ASSOCIATION OF CONSULTING ACTUARIES

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Climate Governance and Environmental Social Governance (ESG) team
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Dear Sirs

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

I am writing on behalf of the Association of Consulting Actuaries in response to the above-named consultation issued by DWP.

Our comments on specific questions raised in the consultation are set out in the Appendix.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me on 07799 893 797 or at stewart.hastie@isio.com

Yours sincerely

Stewart Hastie
Chair, Climate Risk Group and Honorary Treasurer
On behalf of the Association of Consulting Actuaries Limited

Open Consultation

Annex 2: Summary of Questions

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ACA consultation response

Closing date for submission: 7 October 2020

Question 1

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?

Yes. We are supportive of the policy proposals and that it is sensible to start with the largest occupational trust schemes which will have greater resources to implement these requirements (and many have already taken some steps towards these). However, it is important to recognise that pension schemes rely on the reporting requirements of asset managers who in turn will rely on reporting requirements of the companies and institutions they invest in. Therefore, Government and regulators will need to ensure that the reporting requirements for these vital stakeholders in the chain are in place if pensions schemes are to be able to effective assess and report on climate change risks. We note in this regard the intended requirement for all listed companies to disclose in line with TCFD by 2022. Further thought may be required in respect of other major asset classes, not least government debt and derivatives.

We also note that some further detail is needed to fully define which schemes fall under this requirement. In particular, does an occupational scheme that has less than £1 billion of invested assets when insurance buy-in policies are excluded but over £1 billion of total assets when the insurance policies are included have to comply with the requirements? The ability of a scheme in this position to provide disclosures in respect of material insurance buy-in policies will be limited and in any event, we would expect this to be covered through the regulation of the insurance market rather than the pension scheme holding the buy-in policies who will no input into, and no visibility of the insurer's investment strategy and risk management processes.

In respect of extending this to Master Trusts and large DC schemes, it should be recognised that mandates are usually accessed through platforms which can make collecting and analysing this data more difficult. We would hope the industry will converge towards relatively standard requirements such that all fund managers provide a similar suite of information to platform providers (who will then need to aggregate and share it with trustees), although this may take some time. Trustees will again need to rely on platform providers (who they typically contract with, rather than the fund managers directly) to have in place the framework and systems for data collection.

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?

Broadly yes but subject to timely release of the detail to be set out in the regulations and statutory guidance. If these are available this year then we are comfortable with the timetable for compliance. However, if the regulations are delayed until middle or later next year, the proposed timetable for compliance will become challenging and damage the likelihood of effective engagement in the process of assessing climate change risks and opportunities and subsequent actions taken to address these.

The proposed timing of compliance requirements are overly complex and could be simplified. For example, all schemes could be required to comply within 7 months of their relevant scheme year end *to ensure a level playing field. Whilst most schemes will have 7 months following the relevant year end, schemes with a 30 September year-end will need to report by 31 December 2022, only giving them 3 months.*

If the policy intention is to extend the requirements to all schemes from 2024, we question whether it makes sense for schemes whose net assets subsequently fall below £500m in future to then be excluded from the requirements.

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?

We agree it is sensible to undertake a review of the regulations and statutory guidance particularly given the likelihood of further developments in data availability and modelling analysis.

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?

Yes, this has many crossovers with what many schemes are already looking to do (particularly large ones), subject to the statutory guidance being available on a timely basis to ensure schemes can implement efficiently. There may be merit in piggy-backing on the existing requirements to consult the sponsor in relation to investment strategy, mirroring that requirement in these proposed regulations. Many large employers will be developing their own TCFD strategies and disclosures. While we would expect best practice would be for the trustees to work with the sponsor / employers *in relation to ensuring the separate scheme / employer strategies are not inconsistent, the consultation obligation may help facilitate early consideration of this point.*

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?

Yes, subject to the statutory guidance appropriately defining what is meant by short, medium and long term and recognising that different time horizons will apply to different schemes. For example, a DB scheme that is significantly de-risked and near its target of being able to fully insure all of its liabilities will likely only have a short time horizon for assessing and considering climate risks.

The details from funding discussions between trustees and sponsor can often be market sensitive information and it is therefore important any disclosure requirements on trustees contained in the regulations should not conflict with other information sharing requirements on trustees or sponsors.

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?

Scenario analysis can be a helpful tool to understand the impact of uncertain future outcomes and help to inform decisions. It will important to ensure these are qualitative as well as quantitative assessments given the small number of scenarios being consider and any models are relatively new in the context of pension schemes. In comparison, pension schemes are used to assessing and managing risk using stochastic models simulating thousands of scenarios and still overlay this with a qualitative assessment in decision making.

New and more refined ways of modelling the impact of climate change risk will emerge over time and as such we would urge that nothing is hard coded in legislation. Instead it would be better if a central body was responsible for providing regular guidance – for example, could the Pensions Regulator produce an annual statement to set out what they expect to see from trustees. This could also be help smaller schemes transition into meeting the requirement as good practice develops over time.

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?

Yes, this is something that many trustees will be able to implement into existing risk management frameworks and processes. Indeed, in our view, the more that climate risk can be integrated into 'normal' risk management processes the better to avoid it becoming isolated and marginalised.

The time and resources devoted to managing climate risk should however be proportionate and not at the expense of managing other major risks facing the pension (e.g. interest rate, inflation, longevity, covenant risks).

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) 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?

This is an area where although we note the actual measures will not be mandated we think that some additional practical guidance which can evolve over time would be particularly beneficial. This would help trustees to understand the implications of different measures rather than it become purely a compliance and reporting exercise. This guidance could also help trustees deal with data availability issues particularly for some assets such as property, derivative-based strategies, hedge and absolute return funds.

We question whether quarterly reporting is required and that annual should be sufficient in most cases.

There are additional practical complexities for many DC schemes given they typically invest in pooled funds held via a platform and have very little direct connection with the underlying investment managers.

Question 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?

Pension scheme best practice is to adopt an integrated approach to managing the different types of risk that scheme is exposed to. Whilst creating and achieving a target may help achieve Government aims, it is not clear how this will benefit the pension scheme. Ideally the metric and target will be aligned to the other objectives of the pension scheme (e.g. ensuring members benefits are paid, keeping risk within an affordable budget) but requiring schemes to set a specific target could create unintended consequences including conflicting with the trustees fiduciary responsibilities. At the very least, trustees should have flexibility to change the target if necessary, for example, as part of their response to managing overall pension scheme risks that evolve over time.

There is a risk that schemes may adopt less ambitious objectives in relation to climate change risk to avoid reporting a failure to meet its own self-imposed targets. Guidance from the Pensions Regulator could help by setting out good practice and example stretch targets.

Any target should also be set in careful consultation with the sponsor and their asset managements, so that the target is meaningful and achievable in practical terms.

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?

Many members will be pleased to hear that their scheme is considering climate related issues and its impact on climate change. There is an opportunity for communications regarding these issues to lead to positive engagement with members. However, there is a risk that simply giving members a link to the TCFD report (which is not written with members in mind), simply becomes a tick-box/compliance document. The communication style and content are therefore particularly important compared to where the information is accessed from. Trustees could be mandated (or at least encouraged) to add a simplified statement to a range of regular member communications, *including summary funding statements, annual benefit statements, Chair's Statements and DC fund factsheets. Some example statements could be contained in guidance to encourage trustees to share more member-friendly information regarding their climate risk and climate change analysis and policies.*

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?

Yes, if this is being made mandatory then there needs to be some enforcement ability and this seems broadly appropriate. As above, it would be beneficial to have some guidance from the Pensions Regulator on what is considered 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?

Based on our experience of working with a wide range of schemes we think that an annual cost of £15,000 significantly underestimates the cost of complying with the proposals particularly if trustees are to fully engage with the process of identifying, assessing and then managing the risks relating to climate change. Most schemes are unlikely to have sufficient in-house resource to fully comply and will need to rely on external support.

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?

No additional comments here apart from to mention with regards to members (particularly for DC schemes), we think these disclosures need to be simplified and easily understandable if they are to be effective in engaging and driving behavioural change in the pensions industry.

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