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

Department for Work and Pensions

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Moving pensions forward

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Response from the Pensions Management Institute to Department for Work and Pensions consultation 'Taking action on climate risk: improving governance and reporting by occupational pension schemes'

Introduction

PMI is the professional body which supports and develops those who work in the pensions industry. PMI offers a range of qualifications designed to meet the requirements of those who manage workplace pension schemes or who provide professional services to them. Our members (currently some 6,000) include pensions managers, lawyers, actuaries, consultants, administrators and others. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response. Due to the wide range of professional disciplines represented, our members represent a cross-section of the pensions industry as a whole.

PMI is focused on supporting its members to enable them to perform their jobs to the highest professional standards, and thereby benefit members of retirement benefit arrangements for which they are responsible.
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ESG issues have rightly come to the fore, and we would argue that the E, the S, and the G are all equally important in delivering great outcomes for members and contributing to a better and more sustainable society. While this consultation is right to focus on the E aspect of ESG, which is certainly most in the spotlight at the moment, we need to ensure that the S and the G don't get overlooked. If we get the G right and the S and the E should follow.

Furthermore, the more that the Government intervenes on specific issues, the more there is a risk of trustees being conflicted with their fiduciary duty, so care needs to be taken to ensure trustees are not put in an impossible position. Also, we don't think disclosure for disclosure's sake necessarily leads to better outcomes, so our comments are within the context of making a real difference - we need to make sure proposals don't turn into tick boxing exercises.

Finally, consistency is vitally important and we would encourage the DWP to, insofar as is possible, to provide guidance or templates to assist with reporting and require, for example, asset managers to provide this information in an accessible and timely way for trustees.

1. We propose that the following schemes should be in scope of the mandatory climate governance and TCFD reporting requirements set out in this consultation:

a) trust schemes with £ 1bn or more in net assets
b) authorised master trusts
c) authorised schemes offering collective money purchase benefits Do you agree with our policy proposals?

Yes.

2. We propose that

a) trustees of schemes with £5bn 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 £1bn 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 m aster 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

£1bn 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 £1bn asset threshold was met; and
- 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 w hic h has just ended within 7 months of the scheme year end date.

Do you agree with the policy proposals?

Yes.

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 £1bn 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?

Yes.

4. We propose that regulations require trustees to:

a) adopt and maintain oversight of climate risks and opportunities, and
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) c) the role of trustees in ensuring oversight of climate-r elated risks and opportunities; and
d) 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 surveyed PMI's membership in order to prepare our answer to this question. The response was as follows:

Yes	80%
No	20%

Comments from members included the following:

Note that some Trustees may only have the nuclear option (forgive the language) available in their kit bag of powers to act i.e. keep investing or withdraw investment. Other than that, they can only express opinion.

Climate change is financially material and should be taken into account by trustees, alongside other financially material considerations. However, I would not want to see climate risk taking precedence over other forms of risk. Trustee discretion over exactly how to run a scheme in the best interests of members should not be overly prescriptive. The regulator should, however, be looking very closely at any scheme SIP which does not adequately address the climate risk as it manifests itself for the members of that scheme.

Although the reporting on this will need to be carefully thought through - it could become a bureaucratic nightmare and serve no purpose. One has to ask to whom is this reporting directed? If the regs require the reporting to go in the Annual Report and Accounts this will make a document that is never looked at by members even less comprehensible.

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?

Our response to this question is also based on a survey of PMI's membership. The response was as follows:

Yes	68%
No	32%

Comments included the following:

Agree with the goal and principle. Please note the feasibility difficulty and cost of measurement and ensuring consistency.

Trustees must be in a position to demonstrate the way in which they have measured the potential effects of climate change and the measures that they have taken to mitigate the threats.

Climate risk impacts members differently - typically it impacts younger members more in the long run whilst older members are exposed to transition risk in the shorter term. Any Statutory Guidance will need not to be too prescriptive but allow trustees to assess risks in a manner which is appropriate to the age pro le of each scheme. An assessment based upon short medium- and longer-term horizons is sensible.

I agree wholeheartedly with the aim of managing climate change risk but could not be more opposed to adding additional bureaucratic burden to pension scheme trustees. Make legislation to control investment managers by all means but this proposed manner of implementation is "back door" and highly likely to cause collateral damage to occupational pension schemes.

6. We propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of 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?

There have been several regulators' proposals in this area, such as the FCA's proposed rule to require listed issuers to state whether they comply with TCFD and to explain any non-compliance. However, whilst the FCA's proposed rule does not yet mandate TCFD-alignment, the proposals in this consultation for pension schemes do. The challenges of meeting these requirements are not insignificant; the data limitations are well-known, with the Bank of England's recent report into TCFD found that this remains a challenge. It is also acknowledged that the framework needs further refinement.

The nature of climate-related risk disclosures means that different firms' reporting capabilities are varied, making it extremely difficult to achieve comparable data. The climate change risk does require urgent action, but mandating TCFD-alignment for pension schemes ahead of financial services firms being required to do so does pose its challenges. It could lead to reporting that is incomplete, inconsistent and misleading.

This would be a significant undertaking for those within scope. Testing resilience against climate-related scenarios is being considered by other regulators, such as the Prudential Regulation Authority through the Climate Biennial Exploratory Scenario in 2021 and is part of the TCFD framework. However, the PRA has been clear in their proposals that this would be for only the very largest of insurers.

Any regulatory guidance in this area will have to provide trustees with a clear roadmap for how they might begin to undertake such an exercise. The points outlined in the Box give the high-level view, but the Regulator would need to then provide much more detailed guidance on methodology, tools and data in order for it to be done consistently across the industry. The consistency and comparability piece are really key here.

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 support and promote the management of climate related risks. We also recognise that the development of appropriate legislation is likely to play a key part of ensuring appropriate risk management by pension scheme trustees.

We believe that the development of legislation in this area must be guided by two key principles. First, that development provide effective outcomes and that any required processes extend beyond simple matters of record and audit. We consider that it is critical that any new legislation promotes and results in substantive improvements to climate risk management. Second, the introduction of new legislation must be made consistent with the overarching duty of trustees to comply with their fiduciary duty of acting in the best interests of members.

To the extent that there is a potential conflict between these principles (for example, where steps being taken pursuant to appropriate climate risk management would or may result in the best financial outcome for members not being achieved) we believe that statutory protection should apply.

8. We propose that regulations require trustees to:

a) Select at least one 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 support the proposal to adopt a metrics-based approach where it has can be evidenced that this offers a cost effective, achievable and effective method of implementing climate risk management. We are concerned however by the complications identified of trustees obtaining appropriate data on the emissions related to their investments and the complexities of explaining where trustees find themselves unable to comply. Providing disclosure 'to the extent the trustees are able', and the requirement for full explanations of why data disclosed does not cover the full portfolio or extend to all scopes of emissions, risks becoming an onerous obligation upon trustees. It will be vital that guidance sets clear and reasonable expectations on the level of detail required.

We would query what analysis has been undertaken to conclude that an approach based upon metrics and, specifically, a model based upon one GHG emissions-based metric and one non-emissions based metric provides the most suitable method for delivering climate risk management outcomes. We would welcome this analysis being tested (to the extent it has not already) before implementing the proposed structure.

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?

As already noted in our response to Q8, our agreement with these proposals is contingent upon a metrics based / targets approach offering a cost effective and proportionate method of implementing and achieving climate risk management (noting our concerns with the availability of metric information to trustees).

Assuming that a metric based approach is adopted, we consider that appropriate statutory safe harbours are included in the regulations. This will be necessary to protect trustees from potential criticism where, for example, acting in accordance with a target for reducing a specified metric could result in a lower overall return for members and therefore risk a challenge to trustees' compliance with their fiduciary duties.

For climate risk management to be implemented effectively it will be essential that trustees are confident to take forward the steps required to deliver on targets set for specified metrics without the risk of potential litigation or criticism. In the absence of such protection and clarity of interaction with other duties, we consider the prospects of successful implementation will be significantly reduced.

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 m embers to this information?

We are supportive of requirements that provide transparency for members in a cost-effective way for schemes. We agree that signposting to a publicly available website, through the proposed communications, ought to achieve that outcome.

11. We propose that:

a) TPR will have the power to administer discretionary penalties for TCFD reports they deem to be inadequate i n 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) I n 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 welcome the proposal not to adopt mandatory penalties for non-compliance and for penalties to be discretionary (save where a TCFD report has not been published at all).

We also believe that there may be circumstances where non-compliance is appropriate; including, for example, if a scheme is being wound-up.

Our view is that a limitation on TPR's look back period for enforcement should be adopted. A short look back period for enforcement will be important to mitigate against the risk that otherwise compliant practices are revisited at a later point and viewed through the prism of different political pressures or subsequent case law developments.

We believe that best practice guidelines should be issued in respect the proposed regulations and that evidence of compliance with such best practice should provide a safe harbour from prosecution.

We also consider that penalties would only be appropriate in circumstances where material loss to members can be evidenced. Otherwise, there is a risk that cases are brought which could give rise to substantive defence costs for trustees in circumstances where trustees' conduct had no negative impact upon the scheme or its members.

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 have no evidenced comments. However, we would express some concern in respect of the requirement upon trustees to obtain data, as far as they are able (and to explain where they cannot), on emissions and non-emissions-based climate characteristic. We believe these risks are becoming a more onerous obligation than envisaged given the trustees role as ‘end-user’ of this data and the reliance upon others for its availability.

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?

No comments.