Emma Walmsley, Tom Rhodes and David Farrar
The Climate Change and Responsible Investment Team
Department for Work & Pensions
United Kingdom

4th March 2021

Dear Sirs

Governance and reporting of climate change risk : guidance for trustees of occupational schemes consultation response

Introduction

The HSBC Bank (UK) Pension Scheme (the "Scheme") is one of the largest UK corporate pension schemes, with c.£37bn of assets in its closed Defined Benefit ("DB") and open Defined Contribution ("DC") sections. It is governed by a Trustee Board ("we") that is well-informed on climate change risk and which has taken active steps to manage this risk and improve risk-adjusted returns, for example, by applying climate risk tilts in the core DC default fund and investing in renewable infrastructure assets in the main DB section. As such, we are supportive of the Government's commitment to require pension schemes to take action on climate change.

We are members of the United Nations Principles for Responsible Investing ("UNPRI"), Institutional Investors Group on Climate Change ("IIGCC") and Climate Action 100+ and collaborate with other Asset Owners in our engagement activities including through our principal equities fund manager Legal & General Investment Management ("LGIM"). We are a long term investor on behalf of our DC members and believe that climate change and Environment Social & Governance ("ESG") / sustainability issues will be important factors in determining the long term investment returns that can be achieved for the best interests of our members.

We have voluntarily published Task Force on Climate-Related Financial Disclosures ("TCFD") disclosures for 3 years and so have direct experience of the challenges in collecting and publishing such information, as well as with ESG and sustainability information more broadly.

Overall, we welcome the amendments that have been made to the proposals since the August consultation. In particular, we welcome the delineation of the climate change governance and the reporting requirements and the increased attention on the governance requirement. As we have indicated in our response to the initial consultation in October, having produced three TCFD reports over the past three years, we think the effort, resources and time that goes into the implementation of appropriate climate change governance, strategy and risk management processes and the preparation of the annual TCFD statement should not be understated.

The remainder of this letter details our responses to the specific questions asked in your consultation document "Governance and reporting of climate change risk: guidance for trustees of occupational schemes, consultation version" which was published in January 2021.

We would be happy to discuss our responses with you if that would be helpful.

- **HSBC Bank Pension Trust (UK) Limited**
Level 25, 8 Canada Square, London E14 5HQ
Tel: 020-7991 2468

Consultation questions

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?

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

Overall, we welcome the amendments that have taken place in this section since the August consultation as they provide additional clarity for the scope of the requirements.

However, we would like to reiterate the point we made in our response to the consultation in October around the complexity of fully understanding and managing climate-related issues.

By way of context, we have been working towards the TCFD reporting requirements for several years and integrating the recommendations of the TCFD has been an iterative process. We note that making improvements to our processes around climate change governance and risk management has been a resource-intensive exercise over the past few years. As a large UK corporate pension scheme we have been able to devote considerable effort and resource to this and are therefore well positioned to comply with the requirements, however, we note that schemes with fewer resources, either due to size or structure, will likely face considerable challenges in meeting the requirements as currently set out.

We suggest this is taken into considerations especially in light of the proposal to bring forward the review of the recommendations to the second half of 2023. As in our previous consultation response, we would like to reiterate that rather than simply focusing on whether to extend the requirements to a larger group of schemes, the review should have a two-stage focus. First, to assess the extent to which in-scope schemes have successfully achieved compliance and the identification of any barriers, gaps and/or inconsistencies encountered. If the outcome of the first stage is positive, this would provide the rationale for considering whether to broaden the scope of the regulations and the terms on which this might be done.

Question 2

Trustee knowledge and understanding

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

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

We strongly agree with the proposal to include a requirement on trustee knowledge and understanding. Ensuring that trustees hold an appropriate understanding of the assessment, identification and management of climate change risks and opportunities is key in establishing and maintaining oversight of climate-related issues. Knowledge and understanding are also hugely important in ensuring climate-related processes and decisions are integrated into wider scheme processes and decisions and we believe that this should be supported by The Pensions Regulator adding a module addressing Climate Risk to the Trustee Toolkit.

We find that allocating specific time to climate change related training and discussions at Trustee meetings and engaging with industry by participating in collaborative initiatives has enabled us to progress on our climate management journey.

Question 3

Governance

HSBC

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

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

We are broadly in agreement with the draft regulations on governance and note that this is largely unchanged from the August consultation. We believe good governance is key in this area. The Trustees of the Scheme have benefitted from a clear, concise and well-defined set of beliefs concerning climate change, which has guided the implementation of climate-related processes. However, as noted in our response to Question 1, it has taken a number of years to get to the Trustee's position and therefore the proposed timeline, with the largest schemes having to implement governance processes by October of this year, may be too short to expect trustees to gain the required expertise, noting that all of the legal onus falls on the trustees.

We welcome the clarification on "persons managing the scheme" outlined in the proposals as these responsibilities of managing a pension scheme can sometimes fall on in-house executive teams and external advisors.

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?

We are broadly in agreement with the provisions on strategy that have been provided in both the draft regulations and statutory guidance. However, we think the guidance could benefit from clarification that the risk mitigation following assessment of climate risk does not have to come in the form of divestment or portfolio changes. This may be short term and promote unintended consequences, i.e. limiting the ability of the real economy to make the required decarbonisation transition.

We note that the identification of climate risk is more straightforward in certain asset classes than in others. We urge the statutory guidance to recognise that typically more complex investment strategies of large pension schemes involves exposure to alternative non-listed assets where emissions data maybe more difficult to collect for reporting purposes.

These types of assets are often accessed for diversification or for enhancing risk adjusted returns through accessing illiquidity or complexity premia for example and we are wary of potential unintended consequences of investors focusing on asset classes where data is more readily available at the expense of optimal portfolio construction.

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 relevant contracts of insurance are within scope for scenario analysis?

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

We agree that scenario analysis can be a useful tool to carry out the risk assessment over the required time horizons and we welcome the proposal to ease the requirement of conducting scenario analysis to a triennial basis as opposed to the original annual basis. As noted in our previous response, the requirement to conduct annual scenario analyses would likely prove onerous for trustees with little meaningful added value in terms of decision-making year-on-year.

We welcome the clarification in the guidance around the actions DB schemes need to take on funding strategy, however as discussed in our previous response, we note that this requirement creates a

- HSBC Bank Pension Trust (UK) Limited
Level 25, 8 Canada Square, London E14 5HQ
Tel: 020-7991 2468

considerable amount of complexity. For a trustee to carry out scenario analysis on the scheme's liability profile will require the scheme actuary to calibrate longevity and mortality assumptions to different climate pathways. We understand this is being considered by industry bodies including the IFoA and so would look to them to lead on this, however, we think the guidance should benefit from additional clarity in this section as it is to become a regulatory requirement.

We note that trustees rely on their advisers and third-party models/tools to carry out scenario analysis assessments on all three components of the funding strategy and as such we welcome the "as far as able" clause in the draft regulation and the guidance. As in our previous response, we caution that there are limitations to carrying out scenario analysis on the full funding strategy and to what information may be disclosed (e.g. assessments related to the strength of the covenant with the corporate is often confidential and may be market sensitive).

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?

While we note that no additional changes have been made to the original policy proposals on risk management, we would like to reiterate the importance of a scheme taking an integrated holistic view of all the risks they face (including climate change). Therefore, we support the requirement and guidance on integrating climate risk management into existing risk management practices.

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?

We strongly welcome the decision to transition to an annual rather than quarterly requirement for the monitoring of metrics. Our initial hesitation towards the mandating of quarterly monitoring was that this would lead to short-termism and unintended consequences.

We also welcome the clarity provided in the statutory guidance in relation to the metrics that trustees should be calculating and disclosing to monitor their climate-related financial risks. We agree that a suite of metrics (rather than a single metric) should be monitored as different metrics have different limitations and should be used for different reasons. Therefore, we support the view that in order to get a more holistic picture, a number of metrics should be used to identify climate-related risks the scheme is exposed to.

We see rationale in recommending a specific absolute metric and a specific intensity metric to encourage standardisation and comparability, however, if the Government recommends the use of a specific metric, we think the guidance could provide more clarity as to why it has done so. A more detailed explanation around why carbon footprint is now being recommended over other intensity metrics, such as Weighted Average Carbon Intensity ("WACI"), would be welcomed. We calculate and report our corporate equity and credit portfolio's carbon footprint and fund-level WACI measures in our TCFD report. We have found WACI to be useful in understanding our exposure to climate-related risks if carbon emissions are used as a proxy and we have used this metric to prioritise our engagement efforts with investment managers.

We appreciate the flexibility around the optional metric, as we think different metrics reveal different risks the schemes face, and the usefulness of each will be dependent on the scheme's circumstances.

As tools and methodologies to measure investment-related climate risks are emerging and developing quickly, we continue to monitor what the most decision-useful metrics for us to use are. In relation to this,

- HSBC Bank Pension Trust (UK) Limited
Level 25, 8 Canada Square, London E14 5HQ
Tel: 020-7991 2468
Registered in England number 489775. Registered Office: 8 Canada Square, London E14 5HQ.

we strongly urge the DWP to ensure that the metric requirements in the regulation are future-proof and there are robust processes in place for reviewing metrics as methodologies develop. We would like to avoid a situation in which a set of metrics are calculated and reported to satisfy legacy regulatory requirements, while another set of more decision-useful metrics is actually used by schemes to measure and manage their climate-related risks.

The focus on scope 3 emissions is appreciated but we think more clarity could be further provided. From the guidance it is unclear what the protocol for reporting scope 3 emissions is when coverage is low or not available. We would like to caution that there is a potential unintended consequence if companies that disclose scope 3 emissions are penalised due to appearing to have higher emissions, when in fact, they are being compared to companies that recorded zero scope 3 emissions. Being somewhat hyperbolic, but this could incentivise companies to simply not attempt to increase the scope of their reporting coverage. As an industry we need to ensure that we are encouraging the disclosure of scope 3 data rather the disincentivising it. This should be addressed within the statutory guidance – one solution could be to attribute a firm with the average scope 3 emissions for their sector if they have not reported their own.

We think Trustee knowledge and understanding is crucial in this area so we urge the guidance to include as much information or reference to useful resources as possible. Having submitted a case study for the PCRIG guidance on the metrics section, we would like to further encourage the sharing of best practice and case studies to improve trustee understanding in this area.

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?

We are supportive of the changes to this section, as we think it allows trustees the flexibility to set targets that are most relevant to the scheme's strategy and objectives. As discussed in our initial response, targets need to be well thought out and integrated into a decision-making framework to be decision-useful and to avoid a check-box approach to compliance. While the guidance is clear in what the requirements are, we would welcome more detailed guidance on the types of targets that schemes might set and how these targets can best be integrated into investment strategy considerations.

We also support the amendment to the original proposal to provide quarterly performance monitoring against a set target. The transition to having an annual requirement should minimise the risk of taking too short-term a view e.g. divesting rather than engaging from carbon-intensive investments.

The way the regulation is set out, the targets are inherently linked to the metrics disclosed. Again, we raise the importance of establishing processes for ensuring that the targets required are relevant and decision-useful in future years.

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?

We agree with the draft regulations and statutory guidance on disclosure.

Question 10: Penalties

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

- HSBC Bank Pension Trust (UK) Limited
Level 25, 8 Canada Square, London E14 5HQ
Tel: 020-7991 2468
Registered in England number 489775. Registered Office: 8 Canada Square, London E14 5HQ.

We have no comment on the proposed role on the penalties.

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?

We agree with the wider economic and societal impacts outlined in this section and are of the view that the action trustees will need to take as a consequence of the regulations will ultimately lead to increased transparency and a more stable and resilient UK pensions system.

While we think that the costs reflected in the impact assessment are more realistic than initially estimated (and we welcome the recognition of the increased cost to a hybrid scheme), we think the overall annual cost of this exercise per scheme still remains materially underestimated. As previously discussed, trustee training, the establishment of climate change governance practices, data sourcing and the production of a disclosure report all require considerable resources – both in terms of time and cost. The disclosures are complex reports that have to be produced through a combination of outsourced data providers, investment managers, multiple advisers, significant internal resource and hours of trustee governance time. A point that we have raised in our initial consultation but do not see reflected in the impact assessment is the additional costs around an independent assurance process that some schemes might decide to undertake, which is not inconsiderable.

Question 12: Any other comments

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

We have no further comments.

Yours sincerely

Brian Kilpatrick

Lisa Young-Harry, CEO   Brian Kilpatrick CIO

- **HSBC Bank Pension Trust (UK) Limited**
Level 25, 8 Canada Square, London E14 5HQ
Tel: 020-7991 2468
Registered in England number 489775. Registered Office: 8 Canada Square, London E14 5HQ.