XPS Pensions Group

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7 October 2020

Sent via email to pensions.governance@dwp.gov.uk

Dear Bethany, Tom, Andrew and David,

Re: Response to open consultation by the Department for Work and Pensions

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

I am writing on behalf of XPS Pensions Group in response to the above mentioned open consultation.

XPS Pensions Group is strongly supportive of the proposals and recognises that climate change poses a systemic and financially material risk that has the ability to impact member outcomes. We therefore consider the proposals to be aligned to the fiduciary duty of trustees to act in the best interests of their members.

We believe the Task Force on Climate-related Financial Disclosures ("TCFD") framework provides a standardised and well defined framework that will help pension scheme trustees to understand and incorporate considerations of climate risks (and opportunities) within their schemes in a measured and intentional way to the extent that the requirement is not treated as a tick-box compliance exercise. This in turn will lead to improved risk management in relation to climate change within pension schemes that is aligned with the primary aim of delivering beneficial member outcomes. Further, we believe disclosing against TCFD recommendations will enable pension schemes to leverage their position and influence as large asset owners to drive positive change with regards to both climate change and wider ESG issues within companies and thereby society.

In addition to the current proposals, we strongly encourage the Pensions Regulator (TPR) to incorporate further guidance on climate risk within the proposed DB Funding Code of Practice. Climate risk is amongst one of the many risks a pension scheme faces and by incorporating it into the Code of Practice with respect to a scheme's investment strategy, funding targets and wider risk management frameworks trustees will be encouraged to take a holistic and integrated approach to addressing climate related risks amongst the others.

Our response to the specific questions is set out in the Appendix, however we would also like to note the following high level considerations:

> The proposed timescales are demanding and could prove difficult to meet for some pension schemes, particularly in context of the current COVID-19 environment.

> We believe the maximum benefit will be achieved if the statutory guidance helps trustees manage risk in order to deliver member benefits. It would be sub-optimal if trustees consider the guidance a further governance burden. This could be addressed by ensuring the statutory guidance provides trustees with the rationale around the financial materiality of climate risk and links the requirement to consider climate risk to the primary objective of delivering member outcomes.

> Given the complexity and rapidly changing nature of addressing climate change, we believe clear guidance in a number of areas (as highlighted in our response) is imperative to trustees adopting this in an engaged and integrated way.

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> We do not believe the fund management industry is currently fully prepared to support pension schemes with regards to the upcoming requirements. We believe these proposals and subsequent demands from trustees will accelerate change in the right direction, however there are likely to be information gaps in the interim. We encourage a push for the development of minimum requirements which will drive a level of standardisation in the information available from fund managers and data providers.

> The requirement to set targets is complex and requires clarity and guidance particularly on how this will, or should, interact with wider scheme objectives.

> There needs to be further clarity and distinction of approaches and requirements for defined contribution (DC) schemes.

We hope that you find the contents of our response useful. We would be happy to discuss any of the points raised further. If you have any questions, please feel free to contact me on sarita.gosrani@xpsgroup.com or 07436 307266.

Sincerely,

Sarita Gosrani

Head of ESG Research

On behalf of XPS Pensions Group

About XPS

XPS Pensions Group is the largest pure pensions consultancy in the UK, specialising in actuarial, covenant, investment consulting and administration. The XPS Pensions Group business combines expertise, insight and technology to address the needs of more than 1,500 pension schemes and their sponsoring employers on an ongoing and project basis. We undertake pensions administration for over 920,000 members and provide advisory services to schemes of all sizes including 26 with over £1bn of assets. XPS is also a signatory to the UN PRI.

Appendix – Responses to questions posed in the consultation

Q1. ***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 agree with the proposals as they provide trustees with a standardised framework and starting point to consider climate risk and opportunities within pension schemes. The requirement pushes trustees to consider climate risks more intentionally within their broader risk management processes and frameworks, thereby working to deliver member outcomes.

Scope: We do however believe the scope should be extended to superfunds regardless of scale. Given their positioning to be a long-term robust solution for pension schemes, building in resilience to climate risk should be a key element of risk mitigation on an ongoing basis, not just when they reach scale.

Costs: We expect there will be additional cost implications associated with meeting the requirements and therefore the current cost guidance significantly underestimates the costs likely to be incurred. Further, within DC schemes, where costs are borne by members, there is a concern that the cost of compliance will be passed on to the members which may impact member sentiment around the proposals.

Q2. 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?

Whilst we agree with the direction of travel we believe there are some additional points that should be considered, particularly around the timescale.

Timescales: There is a very short lead time for pension schemes to disclose starting October 2021. This will require schemes to shortly begin to prepare and establish the governance process to enable them to disclose in line with the requirement and this could prove challenging for some schemes, particularly in context of the current COVID-19 environment. As such, the regulation/requirements should be released at the earliest opportunity if it is intended for this timescale to remain. Further, there should be strong encouragement for trustees of schemes that fall into the second reporting cycle to familiarise and/or start preparing for the upcoming requirements.

In specific response to part "g" above: We believe trustees of these schemes should be encouraged to continue to disclose as it is unlikely the climate risks they previously faced no longer exist. Further, the trustees would be required to disclose for the scheme year that has ended and therefore will have already gone through the process of establishing the governance requirements and set-up making the case for them to continue to do so where practicable.

Fund management industry: It should be taken into consideration that the fund management industry is not fully prepared to support trustees to meet this requirement and there is currently no standardised approach to measuring and incorporating climate risk. This is to be expected given the complexity and fast evolving nature of the issue, however we believe the development of minimum requirements for fund managers is strongly aligned with schemes being able to meet their requirements.

Guidance: We consider clear guidance for trustees to be imperative to proper adoption of the requirement within the given timescales. Further the current guidance is tilted towards DB schemes and we would like to see this expanded to support master trusts and DC schemes.

A large step up is required in the education of many trustee boards and product offerings from advisers and service providers. We are therefore very supportive of utilising the learnings from the first round of reporting to provide a level of benchmarking, and encourage that any follow up guidance is released at the earliest opportunity.

Requiring high quality disclosures by 2023: The guidance should be extended to defining what high quality disclosures could look like. Further, how the fund management industry can evolve to support these requirements should be fully considered.

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 £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, given that smaller schemes are not immune to climate risk within their schemes. We would however like to highlight the below.

Phased approach: As the governance burden is likely to be higher and the education gap wider for trustees of smaller schemes, a stepped up or phased approach to prepare for full disclosure could help with the adoption of the requirements in a more considered way.

There are likely to be many relevant developments in the climate change arena leading up to the 2024 review such as availability and quality of tools and services that are available at that point in time which will be important to consider.

In addition, coverage of large schemes includes 75% of assets owned by pension schemes leaving 25% of assets uncovered which could leave smaller schemes and their members exposed to climate risk if they did not follow suit. We note that actions taken by the larger schemes could potentially accelerate carbon repricing and therefore

Guidance: A strong encouragement for trustees of smaller schemes to begin to consider material climate risks and opportunities in the interim period before TCFD requirements come into force will help to move trustees of smaller schemes away from a tick-box/compliant mind set. Further, as best practices will be informed somewhat by what bigger schemes can achieve, follow up guidance should be tailored to smaller schemes taking into account the wider use of pooled funds.

Q4. ***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 with the proposal that the trustees are required to adopt and maintain oversight of climate risk and opportunities and describe their role in doing so, as it promotes accountability and ensures that the persons that actions are delegated to are held to account.

Further clarification: We propose that further clarification is provided around the “persons managing the scheme”.

Evolution of fund managers: The ongoing monitoring and management of climate risks will require support from the fund management industry which is still evolving and may prevent trustees from fully meeting this requirement.

Consistency across risk frameworks: A level of consistency should be achieved across other risk management frameworks that pension schemes have in place by amending TPR's other Codes of Practice to be compatible and/or emphasise the need for climate change considerations. TPR should integrate climate change considerations into the trustee toolkit and into funding, investment, IRM and other risk management guidance. This will enable all pension scheme trustees to start to consider climate risk even if they are not captured by the current proposal in the short term due to their size. It should also enable trustees to prioritise the particular risks they face: although climate change is likely to be an important risk, interest rate or inflation risk may be more financially significant to a particular scheme.

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?

We agree with this proposal and consider guidance to be imperative due to the complexity of the issue. From an investment perspective, guidance should provide trustees with information on how to assess and understand the materiality of the risk and how it can be applied in context of their scheme. We caution against dogmatic definitions of short, medium and long term – trustees should determine these based on their own circumstances.

Consistency across risk frameworks: Similar to our response to question 4, we believe the guidance provided as part of this should be integrated into other risk management guidance for trustees.

Q6. 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?

Whilst we are supportive of this proposal, we would like to highlight the following:

Availability of resources: There are issues around the lack of data and also the range of models/tools currently available to trustees which could make it challenging for schemes to meet this requirement in its entirety.

Guidance: Further clarity on the scenarios and metrics, granularity on the quantitative vs. qualitative approaches that would be considered appropriate and also the definition of "as far as they are able" would prove useful in understanding and meeting minimum requirements.

Liabilities: Information is more widely available from an asset perspective. Further guidance on how liabilities can be assessed on their resilience to climate change would be welcome.

Suitability/availability of investment products: There is a consideration around the availability of appropriate investment products from fund managers. Subsequently the suitability of products will depend on wider considerations for the scheme such as risk/return targets, position in journey plan etc. Publicly disclosing the results of the assessment without this context could provide an incomplete picture.

Costs: There could be additional cost implications in meeting this requirement given the fast evolving nature of tools, resources and information. The guidance should cover the expected frequency of updating the analysis and how schemes should factor in the information.

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?

We are supportive overall but would like to highlight the following considerations:

Availability of resources: As highlighted in question 6, there are issues around the lack of data and also range of models/tools currently available to trustees which could make it challenging for schemes to meet this requirement in its entirety, at least initially.

Guidance: We consider clear guidance for trustees to be imperative to proper adoption of the requirement within the given timescales. The current guidance is tilted towards DB schemes and we would like to see this expanded to support master trusts and DC schemes.

Readiness of fund management industry: It should be taken into consideration that the fund management industry is not currently fully prepared to support trustees to meet this requirement and there is currently no standardised approach to measuring and incorporating climate risk. This is expected given the complexity and fast evolving nature of the issue however, we believe the development of minimum requirements for fund managers is strongly aligned with schemes being able to meet their requirements.

Concentration risk: If trustees were indeed to rely on a similar models/tools, this could lead to similar results in terms of assessing and even managing climate risks thereby increasing the concentration of investments in certain investments. This may also be a result of lack of suitable investment products available in the short term.

Monitoring: Frequent scenario analysis and monitoring of metrics may be more practical for the larger schemes whilst smaller schemes may not have the resources to do this with the same frequency. This should be considered when extending the scope to small schemes.

Use of scenario analysis: Climate change is an underlying entity specific issue, so the focus of scenario analysis needs to be on a sector and underlying company level rather than as an asset class a whole.

Q8. 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 agree however would like to highlight the below:

Coverage within asset classes: Whilst data may be available within a certain asset class, the trustees may utilise an investment manager that is not able to provide the required data. This should be considered as part of the requirement in part d). We expect that trustees requiring this data from their investment managers would accelerate and drive change, however there will likely be a lack of completeness in the interim.

Choice of one GHG and one non emissions based metric: This requirement seems prescriptive and it would be helpful if further rationale and information can be provided.

Guidance: The guidance should cover the rationale for why reducing GHG is important linking it to member outcomes and risk management along with how trustees select and monitor metrics on an ongoing basis. Further guidance around the results of the assessment would enable trustees to determine where further action is required.

Consistency of data required: We believe encouraging the use of a small range of defined metrics would help accelerate the standardisation and availability of data making it easier and more cost effective to comply over time.

Flexibility: Not requiring trustees to use a specific metric provides flexibility and is welcome particularly in the short term given the disparity in the availability of data. However, guidance on the use of a range of readily available metrics would be a helpful starting point for the trustees.

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 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?

This proposal needs exploring further.

Complexity: This is a complicated process and will require trustees to really understand what they are targeting, the duration of their target and the ultimate outcome. They will also need to juggle the requirement alongside other scheme objectives. Therefore, we strongly propose clear guidance on how targets should be set and how the target can and should interact with other objectives alongside a distinction between DB and DC schemes.

Phased approach: Given the complexity, there may be a case for looser requirements in the short term, providing the trustees with a time buffer to formalise an appropriate target. We appreciate this may reduce the time to meet the target.

Sponsor: The sponsor may have targets around climate change which may conflict with the trustees' own target.

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 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?

Overall this proposal promotes accountability however, we would like to highlight the below:

Member guidance: There should be clear guidance for members on what the disclosures mean to prevent them from being misled or misunderstood. Where possible, consistency with other disclosures that members of the public may see for other retail investment products would help member understanding.

Further clarification: Clarity on how DB members should be notified is required unless the proposal implies that you only need to notify DB members if they request a benefit statement. Different schemes will communicate in different ways with members so a level of flexibility is required. Clarity on minimum requirements together with flexibility on how this can be achieved would be preferable.

Summary Funding Statement: We do not believe this is the best medium to relay this information as we believe there is a low level of member engagement with it.

Q11. 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?

Further clarity is required on this approach as below:

Clarity on how members are to be notified as per response to question 10.

If TPR is expected to regulate this using a similar approach to DC chair's statements it needs to provide clarity on how it will do so and clear standards of what it deems to be adequate.

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?

Costs: We expect there will be additional cost implications associated with meeting the requirements and therefore the current cost guidance significantly underestimates the costs likely to be incurred. Further, within DC schemes where costs are borne by members there is a concern that the cost of compliance will be passed on to the members which may impact member sentiment around the proposals.

Q13. 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?

No additional comments