Brunel Pension Partnership Response to the DWP consultation on Taking action on climate risk: improving governance and reporting by occupational pension schemes

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Brunel Pension Partnership (Brunel), an FCA-regulated MIFID firm, was formed in July 2017 and manages the investment of the pension assets (around £30bn/$40bn) of ten Local Government Pension Scheme funds in the UK: Avon, Buckinghamshire, Cornwall, Devon, Dorset, the Environment Agency, Gloucestershire, Oxfordshire, Somerset and Wiltshire.

Climate change presents an immediate, systemic and material risk to the ecological, societal and financial stability of every economy and country on the planet. It has direct implications for our clients and their beneficiaries.

We published our Climate Policy in January 2020, where we clearly stated that the financial system was "not fit for purpose". The key objective of our Climate Policy is to systematically change the investment industry to ensure that it is fit for purpose for a world where the temperature rise needs to be kept to well below 2°C above pre-industrial levels.

In our policy we set out a five-point plan – this included encouraging policy makers to establish comprehensive and robust climate change policy frameworks. These frameworks should be used to deliver significant reductions in greenhouse gas emissions, accelerate progress towards the low carbon economy, and enable effective adaptation to the unavoidable impacts of climate change.

A key constraint on the financial system is the lack of climate-related financial disclosures all the way down the investment chain – this must start with companies and other issuers. Our position is unequivocal: we support mandatory climate change disclosure for all companies, assets and other issuers. Only by making it mandatory right along the investment chain can we achieve the outcomes the DWP has laid out. We made the same case in our comments to the FCA relating to carbon disclosures.

Question 1

We propose that the following schemes should be in scope of the mandatory climate governance and Task Force on Climate-related Financial Disclosures (TCFD) reporting requirements set out in this consultation:

a) trust schemes with £1 billion or more in net assets
b) authorised master trusts
c) authorised schemes offering collective money purchase benefits

Do you agree with our policy proposals?

Yes, we recommend starting with the largest (>£5bn), then moving onto those >£1bn, thereby capturing 75% by AUM and 80% by membership by 2022. This is a rational and pragmatic approach. We ask that policy makers proactively encourage smaller schemes to manage climate risk (see question 3 below) and TCFD is sensible framework, irrespective of size. It is unfair that some beneficiaries will have their retirement savings at higher risk just because their fund is smaller. There is an urgent need for the industry to be creative in developing solutions that are time and cost effective for small schemes.

Question 2

We propose that:

a) trustees of schemes with £5 billion or more in net assets on their first scheme year end date to fall on or after 1 June 2020 are subject to the climate governance requirements from 1 October 2021 and the trustees must publish a TCFD report within 7 months of the current scheme year end date or by 31 December 2022 if earlier

b) trustees of schemes with £1 billion or more in net assets on the first scheme year end date to fall on or after 1 June 2021 are subject to the climate governance requirements from 1 October 2022, and the trustees must publish a TCFD report within 7 months of the current scheme year end date, or by 31 December 2023 if earlier

c) trustees of master trust or collective money purchase schemes which are authorised on 1 October 2021 are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report in line within 7 months of the current scheme year end date, or by 31 December 2022

After 1 October 2021:

d) trustees of master trust or collective money purchase schemes which become authorised are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report within 7 months of the current scheme year end date

e) where schemes cease to require authorisation, the climate governance and TCFD-aligned reporting requirements fall away with immediate effect, unless they remain in scope via the asset threshold on the previous scheme year end date

From 1 June 2022 onward:

f) trustees of schemes not already in scope of the requirements and with £1 billion or more in net assets on any subsequent scheme year end date:

- *are subject to the climate governance requirements starting from one year after the scheme year end date on which the £1 billion asset threshold was met*
- *must publish a TCFD report within 7 months of the end of the scheme year from which the climate governance requirements apply*

g) trustees of schemes in scope of the requirements whose net assets fall below £500m on any subsequent scheme year end date cease to be subject to the climate governance requirements with immediate effect (unless they are an authorised scheme) but must still publish their TCFD report for the scheme year which has just ended within 7 months of the scheme year end date

Do you agree with the policy proposals?

In summary, yes, we believe the proposals set out a sensible roll-out programme. Those captured by d) and e) should ideally get started as soon as possible, and not wait until it becomes mandatory.

We support proposals f) and g) and agree that the approach taken in g) addresses the challenges outlined in the consultation paper regarding schemes falling below the threshold. However, we still support a wider roll-out, as outlined above.

Question 3

Subject to Government deciding to adopt any of the governance or reporting requirements proposed in this consultation, we propose to conduct a review in 2024 on whether to extend the measures to schemes with below £1 billion in net assets which are not authorised master trusts or an authorised scheme offering collective money purchase benefits, and if so how and on what timescale.

This review would be informed by consideration of TCFD disclosures by occupational pension schemes to-date, their impact, and the availability and quality of both free and paid-for tools and services.

We would propose also to review any regulations and statutory guidance which had been put in place to identify whether any of this needs to be strengthened or updated.

Do you agree with these proposals?

We ask that policy makers proactively encourage smaller schemes to manage climate risk as soon as possible and TCFD is sensible framework, irrespective of size. It is unfair that some beneficiaries will have their retirement savings at higher risk just because their fund is smaller. There is an urgent need for the industry to be creative in developing solutions for that are time and cost effective for small schemes.

We would work on the assumption – and ask policy makers to communicate – that the intention is to extend the requirements to smaller schemes, unless there was clear evidence that this would be unfeasible.

Question 4

We propose that regulations require trustees to:

a) adopt and maintain oversight of climate risks and opportunities

b) establish and maintain processes by which trustees, on an ongoing basis, satisfy themselves that persons managing the scheme, are assessing and managing climate-related risks and opportunities.

We also propose that regulations require trustees to describe:

c) the role of trustees in ensuring oversight of climate-related risks and opportunities

d) the role of those managing the scheme in assessing and managing climate-related risks and opportunities, only insofar as this relates to the scheme itself and the processes by which trustees satisfy themselves that this is being done

We propose that statutory guidance will cover the matters in the box above.

Do you agree with these proposals?

Yes, Box 2 details many of the key matters for the trustee board. To this list we would add a board-approved implementation plan with appropriate key performance indicators to assist in measuring progress. It is also not explicit that the Board would monitor the climate-related metrics and targets.

Box 2 sets out that the board should have regard to the integration into existing governance processes; we would anticipate that the board should look to integrate climate change into all the processes it oversees, including but not limited to risk management and auditing.

Question 5

We propose that regulations require trustees to identify and disclose the climate change risks and opportunities relevant to their scheme over the short, medium and long term, and to assess and describe their impact on their investment and funding strategy.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Yes, the proposed statutory guidance provides a good checklist for trustees.

Question 6

We propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of defined benefit (DB), funding strategy, as far as they are able, in at least two climate-related scenarios, one of which must be a 2°C or lower scenario and to disclose the results of this assessment.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

We agree with the proposal to use two climate-related scenarios, one of which is the 2°C-or-lower scenario, and to disclose the results of this assessment.

Trustees aim to set long-term investment strategies, often on a triennial or longer cycle. Whilst the disclosures should be made annually, I think the guidance could be clearer that it's not necessary (at least in our view) to keep redoing scenarios every year, unless there is a material change in the investment strategy. This mirrors the processes that guide SIPs. That said, I think it is likely that larger funds may well seek to have a *programme* of undertaking scenarios, taking a deeper dive into elements of the strategy e.g. physical risk on real estate. This is particularly relevant to managing cost concerns. We would like to see further acknowledgement/ clarification that, whilst there are scenario testing tools for listed equities, tools for all asset classes are still in development and can be quite costly.

Question 7

We propose that regulations require trustees to:

a) adopt and maintain processes for identification, assessment and management of climate-related risks

b) integrate the processes described in a) within the scheme's overall risk management

We also propose the regulations require trustees to disclose:

c) the processes outlined in part a) above

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Yes, we agree. The process outlined in b) should also be included in disclosures.

We would support the development of further guidance for Trustees on what good looks like when effectively identifying, assessing, and managing climate change-related financial risks and opportunities.

We would also recommend that the emphasis be placed on processes being fit for purpose, with attention given to where these need to be different due to asset class, geography, place in the capital structure, level of control, etc. It is essential that we avoid blanket statements with little or no meaning in terms of approach or use to stakeholders.

We would also welcome further clarity on expectations to take account and, where practical, mitigate market-wide systemic risk on an individual or collaborative basis. This is consistent with the demands of the FRC 2020 Stewardship Code.

Brunel is also seeking to add disclosure on its own operational risk management and emissions, albeit at a high level, to demonstrate that we are thinking about climate risk and impacts in every aspect of our work. This is consistent with our Responsible Investment Policy.

Question 8

We propose that regulations require trustees to:

a) select at least one greenhouse gas (GHG) emissions-based metric and at least one non-emissions-based metric to assess the scheme's assets against climate-related risks and opportunities and review the selection on an ongoing basis

b) obtain the Scope 1, 2 and 3 GHG emissions of the portfolio, and other non-emissions-based data, as far as they are able

c) calculate and disclose metrics (including at least one emissions-based metric and at least one non-emissions-based metric) used to quantify the effects of climate change on the scheme and assess climate-related risks and opportunities

We also propose in regulations that trustees be required to disclose:

d) why the emissions data that is estimated does not cover all asset classes, if this is the case

We propose that trustees are not mandated to use a specific measure to assess the effects of climate change on the scheme's portfolio.

We propose statutory guidance will cover the matters outlined in the box above.

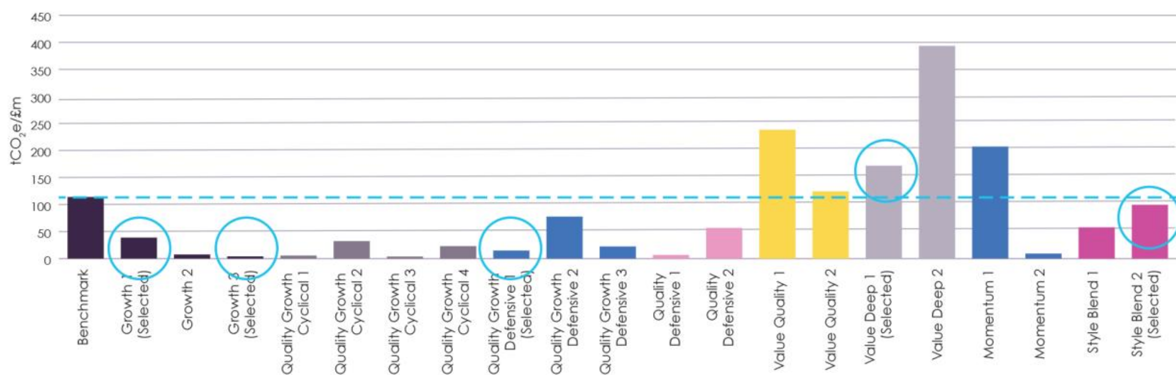
Do you agree with these proposals?

We agree with the proposal to include at least one GHG emissions-based metric and at least one non-emissions-based metric, and for the default to be Weighted Average Carbon Intensity (WACI), including Scope 3 (where appropriate and available). Currently, we look at first tier Scope 3 emissions. We would recommend that the breakdown of emissions is useful, as it helps to show what is driving the emissions intensity.

Brunel produces a carbon metrics report to support our transparency on climate risk. This report includes WACI, reserves and revenues exposures, power generation mix and disclosure levels. In addition, we also include non-emissions-based metrics relating to disclosure and engagement e.g. TPI scores (weighted average) in our Responsible Investment and Outcomes Report. The metrics we publish are useful within the context of listed equity and corporate debt, but we would flag that reporting in other asset classes is more challenging. We agree with the need to make progress and therefore agree that funds should be able to explain where measurement - particular for emission intensity - is not

practical at this time – largely where there is an absence of agreed methodologies as well as data points. We would also suggest it not unreasonable for funds to prioritise their data and reporting practices based on allocations. We need to ensure the time spent by trustees and funds is used for the management of climate risk and opportunities, and not expended capturing data for small allocations. To be clear, we do believe trustees should be aware of risks attached to all allocations – it's the data collection and reporting we wish to be mindful of.

We understand the desire not to be prescriptive in defining metrics but, for DWP to fulfil its objectives, it will need to encourage disclosures that are comparable, at least to a degree. We realise that asset allocation and individual portfolio mandate design will impact carbon intensity outcomes. Thus aggregation at a fund level, whilst often asked for, is far from useful. We do support the harmonisation of data points on climate, particularly at portfolio level, where it can be useful to someone selecting funds or managers. The extract below is from a Brunel case study where we harnessed the carbon intensity of managers to assist in portfolio construction.



Extract from Brunel's 2020 Responsible Investment and Outcomes Report.

We would also support the DWP in setting a timeline for increases in expectations on metrics and targets so that the regulations have a nature future-proofing element to them and encourage innovation. We would support DWP's further collaboration with the FCA-PRA and the FCA-PRA Climate Financial Risk Forum in supporting industry wide metrics from asset managers that can be used by pension funds in their reporting.

Question 9

We propose that regulations require trustees to:

a) set at least one target to manage climate-related risks for one of the metrics trustees have chosen to calculate, and to disclose those targets(s)

b) calculate performance against those targets as far as trustees are able and disclose that performance

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Yes, we agree with these proposals. Please see examples from Brunel's own reporting linked to the asks set out.

a) Brunel has a 7% per annum reduction in carbon intensity (relative to the benchmark) for its equity products by 2022. Our current disclosure is illustrated below.

Weighted Average Carbon Intensity (tCO2 e/mGBP) Relative to Benchmark

Portfolio Name	Portfolio WACI	Benchmark WACI	Portfolio WACI Relative to Benchmark
Brunel Active UK Equity	259	282	-8.2%
Brunel Active Global High Alpha	158	301	-47.5%
Brunel Active Emerging Markets	523	570	-8.2%
Brunel Active Low Volatility	259	334	-22.5%
Brunel Passive Low Carbon	150	301	-50.1%
Brunel Passive Smart Beta	554	554	In line
Brunel Passive UK	281	281	In line
Brunel Passive World Developed	303	303	In line

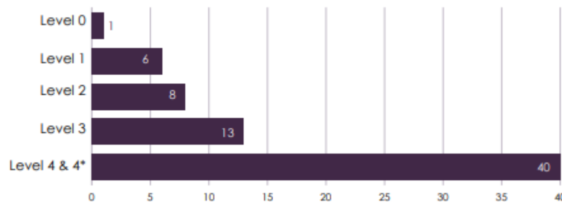
b) All material holdings at TPI level 4 or above by 2022

Transition Pathway Initiative (TPI) Assessment of Our Active Equity Portfolios

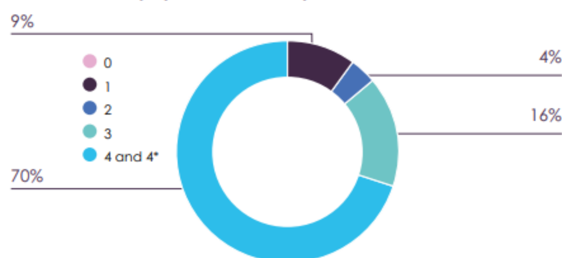
We aim to have all our material holdings on TPI level 4 or above by 2022.

As of December 2019, within Brunel's Active Equity Portfolios there were 68 companies covered by the TPI tool. Of these, 40 holdings (59%) are categorised as Level 4 or above.

Brunel Active Equity Holdings by TPI Level



Brunel Active Equity Market Value by TPI Level



Looking at the breakdown from a market value perspective, 70.2% of holdings within Brunel's Active Equity Portfolios are assessed as Level 4 or above.

Of those companies assessed as Level 3 or below, we are:

- engaging with all that have either fallen or have not improved their TPI Level year-on-year
- considering voting against company management that have not improved at least a TPI Level over the course of a year

The TPI Tool

The Transition Pathway Initiative (TPI) is a global, asset-owner led initiative which assesses companies' preparedness for the transition to a low carbon economy. The TPI tool uses publicly available company information to assess:

Management quality

The quality of companies' management of their greenhouse gas emissions and of risks and opportunities related to the low-carbon transition

Carbon performance

How companies' carbon performance now and in the future might compare to the international targets and national pledges made as part of the Paris Agreement.

Companies management quality is assessed annually across 17 indicators.

Companies are placed on one of five levels:

Level 0 - Unaware of, or not acknowledging climate change as a business issue

Level 1 – Acknowledging climate change as a business issue

Level 2 – Building capacity

Level 3 – Integrated into operational decision-making

Level 4 – Strategic assessment

For more information see www.transitionpathwayinitiative.org

Question 10

We propose that, for all schemes in scope:
a) the trustees should be required to publish their TCFD report in full on a publicly available website where the report is accessible free of charge
b) the trustees should be required to include in the Annual Report and Accounts a website link to the location where the full TCFD report may be accessed in full
c) the trustees must notify all members to whom they must send the annual benefit statement of the website address where they can locate the full TCFD report – this must be set out in the annual benefit statement
d) the trustees should be required to report the location of their published TCFD report to the Regulator by including the corresponding website address in their scheme return
e) the trustees should also be required to report the location of their published Statement of Investment Principles (SIP), Implementation Statement and excerpts of the Chair's Statement by including the corresponding website address or addresses in their scheme return

Do you agree with these proposals?
Is there a better way to notify members of where to find this information?

For example, for DB schemes, might the summary funding statement required by regulation 15 of the Disclosure Regulations be a more appropriate way to signpost members to this information?

Yes, we agree with these proposals.

Question 11

We propose that:
a) The Pensions Regulator (TPR) will have the power to administer discretionary penalties for TCFD reports they deem to be inadequate in meeting the requirements in the regulations
b) there will be no duty on TPR to issue a mandatory penalty, except in instances of total non-compliance where no TCFD report is published
c) in all other respects, we propose to model the compliance measures on the existing penalty regime set out in regulations 26 to 33 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015
d) failure to notify members via the Annual Benefit Statement or to include a link to the TCFD report from the Annual Report will be subject to the existing penalty regime set out in regulation 5 of the Disclosure Regulations

Do you agree with this approach?

We appreciate the need for the regulations to be backed by penalties in order to send a clear message on the importance of compliance. However, we also support the idea of escalation of action, starting with funds having to publicly declare non-compliance and setting corrective action. Fines should be considered, but only over time, and where other interventions have failed.

Question 12

Do you have any comments on the new regulatory burdens to business and benefits, and wider non-monetised impacts we have estimated and discussed in the draft impact assessment?

We are extremely supportive of the proposals. As regulatory discussions evolve in the UK and globally, this is a very important and positive leadership development from the DWP. Climate change risks are material, and in the interest of scheme members it is crucial to start managing the risk now or the impacts will be far greater further down the road. We know from having published our own TCFD report that the process of doing so helps to focus minds internally on what the next steps need to be, so there is huge value in beginning that process early.

Question 13

Do you have:

a) any comments on the impact of our proposals on protected groups and how any negative effects may be mitigated?

b) any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats

c) any other comments about any of our proposals?

As an encouragement to schemes to start early – in a similar approach to that taken by the FRC in providing feedback on draft 2020 Stewardship Code reports – the DWP may wish to consider providing feedback to those who report early and/or sharing best practice from the first round of reporting. This will help to raise disclosure standards across the board.

We would be happy continue to support the DWP in its work in this area.

If you have any questions or comments about this submission please email Faith Ward, Chief Responsible Investment Officer at RI.Brunel@brunelpp.org.

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