BP PENSION TRUSTEES LIMITED

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Climate Governance and ESG team

Sent by email: pensions.governance@dwp.gov.uk

7 October 2020

Dear Sirs,

RE: DWP consultation paper, 'Taking action on climate risk: improving governance and reporting by occupational pension schemes'

We are writing on behalf of BP Pension Trustees Limited ('we'), as corporate trustee of the BP pension fund (the 'Fund') in response to the DWP consultation paper, "*Taking action on climate risk: improving governance and reporting by occupational pension schemes*," ('the consultation').

Overall, we are supportive of the proposals set out in the consultation. We believe that the consultation indicates the Government's commitments on climate change and commits trustees of pension schemes to taking actions to deliver the goals of improving governance and high standards of climate-related financial disclosures. We also believe that the proposals, if legislated, will set good practice principles for all pension schemes, not only on governance, but on reporting and helping pension scheme managers to deliver on their commitments. We also believe that early consultation on any further detailed statutory guidance is important if the legislation is to have practical relevance and applicability. One theme noted throughout our response to the consultation paper is for a proportionate view to be taken on (a) materiality thresholds when assessing whether individual asset classes or sections within a scheme needs to be included in analysis or reporting and (b) metrics, in that a range of metrics is more appropriate as no single metric or pair of metrics will provide adequate coverage or measurability.

Note that our responses are targeted to the questions that are relevant to the BP Pension Fund, i.e. schemes that are £5bn or more in net assets. We have not answered other questions relating to different scheme types in our response. We also note that there have been other consultations sought with regards to TCFD, e.g. the recent FCA consultation, CP20/3, "*Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations*." Whilst it is important to consider the implications of TCFD regulation on pension schemes, it should not be looked at in isolation, but a consistent approach across all industries should be taken.

Q1. The DWP propose that the following schemes should be in scope of the mandatory climate governance and TCFD reporting requirements set out in the 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 DWP's policy proposals?

The Fund is classified as a), a trust scheme with £1bn or more in net assets, and our response to this question provides an opinion only in relation to that classification of pension schemes.

We are supportive of the proposal that trust schemes with £1bn or more in net assets should be in scope of mandatory climate governance and TCFD reporting requirements. In response to a letter dated 27 September 2019 from the Minister for Pensions and Financial Inclusion, we explained that we are embedding the capability to report in line with TCFD recommendations and as such, we welcome these proposals on climate governance and TCFD reporting.

Q2: The DWP propose that

a) trustees of schemes with £5bn 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 £1bn 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 £1bn or more in net assets on any subsequent scheme year end date:
- *are subject to the climate governance requirement starting from one year after the scheme year end date on which the £1bn asset threshold was met; and*
- *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 Fund is classified as a), a trust scheme with £5bn or more in net assets, and our response to this question provides an opinion only in relation to that classification of pension schemes.

We are supportive of the proposed timetable for pension schemes with £5bn or more in net assets. The proposed timetable to implement climate governance requirements from 1 October 2021 and a TCFD report within seven months of the then current year end date or before 31 December 2022, if earlier, is in line with our anticipated timetable for reporting in line with TCFD recommendations. We also appreciate that as TCFD reporting becomes more familiar to pension schemes and the norm, reporting and the quality of such reports will develop with experience both within and outside of the pensions sector.

Q3: Subject to Government deciding to adopt any of the governance or reporting requirements proposed in the consultation, the DWP propose to conduct a review in 2024 on whether to extend the measures to schemes with below £1bn 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.
The DWP 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?

We are supportive of the DWP conducting a review in 2024 of regulations and statutory guidance and considering if amendments are appropriate.

This is particularly true in the case of statutory guidance where we anticipate developments in TCFD reporting over this timeframe may include a considerable amount of new and updated guidance from numerous sources.

Q4: The DWP propose that regulations require trustees to:

a) *adopt and maintain oversight of climate risks and opportunities, and*
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.*

The DWP also propose that regulations require trustees to describe:

c) *the role of the trustees in ensuring oversight of climate-related risks and opportunities; and*
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.*

Do you agree with these proposals?

We believe that good governance is key to the success of any pension scheme in delivering its primary goal of paying its members' benefits when due. We are supportive of the proposals set out in this question. We consider such areas important and the proposals should help set the standard for good practice principles on governance for climate change-related risks and opportunities. It would be helpful to set out further guidance around the format and structure of disclosures.

Q5: The DWP 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
Do you agree with these proposals?

It is important that disclosures around these risks, opportunities and investment and funding strategies are clear. Disclosures should be at a high-enough level that confidential or market-sensitive information is not disclosed, as that could disadvantage schemes and by extension their members, or result in breaches to other agreements covering data and information. Disclosures concerning potential future changes to investment strategy should not oblige trustees to disclose material amounts of information.

Guidance should be written in a way that is neutral. Examples should be chosen with care to avoid inadvertently encouraging a particular approach to investment. For example, if the guidance implicitly or explicitly encourages divestment from companies with high carbon emissions, then this will reduce the opportunities for engagement and stewardship with those companies. To the extent that pension schemes are replaced by investors less likely to engage on reducing emissions, the net effect is likely to be higher emissions and as an unintended consequence, greater acceptance of climate risk leading to further inaction.

Guidance should regularly reinforce the context of TCFD strategy requirements, which is for trustees to understand and disclose climate change risks and opportunities in support of their long-term fiduciary duties of ensuring benefits get paid when due. Guidance should not conflict with the primacy of those fiduciary duties which exist outside of these disclosure regulations.

The burden placed on pension schemes in relation to disclosures generally and disclosures about strategy in particular needs to be proportionate. There should be materiality thresholds applied when assessing whether an individual section within a scheme needs to be included in any analysis and reporting. For example, our DC section has assets of approximately only £15m (0.05%) relative to our DB section with assets of approximately £30bn (99.95%). It would be disproportionate in our view to expect the same level of analysis and disclosure about both sections.

A similar pragmatism should be allowed across asset classes where the effort to include smaller asset holdings may distract from taking material steps to manage material risks in core allocations.

It is important that limitations around data availability and flow are addressed within the statutory guidance. Although data quality is improving and we expect will continue to do so, coverage and consistency across multiple jurisdictions and focus areas remains uneven which poses significant challenges for schemes when evaluating global asset portfolios.

TCFD reporting for private markets will pose further challenges, as even though trustees of large schemes will have collective market power to mandate such requirements at a point of contract, fund managers and general partners are likely to vary greatly in their approach and methodology which might undermine aggregated metrics.

Q6: The DWP propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of DB, funding strategy, as far as they are able, in at least two climate-related scenarios, one of which must be a 2 degree C or lower scenario and to disclose the results of this assessment.
Do you agree with these proposals?

We agree that scenario analysis is useful for pension schemes to assess the resilience of their assets, liabilities and investment strategy.

It is important that any guidance is not too prescriptive, and that the guidance enables trustees to adopt scenarios which reflect their specific scheme, its liability profile, its sponsor covenant and its investment strategy. Professional judgement is needed and must be allowed, given the known shortcomings of such long-term modelling. The role of scenario modelling is to give trustees a deeper understanding of the wide range of uncertainty involved, and guidance should encourage recognition of that.

We have completed climate change-related scenario analysis at varying levels of detail, including stochastic modelling of the potential economic impacts of climate change. We found that the long-term nature of such models mean outcomes being enormously sensitive to even small variations in input parameters. The outcome of modelling or scenario exercises should be considered and discussed as appropriate, but modelling would typically be an input to, rather than a driver of, fundamental changes in strategy.

There has been some recent emphasis on trustees providing evidence of what changes to investment strategy they have made as a result of climate-change considerations. Guidance should reflect that some schemes have a lower exposure to climate-related risks. For such schemes, it may be appropriate not to make any changes to investment strategy as a result of analysis incorporating climate-change considerations. A lack of change in strategy is not in itself evidence of a lack of engagement or consideration of the scenario analysis.

As noted in our response to question 5, the burden placed on pension schemes needs to be proportionate with materiality thresholds applied when assessing whether an individual asset class or an individual section within a scheme needs to be included in any analysis and reporting.

Q7: The DWP 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.*

The DWP propose the regulations require trustees to disclose:

- *c) the processes outlined in part a) above.*

Do you agree with these proposals?

We agree that appropriate processes are key to managing climate risk, as well as all other risks to which pension schemes are exposed. It would be difficult to specify comprehensively how to identify, assess and manage climate-related risks, and so guidance should contain examples of acceptable and workable approaches, without limiting trustees to those.

We encourage the use of approaches that consider the long-term risks in context of risks to the pension scheme's total assets, its funding level and the volatility of that funding level.

Consideration of climate risk is relevant to pension schemes as long-term investors. The proposals put consideration of climate change-related risks by trustees on a statutory footing. Climate change is only one of many material long-term risks to which pension schemes are exposed. Placing undue emphasis on consideration of one particular risk means that there may be less focus on other risks, potentially leading to detrimental outcomes for members. We would encourage the guidance explicitly to state that climate risk should be considered in the context of other long-term risks within a scheme's funding, investment and covenant-monitoring processes.

Q8: The DWP propose that regulations require trustees to:

a) *Select at least one 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.*

The DWP also propose in regulations that the trustees be required to disclose:

d) *Why the emissions data that is estimated does not cover all asset classes, if this is the case.*

The DWP propose that trustees will not be mandated to use a specific measure to assess the effects of climate change on the scheme's portfolio.
Do you agree with these proposals?

Overall, we are broadly supportive of this proposal. We believe that a range of metrics is more appropriate as no single metric or pair of metrics will provide adequate coverage.

We believe that seeking to obtain extensive emissions data and then calculating and ultimately reporting metrics on a quarterly basis is of limited value. It will be burdensome to achieve and less likely to produce useful information because it will encourage a short-term focus. We believe that annual reporting is more appropriate because of the long-term nature of the matters being considered. Quarterly reporting should be at trustees' discretion.

As mentioned in our response to question 5:

- the availability and quality of data from other participants in the investment chain will have a direct impact on the quality of calculated metrics and subsequently might increase risk if those metrics are used to inform further policies (e.g. remuneration) and investment decision-making; and
- the burden placed on pension schemes needs to be proportionate with materiality thresholds applied when assessing whether an individual asset class or an individual section within a scheme needs to be included in any analysis and reporting.

Q9: The DWP 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 target(s).

b) calculate performance against those targets as far as trustees are able to disclose that performance.

Do you agree with these proposals?

If targets are set, then it is appropriate to measure performance against those targets. We think the use of carbon metrics in connection with emission-based targets would naturally tend to direct scheme investments away from companies with high carbon emissions. While this will improve the metrics of individual schemes doing so, on a broader level it reduces the influence that pension schemes can have on companies with high carbon emissions. We believe this may lead to arbitrary investment constraints, and potentially sub-optimal investment approaches.

Furthermore, this could create an unintended consequence from regulation and the opposite impact on the real economy to that intended.

A disinvestment stance will reduce the opportunities for engagement and stewardship with these companies, and to the extent pension schemes are replaced by investors less likely to engage on reducing emissions, the net effect is likely to be higher emissions than had pension schemes stayed invested and engaged, and as highlighted in our response to question 5, this can have an unintended consequence of greater acceptance of climate risk leading to further inaction.

We believe it is important that equal emphasis is placed on qualitative, non-emission-based targets as on emission-based ones.

Q10: The DWP 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?

We support the proposals set out in this question. We note, however, that there is likely to be duplication across a number of documents as pension schemes prepare their TCFD report, Annual Report and Accounts, Statements of Investment and Funding Principles, Implementation Statements, DB Chair's Statement and so on. It would be helpful if the DWP could address the question about duplication and whether incorporation by reference would be a solution, to avoid having to repeat numerous obligations across several different documents.

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?

We think it would be more appropriate for the summary funding statement to remain focussed on schemes' funding position.

Q11: The DWP propose that:

a) 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, the DWP propose to model the compliance measures on the existing penalty regime set out in regulations 26-33 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 are supportive that TPR have limited power in administering penalties for TCFD reports. Part a) of this question raises the question of what would TPR "*deem to be inadequate*?" We would question how this is measured in order to ensure consistency in administering discretionary penalties.

The proposal also assumes that TPR will have sufficient resource and experience to review and analyse the TCFD reports to the required standard.

We are supportive of all other matters relating to the proposals to model compliance measures on the existing penalty regime in the Occupational Pension Schemes (Charges and Governance) Regulations 2015.

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?

We note that the impact assessment assumes that most of the reporting and analysis work would be done by 'administrators' with an assumed hourly wage of approximately £15.

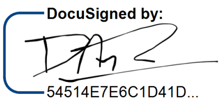
This work is more likely to be done by advisory firms or in-house investment professionals at much higher cost. The cost estimates do not appear to consider the further costs of various advisers' input and training, as well as cost of data, and scenario analysis modelling. Therefore, the costs in the impact assessment are likely to be materially understated.

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 the DWP's proposals?*

We have no further comments.

Yours faithfully,



David Rix
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BP Pension Trustees Limited
on behalf of the **BP Pension Fund**