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Pensions Committee

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Climate Governance and Environmental Social
Governance (ESG) team
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7 October 2020

Dear Ms Livesey and colleagues

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

I am writing on behalf of the Pensions Committee of the 100 Group of Finance Directors with regard to the above-named consultation.

About the 100 Group

The 100 Group represents the finance directors of the FTSE 100, several large UK private companies and some UK operations of multinational groups. Our member companies represent the vast majority of the market capitalisation of the FTSE 100, collectively employing 6% of the UK workforce, and in 2019 paid, or generated, taxes equivalent to 12% of total UK government receipts. Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

The 100 Group represents companies sponsoring defined benefit (DB) pension schemes with assets of approximately £590bn and membership of 3.5m (around a third of the overall DB universe).

Whilst this letter expresses the views of the 100 Group of Finance Directors as a whole, these views are not necessarily those of our individual members or their respective employers.

We are happy for the 100 Group to be included on the list of respondents.

In our response, we have chosen to focus on a few general points. We have left it to those who are better placed to respond to the more detailed, technical points raised in the consultation questions.

General Comments

We are very supportive of the Government's drive to encourage pension schemes to engage with environmental, social and governance (ESG) concerns as asset owners and to provide greater transparency in this area. Many of the companies whom we represent are already addressing these issues from a corporate perspective, and the trustees of our pension schemes are also focused on incorporating ESG into their governance and reporting structures. We therefore welcome this consultation.

Unintended Consequences

We do however have some concerns around potential unintended consequences of the way in which it appears that these measures may be implemented and their impact on the wider decisions taken by trustees. It will be worth the Government spending time considering the consequences of its proposals to ensure that they are implemented successfully, in a way that is proportionate to other risks and opportunities facing pension schemes, and that achieves what the Government hopes. In particular, our concerns revolve around:

1. **The timing of the introduction of the new requirements**

   The latest proposed introduction date for defined benefit schemes in excess of £5bn is 31 December 2022; for some schemes the requirement to comply will fall sooner because of when their scheme year ends.

   For some schemes, this timeline may be achievable because processes are already in place or work is underway to comply with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations either at the pension scheme or the company (or both); for others this timescale is likely to mean that the trustees may be forced to focus on meeting the requirements on a minimum compliance basis rather than taking the time to engage fully in understanding the requirements, establishing appropriate governance controls, drawing up an appropriate climate strategy, creating a framework to monitor the controls that have been put in place and disclosing the results of that monitoring.

   In particular, we recommend that trustees be allowed sufficient time to conduct appropriate scenario analysis, collect and assess high-quality data and calculate metrics and performance against targets in a manner that is rigorous and tailored to the wider needs of their scheme. We agree with the observation made in your consultation that "[e]arlier disclosures – whilst achievable – might well be weaker or more limited" [para 46].

   In addition, it is likely that asset managers may well not have standardised disclosures in place by the end of 2022 and that climate risk modelling capabilities may not yet be widely available by this date,

   There is also a risk that trustees' and sponsors' time will be diverted from other important issues, for instance implementation of the proposals may coincide with a triennial valuation exercise, particularly where we are expecting the new DB funding code to come into force in 2021/2 increasing the amount of time that trustees and sponsors ae likely to need to dedicate to their first valuation under the new regime. In 2022, trustees may still also be focused on shorter-term risks such as COVID-19 and Brexit. Having a longer lead-in period will allow trustees and the sponsoring company to schedule the significant work required, taking account of the scheme's other priorities.

We would therefore encourage the Government to reconsider its proposed implementation date. At the very least, we would advocate introducing a single implementation date of 31 December 2022 so that no schemes would be compelled to comply before that date, although they would obviously be able to do so earlier on a voluntary basis.

2. **<u>The proposed structure of penalties</u>**

We agree that it is appropriate to impose a financial sanction where there has been a significant failure to comply with this legislation.

Whilst the scale of the proposed penalties is such that a fine is unlikely to be a financial deterrent to a scheme of the size under consideration in these proposals, clearly there are significant reputational risks for both the trustees of a pension scheme, and the company that sponsors that scheme if a penalty is imposed.

We would therefore be opposed to any mandatory fee regime. We have seen in the context of DC Chairs' Statements that the imposition of mandatory fines has led to the 'naming and shaming' of trustee boards who arguably have not deserved it. We would therefore encourage the DWP to rethink its approach and leave all fines at the Pensions Regulator's (TPR's) discretion.

We also recommend that TPR should be required to produce clear, consistent and proportionate guidance on how it will exercise such discretion well in advance of the deadline for schemes to produce their first report.

We believe that TPR's focus should be on penalising only those schemes which have not made a serious effort to comply with the new requirements, rather than on fining schemes who may have made a genuine attempt to comply, but may not have been able to meet every single requirement, for example they may not have been able to identify metrics and assess performance against targets in a way that is meaningful to their scheme and balanced appropriately with the trustees' wider fiduciary duties.

We would also expect TPR to engage with trustees to understand why they have implemented the regime in the way they have, rather than measuring them against a 'one-size-fits-all' approach when deciding whether they have met the requirements and therefore whether or not to impose a penalty. In certain circumstances schemes may achieve better outcomes by adopting a different approach to engaging with TCFD recommendations – for example, the benefits of conducting detailed scenario analysis may be disproportionate to the costs for defined benefit schemes targeting buy-out, given that the most significant climate-related risks will only materialise beyond the scheme's time horizon. Similarly, trustees might question whether a particular metric makes sense in the context of their pension scheme, and might prefer to explain why they have chosen not to disclose such information.

3. <u>Costs</u>

We believe that the estimated costs of putting in place additional governance and disclosure arrangements in the impact assessment (at around £15,000 per year) are understated, particularly in the first year that schemes need to comply with the new requirements. We anticipate that the costs of putting in place additional arrangements for governance and disclosure will be higher in the case of larger pension schemes, which hold complex and diversified portfolios (e.g. containing private market assets and direct property).

A significant amount of time is likely to be needed at a management level both in the scheme and, for defined benefit schemes, in the associated sponsoring company, in understanding what is required and in ensuring that the implications of climate-related risks for the investment strategy and employer covenant are fully considered. If TCFD is to be applied as intended, it will require pension schemes to undertake a fundamental review of their strategy and source substantial amounts of data from third parties before they can start to produce their TCFD disclosures, and that analysis will come with significant costs.

We would welcome further steps being taken by Government and TPR to recognise and alleviate those costs on schemes – for instance, extending the deadlines for schemes to comply or producing clear, consistent and proportionate guidance on how TPR will assess compliance with the new regime.

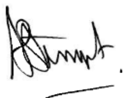
4. **<u>The disclosure of sponsor covenant risks</u>**

We think that there will be particular challenges in the context of defined benefit schemes, where one of the most significant climate-related risks may relate to the covenant of the sponsor.

Trustees should be engaging actively with the sponsor to understand how climate-related risks will affect the sponsor and therefore its covenant to the scheme. However, there could be concerns when it comes to disclosing the results of that analysis, as some matters could be commercially sensitive or contain confidential information supplied by the sponsor. Given how high profile a topic climate change is, there may also be a concern about the potential for misunderstanding and misuse of this information by third parties. It would be particularly unfortunate if trustees were to find themselves forced to choose between damaging their relationship with the employer and facing a mandatory fine, in deciding how much to disclose publicly.

We hope that you find these comments useful. Please do not hesitate to contact me if you would like to discuss any of the points raised.

Yours sincerely,



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