DWP Consulation on Climate Change (26 August 2020)

Responses prepared on behalf of APPT by Tegs Harding - ITS Limited and Vassos Vassou – Dalriada.

> **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?**

The APPT agrees with the DWP's proposal that implementing the largest schemes first makes sense. We are aware that other groups such as ACA have commented that 'the devil will be in the detail' and urges the detail to be released soon, to give schemes time to prepare.

The APPT agree with this and would also add that we would want any framework to be sufficiently prescriptive on what is reported such that it is easy to differentiate between schemes that have made meaningful changes to manage climate risks and those who are taking a minimum disclosure approach without changing the way in which they are investing in practice.

Releasing the details of the requirements to asset managers as soon as possible is key to allow them to prepare the data needed. Although we note the principle of keeping the requirements broad, we would suggest that in reality standardisation of reporting may in fact help the asset managers provide the information trustees need.

We would also note that the governance budget of many smaller schemes does not currently facilitate these boards having sufficient time to be closely involved in 'what is under the bonnet' of their managers. They are reliant on advisors and asset managers to inform them of best practice.

Q2: We 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 if earlier.

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 requirements 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 these policy proposals?

Yes 7 months is sufficient time to prepare. However, the data available from asset managers is not universally complete. I would expect the first few years of reporting for schemes to have gaps.

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 £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.

We would propose also to review any regulations and statutory guidance which had been put in place to identify whether any of this needs to be strengthened or updated.

Do you agree with these proposals?

Yes the methodology is evolving and review in 2024 before requirements are rolled out more broadly is important. It will also be necessary to measure the impact regulations have had on the way in which schemes invest. If TCFD proves to be a ‘box ticking’ disclosure exercise or a useful tool for understanding and managing risk.

Q4. We propose that regulations require trustees to:

a) establish 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.

We also propose that regulations require trustees to describe:

c) the role of 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 process 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?

The APPT are broadly in agreement with this but would reiterate that this is only likely to be feasible for larger, well-resourced schemes at present.

In relation to point d) APPT would like clarity on the role of trustees. If their duty is to consider climate risk in so far as it relates to risk to the scheme itself, this may lead down a divestment route as this is the way to reduce risk in the shortest timeframe and with greater certainty. However if trustees have a wider duty of care to other stakeholders then engagement with Companies becomes more important as this will drive carbon reduction in the real economy.

Consultation Question

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.

We propose statutory guidance will cover the matters outlined in the box above. Do you agree with these proposals?

The APPT would like clarity on whether trustees have a duty to consider climate change in their analysis of sponsor covenant, noting that only a handful of covenant advisors have the capability to do this at present.

Similarly, additional guidance on what is meant by the extent to which climate change impacts funding strategy would be useful. We would also like clarity on whether trustees have a duty to consider the climate impact of scheme exit options, such as buying out assets with an insurer or moving to a consolidator.

Q6. We 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°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?

APPT question whether the tools exist to do this meaningfully at present. We would also note that the largest schemes are those that are most likely to be significantly derisked and invested in government bonds and buy-in policies with an insurer. Scenario analysis may be more usefully applied to parts of the portfolio (equity and credit mandates) to identify specific risks within this.

We do not anticipate that looking at the overall impact on scheme funding level would show a meaningful impact in all but the most extreme scenarios. It may therefore not be useful as a driver for decision making.

Q7. 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?

Yes but additional specific guidance noted earlier as to the requirement (or not) to look at the impact of climate change risk on the below would be useful

- Sponsor covenant
- Mortality
- Inflation
- Interest rates (long term yield on government debt)

Q8. We 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.

We also propose that regulations require trustees 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 required 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?

APPT question whether the data exists to make this a meaningful exercise (resulting in it being useful in trustee decision making) at present. The likely result is a report detailing why data in unavailable or it doesn't apply to that part of the mandate.

It might be worth including the requirement to report aggregate exposure to the sectors identified under the TPI (transition pathway initiative) framework as an interim or additional requirement as this is easier for trustee to understand and consult with sponsoring companies on whether they wish to have exposure to these sectors in the pension schemes they are responsible for. This would also allow boards to set explicit targets for reducing exposure to these sectors over time and as such be a useful way to report in progress.

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 the target(s).

b) calculate performance against the target(s) 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?

APPT agree that setting targets is useful but would welcome greater clarity on the duty of trustees in this regard. If a scheme adopts a net zero target, progress can be made relatively easily against this by divesting from the most carbon intensive industries. However, if what is being sought is a reduction in carbon intensity in the real economy then actually retaining those investments and engaging with companies to encourage them to adopt sustainable business practices is a more appropriate way to do this.

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 most recent 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 most recent 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?

APPT agree with the above proposals. We would also encourage a mechanism by which the sponsoring company has to be consulted on the TCFD report to encourage greater understanding by corporates of how pension scheme assets are invested. This would be more powerful if the exposure to each sector identified by TPI had to be included.

Q11: We 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, 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?

APPT agree with points b-d.

In regard to TCFD reports being inadequate in meeting the requirements in regulations APPT would encourage a more principles based approach as opposed to encouraging lengthy disclosures that actually don't help trustees make decisions or stakeholders actually see the climate risk embedded in portfolios. For example, not every point in the regulations may be addressed by a TCFD report but if on the whole a board can demonstrate they are complying with the spirit of the regulations and are making meaningful change then this should be sufficient.

We would also caution that lack of data availability is likely to mean TCFD reporting is largely not that helpful in the first few years so would welcome a suitable bedding in period before any penalties would be applied.

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?

No.

Q13: Do you have

a. any comments on the impact of our proposals on protected groups and/or 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?

APPT would wish to see an answer to the question 'what substantive changes have you made to your investment strategy in the last 3 years' (as per Guy Opperman's letter of September 2019) in any TCFD report in addition to a summary of exposure to the sectors identified under TPI (transition pathway initiative) as these will be a more meaningful tool for decision making and engagement with other stakeholders.