UKSIF Response: DWP consultation on draft regulations to improve climate governance and reporting by pension schemes

UKSIF
UK Sustainable Investment and Finance Association

Introduction

The UK Sustainable Investment and Finance Association (UKSIF) is the membership organisation for those in financial services committed to the growth of sustainable and responsible finance in the UK. We look to promote a more sustainable and inclusive financial system that works for the benefit of the environment and wider society.

UKSIF represents a very diverse range of financial services firms committed to these aims, and our 240+ members include investment managers, pension funds, banks, financial advisers, research providers, NGOs, among others. UKSIF welcomes the opportunity to respond to DWP's consultation on the draft regulations to enact the Government's policy proposals improving climate change governance and reporting by occupational pension schemes.

UKSIF's recent work

UKSIF has been hugely supportive of the measures in the Pensions Schemes Act to create a greener and more sustainable pensions system in the UK. We campaigned strongly for better climate risk governance and reporting to form part of the Bill as it was debated in Parliament. This work included working closely with policymakers during the passage of the Bill to ensure schemes considered the Paris Agreement goals when ensuring effective climate change governance and reported against the Task Force on Climate-related Financial Disclosures (TCFD) framework.

We also pushed for a central directory of pension schemes' Statement of Investment Principles (SIPs) to improve scrutiny of schemes' ESG investment policies, and we were very pleased the Government committed to taking forward this recommendation in December last year. We have since continued to stress the importance of vastly improving trustees' knowledge and understanding of how to manage climate-related risks. This is particularly crucial as we know that the number of trustees of defined contribution schemes for example considering climate change in their investment strategies remains relatively low, at 43%, according to research by The Pensions Regulator.

We have also sought to understand how schemes, and indeed in time all signatories to TCFD, will make good-quality and relevant disclosures so that investors, savers, and all of us can have better information on climate-related risks and opportunities.

The new draft regulations accompanying DWP's latest measures will play a very important role in these respects. UKSIF and our members are broadly very supportive of the draft regulations, particularly as they are largely in line with the direction of travel signalled by DWP in previous announcements, and we would like to make the following observations in our response.

UKSIF's response

Trustee knowledge and understanding

While we endorse the draft regulations, we do have concerns on the ability of trustees to meet their new requirements, due to a lack of sufficient expertise on climate change and understanding of ESG risks and opportunities. In recent years, we have seen trustees struggle to meet incoming ESG regulations; for example, our 'Changing Course' report found large scale non-compliance among trustees in publishing their updated Statement of Investment Principles (SIPs) as the Government's new ESG rules required.[1]

Our worry is that trustees could face similarly significant difficulties in satisfying upcoming requirements, for example on very complex areas such as scenario analysis activities. There needs to be urgent consideration by government and regulators given to wider work on how trustees can meet the new requirements, without necessarily trustees being required to spend significant new amounts on investment consultants and other support. This would help overcome the huge 'learning curve' that exists, and we would support this being recognised more explicitly in the final regulations. This will be

[1] UKSIF, *Changing course? How pensions are approaching climate change and ESG issues following recent UK reforms*, January 2020.

particularly important as our understanding of climate risks and opportunities evolves, which means trustees' knowledge will need to adapt and improve over time. We would recommend TPR comprehensively updating its Trustee Toolkit, which is long overdue, and DWP engaging in further work, for example it could build on the work of the Pensions Climate Risk Industry Group. Consideration could also be given to all pension scheme trustee boards (above a certain size) having a dedicated trustee focused on ESG issues.

The role of investment consultants will be important to address, and it could be made a clearer expectation of consultants to support their clients on TCFD reports, among other climate-related issues, and to improve their own knowledge of climate issues.

We hope that TPR's upcoming climate change strategy, anticipated later this spring, will address the issues of trustee knowledge and understanding, and the amount of work and knowledge that will be required by schemes affected should not be underestimated.

Scope and timing of the regulations

We welcome the Government's confirmation that it will bring forward its interim review, considering the case for the requirements to be extended to smaller schemes, to the second half of 2023 as opposed to 2024. In our original response, UKSIF voiced strong concerns over a review taking place in 2024, noting that policy action might only take affect for smaller schemes by late 2026, or even further beyond the UK's 2025 'roadmap' for disclosure across the economy, following a review.

We continue to strongly believe that given the threat that climate change poses to all pension scheme savers, regardless of the size of scheme, it is vital for requirements to be extended to smaller schemes as soon as possible in line with the 2025 TCFD 'roadmap.' UKSIF and our members will continue to make the case for DWP's upcoming review in the second half of 2023 to confirm the extension to smaller schemes, including those with net assets below £1bn by the end of 2025.

In the meantime, we continue to have concerns over the provisions for schemes falling out of the scope of the requirements should their assets fall below £500m at a scheme year end. We think that once schemes have started to meet the new requirements, and put in place the necessary processes to fulfil these, then this obligation should not then be lost particularly as the direction of travel signalled by DWP points towards them eventually being impacted.

It is important for reporting, once it begins, to continue to ensure it can be embedded over time. This would mean the UK is sending the right signal to all schemes and wider financial services as we lead to build on our existing global leadership on TCFD disclosure. Prior to the review in 2023, we would support policymakers to encourage trustees of smaller schemes to look to the requirements for large schemes as an indication of best practice on climate risk reporting.

We welcome the explicit inclusion of 'as far as they are able' in reference to trustees taking reasonable steps to meet requirements, including on undertaking scenario analysis to assess the impact on schemes' assets and liabilities. This will be a reassuring message to scheme trustees in smaller schemes in particular in the expectation that requirements are extended to this group.

Metrics, disclosure and costs

We broadly support the requirement for trustees to select a minimum of two emissions-based metrics: an absolute emissions metric and an emissions intensity metric, though consideration could also be given to a stewardship metric as well.

It will be important to have consistency in the metrics that pension scheme trustees select on an annual basis. Shifting the metrics frequently, for example from year-to-year, would be unhelpful with different approaches leading to very different results being calculated for similar portfolios and assets.

We would support the regulations expressing support for trustees to be consistent in the short-term in their selection of metrics to avoid this scenario. Furthermore in time, we hope policymakers can give clarity to trustees on the most effective methodologies available to them so that we can have a clear picture on the total emissions of a scheme's assets for example. We agree with the requirement on trustees to, as far as they are able, undertake scenario analysis for at least two scenarios, one of which we believe could specify a 'business as usual' scenario (4.0C+) to consider the impact of physical risks.

On disclosure, we largely welcome the draft regulations and statutory guidance for schemes producing a TCFD report. For example, we are strongly supportive of requiring trustees to publish their TCFD reports on a publicly available website. However, some of UKSIF's members have noted that informing members about TCFD reports via an annual benefit statement they receive would not be particularly useful, and there might be better suited channels to consider.

We would reiterate our support to be given on ways to highlight best practice among schemes to help schemes learn from one another over time; consideration could be given to building off the work of the Occupational Pension Supervisory Commission to help in this respect.

As we saw trustees fail to show sufficient transparency over their SIPs, we should be attune to the possibility of a similar lack of transparency over the publication of TCFD reports which policymakers will need to take into account. TPR should make it clear in its new climate strategy that it will look to penalise non-compliance with producing TCFD reports.

Finally, on the regulatory costs outlined in the impact assessment, we believe the costs could be enormous and higher than government has anticipated, particular for scenario analysis which carries very high costs due to the complexities involved, such as a lack of good data.

Further information

For more information on our response, please contact Oscar Warwick Thompson, Senior Policy Manager, on: o.warwickthompson@uksif.org.