The ABI's response to the Department for Work and Pensions consultation on *Taking action on climate risk: improving governance and reporting by occupational pension schemes*

October 2020

About the ABI

The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry. A productive, inclusive and thriving sector, our industry is helping Britain thrive with a balanced and innovative economy, employing over 300,000 individuals in high-skilled lifelong careers, two-thirds of which are outside of London.

The UK insurance industry manages investments of over £1.7 trillion, pays nearly £12bn in taxes to the Government and powers growth across the UK by enabling trade, risk-taking, investment and innovation. We are also a global success story, the largest in Europe and the fourth largest in the world.

Founded in 1985, the ABI represents over 200 member companies providing peace of mind to households and businesses across the UK, including most household names and specialist providers.

The ABI's role is to:

- Get the right people together to help inform public policy debates, engaging with politicians, policymakers and regulators at home and abroad;
- Be the public voice of the sector, promoting the value of its products and highlighting its importance to the wider economy and society;
- Help encourage consumer understanding of the sector's products and practices; and
- Support a competitive insurance industry, in the UK and overseas

Executive Summary

1. The ABI is a formal supporter of the Taskforce on Climate-related Financial Disclosures (TCFD). Implementing a consistent climate-related disclosure framework across the board will lead to more informed business, risk and investment decisions. Take up of TCFD by firms is improving; four fifths of the top 1100 global companies now disclose climate-related financial risks in line with some of the TCFD recommendations[1]. Climate change risk is a global risk, and requires coordinated international initiatives. To ensure global consistency in standards, the Government should continue to engage and work collaboratively with global initiatives such as the United Nations Environment Programme Finance Initiative, the Net Zero Asset Owner Alliance and the Network of Central Banks and Supervisors for Greening the Financial System (NGFS).

[1] https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/tcfd-strengthening-the-foundations-of-sustainable-finance-speech-by-mark-carney.pdf?la=en&hash=D28F6D67BC4B97DDCCDE91AF8111283A39950563

2. We support mandatory climate-related risk disclosure in principle and we agree that consistent and comparable climate-related risk data is critical. However we do believe this requires aligned government and regulatory policy in order for it to be achievable and we welcome the FCA's recent confirmation of their plans to consult on requirements for asset managers in the first half of 2021. The proposed requirements for trustees to disclose only as far as they are able does acknowledge that pension schemes may not be able to comply fully with TCFD; this is currently highly likely due to the well-known data limitations, as noted in the Bank of England's recent report into TCFD[2]. The TCFD framework itself also needs further refinement, as Mark Carney highlighted late last year[3]. The climate change risk does require urgent action, but mandating TCFD-alignment for pension schemes ahead of financial services firms being required to do so could lead to reporting that is incomplete, and potentially misleading. We would encourage a consistent approach across the regulatory landscape: for schemes that are initially in scope of the current proposals to have to state their compliance with TCFD, or explain non-compliance. This approach would be consistent with the Financial Conduct Authority (FCA)'s proposed rule for listed issuers, and recognises the developing capabilities of organisations' climate-related risk disclosure[4].

3. We support DWP's objective for schemes to consider their climate-related risk, and agree that reporting this risk is a way in which to encourage this. However, trustees will not be able to do this alone, and will be greatly reliant on their investment managers and advisers to provide the information necessary to make the disclosures. Many firms currently reporting in line with TCFD use third party consultancies to help collate and disclose this data. This of course comes at a cost. Supplementary statutory guidance will be vital for pension scheme trustees and their advisers to better identify metrics and targets; this will also help increase comparability and transparency.

4. We welcome the joined-up approach by the PRA and FCA to set up the Climate Financial Risk Forum (CFRF). The CFRF brings together a small group of senior industry representatives and financial regulators to build capacity and share best practice with the aim of advancing financial sector responses to the financial risks from climate change. The CFRF role includes developing practical tools and approaches that are shared with the wider market[5]. We would encourage the Pensions Regulator (TPR) and occupational pension schemes to fully engage with this Forum.

5. The consultation assumes that trustees will always be asset owners. However, within many occupational pension schemes, including both master trusts and insured single employer schemes, the trustee owns a contract of insurance and does not own any funds, units in funds or direct investments (for instance shares, bonds, etc). Instead, the insurance company owns the assets and "owns" the relationship with the underlying fund managers. It is not clear in the consultation what the expectations on these trustees, or the insurers who have the contract with them, will be. We strongly urge DWP to consider their expectations for these trustees, noting the regulatory expectations of insurers from their regulators, the Prudential Regulation Authority (PRA) and FCA.

[2] https://www.bankofengland.co.uk/prudential-regulation/publication/2020/climate-related-financial-disclosure-2019-20
[3] https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/tcfd-strengthening-the-foundations-of-sustainable-finance-speech-by-mark-
[4] https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing
[5] https://www.fca.org.uk/transparency/climate-financial-risk-forum

Response to questions

Q1: 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?

6. We support the Government's aim to encourage large organisations to improve their climate-related risk disclosures, and as formal supporters of the TCFD, agree that this is the right framework to use in order to achieve this. We support mandatory climate-related risk disclosure in principle and we agree that consistent and comparable climate-related risk data is critical. However, we do note that mandating the TCFD is not the position of other regulatory bodies at this stage. The FCA is currently consulting on a "comply or explain" basis for listed issuers to state compliance with TCFD-aligned disclosures. The decision not to mandate at this time is being taken because "*some issuers may not yet have the data and capabilities they need";* the FCA also acknowledges that to be prescriptive at this stage is unwise, as the standards are "evolving"[6]. We fully support this approach, as it strongly encourages firms within scope to improve their reporting, but recognises that there remain practical difficulties. We strongly encourage the DWP to take a similar approach to the adoption of TCFD-aligned reporting by pension schemes with the ability to mandate once schemes are more able to comply.

7. We agree that moving towards better disclosure should be phased, and for it to be by scheme size on a targeted, cost/benefit, basis. The proposed timings around reporting may be challenging for some schemes to meet, and the statutory guidance will be vital to provide the much-needed clarity to trustees to understand and meet the requirements expected of them.

8. The ABI represents five of the authorised DC master trusts. As the consultation notes, authorised master trusts vary in size, with many of them falling beneath the proposed threshold for all other schemes. We understand that the rationale for this was to provide a level playing field for all authorised master trusts. Authorised master trusts do have to demonstrate greater governance capabilities. However, as the consultation notes, many of these master trusts hold less than £1bn, which is the second phase threshold for the requirements for other pension schemes, and many of them have less than the £500m where the requirement for non-authorised schemes start to tail off. The proportionality arguments that are applied to other smaller occupational pension schemes can be applied to master trusts.

Q2: 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

[6] https://www.fca.org.uk/publication/consultation/cp20-3.pdf

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?

9. In our view it is crucial that for climate-related disclosures to provide meaningful information to users, a consistent climate-related disclosure framework must be adopted across the board, and their users and decision-making needs are clearly identified. TCFD is such a framework in aiming to provide information to investors, lenders and insurance underwriters that is useful, for instance in their buy/sell/hold decision-making. The proposed timetable for the first schemes within scope is a rapid one, but is consistent with other proposed rules for listed issuers[7]. We agree with the proposed timeline, although again we believe this should be on a “comply or explain basis”, which recognises that there may be reasonable practical difficulties in full alignment.

[7] https://www.fca.org.uk/publication/consultation/cp20-3.pdf

10. Some DB pension schemes may have partially de-risked their liabilities, for instance through an insurer buy-in. This buy-in contract would be held on the scheme's balance sheet as an investment asset. This may bring the scheme above the proposed threshold, although it should be noted that trustees have no control over this particular investment asset, as it is only a contract of insurance; the scheme in this instance is the owner of the contract, but not the underlying assets that support it. The statutory guidance will need to be clear of what is expected in respect of these assets.

Q3: 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?

11. Yes, we agree a review in 2024 is a sensible approach.

Q4: 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?

12. Yes, we agree with the proposals. Trustees that are asset owners will play a crucial role in steering asset managers to address climate-related risk, and we also welcome other regulatory initiatives on stewardship. We support the proposal for statutory guidance to give clear instruction on how trustees might manage these expectations.

<u>Q5: 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.</u>

<u>We propose statutory guidance will cover the matters outlined in the box above.</u>

<u>Do you agree with these proposals?</u>

13. We agree with the proposals for trustees to identify and disclose the climate change risks and opportunities over the proposed time horizons.

<u>Q6: 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.</u>

<u>We propose statutory guidance will cover the matters outlined in the box above.</u>

<u>Do you agree with these proposals?</u>

14. This would be a significant undertaking for those within scope. Testing resilience against climate-related scenarios is being considered by other regulators, such as the PRA, through the Climate Biennial Exploratory Scenario. This is expected to be carried out in 2021. However, the PRA has been clear in their proposals that this would be for only the very largest of insurers, and would require those in scope to assess 1,000's of counterparties, which will be very difficult in practice. Requiring reporting as far as trustees are able does acknowledge the likely difficulties of such a requirement, and again, the statutory guidance will have to provide trustees with a roadmap for how they might begin to undertake such an exercise. This statutory guidance will also have to ensure that there is consistency and comparability between pension schemes on methodology, approach and scenario testing.

<u>Q7: We propose that regulations require trustees to:</u>

<u>a) adopt and maintain processes for identification, assessment and management of climate-related risks</u>
<u>b) integrate the processes described in a) within the scheme's overall risk management</u>
<u>We also propose the regulations require trustees to disclose:</u>
<u>c) the processes outlined in part a) above</u>
<u>We propose statutory guidance will cover the matters outlined in the box above.</u>
<u>Do you agree with these proposals?</u>

15. We agree with these proposals, which are broadly in line with the expectations of the PRA for insurers. Firms are expected to have fully embedded their approaches to managing climate-related financial risks by the end of 2021[8]. The CFRF's work, including dedicated working groups on Risk Management, Scenario Analysis, Disclosures and Innovation, will

[8] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2020/managing-the-financial-risks-from-climate-change.pdf?la=en&hash=A6B4DD1BE45B2762900F54B2F5BF2F99FA448424

be a useful guide in helping to achieve this requirement, and the statutory guidance should look to utilise the findings from these workings groups.

Q8: 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?

16. We agree that that it is pragmatic not to mandate a range of metrics at this stage, as these are continuously evolving. We also agree with the requirements for trustees to be based on *as far as they are able*, which acknowledges there will be practical difficulties in doing so. Schemes should be clear on what methodology they have adopted to allow for comparability between schemes. Again, clear statutory guidance on these expectations will be vital.

Q9: 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?

17. If the proposals do proceed, then limiting the expected target metrics for schemes to access is appropriate in the initial years of the requirements, as it is much more manageable. As per our answer to question 8, clear statutory guidance on these expectations will be vital.

Q10: 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?

18. We agree that those schemes who do disclose in line with TCFD be required to publish the report as proposed.

Q11: 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?

19. Yes, we agree with this approach for schemes who adopt TCFD-aligned reporting. As previously stated, we believe that this should be initially on a comply or explain basis.

Q12: 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?

20. The nascent nature of climate-related disclosure will mean that these new requirements will be costly to schemes. These costs will likely be higher in the initial period, as industry continues to learn and adapt to the disclosures. Trustees will place significant reliance on consultants, which comes at a price. This is against the backdrop of an uncertain economic environment and falling asset values. As the consultation suggests, larger schemes will have better scale to be able to shoulder these costs. We agree that wider learnings over the next few years will help smaller schemes if the 2024 review's outcome leads to extending the requirements.

21. In all such developments, new requirements on extra disclosures must provide clear benefit for identified users, for instance to help inform them in making specified decisions. TCFD was developed for specified users of the information - investors, lenders and insurance underwriters. For instance, the publication of TCFD information by listed

companies enables investors in listed companies to make better buying, selling or holding decisions. The Government must be clear on the value of enforcing TCFD on asset owners in scope.

Q13: 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?

22. The guidance assumes that trustees will always be asset owners. However, within insured schemes, which many occupational pension schemes are, the trustee owns a contract of insurance and does not own any funds, units in funds or direct investments (for instance shares, bonds, etc). Instead, the insurance company owns the assets and "owns" the relationship with the underlying funds managers. It is not clear in the consultation what the expectations on these trustees, or the insurers who have the contract with them, will lead to. We strongly urge DWP to consider their expectations for these trustees, noting the regulatory expectations of insurers from their regulators, the PRA and FCA.