is increased from 250 to, say, 1,000.

In paragraph 17 (page 10), an example could be used to indicate what is meant by "sections with similar characteristics".

In the section on time horizons, it would be helpful to clarify whether these are intended to be the same across all sections of the scheme. We can see a strong argument for allowing time horizons to vary between sections, particularly where their maturity or funding level differs (for example, DB time horizons may be shorter than DC).

We support the suggestion in paragraph 39 (page 21) that the longest relevant time horizon may be linked to members' life expectancy rather than the scheme's life expectancy, so that trustees who expect to wind up the scheme well before the last benefits are received by members do not adopt a myopic perspective when assessing climate-related risks and opportunities.

There are various references to funding strategy, liabilities and covenant that are only relevant to DB schemes, and the wording is not always restricted to DB – for example, the definition of "funding strategy" in paragraph 35 (page 20). Rather than inserting multiple references to DB, we suggest making a general statement near the start of the guidance to address this. In addition, it would be helpful to refer in paragraph 35 to the trustees' long-term funding objective or "target end state" - noting this may change over time – as this is a fundamental part of any

DB funding strategy and will inform the trustees' time horizon as well as their sensitivity to the employer covenant.

We believe that trustees should consider a precautionary approach where there is uncertainty. For example, paragraph 47 (page 22) of the statutory guidance states: "Where they cannot form a robust assessment of the impact of climate change on the covenant, for example because of lack of information or uncertainty about the impact of climate change on the sponsoring employer's business model, they should keep the assessment under review and consider elevating covenant risks within their risk management priorities". However, there may be a good case for being cautious where there is uncertainty. We therefore suggest that scheme trustees consider whether the impact of climate change is likely to be positive or negative and, if there is a reasonable chance that it is negative, consider taking a more prudent approach.

Paragraph 56 (page 23) mentions engagement activity with investee companies. We suggest this is extended to engagement with other entities, eg regulators and policymakers, along with a reference to collaborative activities. We note that this paragraph seems more relevant to risk management than strategy.

Question 5: Scenario Analysis

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

Paragraph 7(a) of the Schedule does not seem to be drafted sufficiently widely to cover all relevant impacts. In addition to "steps which might be taken (by governments or otherwise) because of the increase in temperature…", we believe trustees should consider:

- steps which might be taken to prevent further increases in temperature;
- technological change related to the effects/steps mentioned; and
- financial market reactions related to, or in anticipation of, the effects/steps mentioned.

As noted in response to Q4(a), we suggest making it explicit that funding strategy includes consideration of sponsor covenant for defined benefit schemes. This would then ensure that covenant impacts are to be considered as part of scenario analysis, by virtue of paragraphs 7(c) and 9(c) of the Schedule.

Although paragraph 8 of the Schedule seems to meet the policy intention, we believe it would be more appropriate to re-set the triennial cycle for scenario analysis if new scenario analysis is carried out in the interim. In other words, if trustees undertake new scenario analysis in the second year that they are in scope, then they should not be required to repeat the analysis until the fifth year (rather than the fourth year as drafted) unless they conclude that it is appropriate to undertake new scenario analysis earlier than this. This would enable them to align the timing of scenario analysis with their triennial actuarial valuation cycle and/or investment strategy reviews, and hence be better timed to influence funding and investment strategy decisions.

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

We agree with the proposal that all assets of the scheme, including relevant contracts of insurance, are within scope for scenario analysis. This is on the understanding that the statutory guidance will clarify expectations in this area, for example, permitting DC schemes to conduct scenario analysis only on assets invested in popular default arrangements.

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 would appreciate greater clarity regarding the nature of the scenario analysis that is envisaged for DC schemes, for example, whether is it permissible to look at impacts on illustrative members without aggregating across all members invested in the default strategy. In paragraph 19 (page 10), it is unclear exactly what is meant by "trustees may carry out the assessment in the round".

In paragraph 64 (page 24) it states: "Trustees should not assume that this will be best achieved by using the most complex, sophisticated and/or expensive tools available". We agree that a proportionate approach is appropriate here given the significant uncertainties and range of approaches to scenario analysis. However, we note a tension with the guidance at paragraph 59 (page 23) which rightly emphasises the need for trustees to develop the sophistication of their scenario analysis.

In paragraph 74 (page 26), insurer pricing is another liability-related consideration that may be important in certain circumstances (for example where a DB scheme is targeting buy-out with an insurer). This may not be easily modelled in a quantitative scenario analysis, but could certainly be considered qualitatively by trustees.

In paragraph 78 (page 27), it might be helpful to clarify the use of "material", perhaps by way of an example. We would expect the judgement of whether updated analysis is appropriate to be at the trustees' sole discretion, assessed on a proportionate basis with reasonable judgment – ie without undertaking detailed analysis to assess materiality, and based on the information available at the time so trustees are not judged with the benefit of hindsight.

Question 6: Risk Management

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

We note that paragraphs 11-13 of the Schedule relate to climate-related risks and do not mention climate-related opportunities. Whilst this is consistent with the risk management heading, in practice we consider it helpful for trustees to consider risks and opportunities together. More generally, we suggest DWP considers whether references to opportunities have been included wherever appropriate, throughout the regulations.

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

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

This section of the guidance is relatively short, despite risk management being of fundamental importance – the most significant actions that trustees take in response to the new climate requirements are likely to be those that actually manage the climate-related risks and opportunities that scheme trustees have identified. The actions taken will be scheme-specific and so we agree that only limited detail should be included in the guidance. Nonetheless, we feel that the positioning of the guidance could be amended to emphasise the importance of taking action to manage the risks.

We note that page 11 of the guidance has a 3-way classification of climate-related risk (physical, transition and litigation), whereas page 29 has a 2-way classification (physical and transition). We suggest that one of these classifications is removed.

Paragraph 88 (page 29) does not mention the employer. We suggest explicitly acknowledging that trustees may also rely on their sponsoring employer's management teams to help them identify and assess climate-related risks. We also suggest adding an example of how they might do this in practice, in line with paragraph 45 (page 21), such as "engaging in dialogue with the sponsoring employer of the scheme to discuss its assessment of the climate-related risks and opportunities to which it is exposed".

Paragraph 91 (page 30) implicitly just relates to the scheme's assets. We suggest that either this is made explicit or the wording is extended to cover liabilities and covenant.

In our experience, trustees typically do not classify their risks as "financial, operational and strategic risks", so suggest this wording is removed from paragraph 98 (page 31).

Question 7: Metrics

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

Our understanding is that all assets of the scheme, including relevant contracts of insurance, are intended to be within scope for metrics. However, we are concerned that this is not appropriate for relevant contracts of insurance. It is not at all clear how metrics might be calculated in respect of such contracts, particularly as insurers typically do not earmark specific assets to back the contracts. We therefore request that relevant contracts of insurance are either excluded from the scope of the metrics section or it is clearly stated in the statutory guidance that trustees are not expected to attempt to calculate metrics in respect of them.

We note that DB schemes might want to use climate-related metrics for the sponsor as part of their covenant monitoring, although understand that the policy intent is for all three metrics to relate to the scheme's assets (as stated in paragraph 14 of the Schedule).

We recommend paragraph 14(b) of the Schedule is changed to "total **greenhouse gas** emissions" instead of "carbon dioxide" to be consistent with paragraph 14(a) of the Schedule and paragraph 120 of the statutory guidance.

We note that stating "per unit of currency invested" in paragraph 14(b) precludes the possibility of using emissions intensity metrics that use a different normalisation unit, such as unit of revenue. It may be preferable to be less prescriptive in the regulations, so there is flexibility to change the preferred metric in the statutory guidance as market practice evolves.

The definitions of scope 1, 2 and 3 in paragraph 20 of the Schedule are defined in terms of an "organisation" which we understand to mean the organisations in which the scheme invests. However, paragraph 15(a) refers to the "greenhouse gas emissions of the scheme's assets". Strictly speaking, extra wording is needed to attribute an appropriate proportion of the investee organisations' greenhouse gas emissions to the scheme's assets.

Scope 3 emissions are typically defined in terms of the organisation's value chain. For example, the US Environmental Protection Agency says: "Scope 3 emissions are the result of activities from assets not owned or controlled by the reporting organization, but that the organization indirectly impacts in its value chain."[2] Paragraph 20(e) of the Schedule refers to "all indirect emissions from activities of the organisation" which could be interpreted more narrowly than this.

We therefore suggest that the value chain is explicitly referenced in the definition of scope 3 emissions.

It is not clear how scope 1, 2 and 3 emissions should be assigned to some types of assets. In particular, for sovereign bonds, it is not clear which "organisation" the definition references. In theory, scope 1, 2 and 3 emissions could be calculated for government entities, although our understanding is that such data is not published for UK government entities (as a different basis is typically used for calculating public sector emissions) and is unlikely to be available for other countries either. Whilst trustees may be able to use the "as far as able" provision to justify not calculating metrics for their sovereign bond holdings, we note that the draft guidance proposes a method that uses whole-country emissions. However, whole-country emissions – whether on a production or a consumption basis – do not correspond with the required scope 1-3 approach. The proposed approach therefore does not seem to meet the draft regulatory requirement. We suggest DWP considers whether to retain the references to scope 1-3 emissions in the regulations, perhaps with permission in the guidance to deviate from that approach for sovereign bonds, or whether to move the references to scope 1-3 emissions to the guidance with flexibility to use alternative approaches for some asset classes.

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

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

As explained in Q4(b), we are concerned about the level of assessment for DC schemes, specifically the definition of popular default.

Our expectation is that the same three metrics should be calculated in respect of all sections of the scheme (for example, DB and DC). We suggest this is clarified explicitly.

[2] https://www.epa.gov/climateleadership/scope-3-inventory-guidance

Paragraph 20 (page 10) says that "if, in calculating absolute emissions metrics and emissions intensity metrics, trustees believe it is not meaningful to aggregate data across certain asset classes within a given section or arrangement of the scheme, they may choose not to do so." We do not consider it appropriate to aggregate metrics where the basis of calculation differs significantly, for example emissions for corporate securities and sovereign bonds (see comments on the latter in Q7(a)). Nor do we consider it appropriate to aggregate metrics for derivatives with metrics for other assets. This is mainly because derivatives exposure is often leveraged (so the economic exposure can be much larger than the headline value of assets) which would distort the aggregated picture, and also because the trustees do not have any ownership rights or influence over the derivatives' underlying assets. Our preference is for the guidance to state that metrics should not be aggregated in these ways, rather than just permit them to be disclosed separately.

We find it unclear when schemes are first expected to select, calculate and use their metrics. Wording equivalent to paragraph 14 (page 9) ("Scenario analysis must be carried out in the first scheme year during which the Regulations apply – even if the first year of application is a part year") would be helpful.

We welcome the guidance on the attribution of greenhouse gas emissions to the main asset classes. As we have commented in Q7(a), there is a conceptual difficulty in attributing emissions to sovereign bonds using the scope 1-3 approach. Nonetheless it is helpful that the guidance indicates a pragmatic approach for sovereign bonds, whilst offering trustees the flexibility to adopt a different approach. We note that the approach suggested divides whole-country emissions by government debt, whereas a more consistent approach might use a measure of government (public sector) emissions or a whole-country measure of debt.

LDI strategies and derivatives are widely used by DB pension schemes and it is far from clear how emissions should be attributed to them. It would be useful if either guidance were provided or an expectation set that trustees would not (yet) attempt to calculate metrics in respect of them.

We would expect the calculation of the emissions intensity metric to adjust for data coverage. In paragraph 120 (page 34), we suggest that "for which emissions data is available" is inserted at the end of "Trustees should report the emissions in tonnes of GHG emissions for each million (£m) of the scheme's assets". For example, if the total Scope 1 and 2 emissions for a £100m portfolio have been calculated as 5,000 tonnes, but these emissions only relate to 80% of the portfolio by value, we would expect the carbon footprint to be reported as 62.5 tonnes per £m (ie 5,000 divided by 80% of £100m) rather than 50 tonnes per £m (ie 5,000 divided by £100m).

We understand that the "additional climate change metric" can be emissions-based, ie the policy intention has changed since the August 2020 consultation which referred to a "non-emissions based" metric. However, paragraph 134 (page 36) refers to "non-emissions based" metrics (despite then suggesting portfolio alignment and Climate VaR metrics which are implicitly emissions-based).

There is a wide range of metrics that we consider potentially suitable as the additional climate change metric, yet the draft guidance specifies that trustees "should" use one of three suggested metrics. Given that trustees are expected to explain their choice of metric, we request that trustees are given more flexibility by replacing "should" with "may" at the start of paragraph 134 (page 36). Alternative metrics that could be mentioned in the guidance include: exposure to fossil fuel reserves, investment in climate solutions (perhaps defined in accordance with the EU Taxonomy), carbon management scores (such as the Management Quality score calculated by the Transition Pathway Initiative), and the proportion of investee entities that have set a science-based emissions reduction target.

Paragraph 134 says trustees using a portfolio alignment metric "should choose a tool which includes consideration of scope 3 emissions for sectors where these are significant". The Portfolio Alignment Team concluded that further work was required before they could recommend an approach to including Scope 3 in a robust and decision-useful way[3]. We therefore suggest this phrase is deleted or "should" is changed to "may".

The same paragraph gives a Climate VaR example which mentions a 90th percentile. Our understanding is that Climate VaR metrics typically give the expected loss if a particular scenario unfolds without undertaking stochastic analysis or attaching a probability to the likelihood of that scenario occurring. We therefore suggest that the phrase "at a 90th percentile" is deleted.

Question 8: Targets

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

We are supportive of this section of the draft regulations and have no significant comments.

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

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

We find it unclear when schemes are first expected to set and measure performance against their targets. Wording equivalent to paragraph 14 (page 9) ("Scenario analysis must be carried out in the first scheme year during which the Regulations apply – even if the first year of application is a part year") would be helpful.

We believe that targets should not be too long-term, for example no more than five years into the future and suggest this is added to the guidance. For example, we would not consider a target of net zero emissions by 2050 to be sufficient without interim targets.

We note that it is likely to be difficult for trustees to achieve any targets where they invest in pooled funds, unless those pooled funds incorporate a climate-related target (which is currently very rare). Some guidance on what is expected in these circumstances would be useful.

It might also be useful to highlight that targets could be met through changes in portfolio holdings and/or changes in the climate-related exposures of those holdings. For schemes that are already invested in relatively low carbon portfolios, stewardship to encourage decarbonation by investee entities might be the primary mechanism to achieve their targets, and hence trustees may have limited influence over their scheme's performance against the targets.

Question 9: Disclosure

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

A prescribed list of disclosures may not be needed. An alternative would be to require trustees to report on how they have carried out their duties under Part 1 of the regulations.

The draft guidance says trustees should describe concisely the reasons for any deviations from the approach set out in the guidance, but this is not required by the draft regulations or the Pension Schemes Act itself (hence the wording is "should" not "must"). Under the current proposals, trustees are therefore expected to report on three things: the list of items in Part 2 of the Schedule to the Regulations; the various disclosure items listed throughout the draft guidance; and any deviations from the guidance. In some places, the guidance expects trustees to do things but not to report on them, so these things could easily be missed when trustees prepare their TCFD reports. It therefore seems to us that a principles-based disclosure requirement might be preferable, as well as more future-proofed.

[3] https://www.tcfdhub.org/wp-content/uploads/2020/10/PAT-Report-20201109-Final.pdf

We note that, unlike implementation statements for example, draft Regulation 3(1)(b) regarding website publication is not imposed by way of amendment to the 2013 Disclosure Regulations[4]. It is therefore unclear to us whether the notification requirements relating to website publication in Disclosure Regulations 27 and 28 are intended to apply. Regulations 27 and 28 seem to have wide application, rather than specifically relating to the various website publication requirements in the Disclosure Regulations themselves. Hence they could be interpreted as applying to publication of TCFD reports. In our view, the notification requirements set out in Regulation 4 of the draft Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 are sufficient.

The provision in Regulation 3 of the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 that trustees are not required to publish the manuscript signatory of the TCFD report signatory is welcome, to help protect signatories from being targets of fraud. If and when possible, we would like to see this provision applied to other documents that trustees are required to publish online.

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

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 this section of the draft guidance and have no significant comments.

<u>Question 10: Penalties</u>

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

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

While we are generally comfortable with the proposed approach, we question the need for a further bespoke compliance regime rather than using the Pensions Regulator's existing powers in sections 13 and 14 of the Pensions Act 2004.

We note that the mandatory penalty is for a "failure to publish". We recommend this is changed to "failure to produce" to avoid schemes being unfairly penalised in the event of an administrative failure in publishing the report online within seven months of the year-end.

Draft Regulation 6(5)(a) should distinguish between compliance notices issued to trustees and those issued to third parties. We presume that trustees are not intended to be liable for penalties issued to third parties.

<u>Question 11: Impacts</u>

In relation to the changes we have made to the original policy proposals, 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?

We support the changes that have been made to the proposals announced in August 2020 and consider the associated regulatory burden to be appropriate given the likely benefits.

<u>Question 12: Any other comments</u>

Do you have any other comments you would like to raise?

No.

[4] The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734).