ICI Pension Fund

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

Introduction

1 The ICI Pension Fund ("the Fund") was established in 1927 and is one of the largest and most mature defined benefit pension schemes in the UK. Although closed to new entrants since 2002, the Fund remains open to future accrual, with:

- Nearly 45,000 members (38,000 of whom are receiving a pension) with an average age of 75
- An annual payroll of around £500m; and
- Over £10.0bn in assets

2 The Fund adopts a very low risk investment strategy and is almost wholly (99.7% as at 31/07/20) invested in UK government bonds, gilt based derivatives and bulk annuity insurance policies. (We would also note that bulk annuities are illiquid assets which the Fund cannot readily realise unless an insurer has severe solvency issues. We believe that disclosure of the climate-related risks of insurers should be a matter for the insurers and their regulator.) The remaining assets (0.3%) are in the process of being liquidated with the proceeds being reinvested into government bonds. The strategy would also be considered low risk in climate risk terms. As at 31 March 2019 the Fund had a small surplus and the position is expected to be similar as at 31 March 2020.

3 The Fund supports the idea behind the proposals and believes that, in general, pension funds with relevant investments (equity and corporate debt) should address the issue of climate change risks more fully by making informed choices on investments. However, given the already de-risked investment strategy of the Fund outlined above, the Trustee does not believe that the proposals would be meaningful for the Fund. The Trustee believes that it would create additional material costs for no real purpose.

Governance

Q 1. We propose that the following schemes should be in scope of the mandatory climate governance and TCFD reporting requirements set out in this consultation:

a) trust schemes with £1bn or more in net assets
b) authorised master trusts
c) authorised schemes offering collective money purchase benefits

Do you agree with our policy proposals?

We can appreciate the need to have a threshold asset level below which pension schemes are exempt from the reporting requirement on the grounds that the scope to accommodate the additional governance burdens of TCFD reporting are likely to be greater for large schemes than for mid or smaller-sized pension schemes. The Trustee has no particular view on whether £1bn is the right level.

However, the Trustee believes that exemptions from reporting should also apply to schemes with assets in excess of £1bn where the assets of the Scheme are substantially invested in low-risk strategies.

We understand that the policy intention is to encourage trustees to consider climate change more fully in their investment strategies and this will be more relevant in their choice of equity and corporate debt investments.

We, therefore, believe that the assets used to test whether a scheme has more than 1bn should be focused on assets where trustees have a choice and can potentially influence corporate behaviours. The Trustee believes that cash, gilts (including gilt exposures gained via derivatives or repo), interest rate and inflation swaps and bulk annuities, should be excluded from the asset test in determining whether pension schemes are exempt from the reporting requirements. The Trustee is not persuaded that it can make meaningful disclosures on climate change exposures in either case, although expects there could be material cost in complying with disclosure and other related requirements for no real purpose.

In terms of solutions for this issue, the first is in relation to Net Assets. One of the ways these exclusions could be managed is by using a definition of Net Assets which excludes "*non-climate related assets"* such as*:*

- bulk annuities ("Buy-in policies")
- gilts
- gilt exposures gained via derivatives or repo
- interest rate and inflation swaps
- and cash.

This would be similar to the exclusions that were made under the draft Occupational Pension Schemes (Governance and Registration) (Amendment) Regulations 2019 where bulk annuities were excluded under the definition of "Manageable Assets" for the purpose of assessing scheme assets under fiduciary management.

Another solution is that where the threshold for Net Assets is not met i.e. a scheme has a large proportion of "Non Climate Related Assets", there could still be a disclosure requirement where the scheme/trustees confirm that they have considered the legislation, what level of the scheme's assets are climate related (if any) and whether they have to comply with the full disclosure requirement. This should alleviate concerns about transparency for pension schemes in our position and allow a tiered approach to compliance.

Q 2. We propose that a) trustees of schemes with £5bn or more in net assets on their first scheme year end date to fall on or after 1 June 2020 are subject to the climate governance requirements from 1 October 2021 and the trustees must publish a TCFD report within 7 months of the current scheme year end date or by 31 December 2022 if earlier.

b) trustees of schemes with £1bn or more in net assets on the first scheme year end date to fall on or after 1 June 2021 are subject to the climate governance requirements from 1 October 2022, and the trustees must publish a TCFD report within 7 months of the current scheme year end date, or by 31 December 2023 if earlier.

c) trustees of master trust or collective money purchase schemes which are authorised on 1 October 2021 are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report in line within 7 months of the current scheme year end date, or by 31 December 2022.

After 1 October 2021

d) trustees of master trust or collective money purchase schemes which become authorised are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report within 7 months of the current scheme year end date.

e) where schemes cease to require authorisation, the climate governance and TCFD - aligned reporting requirements fall away with immediate effect, unless they remain in scope via the asset threshold on the previous scheme year end date.

From 1 June 2022 onward

f) trustees of schemes not already in scope of the requirements and with £1bn or more in net assets on any subsequent scheme year end date:

• are subject to the climate governance requirements starting from one year after the scheme year end date on which the £1bn asset threshold was met; and
• must publish a TCFD report within 7 months of the end of the scheme year

from which the climate governance requirements apply.

g) trustees of schemes in scope of the requirements whose net assets fall below £ 500m on any subsequent scheme year end date cease to be subject to the climate governance requirements with immediate effect (unless they are an authorised scheme) but must still publish their TCFD report for the scheme year which has just ended within 7 months of the scheme year end date.

Do you agree with the policy proposals?

We have no strong views on the proposed timings for the requirements to come into effect for different schemes. However, we would reiterate that it is important that the asset test that applies to determine whether a scheme falls within the scope of the requirements should be focused on assets where trustees have a choice and can influence corporate behaviours. The Trustee believes that cash, gilts (including gilt exposures gained via derivatives or repo), interest rate and inflation swaps and bulk annuities, should be excluded from the scope of the asset test in determining whether pension schemes are exempt from the reporting requirements. Please refer to our answer to question 1.

Q 3. Subject to Government deciding to adopt any of the governance or reporting requirements proposed in this consultation, we propose to conduct a review in 2024 on whether to extend the measures to schemes with below £1bn in net assets which are not authorised master trusts or an authorised scheme offering collective money purchase benefits, and if so how and on what timescale. This review would be informed by consideration of TCFD disclosures by occupational pension schemes to-date, their impact, and the availability and quality of both free and paid-for tools and services.

We would propose also to review any regulations and statutory guidance which had been put in place to identify whether any of this needs to be strengthened or updated.

Do you agree with these proposals?

A review would be sensible. We would expect that any smaller schemes with substantially de-risked strategies would have a similar view as our own, that they should be exempt from the requirements.

Q 4. We propose that regulations require trustees to:

a) adopt and maintain oversight of climate risks and opportunities, and
b) establish and maintain processes by which trustees, on an ongoing basis, satisfy themselves that persons managing the scheme, are assessing and managing climate-related risks and opportunities.

We also propose that regulations require trustees to describe:

c) the role of trustees in ensuring oversight of climate-related risks and opportunities; and
d) the role of those managing the scheme in assessing and managing climate related risks and opportunities, only insofar as this relates to the scheme itself and the processes by which trustees satisfy themselves that this is being done.

We propose that statutory guidance will cover the matters in the box above.

Do you agree with these proposals?

We believe that maintaining oversight of climate risks and opportunities is a part of the broader need for trustees to manage the risks of their pension schemes, as is the need to be satisfied that persons managing scheme assets are properly assessing and managing risks in general, including climate-related risks and opportunities.

The regulations need to recognise that some schemes will seek to adopt a very low risk approach in general terms (including to climate-related risks) and should avoid placing onerous governance requirements on trustees in reporting and other areas where this is the case. The regulations should therefore be clear what does and does not constitute a low risk approach. In our view, investment strategies focused very largely on liability-hedging strategies should be considered low risk in both climate risk terms as in terms of risks more generally. Such strategies employ UK government bonds, interest rate and inflation derivatives (including derivatives on gilts and gilt repo) and bulk annuity insurance policies.

Q 5. We propose that regulations require trustees to identify and disclose the climate change risks and opportunities relevant to their scheme over the short, medium and long term, and to assess and describe their impact on their investment and funding strategy.

We propose statutory guidance will cover the matters outlined in the box above. Do you agree with these proposals?

As set out in our answers to earlier questions, we believe the regulations should recognise what type of investment strategies represent a low risk approach to climate-related risks and schemes should be exempt from a disclosure requirement where the assets are very largely or wholly invested in low-risk strategies. We have set out in our earlier answers what we regard as low risk strategies.

Q 6. We propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of DB, funding strategy, as far as they are able, in at least two climate-related scenarios, one of which must be a 2 °C or lower scenario and to disclose the results of this assessment

We propose statutory guidance will cover the matters outlined in the box above. Do you agree with these proposals?

We agree with these proposals, in principle. However, we suggest that the legislation caters for the limitations on making meaningful disclosures on climate scenario impacts, if a scheme's assets are invested in UK government bonds and bulk annuity insurance policies.

This is because, where a pension scheme has hedged its interest rate and inflation exposures through gilts and interest rate and inflation strategies, it is not exposed to the climate change impacts on future levels of interest rates and inflation, even if those were predictable under specific warming scenarios (we do not believe they are). The Fund would be exposed in the event the UK government defaulted on its gilt obligations, but we do not believe an informed estimate of the likelihood of this can be made specifically related to a climate change scenario.

While, as the consultation document notes, there may be impacts on member longevity linked to climate change, which would therefore impact the costs of future bulk annuity insurance, the key question is whether there is any robust means of assessing that risk specific to climate change scenarios. As with interest rates and inflation, we are not persuaded that there is.

Where liabilities are hedged with bulk annuities (as they are for the vast majority of the Fund's liabilities), both interest rate and inflation risks, and also risks relating to benefit uncertainties of which the key risk is member longevity, are hedged. The Fund would be exposed in the event both that an insurer fails and the insurer insolvency mitigations (which, in the Fund's case, include full collateralisation) do not wholly cover a shortfall. We would expect the risk to be very low given the solvency capital regime to which insurers are subject, but, in any event, we see no reliable means of quantifying this risk related to specific climate-change scenarios. We would also note that bulk annuities are illiquid assets which a pension scheme cannot readily realise. We believe that disclosure of the climate-related risks of insurers relative to their liabilities should be a matter for the insurers and their regulator.

The Fund itself is well-funded on a low-risk basis and, given its investment strategy, this is expected to remain the case in future. Where there is no material funding shortfall, and asset and liability risks are substantially hedged, a pension scheme's exposure to any sponsor climate-related risks is limited. While we recognise that, for other pension schemes, a material funding shortfall does represent a credit-risk exposure to the pension scheme's sponsor, we would argue that the sponsor would be far better placed to assess its own exposure to climate-change scenarios and report that through its report and accounts.

Q 7. We propose that regulations require trustees to:

a) adopt and maintain processes for identification, assessment and management of climate-related risks,

b) Integrate the processes described in a) within the scheme's overall risk management.

We also propose the regulations require trustees to disclose:

c) the processes outlined in part a) above.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Whilst we agree with these proposals in principle, as set out in our answers to earlier questions, we believe the regulations should recognise what type of investment strategies represent a low risk approach to climate-related risks and schemes should be exempt from disclosure and other related requirements, where the assets are very largely or wholly invested in low-risk strategies. We have set out in our earlier answers what we regard as low risk strategies.

Q 8. We propose that regulations require trustees to:

a) Select at least one GHG emissions-based metric and at least one non-emissions-based metric to assess the scheme's assets against climate-related risks and opportunities and review the selection on an ongoing basis;

b) obtain the Scope 1, 2 and 3 GHG emissions of the portfolio, and other non-emissions-based data, as far as they are able;

c) calculate and disclose metrics (including at least one emissions-based metric and at least one non-emissions-based metric) used to quantify the effects of climate change on the scheme and assess climate-related risks and opportunities.

We also propose in regulations that trustees be required to disclose:

d) why the emissions data that is estimated does not cover all asset classes, if this is the case.

We propose that trustees will not be mandated to use a specific measure to assess the effects of climate change on the scheme's portfolio.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Whilst we agree with these proposals in principle, as set out in our answers to earlier questions, we believe the regulations should recognise what type of investment strategies represent a low risk approach to climate-related risks and schemes should be exempt from disclosure and other related requirements where the assets are very largely or wholly invested in low-risk strategies. We have set out in our earlier answers what we regard as low risk strategies. It is also worth noting that there are no metrics that are available to quantify the Greenhouse Gas emissions from assets such as gilts and bulk annuity policies as there are for equities.

Q 9. We propose that regulations require trustees to: a) set at least one target to manage climate-related risks for one of the metrics trustees have chosen to calculate, and to disclose those targets(s). b) calculate performance against those targets as far as trustees are able and disclose that performance.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Whilst we agree with these proposals in principle, as set out in our answers to earlier questions, we believe the regulations should recognise what type of investment strategies represent a low risk approach to climate-related risks and that schemes should be exempt from disclosure and other related requirements where the assets are very largely or wholly invested in low-risk strategies. We have set out in our earlier answers what we regard as low risk strategies.

This is because we do not believe that there is any effective means of reducing or removing any remaining climate-risk-related exposures attaching to the Fund's investments in gilts and bulk annuities. Furthermore, we believe that any materially different alternative strategy the Fund might operate would involve the introduction of greater risk (through climate-related exposures and/or other risk sources) relative to the Fund's liabilities than the residual risks inherent in the current strategy.

Q 10. We propose that, for all schemes in scope: a) The trustees should be required to publish their TCFD report in full on a publicly available website where the report is accessible free of charge. b) The trustees should be required to include in the Annual Report and Accounts a website link to the location where the full TCFD report may be accessed in full.

c) The trustees must notify all members to whom they must send the annual benefit statement of the website address where they can locate the full TCFD report – this must be set out in the annual benefit statement.

d) The trustees should be required to report the location of their published TCFD report to the Regulator by including the corresponding website address in their scheme return.

e) The trustees should also be required to report the location of their published Statement of Investment Principles ("SIP"), Implementation Statement and excerpts of the Chair's Statement by including the corresponding website address or addresses in their scheme return. Do you agree with these proposals?

Is there a better way to notify members of where to find this information?

For example, for DB schemes, might the summary funding statement required by regulation 15 of the Disclosure Regulations be a more appropriate way to signpost m embers to this information?

As set out in our answers to earlier questions, we believe the regulations should recognise what type of investment strategies represent a low risk approach to climate-related risks and that schemes should be exempt from detailed disclosure and other related requirements where the assets are very largely or wholly invested in low-risk strategies. We have set out in our earlier answers what we regard as low risk strategies.

However, it would make sense for there to be a requirement for trustees of pension schemes which are exempt by virtue of a low risk strategy to inform members and the Regulator that their scheme has not produced a TCFD report for that reason.

Q 11: We propose that:

a) TPR will have the power to administer discretionary penalties for TCFD reports they deem to be inadequate in meeting the requirements in the regulations.

b) There will be no duty on TPR to issue a mandatory penalty, except in instances of total non-compliance where no TCFD report is published.

c) In all other respects, we propose to model the compliance measures on the existing penalty regime set out in regulations 26 to 33 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015

d) Failure to notify members via the Annual Benefit Statement or to include a link to the TCFD report from the Annual Report will be subject to the existing penalty regime set out in regulation 5 of the Disclosure Regulations. Do you agree with this approach?

As set out in our answers to earlier questions, we believe the regulations should recognise what type of investment strategies represent a low risk approach to climate-related risks and that schemes should be exempt from disclosure and other related requirements where the assets are very largely or wholly invested in low-risk strategies. We have set out in our earlier answers what we regard as low risk strategies.

Q 12: Do you have any comments on the new regulatory burdens to business and benefits, and wider non-monetised impacts we have estimated and discussed in the draft impact assessment?

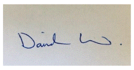
No. The Trustee has not reviewed these impact assessments.

Q 13: Do you have a) any comments on the impact of our proposals on protected groups and how any negative effects may be mitigated?

b) any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats.

c) any other comments about any of our proposals?

No.

Signed: 

Name: David Webb

Date: 5 October 2020

Authorised for and on behalf of the Trustee of the Fund