ASSOCIATION OF CONSULTING ACTUARIES

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To: The Pensions Regulator
Sent via email to Mark.Hill2@tpr.gov.uk

Dear All

Climate Governance and Reporting Regulations - lessons learnt / feedback for TPR and DWP

I am writing on behalf of the **Association of Consulting Actuaries (ACA).** We understand that the Pensions Regulator is gathering thoughts, views and feedback on the subject above. We are responding based on our general experience in advising trustee clients that are subject to the Climate Governance and Reporting regulations.

The ACA welcomes the opportunity to provide input. Members of the ACA are all qualified actuaries – mainly Fellows of the Institute and Faculty of Actuaries. All actuarial advice given by our members is subject to the Actuaries' Code. Members provide advice to thousands of employers and pension schemes – with total assets exceeding £1 trillion – including most of the country's largest schemes – and increasingly consulting actuaries are now involved in a wide range of additional areas. We are therefore responding in the capacity of a representative body for professional advisors who provide advice to a range of workplace pension schemes.

Our comments are set out in Appendix 1. In summary our key points are:

- The ACA believes the Climate Governance and Reporting regulations have been positive overall in prompting trustees to take action, driving up levels of knowledge and understanding, governance and risk management, and have also driven progress with asset managers.
- However we believe that the length and detail of reporting required places an onerous burden on trustees, which in some cases leads to a focus on 'tick box' compliance at the expense than meaningful real world action.
- We believe that any changes to the regulations and guidance should focus on reducing and streamlining climate reporting requirements, and focusing reporting on the actions taken. We set out some specific suggestions in our response.

We would be happy to discuss this matter further. Please contact either me at sarah.keighley@xpsgroup.com or Vanessa Hodge, Chair of the Investment Committee at Vanessa.Hodge@mercer.com.

Yours sincerely

Sarah Keighley
Chair of the Sustainability Group
On behalf of the Association of Consulting Actuaries Limited

Appendix 1 from the Association of Consulting Actuaries

Climate Governance and Reporting Regulations - lessons learnt / feedback for TPR and DWP

1. What has been the impact to date of the guidance and associated regulatory regime?

Although the TCFD reporting requirements have placed a high governance burden on trustees of schemes, our view is overall that introducing these requirements has been a positive step in terms of prompting trustees to take action.

There is a better level of knowledge and understanding of the impact of climate-related risks and opportunities on investment and funding strategies by trustees and consultants.

The level of governance and risk management regarding climate related risks and opportunities has improved for those schemes that fall under the Regulations.

For other pension schemes, the level of governance and risk management is mixed. The driving up of standards for larger schemes has had a secondary effect that smaller pension schemes are more able to access a basic level of climate governance at a lower cost due the development work carried out by larger schemes.

The push effect of large pension schemes requesting climate-related metrics data from their asset managers has helped to improve the availability of data. The requirement to set targets and report on these has had a general effect of driving more focus throughout the value chain (ie fund managers and underlying funds, companies) on embedding climate considerations into decision-making and reporting.

Trustees have been able to have more engaged conversations with asset managers around their climate-risk management and wider climate-related targets, as well as activities related to stewardship.

The detail of the Statutory Guidance has been helpful in explicitly setting out what needs to be included in a TCFD report. The statement that targets are not legally binding is very valuable.

The annual review of reports by the Pensions Regulator has been very useful in highlighting areas of consistent gaps (such as the year 1 report pointing out that many reports talked about the impact of climate risks on investments and funding but not enough clarity around the resilience of the strategies), best practice and examples of value add reporting.

It is unclear whether members have read or engaged with the public TCFD reports or the report summaries.

2. Have there been any unintended consequences which TPR and DWP should be aware of?

The down side of having detailed guidance is that reports can become tick box exercises to complete.

Whilst it's useful having guidance that sets out 'must', 'should' and 'may', many trustees will have treated the 'should' provisions as 'musts' in their reporting to avoid the risk of under-reporting.

In general the cost of producing TCFD reports has been higher than expected in part due to the length and technical nature of the guidance, and the need to carry out scenario analysis. In many cases this has led to costs that are disproportionate to the benefits of producing the reporting. This in turn leads to a reduced budget available for other climate governance actions, such as greater engagement with asset managers and other stewardship activity.

As consultants, we believe the activities supporting the wider climate change governance, which is then detailed in the public reports, is more important than the actual report.

There has also been an unintended consequence of over-focus on emissions related metrics which has seen some schemes celebrate success or take actions as a result of emissions reductions that are either not driven by any action but rather market value and methodology changes, or that don't have any impact on real world emissions.

Some audit firms are asking pension scheme clients to see the TCFD reports so they can audit them (and charge for the service) as part of the annual report and accounts but this is not a mandatory requirement.

3. What specific changes, simplifications or clarifications, if any, could help improve TCFD reporting?

When the Regulations and Guidance were originally published, the pensions landscape was very different, particularly for defined benefit schemes. Since then, the funding levels of many defined benefit schemes have improved significantly meaning they have had the opportunity to reduce investment risk.

We would suggest a review of reporting requirements that ensures the efforts needed are proportionate and impactful for schemes, and focuses on reporting on areas where meaningful change/action is possible. For example, defined benefit schemes that still meet the asset threshold test (which excludes the value of buy-in contracts) but have an investment strategy in liability driven investments and buy-ins only should be excluded as the level of ability to influence climate change outcomes is low as is the exposure to climate risks/opportunities.

We also suggest the DWP/TPR considers an approach to reporting similar to the changes the FRC has recently consulted on in respect of the Stewardship Code. This proposes that signatories prepare two reports: One has information about governance and processes that are unlikely to change year-on-year; the other report sets out annual activities and updates on targets.

The climate change reporting could be split into: 1) Governance, strategy (time horizons, impacts, scenarios if not updated) containing information that is unchanged from previous years; and 2) Activities under each of the four TCFD sections carried out over the reporting year plus the metrics and targets section.

There should be some simplification of sustainability reporting requirements, for example where schemes are required to prepare a TCFD report and an implementation statement and may also prepare other submissions eg for the UK stewardship code.

For scenario analysis, there is still an argument that quantitative scenario analysis supported by scenario narratives is useful for decision making for schemes that have growth assets and are expected to still be operating beyond 10 years (such as defined contribution schemes or open DB schemes). For defined benefit schemes that have de-risked significantly, quantitative analysis may not add any additional insights above the qualitative discussion around the scenario narratives and the expected impact, particularly over shorter time horizons such as 5 years.

Scenario analysis updates should still be considered when there is a change to investment strategy or at least every three years (to allow for updates in general thinking on the climate science and impacts on economic factors).

4. Why any changes have been proposed: what issue it is addressing, or how it would benefit the industry.

The aim of our suggestions is to streamline reporting to reduce the governance burden in terms of time and cost.

This will allow trustee time and cost to be better spent on meaningful actions, such as asset allocation decisions and asset manager engagement.

5. Any drawbacks to the proposed changes and how they could be mitigated.

Any significant change to the reporting requirements, including a structural change similar to what we have proposed, should avoid being presented as a 'start from scratch' as that will incur unnecessary costs in terms of reporting advice and processes. To avoid this there should be a focus on continuity with and limited changes to the existing regulations and guidance, with clear signposting of the changes and the areas where reporting is unchanged. Ideally our proposed approach would allow trustees to work with their advisors to split their existing report into the two proposed sections and focus on the annual activities rather than embark on a full rewrite.

6. How any changes could align with the government's expected move to introduce new UK Sustainability Reporting Standards and to mandate Transition Plans across the economy?

We understand the wider Sustainability Reporting Standards are aimed at companies as part of their annual accounts. If this was to be translated across to pension schemes, we request that it is done in a proportionate and thoughtful way with a clear objective in mind. In our view, the objective will be to help pension trustees understand the potential impact of systemic risks on their pension arrangements to allow them to invest in a way that helps to mitigate those risks, as far as they are able, and to take advantage of investment opportunities, which overall can support members' benefits.

In our proposal, the annual activities and actions report can be considered to be a form of Transition Plan for trustees. Again, any guidance around what should be included in a Transition Plan should be proportionate and practical for pension schemes and the level of required reporting and detail should be proportionate to the level of long-term risk inherent in different types of scheme (for example, DC and MasterTrusts, open DB, closed DB, closed DB -low risk).

Transition plans should not be legally binding.

7. What have been the costs (fees and time) of producing a TCFD report and complying with the requirements?

As noted above, in general the cost of producing TCFD reports has been higher than expected in part due to the length and technical nature of the guidance, and the need to carry out scenario analysis. In many cases this has led to costs that are disproportionate to the benefits of producing the reporting.

We have typically seen that the first year's costs were much higher – in the region of £50k-100k+ per scheme depending on number of sections.

Some schemes set up ESG or climate working groups in year one to discuss each component of the TCFD reports. Most of these working groups have been disbanded or repurposed now that the reporting for schemes in scope is more routine.

We now see lower costs for annual reporting – most costs will be in respect of metric reporting and target monitoring.

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