

DWP Consultation:

**Taking action on climate risk:
improving governance and reporting
by occupational pension schemes**

A response on behalf of the Association of Professional Pension Trustees

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?	<p>The timing changes proposed makes sense and we would welcome the earlier review to check that the regulation is having the desired impact before rolling out to smaller schemes.</p> <p>The change in scope to exclude buy-ins does make the process more straightforward and we agree that the trustee does not have the ability to change provider once implemented. However, it would be useful to establish a principle that climate change should be considered as part of all strategic decision making, including choice of buy-in / buyout partner.</p>
b) Do you have comments on the draft regulations on scope and timing?	<p>One category that we do believe should be excluded is schemes in the PPF consultation period. While climate change could be a risk over a 12-18 month time frame, for schemes in this situation other risks will by definition be much greater.</p>
Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.	<p>The additional governance requirements and costs incurred may distract from trustee time and resource at a time which is critical for member outcomes in what is often very fast-moving situation.</p>

Question 2	Trustee knowledge and understanding
a) Do you have any comments on the draft regulations on trustee knowledge and understanding?	<p>The draft regulation on trustee knowledge and understanding makes sense and we agree this is an important component to help ensure that regulations don't just result in disclosure, but lead to action and genuine risk management.</p> <p>Guidance on this will be important, particularly around how to keep knowledge up to date as metrics, investment opportunities and frameworks are developed.</p>
b) Do you have any comments on the draft guidance?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.	

Question 3	Governance
a) Do you have any comments on the draft regulations on governance?	<p>Clarity on who is in scope of 'persons managing the scheme' is helpful, however ultimately asset managers invest assets on behalf of the great majority of schemes and are the only party that has effective control over how the assets are invested.</p> <p>Even when trustees are provided with information by asset managers on the climate risk of their investments, this will not always allow trustee boards to actively direct investment decisions and limit risk due to climate change. For example, index tracking funds, based on market capitalisation, will always track the constituents of the underlying index regardless of investor views on climate exposure. To effectively manage the risk, trustees would have to make an active decision to change funds and change policy from using low cost passive funds to more expensive active management. This final step to reduce or mitigate risk, or justify why not, is currently missing from the legislation.</p> <p>On fiduciary duty, the consultation says that environmental factors are only required to be taken into account insofar as they are a financially material risk to the scheme.'</p>
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.	

	<p>This may limit the impact of the regulations. A small number of companies have the biggest carbon emissions and footprint and managing financially material risk can largely be achieved by excluding them. However, to have an impact on the real economy, schemes need to be active long-term investors who insist that the asset managers engage with companies through a green transition over the next 20-30 years. It would be preferable to incentivise a shift away from simple exclusion of specific stocks, toward long-term active engagement which is much more closely aligned with the policy intent.</p>
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Question 4	Strategy
a) Do you have any comments on the draft regulations on strategy?	<p>The clarification on timeframe is useful and the regulations and guidance meet the policy intent in our view. We continue to believe that evaluating the impact of climate change on the liabilities will be very hard in practice. Any analysis on potential changes to the discount rate will be the dominant factor and forward-looking projections of the yield curve will be very subjective.</p>
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.	

Question 5	Scenario Analysis
a) Do you have any comments on the provisions on scenario analysis in the draft regulations?	<p>Whilst we are supportive of the wider proposals, the requirements for scenario analysis are problematic due to their highly arbitrary and subjective nature. The proposals are likely to lead to higher costs and the requirement for external consultancy, whilst not necessarily increasing the overall sustainability of a portfolio..</p> <p>If requirements for scenario analysis are to be included, then requiring insurance contracts to be included makes sense as they are an asset of the pension fund.</p> <p>The statutory guidance is helpful in that it provides a clear guide as to what is required, although as noted above, it is highly subjective and will not necessarily produce the desired outcomes. The subjective nature of the requirements are such that adopting more optimistic assumptions could generate a more positive outlook.</p>
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.	

Question 6	Risk Management
a) Do you have any comments on the draft regulations on risk management?	<p>The guidance is helpful in that it provides a structure and assistance with how schemes can incorporate the proposals into their risk management structure. The guidance and draft regulations are, however, focused on approach rather than outcomes.</p> <p>It might be insightful to add a requirement to document those risks that have been mitigated, including how, and the residual risks to which the scheme is exposed and some indication of expected exposure.</p>
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.	

Question 7	Metrics
a) Do you have any comments on the draft regulations on metrics?	The draft regulations and guidance on metrics are helpful, although consideration should be given to the metrics suggested as part of the section entitled “additional climate change metrics”.
b) Do you have any comments on the draft statutory guidance?	Providing a choice of metrics reduces consistency and the highly subjective nature of some of the metrics would incur additional costs and is not necessarily helpful. The subjective nature of the requirements are such that adopting more optimistic assumptions could generate a more positive outlook.
Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.	

Question 8	Targets
a) Do you have any comments on the draft regulations on targets?	Setting a target is an important aspect of the requirements. We question whether or not the choice of metrics in each category should be left open, which could lead to a careful selection of metrics that portray the scheme in an artificially positive light. An alternative approach would be to prescribe various metrics, but allow schemes to omit those metrics that are not appropriate.
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.	

Question 9	Disclosure
a) Do you have any comments on the draft regulations on disclosure?	We welcome the draft statutory guidance in relation to both presenting TCFD disclosures and ensuring they are easily accessible and have no further comment.
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.	

Question 10	Penalties
Do you have any comments on the draft regulations on penalties?	We would support the provision that a mandatory fine is restricted to only those entities which do not produce a report and agree that tPR should otherwise have discretion as to whether a penalty should apply. We would hope that tPR recognizes the increased workload, particularly for smaller, lower impact schemes and only penalises entities in extreme circumstances where the requirements have been wilfully ignored
Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter.	

Question 11	Impacts
<p>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?</p>	<p>In order to comply with TCFD it is important not to underestimate the amount of time which Trustees will need to allocate. There is not solely a financial cost but a governance time cost. More time will need to be allocated to TCFD both initially and on an ongoing basis as each scheme will have specific challenges in terms of reporting (current lack of standardisation across the asset management industry) and continuing trustee education if Trustees want to go beyond mere tick box exercises. Advisors will view this as a significant fee making opportunity.</p>

Question 12	Any other comments
<p>Do you have any other comments you would like to raise?</p>	<p>None</p>