Institute and Faculty of Actuaries

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

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

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. We agree with the policy proposals.

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

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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. We agree with the policy proposals. However we recommend government revisits the scope earlier than the proposed 2024 date to consider whether schemes with less than £1 billion in assets can be included within it.
3. Small schemes are not immune to climate risks and it is important they are encouraged to commence thinking about their approach to managing them. The staged approach proposed by the Department for Work and Pensions (DWP) will allow smaller schemes to learn from the lessons learnt, and emerging best practice, of larger schemes.
4. We acknowledge that smaller schemes are likely to be simpler from an investment perspective, so they may wish to adopt a simpler approach to addressing climate risks. For example, they may not find it essential to perform a full stochastic scenario analysis but just simpler scenario stress tests. This could be a trade-off for requiring smaller schemes to comply with the governance requirements and publish TCFD reports from an earlier date.
5. We note the proposals are not overly prescriptive and this will allow larger schemes to develop their approach in a way most suited to their needs. However, a lack of prescription may act as a barrier to some schemes, particularly with regard to the non-prescriptive elements of metrics. The provision of methodological guidance or standard scenarios by the Pensions Regulator (TPR) would ensure smaller schemes are better supported to comply with the requirements. DWP should consider whether it is appropriate for the proposed policy to place a responsibility on the TPR to develop such guidance.
6. We would also note that the consultation is clearer than the question above that the disclosure requirement relates to the *first scheme year end falling* on or after 1 October 2021 (for £5bn plus schemes) and the *first scheme year end falling* on or after 1 October 2022 for £1bn plus schemes), rather than to the more vague *current scheme year*.
7. For clarity and ease of understanding, it would be simpler if the asset test and the disclosure requirement should always be such that the disclosure requirement is set relative to the asset value at the *previous* scheme year end. The current proposals seem to provide for the asset threshold to be either one or two years before the disclosure requirement, depending on when a particular scheme's year end falls, which seems unnecessarily complex.

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?

8. It is encouraging that DWP has provided a timeframe for review. There would be merit in also conducting an interim review or engagement exercise in 2022/3. An interim review would allow DWP to gain feedback about the process and to identify any barriers preventing scheme compliance or need for further guidance to assist smaller schemes coming into scope. Addressing these issues following an interim review, rather than waiting until the 2024 date, will speed up compliance. Further, climate change and the management of it is a fast-evolving topic. Conducting an interim review in 2022 will allow DWP to ensure the requirements are still appropriate in light of any new developments. Any review should also consider the practices of out of scope schemes to understand whether best practice has filtered down to those schemes that are voluntarily complying.

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?

9. While we agree with the proposals, we note that trustees are having to meet an increasing number of requirements which they may find it difficult to allocate resource for. We encourage DWP to be cognisant of competing priorities trustees may face and to recognise that there may be some extreme circumstances (e.g. proximity to wind-up or PPF entry) where acting in members' best interests may necessitate fewer resources being allocated to TCFD disclosures.

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?

10. We agree with these proposals.

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?

11. When assessing resilience against climate-related scenarios it is important for schemes to look at the type and timeframe of transition, as well as the climate outcome. Failure to do so will limit schemes' ability to understand their exposure and resilience to climate-related risk. Recent research from the Institute and Faculty of Actuaries (IFoA) and Ortec Finance explores how climate scenario analysis can be used for forward-looking assessment of the risks and opportunities for defined benefit pension schemes and other financial institutions. The research considers three scenarios:

    a. Paris Orderly (co-ordinated action to limit global average temperature rises to 2°C which financial markets price in gradually)

    b. Paris Disorderly (same real-world outcomes as the Paris Orderly pathway, but financial markets' reaction is delayed and abrupt)

    c. Failed Transition (no additional climate policies are implemented and global average temperature rises by 4°C by 2100).[1]

    We encourage DWP to consider whether it might prescribe schemes to model the impacts on their assets, liabilities and investment strategy against more robust scenarios than what is proposed, such as the scenarios included in the IFoA and Ortec research paper.

12. Scenario analysis is a useful tool as it enables schemes to consider the potential implications on climate change and prompt longer term thinking about risks and opportunities. DWP could encourage trustees to consider the outputs of scenario analysis in their decision making by requiring them to provide an explanation outlining how they have done so, as well as commenting on why the scenarios have been chosen.

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?

13. We agree with these proposals.

[1] IFoA and Ortec (2020). *Climate scenario analysis for pension schemes: A UK case study.* *https://www.actuaries.org.uk/system/files/field/document/IFoA%20Paper%201.pdf*

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?

14. We agree that trustees should not be mandated to use a specific measure in the first instance. We would encourage DWP to require schemes to include an explanation of why they have selected their chosen metric. This will demonstrate efforts to develop an approach best suited to the needs of the scheme.
15. DWP should regularly review this requirement. If a specific metric emerges as the most suitable, it may be appropriate to prescribe that all schemes use it in their assessment, subject to allowing sufficient lead-in time for trustees to adapt to new requirements.
16. We note the difficulty that is associated with a lack of standard grading or rating. Given this, schemes should place the emphasis on understanding the risks and opportunities of greater aligning portfolios with Paris Agreement. There is scope for trustees to take a different approach if they can explain their rationale, for example, investing in carbon intensive industries if they are driving necessary change.
17. However, data, tools and methodologies are developing rapidly in this space – we expect the rigour and robustness of carbon and associated data to continue to improve. Whilst data is not perfect today there are still sufficient analytical techniques for schemes to be able to undertake scenario analysis and the risks their portfolios are exposed to. As metrics develop further, further guidance from DWP would be welcome and this should be made clear in the document.

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?

18. The challenges of carbon metrics are noted in the DWPs consultation paper. The current carbon metrics available to investors are neither robust, reliable nor complete:

a. not robust: in terms of measuring a portfolio's emission footprint, in part due to the gaps in measuring scope 3, the challenges of double-counting, and using total revenues as a scaling factor without allocating to business activity (e.g. their application to comparing companies in utilities which sets generation vs distribution vs mixed by revenue rather than activity)

b. not reliable: in terms of consistency and audit of numbers

c. not complete: firstly in terms of all companies, private as well as listed but more particular in representing a complete capture of the required future economy.

19. The final point, of representing a complete economy, is particularly challenging. Aggregate carbon metrics can be manipulated down by simply not investing in the carbon-intensive sectors of the economy on which the other economic activity depends. Without a clear allowance for the "whole economy", there is a risk of false representation of the risks and complacency to the aggregate impacts as well as removing the motivation to decarbonise the critical areas of where economic change is required.

20. We recommend an explicit caution on the use of carbon metrics to set targets – but to encourage pension schemes to set funding-level or asset based risk tolerances so that they manage their investment risks within acceptable short and long term risk tolerances.

21. We also note that the challenge of representing a complete economy applies to the "implied temperature rise" (ITR) of investment portfolios. Any such measure needs to make an allowance for the avoided elements of the portfolio particularly as the ITR calculations are likely to be misleading when avoiding the "hard to address" sectors of the economy. Without such an adjustment, the ITR is a very "gameable" metric.

22. The weaknesses within carbon metrics will lead to arbitrary investment strictures, and thus almost certainly sub-optimal investment approaches. We recommend investigating alternative options for targets including the use of portfolio risk thresholds which may be more robust as well as more aligned to our risk management approach and fiduciary duty.

23. Finally, we note that a focus on carbon metrics could have the opposite impact on the real economy to that intended. A disinvestment stance will reduce the opportunities for engagement and stewardship with these companies, and to the extent pension schemes are replaced by investors less likely to engage on reducing emissions, the net effect is likely to be higher emissions than had pension schemes stayed invested and engaged. In the long run, the physical consequences of insufficient carbon transition will be greater than the immediate transition risks. Reduced engagement in carbon intensive sectors reduces the ability to manage these long-term physical risks.

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?

24. We agree that trustees should publish their TCFD report on a publicly available website rather than in their Annual Report and Accounts.
25. We note that TCFD reports will be targeted at regulators, peers and other organisations. Part C proposes that trustees notify scheme members where they can locate the TCFD report. Members may not be aware of reporting requirements placed on schemes and the information contained in the report may not make sense to them. Therefore, in addition to providing the link to the TCFD report, we encourage DWP to encourage trustees to include messaging which is more targeted to this audience within annual benefit statements, summary funding statements and other regular communications with members such as Annual Reports or newsletters. They could outline what the requirements are, how they are meeting them, and provide some key information from the main report.

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?

26. We agree that TPR should have the power to administer discretionary penalties for TCFD reports that do not meet statutory requirements. However it will be important for TPR to provide guidance and clarity about its expectations if it will be subjectively determining the inadequacy of reports. This will be particularly important in guiding smaller schemes on reasonable proportionate interpretations of the requirements, once they come into scope.

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?

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***

c) ***any other comments about any of our proposals?***

27. The £15k anticipated cost to Pension schemes appears low on a per annum basis once implemented. We anticipate implementation costs to scheme to be significantly higher than this in the short term.
28. We support the Government's intention to consult on alignment of pensions portfolios to the Paris Goals in the future. Meeting the UK Government's net zero policy objective which require concerted action from policymakers and regulators, investors, corporates and communities. Given the scale of UK Occupational Pension scheme investments, they will be key in helping the government to achieve its ambitions.

Should you want to discuss any of the points raised please contact Faye Alessandrello, Policy Manager (faye.alessandrello@actuaries.org.uk) in the first instance.