Department for Work and Pensions
Taking action on climate risk: improving governance and reporting by occupational pension schemes

A response from Natixis Investment Managers

Natixis Investment Managers (Natixis IM) welcomes the opportunity to respond to the Department for Work and Pensions inquiry into improving governance and reporting by occupational pension schemes. As a global investment firm with a hub based in the UK, and with five of our 20+ affiliate asset managers based in London, we have been responsible for managing the assets of institutional and wholesale/retail investors in the UK for more than 20 years, and at end July 2020, our serviced assets here amounted to approximately £18 billion.

We are eager to contribute to policy discussions around the role of the financial sector in addressing climate risk.

ABOUT NATIXIS INVESTMENT MANAGERS

Natixis Investment Managers is one of the world's largest asset management firms, serving financial professionals with more insightful ways to construct portfolios.[1] As at June 2020, our global assets under management totalled £823.5 billion.

Our worldwide network of offices provides local expertise within key markets in the Americas, Asia Pacific, Middle East and Africa, and Europe. Each serves as a conduit to a diverse range of investment solutions from more than 20 affiliated investment managers around the globe.

Our firm's history can be traced back to 1967.

We practice Active Thinking® — our insight-driven approach to active management. It balances diverse opinions, deep data, and detailed analysis to uncover new opportunities and deliver unconventional perspectives to help support each client's strategy.

We believe in the power of independent thinking. Each investment manager at Natixis IM focuses on those investment styles and disciplines where they have proven expertise. The result is a selection of more than 200 investment strategies from some of the world's most respected names in investment management.

At Natixis IM, we strive to create sustainable value and help investors seek returns that are more meaningful. Corporate social responsibility (CSR) principles have always been a core part of our culture. Our commitment to CSR is demonstrated in many ways. As an active manager, we look ahead and make thoughtful business decisions designed to create outcomes that endure — for our clients, our business, and our communities.

When we think about investing, we think beyond the balance sheet. As a results-oriented active manager focused on the long term, our multi-affiliate model allows for greater manager autonomy. Because we are a truly active firm, we do not rely solely on benchmarking, and can often respond more quickly and nimbly to market events and offer our clients strong diversification. We take a consultative approach focused on building long-term relationships and solving business problems, not simply selling products.

As part of our Active Thinking® approach, we frequently use environmental, social, and governance (ESG) factors to inform our investment strategies — and, globally, more than 91% of our assets are managed by affiliates that are signatories to the United Nations Principles for Responsible Investment (UN PRI).

[1] Cerulli Quantitative Update: Global Markets 2019 ranked Natixis Investment Managers as the 17th largest asset manager in the world based on assets under management as of December 31, 2018

We have recently had the opportunity of engaging with the Minister for Pensions, Guy Opperman MP, during which we raised two points.

First, we should all be concerned about climate change. This is also the main driver for the proposed regulation. However, we should ask ourselves how much pension funds managing climate risk (which is what TCFD does) will really do to tackle climate change. The emerging consensus on this is that at worst it does not help at all and that at best it helps only marginally. We think this is often where investor concerns stem from when talking about the costs of the regulation: why add the huge compliance, reporting and cost burden if it does not fix the problem?

Related to this, and to the Minister's point about bringing solutions: the government can and should play a much more direct role in 'fixing' climate change. The main solutions that are available to governments that have been proposed by economists and scientists are:

1. Creating price signals such as a carbon tax;
2. Investing in new and emerging energy technologies that today are too risky for the private sector to invest in, such as hydrogen, CCS, battery power, etc.;
3. Using government guarantees and subsidies to mobilise private investments in emerging technologies (e.g. through blended finance tools); and
4. Having a reasonable debate about the role that nuclear power can play and explaining to people that although nuclear also has its downsides, it may be the best we have today in terms of switching to low-carbon energy sources.

There are clear issues regarding the Defined Contribution arena. First, fees are capped, making it difficult to get more expensive active (rather than passive) strategies into play. Second, the requirement for daily pricing and liquidy make it difficult for asset managers to deliver 'impact strategies' in a DC scheme context.

RESPONSES

<u>Question 1</u>

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?

While it is understandable to wish to mitigate the administrative costs for smaller schemes, there is a risk that faster adoption provides an advantage to larger schemes, whether by giving them the ability to showcase their implementation, or by enabling them earlier visibility as to portfolio changes that will help them to comply over the long term. Additionally, undertaking the process will lead to some discoveries that in turn may result in regulatory modification; all schemes should potentially have an opportunity to encounter these issues and convey reports throughout implementation, and we would urge the government to consider a uniform deadline that is consistent for all schemes, albeit starting with larger Defined Benefit (DB) and Defined Contribution (DC) schemes may initially make more sense.

This may mean making the deadline longer than one year, but we believe this necessary for such a meaningful and far-reaching change. There is also a problem whereby the fog of the Covid-19 crisis can elevate a tactical approach above strategic thinking and planning; a slightly longer window may mitigate the risk that schemes compromise attention to their own strategic adaptation.

With regards to DB schemes, inclusion of those with over £1 billion AUM seems reasonable. This would equate to about 400 schemes. We would urge the government to consider a threshold for collective money purchase schemes, as we believe some of these can be quite small.

With regards to DC schemes, our view is that the threshold should be lowered to £500 million. Anything less is substandard and likely to consolidate, whilst anything over is a meaningful scheme and with positive cashflows for the foreseeable future will reach scale against the large DB players.

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 broadly agree with these proposals, subject to the caveats mentioned above regarding scheme sizes. We welcome providing schemes with plenty of time to meet the requirements and initially focusing on the largest schemes.

More broadly speaking we would question the focus on asset value over liability value. The latter, in our view, would be more reflective of the schemes' ultimate size and responsibility to their members.

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?

Our view is that within reason, all schemes should be included, with uniform metrics for trusteeship. Beneficiaries should be able to assume uniform climate stewardship, irrespective of the size of their scheme.

Not undertaking such a process would have operational and market disadvantages, as set out in our answer to Question 1.

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?

The proposed requirements set out in questions 4–9 seem a sensible way to ensure funds meet the over-arching objective of understanding, quantifying and mitigating their exposure to climate risk.

On this question specifically, we are particularly supportive of proposals to establish and maintain processes by which trustees are required to satisfy themselves on an ongoing basis that persons managing the scheme are assessing and managing climate-related risks and opportunities. We would encourage a requirement to ensure that managers are continually improving and updating their knowledge, so as to avoid static benchmarking.

With regards to emissions-based metrics, we are of the view that there should be one consistent portfolio carbon temperature measure (Scope 1-3) that trustees will be able to understand and scrutinise.

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 broadly agree with the proposals, although we note that climate risks can be highly unpredictable and are constantly evolving. We would prefer that guidance is mandatory to be in good faith, with reasonable effort, expertise and expenditure, but which allows for certain risks to remain unknown.

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 do not agree with the proposed approach. There exists a huge range of potential climate outcomes under any scenario formed on such a broad metric as that based on global average temperatures. That is made more complex by the uncertainty of future expectations: even if 2°C or lower is realised, the risks can still appear worse in five years' time than they do currently, which could lower future values.

We would encourage the government to consider a more specific test, which looks at certain assets (e.g. coastal real estate, securities of countries highly dependent on high-emission industries, stranded assets, etc.) and marks those assets in terms of downside risk based on three grades of climate-related risk (minimal, moderate, severe) across timeframes of one, five, 10 and 30 years.

The scoring exercise would form an input to risk models which may, over time, allow schemes to identify such metrics as climate risk premiums, which can be compared across schemes.

This would also be reasonable for DC scheme assets.

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. As mentioned earlier, with a consistent portfolio carbon temperature measure, trustees will be able to understand and challenge their asset managers on this metric. At the same time, employee engagement will increase exponentially as members will understand the concept too.

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) ***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 do not agree with the proposed approach, preferring instead to leave the choice of metrics fully to the individual schemes given that:

1. Schemes will have different sizes, different liabilities, and different resources, so the way they perceive risks will be different.
2. Metrics to assess climate risk are a work-in-progress, and many would agree that whilst more meaningful metrics may be developed in the future, existing metrics are poor risk indicators.
3. Reporting and relying on any one metric will give trustees and beneficiaries a false sense of security.
4. Climate-related risk depends mostly on what kind of action governments will take to tackle climate change and, in the absence of this information, there is very little investors can do to act on any climate risk assessment, regardless of the metric.

Moreover, Scope 3 greenhouse gas emissions are a good example of where no harmonised or widely accepted methodology currently exist on the market. It would be premature to force schemes to disclose it in the absence of a common and reliable methodology.

The metric could be chosen on a standardised basis, with rotation among metrics. Over time this would provide more consistency, allowing for lessons to be learned from peer review and best practice sharing, and avoiding metric shopping. It would spur a process of research and analysis amongst both administrators and trustees, which is crucial in dealing with an evolving and unclear set of portfolio risks. Scenarios could draw on actual events related to climate change (such as a severe storm), and ask about portfolio changes made in that light.

<u>Question 9</u>

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 do not agree with this proposal. Making climate-related targets a requirement presupposes that every pension scheme will need to make changes to its investments; that all information necessary to manage climate risk is available today; and that climate is the only variable affecting investments in the coming years.

If trustees conclude that they have access to new investment-relevant information based on these climate assessments (and recognising the unreliability of metrics and the absence of information on future government climate policy), which in turn prompts them to make changes to their investment portfolios, they may choose to set targets on this.

Most pension schemes will find it more advisable to have a continuous dialogue with their asset managers as new information on climate impact on their investments and government climate policy comes out, and to make adjustments to their investments as needed, also taking into account the broader economic factors at that time. In this context it should be noted that climate investment risk management does not equate to tackling climate change and that setting targets for climate-related investment risk will not accelerate or facilitate efforts to tackle climate change.

NATIXIS INVESTMENT MANAGERS

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?

We agree with these proposals, assuming similar transparency requirements apply for other investment considerations and processes for pension schemes.

The shorter and more coherent the report, the easier it will be for beneficiaries to digest. The objective of this proposal should be to get people to read it and see what is being done and why, and build support among beneficiaries for the plan's actions – as well as invite feedback as to improvements (things like simple, web-based survey questions can be effective). This would go some way to avoiding it becoming a box-ticking exercise.

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?

We do not agree with this approach, which in our view seems draconian given our comments above vis-à-vis unreliability of metrics and lack of clarity on government policy.

We would also caution against this approach in recognition of the fact that TCFD is a recent development and provides only a high-level framework, leaving much room for flexibility and discretion in its application and reporting.

In summary, it is likely to be difficult to establish an objective standard on whether the TCFD report is 'adequate'.

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?

We remain concerned over the ability of funds to source the significant amount of data required by the regulations. In most cases this process will rely on the relevant investee company to provide the information. Should that company be unable or unwilling to do so, the fund will have to seek to oblige the company to do so, estimate the data, or simply sell the investment in question. The funds' leverage to insist that the investee company provide the required data may not be high, particularly in the case of minority investment positions or with non-UK-domiciled companies. Moreover, a forced sale may lead to misallocation of capital to the ultimate detriment of UK pensioners.

Regulators and government would do well to consider measures to encourage the issuance of explicit green bonds in the GBP market, which is a notable laggard compared to the Euro market. Equally, UK issuers are notably underweight, especially compared to French issuers. This is important in the context of pushing UK pension funds, insurers and banks to demonstrate greater eco-resilience and, by implication, invest a high proportion in green assets.

Finally, concerns remain over liquidity risk. Currently, UK insurers and pension funds are unable to invest in liquid long-dated green GBP assets to match their liabilities. The Bank of England and the government should consider coordinating with the Debt Management Office to encourage the issuance of Green Gilts (particularly in the context of the government's announced initiatives around investment to support the net zero transition for the UK economy) and, eventually, possibly even Green Index-Linked Gilts. This should also encourage greater participation in the GBP green bond market from other issuers and investors.

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?***

As noted throughout our response, care should be taken to avoid a process that even the smallest schemes have trouble with. Ultimately, the goal is to improve portfolios, mitigate risks and improve trusteeship capacity. The government could clarify the precise objectives of this regulation, and how the actions prescribed by the regulation will achieve those goals.

Our concern above all relates to the availability of data. It would be a mistake to place importance on the data that can be measured, in the absence of more important data that cannot be measured. The complex relationship between financial services and climate cannot be fully understood with a data set that is so generalised as to make it irrelevant.

We have to recognise that while it is good for investors to be aware of climate investment risk, today we do not have the company metrics or the knowledge about future government policy that will allow us to invest more optimally.

Whilst corporations and investors have a role to play in enabling effective government policy, for the world to become more aligned to the Paris Agreement will require a systemic change that can only be forced by governments themselves. In that context, it is important that, whatever the outcome of trade negotiations between the EU and UK, both jurisdictions continue working closely on the climate issue. This is especially true in establishing consistency of approaches if we are to avoid duplicating reporting frameworks and standards.

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Responses provided by Natixis Investment Managers, Natixis Bank and Loomis Sayles & Company (a Natixis IM affiliate asset manager).

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