PENSIONS AND LIFETIME SAVINGS ASSOCIATION

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Dear David,

RE: TACKLING ACTION ON CLIMATE RISK CONSULTATION

The PLSA supports the government's intention to deliver this framework through the wide-scale adoption of TCFD. We believe this will provide a valuable framework that can be embedded across the financial services industry.

There is universal appetite among pension schemes and their service providers to take climate change seriously. As the government's consultation makes clear there is strong evidence to demonstrate that factors relating to climate change and climate policy will have – and are already having – financial consequences for nearly every business in every sector.

Certainly, the way that long-term investment is thought about will need to recognise the impending realities of climate change and the investment risks and opportunities that it creates. Pension schemes should and have been at the vanguard of that thought, but they will need the right regulatory framework and the support of their service providers to be able to use their influence and scale to bring about change.

The consultation proposes that for the pensions sector the regulatory regime is first applied to the largest trust-based schemes, and authorised master-trusts. We believe this is an appropriate approach given the concentration of members and assets under management in this cohort. Discussions with members, and member surveys during the consultation period, indicate that amongst this part of the market around 40% of schemes will already be reporting against the TCFD recommendations – though a sizeable minority are using approaches that differ to those in the government proposals.

Even for such large schemes there will however be challenges. The most common being accessing accurate data across a heavily intermediated investment chain, the timeline for implementation given other regulatory requirements and broader challenges facing scheme and their employers', and the costs and resource implications. For these, and other reasons, a significant minority of members consider the timetable for implementation is too ambitious.

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In order to meet the new regulatory requirements, and also mitigate the risk of regulatory sanction pension schemes will need high-quality disclosures on climate from their asset managers. Whilst, we would expect a positive response from managers to client requests, especially in light of recent announcements by the FCA, we would note that they are not presently (unless contractually) obliged to provide mandatory TCFD reports – unless they happen to be a premium listed issuer.

In practice, this is likely to lead to schemes having some difficulty receiving complete information across their investment portfolio, or potentially facing increased costs to access relevant data in a manner that will allow them to meet in full or on a 'best endeavours' basis their new duties. The information that managers themselves receive or provide have further flaws.

These concerns our reflected in our members' feedback on the proposals on governance, risk, scenario analysis, risk management, metrics and targets, with the detail in relation to risk management being considered most appropriate management (67%) and those on metrics and targets seen as being the least acceptable (33%) with a significant majority expressing doubts about their ability to meet them within the timeframe.

We believe that greater transparency can be a positive driver for change, to establish and share best practice and to enhance member engagement with their scheme(s) and their pension. However, with a number of regulatory disclosures in relation to schemes' actions in relation to responsible investment due to come into force next year it is sensible to consider whether this will result in an information or disclosure overload, and to whom information is most useful, in what format– whether that is regulators or members. Avoiding duplication and overlapping regulatory obligations or codes in highly desirable. Keeping reporting simple is also key. The industry and government have made significant strides with the simpler annual statement with the express purpose of making information relatable to be savers. Many of the new Stewardship, and Climate Investing initiatives and regulatory requirements will by contrast be highly complex.

As noted above the largest pensions schemes will typically have the greatest resource, including some with dedicated in-house investment resource. Their ability to react to new activities does however remain finite. The cost of implementation also seems to be greatly understated in the consultation. In response to our survey three in five members estimated the costs to their scheme to report TCFD in line with the proposal will be in excess of £50k, with one in five saying it will cost more than £150k.

The consultation notes that The Pensions Regulator is considering its approach to guidance, supervision and enforcement of the proposed regulatory requirements. This is welcome and we look forward to engaging with the regulator on the detail of its proposals. At this early stage we think it is important that any new requirements learn the lessons from the introduction of similar obligations – in particular both the framing and application of the DC Chair's Statement, which resulted has resulted in confusion, and disquiet amongst schemes, and a lack of discretionary flexibility for the regulator when exercising its functions. Timely guidance from the Regulator setting out its expectations about 'what good looks like' will also be essential.

Given, as the consultation document acknowledges, the intention is for the proposals to nudge change in the investment chain, and the fact that regulatory obligations within it, are not yet aligned or mature, and that trustees could face significant financial penalties, this flexibility will be essential.

We agree with the requirement to publicly disclose the TCFD report, including providing a web link through the Scheme Return.

We believe that scenario analysis will be a useful element of assessing climate aware investment. Its sophistication will undoubtedly grow over time, and may have a positive impact in driving market behaviour – for example for investment products that reduce their carbon footprint over time and match scheme needs. As with metrics and standards this is a developing area, and therefore a flexible approach to how scheme's approach their analysis will be necessary. Not least, because schemes will have varying data inputs and receive data of varying quality until some of the wider issues with climate reporting are addressed. Scenario analysis, or models will also always be subject to limitations and should not be viewed as a panacea.

At this stage we believe it would not be appropriate to require schemes to carry out scenario analysis on an annual basis, unless there is a significant change in their investment portfolio – and in such cases it is likely to be more efficient and effective use of scheme, employer and member resources, to provide additional information rather than repeat an expensive analysis.

For the majority of schemes carrying out an analysis at the point of their tri-ennial valuation, a review/change of their default offering or when significantly changing their investment strategy is more appropriate and would ensure they can align the exercise with various other regulatory requirements e.g. their funding plan.

We expect this would also reduce the operational costs, to the Regulator, and allow a process that was based on reviewing tranches. This will be even more beneficial as additional cohorts of schemes are required to report against the TCFD recommendations.

For similar reasons, we think it would not be appropriate for schemes to be required to obtain emissions based data on a quarterly basis. These metrics are not readily available on this basis and it is unclear from the consultation what benefit requiring such regular capture of this information would be for schemes and savers. Instead we suggest that this information, where it is available, is sought on an annualised basis. We support the decision not to mandate a specific Green House Gas measure across the portfolio.

We would also highlight that further consideration of the proposals is required to mitigate the impact on multi-employer schemes – some of whom will have dozens of employers or sections, and where the impact could be enormous (in cost and time). Very many of the largest DB schemes by volume of members and assets under management will fall into this category, and a large proportion will be heavily de-risked.

We hope that this information has been of use, and we would welcome the opportunity to discuss further, in particular to share the findings our soon to be published report on climate aware investing.

Yours sincerely

Joe Dabrowski
Head of DB, LGPS & Standards

Encl.

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