PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

THE PENSIONS REGULATOR: GUIDANCE ON GOVERNANCE AND REPORTING OF CLIMATE-RELATED RISKS AND OPPORTUNITIES

A NEW APPENDIX TO TPR'S MONETARY PENALTIES POLICY

AUGUST 2021

CONTENTS

EXECUTIVE SUMMARY

- We welcome The Pensions Regulator's (TPR) draft guidance, which is an important step in setting expectations for schemes that will shortly be required to produce Task Force for Climate Related Financial (TCFD) aligned disclosures. In general, we believe that the draft guidance strikes the right balance between encouraging ambitious governance standards and acknowledging the many challenges schemes face.
- As the pensions sector adjusts to the new expectations, and given the lag in other parts of the investment chain coming within the scope of new mandatory disclosure requirements, we encourage TPR to ensure that, in the initial years, focus is on working with trustees to improve standards, by highlighting and sharing best practice, and not on issuing fines and enforcement action unnecessarily.
- Though we note TPR's commitment to produce further guidance on how to handle covenant risks, we are concerned that the lack of information within this guidance leaves those schemes already preparing reports (and where there are challenging covenant issues to consider) unclear as to how to best proceed. We would urge TPR to address this anomaly as soon as possible. The DB Funding Code could be a natural place in which this issue is handled, but there are concerns that waiting for the Code to come into effect may be too late for the purposes of climate-related risk assessment and disclosure.
- We believe that TPR should provide more guidance to trustees on how to assess climate risk across different asset classes. The recent drive by the Government to encourage more diversified portfolios could make it harder to obtain the myriad of data on climate risk and to do so in an expected timeframe by the Regulator; we would like to see this addressed in the guidance more comprehensively.
- We believe the guidance should provide more direction on the factors trustees should be considering in relation to quantitative and qualitative scenario analysis.
- Pension schemes are keen to ensure that their published TCFD reports are well read, and act as a genuine source of member engagement and scrutiny. We would appreciate more guidance from TPR on what flexibility trustees have in how they present this information, particularly in order to avoid duplication and overly lengthy documents, but without reducing the minimum requirements.
- Finally, we welcome TPR's mandatory and discretionary monetary penalties policy, which should give trustees reassurance that enforcement action will be undertaken sensibly and will take into account the evolving circumstances. The vast majority of pension schemes will seek to comply with the new regime and we hope that this will be reflected in proportionate enforcement activity.

ABOUT THE PLSA

We're the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with 20 million members and £1 trillion in assets, across master trusts and defined benefit, defined contribution, and local government schemes. Our members also include some 400 businesses which provide essential services and advice to UK pensions providers. Our mission is to help everyone to achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings, and to build the confidence and understanding of savers.

Guidance on governance and reporting of climate-related risks and opportunities

Background

B1. Is this section of the guidance clear when read alongside the DWP's guidance?
B2. Are there any areas on which you would welcome further clarification?

In general, we welcome TPR's approach in terms of the structure and tone of the guidance. While there are differing schools of thought within our membership as to whether separating this guidance from DWP's statutory guidance – albeit with links between the relevant sections – is the best approach in terms of ease of use, there is agreement that it is important to separate what is mandatory and what is not. We believe, in the current format, this is largely achieved.

In this section, we welcome the further clarification on the 'as far as you are able' provisions with the regulations. We believe that TPR's stated position on this is a reasonable one. We hope that the implementation of the new requirements will be mindful that pension schemes are 'learning as they go' in terms of producing TCFD reports. It is also probable that the majority of schemes will be producing reports before most of the rest of the investment chain has had a chance to catch-up on data requirements around entity, product or portfolio level disclosures and metrics (where statutory requirements don't come into force until 2023[1]). We would hope that, certainly in the initial years, TPR will take a cautious approach to any enforcement action against schemes deemed to be breaching discretionary requirements, and also that the focus will be on engagement with and education for trustees and wider pensions community of advisers and asset managers.

At the time of writing there is a large amount of activity in this area, with two ongoing FCA consultations underway that seek to extend TCFD requirements to asset managers and listed companies, as well as a recent BEIS consultation. Similarly, there is a great deal of activity elsewhere – the Financial Stability Board recently consulted on changes to their TCFD guidance, and the IMF is looking to carry out stress testing. We hope that TPR will continue to work with other regulators and bodies both to ensure reporting inconsistencies and overlaps are resolved, but also to ensure that lessons can be learnt and shared across the sector.

Finally - and we have outlined our concerns about this in more detail in the Strategy section below - we note that reference is made here to TPR producing covenant guidance at some point in the future. Engagement with our membership suggests this is an area causing concern, and so we would encourage the publication of further detailed guidance on how to assess covenant issues as soon as possible. Given the regulatory deadlines (with the largest schemes due to report in the coming months) many trustees are already in an advanced stage of this process, and many feel they are lacking direction in how to handle complex and sensitive covenant considerations alongside

[1] https://www.fca.org.uk/publications/consultation-papers/cp-21-17-climate-related-disclosures-asset-managers-life-insurers-regulated-pensions

investment risk. The DB Funding Code may be the most natural place to provide clarity over covenant assessment in this regard (please see the section on covenant under 'Strategy and scenario analysis').

Governance

G1. Is this section of the guidance clear when read alongside the DWP's guidance?
G2: Is the example on establishing oversight helpful?
G3: Is the example on climate competency of service providers and advisers helpful?
G4: Are there any other case studies or examples you would find helpful in this section?

We believe that this section is generally helpful, and that the examples provided fulfil their purpose.

Strategy and scenario analysis

S1: Is this section of the guidance clear when read alongside the DWP's guidance?
S2: Is the example of different time periods for schemes with different characteristics helpful?
S3: Are there any other case studies or examples you would find helpful in this section?

Overall, we believe this section is useful and that the detail on climate scenario analysis is in keeping with our expectations. However, we hope that TPR will look to strengthen it in the following areas.

***Covenant* -** For DB schemes that expect to be producing TCFD reports in the near future, there remain concerns as to what expectations there are on metrics and methods for stress testing the potential impact of climate risk on investment portfolios and employer covenant, and over what timeframes this kind of risk can occur (indeed, the DWP has recognised that the methodology for climate scenario analysis is still evolving). Though external providers can and do assist, the lack of emerging consensus on what would be considered a standard approach – and indeed what would be in keeping with the Regulator's and stakeholders' expectations – remains a concern for schemes already preparing to publish their first reports, and may risk a wider variation that would be helpful for meaningful comparison.

In addition, while we are aware that there is existing guidance on how to hand the interaction of covenant risk with investment risk, we would appreciate additional and specific further guidance on how covenant risk interacts with climate investment risk – for example, where a sponsoring employer has been identified as being exposed to significant climate risk. Feedback from some members suggests uncertainty about how this ought to be handled - for example whether the exposure to climate risk in investments should be reduced to offset this, or whether this ought to be discussed with the employer with a view to a different funding arrangement being agreed, and how often this ought to be discussed. An integrated risk management approach is of course a first port of call, but it will be important for trustees to be given as much explicit guidance in this emerging area of work as they need to make the right decisions.

We appreciate both that TPR has indicated that further guidance will be published, and that this topic strays into the DB Funding Code considerations. Nevertheless, given the timescales and the likely profile of these reports when published, as well as the clear cross over with climate governance considerations, we believe that these challenges will need attention as soon as possible, and very likely before the DB Funding Code will come into effect. Schemes need assurance that they won't be penalised for a lack of guidance.

Asset classes - This section notes that trustees will be required to assess impact on different asset classes. We would like to see more guidance given on how trustees should go about assessing different asset classes, particularly beyond listed equities. It would also be helpful to have clarity around the methodology on how asset classes could be aggregated. This is particularly relevant given the UK government's drive to encourage more pension fund investment into alternative asset classes, through the Long Term Asset Fund[2], the Productive Finance Working Group[3], and the recent joint initiative from the Prime Minister and Chancellor encouraging investment in infrastructure via an 'Investment Big Bang'.[4] Though we do not believe that such investments would automatically be considered riskier from a climate risk perspective, it is the case that they pose more of a challenge to trustees who want to have a diversified portfolio, maximise member returns, and to fully consider and publish the extent of their climate risk. We would therefore encourage TPR to consider how climate risk can be fully identified and considered in relation to alternative asset classes, some of which may be less regulated or overseas. A lack of guidance in this space could mean an absence of consistency in how figures are presented across the industry, which may create unintended inaccuracy and lack of comparability in the metrics produced.

We note a view from within our membership that some asset classes should be excluded from these requirements, where there is no obvious means of obtaining the necessary information (for example, in currencies and interest rate swaps). Again, we would appreciate further guidance on how trustees can best handle this.

Qualitative analysis – The regulations allow for either quantitative or qualitative scenario analysis. We take the view that qualitative analysis would, in many instances, be a more meaningful exercise to begin with, particularly if a full analysis of external data is not being undertaken before publication. At the moment, the guidance does not reflect this as an option, or give suggestions on

[2] https://www.fca.org.uk/publications/consultation-papers/cp21-12-new-authorised-fund-regime-investing-long-term-assets
[3] https://www.bankofengland.co.uk/financial-stability/working-group-on-productive-finance
[4] https://www.gov.uk/government/news/prime-minister-and-chancellor-challenge-uk-investors-to-create-an-investment-big-bang-in-britain

how trustees can approach their decision on this, and what factors may come into play when deciding how best to progress.

Risk management

R1: Is this section of the guidance clear when read alongside the DWP's guidance?
R2: Is the template dashboard helpful?
R3: Is the example on processes to identify and assess climate-related risks helpful?
R4: Are there any other case studies or examples you would find helpful in this section?

In general, we believe this section is useful, and that the suggestions are strong.

Feedback from our members suggests, however, that the template provided would probably not be adopted by them, for a number of reasons. Members told us, for example, that they felt that such a format was better suited to short term monitoring (whereas they would be taking a long term view of the risks), or that they felt this would effectively be repeating elements of their scenario analysis.

We note that, in addition to the suggested template, this section seeks information on how risks are identified and assessed, the tools being used, and the outcomes of those tools. We feel that, though it is right that those areas are reported on, there would be significant overlap with the requirements set out in the Metrics and Targets sections. Feedback from our members suggested that they feel there are a number of areas where the same information was required in several different places, and this should be avoided. We have expanded on this point more generally below. However, it would be useful if the guidance acknowledged the cross referencing with other sections, and gave more instruction as to whether the requested information required in relation to other 'pillars' of the report needs to be duplicated in order to demonstrate effective Governance.

Metrics

M1: Is this section of the guidance clear when read alongside the DWP's guidance?
M2: Is Example 1 on the selection of metrics helpful?
M3: Is Example 2 on the selection of metrics helpful?
M4: Is the example on using a metric in risk management helpful?
M5: Are there any other case studies or examples you would find helpful in this section?

This section is largely in keeping with our interpretation of the regulations.

Though we have the expectation that, in areas that cannot be reported on, trustees should demonstrate some progress in subsequent years (or at least demonstrate what steps have been taken to affect progress) we hope that TPR will not take enforcement action against schemes where a reduction in data availability is the result of evolving investment decisions. For example, where a change in investment manager or types of asset classes (a move away from listed equities to private markets, for example) results in a reduction on how far they are able to report on their whole portfolio in relation to some metrics relative to the previous year. Trustees should still be required to demonstrate that reasonable steps have been taken to obtain the information (and that progress can be demonstrated in subsequent years where they are not able to).

Targets

T1: Is this section of the guidance clear when read alongside the DWP's guidance?
T2: Is the example on monitoring against targets helpful?
T3: Are there any other case studies or examples you would find helpful in this section?

We believe this section is clear and largely helpful.

Publishing your report and notifying members

P1: Is this section of the guidance clear when read alongside the DWP's guidance?
P2: Are there any areas on which you would welcome further clarification?

This section is clear.

General questions

Q1: When read alongside the DWP's guidance, is our guidance clear on what you need to do and report on in order to comply with the new legislation? If not, how could we make it clearer?
Q2: Do you have any other feedback on the guidance?

In addition to the comments made above, we would flag the following points.

Smaller schemes – At the time of writing, it's not clear when smaller schemes will be required by legislation to report against TCFD, though we are expecting that it will eventually be a regulatory requirement.[5] Given this, we appreciate that it remains unclear as whether the expectations would be the same. In the meantime, we gather TPR is encouraging schemes of all sizes to make use of this guidance, which is something the PLSA would also support. However, we note the requirements are extremely detailed, and may be beyond the resources of smaller schemes at this time. We would ask that, firstly, in advance of any new mandatory requirement on smaller schemes, consideration is given to whether this guidance is suitable. In the meantime, we would

[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933783/FINAL_TCFD_ROADMAP.pdf

prefer, if TPR is seeking to encourage better disclosure across the board, that consideration is given to adjustments that can be made to accommodate the differing needs of smaller schemes.

Upskilling – We note, and welcome, TPR's recent commitment in its Climate Change Strategy to ensure staff are provided with training on these issues. We hope that TPR will ensure that this has been completed before the assessment of the content of the first reports begins from May 2022 onwards. Similarly, we note that the Trustee Toolkit needs updated with the latest climate governance advice, which we hope will be taken forward as part of that strategy.

Presentational issues – We are conscious that the purpose of these reports is to be read and to enable effective stakeholder engagement. We wondered if TPR might give some further comment on whether it is acceptable to cross reference different sections of the report in relation to specific data items, or whether enforcement action would be taken if the mandatory information is in the report, but not across all the pillars that are seeking it (we've noted an example above where similar metrics are requested in both the 'Risk Management' and 'Metrics' sections). This is likely to be particularly true if trustees are also making use of some of the other documents the guidance refers to, such as the TCFD Financial Stability Board guidance, and PCRIG guidance.

We note the preference from TPR that reports should be written in 'plain English' as far as possible, and our members similarly share a desire that these reports do not run into hundreds of pages of repetitive information. Feedback suggests that the requirements, as structured, do not make for a particularly 'readable' document, and there is a desire that these reports are not produced merely to tick a regulatory box, but to also act as a tool for engagement, an opportunity to promote positive work to savers, and to allow for genuine scrutiny of a key issue for schemes' members.

It would be helpful if TPR could give more guidance on what they would consider acceptable in terms of format, and if there is a risk that trustees might face enforcement action if the mandatory information is within the report, but is not set out explicitly in relation to every section that requires it. We do not believe that this should reduce the minimum requirements, but would appreciate a view on whether trustees have some flexibility on presentation. We note that members often feel that some documents they produce in order to meet regulatory requirements often have very low readership rates, and so may not be serving their intended purpose.

Consultation questions for: New appendix ('Breaches of the climate change governance and reporting regulations') to TPR's monetary penalties policy

1. The amount of the monetary penalty will be considered on a case by case basis. Is the outline of likely band levels clear?
2. Do you think the examples given for the different band levels are appropriate?
3. Does the calculation of the amount of the mandatory penalty beyond the minimum threshold sound reasonable?
4. Is the appendix clear on our approach to discretionary penalties for breaches of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021? If not, how could we make it clearer?
5. Do you have any other feedback on the appendix?

We welcome TPR's approach to setting out different expectations on mandatory and discretionary fines, and believe that the guidance as set out is strong.

We note that, at times, difficult experiences of some members impacted by regulatory action in relation to Chair's Statements and, though we welcome the policies being set out more specifically in this format, we hope that TPR will take a more conciliatory approach to taking action against those deemed to be not meeting minimum standards.

As set out above, this is not only a significant new requirement on schemes – and one which there remains a lack of established consensus in some areas – but most of the fund managers and businesses that schemes are dependent on for information remain some years away from being required to provide this data. We strongly agree with the DWP's approach in ensuring the regulations accommodate this (by including 'as far as able' provisions), and feel reassured that this guidance similarly reflects this ethos. We very much hope that this will also be reflected in enforcement activity, particularly in the early years.

As we contemplate the growing evidence on the scale of the climate emergency we face, we hope that TPR will be sensitive to the increased public scrutiny pension schemes are likely to face, and the clear evidence that most are seeking to 'do the right thing'. We would therefore encourage TPR to prioritise improving standards and working with trustees to set out clear expectations where it is felt they are not being met, rather than focus on fines alone.

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