HL response – Taking Action on Climate Change Risk

About Hargreaves Lansdown

Hargreaves Lansdown (HL) is the UK's largest direct-to-investor service with more than 1.4 million clients.

Our purpose is to empower people to save and invest with confidence. We want to provide a lifelong, secure home for people's money that offers great value, an incredible service, and makes their financial life simple. We help people through three distinct channels:

1. People that come to us directly to access our information, happy to make their own decisions and manage their finances through our investment platform.
2. People that would like personal financial advice.
3. People that are clients of Hargreaves Lansdown by virtue of their membership of their employers pension scheme.

Our response is informed by our experience and expertise across these three groups of people and our desire to drive better outcomes across all of them.

We are keen to be of assistance, if you have any questions or points you'd like us to address please contact Nathan Long (nathan.long@hl.co.uk).

Executive summary

Overall we feel the proposed regulations are a positive step towards greater awareness of the risks and opportunities presented by climate change. However for real change to occur, we feel scheme members must be a central consideration. While we feel these regulations go some way to providing members with the information they need, many of the disclosures have the potential to be too technical and long-winded for workplace pension savers, who have been automatically enrolled into a company pension. Our analysis suggests they are some of the least-engaged client-types.

We believe a simplified version of the TCFD report (1-2 pages maximum), to be included in the annual report sent to scheme members, would go some way to solving this problem. The simplified version should pull out headline information and statistics, and grab members' attention with the use of graphics and charts. For members who want to know more, a link to the full report should also be included.

We also think the Department for Work and Pensions (DWP) should be cautious in its requirements for trustees to apply targets. We agree that targets can be a useful way to signify a direction of travel, but emissions-based target setting has the potential to pressure active investment managers into changing their long-established investment processes and philosophies, which could have a negative impact on returns.

There are many examples of high-polluting companies that have turned their business models around and become sustainable leaders. But investment managers may feel unable to access these opportunities for fear of the impact it will initially have on their portfolio's climate change metrics. DWP should approach targets with pragmatism. It should be recognised that targets sometimes aren't met, but that does not undermine the need for targets in the first place.

We have also made several other points in our response:

- We believe DWP should include smaller schemes in the scope of this regulation as this will help drive scheme consolidation

- Schemes not captured in the first wave of regulation should be required to put a placeholder comment about TCFD Reporting in their annual report, to help set member expectations
- The DWP should specify at least two global warming scenarios which schemes must stress test their schemes against, with one being 'business as usual', to aid comparability
- The DWP should review the use of warming scenario methodologies in 2024 with the potential to mandate the use of a particular methodology, if a clear leader has emerged
- The DWP should specify one non-emissions based measure that all schemes must publish for the sake of comparability

We've also answered the questions in full below.

Response to questions

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?

Climate change is the defining issue of our time. Government and industry must pull together to ensure a robust response.

We think it is right that the government is aiming to improve the quality of climate change reporting across the pensions industry. We also feel that TCFD is the right framework to apply given it has already been widely adopted on a voluntary basis amongst many large businesses, ahead of mandatory adoption in 2022.

The proposed regulation initially covers the largest pension schemes, who are best positioned to comply with the regulation. We think this is the right approach, although we would also like to see a timeline set out now for the compliance of smaller schemes. We think this will encourage proactive schemes to start preparations and encourage very small schemes to consider consolidation.

We think it's problematic that in situations where pension scheme members take exception to the way climate change is being handled by their own scheme, their options to transfer elsewhere are limited. If they are an active member of a defined contribution pension scheme, they can't choose to leave the scheme and transfer elsewhere without losing their company contributions. We feel strongly that pension members should be able to transfer to a different scheme without their contributions being impacted, thereby increasing pressure on schemes to act responsibly. We have a blueprint for how this could work and would be happy to discuss it separately.

For defined benefit scheme members, we appreciate that transferring cannot be an option, therefore we would urge the DWP to consider options for how members can express their dissatisfaction and influence the trustees.

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 DWP has been clear in its intention to drive consolidation within the pensions industry. We think this is the right approach. Larger schemes are generally better resourced to manage pension assets than smaller schemes. We think setting a timescale for smaller schemes to be captured within the regulation will help to achieve the Government's consolidation objective.

We also think schemes that are not captured in the first wave of this regulation should be required to write a placeholder comment in their annual reports outlining why they're not currently captured under the regulation, and explaining that they will be in future, preferably with a proposed timescale for TCFD implementation. Our reasoning is best captured through use of an example.

Consider a client who is a member of many pension schemes. The larger schemes will report in line with TCFD regulations and thorough information on the scheme's approach to the risks and opportunities of climate change will be made available. But the client will be unable to find equivalent information covering their smaller schemes. A placeholder comment will help to set client expectations. This is in keeping with the drive for consistency of disclosures that DWP and FCA seek to achieve.

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?

As discussed in our response to question two, we feel strongly that smaller schemes should be included within these proposals. The additional cost of these regulations will bring into question the viability of some smaller schemes, thereby driving the Government's consolidation objective.

Outlining a timescale for the inclusion of smaller schemes now would also provide more certainty for them, allowing for them to plan for TCFD alignment potentially years in advance.

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?

We agree with this proposal. Trustees play an important role in overseeing the management of a pension scheme. They have a responsibility to ensure risks and opportunities are properly managed, including those arising from climate change.

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?

We feel this is a reasonable approach. However care should be taken to ensure that any disclosures are presented clearly.

In our experience, clients rarely sit and read excessively long documents, and this is particularly the case with workplace pension savers, who have been automatically enrolled into a company pension. Our analysis suggests they are some of the least-engaged client-types.

We strongly feel the best approach would be for schemes to summarise their TCFD report in a one or two page document that forms part of the annual report sent to scheme members. Care should be taken not to mandate the design of this so as this allows innovation and for schemes to work out what resonates best with their clients

Members should then have the option to follow a link to the full, detailed report. The shorter document should include headline statistics, such as the portfolio warming scenarios, and emissions and non-emissions based metrics. Graphics and charts should be employed where possible, and large chunks of text should be avoided to improve the chances of scheme members taking on board this important information.

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?

We feel it would be useful if the DWP specified at least two warming scenarios for which all schemes must provide data in order to aid comparability. Trustees should also have the ability to add other scenarios as they see fit. One of the required scenarios should be a 'business as usual' scenario, taking into account what would happen if no further action was taken to limit climate change. This would act as a benchmark against which other warming scenarios can be measured.

We note that climate change scenario analysis methodologies are still emerging, and data quality is improving all the time. For this reason, we suggest the DWP should review their stance on this point in 2024 with the potential to require trustees to use a single methodology if a clear leader has emerged.

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?

It is important that climate-related risks are considered just as important as other, more traditional risks, so we agree with the proposal to include climate risk processes within the overall risk management process. Disclosures around the way schemes identify, assess and manage climate risks should be easily accessible and written in plain English to enable pension scheme members and other stakeholders to judge a scheme's progress for themselves.

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?

We think it is important that scheme members and other stakeholders can compare schemes, and emissions and non-emissions-based metrics will help in this endeavour. We therefore support the governments' call for trustees to use Weighted Average Carbon Intensity (WACI). Where schemes do choose to report WACI as their emissions-based metric, we feel they should be compelled to apply a common methodology for calculating greenhouse gas emissions, such as the GHG Protocol methodology.

We also support the proposal for statutory guidance to outline the non-emissions based metrics that can reasonably be used. However we feel the government should specify one non-emissions based measure that all schemes must publish for the sake of comparability.

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?

We are in favour of targets. They set a direction of travel and encourage positive behaviours. However we feel targets for emissions and non-emissions based metrics should be considered in the same way as financial targets. It should be accepted that sometimes they are not met. There is an important balance to strike.

When targets are applied, there is a risk that the investment manager feels pressured to invest in a way that deviates from their long established, time-tested investment approach. It's possible to envisage a situation where investment managers avoid investing in what is otherwise a great opportunity because of the impact that the company would have on the portfolio's overall emissions intensity.

Targets also may not take account of the potential for improvement within individual companies. Consider Orsted, the Danish multinational power company. A decade ago, Orsted was one of the most fossil fuel-intensive energy companies in Europe, but following a period of transformation and reinvention, it is now focused entirely on renewable energy and ranked the most sustainable company on the planet (Corporate Knights 2020 Global 100 Index),.

Applying targets could prevent investment managers from taking advantage of companies that have opportunities for improvement, due to fears of falling short on an emissions-based target. This could have a knock-on effect on investment returns.

In summary, we don't disagree with the need for targets. But DWP should stress the importance of carefully considering targets to ensure they don't unduly impact the manager's philosophy or investment process, to the detriment of investment returns.

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?

As discussed in question five, we feel strongly that pension scheme members who have been automatically enrolled into a company pension are some of the least engaged client-types, and therefore will not click on a link and read a lengthy TCFD Report.

Our solution is for schemes to summarise their TCFD report in a one or two page document that forms part of the annual report sent to scheme members. Members should then have the option to follow a link to the full, detailed report. The shorter document should include headline statistics, such as the portfolio warming scenarios, and emissions and non-emissions based metrics. Graphics and charts should be employed where possible, and large chunks of text should be avoided to improve the chances of scheme members taking on board this important information.

It may be useful for the DWP to consider an example. The Wealth Shortlist is a list of funds our analysts believe have the best long-term performance potential. When viewing the Wealth Shortlist page on our website, clients are able to choose between a 'simple view' and an 'advanced view', with more detailed information. We think it's instructive that, of the hundreds of thousands of clients that have visited the page since launch of the Wealth Shortlist in July, just 3.1% selected the 'advanced view'.

In our experience, clients are more likely to engage with a topic if they are given relevant information in a concise and approachable way. Of course, the more detailed information should also be made available for those who want it.

We believe this simplified approach will help make a greater number of pension savers aware of how their pension is positioned to navigate climate change. If clients are unhappy with what they see, they can lobby the trustees to improve their approach, although being able to transfer and select another provider would drive greater competition and impact.

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?

We agree that the Pensions Regulator should have the power to administer penalties for inadequate or incomplete TCFD Reports.

The maximum penalty limits seem rather low and may not act as a sufficient deterrent to schemes creating sub-standard TCFD reports. However we appreciate that the level of fines for breaches in this area need to be proportionate when compared to other areas where The Pensions Regulator can impose fines.

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?

While we appreciate the necessity of these regulations, the DWP's implementation cost estimate of £15,000 is a gross underestimate, given we are still in the relatively early stages of climate change disclosure, and standards are still evolving. Trustees of larger schemes will likely want to hire expert consultants, which will come at significant cost. Some will also need to buy in additional data, at further cost. We agree that the larger schemes will set the standard, which should mean smaller schemes can conform to the regulations without such a large expense.

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?

We do not foresee any undue impact on protected groups providing schemes take reasonable steps to ensure accessibility to the reports. Annual reports covering the Hargreaves Lansdown Self-Invested Personal Pension can be sent to our clients in a variety of accessible formats, including large print, braille and audio alternatives.