

DWP consultation – Taking action on climate risk: improving governance and reporting by occupational pension schemes

Response from the Investment Association – 12th March 2021

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. That is 13% of the £67 trillion global assets under management. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

We welcome the opportunity to respond to DWP’s second consultation on TCFD reporting by occupational pension schemes. Greater integration of the climate change risks and opportunities in pension schemes’ investment will lead to better-adjustment outcomes for the investments made on behalf of pension beneficiaries.

The investment management industry welcomes the government’s published roadmap on making TCFD reporting mandatory across the economy by 2025, of which DWP’s proposals are a key part. We set out in our recent position paper on climate change¹ that we are committed as an industry to working with pension fund clients to help them meet their climate-related disclosure requirements. This includes helping them find solutions to issues on data quality and consistency, including in relation to standardisation efforts and accessibility of data and information.

In that spirit, we recognise that TCFD reporting by pension schemes will be a new and challenging process, with which they will require significant support from their investment managers and other service providers. We urge DWP and TPR to take a pragmatic and proportionate approach to assessing pension schemes’ compliance with their TCFD reporting obligations, focusing initially mainly on how schemes embed climate risk into their investment governance and decision-making structures. The quantitative elements of TCFD reporting are essential to informing better investment decisions, but it should be recognised that these elements of the framework will require more time to reach the requisite quality and will in any case only be helpful where they are decision-useful for

¹ [Investment Association Position on Climate Change](#), 2020.



schemes' investment processes and support trustees to develop effective governance of climate-related risks.

This approach reflects four key points that we make on the DWP's proposals, which we discuss in more detail below:

1. There is a need for **greater coherence of approaches to TCFD reporting through the global investment chain**. Pension funds need high quality, meaningful and comparable disclosures from their investment managers, who in turn need quality disclosures from investee companies, the ultimate source of the data and information needed by pension schemes for their TCFD reporting. We remain of the view that there is a mismatch between the DWP's mandatory proposals for pension funds and the FCA's current 'comply or explain' approach for premium listed companies. While we welcome the FCA's and BEIS's commitments to address coverage gaps, further work is needed across the government and regulatory community to address this in a timely manner. This should also include work with securities regulators in other jurisdictions, to increase the coverage of TCFD reporting by companies at a global level.
2. As a related point, we note that the **quality of data** (even where it is available) is a work in progress and welcome the DWP's inclusion of a provision that requires trustees to produce scenario analyses, obtain data, calculate metrics, and set targets on an "**as far as they are able**" basis. In the short-to-medium-term this provision will provide reassurance to trustees and investment managers that there is a recognition that time is needed for data quality to improve.
3. There have been some positive changes to the scenario analysis, metrics, and targets requirements since the previous consultation, and we now believe that **the level of optionality for trustees in selecting scenarios, metrics, and targets is appropriate**. The guidance now allows for a narrower set of 'core' requirements, with trustees free to use their discretion beyond these. The IA and its' members would be happy to work with the DWP and the pensions industry to develop mechanisms for standardising client information requests and supporting the development of meaningful scheme level data across a variety of asset classes.
4. As DWP finalises its' proposals, it should be mindful of **the necessary consistency between the TCFD reporting for pension schemes and the FCA's future requirements for investment managers' client facing TCFD disclosures**. Were the FCA's forthcoming proposals for product/portfolio level disclosures from investment managers to their clients to diverge from the DWP's proposals, it would result in disclosures that investment managers would be obliged to produce, but which would be insufficient to deliver pension funds' own obligations under the DWP regulations. We recommend that the DWP and FCA collaborate to ensure consistency between pension schemes' and asset managers' requirements, such that the requirements in relation to scenario analysis, metrics and targets for pension schemes match the core requirements in these areas for asset managers' client facing disclosures. We are also aware of the likely timing mismatch as the first set of requirements on the largest occupational pension schemes and authorised master trusts will come into effect in October 2021 while we have yet to see the FCA's consultation on TCFD reporting by asset managers and FCA-regulated pension providers.



1. Coherence of approach towards TCFD reporting through the global investment chain

For climate-related disclosures to be meaningful, they must be disseminated coherently along the full length of the investment chain. Pension funds need high-quality, meaningful, and comparable disclosures from their investment managers, who in turn need quality disclosures from investee companies, the ultimate source of the data and information needed by their investors, including pension schemes.

The DWP's proposals for TCFD reporting by pension schemes are ambitious in scope. The IA continues to support our members in their capacity as stewards, to improve the quality and comprehensiveness of companies' climate disclosures – setting a clear expectation in our [2021 Shareholder Priorities](#), that UK listed companies should report in line with all four pillars of TCFD. While engagement and demand from pension schemes and their investment managers will help investee companies see the benefits of TCFD reporting, we remain concerned that the FCA's own approach to TCFD reporting requirements on premium listed companies – a 'comply or explain' requirement – does not match the mandatory nature of the DWP's proposals.

Moreover, UK pension schemes hold highly diversified and globalised portfolios. Across both DB and DC schemes in the UK, domestic equity exposure has fallen from around 75% of pension schemes' total equity holdings in the late 1990s to around a third of their total equity holdings today.² At asset class level there has also been a move to greater diversification by UK pension schemes, particularly DB schemes, which now hold around 18% of their equity holdings in unquoted/private equity.³ DC schemes are also increasingly exploring making allocations to private markets.⁴ Finally, DB schemes, driven by regulation and innovations in liability driven investment strategies, have moved heavily to increase their fixed income allocations over the last 15 years, with bond holdings increasing from 28% of DB assets in 2006 to 69% of total DB assets in 2020.⁵

With such a diversified asset allocation across both geography and asset class, gaps in the existing coverage of TCFD reporting both in the UK and overseas mean data will be incomplete:

- Premium listed UK companies may choose to explain why they are not disclosing a TCFD report, although the FCA's clarification over the limited range of circumstances where an 'explain' approach is appropriate should partially mitigate this risk.
- Both standard listed and unlisted UK companies are not covered by the FCA's rules on corporate TCFD reporting, although we note that forthcoming consultations from the FCA and BEIS will consider extending the requirements to a wider scope of listed issuers and large private companies, respectively. However, small companies remain out of scope.

² Global Pension Assets Study 2021, Thinking Ahead Institute, Willis Towers Watson.

³ The Purple Book 2020, Pension Protection Fund.

⁴ Growing Pains: Master trusts beyond auto enrolment, Richard Parkin Consulting, 2020.

⁵ The Purple Book 2020, Pension Protection Fund.



- As highlighted above, UK pension schemes have significant allocations to overseas investments that are not subject to any TCFD reporting.
- Given the significant allocation by pension schemes to bonds, more effort is needed to improve climate disclosures from bond issuers, both sovereign and corporate.

While forthcoming FCA rules for investment managers to facilitate client reporting under TCFD will provide helpful clarification to investment management firms and their clients, these rules will not change the fact that investors, including investment managers and pension schemes, remain reliant on the access and quality of the underlying investee companies.

These data issues are not a small or localised problem and co-ordinated global action is needed to address them. We recommend that government and regulators around the world continue to work in partnership with the investment industry on an on-going basis to ensure the coherence of the information flows between investee companies, investment managers and asset owners.

The FCA's and BEIS's commitment to consult later this year on extending the scope of TCFD reporting to standard listed and large private companies, respectively, is a welcome start here in the UK. Additionally, we would support the UK using its' role as host of this year's COP26 and G7 summits to advocate mandatory TCFD reporting in other jurisdictions on a similar timescale to that set out in the UK government's TCFD roadmap. Inspired by the ambitious DWP proposals and building on the Roadmap, this call represents an opportunity for the UK government and investment community to demonstrate global leadership on managing climate risk.

2. Data quality and the “as far as they are able” provision

Where UK companies are providing TCFD reports, early signs – while encouraging – suggest that they have more work to do with their reporting – understandable given that companies are on a journey to considering the impact of climate change on their business model and strategy.

However, we note that UK listed companies are not always disclosing against all four pillars of TCFD and, where there are disclosures, it is not clear that they are always decision-useful. For instance, on the question of strategy, company disclosures have not always provided investors with an understanding of how capital allocation will be affected by any changes to the company's strategy.⁶

Reflecting efforts by investment managers to improve the quality of investee companies' TCFD reports, it may be useful for pension schemes to take into account their managers' stewardship activities that target better disclosures from investee companies' as a part of their own TCFD assessment.

We note also that there are issues with data quality at the asset class level too. In asset classes outside of listed equities and investment grade corporate bonds, the quality of the data needed to fulfil TCFD reporting requirements by both pension schemes and asset

⁶ See '[Shareholder Priorities for 2021 – Supporting Long Term Value in UK Listed Companies](#)', The IA, 2021.



managers remains a work in progress. This will have a differential impact at pension scheme level given different investment strategies and asset allocations across schemes. Accordingly, the quality of TCFD reporting is likely to vary considerably across schemes given the inconsistent access and quality of the underlying data.

Measuring and disclosing scope 3 emissions data represents a particular challenge for companies (and hence, trustees, as the guidance already notes) and their inclusion within the “as far as they are able” provision is welcome. However, we support the ambition to collect this data over time and the demand from investors will provide companies with an incentive to start providing this data. In that regard it is important to start the process and DWP’s proposals do that.

Notwithstanding the challenges around the availability of accurate and comparable data from investee companies, investment managers are working at pace to evolve and develop their approach to analysing climate data and integrate this data into their investment process, recognising that imperfect data is not a justification for lack of climate action. Third party data providers are playing a role in supporting these developments. However, it is important to note that the quality of this analysis will always be limited by the quality of the underlying data and trustees will need to be mindful of this when using this analysis to inform investment and allocation decisions. Organisations such as the newly announced UK Centre for Greening Finance and Investment⁷ will also be of assistance to trustees in sourcing climate data and analytics. Any further guidance that the DWP can provide to support trustees to understand and interpret the reliability of climate related data would be useful.

Alongside this, we welcome the DWP recognising the challenges with data quality, in particular the inclusion in the regulations of a provision that, in instances related to the production of scenario analyses, calculation of metrics and assessment against targets, requires trustees to carry out such activities only “as far as they are able”. This is reassuring since it signals that the DWP recognises the challenges that schemes face in the metrics, targets, and scenario analysis elements of the TCFD framework. We urge TPR to be similarly pragmatic in its oversight of schemes’ TCFD report⁸, focusing in the first instance on the quality of schemes’ climate risk governance, recognising that the quantitative elements of scheme reports will get better over time as coverage and data quality improves.

3. Scenario analysis, metrics, and targets

Our response to the DWP’s earlier TCFD consultation highlighted several concerns that we had with the original proposals relating to scenario analysis, metrics, and targets.

The original proposal for quarterly calculation and reporting of metrics risked being both misaligned with companies’ reporting of the necessary information on an annual basis, as well as inadvertently introducing a short-term approach to the consideration of climate risks and opportunities that should be more medium-to-long-term in nature. In that regard

⁷ <https://www.ox.ac.uk/news/2021-02-15-uk-launches-new-oxford-led-research-centre-accelerate-greening-global-financial>

⁸ The role of TPR in monitoring pension schemes’ TCFD reporting should be clarified. If the role goes beyond verification of compliance with the law and involves an assessment of the quality of schemes’ TCFD reports, we recommend that TPR should familiarise itself with the TCFD framework and climate finance more generally.



we welcome the DWP's plans to move the metrics and targets requirements to an annual basis. Not only does this better align with corporate disclosures, it also helps trustees and their investment managers better focus on supporting investee companies over the long term as they transition their businesses to a net zero economy. Investors have an important role to play in using their stewardship obligations to respond to this systemic risk. We welcome the emphasis on supporting investor stewardship on climate change so that investors can actively engage with the companies they are invested in to support them to manage the physical and transition risks from climate change and make progress to more sustainable business models.

Our concerns with the initial proposals also centred around the degree of optionality available to trustees in choosing and calculating metrics and reporting against targets. With different pension funds selecting different metrics and targets for their managers to report to them, this would result in managers producing differing sets of metrics and targets for their clients within the same fund, leading to inconsistency and lack of comparability. While we recognise that some schemes may agree with their managers the use of specific additional metrics aligned with their investment objectives and more reflective of their investment philosophy, having a core set of common metrics would help with consistency and comparability, which is one of the main objectives of the TCFD framework.

The revised proposals allay most of these concerns. We welcome what appears to be the standardisation of absolute emissions and emissions intensity metrics (total GHG emissions and carbon footprint respectively) through their presentation as 'recommended' measures in the statutory guidance, which trustees are expected to follow. However, the inclusion of Weighted Average Carbon Intensity (WACI) as an optional additional emissions-intensity metric that trustees can select continues to mean that there is potential for multiple measures of emissions intensity across clients in the same fund. We think it would be better to focus on a single measure of emissions intensity in the interests of standardisation and comparability. In that regard, we would recommend replacing carbon footprint with WACI as the recommended emissions intensity metric, in line with the original TCFD framework under which companies will be reporting.

As far as non-emissions-based metrics⁹ are concerned, we welcome the application of the "as far as they are able" provision to their calculation, in recognition of the challenges inherent in their calculation.

For the core metrics set out in the statutory guidance, the IA would be happy to work with the pensions industry and DWP to develop mechanisms for standardising client information requests and supporting the development of meaningful scheme level data across a variety of asset classes.

Beyond the core metrics, we recognise the importance of maintaining additional flexibility for trustees to explore and use other metrics that may help add deeper insights for

⁹ There appears to be an inconsistency in the guidance: paragraph 130 requires that trustees should obtain details from their asset managers or third-party data providers the proportion of data in respect of scope 1-2 and scope 3 emissions which is verified, and the proportion which is estimated. The reference to 'should' means that if trustees do not do this they have to explain why. But Data Quality is listed as one of the non-emissions-based metrics that trustees can choose. Data Quality is the proportion of the portfolio for which each of scope 1-2 emissions and scope 3 emissions are verified, reported, estimated or unavailable. However, the use of the word 'should' in paragraph 130 implies that Data Quality is not an optional metric. This should be clarified in the final guidance.



particular portfolios or asset classes. In many cases, a small set of simple metrics will not tell the whole story of climate risk and opportunity that different portfolios may be exposed to; additional insights may still be required, and these should be at the discretion of trustees and their investment managers. In that regard, the recently published final version of the PCRIG non-statutory guidance¹⁰ will be a useful resource for trustees to consider as part of their TCFD reporting process.

Finally, we reiterate that the availability of much of the data needed to calculate the proposed metrics will depend on the ability of investment managers to aggregate the data available from investee companies and other assets, which again relies on a consistent set of data from underlying assets with comparable underlying methodologies. Given that the FCA's rules for corporate TCFD reporting implies the expectation is for in-scope companies to use the metrics or targets set out in the global TCFD framework, and only applies to listed equities, there is no guarantee that the metrics and targets pension funds choose to report on will be available from investee companies. Although the "as far as they are able" provisions will cover this in the short term, we think further action is needed to assist pension schemes and investment managers here.

We stated in our response¹¹ to the FCA's proposals on corporate TCFD reporting that there needs to be greater levels of comparability between the data provided from investee companies. TCFD's 2020 Status Report¹² found that 42% of issuers considered that there was a lack of standardised metrics for their industry. Investors have similarly voiced concerns that the metrics and targets pillar require improvements. This is particularly the case within individual sectors. Without sector-specific metrics, the comparability of the data, and therefore its utility, is reduced.

We therefore encourage the development of sector-specific standardised metrics and encourage the FCA to signal their support for alternative sustainability disclosure frameworks which complement and support TCFD, in the same way that the FRC has done for corporate TCFD reporting. Specifically, investors support greater adoption of SASB, which has the strength of featuring less optionality on key climate-related metrics than TCFD as well as a sector-based materiality lens. We welcome developments and recommendations by the IFRS Foundation, IOSCO and the European Financial Reporting Advisory Group (EFRAG) to support global harmonisation of sustainability reporting by corporates, with particular urgency around climate change reporting.

4. Aligning TCFD reporting for pension schemes and asset managers

Our final set of comments concerns the interaction between the TCFD reporting of pension schemes and TCFD reporting by investment managers that is designed to facilitate pension schemes discharging their own obligations.

The FCA has signalled that they will consult on enhancing investment managers' climate related disclosures in their capacity as regulated firms later this year and we look forward to engaging with these proposals. Without specific recommendations at this stage, it is not possible to assess the extent to which the proposed regulatory obligations on investment managers will be consistent with the DWP proposals. At this stage we would simply

¹⁰ Aligning your pension scheme with the TCFD Recommendations, The Pensions Climate Risk Industry Group, 2021

¹¹ [IA response to FCA CP20/3](#).

¹² See Figure C1, TCFD 2020 Status Report



recommend that where DWP proposes that pension schemes must carry out specific scenario analyses and calculate specific metrics, these should also be core requirements for investment managers' client facing disclosures.

Beyond the disclosures aimed at UK pension schemes, the FCA could also look at the climate metrics and methodologies specified under the EU's Sustainable Finance Disclosure Regulation (SFDR). There are significant efforts underway by investment managers to implement SFDR and the adoption of some of the metrics and methodologies of SFDR into TCFD disclosures will aid standardisation and comparability.

Client obligations such as those being introduced by DWP become de facto requirements for investment managers on commercial and reputational grounds. It is therefore vital that there is alignment and consistency between the FCA's and DWP's proposals. Were the FCA's forthcoming proposals for product/portfolio level disclosures from investment managers to diverge from the DWP's proposals¹³, it would result in disclosures that investment managers would be obliged to produce, but which would be insufficient to deliver pension funds' own obligations under the DWP regulations.

As a final point, we note that this need for consistency applies equally to the FCA's approach to TCFD reporting by contract-based pension schemes, which from a member and employer perspective are substitutable with the trust-based schemes regulated by TPR. Accordingly, TCFD requirements should be equivalent across the pensions market. This will also be of assistance to investment managers serving the entire UK pensions market.

5. Concluding remarks

We reiterate our support for pension schemes embracing the TCFD reporting challenge. The transparency and accountability it will bring over time plays an important role in supporting UK pension schemes to prepare for the transition and the UK's 2050 legally binding target. However, the actions of pension schemes and investment managers alone are not enough, and further and swift policy intervention is needed.

It is critical that governments around the world provide clear and actionable signals on the nature and speed of the transition as soon as possible. Action today helps minimise financial stability risks arising from stranded assets and cliff edge policy decisions at a future date. In that regard we strongly support the UK using its' role as host of this year's COP26 and G7 summits to advocate mandatory TCFD reporting in other jurisdictions on a similar timescale to that set out in the UK government's TCFD roadmap.

Clear policy signalling from the government gives companies clarity about their own transition risks, enabling them to improve their reporting on them and adapt their business models accordingly. This in turn helps investment managers engage with these companies more effectively to help support them in making the capital allocation decisions necessary to transition. This policy signalling also provides the requisite clarity to allow investment managers to price assets effectively for the long-term benefit of their clients.

¹³ A similar issue arises with respect to the risk of divergence between FCA and future BEIS rules on issuers. Since pension funds and investment managers will be reliant on the disclosures of underlying companies, FCA and BEIS rules will need to ensure their rules can deliver what pension schemes and investment managers need in order to meet their own obligations.



Investment managers invest in different sectors. Each of these sectors will face different challenges and have different drivers and constraints shaping their path to transition to Net Zero and their contribution to meeting the Paris Agreement goals. To drive forward change and set an example in the UK, the government should seek to set out its plans for policy interventions specific to each sector as soon as it is able. Typically referred to as “sector specific pathways to transition”, there are different policy options available to meet Net Zero and the Paris Agreement goals. These different options will impact on the pricing of assets and include tax, regulation, innovation and leveraging private sector finance.

By setting out clear pathways to transition to Net Zero for different sectors of the economy, the UK government can help create the investable opportunities for private capital. As an industry we are committed to working together with the government both to create the investable opportunities necessary for the transition to Net Zero as well as ensuring the requisite policy interventions are brought in to facilitate the transition for different sectors.