Tesco Plc Pension Scheme Trustee – Response to consultation
Consultation name: Taking action on climate risk: improving governance and reporting by occupational pension schemes

Overview

We are very supportive of the aim of managing climate risk and pension schemes playing our part, as both investors and on behalf of our members, in increasing awareness and encouraging the right behaviours. We are also supportive of the TCFD and started, some time ago, to put in place processes to align with the proposed requirements.

We respond to your questions individually in the next section, but wanted to start by outlining our main comments:

1. Understanding what we are trying to achieve

In our view, the key benefits of this initiative are to:

- Engage our membership with the topic of climate change, so raising awareness and increasing engagement with their pensions savings – which we have already started to do
- Use the investment clout held by the £1 trillion of pension fund assets to influence corporations to take proactive action in the context of climate change
- Protect our pension schemes from the risk of climate change (alongside other risks being faced such as covenant, financial and demographic risks).

In our response we have tried to consider

- What updates to the requirements could help achieve the benefits above,
- Whether there are more proportionate ways to achieve these benefits, and
- Whether it would lead to any other unintended consequences in trustee decision-making.

To achieve the first benefit, simplicity will be key if we want members to understand and engage with the topic. We are keen to avoid this process evolving, as we have seen for the Statement of Investment Principles, to an exercise that becomes a compliance process due to having too many “boxes to tick”.

For the second objective, a hard focus on metrics and targets, especially in the short term, (e.g. where the lowest emissions metric is considered the best) could potentially result in unintended consequences. For example, investment being diverted away from companies that could have otherwise have been influenced / need reinvestment to move to a greener approach to climate change initiatives.

2. Proportionality vs trustees’ other duties

We note that climate change is one of many risks that trustees will need to consider when deciding on how to act in the best interests of their members. Trustees need to consider all these different risks proportionately, and also invest a proportionate amount of effort in mitigating each of them.

With this in mind, we hope that the regulations will clearly re-inforce trustees’ overall legal responsibilities which includes considering climate related risks and opportunities as one of many factors – to make sure an appropriate balance is maintained to avoid unintended consequences.

Equally, we would expect any penalties that may apply to consider and reflect the broader legal Trustee responsibilities and for them to be totally appropriate – again, to avoid unintended consequences.

3. Public disclosure of reports

We are very supportive of the disclosure of the reports to members – particularly if the information is written in a way that's clear, simple and relevant to members.

However, we have concerns about the consequences of the requirement for trustees to publish their TCFD report in full on a publicly available website. While we are supportive of the aim of transparency, given the high-profile nature of this topic, we are concerned that the publication of this information could lead to unintended consequences, such as the report being mis-reported or misrepresented, and thereby not providing an accurate position to members.

Detailed 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?

These proposals are reasonable in our view. The Trustee of the Tesco PLC Pension Scheme has formally supported the conclusions of the TCFD by signing the Statement of Support, and believes the TCFD framework is appropriate and provides a consistent and comparable way for schemes to report in a decision-useful and efficient way.

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

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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?

These proposals are reasonable in our view, subject to the detailed regulations being available in good time.

The timing for Schemes to implement the governance requirements by 1 October 2021 (which will be less than one year from when the regulations are laid) could be challenging for some schemes if they are to lead as examples of good practice for others, owing to the number of steps required for full compliance.

However, it's clearly important that to meet the proposed timeline trustees would need the timely release of the detail to be set out in the regulations and statutory guidance. If the regulations are delayed until middle or later next year, the proposed timetable for compliance will become challenging.

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 agree that any regulations and statutory guidance should be reviewed at regular intervals.

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?

With regards to the requirement "to establish and maintain processes by which trustees satisfy themselves that the person managing the scheme assess and manage climate-related risks", we suggest that "employees of the principal or controlling employer" be narrowed /clarified to refer to just employees who carry out duties in relation to the scheme.

Otherwise we agree in principle with this, subject to seeing the detailed guidance and regulations. We would be concerned if the combination of this results in requirements that are either too onerous given the information that would be accessible to trustees/investment managers or too vague resulting in trustees/investment managers not having a clear standard of what is expected of 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?

We suggest that trustees are given flexibility to decide based on their circumstances the "levels at which identification and assessment of risks and opportunities be carried out". For example, there may be good reasons why different sections in a scheme may be grouped together, or disclosure may be more difficult if there are several investment classes grouped together in say a DGF-like fund.

It would also be helpful to clarify how 'short, medium and long-term' are defined.

Otherwise we agree in principle with this, subject to seeing the proposed guidance and regulations.

Again, the required disclosure should consider to whom the information is being addressed (e.g. members) and make sure the members' needs and preferences for disclosure are properly considered – unless this is required as a technical compliance obligation.

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?

We agree with the approach of "the Government does not propose to prescribe whether scenario analysis should be qualitative or quantitative" and that it is proposed trustees are given flexibility to decide based on their circumstances the "levels at which identification and assessment of risks and opportunities be carried out". For some schemes a qualitative view on the impact of a few scenarios would be more proportionate and could lead to more useful discussions. For many schemes, managing cost of this exercise will be a key consideration.

We welcome guidance on what scenarios could look like for a 2°C world for consistency between schemes.

We suggest that the requirements include some flexibility to run the scenarios based on different limits if more recent developments suggest that would be more relevant. For example, for our own operations Tesco have focussed on a 1.5°C target.

There are also the challenges of 1) ensuring this exercise is forward looking and relevant, when there may be a time lag for some of the input data, and 2) pragmatic. The underlying stocks across the Scheme's asset allocation will no doubt have changed since the start of the exercise and it will certainly be out of date by the time its reported. So the purpose and expected output of scenario testing should be clear to make sure it's an efficient and effective piece of work – that will be of real benefit.

If it was qualitative or targeted more at the type of investment, more holistically, to stimulate a discussion and perhaps key decisions (of action) then this might be a more relevant and practical approach than a bottom up detailed (theoretical) exercise.

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?

Within the statutory guidance it's important to understand that the assessment of risk and opportunities of climate related risks should be embedded in the investment process right across the scheme's asset base – along with other important aspects of assessing risks and opportunities.

As Trustees typically don't disclose the 'process / elements' they use in other aspects of risk assessment within their investment process, it's important to understand the purpose of this – compliance or member communication. If the latter, it is important to consider the wording used in the regulation/guidance, which often ends up being used in member communications, so it is easy to understand and free of jargon.

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?

For point a)

- In the near term there's a large number of investee companies that still do not publicly report certain metrics (i.e. Scope 1 and Scope 2 emissions) – although we would expect this to change as the requirement becomes mandatory by 2022. Equally, we need to consider available information not just from quoted entities but also private markets – as these are making up an increasing proportion of Scheme's assets and patient capital is an area that Government is encouraging pension funds to invest more in.
- Disclosures may evolve over time as more information becomes publicly available.

- We agree there should be a non-emissions metric as in our view emissions do not show the entire picture of climate risk. We also agree that having flexibility rather than being locked in to a specific metric will be helpful.
- We would suggest that annual (vs quarterly) reporting would be sufficient given the long-term nature of the subject and likely availability of data.

For point b)
- We agree that the requirements should be "as far as they are able" at this stage, given the potential lack of readily available information and the time it may take for investee companies to build up their disclosures.
- The quality of Scope 3 data, and hence its usefulness, is currently questionable. We suggest it would be more appropriate for Scope 3 to be voluntary for now and review this again in future when reporting of Scope 3 by companies is likely to be more widespread and robust.

We agree that trustees should not be mandated to use a specific measure (which implies that even though WACI is expected to be used for the emission target a different one may be used). For example, there may be non-standard investments (e.g. in private markets) where this is less easy to obtain or not available.

Again we suggest that trustees are given flexibility to decide based on their circumstances the "levels at which metrics should be calculated and reported". In this case, larger schemes may invest in a many different individual investments and it could be disproportionate to be required to collect information for those that are not significant in the context of the scheme.

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 would ask DWP to consider any potential unintended consequences for such targets impacting trustee decision-making and the wider economy.

The key challenge is how asset owners can deliver on their ultimate fiduciary obligations whilst influencing and supporting all entities to adopt and accelerate a climate responsible strategic approach.

Trustees should also have the flexibility to review and change the target if totally appropriate as part of their overall management of the various risks (including other aspects such as inflation / longevity / interest rates) facing the pension schemes.

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?

In our view proposals b) to e) are reasonable, though we suggest considering if say a shorter, simpler report to the full TCFD report might be more engaging for members.

Proposal a) may result in potential misuse of the information by third parties, which could lead to unintended consequences such as members disengaging from pensions due to negative coverage. There may also be commercially sensitive information, for example in assessing the impact on covenant.

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?

Given the complexity of the likely disclosures and the aim to develop improved best practice, we would suggest that a ‘first year’ grace period from penalties and fines should be applied. This will also prevent negative association with the new disclosure requirements if, for example, naming and shaming was also adopted.

We would also be opposed to any mandatory penalty regime, for example as introduced for the DC Chairs’ Statements.

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?

As noted above, we are concerned with the potential for unintended consequences in trustee decision-making and from this the potential wider economic impact if the bulk of the pensions industry moves their investments towards a concentrated group of assets and, in the process, fails to make a difference with the wider universe of investable entities.

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?

Question not answered.

b) any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats

We currently convert some of our communications to audio formats for some members.

c) any other comments about any of our proposals?

To enable trustees to carry out their duties, we would be supportive of any steps that can be taken to encourage disclosure of key metrics by investee companies.

We also note that trustees of pension schemes are also bound by their overall fiduciary duties, so their decisions need to reflect a range of duties of which managing climate related risks is one. We should also make sure that the proposals deliver on the ultimate objectives and don’t instead create unintended consequences.

In terms of the drafting of the regulations, we would suggest ensuring, as far as possible, that everyday language rather than technical jargon is used as this often then finds its way into member communications.

Summary

Climate change represents one of the greatest issues we face today. We support the passion, pace and approach of the Minister and Department to get pension funds to take proactive action on climate change and to engage with members with clarity and transparency on the action that is being taken and the difference that is being made.

We feel it's important that proposals (e.g. scenario testing) are thoroughly thought through and are relevant, timely and actually make a difference by influencing positive future actions and outcomes – rather than being too remote and out of date with no real benefit.

It's also important to clearly distinguish between the disclosures that are to be made for (technical) compliance purposes compared to those that are meant to inform, communicate and engage with members – and where each of those disclosures should be shown also acknowledging potential unintended consequences.

Connected to this, we have an opportunity to learn from experience and to avoid regulation that includes technical jargon, that people just won't understand, that might naturally get transferred into member communications. This is an opportunity to have customer / member led regulation, where appropriate, that would influence the consistent use of clear and simple everyday language right across the industry from Trustee and Governance discussions through to the communications that members receive.

At the early stages of this journey, this is an opportunity to make a real difference by setting the right tone, doing it in the right way and creating a foundation for clear, simple and relevant member engagement as part of this – on a subject that matters to our people and planet.

We would be very happy to discuss the consultation with you and provide further information if needed.