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

RESPONSE TO THE CONSULTATION FROM CREATIVE GROUP
OCTOBER 2020

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Introduction

The Creative Group is a pensions focused, but broadly based financial services group. It consists of three main service provisions –

- Creative Pension Trust is a master trust Authorised under the Pension Schemes Act 2017. It is a unique auto enrolment and pension scheme packaged solution which was opened to market in March 2015. Today there are c.14,000 participating employers, broadly 103,000 active members and 82,000 deferred. Funds under management are c.£400m and are growing at c.£12m a month (excluding transfers).
- Creative Pension Trust is the fifth largest master trust pension scheme in the UK, measured by number of participating employers.

In addition to Creative Pension Trust –

- A range of Employee Benefit Services is provided to some 500 employers.
- A range of Wealth Management services is provided to the individual employees of the employers who are either master trust or employee benefits clients, and others.
- Overall, Creative Group supports employers who employ c.500,000 staff.

The main consideration in this matter is the effect that any proposals resulting from this consultation would have on Creative Pension Trust (CPT) and its members.

The Creative Group welcomes this opportunity to respond to the consultation.

General

The Creative Group (Creative) welcomes this opportunity to respond to the Government's consultation. We generally agree that it is right for the Government to take action to embed climate change risk assessment, management and reporting in the UK pensions industry further. We agree that such action is likely to drive positive change and improve transparency.

The mandatory adoption of the TCFD recommendations appears to be an appropriate method of achieving those goals and we agree that any action should avoid becoming a tick-box exercise.

Creative, as Scheme Sponsor and Investment Adviser for Creative Pension Trust (CPT) works tirelessly with the Board of Trustees of CPT to ensure that members receive –

- Good value for money
- Excellent service
- A fair and valuable contribution towards their standard of living in retirement from their experience of being scheme members
- The comfort and reassurance that their pension savings are invested in a financially stable master trust

We were very pleased that CPT was Authorised by The Pensions Regulator (TPR) under the Pension Schemes Act (2017).

Context

Before we complete our general remarks and go on to answer the specific questions raised in the consultation, we would like to comment on other initiatives, their timing and the costs associated with them.

New Initiatives

There is a growing list of initiatives that will have a positive and welcome effect on members of pension schemes, including master trust members (the following is not exhaustive) –

- Pension Dashboards
- Increased protection activity from The Pensions Regulator (TPR)
- Master Trust Authorisation
- ESG strategies & Policy Disclosure
- Improved standards of Trustee Governance
- Statement of Investment Principles (SIP) Implementation Statements
- Charge Cap and Standardised Cost Disclosure Review
- Review of Relief at Source (RAS)

Each of these developments is potentially positive for members of pension schemes and we are supportive of all save perhaps for the RAS review. We do not therefore propose to outline the benefits here, suffice to say we support nearly all of them.

The challenge is that each of these initiatives brings cost and, in a DC pension scheme/master trust where a large majority of the pension scheme members are invested in a default strategy, the ability for those costs to be passed on to members is significantly restricted by the Charge Cap, even if the Trustees deemed that appropriate. Additional costs will therefore largely, if not exclusively, have to be absorbed by schemes

It is informative to consider the quantum of the costs involved.

Master Trust Authorisation

A policy we fully support.

The cost to Creative during 2019 was c.£0.5m *before* any consideration of the opportunity cost of the time spent by executive management on the development.

In addition, each master trust must (rightly) have a fully costed Financial Reserves strategy. This means that each will have a significant amount of capital tied up which is effectively "dead money" that cannot be used to meet the costs of funding developments of the master trust proposition.

TPR published the "Facts & Figures post-Authorisation" of master trusts in November 2019 which confirmed that a not insignificant £524m is 'being reserved' to protect master trust members.

The use (or non-use) of this capital requires funding.

Improved Standards of Trustee Governance

In addition to the work undertaken by Trustees in response to master trust Authorisation there is a myriad of matters which have increased the time Trustees have to spend on their responsibilities. Our Trustee meeting agendas now extend to twenty-four items, with time spent on meetings correspondingly increased.

The costs related to the Trustees of CPT have doubled in recent years.

Pension Dashboards

A policy we support.

In a paper for a recent PPI Roundtable on the financial sustainability of master trusts, PPI modelling suggested that the cost of preparing for Pension Dashboards is estimated to be £0.2m with an annual maintenance cost of £0.1m.

ESG

Another policy we are keen to support.

Government, Trustees and scheme sponsors are all committed to improving the stewardship of the investment activities of pension schemes. Social and climate change considerations are already present and are, rightly, subject to more and more scrutiny.

At this stage it is not possible to predict the cost of general ESG considerations but we are acutely aware that if fund managers are to improve ESG reporting, or potentially “tilt” funds towards (or away from) certain types of assets/investee companies it will put pressure on their costs which in turn will increase the costs of fund management overall. We believe this pressure will only be increased as a result of the much more specific and detailed requirements proposed in this consultation.

Increased Protection Activity from TPR and the General Levy

If we are to encourage UK citizens to save for their retirement in Authorised pension vehicles, they must be reassured that their savings are protected.

We find TPR to be a challenging but constructive Regulator and we support its increased activity. Having said that they must also be held to account as to their costs. However, rather than make that point in detail here, we have made it in our response to Government consultation on the General Levy.

Here we focus simply on the effect of that increased activity and the cost of it. We recognise that The General Levy covers costs wider than TPR – Maps, The Pensions Ombudsman – but the vast bulk of the levy monies raised go to fund TPR.

The DWP’s “General Levy Review” of 18^{th} October 2019 confirms that levy related expenditure increased from £40m in 2013/14 to £60m in 2018/19 and is forecast to increase to £100m in 2022/23.

We welcome the fact that Government has delayed the implementation of any proposals to increase the Levy owing to Covid-19 and also its decision to link it to this and other consultations so that things can be looked at “in the round”. However, we note that the costs described in the preceding paragraph represent an increase of 150%. Whichever model is finally adopted by Government we are anticipating increased costs to CPT for the General Levy.

SIP Implementation Statements

The CPT Trustee Board will have to produce its first implementation statements by October 2021. We think it is right that the Trustees should report on the performance of the scheme’s investment strategy relative to the policies set out in the SIP. However, there will be a significant amount of work required to produce the implementation statements, including seeking to identify portfolio turnover costs, separately from transaction costs, that the Investment Managers and underlying fund managers have not generally been asked to provide previously.

We conclude this section by suggesting that straightforward economics tell us that at some point, the cost of all of these and future initiatives will inevitably put upward pressure on member charges and, potentially, the price cap itself.

CPT Investment Background

The CPT scheme has two sections, each aimed at different cohorts of employers and members. Each section has a different Investment Manager with different default investment strategies and investment options available to members in line with the perceived requirements of those members. The only consistency between the investment options for members between the two scheme sections is the underlying funds made available to members who wish to invest in line with Shariah principles and ethical principles.

For section 1 of the CPT scheme 99.7% of the members were invested in the default investment strategy as at 30 June 2020, with 69.8% of the section 2 members invested in the default at the same date. While we and the scheme Trustees are committed to constantly improving member engagement the default investment strategies are aimed at typical members and so we expect the proportion of members invested in the defaults to remain high. As a result, the significant majority of members is subject to the charge cap.

Within each section the Investment Manager makes significant, or exclusive use of sub-funds managed by other fund managers. This creates a significant chain for provision of data and information to the CPT Trustee Board.

The CPT Trustee Board has a preference for passive index/market tracking underlying investment management utilising pooled funds.

This is underpinned by the Trustees' core belief that the primary driver of long term investment returns is asset allocation (as opposed to individual stock/investment selection), as well as the expectation that passive management reduces the risk of significant underperformance relative to the market being tracked and minimises investment expenses. As such the Trustees believe that passive investment management for each underlying market sector provides better value for money for Scheme members.

This is considered in light of other risks and opportunities such as those posed by climate change.

Total assets for the CPT scheme were circa £410m as at 2 October 2020 and we conservatively estimate that figure will grow to circa £575m by 1 October 2021.

Impact Assessment

We believe the impact assessment in the consultation has significantly underestimated the time, resources and costs that will be involved in complying with the proposals for the majority of schemes in scope that have not already meaningfully adopted the TCFD recommendations.

As an authorised master trust scheme the CPT Trustee Board is comprised of four professional Trustees and their fees are all in excess £300 per hour. We believe that the vast majority of pension schemes with ≥£1 billion of assets and all authorised master trusts would employ professional trustees that will charge well in excess of the £29.11 per hour quoted in the consultation impact assessment.

We also believe that the drafting of the TCFD report and other background work to comply with the proposed requirements cannot be undertaken by a basic administrator at cost anywhere near as low as £14.92 per hour, especially in the initial implementation phase.

Familiarisation

While three hours may be sufficient for Trustees to familiarise themselves with the basic content and requirements of the proposals in the consultation we think Trustees will probably have to spend considerably more time familiarising themselves with the data and practices that will be required to comply with the requirements for a particular scheme. For some professional trustees, familiarisation with the general requirements proposed in the consultation may be spread across multiple schemes they are involved with, spreading the cost. However, each scheme will have different circumstances that will impact the familiarisation process.

The same is true for scheme Investment Advisers, Investment Managers, fund managers generally and staff of scheme sponsors and managers, so is not limited to trustees.

Documentation and Disclosure

We agree that it will be beneficial for trustees to produce an annual TCFD report.

However, we believe the impact assessment considerably underestimates the time it will take to collate the relevant information, draft, review and sign off the report. We believe that it is unrealistic to expect an administrator to collate the information and draft the report in only three hours at a cost of only £14.92 per hour, especially for the first report. We believe that just to draft the first report will probably require multiple days of work by both an administrator and more senior staff. Drafting reports in subsequent years will probably require less resource and cost, but as the process evolves in the early years there may still have to be substantial changes and developments to the report drafting process.

Again, as set out elsewhere in this response we believe the costs for trustees' time in reviewing and signing off the TCFD reports will be substantially higher than those outlined in the consultation impact assessment.

Scenario Analysis

We think it is right to expect trustees of larger pension schemes and master trusts to undertake quantitative scenario analysis to assess climate change risks and opportunities meaningfully, to set targets and benchmarks, allow industry comparison and drive material improvements for members. However, we do think there will be significant costs for most schemes to implement that and it will be a significant challenge to manage it in the timescales proposed in the consultation. We also believe there will be significant barriers in relation to obtaining the underlying data to facilitate that to an appropriate level of accuracy.

As the Scheme Sponsor and Investment Adviser for the CPT we have sought input from the scheme Investment Managers on the consultation proposals. One Investment Manager has yet to respond, but from discussions with the scheme's other Investment Manager it is in the early stages of negotiations with a third party climate change modelling provider that would potentially be able to provide quantitative scenario analysis. However, it seems very likely that there will be a discrete additional cost for that service. As yet we have no indication of what that might be, so it is difficult even to estimate the impact for the CPT. However, we do expect that cost to be material in conjunction with the other costs of adopting the consultation proposals. There is also significant uncertainty at the moment of when that modelling service might be available. If the Investment Managers are unable to provide such a service the Trustees will be forced to consider an alternative route, which will have a significant lead in time and additional procurement costs.

Metrics and Targets

We agree that the sourcing and publishing of metrics in relation to climate change risks and opportunities will be beneficial, as will setting targets. It will allow comparison across schemes and investments and should help to drive positive change in the pensions and wider investment industry.

However, we see considerable difficulty in obtaining data (such as quarterly GHG emissions metrics) from fund managers in a format that is sufficiently consistent to allow collation and comparison and then develop meaningful information for publication. While we think that fund managers are unlikely to make additional explicit charges for providing the relevant data we do think it will create upward pressure on Annual Management Charges (AMCs) for funds that pension schemes invest in, alongside other recent and planned changes in relation to cost transparency and value for money assessment. As such some of these initiatives may actually be counter-productive.

We therefore believe that the cost per scheme in the impact assessment for the consultation is likely to be significantly underestimated not just in the first year, but in the first few years as the pension and investment industries gradually adjust to the requirements that most schemes will only just start to impose on fund managers.

Publishing and Signposting

We agree that the cost of this should be minimal once the report has been produced.

COVID-19

While for the CPT we have seen a relatively limited impact from the first wave of the global pandemic the unwinding of the Job Retention Scheme may have a more significant impact, as will any significant second wave. This may result in a retardation of the growth of member and employer numbers for the CPT and projections for income growth have already been adjusted accordingly. The growth in the CPT net asset value has already been hit by the global pandemic and that is likely to be sustained until a vaccine is available. These factors restrict growth of income for the CPT and therefore the capacity to meet increasing cost requirements in the shorter term.

Data Availability

As mentioned elsewhere in this response we have requested input from both the Investment Managers employed by the trustees of CPT to try to understand what data is currently available and what might be available within the timescales set out in the consultation proposals. The responses have been very limited so far and have given us little confidence that the necessary data will be available in order for the CPT Trustee Board to comply with the proposals in a materially useful way.

Given the time constraint for responding to this consultation we have also conducted some very limited research in relation to the underlying investment funds currently used by CPT. Based on that it appears that public TCFD reporting is almost non-existent from the fund managers and while most of the underlying managers used within CPT produce information on climate change risk policies and practices, data at a fund level is very thin on the ground.

Being able to obtain Greenhouse Gas (GHG) emissions and other metrics in relation to the consultation proposals seems likely to be a very tall order initially.

We accept the consultation proposals make allowance for an “as far as trustees are able” approach with the ability to use estimates, but that will still have a significant resource and cost implication and be a barrier to useful reporting.

We would encourage Government and regulators to seek to impose mandatory industry wide reporting requirements on fund managers as a first step, such that data is then readily available across the investment industry, not just for pension scheme trustees, advisers and managers, but for all consumers.

ANSWERS TO SPECIFIC QUESTIONS

Question 1

We agree that the largest pension schemes should be the first to be in scope for mandatory adoption of the TCFD recommendations. We believe that larger schemes generally have greater resources and capacity to deal with the significant costs of implementation. While we agree that authorised master trusts should be at the forefront in terms of governance standards we question why any reference to their net assets is excluded. We believe that while master trusts should be in scope the timing referred to in question two should be adjusted based on the same £1 billion net asset threshold for other trust based schemes. The cost of compliance with the proposals is likely to be a mostly fixed cost (i.e. not significantly linked to net asset size or membership) with a more significant up-front cost in the first year or two. Larger schemes will generally be able to absorb those costs much more easily.

As mentioned elsewhere in this response we question why pension schemes are being targeted in this area prior to investment/fund managers. Our understanding is that the majority of UK pension schemes invest some or all their assets in pooled investment funds run by one or more investment manager. It would seem to make sense that standardised climate change reporting requirements are first imposed on the investment/fund managers for each of the funds they run such that pension scheme trustees and their investment advisers then have easy access to uniform/consistent data for comparison to facilitate informed investment decisions in relation to climate change risks and opportunities. One of the biggest problems we currently face in terms of the scheme investment strategy is obtaining comparable and consistent ESG, Stewardship, climate change and charges information from investment managers.

Question 2

We see the benefit of a progressive and phased implementation of the new requirements and the value of early adoption. However, the proposed timescales are very short considering other initiatives that will, or may potentially, need to be addressed at the same time, such as the new SIP implementation statement requirements, and pension dashboard. As an authorised master trust provider we would be required to support the scheme Trustees to implement the initial phase of the proposals in a fairly compressed timescale, putting a significant strain on resources as well as the additional costs. With the significant level of detail that the Trustees will have to consider, and ultimately report on, and the difficulties we see with obtaining the necessary data from fund managers, the proposals present a very significant challenge. Under the current proposals the CPT would have to comply from 1 October 2021 and produce a TCFD report by 31 October 2022 at the latest. We believe the Trustees would therefore have to have initial processes in place by 1 April 2021 (the start of the next Scheme year) to facilitate that with confidence.

We suggest that authorised master trusts are treated the same as other schemes in terms of the £1 billion net assets threshold.

Question 3

Yes, the proposal to conduct a further review in 2024 to decide on extending the requirements to smaller schemes appears to be a proportionate approach. Assuming the other consultation proposals in scope and timings are adopted this would not directly affect our scheme as an authorised master trust, but it may help to improve the standards and consistency of management and reporting across the pension and investment management industries.

Question 4

Assuming the other consultation proposals are adopted yes, we believe it makes sense to clearly define the roles and responsibilities of the relevant parties in managing climate change risks and opportunities for a scheme. This is a relatively simple task which is likely to incur a small additional cost for schemes.

Question 5

Yes, it makes sense to consider the impacts over different time horizons relevant to the scheme and how they affect/influence the actual investment strategy, as long as Trustees have the proposed flexibility to determine the time horizons.

Question 6

Yes, in principle setting a benchmark should provide consistency of reporting, not only for members, trustees and schemes, but also for investment managers, investment advisers and modelling providers, which should help to provide some industry standard that seems to be lacking at the moment. Reference to the Paris Agreement upper limit appears to be a reasonable starting point. The difficulty we see is with obtaining appropriate modelling services and data to enable trustees to comply with this proposal.

Question 7

Yes, if the other proposals are adopted as set out in this consultation it will be necessary to further develop and fully integrate climate change risk management processes alongside other risk categories and it will then be appropriate to disclose those processes.

Question 8

While the proposals to select and report on GHG and non-GHG metrics make general sense to us as a goal we are unaware of how easily such information may be obtained and we suspect it will initially be very difficult to obtain consistently across a range of different investment options and asset classes from various fund managers. We suspect this is going to be very challenging to implement for our scheme from the outset especially by the proposed reporting deadline of 31 October 2022. Without further research we are unable to confirm our suspicions, especially considering the short window to provide responses for this consultation. As mentioned elsewhere in this response we have approached our Investment Managers for input, but are still awaiting a response from one Manager.

The discussions we have had with the other Manager have not provided a significant insight so far. We accept that the trustees can disclose why not all asset classes are covered, but with no standard for the investment management industry we think the gaps might be greater than those that can be report initially. As a result we are concerned that these proposals are overly prescriptive to implement from the outset and we would prefer for them to be phased in, or better still reporting requirements should be placed on fund managers first.

Question 9

Assuming the other consultation proposals are adopted we agree that the setting targets, measuring against those targets and disclosing that is appropriate to drive improvements. However, as per our response to question 8, we question whether the metrics will be appropriate and whether trustees and their advisers will be able to obtain the necessary data to make that viable. In that respect we welcome the "as far as the trustees as are able" approach, but again would prefer to see reporting requirements being imposed on fund managers first. The proposal that trustees will need to review performance against the benchmark/target on a quarterly basis, while only reporting on an annual basis also seems overly burdensome to us.

Question 10

Yes, assuming the other proposals are adopted we find the proposals for the reporting to be made available publicly acceptable considering the existing requirements for the SIP and Chair's Statement. We agree with the minimum signposting requirements for members via the annual benefit statement. The inclusion of a website link in the annual report and accounts poses no issue for us, nor does the proposed reporting requirements for TPR. As with for example the SIP we would expect to make the TCFD report available via the member portal for the scheme, as well as the general website, and would probably consider other member signposting.

Member signposting via summary funding statements for DB schemes makes sense, although it in not relevant for our scheme.

Question 11

Yes, assuming the other consultation proposals are adopted the proposal that mandatory penalties would only apply for total non-compliance is reasonable from our perspective. Discretionary TPR penalties for inadequate reports also seems proportionate and otherwise the existing penalty regimes for compliance and signposting are acceptable.

Question 12

While we expect the Government and regulator to seek to progressively improve governance standards, adapt legislation and regulation to changing conditions the rate of new requirements on pension scheme providers has a very significant burden on trustees and scheme managers where the costs that can be passed on to most members are restricted by the charge cap. Please see the section of this response document titled "Impact Assessment" for a more detailed response to this question.

Question 13

No other comments for this question.

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