Smart Pension

Taking action on climate risk: improving governance and reporting by occupational pension schemes - Smart Pension's response

6 October 2020

Executive summary

- **Climate change is a huge issue facing the future of our planet. Pension funds, as considerable asset owners, have a key role to play in fighting climate change and contributing to a more sustainable future.**
- **We broadly support the proposals in this consultation. It is only right that all large institutional investors are transparent in their approach to tackling big societal issues and report on activity and actions.**
- **While disclosure and transparency can help drive better outcomes, we need to avoid such disclosure becoming yet another box ticking exercise. In particular, making reams of information available to members doesn't work (it isn't read), so schemes and providers should have flexibility in how they communicate in an engaging way with members, while making detailed information available for further scrutiny.**

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- **Explicitly integrating climate change into the trustee governance process is welcome, not least because it is a material and accelerating risk to pension schemes. However, we should not lose sight of social and governance considerations and we would hope that the increased focus on climate change is complementary to the need to raise ESG standards across the board. Given a trustee's fiduciary duty, a focus on good governance should lead to the trustee adopting appropriate policies to manage 'E' and 'S' risks.**
- **We also argue that consistency is important to ensure a joined up approach throughout the investment chain. Common language, standards and reporting are crucial. We welcome the intention indicated in the consultation to align FCA regulations with the pension regulations insofar as is possible, which should also include climate scenario analysis. We would urge both regulatory systems to encourage minimum levels of consistency in methodology and different scenarios, and to reflect evolving best practice.**

Questions

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?

1.1. We agree with the DWP's proposals although think that these requirements should be extended to cover all workplace pensions (not just trust-based).

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?

2.1. We question whether the schedule is unnecessarily complicated. A firm deadline of 31 December 2022 for the first workplace schemes to report and 31 December 2023 for the second group might be easier to administer and avoid any confusion.

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?

3.1. Yes. It makes sense to keep the requirements under review.

3.2. The pace of development of services and products to measure, target and address climate change is accelerating. The availability and indeed quality of such services and products will almost certainly be far greater in 2024 than today and should be taken into account at later review.

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?

4.1. Yes, We agree with the proposals.

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?

5.1. We agree with the proposals. As climate change, and attendant policy action, is a material and accelerating risk to pension schemes it needs to be explicitly integrated into the trustee governance process. Similarly, climate-related investment opportunities are increasingly becoming available and their appropriateness for workplace pension schemes should be considered in the course of investment strategy.

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?

6.1. As noted in the consultation, climate scenario analysis is very nascent and imperfect and subject to a wide range of methodologies and hence outcomes. Where diversified default arrangements are built of multiple underlying funds provided by external investment managers, to avoid high costs ideally workplace schemes would seek to leverage scenario analysis undertaken on each individual fund. We welcome the intention indicated in the consultation to align FCA regulations with the pension regulations insofar as is possible. These should seek to include climate scenario analysis. We would urge both regulatory systems to encourage minimum levels of consistency in methodology and different scenarios, and to reflect evolving best practice.

6.2. Furthermore, the consultation paper references concerns over potential litigation risk to trustees in respect of hindsight proving their climate scenario analysis was incorrect. Whilst we understand that it is unfeasible to expect the DWP to fully absolve trustees from litigation risk, it is likely to lead to the widespread adoption of "herding" in the analysis produced by schemes. I.e. very similar outcomes. We question whether this is the intended outcome of the regulation or indeed the TCFD itself. Therefore we suggest the DWP take this under further consideration and consider how to remove such risk if it can be shown that trustees are acting entirely in the best interests of members.

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?

7.1. We agree with the proposals. Risk management is a fundamental obligation of trustees and climate-related risks are of material importance to workplace pension schemes.

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?

8.1. Having greater clarity on what is expected from disclosures is welcome, not least as a stepping stone to greater consistency and with it, comparability, across schemes.

8.2. The consultation document notes that most schemes utilise external asset managers for part or all of their investment and as such will necessarily be dependent on their disclosures. As such we fundamentally support the intention of the FCA to bring in regulations in line with the intended proposals and indeed to provide pension scheme trustees with the widest range of information on the underlying investments funds as possible.

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?

9.1. The proposals to select at least one target and measure performance against the target are reasonable. Recognition of the obvious provisos and challenges of measuring performance is well-received. We would make the following observations:

9.1.1. It is questionable whether quarterly performance measurement will achieve much in a practical sense. Disclosures at issuer level are predominantly made on an annual basis. Adjustments to investment strategy and asset allocation will therefore not give an accurate indication of "performance";

9.1.2. The consultation emphasises that there is no intention to prescribe the investment strategy pursued by trustees. Can we clarify that this extends to performance against targets chosen at the discretion of trustees? On a short term horizon at least, focusing excessively on such targets can potentially lead to damaging side effects to members, inconsistent with other fiduciary requirements.

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?

10.1. The proposals are fine as they relate to directing members and other stakeholders to the TCFD report and SIP. More pertinently for workplace pensions to consider is whether the TCFD format itself is likely to increase member engagement. Or indeed achieve the goals underpinning regulatory action. The format of the report may be too abstract and technical for many members. Moreover the focus of the report - essential though it is - on the financial risk to pension schemes from climate change may prove to be too esoteric to drive a significant increase in engagement and with it pressure from members and employers..

10.2. To actually achieve member engagement, the DWP should consider whether there should be some form of compulsion to produce a one-or-two page summary of the key findings in everyday vernacular that a scheme member would understand. This could take a consistent format so that comparisons can be made between schemes and providers.

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?

11.1. Regarding failure to produce a TCFD report or failure to provide correct locations or links is straightforward. The proposal a) however is very vague and subjective. Aside from the distinct aspects on which it is proposed trustees will be required to report, the content, including choice of metrics and targets and format of scenario analysis, is left to the discretion of the trustee.

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?

12.1. The consultation document estimates the cost of producing a complete TCFD report and complying with the proposed regulations to be in the region of £15,000. In our opinion the cost will be significantly higher. Significant internal resources and man hours will need to be allocated to preparing a substantive and meaningful report which meets the intended goals of the new regulations. For some schemes this will require additional headcount. For others it may lead to further outsourcing given the increases in investment governance requirements, particularly at the smaller end of the spectrum.

12.2. Conducting meaningful scenario analyses on (multiple) portfolios may lead to additional licensing fees, consultancy fees etc. Few, if any, schemes will have the internal capability. Unless 3rd party partners / investment managers will undertake such exercises without charge, the additional costs will be significant.

12.3. We agree entirely with the principles driving the proposed regulation and that the need for robust governance, investment strategy and risk management is essential to best serve members interests. We would further argue that it is also an important strategic opportunity to engage members and increase their input into how their pensions are managed and invested.

12.4. It is difficult to quantify either the monetary or non-monetary benefits at this stage. We would anticipate the additional monetary costs being in the range of £20,000 to £50,000 depending on advisers and depth of analysis.

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

13.1. It is not clear to us that the proposals impact on protected groups in any way.

Contact details

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