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Submitted via email to:

Climate Governance and ESG team
pensions.governance@dwp.gov.uk

Dear Sir/Madam

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

Deloitte Total Rewards and Benefits Limited and Deloitte LLP (together "Deloitte") are pleased to respond to the Department of Work and Pensions (DWP) consultation on proposals to require certain occupational pension schemes to incorporate the consideration of climate related risks and opportunities into their governance processes and decision making, as summarised in a series of mandatory disclosures.

Deloitte Total Reward and Benefits Limited's team of actuaries and other pension experts provide advice to trustees and corporate sponsors of UK pension schemes on a range of issues. Our Investment Services team is specifically focussed on providing investment advice which takes full account of pension scheme liabilities and long-term funding targets.

We welcome the consultation and Deloitte is committed to contributing positively to improved climate outcomes. We also fundamentally believe that climate risks and opportunities are sufficiently material to impact pension scheme funding positions over various time horizons. While our response takes account of our views on the implications of climate change, we also consider the practical implications for pension scheme trustees, noting that their primary objective is the provision of all benefit cash flows as they fall due.

TCFD is market-driven and investor-focused, and is recognised as an appropriate framework by the International Organization of Securities Commissions (IOSCO) globally and by the European Securities and Markets Authority (ESMA) in the EU. It is a very useful framework to think about climate, and reporting having regard to the principles within it is an important priority. is also an important contribution to developing global sustainability-reporting standards for climate-related information. In recent weeks we have seen significant steps made by IOSCO and the IFRS Foundation. Furthermore, leading international sustainability standard setters and frameworks have published a statement of intent to work towards a comprehensive corporate reporting system and issued an open letter to call on IOSCO to take a leadership position in creating the standard-setting architecture that would deliver a global climate reporting standard that incorporates TCFD recommendations. This global direction of travel should be taken into account in the development of any UK climate-related disclosure requirements. Therefore we believe that the obligation to report against the statutory guidance should be considered a short-term measure.

As disclosure moves from compliance with the TCFD recommendations to a future standard it will be important that the regulations themselves do not contain too much detail, given the need for Parliamentary time to revise them.

We therefore suggest that:

- The Regulations are very high-level, referring to the need to report against the statutory guidance which will cover, inter alia, governance and risk management disclosures as well as metrics and other climate-related disclosures. This is just enough detail to allow for differential implementation dates for the governance and risk elements and the rest.
- The statutory guidance then requires reporting on a "comply or explain" basis against the TCFD recommendations. This would acknowledging that TCFD is a set of recommendations rather than a reporting standard, so it may provide challenging to determine what compliance might look like in some respects, and would be consistent with the approach being taken by the FCA for premium listed commercial companies.
- The statutory guidance should not seek to copy out the whole of the TCFD recommendations tailoring them for pension schemes, as this would be a significant effort and risk confusion; copying out and tailoring only parts of the recommendations would equally leave gaps in the materials. We suggest instead that it provide brief application material as to how a scheme might apply the TCFD materials as issued, as well as requiring that if trustees cannot report against some of the TCFD materials that they should explain why they should not and the steps that they are taking (including the steps they are taking to obtain information from third party asset managers, investment advisors etc.). This approach is appropriate given that some of the recommendations in TCFD are more in the nature of principles, rather than rules and will allow trustees to be held to account in subsequent years for progress or lack thereof.

In the long term, we believe reporting of climate related information in line with TCFD recommendations or subsequent climate reporting standards should be required for all large economic enterprises – including both users and providers of financial capital. We encourage the DWP to work with the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA), the Pensions Regulator (tPR), and the Department for Business, Energy and Industrial Strategy (BEIS) and other UK regulators to ensure a consistent and joined-up approach to the introduction of climate-related reporting requirements across the various types of entity within the regulators' respective remits. In particular we note that the ability of pension trustees to provide data "as far as they are able to" may well depend on their ability to source data from investment managers acting on their behalf; with the UK not having adopted the EU Disclosures Regulation (2019/2088) and the FCA not yet mandating disclosures by asset managers, AIFMs and UCITS operators, trustees may struggle to obtain data for at least the first year or two.

The response below addresses each of the questions raised by the consultation.

We would, of course, be happy to discuss any of our points made in further detail if required.

Yours faithfully

Richard Slater
Head of Investment Services
Deloitte Total Reward and Benefits Limited

Question 1
We propose that the following schemes should be in scope of the mandatory climate governance and Task Force on Climate-related Financial Disclosures (TCFD) reporting requirements set out in this consultation: a) trust schemes with £1 billion or more in net assets b) authorised master trusts c) authorised schemes offering collective money purchase benefits Do you agree with our policy proposals?
Our response
With regard to a) trust schemes with more than £1 billion of assets, we agree that a minimum size requirement is justified initially given the likely time and cost involved to comply with these new requirements. Trustees of these larger schemes will be better able to cope with the lack of precedence and potential absence of established metrics, calculation methodologies and scenario analysis tools as market participants get up to speed and investment managers and advisors standardise their approach. We agree that assets in excess of £1 billion is an appropriate definition of large occupational pension schemes and are supportive that you have proposed that very large pension schemes with assets in excess of £5 billion will be the first to be captured by the proposals. We also agree in respect of the inclusions of b) authorised master trusts given their expected growth in size. However, it is not clear why a small master trust is not afforded the same terms as small trust schemes in terms of timescales for preparing to meet these requirement. We suggest that the £1bn threshold be applied to each of (a)-(c).

Question 2
We propose that: a) trustees of schemes with £5 billion 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 £1 billion 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 £1 billion 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 £1 billion asset threshold was met
- 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?

Our response

In general it appears that in the various scenarios cited, impacted pension schemes will be given approximately a year to comply with the requirements. We have no issues with this timeframe provided these requirements are well established. However, those schemes which are captured initially will be at a disadvantage given their reliance on data and advice from elsewhere in the investment chain. Consideration should therefore be given to extending the period for these schemes, in particular given that many schemes may be dependent on FCA regulated asset managers for the necessary information. Given that in FCA CP 20/3 the FCA has not proposed imminent obligations on unlisted asset managers to report against TCFD, nor to report mandatory GHG metrics, and that the UK has not decided whether to adopt the EU Disclosures Regulation (or an equivalent) once EU law ceases to apply, trustees of schemes may struggle to obtain reliable information with which to prepare their own reports. Whilst a DWP mandate may provide a market led pull for asset managers to provide the necessary information, we believe it would be more appropriate for a joined up FCA/PRA/DWP timetable for adoption

In any event, time will be of the essence and so we request that DWP publishes the results of the consultation, draft legislation - and consults on the content of the statutory guidance - as soon as possible. With so many approaches possible when it comes to pension scheme compliance, we consider timely guidance to be particularly important.

We note that under the proposals, £1 billion trust schemes are required to comply one year later than £5 billion schemes. We consider that schemes with assets in excess of £5 billion should be some of the best run schemes in the UK, but that governance budget and the ability to bear additional costs may differ at the £1 billion asset level. The very largest schemes are also more likely to be able to collect information in house; those schemes between £1bn and £5bn may still outsource at least some asset management to asset managers who may not yet be obliged to report against TCFD. Consideration should therefore be given to establishing a longer gap between the deadline for those schemes with £5 billion and those with £1 billion in assets, to provide sufficient time for the establishment of standardised metrics and analysis, negotiation of information provision by asset managers, as well as clear compliance strategies.

In relation to g), consideration should be given to situations where a scheme reduces in size materially between scheme year-ends. For example, requiring a scheme to still meet the requirements at the end of a scheme year in which it has been subject to a full scheme buy-out seems overly onerous and would have minimal value with regard to contributing to an improved climate outcome. It may even prevent that scheme from being wound-up.

Question 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 £1 billion 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?
Our response
We agree that consideration should be given to extending the measures to all occupational pension schemes. The combined size of all UK pension schemes is obviously significant and their collective ability to influence future climate trends is undoubtedly meaningful. That said, at the point of review, consideration should be given to the large number of very small schemes. These requirements would create an increased governance burden for trustees of schemes which have a disproportionately lower impact on future climate trends on an individual basis. Their investment strategies will commonly invest in established and sizeable pooled funds which will already be subject to scrutiny from larger schemes.

Question 4
We propose that regulations require trustees to: a) adopt and maintain oversight of climate risks and opportunities 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 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?
Our response
We believe that these requirements are appropriate given the aims of the disclosures, namely the integration of climate risks and opportunities into trustees' existing governance frameworks. That said, the asset management industry has work to do to demonstrate the integration of climate considerations into their own processes, thereby providing the necessary reassurance to pension scheme trustees. Statutory guidance will be particularly valuable as these requirements, as articulated in the question, will be open to interpretation.

Question 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.

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Do you agree with these proposals?

Our response

Assessment over different time periods makes sense as asset allocation will evolve given many schemes are working towards longer term funding objectives and the ultimate goal of meeting cash flow obligations as they fall due, with the aim of doing so with increased certainty as time progresses.

The impact on liabilities must also be considered. We are equally supportive of the proposal for an integrated risk management approach, whereby assets, liabilities and covenant are all considered when assessing climate related risks and opportunities. In this context, the consideration of different time horizons also makes sense. Final salary pension schemes will be more reliant on their covenant over the short to medium term for example with climate risks having an impact on the covenant strength and the adequacy of agreed recovery plans. Similarly, liabilities typically extend many decades into the future and hence a longer-term assessment is also appropriate.

We recognise that certain physical and transition risks will be more or less impactful over different time periods and assessing the general impact of climate considerations over different time periods will enable trustees to understand the full breadth of their scheme's exposure.

Statutory guidance will need to provide clear definitions of the different time periods which should be considered. Given that each scheme will be different in terms of maturity profile and funding position relative to its long term goal, the guidance must be flexible but also practical in a pension scheme context. Perhaps instead of the cited definitions of short, medium and long term, pension schemes could be asked to consider climate risks and opportunities over their existing recovery plan period to the attainment of their long term funding objective (i.e. low dependency/buy-out) if different. For those schemes targeting low dependency, the longer term period post the implementation of their low risk, cash flow generating low dependency portfolio might be appropriate.

Question 6

We propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of defined benefit (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?

Our response

We agree that scenario analysis is a useful tool and will help trustees to assess the impact of climate issues. Its use will also align climate risks with other key risks impacting a pension scheme's funding position. For example, interest rate, inflation and equity exposure are already subject to extensive analysis and modelling.

However, clear and detailed statutory guidance is required, which should include a summary of acceptable metrics, scenarios and methodology. In the absence of clear guidance, we would be concerned with the consistency, comparability and quality of the analysis being performed. We note that there is a wide range of metrics which could be used, the same metric could even be calculated differently, and models used to conduct scenario analysis could differ greatly from a methodology perspective while also being highly reliant on its various assumptions.

Trustees will be particularly reliant on their asset managers and advisors in this regard. Climate data and analysis is a specialised field and many market participants may not have the understanding of the nuances and ultimate relationship between an asset's climate exposures and how they inform its contribution in relation to potential warming scenarios.

Guidance should be made available as soon as possible to afford asset managers and advisors the time required to carry out the requisite work to examine their assets and provide climate data in the form required to enable schemes to carry out consistent, reliable and comparable analysis.

Question 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?
Our response
We agree. We see these requirements as an extension of what schemes already do in relation to other key risks and the new requirements around financially material considerations specifically. Guidance, as ever, would be helpful - with efforts made to ensure that these particular requirements aren't overly burdensome and don't lose sight of the ultimate goals of the exercise.

Question 8
We propose that regulations require trustees to: a) select at least one greenhouse gas (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?
Our response
The use of metrics will be valuable to the ongoing monitoring of climate risks. We support that the proposal is that schemes won't be required to measure a vast array of different metrics. The challenge trustees will face will be selecting the "best" metric. Ultimately, schemes are different, with differing asset strategies and funding targets. The most appropriate metric will also differ as a result. It will be

important to reach a balance between trustees' need for guidance, given the vast array of metrics and calculation methodologies available, and the need for metrics to be relevant to the scheme in question.

We also note the expected reliance on third parties to provide this data. Without clear guidance, investment managers may be under pressure to produce a large variety of different metrics at the request of different investors. This could be particularly challenging given the proposed timescales.

It could therefore be helpful to provide a small range of recommended metrics, and suggested targets around each metric, to help trustees with metric selection and support investment managers to focus appropriately.

Noting our points around the differences between pension schemes, we also have some concern that the disclosure of metrics may create inter-scheme comparisons, which are neither helpful nor insightful. The emphasis of any legislation and guidance should be on trustees' fiduciary responsibilities and the consideration of climate risks in this context. We would be wary of peer-group/member pressure potentially increasing the emphasis on reducing metrics at the possible detriment of improving the probability of achieving funding outcomes.

Question 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?

Our response

Our views in relation to question 9 mirror those in question 8 above. Targets have obvious value but need to be scheme-specific. A mature scheme holding mainly hedging assets (gilts and index-linked gilts) may have minimal exposure to climate risks and the ability to improve exposure relative to a specified target is diminished. Similarly, schemes which need to hold large portions of their portfolios in asset classes such as equities to meet their funding aims may have limited ability to improve a particular metric.

Whilst trustees will have scope to set appropriate targets, public disclosure may create undue pressure on those schemes which may ultimately lead to sub-optimal behaviour. For example, a scheme which needs to hold growth assets to meet performance targets may be encouraged to hold less of these in order to improve certain climate metrics relative to other schemes.

Question 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 members to this information?
Our response
We agree that members should be kept informed of their pension scheme's approach relating to climate risks and opportunities, since trustees are ultimately managing the scheme on members' behalf. Notifying members through annual benefit statements seems appropriate in our view. We also support full disclosure to the Pensions Regulator on accountability and enforceability grounds.

Question 11
We propose that: a) The Pensions Regulator (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?
Our response
We are comfortable with the proposals given the use of discretion. Trustees should be afforded the opportunity to explain any non-compliance and the steps they will take to remedy the situation. For example, if an investment manager is unable to provide the data necessary for disclosure - but the trustee is working with the manager to ensure timely release of data for disclosure requirements ahead of the next scheme year end - then this should be considered reasonable.

Question 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?
Our response
Ultimately it is difficult to quantify the burden/costs involved and this needs to be balanced in the context of the climatic and social benefits expected form these changes. Experience will be key and hence the initial roll-out to just those larger schemes, who will likely be better able to absorb any costs, should prove a useful barometer in this regard. We do consider that the costs set out in the draft impact assessment are likely underestimated, however, as the impact analysis does not adequately reflect the likely role investment advisors will need to play in getting trustees

up to speed, setting policy, performing analysis and drafting the TCFD report. Larger schemes will also have more than three trustees and costs are likely to differ by scheme due mainly to the relative complexity of asset strategy.

We note however that costs are likely to reduce in subsequent years as policies are established and advice/analysis becomes more standardised.

Experience will again be key to assess the benefits versus the costs though efforts should be made to minimise complexity where possible. The costs associated with the reporting will need to be put in context against the measurable benefit of changing investor behaviour.

Question 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?

Our response

No further comments.