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By email only: pensions.governance@dwp.gov.uk

Climate Change and Responsible Investment Team
DWP
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6 January 2022

Dear Climate Change and Responsible Investment Team,

SPP RESPONSE TO DWP CONSULTATION: CLIMATE AND INVESTMENT REPORTING: SETTING EXPECTATIONS AND EMPOWERING SAVERS – CONSULTATION ON POLICY, REGULATIONS AND GUIDANCE

Executive Summary

We welcome and support this consultation by DWP and are in full agreement that climate change poses a material financial risk to pension schemes. We are also broadly supportive of trustees of larger occupational pension schemes, and all authorised schemes, working towards the identification, assessment and management of climate-related risks and opportunities. This includes requirements to select and calculate climate-related metrics and to set and measure performance against targets.

TCFD reporting by pension schemes will be challenging for trustees, and they will require significant support from their advisors and investment managers. We welcome the pragmatic and proportionate approach set out by DWP, in particular the focus on larger schemes and the flexibility around the choice of which portfolio alignment metric to report. But it should be recognised that published data will require time to reach the requisite quality and that schemes' investment in time and money on data acquisition should be reasonable and proportionate.

Detailed Response

Q1. We propose to amend the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 to require trustees of schemes in scope to measure and report their

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<u>scheme's Paris-alignment by adding a requirement for them to select and calculate a portfolio alignment metric and to report on that metric in their TCFD report.</u>

<u>Do you agree with this policy proposal?</u>

We are broadly supportive of this policy proposal, on the condition that the portfolio alignment metric(s) are meaningful, well defined, and measurable in a consistent and repeatable way over the required time periods, and that they can be acquired without unreasonable cost to pension schemes, their advisors or investment managers.

We welcome the fact that DWP are seeking to broadly align with the TCFD's updated guidance in this area, although it should recognise that not all schemes (nor their investment managers or advisors) are at the same stage in terms of their familiarity with and knowledge of TCFD reporting.

We are concerned that the availability of climate-related data and a lack of standardisation in methodologies for gathering and measuring such data could be a significant issue for trustees, and may be a barrier to schemes meeting this requirement. Pension schemes, their advisors and their investment managers rely on the quality of disclosures from underlying companies, which are the ultimate sources of the required information. Most UK pension schemes' investment portfolios are highly diversified and global in nature, which presents an obstacle to gathering the required data in a consistent, comparable, and meaningful way. While outside the scope of this consultation, we would encourage the Government and the UK regulatory community to work with regulators in other jurisdictions to improve TCFD reporting by companies at a global level. We welcome the launch by the IFRS of the International Sustainability Standards Board at COP26 as an important step in the right direction.

Asset class diversification by UK pension schemes, particularly DB schemes, is not just global in nature and has extended in recent years to greater allocations to private market assets. Even DC schemes are increasingly exploring how to allocate to private markets. Given the more limited reporting requirements for unlisted companies, this also presents an obstacle to gathering the required data in a consistent, comparable, and meaningful way.

We also note the difficulty in measuring portfolio alignment metrics where a scheme has a buy-in policy where visibility into the investment assets held by the insurance product is likely to be less transparent than other investment assets.

With respect to the three broad categories of portfolio alignment metrics we note the following:

- Binary target measurements: These are the simplest and easiest to calculate, e.g. the percentage of a given portfolio where an investment or counterparty has made a net-zero/Paris alignment commitment. We see that these data points are being developed by multiple ESG data providers and they should be widely available and broadly comparable over time and between portfolios.
- Benchmark divergence models: These tools are a more complex measurement that compare the forecasted emissions performance of investments or counterparties against one or more benchmarks. We see that ESG data providers have developed / are developing these models but, in contrast to the metric above, there is a variety of different models and their output is consequently less standardised and less likely to be comparable between portfolios.
- Implied temperature rise (ITR) models: these are similar to the benchmark divergence approaches, except that they extend the output further by translating each investment's

benchmark alignment into a measure of the consequences in term of a single temperature score. These are the newest type of portfolio alignment metric, with an additional layer of assumptions and complexity, and a variety of methodologies used to produce them. Although some ESG providers have begun to provide these metrics there is still substantial uncertainty as to the robustness of the models and their consequent usefulness.

Given the differences set out above between the three portfolio alignment metrics, we appreciate the methodological flexibility set out in the consultation document. We welcome the inclusion of a provision that requires trustees to carry out such activities only "as far as they are able". We also welcome the intention that trustees will be supported with regular updates to statutory guidance.

Q2. We propose that:

(a) trustees who are subject to the requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations on or after 1 October 2022 (including trustees to whom the requirements are re-applied in accordance with regulation 3(4), 4(4) or 5(4)) will be required to select, calculate and report on a portfolio-alignment metric and to publish the findings in their TCFD report within 7 months of the relevant scheme year end date in the same way as they are for other metrics. This will apply to:

trustees of a trust scheme which had relevant assets equal to, or exceeding, £5 billion on their first scheme year end date which falls on or after 1st March 2020, and who remain subject to the requirements in Part 1 of the Schedule on 1 October 2022

trustees of a trust scheme which has relevant assets equal to, or exceeding, £1 billion on a scheme year end date which falls on or after 1st March 2021

trustees of all authorised master trusts and authorised collective defined contribution schemes

After 1 October 2022

(b) trustees will cease to be subject to the requirements to select, calculate and report on a portfolio alignment metric in accordance with regulations 3(4), 4(3), 4(5), 5(3) and 5(5) of the Climate Change Governance and Reporting Regulations, in the same way as they would be for other metrics:

trustees of a scheme with relevant assets of less than £500 million on a scheme year end date which falls after 1 October 2022 will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must still report on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless the relevant assets on the scheme year end date were zero

trustees of an authorised scheme which ceases to be authorised after 1 October 2022 (a "formerly authorised scheme") and which had relevant assets of less than £500 million on the scheme year end date immediately preceding the scheme year in which authorisation ceased, will cease to be subject to the requirements to select, calculate and report on a portfolio alignment metric with immediate effect

trustees of a formerly authorised scheme which has relevant assets of less than £500m on a scheme year end date after authorisation ceased, will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must still report

on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless the relevant assets on the scheme year end date were zero

Do you agree with these policy proposals?

We are broadly supportive of the DWP's proposed approach to scope and timing of the new requirements and agree that the initial focus of TCFD reporting should be on the largest occupational pension schemes as well as those which are regulated to higher standards of governance.

We agree that the focus for UK pension schemes should be on getting started, rather than waiting for perfect data, and welcome the "as far as they are able" principle allowing trustees to make reasonable and proportionate efforts to obtain the relevant metrics.

While currently beyond the scope of this consultation, we note that the requirements of the proposal would currently be burdensome for smaller pension schemes if it were to be extended to these schemes following the proposed Government review in 2023. Whilst we note that the burden is likely to decrease as measurement methodologies become standardised over time, we support a further review of the situation before extending the scope to smaller schemes.

Q3. We propose to incorporate the requirements to measure and report a portfolio-alignment metric into the existing Climate Change Governance and Reporting Regulations so that the requirements are subject to the same disclosure and enforcement provisions as the other metrics requirements.

We broadly agree with the DWP's proposed approach but note that in monitoring and enforcing compliance with the new requirements the Pensions Regulator should recognise that not all schemes (nor their advisors or investment managers) will have the same knowledge or familiarity with TCFD governance and reporting concepts when applied to the measurement of portfolio alignment metrics. Initial compliance is likely to have a wide variance, and this should be taken into account when setting the Pension Regulator's approach to monitoring and enforcement.

In particular, it will be essential for the Pensions Regulator to give clear guidance on its enforcement policy with regard to its new powers under the regulations, especially its interpretation of the "as far as they are able" test.

Q4.

(a) Do you have any comments on the draft amendments to the Regulations?

(b) Do you have any comments on the draft amendments to the Statutory Guidance?

Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter.

We particularly welcome comments on the definition of "portfolio alignment metric" and whether respondents think it reflects the policy intent?

We consider the draft amendments to the Regulations and Statutory Guidance broadly reflect the Government's policy intentions, but we can see a potentially unintended outcome.

Trustees are required to select a minimum of four metrics with paragraph 15(c) stipulating '*one additional climate change metric'* as being required and this additional climate change metric being defined as one which is not an absolute emissions metric, an emissions intensity metric, or a portfolio alignment metric. This would technically appear to allow trustees to choose as their fourth metric another Paris alignment metric (in addition to the one now being required), so long as the target is not 1.5 degrees (because that is what the draft regulations say they cannot choose). So, for example they could choose a 2.5 degrees Paris alignment metric and that would technically be within the legislation. We question how that would be consistent with the policy intent. We recognize that guidance may have a role but perhaps the regulations could directly address this point.

Q5. Do you have any comments on the new regulatory burdens to business and benefits of requiring schemes to measure and report their Paris alignment?

We support the ambition for schemes to report portfolio alignment metrics over time and believe that the demand from investors will provide companies with an incentive to provide the required data and supporting analysis. In that regard it is important to start the process and DWP's proposals do that.

However not all large pension schemes have sufficient in-house resource and investment expertise to be able to produce the climate-related disclosures and the supporting analysis. Measuring and disclosing scope 3 emissions data represents a particular challenge for companies.

This will place greater reliance on the support of external experts and consultants, which may increase costs.

At paragraph 98 of Chapter 1 the consultation claims that no significant additional cost is expected. It does this by reference to a previous impact assessment (see footnote 40 on page 28 of the consultation paper). However, that impact assessment does not directly address and assess the introduction of a portfolio alignment metric as is now proposed. We therefore feel that this observation has not been demonstrated.

Q6. Do you have

a. any comments on the impact of our proposals on protected groups and/or 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 further comments.

Q7. Should DWP include a vote reporting template in its implementation statement guidance which trustees are expected to use? If so, should such a template be based on the PLSA's vote reporting template? What changes, if any, would be needed to the PLSA template if it were to be adopted?

<u>What are your views on the adoption of an engagement reporting template? Should it be separate from any vote reporting template or integrated with it, so that – in relation to equities – both voting and engagement activities are described for the same set of assets?</u>

Vote reporting template

We believe that a vote reporting template for trustees to use when gathering information from investment managers would be helpful. The DWP endorsing a template for the provision of information from managers to trustees would help to level-up the richness of reporting across the board and enable trustees to assess and compare managers more effectively. The PLSA's vote reporting template is a good starting point for this. We do though suggest that the DWP guidance should reflect that the PLSA template is evolving and will therefore be updated and reformed over time.

The PLSA's template is intended for use between trustees and managers only – it is not a template for trustees to use when reporting on voting activity in their implementation statement. If DWP are considering developing the latter form of template, we would not be supportive of that proposal. Trustees can be expected to receive a significant amount of information from a variety of sources (managers of pooled and segregated funds, managers of funds of fund, providers of investment-linked life policies, platform providers, etc) and the views which trustees form on that information, the actions they take and the details they feel appropriate to disclose in relation to their particular scheme are all matters of judgement and cannot readily or helpfully be reduced into a standard form.

Engagement reporting template

We think it would be useful for engagement activity to be reported to trustees alongside voting activity for the same investment mandate/asset class and so we believe an engagement reporting template should be integrated into any vote reporting template the DWP might produce/endorse. However, as with vote reporting, we do not think it would be practical or helpful for trustees to be required to report on engagement activity in their implementation statement using a template.

<u>Q8. Do you have any comments on our cross-cutting proposals for the draft Guidance on Statements of Investment Principles and Implementation Statements, in particular that:</u>

<u>a) they are written for members?</u>
<u>b) these are trustees' statements, not their consultants'?</u>
<u>c) Implementation Statements should set out how the approach taken was in savers' interests?</u>
<u>d) trustees should be able to include material from voluntary disclosures, such as Stewardship Code reporting, as long as they meet the requirements in the Regulations?</u>

We agree that SIPs and implementation statements should be written in a way that enables a reasonably engaged and informed scheme member to interpret and understand the trustees' disclosures and to raise concerns or questions where appropriate. As the Pensions Regulator has statutory responsibilities for ensuring compliance with the investment and disclosure regulations, the Regulator will inevitably have an interest in the content of SIPs and implementation statements, but its interest is indirect and emanates from its supervisory duties. We therefore do not believe that the Pensions Regulator should be regarded as "another key audience" for SIPs and implementation statements. If SIPs and implementation statements do not meet an applicable disclosure standard then this will be a matter for the Regulator, but we would expect the presentation of SIPs and implementation statements to diverge from a form most helpful to reasonably engaged and informed scheme members if these documents are meant to be written for the Regulator too. This has been seen in relation to DC chair statements where documents that were originally intended to be for members became unsuitable for that when trustees were impelled to write them for compliance in order to avert regulatory intervention. This outcome may be avoided by a more measured enforcement approach to these documents. Nevertheless, our view is that, if the Regulator wishes to develop a deeper understanding of trustees' disclosures or to raise concerns or questions about the trustees' disclosure or underlying governance process, the Regulator will be free to undertake direct engagement with the trustees through a private channel.

We agree that SIPs and implementation statements must be owned by trustees and must not be regarded as the primary responsibility of consultants. That said, some degree of homogeneity is inevitable given the pooling of advisory and management services that takes place when assets from a fragmented set of pension asset owners are brought together for investment in the way seen in the UK. We would also note that, while the expectation is rightly that SIPs and implementation statements should reflect the priorities and activities of the relevant scheme's trustee board, there can be real value for schemes and their members in trustees being able to leverage from the collective – particularly where the scheme is relatively small and/or has a finite governance budget.

We are not wholly supportive of the expectation that implementation statements should set out how the approach taken was in savers' interests. Setting that expectation would be likely to result in vague and generic umbrella statements, or multiple repetitious and formulaic statements throughout these documents. Implementation statements are meant to report on the steps taken towards fulfilment of the SIP and the SIP is prepared in compliance with a combination of statutory and common law duties. The measure should therefore be whether (and to what extent) the actions taken have achieved the purpose of implementing the SIP. If trustees are to be required to articulate their stewardship priorities (a proposal which we think is helpful), that should establish a natural link between the SIP and implementation statement and should be sufficient to demonstrate to members how the actions reported on in the implementation statement fulfil the trustees' legal obligations (and, through that, are in members' interests).

We agree that it should be permissible for disclosures from other publications to be used to meet the applicable requirements for implementation statements and that this should not be done by simply cross-referring to those other disclosures or annexing them, since implementation statements should be capable of being read and understood as standalone documents. However, we do not believe trustees should be expected to transform content from other disclosures into their implementation statements – it should be possible for trustees to lift content over and deploy it in their implementation statement if they feel that doing so will still enable them to meet the applicable requirements.

Q9. (a) Do you have any comments on our proposed Guidance on stewardship policies? (b) Do you have any comments on our proposed Guidance on significant votes?

Proposed guidance on stewardship policies

We agree that it is insufficient for trustees simply to state that they have delegated responsibility for stewardship to their investment managers, but we believe the proposed guidance goes too far by saying that, where voting and engagement rights are exercisable by a third party rather than by trustees, trustees must "acknowledge responsibility for the voting policies that asset managers implement on their behalf". We do not believe this gives proper recognition to the practical and commercial barriers trustees face in ensuring that, where they have a policy on stewardship, this is implemented by each asset manager they appoint (or, moving forward, that any expression of wish is followed by a pooled fund manager). A balance which is closer to the reality is that investment managers are unable to accommodate all aspects of each trustee investor's policies and trustees are therefore forced to be pragmatic in considering whether that can be accepted in the round (and in view of all the other considerations relevant to the decision whether or not to proceed with an investment). For the proposed non-statutory guidance on SIPs to take the position that, in these common situations, trustees are "responsible" for the manager's voting policies is a step too far in our view. We prefer the current approach of saying that trustees are responsible for overseeing and, where appropriate, challenging managers' policies, especially where managers' policies are not aligned with trustees' policies and also, as the guidance notes, at the stage of first appointment.

We note that paragraph 33 of the proposed non-statutory guidance on SIPs says that: "Once trustees have selected the scheme's stewardship priorities, it is recommended that trustees identify whether there are any particular aspects beneath that priority, which are important to the scheme and members and beneficiaries." In a scheme where members do not have investment choices – and particularly in a DB context – many trustees will not have considered what is important to members and we do not believe they are, or should be, required to do so.

Proposed guidance on most significant votes

We believe it is helpful for the proposed guidance to suggest that trustees determine their most significant votes by reference to their own stewardship priorities for the scheme, although it should be acceptable that, for most schemes, these priorities will likely focus on governance and financial value (and so major on many of the criteria set out in Annex 4 of the PLSA's vote reporting guidance).

The PLSA's vote reporting template asks managers to disclose at least ten most significant votes to trustees and so, if all managers do that, requiring trustees to disclose "all" their most significant votes would in our view be likely to make implementation statements unwieldy and inaccessible to members. We suggest disclosing the top five most significant votes would strike the right balance for members, especially given the (fairly extensive) list of minimum information which the proposed guidance suggests should be provided in relation to each most significant vote (with which we broadly agree).

We also think that a degree of proportionality is required in setting expectations for smaller DB schemes.

Q10. Do you have any comments on our proposed Statutory Guidance on the information to be included in the Implementation Statement with regard the requirements under the Disclosure Regulations, Schedule 3, paragraph 30(f)(i)-(iv)?

No further comments.

Q11. Do you have any comments on our proposed Statutory Guidance on meeting the Implementation Statement requirements in the Disclosure Regulations relating to choosing investments?

We believe there should also be reference to the requirement in section 36(4) of the Pensions Act 1995 for trustees to determine the intervals when it would be desirable to take proper advice on "retaining" investments and to then obtain and consider such advice at such intervals.

Q12. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to investment strategy?

No comments (save that paragraphs 79 and 80 of the proposed guidance do not mention the expectation that trustees will explain the extent to which the steps taken are in members' interests).

Q13. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to financially material considerations (including ESG and climate change)?

No further comments.

Q14. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to non-financial matters?

Paragraph 93 of the proposed guidance (the non-statutory guidance on SIPs) says that "Trustees … are encouraged to have a mechanism by which members may express views about the consideration of non-financial matters in the selection, retention and realisation of investments, including about stewardship. This is particularly the case where savers directly bear the financial risk. In relation to investments, trustees are encouraged to make it possible for savers to express views on both self-select options and any default arrangements." Whilst members may bear the investment risk, ultimately the responsibility for selecting appropriate funds rests with trustees, particularly in the case of default arrangements. Trustees should clearly consider any views directly expressed by members but, where they have a fiduciary responsibility for fund selection (which does not include any obligation to consider member preferences), we are not convinced that trustees should be encouraged to take account of member views on non-financial matters. We believe some trustee boards may find it helpful to know members' views on these matters, but many will be reluctant to invite views from members only to have to then explain why they were disregarding them.

Paragraph 96 of the proposed guidance (the statutory guidance on implementation statements) says that "Trustees should explain what actions, if any, they have taken as a result of views expressed by members in relation to the selection, retention and realisation of investments. Trustees should explain how this is in the members' interests. They may additionally explain what actions they have taken in relation to members' views on stewardship and how this is in the members' interests." We believe this goes beyond the statutory requirement to state how, and the extent to which, the SIP has been followed. Trustees are not required by the legislation to explain how their actions are in members' interests and, for the reasons set out above (in relation to paragraph 93), we do not believe it is appropriate to expect them to do so.

<u>Q15. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to arrangements with asset managers?</u>

No comments (save that paragraphs 101 to 105 of the proposed guidance do not mention the expectation that trustees will explain the extent to which the steps taken are in members' interests).

Response ends

Yours faithfully

Neil Davies
Chair, Investment Committee, SPP

Mark Bondi
Chair, Legislation Committee, SPP

Fred Emden
Chief Executive, SPP

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