atlas
The considered choice of master trust

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

Foreword

This is the response to DWP's consultation 'Taking action on climate risk: improving governance and reporting by occupational pension schemes' from the Atlas Master Trust (Atlas). Atlas is an authorised DC Master Trust (and thus directly impacted by these proposals) with more than 100,000 members and circa £1.2bn in assets. The Funder is Capita Employee Benefits Limited and the Trustee – Atlas Master Trust Trustee Limited – is independent of (and unaffiliated with) the Funder and Funder's Group.

We are supportive of the UK Government's initiatives for investors to understand, plan for and (to the extent that they can) mitigate climate risks in their investment portfolios. We also share the view that members are increasingly concerned about such matters and want their long-term investments to be a force for good. We therefore also agree that disclosure will become increasingly important to growing numbers of members. Action of this type will be a contributor to pressure to reduce GHG emissions but it should be noted that it is not enough and needs to be part of a collection of measures, many of which will have to be taken by Government

The consultation acknowledges that most schemes that will be affected by this new requirement invest in pooled funds. Trustees can appoint managers who are the most closely aligned to their ESG beliefs and emission reduction targets but cannot impose their beliefs or targets on those managers if they need to invest via pooled funds. Requirements to make progress therefore need to be placed on asset managers as well as on trustees Huge progress is being made on the development of measurement and on benchmarks which, for example, are aligned to the Paris agreement Encouragement for these actions and for the development of pooled funds which align with them should be an objective of any government intervention

In order to achieve ambitious targets, it seems inevitable that many investors will (to the extent that they can, given the nature of tracker funds) divest from the most polluting industries (e.g. mining, petrochemical) but it is important that investors are able to continue to allocate capital to companies within these industries who are making most progress towards a transition to am low carbon economy

When taking on new employer clients, many Master Trusts take on the pre-existing investment strategy, either for the long term or until transition management opportunities arise as this is often in the best interests of members and achieves the value for money objectives which we have. The proposals in this consultation challenge this practice, especially where such assets are significant, and where targets and metrics are unaligned. We propose no solution at this time but we believe that more thought needs to be given to this situation.

Atlas Master Trust

17-19 Rochester Row, Westminster, London SW1P 1JB
Tel: 020 7709 4500
www.capitaemployeesolutions.co.uk/atlasmastertrust

Finally, we would suggest that the focus should be on encouraging schemes to take action designed to improve emissions performance in the long term rather than on detailed compliance

Paul McBride
Head of Risk & Governance
Atlas Master Trust
7th October 2020

Question 1

We propose that the following schemes should be in scope of the mandatory climate governance and Task Force on Climate-related Financial Disclosures (TCFD) reporting requirements set out in this consultation:

a) trust schemes with £1 billion or more in net assets
b) authorised master trusts
c) authorised schemes offering collective money purchase benefits

Do you agree with our policy proposals?

Answer

We are in broad agreement with two exceptions.

First, we believe that some Master Trusts, which neither operate nor aspire to operate on a commercial basis, and which were brought into the authorisation regime by virtue of the definitions in PA2017, are deserving of a more sympathetic approach. This is especially so where DC assets are below say, the £500m threshold (or preferably lower) proposed elsewhere in this consultation. (One might argue that the term 'arbitrary' used in paragraph 23 of Chapter 2 more appropriately refers to the definition of Master Trust in PA 2017 that 'captured' such schemes, whose employers and members are - to all intents and purposes - powerless to use a different scheme if they do not agree with the Trustee's ESG strategies.) We believe that the additional costs of compliance in your impact assessment are understated, for reasons set out later in this response. Consequently we believe that for Master Trusts such as these, the additional costs of research, advice, monitoring and compliance could or would be disproportionate and a comply or explain regime would be a better fit.

Second, until such time as they are open to business, none of the proposals set out in this paper can be applied to 'shell' Master Trusts which have become authorised but which are yet to hold members or assets.

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?

Answer

With the two exceptions noted in our response to question 1, we are in broad agreement with these proposals.

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?

Answer

Extending the scope of these regulations to include all schemes would render the compliance costs deduced elsewhere in this consultation paper (which we believe to be an understatement in any event) to be entirely disproportionate to some schemes. Almost all schemes of this nature will have to rely on continued employer largesse in order to comply. Therefore such an additional compliance and cost burden will undoubtedly hasten consolidation of single employer trusts into Master Trusts (thus satisfying that particular policy objective), but consideration will need to be given to market capacity to respond to sudden demand safely (that is, safely ensuring accurate data transfers and effective asset transitions). Consideration should therefore be given to an 'amnesty' approach for schemes which have made a binding commitment to consolidate into a Master Trust by that time, whilst they are waiting for their turn in the queue.

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?

Answer

The aspiration in this proposal is not met by the reality of the situation.

As acknowledged in this consultation, a majority of schemes affected by it invest in pooled funds. This situation can be expected to persist for the foreseeable time. As noted in the introduction, this means that most Trustee's cannot 'drive' a personal ESG strategy/agenda. For most, the best that they can do is to identify which managers most closely reflect their beliefs and – if all other due diligence is satisfied – hitch their ESG wagon to them.

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?

Answer

Clarification is necessary about what is considered to be an 'opportunity'. Risk avoidance is relatively straightforward to understand and achieve but as noted above in the introduction, opportunities may remain substantively theoretical until taxation policies and other financial levers introduce a tangible, and measurable, financial incentive for investee companies, which in turn can be expected to translate to a genuine financial benefit to investors. Without that – and its converse (taxation policies and other financial levers which introduce a tangible and measurable financial *disincentive* for investee companies) - 'opportunities' will be as much conjecture as reality and therefore potentially misleading to the ultimate investors (members).

Question 6

We propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of defined benefit (DB), funding strategy, as far as they are able, in at least two climate-related scenarios, one of which must be a 2°C or lower scenario and to disclose the results of this assessment.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Answer

No. We suggest that (for now at least) only one scenario is resilience tested and that that scenario should be prescribed by Government from time to time to reflect contemporaneous scientific theory. Moreover, allowing Trustee's flexibility in this regard will be too challenging for the investment firms that they rely on. How, for example, would a pooled fund manager respond to requests from different Trustee clients for resilience tests ranging from, say, 0 to 4 degrees in half degree increments? Prescription would also have a benefit in facilitating more reliable and meaningful comparison between schemes and (importantly) better enable Trustee's to identify whether their strategy is taking on more risk or is less resilient than others'.

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?

Answer

As noted elsewhere in this response, the proposals wrongly assume more control over climate risks and strategy than most Trustees enjoy. In practice, identifying, assessing

and managing climate risks will be performed in the main by the investment managers to whom Trustees have hitched their wagons. The policies and processes will therefore be dictated by those organisations rather than by Trustees. In most instances this requirement will therefore be delegated to a third party who is not subject to the statutory obligation.

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?

Answer

We do not disagree with this proposal but make the point that for the overwhelming majority of schemes where multiple managers are used, each of these will have to be selected simply to accord with that single metric. This could significantly distort the manager selection process.

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?

Answer

We do not disagree with this proposal but we would make the point that for the overwhelming majority of schemes where multiple managers are used, each of these

will have to be selected simply to accord with that single target/metric. This could significantly distort the manager selection process.

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?

Answer

These proposals flow logically from current Disclosure Requirements. However, sensible use of URLs should be encouraged to make these documents more readable and easier to navigate. Use of URLs for compliance with Governance Statement disclosure requirements has been met with inconsistent and incoherent criticism and fines from TPR, and this type of outcome must be avoided (also see answer to Q11).

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?

No. Guidance and/or Codes must be unequivocal. TPR should not be allowed to exercise discretion. It is contrary to natural justice and the rule of law to have substantial penalties subject to discretion. The precedent of Governance Statements is reliable evidence why so. DWP is fully aware of the justifiable criticism from many

pension schemes about how TPR uses its discretion to interpret terminology in the regulations in a manner which is often not consistent with common usage, in such a way that the focus on compliance detail trivialises the policy objective. This situation damages the reputation of industry, damages the relationship between regulator and regulated and brings no benefit to members.

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?

Answer

We believe that the regulatory and governance burden is necessary but is grossly underestimated: in addition to increasing the resource required by Trustees, which comes at cost, and in addition to increased investment consultant fees, we can expect an increase in investment management fees as the majority of what will be onerous duties and measurement will in practice be carried out by them. For bundled schemes (Master Trusts in the main) higher investment costs will then be passed to members. This is important when considering DWP's simultaneous consultation on charge caps.

Many schemes use multiple managers. Since these regulations apply to the entirety of a portfolio, it will not be sufficient to simply publish reports from each manager. Data will need to be aggregated and measured against targets. This is a significant amount of work. With the addition of higher audit fees (also affected by the number of managers used) we would estimate that the compliance costs will be more than double DWP's estimate. We believe this needs to be re-evaluated, with industry support (including ICAEW).

An unintended consequence of these new requirements could be for trustees to reduce the number of funds it offers members.

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?

Answer

We have no additional comments or evidence in this regard.