ASSOCIATION OF PENSION LAWYERS
c/o Dominic Harris, CMS, Cannon Place, 78 Cannon Street, London EC4N 6AF

Bethan Livesey, Tom Rhodes, Andrew Blair, and David Farrar
DWP
Climate Governance and Environmental Social Governance (ESG) team

By email to: pensions.governance@dwp.gov.uk

7 October 2020

Dear Bethan, Tom, Andrew and David

Taking action on climate risk: improving governance and reporting by occupational pension schemes (the "Consultation")

I am writing on behalf of the Investment and Defined Contribution Sub-Committee of the Association of Pension Lawyers of the United Kingdom ("**APL**"). The APL is a not-for-profit organisation whose members comprise over 1,100 UK lawyers, including most of the leading practitioners in the field, who specialise in providing legal advice on pensions to sponsors and trustees of pension funds and others, including the largest pension funds in the UK. Its purposes include promoting awareness of the role of law in the provision of pensions and to make representations to other organisations and governments on matters of interest to APL members.

The purpose of this letter is to set out our responses to a number of the questions asked in the Consultation. As is usual, we do not comment on issues of policy other than where we do not think your proposals achieve your stated policy aim.

<u>Question 1</u>

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?

<u>Net assets threshold</u>

It would, in our opinion, be sensible to set out further detail on what amounts to "net assets" in this context.

Large trust schemes that we work with are at very different stages of their life cycle. A scheme that closed to accrual and new entrants some years ago is likely to have 'de-risked' its investment strategy. For example, it may well have entered into large buy-in policies with an insurer – and these are often measured in the hundreds of millions of pounds, or indeed in the billions. In return for the premium paid by the trustees, these policies will simply provide a contractual payment stream matching the payments promised by the relevant tranche of the scheme. Assets held by the insurer as regulatory capital to back such policies are controlled by the insurer and the trustees as policy holder will have no ability to direct or influence how such regulatory capital is invested. As such, in our opinion, it is the insurer on whom any TCFD obligations should fall.

These policies are an investment, and will count as an asset of the scheme. However, once entered into, a buy-in policy cannot usually be surrendered or unwound. Other similar long term de-risking options (such as a longevity contracts) will similarly be difficult, and in some cases impossible, to unwind.

Given that the regulatory capital backing buy-in policies (and certain other insured de-risking contracts) is not controlled by the trustees and such policies cannot usually be unwound, there would, in our view, be a mismatch between what is legally considered asset of the scheme and the intended policy objective. As such, we do not consider that assets such as a buy-in should count towards the £1bn threshold (or £5bn threshold for early adoption).

For similar reasons, there is also clearly an argument for excluding investments in cash, gilts and many derivative products from the net asset threshold.

<u>Reporting obligations for certain assets</u>

Whether or not the Government decides that these assets should still count towards the net asset threshold, as a separate matter, and for the reasons given above, it may also be appropriate to also consider excluding them from the reporting obligation.

In our view the proposed legal obligation requiring trustees to report on, say, a buy-in over which they have no control and cannot realistically disinvest or, say, a cash fund, which has no climate change implications does not appear to us to assist in fulfilling the policy objective.

<u>Appropriateness more generally</u>

More generally, many mature schemes are also fully funded and fully hedged – and for these schemes, with only a very short time horizon, the burden of this process may far outweigh any benefits that arise from the process.

Similarly, many DC and hybrid schemes are (and, we expect, will be) looking to transfer their DC benefits to alternative vehicles (commonly to a DC master trust), which would leave the scheme with no assets or net assets below the proposed threshold. Again, the burden of further disclosure during this DC wind-up period may outweigh the benefits.

Provisions inserted in Regulation 2(3) of The Occupational Pension Schemes (Investment) Regulations 2005 in 2019 allowed trustees to take a view on the appropriate time horizon of their scheme when looking at ESG. In this case, where the appropriate time horizon is short, might it also be possible for trustees to disclose that and undertake a more limited process?

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?

The current proposals require the reporting obligation to be met by the earlier of 7 months from the current scheme year end date and 31 December 2022 / 23 (depending on asset size).

This timetable is likely to be problematic for schemes with year-ends between 30 June and 30 September for whom the reporting obligation would fall as follows:

£5bn+ schemes:

Scheme year end date	**First scheme year to which governance obligations apply**	**Report and accounts due**	**Reporting deadline under proposal**	**Period between scheme year end and reporting deadline**
30 June	July 2021 – June 2022	January 2023	December 2022	6 months
31 July	August 2021 – July 2022	February 2023	December 2022	5 months
31 August	September 2021 – August 2022	March 2023	December 2022	4 months
30 September	October 2021 – September 2022	April 2023	December 2022	3 months

£1bn+ schemes:

Scheme year end date	**First scheme year to which governance obligations apply**	**Report and accounts due**	**Reporting deadline under proposal**	**Period between scheme year end and reporting deadline**
30 June	July 2022 – June 2023	January 2024	December 2023	6 months
31 July	August 2022 – July 2023	February 2024	December 2023	5 months
31 August	September 2022 – August 2023	March 2024	December 2023	4 months
30 September	October 2022 – September 2023	April 2024	December 2023	3 months

As can be seen, such schemes would, under the current proposals, have to meet the reporting obligations in a shorter period than would usually be available to complete their report and accounts. The issue would be being particularly acute for schemes with a year end of 30 September having only 3 months to complete their TCFD report.

This seems unfair and could result in an inability for them to provide meaningful reports in the first year.

We appreciate the Government's desire to attain the goal, set out in its Green Finance Strategy, of all listed companies and large asset owners disclosing in line with the TCFD recommendations by the end of 2022 but consider it would be appropriate to give all schemes until 7 months from their year-end to comply. This timetable would also have the benefit of bringing the drafting of the TCFD report into line with that of the scheme's annual report from the outset.

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?

Yes, we agree. In particular, we believe it would be helpful to review any regulations and statutory guidance already in place at that time, to ensure they remain appropriate. ESG disclosure obligations are relatively new to trustees and advisers alike, and the ease by which compliance can be achieved in practice is often properly understood after the obligations have come into force.

We would also observe that the relatively large number of recent ESG disclosure and governance requirements imposed on trustees have been introduced in a piecemeal way. We believe that many of these obligations would be better looked at "in the round" – and so it may be helpful for any review in 2024 to look at the TCFD requirements in the context of the package of trustees' wider ESG obligations and duties.

Similarly, this would also allow the Government to reduce the administrative burden on trustees and managers by consolidating these governance and disclosure requirements into a single source and, perhaps, to have a single disclosure covering the many ESG and stewardship obligations that have come into force over recent years. This would also allow members and consumers to look only at a single document (for example, incorporating all of these requirements into an annual report).

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?

While in principle we agree with these proposals, in our view it may be helpful to be more prescriptive in setting out who the "persons managing the scheme" may be, to avoid any confusion. For example, on the face of it this may not encompass persons managing the assets (although these individuals would seem to sit four-square in the policy intent – e.g. the decision makers in an in-house, trustee owned fund manager). On the other hand it is suggested that it would include employees of the principal or controlling employer (who of course have their own interest when it comes to the decisions made in relation to scheme investments – as is reflected by the requirement that trustees consult with the employer before making changes to the scheme's statement of investment principles).

Assuming that a person 'managing the scheme' would include individuals to whom the trustee has delegated certain duties, it would be helpful for any guidance to clarify the extent of autonomy and decision-making power required to constitute a scheme management role. A similar discussion was had around the identification of 'scheme strategists' (as part of the DC master trust authorisation and supervision process), where TPR guidance was needed to avoid large numbers of individuals being categorised in a manner that did not align with policy intent. It can be very helpful to include examples within guidance to help with the interpretation of the legal obligation.

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.

Do you agree with these proposals?

No comments (but see response to question 6 below)

<u>Question 6</u>

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?

<u>Ability to obtain information</u>

We welcome the caveat that trustees should assess the resilience "so far as they are able". This reflects the fact that much of the information they will require in order to carry out this (and indeed a number of the other tasks set out in the consultation) will be dependent on information being provided by third parties – and asset managers in particular. As a result, it is pleasing to see the statement from the Minister and FCA (https://www.gov.uk/government/news/fca-climate-risk-plans-welcomed-by-pensions-minister) – though it will be important to ensure that the links between the trustee and asset manager community are seamless, in terms of timing, content and format. In our experience, even very large schemes do not always have the commercial leverage to quickly obtain necessary information from asset managers in order to meet regulatory requirements.

Trustees will also face additional costs and resource demands in order to achieve compliance. We appreciate that the consultation provides estimated trustee costs (see response to question 12 below) and this fact has been taken into account when deciding where to set the net asset threshold. However, it would be useful to understand (by way of guidance and/or in the regulations) the extent to which the caveat of "so far as they are able" enables trustees to take a proportionate approach to compliance. For example, if third parties were to levy charges on trustees for certain information.

<u>DB funding strategy</u>

Clearly pension scheme investment and employer covenant are linked (as has been discussed in the recent DB funding code consultation). To the extent that a sponsoring employer is in an industry that benefits from opportunities, or has specific risks arising from, climate change, then it is likely that will already be taken into account during an actuarial valuation and the associated covenant review. However, this is a triennial process.

To the extent that work beyond that is required, for example an annual review, it is likely that the covenant advice alone would likely exceed the estimated costs for trustees (referred to in question 12 below) by a material amount. It will also require the employer to provide ongoing covenant information beyond current expectations/requirements.

It is also inevitable that actuarial advice will be needed (e.g. to understand the impact of climate related risk on the scheme's liabilities). We note the actuarial profession's work in this complex area for some years now. The cost of such advice does not appear to be covered in the anticipated trustee costs.

Generally speaking, it might be helpful for any statutory guidance to guide trustees as to the input they might want to seek from different types of advisers where proportionate for them to do so.

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?

No comments

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?

As set out in our answer to question 1, it may be sensible to explicitly exclude some asset classes (for example, gilts and insured de-risking products) from the requirement – as we suspect that many trustees will simply not include emissions data for those asset classes in any event.

Furthermore, while it is helpful that trustees will not be mandated to use specific measures of assessment, in view of the possibility of discretionary fines for non-compliant processes and disclosures, we feel it will be important to provide comfort in guidance on the range of metrics that might be used, minimum standards and what would be acceptable and what would not be.

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?

Whilst targets may be helpful for trustees to better manage climate related-risks within their schemes, it will be important that these are set by trustees with the purpose of managing financially material factors in line with their fiduciary duties. It may be helpful for any statutory guidance to guide trustees as to the use of targets in order to avoid them being set as arbitrary non-financially based goals.

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?

There is currently a mismatch between DB and DC in this regard – as while annual benefit statements must be provided to most DC members, the annual report is only distributed to members on request. On that basis using the summary funding statement, which is sent out as a matter of course to most DB members, does seem to be a sensible approach.

DC members are notified of a range of information in the annual benefit statement e.g. the online publication of the Chair's statement, the SIP and the eventual publication of the implementation statement. This statement will therefore, if it also signposts the TCFD report, contain links to complementary investment related documents for DC members. There is no equivalent annual reporting structure for DB members. Normal disclosure rules apply to telling DB members that the SIP or implementation statement is online, which may be via a different document and not via the scheme funding statement. This may or may not align with policy intent.

We would also note the risk of confusion regarding the intended audience for the publicised document. For example, to what extent is it a tool to improve trustee governance, a member engagement tool and/or a document for regulatory oversight? A lack of clear intended audience can make compliance with the disclosure obligations more complicated and more costly. We are seeing this in practice in respect of the drafting of SIPs and initial work on implementation statements. Any clarity that guidance could bring on this would be welcomed. In more general terms, in our view, and as we set out in our response to question 3, we believe that this area that may benefit from consolidation – perhaps allowing trustees to disclose a single document that includes the ESG and stewardship disclosures that are relevant to the scheme in question.

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?

Yes. We welcome this approach. In particular, we agree with the limited use of the mandatory penalty to total non-compliance, which we understand to mean complete failure to publish any form of TCFD report online.

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?

In our view the workload on trustees will be significant, and will be much higher depending on the structure (not the total assets under management) of the scheme. For example, the number of asset managers employed is likely to be of particular significance. Similarly, as we flagged in our answer to question 6, we believe the covenant costs alone may well require consultant input with the associated costs.

In turn, this leads us to believe that the estimated cost of £15,000 per scheme, per year is unrealistically low. Although larger schemes may have more resource, that is often to be found in costly managers and consultants.

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?

No

We should, of course, be delighted to discuss any of the contents of this response in further depth if that would be helpful. Please feel free to contact me (dominic.harris@cms-cmno.com), Stuart O'Brien (Stuart.OBrien@sackers.com) or Anna Copestake (Anna.Copestake@arcpensionslaw.com).

Yours sincerely

Dominic Harris

For and on behalf of the Association of Pension Lawyers