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CONSULTATION RESPONSE: TAKING ACTION ON CLIMATE RISK - IMPROVING GOVERNANCE AND REPORTING BY OCCUPATIONAL PENSION SCHEMES

This is Third Generation Environmentalism (E3G)'s response to the DWP's consultation on the consideration of climate risk by occupational pension schemes.

About E3G

E3G is a not-for-profit public interest organisation with offices in London, Brussels, Berlin and Washington DC. E3G's mission is to accelerate the global transition to a climate-safe world. E3G has a track record of experience and expertise on sustainable finance and international climate finance.

Overview

The UK's leadership on green finance is to be celebrated, as the world's first major economy to implement mandatory TCFD by 2025, and with the announcement of a UK green Taxonomy. E3G welcomed the recognition by HMT of the 'importance of the UK as a financial centre, and the role it plays in the global financial system'. We also noted that in the Chancellor's Financial Services Statement of 2020 he set out an aim for the UK, post Brexit, to put "the full weight of private sector innovation, expertise and capital behind the critical global effort to tackle climate change and protect the environment."[1] The role of the pensions sector in this transition will be significant.

[1] Financial Services Statement to the House of Commons, 2020, **https://www.gov.uk/government/speeches/chancellor-statement-to-the-house-financial-services**

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We welcome DWP's efforts to date to improve climate risk reporting and governance in the pensions sector – and support the intention for UK pensions to be world leading in their approach to tackling climate change.

In the following consultation response, we propose that an overarching requirement for pension schemes to ensure alignment with the UK's target of net-zero emissions by 2050, and with the goals of the Paris Agreement, should be enshrined in the regulation around climate risk for the UK pensions sector. If underpinned by a robust governance mechanism to ensure effective operationalisation, this addition offers a clear opportunity to establish the UK as a world leader in green finance.

The appetite from the private sector is there. **A recent global survey** of over 500 pension funds and over 500 insurers indicated that 94% of insurers and 90% of pension funds either had committed to net-zero or were planning to do so. The sector transition is clearly underway. It is in the Financial Sector's own interest to act – as unmitigated climate change will nullify the business model as is.

HMG's role in markets is to enable the free market and private finance in achieving sustainable profits for the long term. This can be achieved through providing a clear direction of travel and guidance to institutional investors through regulation around Net Zero targets and mandating for Paris Alignment/Net Zero transition plans.

Outline

Our response addresses the following consultation questions:

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?**

3. **Governance**

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

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

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?

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?

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?

12. Any other questions?

Consultation Response

- **Question 1: Scope and Timing**

  Under current proposals, eligibility for TCFD reporting by Pensions companies is based on a broad-brush measure of AUM. It is important that DWP signals that it will extend TCFD compliance to all institutional investors who hold non-Paris aligned portfolio investments.

  Mandatory TCFD by 2025 is too late to have a meaningful impact. DWP should encourage the pensions sector to align with TCFD far in advance of this date i.e. by 2023 latest.

- **Question 3: Governance**

- It is very important that DWP engages in regular consultations with the pensions industry, NGOs, and civil society. This regular feedback is important to ensure a rigorous approach to policy-making processes, particularly in the context of our suggested overarching Paris Agreement and net-zero alignment requirement. It will be necessary for these consultations to allow for input from a range of stakeholders who have the relevant expertise to hold HMG and the pensions sector to account.
- Pensions companies need to report under TCFD requirements ''as far as they are able'. DWP needs to extend this requirement to tie up this loophole and ensure that pensions companies allocate sufficient resources and skillsets to climate risk reporting, and to ensure regular and consistent reporting. This will lessen the opportunity for exceptions to reporting under TCFD. Moreover, in so far as realising fiduciary duty, Pensions companies should be obligated to consult with shareholders on their appetite for climate alignment, as an additional mechanism to encourage ambition.
- **Question 5: Scenario Analysis and Stress Testing**
- The new DWP recommendation is a change to the original proposal on scenario analysis so that 'trustees must undertake scenario analysis in the first year they are subject to the requirements and every three years thereafter. In the intervening years they must review, on an annual basis, whether or not circumstances are such that they should refresh their analysis, and either carry out new scenario analysis "as far as they are able" or explain in their TCFD report why they have not done so'.
- We welcome regular reviews of scenario analysis to ensure that the assumptions of the Pensions sector in accounting for climate risk are as up to date as possible. These reviews should also reflect an intention for the pensions sector to ratchet up ambition beyond just disclosure, and to set science-based targets for their decarbonisation and net-zero targets,
- **Question 7: Metrics**
- DWP has amended their 'original proposal of quarterly performance monitoring against a set target to an annual requirement'.
- The risk with reducing the prevalence of assessment is its de-prioritisation against other objectives in terms of company targets. We recommend that Pensions should assess their performance against climate objectives, as well as profit, on a regular basis i.e. quarterly.

- **Question 8: Target setting and monitoring**
- DWP should signal their intention to advance the pensions sector beyond TCFD and risk disclosure and should set a clear direction of travel for the pensions sector towards mandatory transition plans/net zero targets.
- We propose an overarching requirement for pension companies to demonstrate alignment with the UK's Net Zero target and with the goals of the Paris Agreement.
- **Question 12: Any other comments**
- In December, the Climate Change Committee (CCC), as the UK's independent public advisory body on climate, published a report on "The Road to Net-Zero Finance", recommending that the UK lead the world by committing to be the first net-zero finance system – and, among other policies to achieve this, make net-zero targets mandatory for financial institutions.
- Building on the UK's existing expertise in green finance would allow the UK to maintain its position in the world as a hub of green finance, supporting the City of London and domestic finance in continuing to attract business and investment to the UK.
- Mandatory climate risk reporting marks an important step forward. But it isn't enough for financial institutions to merely assess the risk of climate change to their investments. They must act and ensure that their investments are in line with the Paris Agreement. Without making this a requirement, private finance will not move to net-zero at the speed and scale required.
- Clear regulation on net-zero strategies will help market actors in designing robust and long-lasting net-zero transition pathways and will propel the UK into a world-leading position. The number of different standards and commitments worldwide means that market actors are facing significant hurdles when designing their net-zero pathway, and policymakers and the public alike are struggling to assess how robust these are.
- Confusion in the finance sector as to standards, methodologies, and timelines will only hinder private finance actors in developing credible plans. Regulation can ensure that everyone undertakes these plans to a high standard. The UK financial services industry wants to play its part in achieving a sustainable future and setting up the UK as a leading net zero

nation. It needs the government to step up its role and outline the road ahead and use policy and regulation to get the real economy on track to 1.5 degrees Celsius and leverage the power of the financial markets behind it.

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Contact: heather.mckay@e3g.org