

To: Department for Work and Pensions

By e-mail only pensions.governance@dwp.gov.uk

10 March 2021

SOCIETY OF PENSION PROFESSIONALS' RESPONSE TO CONSULTATION ON THE DRAFT OCCUPATIONAL PENSION SCHEMES (CLIMATE CHANGE GOVERNANCE AND REPORTING) (MISCELLANEOUS PROVISIONS AND AMENDMENTS) REGULATIONS 2021 AND THE OCCUPATIONAL PENSION SCHEMES (CLIMATE CHANGE GOVERNANCE AND REPORTING) REGULATIONS 2021

The Society of Pension Professionals welcomes the opportunity to respond to this consultation.

Question 1 - Scope and Timing

a) Do you have comments on the proposals to change the “reference date” used for the purposes of determining whether a scheme is in scope, or the arrangements made for schemes which obtain their audited accounts later than 1 October 2021, or 1 October 2022?

We are broadly supportive of the change in the reference date, which should (as the consultation response notes) give greater certainty to schemes as to whether or not they are in the first wave of governance and reporting requirements. Having a common reporting deadline of seven months from the end of the relevant scheme year (where applicable) is also a welcome change to the original proposals and should allay concerns from some schemes that the deadlines for reporting were too tight (although please see the response to Question 5(a) below).

However, we consider that in monitoring and enforcing compliance with the new requirements the Pensions Regulator ought to recognise and take into consideration that not all schemes (and advisers) are at the same stage in terms of their familiarity with and knowledge of TCFD governance concepts and reporting. Initial compliance (particularly for “first wave” schemes) is likely to have a wide variance and, whilst we understand the Government’s desire to set a high standard for other schemes to follow, we do not consider that it would be constructive to duly criticise other schemes which are further behind on the learning curve. This should be taken into account when setting the Pension Regulator’s “base line” approach to monitoring and enforcement.

b) Do you have comments on the draft regulations on scope and timing?

We consider the regulations broadly reflect the Government’s stated policy intention on scope and timing. In terms of the definition of “relevant contract of insurance”, we note that this is more restrictive than existing statutory definitions (e.g. section 161(8) of the Pensions Act 2004) and is potentially overly so. We consider that limb (i) of the test ought to be amended as set out below:

“the contract provides for payments to be made by the insurance company to the trustees which are intended ~~in all circumstances~~ to fully meet the cost of ~~specified~~ benefits specified in the contract”

and which are not money purchase benefits under section 181(1) of the Pension Schemes Act 1993 and which are, or will become, payable in accordance with the scheme rules; or”

Further both limbs of the “relevant contract of insurance” definition are subject to the following condition:

“...and the insurance company **has full and ongoing discretion over the investment policy** for any assets used to meet its liabilities to make payments under the contract;”

The bold wording above potentially presents a difficulty with regards to insurer matching adjustment applications and Prudential Regulation Authority requirements (this could be overcome by making the test “subject to regulatory requirements”) and also where the buy-in policy is collateralised. Is it the Government’s intention to exclude collateralised buy-in contracts from the definition of “relevant contract of insurance”?

We also assume that in the definition of “Scheme year” (regulation 2), the cross reference to “(aa)” in sub-paragraph (ii)(bb) should be to “(i)”?

Question 2 - Trustee knowledge and understanding

a) Do you have any comments on the draft regulations on trustee knowledge and understanding?

We consider the regulations broadly reflect the Government’s stated policy intention on trustee knowledge and understanding (TKU) requirements regarding TCFD. We note, in particular, the new TKU requirements are only intended to apply to trustees to whom the requirements of Part 2 of the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 also “apply” (rather than all trustees, as is the case with other current TKU requirements).

However, in our view, the timing of the TKU requirements could be clearer. For example, we do not think it is currently clear in the drafting of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 that the whole of Part 2 ceases to apply to trustees who fall within one of regulation 2(5), regulation 2(8) or regulation 2(9) and so arguably the new TKU obligations would continue to apply even when the obligations under Part 1 of the Schedule do not.

We would suggest that the reference to “Part 2” in regulation 2 of the draft Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 be amended to “Part 1 of the Schedule” and that it be made clear that should those requirements cease to apply, then the TKU requirements will also cease to apply.

b) Do you have any comments on the draft guidance?

We note that the guidance on TKU is “carved out” of the statutory guidance and so trustees will not be expected to report on it in their TCFD reports. We assume that this is the policy intention although this is not specifically addressed in the consultation response. It would be helpful to understand the Government’s rationale for this in the consultation response.

Question 3 - Governance

a) Do you have any comments on the draft regulations on governance?

We consider the regulations broadly reflect the Government’s stated policy intention on TCFD governance requirements. We query whether asset managers and administrators should be expressly carved out of paragraph 2(a) of Part 1 of the Schedule to the regulations (similar to the carve out for legal advisers at paragraph 2(b) of Part 1 of the Schedule) in order to be consistent with the statutory guidance (see Part 3, paragraph 12).

The definition of persons who “*advises or assists with respect to governance activities*” at paragraph 2(b) of Part 1 of the Schedule is very wide and would arguably cover, for example, organisations which provide electronic board pack services to the trustees. Compliance with this obligation is likely to be overly burdensome and we would suggest (if the definition is to remain widely defined in the regulations)

that a materiality condition be inserted (i.e. “*advises or assists with respect to material governance activities*”) to avoid it capturing incidental service providers as noted above.

b) Do you have any comments on the draft statutory guidance?

See comments regarding the “as far as they are able” test at Question 12 below.

Question 4 - Strategy

a) Do you have any comments on the draft regulations on strategy?

We consider the regulations broadly reflect the Government’s stated policy intention on strategy requirements.

b) Do you have any comments on the draft statutory guidance?

See comments on Question 5(c) below.

Question 5 - Scenario Analysis

a) Do you have any comments on the provisions on scenario analysis in the draft regulations?

We consider the regulations broadly reflect the Government’s stated policy intention on strategy requirements. However, we consider the use of the term “undertake” in paragraphs 6, 8, 9 and 10 of Part 1 of the Schedule to the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 may cause confusion as it isn’t clear whether this requires the analysis to be merely started in the relevant scheme year (but not necessarily finished), concluded by the end of the relevant scheme year, or whether it permits trustees to use an “effective date” in the relevant scheme year but not conclude (and report on) the scenario analysis until the following scheme year (i.e. much in the same way as statutory actuarial valuations are currently carried out). We would recommend the Government’s policy intention is clarified in both the final regulations and statutory guidance.

We note that the initial scenario analysis must be undertaken “in the first scheme year in respect of which the requirements of this Part apply in accordance with regulation 2”. Arguably for some schemes, this will mean conducting a scenario analysis for the current 2021 scheme year (i.e. for “first wave” schemes with a year end of 31 December). We think that this is likely to be challenging for first wave schemes – even with the easement of reporting seven months after the end of the scheme year. We would, therefore, suggest paragraph 8(a) of Part 1 of the Schedule to the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 be amended to read (at least for “first wave” schemes):

*“in the first **full** scheme year in respect of which the requirements of this Part apply ~~in accordance with regulation 2~~”.*

We would also suggest that the timing of the scenario analysis should further address the following concerns:

- What will the deadline be for the “every three years thereafter” requirement in paragraph 8? Is it by three years after completion of the first scenario analysis or is it by the end of the fourth, seventh, tenth etc. scheme years?
- Paragraphs 9 and 10 require the trustees to do scenario analyses more frequently than every three years where they have determined that they should do so. But where they do, this does not seem to alter the fixed triennial schedule in paragraph 8. Trustees could therefore decide to do a new scenario analysis when not required and then be required to do one again the next or following year, even if they do not think that they need to. This may make it less likely that trustees will decide to do new scenario analyses out of the usual triennial cycle. We therefore suggest that where trustees do a new analysis, this should reset the triennial cycle.

b) Do you have any comments on the proposal that all assets of the scheme, including relevant contracts of insurance, are within scope for scenario analysis?

We broadly agree with the proposal that all assets of the scheme, including relevant contracts of insurance, are within scope for scenario analysis. Trustees should be permitted to rely on TCFD reports issued by insurers in relation to assessing the impact of relevant contracts of insurance.

c) Do you have any comments on the draft statutory guidance on scenario analysis?

The draft statutory guidance notes that employer concerns over sharing confidential information to allow for strategic risk setting and scenario analysis could potentially be overcome through confidentiality agreements – as is currently the case with, for example, covenant analysis undertaken by trustees and their advisers.

That is true in circumstances where the use of confidential information (and the conclusions that flow from it) remains confidential and are not put in the public domain. However, in circumstances where the trustees are required to publish the results of their strategy setting and scenario analysis (we note the “as far as they are able test” does not extend to disclosure of such information in the TCFD report), the use of confidentiality agreements will likely not fully mitigate employer concerns and may be a barrier to effective information sharing (even where disclosure is at a high or summary level). For that reason we consider the Government should extend the “as far as they are able test” to disclosure obligations under paragraph 21(h) of Part 2 of the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

We would also recommend that the statutory guidance further encourages trustees to consult with employers on scenario analysis and climate related risks to funding strategy to minimise the risks of trustee views as to climate related risks on the employer covenant being out of line with those of the employer (who may also have its own TCFD reporting obligations). We consider this is a very real risk given our experiences with “standard” covenant assessments – particularly for companies in the energy sector. It would also be helpful if the statutory guidance could further clarify the extent to which trustees can rely on third party TCFD disclosures (e.g. those of insurers with whom the trustees hold a policy and/or the sponsoring employers) and the steps they should take (if any) to verify the accuracy of the information, particularly metrics and scenario analysis. Where those TCFD disclosures are made in compliance with the issuer’s own legal obligations we would recommend that statutory guidance indicate that it would be reasonable for trustees to place reliance on them.

Question 6 - Risk Management

a) Do you have any comments on the draft regulations on risk management?

We consider the regulations broadly reflect the Government’s stated policy intention on risk management requirements.

b) Do you have any comments on the draft statutory guidance?

No substantive comment.

Question 7 - Metrics

a) Do you have any comments on the draft regulations on metrics?

We consider the regulations broadly reflect the Government’s stated policy intention on metrics but we would request that “on an annual basis” (see paragraphs 15, 16 and 18 of Part 1 of the Schedule to the regulations) be expressed more precisely, to give trustees certainty. For example, does it mean: once every calendar year or scheme year; around the same time every year; in the same month every year; or by the same date as the previous year?

We do have a concern that the “absolute emissions metric” and “emissions intensity metric” are overly prescriptive and could lead to misleading “ranking” of schemes by social interest groups or journalists as neither of those metrics taken in isolation gives an indication of the real impact the pension scheme portfolio is having on or contributing to climate change. The more meaningful metric is likely to be the “additional climate change metric” which is unlikely to be reported on given it will vary from scheme to scheme and not lend itself to easy comparisons.

b) Do you have any comments on the draft statutory guidance?

We consider the guidance could more clearly address how metrics should be calculated for certain asset classes (especially sovereign bonds and derivatives), recognising this is a rapidly developing area which applies significant qualitative judgements in relation to the underlying sovereign issuers rather than qualitative ones based on carbon emissions linked to a particular bond issuance. There is also a wide range of metrics that we consider potentially suitable as the additional climate change metric and, given that the trustees are expected to explain their choice of metric, would prefer DWP to adopt more flexible wording (i.e. ideally replace “should” with “may” at the start of paragraph 134 of the statutory guidance).

Question 8 - Targets

a) Do you have any comments on the draft regulations on targets?

We consider the regulations reflect the Government’s stated policy intention on targets.

b) Do you have any comments on the draft statutory guidance?

We would recommend that guidance confirms that targets must be in line and compatible with trustees’ overarching fiduciary duties and not in conflict with their investment duties or SIP. We recognise that this is already implied in the guidance but we understand there remains concern in the trustee community that target setting in relation to climate risks can potentially be at odds with acting in the financial best interests of members. It may be helpful for the statutory guidance to cross refer to the Pensions Climate Risk Industry Group (PCRIG) non-statutory guidance here, which addresses this topic well. It will also be worth re-emphasising that there are no penalties for failing to meet targets that have been set.

Question 9 - Disclosure

a) Do you have any comments on the draft regulations on disclosure?

See point below regarding Part 2 of the Schedule to the regulations regarding reporting against compliance with statutory guidance.

We also note the helpful inclusion of the provision allowing the chair's manuscript signature to be omitted (regulation 3(3)) but it could be used to argue that the DC chair's governance statement publication requirement, which does not include such a provision, does require the manuscript signature to be published. We would recommend that the miscellaneous provisions regulations are used to amend that requirement to match the one here.

b) Do you have any comments on the draft statutory guidance?

The draft statutory guidance states at Part 1, paragraph 20:

“*Must’ vs ‘Should’ vs ‘May’*”

In this Guidance, activities will be described as things trustees either ‘should’ do, ‘may’ choose to do or ‘must’ do. What this means for the purposes of the Guidance is set out below:

*Should – It is expected that trustees will follow the approach set out in the Guidance and if they choose to deviate from that approach they **should** describe concisely the reasons for doing so in the relevant section of their TCFD Report.*

May – Trustees can choose to follow the approach set out in the Guidance, and are encouraged to do so where possible, but if they choose not to they are not expected to explain their reasons in their TCFD Report.

Must - This is a requirement imposed by legislation. Failure to meet the requirement may lead to enforcement action by The Pensions Regulator.”

With regard to the **highlighted** wording above, should this be “must” or is it not intended that this be a “hard” legal requirement (a breach of which could trigger penalties for non-compliance)? If it is intended to be a “hard” legal requirement, then we suggest that reporting against statutory guidance is added to the list of disclosure requirements in Part 2 of the Schedule to the regulations to give clarity and certainty to trustees.

We would also recommend that statutory guidance notes that trustees may consider producing a summary TCFD report (i.e. a two page simplified summary which would be more accessible to members) as well as a more detailed report to enhance member engagement.

Also see comments on disclosure of confidential information at Question 5(c) above.

Question 10 - Penalties

Do you have any comments on the draft regulations on penalties?

We consider the draft regulations reflect the Government’s policy intentions.

For the reasons noted above, 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 including but not limited to:

- its interpretation of the “as far as able” test;
- how the new TKU requirements are to be assessed;
- whether enforcement of the new requirements will be rolled into “1-2-1” supervision (which most in scope schemes will already have) or whether it will be a bespoke TCFD reporting team (or a combination of both); and
- the circumstances in which third party compliance notices might be issued (for example, against scheme advisers or service providers, such as asset managers).

Question 11 - Impacts

In relation to the policy changes we have made, do you have any comments on the regulatory burdens to business and benefits, and wider non-monetised impacts which are estimated and discussed in the draft impact assessment?

N/A

Question 12 - Any other comments

Do you have any other comments you would like to raise?

“As far as they are able” test

We comment on this here as it comes up in relation to a number of areas (scenario analysis, data, metrics and targets). We note the expanded definition in the regulations at paragraph 19 of the Schedule which describes the test as “*taking all such steps as are reasonable and proportionate in the particular circumstances*”. That is potentially a high bar given the size of the schemes in scope and the potential significance of the climate change risks. Arguably it might require schemes to incur significant costs and use their “market power” (see chapter 2, paragraph 89 of the consultation response) to obtain necessary information. The draft statutory guidance helpfully touches on costs but does not refer to situations where trustees do not have any legal right to the necessary information (for example, from asset managers or underlying issuers/funds or from the employer in terms of covenant information); it would be helpful if this could be added into the final version of the guidance.

Yours faithfully

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