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

RESPONSE FROM ICAS TO THE DEPARTMENT OF WORK AND PENSIONS

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Background

ICAS is a professional body for more than 22,000 world class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business; many leading some of the UK's and the world's great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have over 4,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

General comments

ICAS welcomes the opportunity to comment on the Department of Work and Pensions consultation 'Taking action on climate risk: improving governance and reporting by occupational pension schemes'.

ICAS supports the UK government's Green Finance Strategy and recognises that the proposals on climate governance for pensions schemes and for pension schemes to adopt Task Force on Climate-related Financial Disclosures (TCFD) are part of a wider strategy to green the economy while managing climate change risk more effectively.

In 2017, ICAS was a signatory to a Statement of Support for the TCFD recommendations, along with other leading accountancy bodies, in recognition that these provide a framework for the disclosure of climate related risks and opportunities within mainstream reporting.

Behavioural change is needed to achieve these goals so that markets behave in a different way. For pension schemes to address climate risk within their investment portfolios, it is vital that new climate governance arrangements and reporting requirements are outcome focused.

Any new governance and reporting requirements should be designed to demonstrate how they benefit key stakeholders, for example, how managing climate change risk benefits scheme members/ beneficiaries and the employers of defined benefit (DB) schemes. If DB scheme investments fall in value as a result of risks not being properly managed this has a negative impact on the employer covenant.

Trustees have a fiduciary duty to act in the best interests of scheme members and beneficiaries. They seek to achieve this through taking an integrated approach to managing risk, we recognise that the objective of these proposals is to support trustees in meeting this duty.

Our response, developed jointly by the ICAS Pensions Panel and the ICAS Sustainability Panel, is therefore aimed at ensuring that pension schemes are in a position to implement climate governance and reporting arrangements which are outcome focused and not narrowly focused on mere compliance.

We recommend that the timetable for implementing these proposals is revisited to enable pension schemes to have in place climate governance arrangements for an entire scheme year (i.e. reporting period/ financial year) prior to preparing their first TCFD report. As the proposals stand, schemes will be required to place a link within their annual report, including the financial statements, to an initial TCFD report which does not relate to the reporting period of the annual report. We believe that the period covered by the TCFD report, including reporting on any metrics and targets, would be best aligned with the scheme year.

By revisiting the timetable, the industry would be given the opportunity to further address the significant knowledge gap we believe exists in relation to climate governance and reporting and to improve the quality of the data needed to produce a quality TCFD report.

We appreciate that this is a journey and we would not expect implementation of the proposals to be delayed until all the requirements can be met in full. Therefore, we welcome the comply or explain approach to compliance mooted in the consultation paper.

As part of a post-implementation review of the proposals, we would welcome a broader review of the investment reporting requirements placed on pension schemes with a view to taking a more integrated approach to these. In addition, we recommend that in the interests of transparency that pension scheme annual reports, at least of the largest schemes, are published in future.

We are content for our response to the consultation to be made public.

Any enquiries should be addressed to Christine Scott, Head of Charities and Pensions at cscott@icas.com or Anne Adrain, Head of Sustainability and Corporate & Financial Reporting at adrain@icas.com.

Appendix

Responses to consultation questions

Questions 1 to 3 on scope and commencement of the proposals

Question 1 – schemes impacted by the proposals
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?

Response
We have the following comments on scope of the proposals:

- Regarding the size of defined benefit (DB) and defined contribution (DC) trust-based schemes, we do not consider a scheme with £1 billion of net assets to be a particularly large scheme. We acknowledge that the £1 billion net assets threshold may be designed to capture the largest DC schemes (see paragraph 9 of chapter 2 of the consultation papers) during the second phase of implementing the proposals.
- In finalising the criteria for applying the climate governance and TCFD report proposals, consideration should be given to the different circumstances of DB and DC schemes.
- While introducing a net assets threshold only for trust-based DB schemes, we believe it may be desirable to take another key feature into account, i.e. whether the scheme is open or closed. The Pension Protection Fund's (PPF's) Purple Book 2019 highlights that 44% of all private sector DB schemes are closed to future benefit accrual and this is likely to be an increasing trend. Closed schemes are on different journey plans from open schemes, with the sustainability of open schemes being a much longer-term concern than for closed ones. Therefore, we recommend, as a minimum, that consideration is given to reducing the reporting burden on closed private sector DB schemes, for example to exempt them from the scenario analysis. The overarching objective should be to apply the full proposed requirements to schemes where doing so would have the greatest impact on the policy objectives.
- Not all authorised master trusts have achieved scale therefore applying the climate governance and reporting requirements to all of them could be unreasonably burdensome. Therefore, we recommend that the size criterion applied to trust-based DB and DC schemes should also be applied to authorised master trusts.

Question 2 – detailed scope and start dates
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

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.

Response
We have the following comments on the implementation timetable and the continuing application of the requirements:

- Schemes with £5 billion or more of net assets (or the first tranche if the criteria are revised) will be impacted by the reporting requirements for periods commencing on or after 2 June 2019 and ending on or after 1 June 2020, i.e. reporting periods which have started and ended before the governance arrangements, including systems and controls around the gathering of data have been implemented. If the objective of the proposed regulations is to improve member outcomes by managing climate risk more effectively, the proposed timetable could be counter-productive by encouraging a 'tick box' approach to reporting. We are seeing a 'tick box' approach to compliance in other areas, for example, Chair's Statements, with the focus of advisers being to make sure their client is not fined.
- There is also the risk that the quality and meaningfulness of reports produced for periods where the governance arrangements which underpin them have not been in place could be negatively impacted, including the risk that the costs of producing these would outweigh the benefits. Therefore, we recommend that the reporting requirements are implemented for the first full reporting period where the governance arrangements are in place. This would mean altering the implementation timetable to enable schemes to have governance arrangements in place from day one of a reporting period.
- We believe that this approach is more likely to be effective in achieving the objectives of these proposals, which we support. We fully appreciate that the quality of data will improve over time and that the quality of scenario planning and the metrics prepared by schemes will evolve, so we are not suggesting the timetable is delayed beyond the time needed to implement the governance arrangements for a full reporting period. We would also recommend that schemes are permitted to report early if they are in a position to do so.
- We recommend that a revised timetable for schemes with net assets of £1 billion or more (or the second tranche if the criteria are revised) is adjusted to dovetail with our recommendations for the first tranche.
- We believe that the same size criterion should apply to authorised master trust schemes as is proposed for trust-based DB and DC schemes in relation to the initial implementation of the regulations.
- We believe that the same size criterion should apply to authorised master trust schemes as is proposed for trust-based DB and DC schemes in relation to the climate governance and reporting requirements ceasing to apply.

Question 3 – post implementation review with a view to extending scope to more schemes
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?

Response
We would support the conduct of a robust post-implementation review following the completion by larger schemes of three reporting cycles. We see this as good practice and it would enable improvements to be made to the regulations while still giving knowledge and experience of the requirements to be established.

We recognise that implementation will be challenging for all schemes, particularly those which do not have a professional trustee. However, with regard to extending the regulations to schemes with assets of less than £1 billion, small schemes invested in pooled funds will only be able to report on the basis of information provided, via the investment chain, by investment managers so compliance by such schemes would be reduced to a ‘box ticking’ exercise meaning that TCFD reports would not be particularly meaningful.

Questions 4 to 9 relate to Chapter 3: Climate governance and TCFD

Question 4 - governance
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 set out in the consultation paper.

Do you agree with these proposals?

Response
We support these proposals in principle.

However, we believe that the level of trustee knowledge and understanding of this important issue is not yet at a sufficient level across the board for trustees to implement the proposed governance arrangements effectively.

Trustee education, and the education of all those in the investment chain, is therefore key. A shared understanding of the requirements and sufficient underlying knowledge, in relation to each individual role in the investment chain, is needed, for example to ensure that investment managers, pension consultants and trustees can communicate effectively.

There needs to be a major investment in education through the sharing of examples of good practice in relation to climate change. The TCFD has created a Knowledge Hub therefore greater dissemination and use of the guidance and training available within this resource could be a good starting point in the education of trustees https://www.tcfdhub.org

HRH, The Prince of Wales, Accounting for Sustainability (A4S) project has also created a suite of resources and practical steps based on the experience of organisations currently implementing the TCFD recommendations. These resources may also be helpful as part of the education of pension trustees.

ICAS has signed the Green Finance Education Charter which includes a commitment to integrate climate change and green finance into its education and training programmes. Other UK accountancy bodies are also signatories to the Charter along with the Institute and Faculty of Actuaries, some banks and insurers. However, this commitment will take time to raise the level of knowledge.

The regulations, and the knowledge that these are forthcoming, should provide an impetus for narrowing the knowledge gap and together with our recommendations on the reporting timetable should place schemes in a better place for implementing the proposals more effectively.

Question 5 – impact on investment and funding strategy
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 consultation paper.

Do you agree with these proposals?

Response
We agree in principle with these proposals.

DC schemes provide savers with a default strategy so making changes to default funds to better manage climate risk could have a direct impact on member choice.

We recognise that scheme members have the choice of whether to invest in the default, in other assets or in a combination of both. It is important that any revised default strategies continue to be effective for the vast majority of scheme members who rely on these.

Communication by the trustees to scheme members will need to be considered, should the default be impacted by new climate governance arrangements.

Question 6 – scenario analysis
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 consultation paper.

Do you agree with these proposals?

Response
We believe that consideration should be given to adjusting this requirement for private sector DB schemes which are closed to future accrual. Scenario planning by open DB schemes is likely to be more meaningful given that such schemes are expected to continue for the foreseeable future.

Question 7
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 consultation paper.

Do you agree with these proposals?

Response
We support these proposals.

Question 8
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 consultation paper.

Do you agree with these proposals?

Response
Good quality data will be needed to prepare meaningful metrics so we agree that a comply or explain approach to the inclusion of metrics in the TCFD report is particularly important in this area.

Question 9
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 consultation paper.

Do you agree with these proposals?

Response
The introduction of targets may be more meaningful when prepared by open DB schemes and DC schemes than for closed DB schemes.

Question 10 relates to chapter 4: disclosing TCFD

Question 10
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?

Is there a better way to notify members of where to find this information?

For example, for DB schemes, might the summary funding statement required by regulation 15 of the Disclosure Regulations be a more appropriate way to signpost members to this information?

Response
We have the following points to raise about the publication of TCFD reports:

- The consultation paper clarifies that "Where TCFD material is linked to within the Annual Report, it would constitute Other Information and as a result, whilst it would not be audited, it would be subject to consideration by the auditor in line with the requirements of ISA (UK) 720 [The auditor's responsibilities relating to other information]." We would like to highlight that reviewing the TCFD report for consistency will likely impact on the audit fee and will therefore add to the costs of compliance with these regulations. It will take time for the auditor to review the report and to form a judgement on its consistency or otherwise with the financial statements.
- In addition, under ISA (UK) 250 (Section A - Consideration of laws and regulations) the auditor is required to consider the implications for the audit if they conclude that the TCFD report has not been prepared in accordance with legal and regulatory requirements, so additional compliance costs for the scheme, by way of additional audit fees, could arise here too.
- Over the past few years pension schemes have, to varying degrees, had to comply with ever growing demands to publish investment information from the publication of Statements of Investment Principles, Chair's Statements and, most recently, Implementation Statements. The consultation paper makes it clear that the introduction of these regulations will have no impact on these other requirements. We do not believe it is in the best interests of scheme members either in terms of the additional costs of compliance or in terms of transparency for new reporting requirements to be introduced in a piecemeal fashion. We believe there is a case to be made for the DWP to review all the investment reporting requirements placed on schemes with a view to delivering a more integrated approach to investment reporting. While sometime away, it could be helpful to do this as a part of a post-implementation review of these proposals.
- We do not understand why there are no plans to require pension scheme annual reports, including the financial statements, to be published. Requirements to make certain investment information public suggests that a broad range of stakeholders have an interest in reporting by pension schemes. We also believe that requiring publication of the annual report, including the financial statements, especially by larger schemes, will improve reporting more generally as it will better enable good practice to be shared.