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

DWP consultation response

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Responses to questions

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?

We are supportive of the proposals. We believe larger schemes, with more resources and sophisticated governance structures, are well-placed to lead the way and be examples to smaller schemes. This can also encourage asset managers to continue to prepare themselves to provide better, more consistent, and comparable information.

There should be some clarification around whether the definition of assets should include insurance policies, such as pensioner buy-in policies. Our preference would be for climate data to be excluded from the reporting requirements for such assets. We feel this legislation should be focused on pension schemes and it is not the responsibility for pensions scheme trustees to influence change in the insurance industry. We understand insurance companies are covered by TCFD reporting requirements separately and therefore do not feel disclosure inclusive of insurance products is necessary.

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?

We are broadly supportive of the proposals. As per Q1, we believe larger schemes are well-placed to lead the way and be examples to smaller schemes. We believe it is important to start planning now how smaller schemes will be enabled to "catch-up" with their larger peers. We think real progress requires an increase in the absolute number of engaged stakeholders not on an asset adjusted basis.

We found the proposal g) where reporting obligations cease to be applicable following a decrease in asset values confusing and unnecessary. Emphasis should be on the fact that all schemes should eventually report according to TCFD. Reporting according to TCFD disclosures should be integrated as part of a scheme's risk management framework without a cut-off date and should not be contingent on other factors such as falling asset values. Based off the fact that this reporting may apply to all schemes after 2024, it appears unnecessary to have complex loopholes when this regulation will no longer apply and therefore schemes can stop reporting in line with TCFD.

We suggest that once a scheme falls in scope, this marks the start to reporting in line with TCFD and once started any scheme should continue until they have paid all their benefits or have gone on to buyout their liabilities with an insurance provider.

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?

We disagree with the proposal for a review in 2024 as we think smaller schemes should be brought within scope as soon as possible. The proposed regulation as it stands may lead to larger schemes "front-running" smaller schemes in terms of investing in climate change opportunities and avoiding climate risks. The outcome of the proposal as it stands seems to be that small schemes may be regulated after 2024 which could result in a minimum of three years' worth of climate change risk being unaccounted for. We feel this may result in smaller schemes being left with stranded assets and strategies that are not aligned with a transitioning economy.

We agree that it should fall to the largest schemes of £5bn in assets and above to be the first to break new ground in terms of TCFD reporting as they clearly have the most resources to undertake this resource-intensive task for the first time. We think this will start to change market dynamics, and this will be intensified when £1bn - £5bn schemes are included. We feel therefore that all schemes should be included in this regulation from 2023, regardless of size.

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?

We agree to the proposals on the role of trustees in considering climate risk.

In our experience, most UK pension scheme trustee boards are less experienced in ESG-related issues and so this regulation should highlight the importance of a competent trustee board with the knowledge, training, and tools to undertake these exercises effectively.

The role of fiduciary managers should also be clearly defined as there is a risk of confusion in responsibilities and drawing out this distinction would be useful.

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?

We agree with the proposals for trustees to identify and disclose climate change risks and opportunities. However current reporting standards need improvement in terms of both accuracy and comparability to ensure that the integration of data in disclosures will result in meaningful disclosure and peer group comparisons. In particular, some standardisation of data should be encouraged, and consideration should be given on the publication of best practice climate change risks in derivative-based strategies and closed-ended funds such as property and hedge funds. We believe these asset classes in particular are likely to be amongst the more difficult for investment managers to deliver comparable climate change risk data to investors.

We believe there should be further clarification around risks and opportunities over short, medium and long term time horizons. An alternative might be to assess immediate risks and long-term risks, as opposed to three distinct, but not well-defined periods. Regardless of which horizons are ultimately decided upon, they may not apply to all schemes, for example a DB scheme that is shortly to move to buy-out of its assets with an insurance provider.

A suggestion could be for trustees to make an assessment relevant to investment strategy as a whole, and link this to journey plans and the shift to de-risking investment portfolios over time.

Finally, for DB schemes, we think the regulation should include a requirement for climate related risk to be considered as part of a covenant assessment to deepen the understanding of climate change risk in the integrated risk management framework.

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?

The Bank of England stress test model and TCFD guidance consultation published earlier this year models three different scenarios:

- Orderly transition, 2°C or lower scenario
- An abrupt transition, 2°C or lower scenario
- No transition, pathway to 4+°C scenario

Our view is that due to the complexities of science and the uncertain nature of climate change there is a large spread of outcomes in terms of the effects of climate change on portfolios and liability valuations. We feel that consideration of 3 scenarios in keeping with the BoE models should be mandated to reflect the spread of outcomes with as much guidance as possible to maximise the impact of peer group comparison. This will require close liaison with the relevant professional bodies (Institute and Faculty of Actuaries, ABI etc) to ensure the liability modelling data is available and robust.

We recognise the difficulties in acquiring inputs for scenario analysis however we would stress the importance of quantitative scenario analysis. Quantitative disclosures are, in our view, less likely subject to greenwashing and can provide a more suitable methodology in terms of aggregation and extrapolation of data. The quantitative outputs are also more useful to a decision-making framework and minimising these quantitative results can form a key part of a good risk management framework for trustees.

We would not, however, dismiss the benefits of qualitative scenario modelling and acknowledge that it will take time for processes to be established to run quantitative data. Qualitative narrative could be used to describe the quantitative inputs, including limitations. For DB schemes we feel that scenario analysis on the strength of the covenant is important, and we acknowledge that the results of this are likely to be qualitative.

We recognise in terms of scenario analysis, different advisers and trustees will utilise their own models which will lead to diversity of outcomes which could result in a range solutions that could be implemented. This drives our comment above on the need for guidance as part of proposed regulation.

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?

We agree with the proposals. Climate-related risk assessment should, in our view, be built into the existing risk management framework trustees utilise for assessing and managing risks to their overall strategy.

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?

We view the proposals as a good starting point, however further guidance should also be published alongside the regulations on choosing metrics for assets and funds that traditionally have been characterised by low availability of reporting data such as derivative-based investment strategies, private market investments and, in particular, property funds. For example, hedge funds and absolute return funds that are investing in or shorting a particular index are not invested in an index constituent company directly, but they are exposed to gains and losses associated with company performance. Property funds, based on our research experiences, struggle to obtain climate change data from their tenants sufficiently regularly to be able to provide coherent commentary to investors. Guidance should include examples of best practice in obtaining data in these funds. In addition, consideration should be given to encouraging the property sector to do more in facilitating climate-related exposure.

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?

We feel that targets should be set for all the metrics that the scheme has selected (i.e. at least one emissions-based metric and at least one non-emissions-based metric) and that this should be made clear in the regulations. In our view there is little merit in reporting on a metric without any concrete targets in place aiming to improve performance against this metric.

We would also suggest further guidance on the definition of what a reasonable target might look like. Trustees should be encouraged and guided to set targets sufficiently ambitions to make a difference.

We propose that guidance could include options such as targets aligned with international goals such as the Paris Agreement or Goal 13 of the UN Sustainable Development Goals.

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?

We agree with the proposals. This is in line with the current SIP regulations and we believe the proposals to notify members are appropriate.

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?

For a), we would flag that the discretionary penalties for non-compliance should be balanced against the cost of producing a report. For example, if trustees are fined for the failure to produce TCFD aligned disclosures, the fines should be above the expected cost of producing a report. If the costs are higher than the fines, there is less motivation for trustees to be compliant as the paying fines will result in cost savings for trustees compared to producing the report.

For b), if a mandatory penalty is only issued in cases of total non-compliance, trustees could prepare report of low quality to meet the minimum requirement and no penalty would be applied. Further guidance is required regarding the standards of inclusion of the various disclosures required under TCFD reporting to prevent substandard reporting from schemes. We propose that a checklist for compliance is included and penalties for each section/disclosure is included correspondingly.

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?

The direct costs provided in the document are below what we would estimate for the completion of the report in 2022. I.e. what the schemes £5bn and over will bear in terms of costs of the guidance.

We believe costs could be significantly higher for the "Ongoing – Reporting and Disclosure" and "Metrics and Targets "as this will involve trustee boards discussing with their advisors the metrics throughout the year and deciding strategic actions. In addition, it will take some time before the asset managers are able to produce the required metrics meaning increased direct costs will be incurred in working with the managers to produce the required metrics. We would note that a handful of trustee boards are already allocating a reasonable budget to environmental analysis and for these, the additional direct costs associated with the proposed regulations are unlikely to be significant.

We would also suggest that time is budgeted for drafting and reviewing the TCFD report. From our experience with Implementation Statements, these (in time public) documents will be bespoke to each specific pension scheme and the output needs to cater to the interests of the members of the scheme. There will be no "one-size-fits-all" approach for how the document will be laid out and this should be considered in the costings.

We agree that after 2022 there should be efficiencies for the smaller schemes to benefit from once the largest schemes go through the process a year earlier and would encourage early engagement on how this can be delivered.

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?

We would like to reiterate the importance of having smaller schemes report on climate-related risks. Understandably, smaller schemes typically have – fewer resources to prepare TCFD aligned reports but they also have less capacity to withstand the non-diversifiable impacts of climate change, especially with a delayed response to the transitioning economy.

The success of TCFD aligned reporting relies heavily on market forces to driving better disclosure and monitoring and hence enforcement of this regulation is crucial in ensuring stakeholders are committed and engaged. Metrics must be useful, and targets have to be reasonable and in line with international standards to ensure benefits show through

As mentioned previously, we would like to reiterate the need for a compliance checklist where it is made clear what penalties apply for not meeting various parts of the regulation

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