

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

Response to Consultation on Regulations

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Consultation document: [Taking action on climate risk: improving governance and reporting by occupational pension schemes \(publishing.service.gov.uk\)](https://www.publishing.service.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes)

Q1 Scope and Timing

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 are supportive of the proposals to change the reference date. We also agree that the proposed changes resolve the ‘backstop date’ issue within the original proposals.

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

Paragraphs 2.1.b and 2.2.b in the draft regulations make reference to ‘that scheme year end date’. Our understanding is that, for paragraph 2.1.b, this refers to the first scheme year end date which falls on or after 1st March 2021 and for paragraph 2.2.b this refers to the first scheme year end date which falls on or after 1st March 2022, thereby with scheme accounts due on or after 1st October 2021 and 1st October 2022 respectively. However, the wording is not explicit about this and could be made so to remove any confusion.

There could also be further clarity within the regulations as to what an ‘earmarked scheme’ is as we note that this is not defined within these regulations and instead is defined elsewhere.

The regulations refer to ‘the date on which the trustees obtain audited accounts in relation to that scheme year end date’. We note, on page 46 of the consultation response document, that where accounts are not received within that 7 month period from the scheme year end then the date that the accounts are obtained is the date from which the regulations apply. Therefore, our understanding is that the governance requirements take effect from the later of 1 October 2021 or the date that the trustee report and accounts are obtained with respect to the scheme year on or after 1 March 2021 or 1 March 2022 for the first and second waves respectively, which may be later than the 7 month deadline of the trustee report and accounts.

We appreciate the case studies of schemes with specific year end dates provided within the guidance.

Q2 Trustee knowledge and understanding

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

We are supportive of the obligations on trustees to ensure they have the right knowledge and understanding on the topic of climate risk.

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

We believe the guidance helpfully sets out what trustees should do with regards to knowledge and understanding of climate risk. This should help broaden the approach of trustees and prevent the requirements becoming purely a reporting piece by ensuring a deeper understanding of the topic.

The guidance could be made clearer on how trustees may be expected to demonstrate their knowledge and understanding of the topic. Part 2, paragraph 32 of the guidance makes reference to trustees “not needing mastery of technical detail” which we support, acknowledging that this is a particularly wide subject matter. We believe that trustees should focus on building an understanding of issues that are most relevant to their particular circumstances, allowing them to challenge those with expert knowledge and skills, rather than there being an expectation of building a broader knowledge base.

The guidance refers to the relevance of climate change to overall risk management but we believe this could be clarified to ensure wider integrated risk management is a part of this broader piece.

The guidance should note how the knowledge required with respect to climate change may differ between types of occupational scheme, as well as between schemes at different points in their scheme journey.

Q3 Governance

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

The regulations specifically carve out legal advisers from those advisers that assist or advise the trustees with respect to governance activities. Given that legal advisers regularly assist with governance activities and even, to an extent, comment on investments and funding, we consider it odd that they are not included within the advisers to which this requirement applies.

This feels discordant with the idea that advisers to trustees should work collaboratively as a team and as such, we would want legal advisers that we collaborate with on clients to be adherent to or subject to this regulation.

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

Part 3, paragraph 12 of the statutory guidance notes that asset managers and administrators are not considered to be in scope of those undertaking 'governance activities'. However, we would expect good trustee governance in this area to ensure that trustees satisfy themselves of asset managers' own governance processes with respect to climate risk and opportunities, particularly where certain activities are delegated to asset managers or implemented through fiduciary management arrangements. The guidance should reference this point.

Q4 Strategy

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

We are supportive of the principles set out in Schedule Part 1 paragraphs 3-5 of the draft regulations (and parts (d) to (f) of paragraph 21). Indeed, we would expect the identification of risks and opportunities (in any area) to be a key part of trustees' ongoing review of funding and investment strategies. However, as worded, the regulations could be interpreted very broadly and we would suggest paragraph 3 is changed to limit the scope to risks and opportunities which the trustees consider will have a "material" (or equivalent) effect. The guidance allows for this when it talks about "relevant" risks and opportunities (paragraph 42).

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

No comments.

Q5 Scenario analysis

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

We have reservations about the regulations requiring only two scenarios given the potential for the selection of more favourable outcomes (i.e. delayed activity) as a basis for justifying inaction. Given the guidance notes three commonly used, but somewhat flexible, scenarios which focusses on the pace and nature (or absence) of a transition, it would seem sensible to extend this consideration to three scenarios.

Schedule Part 1 Paragraph 9 mostly repeats provisions in earlier paragraphs so we suggest it could be simplified by referring to previous paragraphs.

Schedule Part 1 Paragraph 19 defines "as far as they are able" to mean trustees must "take all such steps as are reasonable and proportionate". To clarify how this is determined we believe it should instead say "take all such steps as they believe are reasonable and proportionate".

The regulations envisage that scenario analysis will be undertaken triennially, which we support. However, it is likely that such analysis will be tied to a triennial valuation cycle and hence the requirement to complete such analysis during the first year of the regulations may result in such analysis being undertaken purely for the purposes of meeting regulatory requirements and may actually discourage pension schemes undertaking such analysis ahead of the regulations coming into force. We would suggest that the regulations allow for such analysis to be undertaken at any date within three years of the scheme year end for the initial year of the regulations being in force and at least triennially thereafter.

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

We are supportive of this suggestion. To clarify this requirement and avoid any confusion with the definition of “relevant assets” (which excludes such contracts), we suggest the guidance includes wording to make it clear that these assets are included in the scope for scenario analysis.

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

The purpose of undertaking scenario analysis is buried in the middle of paragraph 64 and consequently not immediately evident to the reader. We believe this statement is important and should be better highlighted.

Paragraph 70 states that trustees “should not focus on scenarios that rely on progress, or otherwise, that they consider unlikely to happen”. In this statement, we note the intent is to require trustees to frame plausible scenarios which require action over a sensible timeframe, rather than scenarios which backdate action beyond the timeframe of the scenario projection. We believe the statement should therefore emphasise that the scenarios being tested may seem extreme relative to other scenarios that trustees may have explored, although this is the purpose of the exercise.

Q6 Risk Management

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

We are supportive of the principles set out in 11-13 of the draft regulations; in particular its intention to ensure climate-related risks are integrated into schemes’ existing risk management frameworks. The brief and non-prescriptive nature of these three statements allows trustees to take the steps that they believe are appropriate to their circumstances (in a manner consistent with the guidelines).

- 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.

Paragraph 84 would benefit from being strengthened; in particular “should be mindful of...” – employer covenants are a critical part of the risk management of schemes, the nature of which is not adequately emphasised by the current language.

Conversely, paragraph 85 suggests that a “risk management system will allow trustees to keep scheme assets safe and protect the scheme from adverse risks”. Whilst robust risk management can certainly support the identification of and mitigation or lessening of some risks, it is neither possible nor desirable to eliminate or protect from all risk.

The description of physical risks on page 29 of the consultation would benefit from the inclusion of the destruction of biodiversity as a result of climate change. This has far-reaching consequences –

damage to ecosystems threatens the prosperity and stability of companies, economies and societies. Companies (or indeed countries) that rely heavily on ecological capital assets are particularly vulnerable to material disruption where such assets are threatened by climate change.

Paragraph 91 would benefit from a recognition that, whilst considering risks at an asset class level is a useful starting point, there may be a breakdown of longer-term average correlations between asset classes, particularly where climate change impacts accelerate and worsen, or where policy reaction is swifter and more substantial than currently priced in by the markets.

Q7 Metrics

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

We are supportive of the principle of requiring climate-related metrics to be obtained and disclosed – and to the principle of allowing trustees to select from a range of possible metrics. However, one of the policy outcomes from this exercise will be to allow some basis of comparison and consequently challenge of asset owners to act. For such comparison and challenge to be possible, it would seem sensible for at least one emissions metric (carbon footprint) to be required with trustees then having freedom around other metrics.

- 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.

We note that Scope 3 emissions data currently remains limited and, although the ambition to report on Scope 3 data is reasonable, it seems likely that there will be limited ability for trustees to do so for several years whilst data quality improves. Further, we note the overlap between Scopes 1 and 2 and Scope 3 emissions and the guidance should state that disclosures should not combine emissions from different sources.

Paragraph 112 of the guidance suggests trustees “do not need to provide justification for their choice” – we think it would be beneficial for schemes to set out why they have chosen a particular methodology; and this can easily be included as part of the description of their chosen methodology.

Paragraph 122 suggests that “Trustees should seek to calculate the carbon footprint for each... popular DC default arrangement in the scheme” – we suggest the calculation should cover all default options in addition to popular self-select fund options.

Paragraph 131 suggests that trustees should seek to fill material data gaps although there is a trade off to be considered as reporting gaps may be more meaningful than reporting estimated numbers. If trustees seek alternative means of populating these gaps then managers may be less incentivised to provide actual disclosures.

Q8 Targets

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

We welcome the reduction in frequency from quarterly to annually – we do not believe obtaining such metrics on a quarterly basis represents a cost-effective, risk-based approach. It is also critical that these targets are non-binding, to prevent unintended consequences and short-termism in decision-making.

We suggest paragraph 18b should be amended (consistent with 18a) to “taking into account the scheme’s performance against any target they have set” to distinguish against any non-climate-target scheme performance.

We believe paragraph 18 would benefit from an additional, third component, requiring, if targets are missed, detail on why this is the case, alongside any action being considered (e.g. engaging with investee companies).

- 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.

In addition to the required elements being adequately described, the guidance gives schemes sufficient flexibility for schemes to choose their preferred mechanisms for any target-setting exercise.

The guidance would benefit from a reiteration that targets are not intended to divert emphasis from a long-term approach to managing climate risk, nor intended to precipitate changes to investments based solely on any climate-related targets chosen.

Whilst targets are non-binding, we suggest that trustees be required to explain the reasons why a target has not been achieved where appropriate.

Q9 Disclosure

- a) Do you have any comments on the draft regulations on disclosure?
No specific comments
- b) Do you have any comments on the draft statutory guidance?

We note that the members are one potential user of TCFD disclosures although the content of a TCFD report is unlikely to be engaging to the average scheme member unless written in an appropriate manner. Better disclosures are likely to combine a short and digestible summary of the key issues supported by a more technical backing document that meets the broader disclosure requirements. Whilst the guidance refers to what may be disclosed for members, the distinction between the two elements of a TCFD report could be more clearly made.

Q10 Penalties

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

No specific comments. We acknowledge the Regulator's climate change strategy which includes sharing best practice examples which will also help encourage compliance.

Q11 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 would acknowledge that the commitments will be onerous and timescales challenging but we are supportive of the measures.

Whilst we are supportive of the requirement to analyse at least two scenarios (and would suggest that these are chosen to be relatively 'optimistic' and 'pessimistic' in terms of climate outcomes), as set out in Q5, we suggest this is extended to three, given the guidance also refers to three scenarios.