Shell Pensions Trust Limited
Shell Centre
London
SE1 7NA
United Kingdom
Tel 020 7934 5590
Email SCPFtrustee@shell.com
Internet http://pensions.shell.co.uk/

Emma Walmsley, Tom Rhodes and David Farrar
Climate Change and Responsible Investment Team
Department for Work and Pensions
Email: pensions.governance@dwp.gov.uk

10th March 2021

Dear Ms Walmsley, Mr Rhodes and Mr Farrar,

Climate Change Governance and Reporting Consultation

Thank you for the opportunity to respond to the consultation on the implementation of the provisions of the Pensions Schemes Act 2021. I am replying on behalf of Shell Pensions Trust Limited, the Trustee of the Shell Contributory Pension Fund (the SCPF).

Our response is by exception and we are not, of course, making any comment on the enacted provisions themselves. We have also not addressed here the question of investment decision making and climate change in the context of our responsible ownership policy which, as we explained in our recent letter to the Pensions Minister, we are in the process of reviewing.

Q5 (a) Do you have any comments on the provisions on scenario analysis in the draft regulations?

For schemes operating an integrated risk management approach, the rules on timing of scenario assessments should be flexible enough to allow them to be integrated into the triennial integrated cycle of covenant assessment/liability valuation/investment strategy update. Regulation 8 anchors them instead on a three year cycle starting from the year the scheme happens to come into scope.

Q5 (c) Do you have any comments on the draft statutory guidance on scenario analysis?

The distinction made between qualitative and quantitative scenario analysis made in paras 58-60, with the former essentially being characterised as more primitive, would benefit from clarity as to what is meant by the term 'scenario'. This could import the TCFD terminology: 'a scenario describes a path of development leading to a particular outcome; scenarios are not intended to represent a full description of the future, but rather to highlight central elements of a possible future and to draw attention to the key factors that will drive future developments; they are hypothetical constructs, not forecasts, predictions or sensitivity analyses'.

It will be important that those policing the regulations have a good understanding of the limitations to scenario analysis and to its application to decision making. The chosen scenarios will provide a set of internally coherent possible outcomes which can inform strategic thinking and risk assessment. In particular, they may help assess DB pension funding resilience in a range of plausible but different outcomes. They are useful for providing strategic background to contribute to investment strategy decisions, but they should not replace stochastic analysis and the use of market derived data for informing key valuation assumptions. Nor, being very different but plausible outcomes, will they generally be of use in specific investment decision making. It should also be noted that the production and updating of good quality scenarios is a non trivial activity.

For DB pension schemes we agree that for scenario analysis to be beneficial in the assessment of climate change risk the approach needs to be integrated for investments, employer's covenant and pension liabilities. As we set out in our response to Q6(b), we recommend this is reflected more clearly in the guidance and it would be benefical if further guidance is provided on integrating climate change scenarios to include macro-economic and demographic factors that affect liabilities.

Q6 (b) Do you have any comments on the draft statutory guidance on risk management?

There are many specific risks, both transition and physical in the TCFD's terminology, but they unfold and interact in ways which are extremely difficult, if not impossible, to predict. They have material cumulative effects seen in the key macro impacts for pension funds - interest rates, inflation rates, expected returns on asset classes and demographic effects. These impacts are already what pension schemes primarily model in their management of the funding strategy.

Our fund has long sought to maintain a highly diversified portfolio. This means that the impact for good or ill of individual investment performance or even that of entire sectors is, by design, limited. We are also sceptical about the ability to pick winners and losers in liquid and well researched markets. This also means that we put our efforts into engagement rather than selective divestment, though we have introduced an ESG/low carbon tilt into our investment process. In any case, as we pursue a derisking path over the medium term, our investments are progressively reducing exposure to equity type risk.

Taking into account the TCFD's climate change related risk types (set out in para 84 of the draft guidance material) is a part of specific investment decision making, along with other risks that can affect returns on individual investments. At the strategic level however, especially over the medium to long term, it is the macro effects which dominate. We think it would be helpful if this aspect were reflected more clearly in the guidance. The comments in para 88 seems to relate more to individual investment selection than to the understanding of how the developing response to climate change may affect the macro effects which will predominantly shape the future funding risk of pension schemes. While it is true there are opportunities as well as risks at the individual investment level (albeit the opportunities will generally be for equity holders rather than debt holders), our first duty is to ensure scheme resilience whatever happens.

We note in para 74-75 the caution about assessing impacts on liabilities. Yet this aspect is an essential part of the risk management process and it would be unfortunate if the attention given to scenarios, metrics and the associated target setting were to divert attention away from thinking about liabilities. We think this discussion in the guidance, including in respect of scenarios, should be more extensive. Much of the focus on handling climate related risk has been on asset holders because they are believed to have influence over the behaviour of enterprises. But we are liability holders before we are asset holders.

Q7 (b) Do you have any comments on the draft statutory guidance on metrics?

As we derisk our fund (along with most other UK pension schemes), the metrics will increasingly be bond metrics. Given the importance of sovereign bonds and especially index linked gilts, will the UK Government be publishing the CO_2e per £ number for UK gilts, both vanilla and green? It seems inefficient to require all asset owners to attempt to do this. At the very least, we recommend that the guidance provides a single approach to the calculation methodology to be applied for UK government bonds (paras 112 and 125 of the draft guidance leave this open to trustees) in order to achieve consistency through the disclosures.

We would be happy to discuss any part of our response if that would be helpful.

Yours sincerely,

Tim Morrison
Chairman, Shell Pensions Trust Limited