CFA Society United Kingdom

10th March, 2021

Climate Governance & ESG Team
Department for Work & Pensions
Caxton House
Tothill Street
London
SW1H 9NA

Submitted by Email to: pensions.governance@dwp.gov.uk

Dear Ms. Walmsley, Mr. Rhodes and Mr Farrar,

CFA UK Response to DWP's Consultation Response & Consultation on regulations ("the consultation")

CFA UK broadly welcomes the decisions the DWP has made within the above publication and are heartened to see that so many of the opinions expressed in our formal response letter to your initial consultation in October have been shared by many other respondents and endorsed by you.

Climate change is a matter of great and growing importance to our members and the wider investment profession. Further to our letter of 7th October in response to the initial consultation we are pleased to confirm that CFA UK will be proceeding with the launch this year of a new certificate qualification on the specific subject of climate change in investing. We hope that this new qualification will prove to be a practical and helpful resource to assist pension professionals and trustees at a personal level with the implementation many aspects of the reforms envisaged in the Consultation.

We thought it worthwhile to clarify our thoughts in the three following areas:

***SCOPE & TIMING*:** (Question 1)

We are supportive of the revisions with respect to the "reference date" being changed from 1 June 2020 to 1 March 2020 for the first wave of schemes in scope, and from 1 June 2021 to 1 March 2021 for the second wave.

With respect to reviewing the scope for disclosures based on asset-based thresholds and in light of anticipated cost reductions involved with climate change assessments, we would suggest to make the review date earlier rather than the proposed date in the second half of 2023 which may lead to further proposals only in 2024 and potential implementation only in 2025.

We make reference to the HM Treasury's Interim Report of the UK's Joint Government-Regulator TCFD Taskforce (November 2020), pages 14-16. Whilst we note the caveats & footnotes detailed in the interpretation of the Roadmap towards mandatory TCFD-aligned disclosures, we highlight that: (i) Listed commercial companies may have achieved 100% coverage by 2023, (ii) Banks & Building societies may have achieved 94% coverage by 2023, (iii) Insurance companies may

have achieved 89% coverage by 2023, (iv) Asset Managers may have achieved 96% coverage by 2023, (v) Life Insurers & FCA-regulated pension schemes may have achieved 98% coverage by 2023, and (vi) Occupational Pension Schemes may have achieved 72% coverage by 2023, remaining at 72% in 2024 and possibly increasing to 85% coverage by 2025. We note that the timescale for Occupational Pension Schemes is related to the asset-based thresholds and the proposed review date, however we believe that given rapidly evolving methodologies, toolkits and services all geared to tackle the climate crisis, widely available cost-effective solutions will be available well ahead of this date. These could be implemented sooner if schemes out of the current scope thresholds were required to do so. We also recognise that obtaining climate data is easier for certain asset classes e.g. listed equities, as compared with others e.g. private markets assets. With this in mind, we would encourage the reporting of portfolio climate metrics where possible on a "best efforts" basis taking account of each scheme's available resources and with reference to the guidance you provide in paragraphs 5&6 of chapter 2 of the consultation and accompanying footnote 18[1]. We believe such an approach will ultimately drive faster adoption of scheme-wide climate reporting.

In our original response in October 2020, we, alongside others, were supportive of lowering the threshold for schemes. We believe that pension schemes with assets lower than the suggested threshold may still be in a position to provide TCFD reporting especially if they have outsourced their investment decision to a Fiduciary Service provider, who may in aggregate have assets under management which would be above the suggested minimum thresholds. TCFD reporting would then be possible as this exercise would be carried out by the Fiduciary Service provider and shared with the pension scheme, allowing for a greater coverage of scheme assets without placing an additional administrative burden on schemes with lower asset sizes. This would provide the means by which smaller schemes would be able to report climate disclosures given they were benefitting from the resources of the fiduciary service provider.

While we do recognise some of the challenges with respect to the scope and timing of implementation as shared in the Consultation, we would recommend to move-up the suggested date for review. Referencing the Government Response as shared in the document point 135, we believe that not changing the time-frame within which smaller schemes may be brought in scope, for reasons of proportionality may not be in the best interests of scheme participants as we transition to a low carbon economy. With respect to the Government's response on encouraging TCFD reporting on a voluntary basis on the part of smaller schemes in the interim period, we believe this may not be taken-up by the majority of schemes. We are of the opinion that the fastest adoption of TCFD disclosures would be achieved if smaller schemes were also obligated to disclose. We would also advocate to best align the roadmap for Occupational Pension Schemes with other industry groups so as to meet the UK's ambition to implement TCFD with the broadest scope and in the shortest time.

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[1] *Footnote 18, p25 reads: "In the accompanying impact assessment, we estimate the ongoing burdens to business of complying with the requirements (those which are not already part of trustees' fiduciary duty of £19k for the most common type of scheme [first year burden on business is estimated at £26k for most type of scheme.]…The proportion of governance spend would therefore be £19k as a proportion of £0.5m-£1.0m, or approximately 2-4%.*

A final suggestion for smaller schemes would be to consider (i) separating specific reporting duties within the disclosures and (ii) using a multi-step process across pre-defined time periods to comply with specific disclosures. The rationale for this would be that each specific disclosure has an associated cost with some disclosures requiring lessor resources. As shared in point 33. of the Consultation, this is commented on in the report "Measuring Portfolio Alignment" authored by the Portfolio Alignment Team. The report discusses a range of approaches to measuring portfolio alignment on a spectrum of sophistication as follows: (i) the percentage of assets with net zero targets, (ii) the deviation from benchmarks and (iii) degree warming metrics / ITR. To illustrate an example, from a resource perspective, smaller schemes may be in a position to implement (i) and (ii) ahead of (iii). As such, a two-staged implementation process, for example (i & ii) by an earlier date, followed by (iii) at a later date would be a possible approach.

GOVERNANCE: (Question 3)

While we agree with the proposals, we would ask for clarification on the following as shared within the DWP's paper, *"Governance and reporting of climate change risk: guidance for trustees of occupational schemes (Consultation version January 2021)"*. In Part 3: Climate change governance and production of a TCFD report, in the section '*Oversight of climate-related risk by those who undertake governance activities and advise or assist with those activities (page 17)*', we believe the current definition (point 18) inadvertently includes a larger group of individuals than may be warranted. Currently point 18 details individuals advising or assisting the trustee with scheme-wide decisions and includes those undertaking governance activities or advising or assisting with respect to (i) employees of the scheme, (ii) employees of the principal or controlling employer, (iii) employees of the scheme funder or strategist, and (iv) external advisers who provide services to the trustee. We would highlight the breadth of this definition and make the distinction between those individuals who are directly involved in supporting governance decisions as opposed to other individuals who are only indirectly involved. An example of an individual who may be indirectly involved could be someone who provides data inputs, which are then used in the decision-making process. We would suggest that the current language be reviewed so as to provide more precise direction and an ultimately simpler route for implementation.

TARGETS: (Question 8)

While we agree with the proposals on metrics in the draft regulations, we continue to see a potential dichotomy of a trustees' legal obligation in maximising long-term risk-adjusted investment returns for plan beneficiaries versus an investment strategy driven to targeting portfolio climate metrics in isolation.

We appreciate that it is a statutory duty of trustees to consider financially material factors when making investment decisions, and that this should be interpreted to include ESG factors. However, we recommend that the regulation be made more explicit than is currently the case with respect to how the climate target interacts with the trustees' fiduciary duties when acting in the best interests of plan participants.

We note the following comments from page 10 when referring to the Pension Schemes Bill:

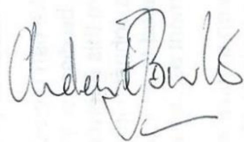
> *"Ultimately, trustees have primacy in investment decisions; it is not for the government to direct trustees to sell or buy certain assets and these proposals do not create any expectation that schemes must divest or invest in a given way. The climate change risk powers in the Pension Schemes Bill can only be used to secure that there is effective governance of occupational pension schemes with respect to the effects of climate change and to require associated disclosures."*

We also acknowledge points 9-11 on pages 100-101 of the Consultation detailing that trustee-targets would not carry a legal requirement to meet or exceed previously set targets, but rather support a direction of travel encouraging positive behaviours in tackling the climate crisis. However, again we would actively encourage further statutory guidance which explains how the current fiduciary duty, as understood and clarified by the Law Commission in their 2014 review of fiduciary duties of investment intermediaries[2], interacts with the trustee's climate targets, when the two objectives conflict.

We hope very much that these points of clarification are helpful. Should you wish to discuss any of this further, we and the members of our working group would be happy to meet.

Yours sincerely,

Will Goodhart,
Chief Executive
CFA Society of the UK



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With thanks to contributions from the CFA UK Pensions Expert Panel (PEP)

and the oversight of the Professionalism Steering Committee.

[2] https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/