Institute and Faculty of Actuaries

12 March 2021

Taking action on climate risk: improving governance and reporting by occupational schemes – response and consultation on regulations

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.

The Institute and Faculty of Actuaries (IFoA) welcomes the ongoing efforts to introduce requirements for trustees of larger occupational pension schemes and authorised CDC schemes and master trusts to address climate risks and opportunities.

We responded to the DWP's consultation in August 2020 to provide views on the policy proposals, which were largely supportive. In our feedback, we identified areas where proposals could be strengthened or clarified. It is pleasing to see that much of this feedback has been taken on board and the draft legislation and draft statutory guidance reflect this.

There are several areas where we have further feedback. These are identified below:

Scope and timing

We would welcome clarity over the reference in the draft regulations to schemes coming into scope from 1 October 2021 (or 2022) or "if later, from the date on which the trustees obtain audited accounts in relation to that scheme year end date". Whilst we believe the intention is that this exception allows for cases where an extended scheme year of more than 12 months could result in accounts for asset measurement purposes not being due by the relevant 1 October deadline, it appears that the exception might also be deemed to apply to cases where the accounts are due on or before 1 October but are not completed by that time (i.e. where they are completed after the 7 month statutory deadline). This may be interpreted that a breach of the statutory requirement to obtain audited accounts would automatically extend the compliance deadline for the climate change governance requirements and reduce the period covered by the first TCFD report, hence it may be helpful for DWP to clarify if this is the intention.

Trustee knowledge and understanding

It is reasonable that the regulations require trustees to have sufficient knowledge of climate risks to enable them to run their scheme. There is an opportunity to provide further clarity around what a sufficient level of knowledge and understanding looks like. We note the guidance provides principles regarding this but we have concerns they are not sufficiently clear.

Continued efforts by the regulator to provide clarity and develop supporting materials to assist trustees in meeting these requirements would be welcomed. For example, the Pension Regulator's (tPR) could develop template materials and guidance to both mitigate the cost burden on schemes coming into scope early on and to ensure good practice is developed and understood before more schemes come into scope. It would also be useful for tPR to collate and publish examples of best practice, as this emerges from the larger schemes, to ease the eventual roll out to smaller schemes. These materials, along with a suggested course of knowledge could be included in the tPR's Trustee toolkit.

Governance

We agree that trustees should establish processes to satisfy themselves that any person undertaking governance activities, or advising or assisting trustees with governance activities, takes adequate steps to identify, assess and manage climate-related risks and opportunities relevant to the scheme.

Again, we think there is an opportunity for the guidance to provide clarity on processes trustees can establish and employ to satisfy themselves. We are conscious that this requirement places an additional burden on trustees and additional guidance and support that makes the process simpler for trustees would be welcome.

Scenario analysis

The guidance states that trustees may wish to overlay quantitative analysis with a qualitative narrative which provides some wider context and explains the impact of their scenario analysis to help with their own, and others' understanding. The guidance also makes reference to an example included with the Final Report of the Task Force on Climate-Related Financial Disclosures. We agree that it is important for trustees to consider the outputs of scenario analysis in their decision making and to demonstrate this through an explanation of how they have done so. In addition to this, trustees should be asked to demonstrate how the scenario analysis fits in with their overall strategy setting and decision making and monitoring processes. This will increase the likelihood that these considerations will become embedded, rather than becoming tick box exercises. More detail around how trustees can show, use and embed their working should be included within the guidance itself. DWP should also make ongoing efforts to support trustees with this.

It is useful that guidance highlights that trustees should have regard to the different assumptions made, and how this will impact the findings of scenario analysis, in their decision making. However, we are conscious that unless consistent assumptions are used, it will be difficult for trustees to compare findings. Where there is limited information available, DWP may wish to provide guidance about what underlying assumptions are used to fill the gaps to ensure a greater degree of consistency.

Metrics

We recognise the importance of collecting Scope 3 emissions at the company level. However due to double counting, Scope 3 emissions do not meaningfully aggregate to the portfolio level. Whilst the DWP may wish to request the reporting of scope 3 data to improve industry compliance, we recommend that the attention of trustees and regulators be focused on the portfolio's aggregate Scope 1 & 2 emissions and not the aggregate Scope 3.

We recommend DWP provides clarity on its preferred method for calculating total emissions. The statutory guidance makes reference to the emerging standard being developed by the Partnership for Carbon Accounting Financials (PCAF). The PCAF approach to calculating financed emissions provides a more specific detail to the approach to calculating Total Emissions and Carbon footprint than that contained within the Pensions Climate Risk Industry Group (PCRIG). We support the use of the PCAF approach and recommend DWP provide greater detail within the statutory guidance about how this calculation is performed, and the specific inputs and figures used, to ensure consistency.

Extending the above comment on consistency, it is not clear how trustees should approach the Liability Driven Investment (LDI) element of the portfolio. There is a range of potential approaches that could be employed for the same economic exposures, dependant on the use and treatment of repurchase and derivative instruments.

There are further questions on approach to be used for UK emissions and for carbon footprint calculations the use of net or gross asset value. To gain consistency across the industry, we recommend the DWP provides clear guidance on its preferred calculation methodology. This methodology should be focused on providing consistent metrics independent of the investment instruments used. For the Carbon footprint calculation, we recommend the use of gross asset value vs net asset value for the value of LDI exposure. We also recommend that regulatory TCFD reporting is undertaken both with and without the LDI portfolio. This is due to the potential of different levels of LDI to distort comparisons between schemes. We also note these LDI emissions reflect the policies of the UK government and UK population which are much more in the control of the UK government than UK Pension Fund Trustees.

DWP should provide greater clarity on whether it would like metrics for each Scope of emissions to be provided separately or combined.

If, as recommend here, there is to be different basis for the disclosures, it would be helpful if the DWP can provide a simple grid for emission metrics which highlights the exact requirements to promote consistency across the industry. An example is provided below. We note it would not be necessary to specify the grid for the additional climate risk metric as there is no statutory guidance on the preferred metric or data that is included.

	Portfolio ex LDI		**Gross Portfolio inc LDI**	
	Scope 1 & 2 combined	Scope 1, 2 and 3 combined	Scope 1 & 2 combined	Scope 1, 2 and 3 combined
Total GHG Emissions				
Carbon Footprint				

The targeting of emissions metrics at the portfolio level is highly gameable especially in regards to declining targets over time. Trustees should be warned of potential unintended consequences of such targets especially the potential for year-end "window dressing" by investment managers. DWP should encourage the targeting of risk-based metrics which best reflect the trustees' fiduciary duties, and which will almost certainly better integrate with their overall investment policy.

Further, we acknowledge the potential impact of short term versus longer term analysis and decision making. Actions, such as divestment or exclusion, which are taken with a short term lens may make it more difficult to achieve longer term targets. Asset managers are typically assessed over much shorter time horizons than the time horizons which trustees will be managing. Their objectives may not be aligned with a trustee's longer-term objectives. For example, the carbon intensity of a business at a point in time may not necessarily be a good indicator of their alignment with a 2 degree scenario over a longer time horizon.

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