ASSOCIATION OF CONSULTING ACTUARIES

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6 January 2022

Climate Change and Responsible Investment Team
DWP
Caxton House, Tothill Street, London SW1H 9NA

Email: pensions.governance@dwp.gov.uk

Dear Sir/Madam

Climate and investment reporting

I am writing on behalf of the **Association of Consulting Actuaries (ACA)** in response to the above-named DWP consultation.

The ACA is the representative body for UK consulting actuaries. Our members are all qualified actuaries – mainly Fellows of the Institute and Faculty of Actuaries. Members provide advice to thousands of employers and pension schemes with assets exceeding £1 trillion, including most of the country's largest schemes – and increasingly consulting actuaries are now involved in a wide range of additional areas.

Our submission represents the views of our Climate Risk Group, Investment Committee and Defined Contribution Committee, who represent our members in the important areas of climate change risk and investments. We feel it important to indicate our views as a collective group with significant influence in the pensions industry.

Our comments on specific questions raised in the consultation are set out below.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me on 07799 893 797 or at stewart.hastie@isio.com

Yours sincerely

Stewart Hastie
Chair, Climate Risk Group and Honorary Treasurer

Vanessa Hodge
Chair, Investment Committee

Tessa Page
Chair, Defined Contribution Committee

On behalf of the Association of Consulting Actuaries Limited

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ACA response to DWP Consultation: Climate and investment reporting

General Comments

The ACA is supportive of the Government's drive to enhance trustees' stewardship duties and to promote better alignment of investment portfolios (via investment and/or stewardship) with the goals of the Paris Agreement. We also support the intention for the Implementation Statement ("IS") to provide clearer information to members of pension schemes rather than be seen primarily as a compliance report.

We would like to emphasise the value in requiring *less* reporting detail:

- For climate reporting, we support the introduction of a new mandatory Portfolio Alignment metric as an informative tool for pension trustees in managing forward-looking climate risks but we recommend the other additional metrics fall under the 'should' criteria rather than 'must';
- We suggest the DWP considers an interim provision whereby schemes that fall under the regulations from 1 October 2022 can choose to report either a Portfolio Alignment metric *or/and* an Additional Metric in their TCFD report for the scheme year ending after 1 October 2022. The requirement to report against four metrics would come into effect for reports in respect of the scheme year ending after 1 October 2023.
- For Statements of Investment Principles ("SIPs"), we suggest the required detail on ESG and stewardship policies is contained in a supplementary statement to the SIP so the main body of the SIP focuses on investment objectives and strategy;
- For the IS, we welcome the clarification on the level of wording expected when summarising how the policies in SIPs have been carried out over the year. The explanation on significant votes is useful though we would caution around the expected level of information required under the proposed Statutory Guidance when reporting the significant votes. We would suggest the main IS includes a summary/overview of the analysis reviewed by trustees. Trustees may include the supporting qualitative analysis as an addendum to the IS.

In the draft Guidance on SIPs and IS, we suggest there are clear signposts throughout the document to indicate paragraphs, as well as sections, that cover statutory or non-statutory guidance.

Chapter 1 – Measuring and Reporting Paris Alignment

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 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.

Do you agree with this policy proposal?

Yes, we are supportive of greater focus on forward-looking climate-related metrics, which, alongside carbon emissions based metrics, will give trustees a better understanding of their investment exposure to climate-related risks and opportunities.

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:

- ***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 £500 million 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?

Yes, we agree with the proposal to incorporate the additional metric reporting requirements into the existing Climate Change Governance and Reporting regulations but not in terms of the timing.

We have heard from several large pension schemes, which fell into scope of the Regulations with effect from 1 October 2021, requesting a deferral on the reporting of a fourth metric. To ensure consistency with the reporting and interpretation of the information, schemes will need to report all metrics, including the new metric, at the same time point. This may mean these schemes may need to consider the additional metric at an effective date before 1 October 2022 (within the scheme year). Trustees will need to have sufficient training on the new metrics as well as have sufficient time to include the reporting within their governance processes.

We do, however, suggest the DWP considers an interim provision whereby schemes that fall under the regulations from 1 October 2022 can choose to report either a Portfolio Alignment metric *or/and* an Additional Metric in their TCFD report for the scheme year ending after 1 October 2022. The requirement to report against four metrics can come into effect for reports in respect of the scheme year ending after 1 October 2023.

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.

Do you agree with this policy proposal?

We agree with the proposal. Consistency with other metric requirements will avoid confusion and potential miscommunication of information.

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 a portfolio alignment metric and whether respondents think it reflects the policy intent?

We do not have any comments on the draft amendments to the Regulations as these meet the policy intent stated in the chapter.

For the statutory guidance, we make the following comments about the recommended metrics:

(a) Portfolio Alignment

- Binary target measurements – this is relatively simple in the way it is presented but harder in terms of interpretation and making informed investment decisions. For example:
    - Companies may have set net zero targets but no credible transition plan or milestones to help reach their target. Action today is more important than a target in the future.

- The targets will have different time horizons for achieving net zero. This information is important when setting portfolio decarbonisation pathways and assessing progress.
- Some companies may be reliant on offsets in order to meet their targets, rather than focussing on reducing operational and value-chain carbon emissions as far as possible.

Science-based target verification will help reduce some of the uncertainties set out above. The data set is currently limited in terms of companies who are reporting science-based targets though this data set will increase over time as more companies seek to get their targets verified. We also note that coverage is more limited in non-listed markets and for smaller companies.

- Benchmark divergence models – we suggest providing supporting guidance on how to report against this type of metric to ensure consistency across trustee boards looking to use this approach. PACTA's tool is helpful in analysing portfolio alignment against different decarbonisation pathways but will need support from subject matter experts to help trustees to interpret that output. TPI's tools are useful to understand transition progression at the company level within certain sectors but will not provide full portfolio coverage and can be time consuming to use in order to generate a single metric.

- Implied Temperature Rise models – the output from these models is intuitive and simple to understand but needs careful interpretation, particularly by members, in order to avoid making investment decisions that based on this metric alone, such as moving assets away from non-aligned asset classes or investment sectors. There are different methodologies for calculating an implied temperature rise therefore stating the name of the data provider and setting out the high-level assumptions used to calculate the metric should form part of the disclosure requirements when monitoring this metric.

(b) Additional climate change metrics

We would recommend that the additional climate change metric is listed as a 'should' provision rather than a 'must'. In our view, the proposed Portfolio Alignment metric will be more useful to trustees in their investment decision-making than the additional climate change metrics.

In terms of the recommended additional metrics, we have no comments on the existing metrics: climate value at risk and data quality.

The statutory guidance contains an additional six metrics for trustees to consider which are consistent with the updated recommendations from the TCFD. In our view, the six new metrics would be useful for *asset managers* carrying out due diligence at the individual stock/security level but generally less useful for pension schemes. For trustees (of all but the very largest schemes), who are typically considering climate-related metrics at the total fund, asset class or total portfolio level, the metrics will be hard to consolidate and to interpret.

The DWP could consider including other metrics that would be more relevant for pension schemes: for example, around climate related voting and engagement statistics or the percentage of green revenues from the underlying investments in an asset portfolio as additional forward-looking metrics.

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?

Our members are helping trustees of schemes that fell under the Climate Change Governance and Reporting regulations in 2021, and those that want to start measuring their investment portfolio climate-related metrics. Whilst there are standardised data requests available for consultants to send to asset managers on behalf of their clients (for example, the ICSWG metrics template), the responses from asset managers are varied in terms of: data coverage; data quality; methodology; units; and assumptions used in the calculation of the metrics. There is low coverage and quality in a number of markets, particularly non-listed markets. Smaller asset managers, and those based outside of Europe, have struggled to provide the relevant information.

Trustees will be reliant on their advisors to help interpret the metrics in order to help them make informed investment decisions and to set relevant climate-related targets for their particular scheme. We envisage the cost of the provision of these metrics, and the data cleansing required, to reduce over time as they become more familiar and standardised.

We see there is value in reporting the Paris Alignment of an investment portfolio, as ultimately it is in the best interests of pension scheme members, and wider society, to aim to limit global warming to 1.5^{o}C.

We would caution the interpretation and reliability of the recommended Alignment metrics (please see our response to question 4) and recommend there is guidance provided to trustees around setting a target against an Alignment metric in order to avoid driving specific investment decisions such as divestment from high emitting assets. Paragraph 38 of the consultation suggests this will not be the case though we would challenge this. As an example, looking at the Implied Temperature Rise metric alone could lead you to conclude that the best course of action to support the goals of the Paris Agreement will be to remove all exposure to emerging markets. This, however, ignores the wider strategic rationale for investing in emerging market assets and does not consider the support required for a Just Transition. A better conclusion would be to consider appointing active managers when investing in emerging markets, and appointing one with climate transition in mind, to direct investments to those regions and companies that require funding in order to help transition to a low carbon economy as well as having a focussed engagement (and voting) strategy with the same aim.

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?

We do not have any comments on this matter.

Chapter 2 – Stewardship and the Implementation Statement

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?

The PLSA's template was developed by pensions and investment professionals across the industry to be able to provide the information that pension trustees need to understand the voting activity carried out by asset managers on their behalf. This is a useful document that trustees could use and which can help with the standardisation of data requests.

In our view however, the DWP should not provide a vote reporting template but should reference example templates, like that of the PLSA, that could be used by trustees. This allows some asset owners or asset managers to be flexible in the questions they ask the underlying asset managers in order to provide specific information for a particular client.

Whilst vote reporting is an enhancement to trustee stewardship responsibilities, understanding the impact of the vote outcome will be of more interest and use to trustees in holding their asset managers to account.

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?

There is merit in keeping voting and engagement templates separate. Engagement activities are important across a range of different asset classes whereas voting only applies to a sub-set of asset classes, notably public equity.

As noted above, we believe the DWP should provide references to example templates that could be used by trustees, rather than providing an engagement template.

The ICSWG has produced a template for engagement reporting, which was launched relatively recently but has not yet been used by many trustee boards. We would suggest the ICSWG's template is referenced in the Guidance.

For both voting and engagement disclosures, trustees should be encourage to focus on how the information can/should be used, rather than a 'statement of fact' that does not drive action.

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:

(a) they are written for members?

(b) these are trustees' statements, not their consultants'?

(c) Implementation Statements should set out how the approach taken was in savers' interests?

(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?

(a) SIPs are written as governance policy documents and are owned by the trustees of the scheme however, with SIPs being more readily available to access via publicly available websites, trustees should ensure the language in the document is accessible to members and other interested parties.

The DWP designed Implementation Statements with members in mind however, these documents have now become compliance statements, in part following reviews from legal advisors and auditors. We agree that Implementation Statements should be written as a document for members. For relevant schemes requiring a Chair's Statement of DC Governance, there is potential for overlap across these documents (particularly if the current 'compliance focus' remains embedded). We would encourage guidance to be provided to trustees to reduce the risk of considerable repetition across the SIP, IS, Chair's Statement, and the investment disclosures in the Report and Accounts.

(b) SIPs and IS are trustee statements and not consultant statements though many statements will reflect the language, style and design of the consultants that are employed to help trustees prepare their statements. It is also sensible to acknowledge that many consulting firms will adopt templates in order to reduce the cost of production and therefore the format and content may be similar across schemes.

(c) Implementation Statements require trustees to explain how the policies in the SIP have been carried out over the year. The policies will reflect the overall strategic investment objectives of the trustees, which will ultimately be to ensure members' benefits are paid. Therefore, all actions taken by trustees will be in savers' (or members') best interests.

(d) There is reasonable overlap across Stewardship Code reporting and Implementation Statements. Stewardship Code reports have a broader and deeper coverage. We agree that material from other disclosures should be used in Implementation Statements, as long as they meet the requirements of the Regulations.

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?

(a) We support the DWP's intention to require trustees to own their stewardship policy and not simply delegate to an asset manager. The guidance on stewardship policies will be useful in helping trustees to shape their policy though we note that setting and monitoring a bespoke stewardship policy can require significant time and resource. As an observation, we expect many trustee boards to adopt similar stewardship priorities in terms of priority themes.

We see there is merit in trustees having a core part of the SIP, which focuses on investment strategy, and a supporting document, which sets out trustee's sustainable investment policies (including their stewardship policy) in detail. Trustees are required to consult with the sponsoring employer if there are any changes to the SIP.

(b) It is helpful to have better clarity on the definition of significant votes. We would caution around the list of required points set out under paragraph 63, which are 'a minimum' for any significant votes as these could potentially expand the size of the IS. We suggest commentary around the analysis of the significant votes is included in the main body of the IS with the detail (as set out in paragraph 63) included as a supplement.

In addition, the Guidance needs to avoid trustees reporting every vote that relates to their stewardship priorities. For example, if a priority theme is climate change, there would be little value in reporting every climate-related vote. Instead, votes where there was a resolution on a material change, or where the scheme/mandate has a large holding, should be classified as being a 'significant' vote.

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)?

The clarification in the Guidance on this point is helpful and we have no 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?

The clarification in the Guidance is helpful. We expect this will lead to commentary that is more succinct regarding 'choosing investments'.

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

The clarification in the Guidance is helpful. We expect this will lead to commentary that is more succinct regarding 'investment strategy'. We suggest re-labelling the heading of this section of the Guidance to say 'investment strategy' instead of 'investment'.

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)?

As set out in our response to question 8, all policies in a SIP reflect the overall strategic investment objectives of the trustees, which will ultimately be to ensure members' benefits are paid. Therefore, all actions taken by trustees will be in savers' (or members') best interests. We challenge the requirement under paragraph 88 to explain how the implementation of SIP policies in

relation to financially material factors (including ESG and climate change) was in

members' interests. We would expect trustees to include an explanation if the policies were NOT followed and this action was taken in the best interests of members.

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?

We have no comments on the wording in paragraphs 90 – 97.

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?

Paragraph 103 states that 'The IS should explain how mandates integrate stewardship in the investment time horizons, and what monitoring has been carried out to ensure that assets

have been managed in alignment with the time horizons of the scheme.' If this is included in the Statutory Guidance, we request that examples are provided to assist trustees in understanding the level and detail of explanation that will be required in the IS.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me on 07799 893 797 or at stewart.hastie@isio.com

Produced by the Association of Consulting Actuaries (ACA) **6 January 2022**