CLIMATE AND INVESTMENT REPORTING: DWP CONSULTATION

6th January 2022

Private and Confidential

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Dear Anna, Melanie, Emma, Tom, Mark & Vanessa,

Consultation on Climate and investment reporting: setting expectations and empowering savers – consultation on policy, regulations and guidance

Redington Ltd is delighted to respond to the above consultation. We are broadly supportive of the Chapter 1 proposal to introduce a requirement for in-scope pension schemes to report on a portfolio alignment metric. While we think the use of these metrics needs to be carefully caveated we view a forward-looking indicator as assisting Trustees in better understanding the impact of their investment decisions, and in better communicating with members.

We also welcome the refocus of attention on implementation statements outlined in Chapter 2; we think that in their current incarnation they are not sufficiently focused on the main issues that matter to individual schemes. In our opinion, the primary constraint on improving implementation statements is the quality of reporting on stewardship matters by fund managers.

Redington is an independent investment consultancy based in London. We advise a range of long-term investors, including DB, DC, private wealth and insurance clients. Our mission is to help make 100 million people financially secure – for the benefit of people and planet.

Yours sincerely,

Paul Lee

Chair of the Sustainable Investment Committee

REDINGTON

Chapter 1 – Measuring and Reporting Paris Alignment

A fourth climate metric: portfolio alignment

At Redington we have made a public commitment to supporting each of our clients in setting an appropriate Paris-aligned emissions reduction pathway – one that fits with their investment objectives. This will enable our clients to achieve better outcomes for their end beneficiaries, while also contributing to the real-world transition towards a net-zero economy.

We see portfolio alignment metrics as a vital tool in allowing us to be able to determine the forward-looking trajectory of our client's investments. This will aid us in gauging whether they are on target to meet their climate objectives. The use of a forward-looking metric, rather than simply backward-looking emissions metrics, can help mitigate the otherwise strong incentive to divest from companies that need capital investment to further the transition to net zero. As such, we are supportive of the extension of the policy proposals made under the Occupational Pension Schemes (Climate Change and Reporting) Regulations 2021 to encompass a mandatory portfolio alignment metric.

We recognise the strongly intuitive nature of portfolio alignment metrics, and so their value in enabling member engagement with climate issues at their pension schemes. However, the current suite of portfolio alignment metrics is heavily reliant on a series of assumptions and simplifications which mean that there is a danger that the simple metrics may be misleading. In essence, the intuitive nature of the metrics is the flip-side of the way that they simplify a complex set of issues - the complexity being particularly great, and so the simplification particularly significant, once data is aggregated at the pension scheme level.

We think that any introduction of these metrics should be accompanied by education surrounding the inherent risks associated with using them to guide decisions surrounding the allocation of capital. We also hope that the greater focus on portfolio alignment metrics as this adoption moves forward will ensure that the methodologies for their calculation will be enhanced.

Fundamentally, as measures of the future, portfolio alignment metrics purport to represent what is in practice unknowable. This does not mean these metrics are without value, but it does mean that their use should be carefully caveated. It must be made clear that the inherent assumptions mean that they cannot be depended on as anything other than the broadest brush indicator.

We also note that the definition of "portfolio alignment metric" in the Regulations makes explicit reference to "limiting the increase in the global average temperature to 1.5 degrees Celsius above pre-industrial levels". Whilst we agree that this is in keeping with the industry focus on net zero, we note that this is more stringent than the actual temperature goals of the Paris Agreement, let alone what seems likely following COP26 in Glasgow. This may make it hard to report on the binary target measurement option given that most fund managers will report on Paris-alignment as opposed to 1.5 degree alignment. It may also require pension schemes to seek aims that are detached from the likely trajectory of the real economy – something which may need careful consideration from a fiduciary duty perspective.

Scope and timing

We agree with the proposed terms for introducing the amendments and the DWP's reasons for introducing the amendments for all in-scope schemes at the same time. We are also supportive of the

proposal to have all the most up-to-date requirements in one policy document as this will make the regulations easier for trustees to reference.

Extending the range of additional metrics:

Whilst we agree with the expansion of the list of recommended additional climate change metrics in light of the new proposals around the portfolio alignment metrics, we do not fully agree with the choice of metrics included in the expanded list.

Specifically, we recommend the DWP removes the carbon price and remuneration metrics, which are more suited to individual portfolio companies than pension scheme trustees. We think that including these two metrics in the list of additional metrics could distract trustees' attention from metrics that are likely to be more useful in their decision-making. We would encourage the DWP to recommend metrics that are actionable and most useful from an asset owners' perspective, rather than simply a list that aligns with the updated cross-industry TCFD recommendations.

We would also like to see more detail on some of the other metrics, particularly exposure to physical risks, transition risks and climate opportunities, to make it clear what these metrics are intended to achieve and to provide examples of specific metrics trustees could use for these categories.

We also hope that the DWP continues to monitor developments in this space and keeps its approach and proposals under review.

Chapter 2 – Stewardship and the Implementation Statement

We are supportive of the refocusing of attention on the Implementation Statement as a tool by which the quality of stewardship practices in the investment value chain can be improved. We do not think that in their current form Implementation Statements are meeting their intended purpose of being annual statements about the implementation of each Scheme's Statement of Investment Principles.

We believe that the proposals for the draft Guidance are sensible and develop an appropriate approach to encouraging improved Implementation Statements. We view the main constraint on improving Implementation Statements as being the quality of reporting on stewardship matters by fund managers. The negative reaction from the fund management industry to the PLSA voting template, which was simply an attempt to reflect the requirements placed on pension schemes under the Implementation Statement rules, was strong evidence of how far these service providers are from delivering what their clients need in this respect. This places a limit on the quality of Implementation Statement reporting that is possible by pension schemes.

Fund manager reporting needs to develop so that it can allow for the development of Implementation Statements that are genuinely tailored to the issues that matter to a scheme and its main investment exposures. We are keen to work with our clients to help them turn the reporting that they receive from managers on its head so that it is much more client-specific and client-focused, and we are developing models to deliver this – we believe this approach will deliver the original intent of Implementation Statements.

We strongly welcome the alignment of the proposals with the principles of the Stewardship Code. It is positive if signatories can streamline their overall reporting burden by aligning their Implementation Statements with their Stewardship Code reports.

We also welcome the clarification to the Statutory Guidance that makes clear that schemes do not need to disclose further detailed information with regard to the requirements under the Disclosure Regulations Schedule 3 paragraph 30(f)(i)-(iv). This reduces the likelihood of trustees falling back on the use of boilerplate wording.