ClientEarth

October 2020

DWP Consultation:

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

ClientEarth Response

Top Lines

- We welcome the comprehensive and progressive trajectory of these policy proposals. We look forward to continuing to engage with the DWP and other stakeholders to assist with making any subsequent policies or regulations as robust as possible.
- Adoption of the proposals should be extended to trustees of schemes which fall below the £1 billion threshold. We acknowledge the challenges with doing so but provide suggestions for initially involving these schemes on the basis of reduced requirements.
- If the requirements are to achieve the objective of responding urgently to the risks of climate change (in particular those affecting the financial sector and wider economy) there is a limited window in which they can be introduced, reviewed and potentially updated.
- In light of increasing ambition in the pensions industry and the wider economy, we suggest that a mechanism by which a review of the requirements and statutory guidance can be expedited would ensure that the pensions industry is able to respond to developments on climate change (for example, by policymakers or industry) in a more agile way.
- The proposed regulations are to be supported heavily by statutory guidance. In the case of the governance and TCFD requirements, the statutory guidance allows for deviations from the approaches set out, with explanations. This has the potential to be confusing and lead to a

“comply or explain” approach, which would not result in the ‘decision-useful’ disclosures required. A robust process for analysing the legitimacy of any deviations should be put in place.
- The Pensions Regulator (**tPR**) will play a vital role in ensuring the regulations are enacted in a robust and credible way. tPR must be required to confirm how it is preparing for this role.
- We need to see the disclosures supplemented as soon as possible with requirement for pension schemes to prepare and disclose credible, ‘Paris-aligned’ strategies. We note that this Consultation foreshadows that there will be a further consultation on Paris aligned strategies, in due course and we would urge the DWP to bring forward that consultation as a matter of urgency.

1 Background

1. ClientEarth is a non-profit environmental law organisation based in London, Brussels, Berlin, Warsaw, Madrid, New York, Luxembourg and Beijing. ClientEarth's climate finance initiative conducts research and advocacy in relation to the legal implications of climate change-related financial risks for a wide spectrum of market participants, including companies, investors, company directors, their professional advisers and regulators.
2. On 26 August 2020, the Department for Work and Pensions (**DWP**) published a consultation seeking views on policy proposals to require trustees of larger occupational pension schemes and authorised schemes to address climate change risks and opportunities through effective governance and risk management measures, and to disclose these in line with the recommendations of the international industry-led Task Force on Climate-related Financial Disclosures (**TCFD**) (**Consultation**). This is ClientEarth’s response to the Consultation, including our Top Lines (above) and initial comments in relation to selected questions.
3. Please do not hesitate to contact Joanne Etherton (jetherton@clientearth.org) or Kyla Taylor (ktaylor@clientearth.org) for further information on anything contained in this response.

2 Responses to Consultation Questions

Question 1: Scope of requirements

4. We are supportive of the proposals but have the following comments in relation to the proposal to include in scope only trust schemes with £1 billion or more in net assets.
5. All pension schemes are exposed to climate-related risks, regardless of size. As part of their fiduciary duties and their regulatory obligations, trustees are already required to take into account financially material factors (including climate-related financial risks and opportunities) in their investment, stewardship and governance activities. If they are properly engaging with these obligations trustees should already be well on their way to integrating many of the governance and disclosure proposals set out in this consultation. Existing legal duties are not based on asset thresholds and only a small proportion of schemes are excluded from the regulatory obligations.
6. As a result, adoption of the proposals should, on the basis of fairness for all pension scheme members, be extended to trustees of schemes which fall below the £1 billion threshold (as described in Ch.2, para. 71 of the Consultation).

7. We acknowledge, however, the reality of (i) the complicating factors in reaching full coverage (Ch.2, para. 72), (ii) the DWP's desire to take a proportionate approach which enables them to move rapidly forward in line with the urgency and scale of climate change risks, and (iii) the efforts made to apply the proposals to a large majority of the market by membership (81% by 2023) and by assets (74% by 2023).

8. As a result, we support the proposals, but have suggested options by which fuller market coverage may be achievable.

9. The Consultation helpfully sets out a cost analysis summary of putting in place additional governance requirements to make TCFD-aligned disclosures. This includes typical costs of around £15k per year, estimated to equate to a "potential" 15 to 30% of the annual governance spend of a scheme with around £100 million in assets.

10. Our suggestions are:

    - That the regulations should apply to all schemes with assets below £1 billion unless they can demonstrate that implementing the proposals would lead to disproportionate costs exceeding a certain threshold of the annual governance spend; and
    - Those schemes exempted from the requirements as a result of (i) should be subject to reduced requirements (rather than no requirements). For example, these schemes could (for the time being) be excluded from the activities considered most cost-intensive, which we understand from the Consultation to be Scenario Analysis activities and the production of Metrics and Targets.
    - These schemes could also be phased into the process in a similar way to the subject of question 2.

11. As a possible alternative to our suggestion (i) above all schemes with assets below £1 billion (with limited exclusions to exempt the very smallest schemes) could be subject to the reduced requirements referred to in ii above.

12. We appreciate that these suggestions do not take into account the additional costs of monitoring this process. It should not, however, create a substantial additional burden on smaller schemes if they are already complying (as they should be) with their legal duties on climate change. The intention is that all pension schemes are engaging with the requirements at an early stage which will assist with limiting the effects of climate change risks on the members of those schemes, and allow those schemes to participate more directly in governance and disclosure developments which fundamentally benefit their schemes.

13. The consultation addresses hybrid schemes and DB superfunds, and we agree with these assessments. We also agree with the proposals in relation to authorised master trusts and authorised schemes offering collective money purchase benefits

14. Separately, we would like to see a level playing field provided for other parts of the pensions market which are not covered by these regulations, primarily: contract-based schemes and local government pension schemes (**LGPS**).

15. In this regard, we understand from the Consultation that the Ministry of Housing, Communities & Local Government will make provision for LGPS and that the Financial Conduct Authority (**FCA**) will be coordinating with the DWP and other regulators and government departments to enhance climate-related disclosures within its regulatory remit. We welcome the FCA's recent commitment to consult on "implementing client-focused TCFD-aligned disclosures for asset managers and contract-

based pension schemes in the first half of 2021, with a view to new obligations coming into force in 2022."[1] It is vital, however, that the solutions advanced by the FCA are equivalent in ambition, scope and pace of implementation.

Question 2: Timing

16. We agree that this is a logical set of proposals. Our comments, however, are two-fold:

- the timing must not be allowed to slip, and
- there is rapidly increasing understanding and capacity by stakeholders in the pension industry and the wider economy to address climate change issues. As a result, given the urgent timeframes involved, it would be useful to have a mechanism by which a review could take place earlier than 2024 to reflect positive changes and ensure that the pension industry remains a leader on addressing climate risk.

17. First, the timing of this approach must not be allowed to slip. The UK has committed to becoming "net-zero" by 2050. In order to achieve this, the UK economy will need to reduce its GHG emissions by around 50% by 2030. Whilst we appreciate that pension scheme trustees are not bound by government targets, the target is in place in order to address dangerous climate change and the shocks that it will manifest if climate change is allowed to go on unabated which will affect pension schemes and members' savings. As a result, pension schemes should be mindful of this target and leading asset owners have realised that the only way to meaningfully protect the interests of beneficiaries is to contribute to rapid reductions in global GHG emissions.[1] The likelihood of achieving net zero by 2050 is diminished substantially without participation from the financial sector, of which pension schemes and other asset owners are a crucial part. The Government's plans for pension schemes are a positive step in the right direction but there is a need to continue to push for ambitious change.

18. On the current timetable, the deadline for the last introduction of disclosures (broadly applicable to schemes with more than £1bn but less than £5bn of assets) is 31 December 2023, followed by a review of the measures in 2024. We understand from the Consultation that the intention is to provide an opportunity to (i) examine the emerging effects of the measures and any unintended consequences, (ii) assess whether the key "as far as trustees are able" requirements can be replaced with stronger requirements on data collection in light of any development of capabilities in the sector or the economy more widely, and (iii) consider extending requirements to schemes with less than £1 billion in assets (in relation to which, see our response to question 1).

19. By reference to the UK's (and global) emissions targets, the timetable is tight if a review concludes that the measures are proving inadequate.

20. We would suggest that this issue could be alleviated by providing a mechanism for early review or by expanding the scope so that schemes with assets between £1 billion and £5 billion do report at the same time, potentially with some differences.

---

1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/923327/fca-letter-climate-related-financial-disclosures-sept-2020.pdf

[1] https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

21. There is increasing understanding and capacity by stakeholders in the pension industry and the wider economy to address climate change issues. There are many examples of this, including:

- At the time the Green Finance Strategy was published in July 2019, 785 organisations had signed up to the TCFD Recommendations since its inception in 2017.[2] As of September 2020, in one year support for the TCFD has doubled to 1440 organisations.[3] Although these are global and cover a range of industries, this is indicative of the pace of change.
- Investors, including a significant number of pension schemes, with over $US 4.6 trillion AUM have signed up to the Net Zero Asset Owner Alliance and committed to transition their portfolios to net-zero GHG emissions by 2050.[4]
- The Consultation itself notes that 42% of respondents to the Minister's letters to the 40 largest DB schemes and the 10 largest DC schemes had already reported in line with the TCFD recommendations or planned to in 2020, and evidence from PRI showed that more than 50 of its signatories, many of them large pension schemes, were reporting on TCFD-based indicators.[5]

22. In addition, consulting firms and service providers have significantly increased their expertise and capabilities to provide comprehensive advisory services to pension schemes relating to TCFD disclosures.

23. Finally, the current proposals allow for some flexibility for developments and innovation, with the typically most burdensome and costly requirements (Scenario Analysis activities and the production of Metrics and Targets) implemented on the basis of "as far as you are able". This could allow more schemes to participate at an earlier stage: initially allowing certain schemes learning opportunities in relation to certain disclosures, whilst allowing them to participate fully in relation to others.

24. These factors suggest that as capacity increases at pace, arguments that schemes need more time to prepare before the requirements apply to them will fall away.

25. If proposals do proceed on the current timetable, to limit excuses for poor quality disclosures, strong statements must be made to those schemes who fall within later phases that there will be no excuses for poor quality disclosures when they have been given the time to engage and prepare.

Question 3: Review of measures

26. We agree that there should be a review of the measures and statutory guidance after the first round of deadlines complete. The proposals would benefit from a review to enable learnings to be reflected and the requirements to be strengthened as necessary. This commitment should have a statutory footing. Please see our comments on the timing of this in our response to question 2.

27. It will also be imperative that tPR is monitoring compliance by pension schemes and quality of disclosure on an ongoing basis. As noted in the Consultation, the review provides an opportunity to examine the emerging effects of the measures, including the emergence of any additional tools which would assist with forming comparable and consistent disclosures. It will also provide an opportunity to examine any unintended consequences, and whether anything stronger should replace the "as far as trustees are able" requirements. We would like to see tPR being required to

[2] Green Finance Strategy, page 23: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf
[3] https://www.fsb-tcfd.org/tcfd-supporters/
[4] https://www.unepfi.org/net-zero-alliance/
[5] Ch.2, para. 9 and 10

report at the relevant time to enable the review process to be expedited and any necessary changes implemented rapidly. It will be important that tPR is resourced and equipped to engage with this process.

Question 4: Governance

28. We agree with these proposals. It is particularly important that trustees recognise that "the adoption of effective climate risk management, comprehensive governance process and techniques such as scenario analysis and calculation of metrics to be as integral to the implementation of the TCFD recommendations as the disclosures themselves."

29. We are also supportive that the requirements be adjusted in order to capture the varied nature of the management of occupational pension schemes. We agree with the proposals which recognise that the board of trustees are ultimately responsible for assessing climate change risk and opportunities and the actions taken as a result of that assessment. We also welcome the clarification that trustees ultimately take responsibility for the advice they receive and the subsequent actions they take. We agree with the proposals which requires trustees to satisfy themselves that the persons managing the scheme assess and manage climate-related risks and opportunities.

30. We agree with the matters covered by statutory guidance.

31. Statutory guidance in relation to the mandatory governance and disclosure requirements allows schemes to take their approach as long as an explanation is provided explaining material deviations from the suggested approach(es). We recognise that this allows for greater innovation and development of industry standards, however, care must be taken that it does not detract from the mandatory nature of these proposals. It has the potential to be confusing as it could inadvertently suggest that the proposals are in effect a "comply or explain" approach which is not the policy intention. It must be made clear to trustees that the requirements are mandatory and any failure to report will require clear and evidence-based justification.

Question 5: Strategy

32. We agree with these proposals. The same concerns apply in relation to the option to deviate from the recommended approaches set out in the statutory guidance described in the answer to question 4.

Question 6: Scenario Analysis

33. We agree with these proposals, subject to the following comments.

34. More than two scenarios should be assessed. There are a wide range of potential climate scenarios. As far as possible a range of scenarios should be assessed which reveal the scheme's future exposure to climate change risks. We appreciate that this comes with certain additional costs and suggest that a practical compromise would be three scenarios, which would allow for the three typical scenarios set out in the PCRIG guide consultation document for trustees on aligning pension schemes with the TCFD Recommendations:

- 2°C or lower (orderly transition),
- 2°C or lower (abrupt transition) and
- pathway to 4+°C scenario (no transition).

35. In any event, we agree that at least one of the scenarios should be a 2°C or lower scenario. We also think it is essential that schemes are assessing their resilience to a much higher projection (a pathway to 4+ºC scenario). As things currently stand and in the absence of unprecedented action to reduce global emissions, global emissions trajectories will increase to the 'high-end' scenarios with the potential for temperature increases of 2° to 3°for the UK alone.[2] It is important that pension schemes recognise first what these changes will mean for the scheme's assets, and secondly understand the urgency with which they must act to reduce the impact of these changes.

36. We recognise that, at this stage, it may be difficult to prescribe the detail of the scenarios to be used. However, there must be expectations set that any assumptions and methodologies used are reasonable, precautionary, evidence-based and regularly updated in line with the best available science. To kick-start this process, we support the use of examples in statutory guidance to outline those scenarios available and the inclusion of "what is expected of trustees in terms of undertaking scenario analysis 'as far as they are able'". Setting out what is expected will be particularly important in ensuring quality, decision-useful information is produced.

37. The same concerns apply in relation to the option to deviate from the recommended approaches set out in the statutory guidance described in the answer to question 4.

Question 7: Risk Management Proposals

38. We agree with these proposals. They are an important part of embedding climate change risk management into business-as-usual operations. In particular, they contain a vital component of the risk management framework that should require trustees to take action when they identify climate-related risks.

39. We agree with the proposals in the statutory guidance and support the inclusion of opportunities in relation to which scheme trustees might want to consider and manage their exposure.

40. We agree with the proposals in relation to statutory guidance. The same concerns apply in relation to the option to deviate from the recommended approaches set out in the statutory guidance described in the answer to question 4.

Question 8: Metrics

41. We agree in the main with the proposals, however, it should be made clear to schemes that expectations of the number and range of metrics used will vary depending on the size and characteristics of the scheme. Two metrics will not be sufficient for all schemes in order to adequately inform target-setting and forward-looking strategies. As there is no intention to mandate particular metrics for which targets should be set, or the ambition or timing of targets, it will be crucial that trustees choose and employ metrics on a prudent and precautionary basis to the best available science, and use assumptions and methodologies which are reasonable and supported by evidence, i.e. that can be clearly justified. To this end, we support the suggestion in para. 84 that trustees will be required to explain their approach to metrics, supported by explanations in the statutory guidance as to the level of detail expected.

42. In addition, although we appreciate the difficulties which exist with gathering certain pieces of data (such as scope 3 emissions data), trustees should be ensuring that they are including in their planning the various governance tools available to them use to encourage disclosure of this data.

[2] https://www.theccc.org.uk/2020/04/21/how-much-more-climate-change-is-inevitable-for-the-uk/

43. The same concerns apply in relation to the option to deviate from the recommended approaches set out in the statutory guidance described in the answer to question 4.

Question 9: Targets

44. We agree with the proposals.

45. In particular, trustees should be setting targets in relation to the soonest possible date by which they can achieve net zero GHG emissions or align with the Paris Agreement's temperature goals. These commitments must include short, medium and long term targets (including 2025 and 2030 targets). As mentioned above in relation to metrics, targets should be set using a prudent and precautionary approach to the best available science, and assumptions and methodological choices must be reasonable and supported by evidence.

46. The same concerns apply in relation to the option to deviate from the recommended approaches set out in the statutory guidance described in the answer to question 4.

Question 10: Disclosure

47. We agree with the proposals. We have two main comments. The first is that it is important that by being situated as a link in the annual report, the TCFD disclosures are of themselves, subject to the same levels of internal controls and accountability mechanisms as for any other information which would be included in the annual report.

48. The second is in relation to increasing transparency and engagement with members. It is clear that to date, although members have struggled to engage with their pension in some respects, they are concerned about what their pension scheme is doing on climate change. The consultation recognises the challenges of communicating information to beneficiaries with a wide range of levels of engagement and pensions knowledge. Whilst including a link to the report in the annual benefit statement would be beneficial and is a proposal we support, we would also support the integration of certain key parts of the information disclosed on the new Pensions Dashboard service.

49. The introduction of the new Pensions Dashboard service is an important reform which is critical to ensure that savers have easily accessible information about their pension funds. It will quickly become the primary means through which savers obtain information about their pension fund. It is therefore critical that savers can obtain information about how their scheme is managing climate change related-risks through this service.

Question 11: Penalties

50. We agree with the proposals in principle.

51. It is vital that tPR enforces the mandatory rules. Given the way the proposals intend to build in scale and scope, it is also vital that tPR has discretionary powers in relation to the quality and adequacy of reports. It is clear, however, that there are many elements of the overall proposals which will require regulatory oversight and engagement in order close the gap on accountability and to support the speed and efficiency with which these proposals are rolled out. For example, in relation to question 3, we identified the importance of the Regulator's role in ongoing engagement and landscape reporting until the first review.

52. tPR has made useful statements on climate change and the expectations on trustees overall.[3] We are yet to see any indications of how tPR is planning to supervise the quality and adequacy of the disclosures, nor how it is equipped to undertake enforcement action where necessary. It must be in a position to identify and act swiftly when enforcement action is required.

Question 12: Impacts

53. We do not intend to respond to this question.

Question 13: Additional comments

54. All of our above comments are subject to the view that the disclosures should be expanded to include disclosure of a 'Paris-aligned' strategy with a credible plan for how pension schemes can achieve net zero emissions by 2050. This should include how schemes intend to use their stewardship policies and activities to drive all portfolio companies to adopt a Paris-aligned strategy. On the basis that we understand a further consultation will be issued on mandatory 'Paris alignment' reporting soon (noted in the Ministerial Foreword of the Consultation), we will address these issues fully at that time. However, we expect that the proposals in this Consultation will need to be considered and reframed in light of the results of the anticipated 'Paris alignment' consultation.

[3] See the most recent blogpost, A Changing climate for pension trustees: https://blog.thepensionsregulator.gov.uk/2020/10/01/a-changing-climate-for-pension-trustees/

Joanne Etherton

Senior Lawyer, Climate Finance Lead

020 3030 5992

jetherton@clientearth.org

www.clientearth.org

Kyla Taylor

Lawyer

0203 030 5976

ktaylor@clientearth.org

www.clientearth.org