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By Email only

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Dear Bethan, Tom, Andrew and David

Consultation response: taking action on climate risk

Thank you for inviting responses to the policy proposals to introduce new governance and reporting duties for occupational pension schemes in relation to climate change, as set out in the consultation document published on 26 August 2020 (the "**Consultation**"). This letter sets out our response to the Consultation. We would be delighted to meet with you to discuss the proposals and the comments in this letter further if that would be helpful to the Department in ensuring the proposals achieve the policy objectives.

1. INTRODUCTION

1.1 Travers Smith LLP is a firm of solicitors with one of the largest specialist pensions law departments in the City of London. We act for trustees and sponsors of a wide range of occupational pension schemes. Our clients include many trustees and providers of authorised master trusts and schemes with assets exceeding £5bn or £1bn who would become subject to the proposed new duties during the first and second phases of implementation (proposed for 2021-2023 in the Consultation).

1.2 In our response below we have not sought to answer all Consultation questions and instead have aimed to address those aspects where we can provide insights from a commercial legal perspective. Since the policy proposals extend beyond the purely legal, we have also engaged informally with a number of our clients who would be subject to the proposed new duties, in order to test their opinions and views. This engagement included a webinar and discussion forum facilitated by us where clients were invited to share their thoughts and questions. Our Consultation response includes a synthesis of the key points emerging from our clients' informal feedback.

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2. GENERAL COMMENTS

2.1 We agree with the views expressed in the Consultation that climate change is a key risk – both for society and for pension schemes – and that climate risk can and should be integrated into scheme activity to the extent it is financially material and supported by the wider legal framework of trustees' duties. Given the political priority attached to the UK showing leadership on the management of climate change risks and driving increased TCFD compliance among asset owners, introducing certain specific duties on trustees would be helpful in providing greater clarity around the actions expected of them.

2.2 Before we address the specifics of the Consultation, we would like to draw the Department's attention to two high-level aspects that were identified as potential challenges through our analysis and engagement with clients.

2.3 First, the political choice has been made in the Pension Schemes Bill to legislate for climate change indirectly - by requiring trustees to take the climate risks that affect them through a governance process and then decide what action to take as a result. We think this approach is consistent with the current fiduciary duties that apply to trustees when exercising the power of investment. But our analysis and client feedback is that there are aspects of this approach that leave trustees in a legally ambiguous position:

- The proposals essentially make climate change a mandatory 'relevant factor', meaning that trustees *must* integrate it into their decisions whether or not they judge it to be financially material or how much weight trustees might apply to this factor compared to others. Very few other decision-making factors in pensions law carry this level of legal weight.

- Despite this, the wider general law and trustee duties remain unchanged. In particular, trustees must still invest prudently in members' best (financial) interests, taking account of all financially material factors. And trustees must continue to exercise their powers so as to achieve the purpose of the pension scheme – which is primarily to provide beneficiaries with the financial benefits they are entitled to.

- At a more practical level , some trustees have already started integration of financially material ESG factors into their investments pursuant to the existing legislation, but may have focussed on areas unconnected (or only indirectly connected) with climate change, for example taking account of other environmental harms such as plastics or water pollution. Realistically, trustees have finite ESG resources, so how should these other ESG activities now be reconciled with climate change duties?

- In light of the three points above it seems possible that the proposed new duties, if not set properly into their wider legal and practical context, could

have a distortive effect on lawful trustee decision-making where climate risk 'crowds out' consideration of other materially relevant factors – partly because of its new legal prominence in the matrix of relevant factors trustees must look at, and partly because of the level of resource that is likely to be needed in order to comply with the new duties (compliance burdens are discussed further below). This may achieve progress on TCFD compliance, but at the cost of adverse impacts or insufficient progress elsewhere.

2.4 In our view, it is therefore important to strike a clearer balance within the proposals: ensuring that schemes are given the tools for taking actions and decisions on climate risk where appropriate, whilst not unduly or excessively disrupting the other essential social and economic functions of pension schemes. To be clear, we believe this is the overarching policy intention. But in order to achieve this we consider that the Government needs to provide further clarity and practical guidance for trustees about how the climate change duties should be integrated with their wider duties and responsibilities. This could potentially be addressed in the statutory guidance, but we make some additional suggestions below that would help in relation to specific areas of the proposals.

2.5 Secondly, discussions with our clients reveal widespread apprehension that the Consultation proposals will impose a significant new governance burden upon trustees. Some schemes are not confident that their investment committees have the capacity to take on the new climate risk role. Some are actively considering a specific climate change sub-committee structure, but are finding difficult to staff the committee with sufficient expertise. Consistent with the Consultation, our experience also suggests that some of the third-party services and data sources that trustees will need in order to discharge the new duties do not yet exist, or exist only in limited form. We anticipate potential capacity issues among advisers and service providers as large schemes seek to bring themselves into line with the new duties over a short period.

2.6 The Consultation acknowledges these challenges in part and accepts that there will be a learning curve as schemes seek to comply. We agree that this is not a reason for taking no action, and the reassurance in the Consultation is likely to be welcomed. However, the implications of this situation are not fully reflected within the limited 'safe harbours' currently proposed for the regulations. We suggest below some areas where this could be developed further. We also believe that it will be essential for statutory guidance to set out not only *what* trustees should do to comply with the regulations, but options for *how* they can do so.

2.7 We would encourage the Department to reflect further on these high-level points and provide greater clarity to the industry where possible in the finalised regulations and statutory guidance.

3. SCOPE AND TIMING (QUESTIONS 1 AND 2)

3.1 The Consultation proposes that the regulations would be phased in. We agree this is a sensible approach. In this rapidly developing area, it makes sense for the legislation to begin with schemes that are more likely to be better placed to innovate (it also makes sense for the legislation and guidance to encourage them to do so).

3.2 Our question is whether the current phasing approach set out in the Consultation will be sufficient to achieve this objective:

3.2.1 Although scheme asset size or authorised master trust status are objective criteria and easy to apply, in our view they are not directly correlated with preparedness or governance capacity for TCFD. In relation to asset size, this seems to be reflected in the Department's own evidence as cited in the Consultation. It is also consistent with some of our experience. Separately, we should point out that not all authorised master trusts are large commercial providers with significant governance capacity: we are aware of some schemes that triggered the authorisation requirements due to the historical coincidence of having non-associated employers but which are in all other respects essentially smaller occupational pension schemes.

3.2.2 Given the potential compliance burden of the new duties (see 2.5 above), the proposed timing of the first two phases (from October 2021 and October 2022) seems ambitious on any view.

3.2.3 For schemes with years ending on or after 30 June in 2022 or 2023 (depending on asset size) there could be further timing challenges. This is because the proposed longstop reporting deadlines of 31 December 2022 or 2023 would fall before the end of the seven-month period that otherwise applies for preparing the annual report in these cases.

3.3 In view of the above, and to reduce the risk of rushed or 'defensive' attempts at compliance that drive little real progress towards the main TCFD policy goals, we propose a refinement to the phasing approach.

3.4 Our suggestion is that alongside the existing asset size/status and timing criteria, an easement should be included within the regulations so that each scheme's first year under the new regime is a 'rehearsal year'. In the rehearsal year, schemes would be subject to regulatory penalties if they entirely failed to put systems in place and prepare a TCFD report, confirming this to the Pensions Regulator via the scheme return; but for that first year only there would be no other discretionary penalties and no requirement to publish disclosures (these would start to apply in the following year). Thus, the original timescales and criteria for triggering the duties would still apply (and schemes would have to act accordingly) but there would be valuable additional space for trustees to prepare, experiment, gather baseline data and embed their systems, before the full enforcement consequences came to bear.

3.5 In our view, this approach recognises the reality of the industry's current situation. It also seems consistent with the valuable notes in the Consultation about trustees taking time to prepare in advance, and the likelihood that schemes will need to develop their TCFD approaches iteratively. We acknowledge that an easement like this is a potentially novel approach within pensions legislation, but we note that similar approaches have been deployed very successfully in many other areas, e.g. EMIR. We would encourage the Department to give this option serious thought and we would be happy to discuss it further.

4. REVIEW IN 2024 (QUESTION 3)

4.1 We agree with the proposal to review the provisions in 2024 and would encourage the Department to adopt the broadest possible scope for the review.

4.2 In particular, our comments elsewhere in this response lead us to suggest that the review should evaluate the *overall effectiveness* of the regime (and how effective it is likely to continue to be), beyond any decisions about extending it to smaller schemes or updating particular aspects of it. This would involve looking broadly at what practical change the regime has delivered compared to the policy objectives and the compliance burdens it entails, the experiences of schemes and other stakeholders since the duties originally came into force, whether it has become possible to achieve greater integration and consistency with climate change legislation in other areas of the economy, and whether other viable new climate risk approaches have developed in the interim.

5. ONGOING DUTIES: GOVERNANCE, STRATEGY AND RISK MANAGEMENT (QUESTIONS 4, 5 AND 7)

5.1 The Consultation asks, broadly, whether respondents 'agree' with the proposed ongoing duties around governance, strategy and risk management and their accompanying disclosures. These proposals are outlined in boxes 1a, 1b, 3a, 3b and 7a and 7b of the Consultation document. While we agree with the broad outline of policy proposals for ongoing duties, we set out below some specific thoughts on how they could be refined and clarified.

5.2 Who should owe the ongoing duties and what support will be available?

5.2.1 We agree that it is probably right for the duties to fall upon trustees rather than other parties. In law the trustees are ultimately responsible for the governance and operation of the pension scheme. This would also be consistent with the division of legal responsibility between trustees and experts in other areas of pensions law – for example the actuary in relation to scheme funding and CETVs.

5.2.2 But in contrast to these well-established scheme procedures, we caution that in our experience few trustees are likely to have well-developed climate

risk knowledge or expertise. There is likely to be heavy reliance on professional advisers. This gives rise to two issues:

(a) Trustees may not be equipped with the skills or knowhow to interrogate effectively the climate risk information and advice they receive, or to know what systems of climate risk oversight and supervision to put in place and whether these are working, at least in the early years of the regime. We believe this 'knowhow' element will need to be addressed comprehensively and at an early stage in the statutory and non-statutory guidance, for example by building out the suggested 'questions for advisers' outlined in the PCRIG draft guidance. It would be useful for the Department to continue to collaborate with industry groups like PCRIG and the PLSA to develop industry knowhow and best practice. If and to the extent that the Pensions Regulator does not publish significant guidance in this area, we believe the Department should consider actively sponsoring and endorsing alternative guidance from these groups as a single authoritative and reliable source for trustees.

(b) There is an emerging climate risk advisory profession. In the longer-run, should climate advisers to pension schemes be subject to professional regulation in a similar way to other scheme advisors?

5.3 Which areas of scheme operations are (or are not) in scope of the ongoing duties?

5.3.1 The 'legal perimeter' of the ongoing duties is not entirely clear to us from the Consultation, and we are concerned that this could lead to uncertainty for trustees if this is replicated in the final regulations.

5.3.2 To illustrate this: we note that the strategy duties require integration of climate risks into investment strategy (and funding strategy for DB schemes). But, looking at all the proposed ongoing duties as a whole package, it is not clear whether these are the *only* climate risk areas that trustees should address. In particular, the proposed general governance and risk management duties that sit alongside the strategy duties are *not* limited to investment and funding.

5.3.3 So, is the policy intention that trustees should extend their consideration of climate risk beyond investment and funding into wider scheme operations too? Examples could include the risks of climate-related physical disruption and the contribution to climate change arising from scheme systems, processes and service providers. And, if there will be scope for these wider climate issues to be considered, what priority should trustees give them compared to climate risks to investments and funding?

5.3.4 We appreciate that the intention might be to leave flexibility for trustees to identify and manage the climate risks they consider most significant for their scheme. Nevertheless, we suggest making the legal perimeter of the ongoing duties clearer within the final regulations so that, at the very least, trustees know whether or not the regulations require or permit them to manage climate risks outside their investment and funding strategies.

5.4 What legal standards will apply to trustees when carrying out the ongoing duties?

5.4.1 Recognising the data challenges that may arise, the Consultation proposes that trustees will have to comply with the discrete duties "as far as they are able" (discussed further below). By contrast, no legal standard of compliance for the ongoing duties has been specified.

5.4.2 As mentioned above, because of the governance-based approach to legislating for climate risk within pensions, climate change will be only one point on a spectrum of key relevant risks that trustees will need to manage. Given our real-life experience of trustees having finite governance capacity and budget, it is likely they will have to make decisions about how to allocate this between climate and other risks.

5.4.3 In that context, a lack of certainty about the legal standards expected in relation to ongoing climate change duties could lead to extreme or perverse results: at one end, trustees expending all possible time and resource on climate change risk, to the detriment of management of other material scheme risks; and at the other, only basic or superficial TCFD compliance while resource continues to focus in other areas. To manage these issues and provide greater certainty, we suggest that the duties should be subject to a standard of *proportionality*. For example:

(a) Trustees must establish and maintain *proportionate* oversight of climate-related risks and opportunities (duty G1).

(b) Trustees must adopt and maintain, on an ongoing basis, *proportionate* processes for assessing and managing climate-related risks (duty R1).

5.4.4 In law, 'proportionate' does not mean ineffectual or watered-down. It means appropriate having regard to the resources and circumstances of the scheme, including climate related risks and the matrix of total risks and exposures the scheme faces. We believe this concept is no more than is already suggested in the descriptions of the overall approach and expectations of trustees within the Consultation.

5.4.5 Thus, a legal proportionality standard would not weaken the proposals. Instead we believe it would provide helpful legal certainty for both trustees

and regulators as to the standards of compliance expected under the new ongoing duties. To the extent necessary, statutory guidance could be updated periodically with indications of what the Government considers to be proportionate, as industry practice develops.

5.5 Should there be greater flexibility in some areas?

5.5.1 Although we recognise that the proposed duties have been drafted to reflect the TCFD recommendations, we consider that there are a number of areas where providing additional flexibility to reflect the specific circumstances in which pension scheme trustees operate would help to encourage meaningful engagement with the requirements. For example:

(a) As drafted, trustees will be required to identify climate-related risks and opportunities that will have an effect on their investment strategy (and, in the case of DB schemes, their funding strategy) over the short, medium and long term. However, assessing climate risk and opportunities over different time horizons may not be the most helpful or meaningful metric for pension schemes to use; as the Consultation recognises, some schemes might continue to run for many years whereas others may be planning to wind up within 3 to 5 years, rendering any exercise to review climate risks over different time horizons potentially of limited practical value. As an alternative, trustees could instead be encouraged to identify, assess and prioritise climate-related risks and opportunities according to the *assessed level of risk*. The assessed level of risk could involve having regard to time horizons, but it would also enable trustees to take into account the wider circumstances of their scheme and the other risks they face.

(b) In circumstances where a scheme has multiple DC default arrangements, the Consultation indicates that an assessment of the impact of identified climate-related risks and opportunities should be undertaken for *each* popular default. Carrying out an individual assessment in this way could lead to unnecessary duplication. One alternative would be to require trustees to undertake a higher level review initially, with scope to expand on this but only to the extent that there are material differences between different arrangements that might be expected to give rise to different climate-related risks and opportunities.

5.5.2 More generally, we note that there is a significant degree of overlap between the proposed duties and between the annual disclosures it is proposed trustees will need to make. For example, the duty to identify climate risks and opportunities that may affect investment and funding

strategy (duty S1) is likely to share a lot of common ground with the duty to establish and maintain oversight of climate-related risks and opportunities (duty G1) and the duty to adopt processes for identifying and assessing climate-related risks (duty R1). The same point applies to the disclosures it is proposed will be required in relation to each of those duties.

5.5.3 Although this follows the template set down in the TCFD recommendations, there is a risk that adopting an inflexible approach may inadvertently encourage a "box-tick" approach to compliance with the new requirements that might impede substantive progress. One option could be to streamline the proposed duties to reduce unnecessary overlap and increase focus and activity on fewer core actions that are likely, in substance, to make the greatest practical difference. An alternative may be to ensure that the statutory guidance gives trustees sufficient flexibility to comply with the new requirements (particularly in relation to disclosure requirements) in a proportionate manner and in a way that makes sense for their particular scheme, and which acknowledges that the different duties do not require trustees to take multiple steps to satisfy multiple duties where one step can suffice for more than one duty.

6. DISCRETE DUTY: SCENARIO PLANNING (QUESTION 6)

6.1 The Consultation recognises that scenario planning is likely to be one of the most complex parts of the TCFD recommendations for an organisation to undertake. We agree with this. We note that this is likely to be a particularly complex exercise for an organisation to undertake where that organisation is an institutional investor (such as a pension scheme trustee), and where the scenario analysis is to be carried out on its investment portfolio. In this case, the analysis is not limited to assessing the impact of different climate scenarios on a single entity; rather the portfolio effectively consists of many hundreds of different investee entities who may all be affected by different climate scenarios in different ways.

6.2 Level of scenario analysis – role of the trustee in the investment process

6.2.1 We think the type and extent of the scenario analysis that is carried out by the trustee (as opposed to others in the investment chain) should have proper regard to the trustee's role in the investment process. Trustees are generally not authorised to take day to day investment decisions and would not be expected to (nor indeed legally able) to make investment decisions at an individual stock selection level. Such decisions will usually be delegated to discretionary managers or the managers of pooled funds in which trustees invest. Importantly, trustees cannot choose to either invest or disinvest in any specific investee company because of the specific climate related risks or opportunities represented by that investment, and in many cases will not have any certainty as to the specific investments (at an entity

level) that are likely to form part of the investment portfolio at any future point.

6.2.2 The consultation recognises that scenario analysis can be undertaken in different ways and at different levels (including both qualitative and quantitative) and could be top down (by reference to features of particular types of assets/sector investments), or bottom up by reference to the specific investments in the portfolio, with statutory guidance covering how trustees should approach this exercise.

6.2.3 The purpose of the scenario analysis is to help trustees identify the potential climate-related risks and opportunities which they face and, presumably, be able to take actions in response when discharging their ongoing duties discussed above. It is important that the scope of the scenario analysis that trustees are expected to carry out (as set out in the statutory guidance) takes account of the trustees' proper role in the investment process, and at a level which can usefully inform the type of investment decisions that trustees can take. For example, carrying out scenario analysis at an investee entity level may be of limited use, recognising that in most cases it is highly uncertain whether those specific stocks will form part of the portfolio in years to come, and trustees are not the ones taking those stock selection decisions.

6.3 Choice of scenarios

6.3.1 The consultation suggests that trustees should be able to choose the scenarios that are analysed, subject to one scenario being an ultimate temperature rise of between 1.5 – 2°C.

6.3.2 We recognise that this choice is intended to give trustees flexibility to choose a scenario that might be most relevant to their circumstances. However, we can see some disadvantages of this. Trustees are not climate scientists and cannot be expected to know which scenarios are more or less likely to occur. Consequently, imposing an obligation which requires them to spend time and resource in deciding what alternative scenario is most appropriate to model and which is most relevant to the scheme may not be the most efficient use of resources. Equally, we think there is a risk that this choice is wrongly perceived by members as equating this to either a climate scenario objective of trustees, or the trustees' views of what climate scenario objective is most likely.

6.3.3 It may be more helpful therefore for the guidance to give a very clear direction to what type of second scenario it would be appropriate for the scheme to choose, by reference to objectively identifiable circumstances of that scheme.

6.3.4 We also question whether having more prescribed parameters around the scenarios that should be modelled (even within the 1.5-2°C scenario) may help drive the development of information flows and modelling resources (throughout the investment chain) that are available to in investors if there was a narrower range of prescribed potential scenarios that schemes would be required to model.

6.4 The comments made elsewhere in this response as to the availability of resource to help the trustees carry out these obligations is particularly relevant here, where we expect trustees will be heavily reliant on external resource to comply with these requirements.

7. DISCRETE DUTIES: METRICS AND TARGETS (QUESTIONS 8 AND 9)

7.1 We are broadly supportive of the proposals set out in respect of the choice, calculation and disclosure of metrics and the setting of targets and calculation of performance by trustees, as far as they are able, against those targets. We do, however, have comments as set out below. We have set these out on a general basis across the metrics and targets proposals because we see these as inter-linked.

7.2 Prescription vs. market development

7.2.1 Our view is that some prescription of metrics based on type/maturity of scheme, at least in the short term, will be useful to enable trustees to become comfortable with choosing metrics. In particular:

(a) the Consultation suggests that metrics are the characteristics that trustees are choosing to measure in order to assess assets against climate-related risks and opportunities. However, what is unclear from the Consultation, and which should therefore be set out in the statutory guidance, is the extent to which trustees should be basing their choice of metrics on the climate-related risks and opportunities identified by performing scenario analysis and the wider risk management activities undertaken pursuant to the new duties;

(b) as the trustees' analyses of different scenarios will probably yield different results in terms of risks and opportunities, we have questions around the extent to which trustees will be able to navigate these risks without recourse to additional climate advisory services, whether from their investment consultants or elsewhere. We would suggest that the statutory guidance gives clear examples of expectations in terms of how to approach the choosing of metrics, having particular regard to how trustees ought to translate the risks or opportunities they have identified into a choice of relevant metrics and how those can be objectively measured, including the types of targets that would be useful to

set and clarity over whether trustees will be obliged to try to meet those targets.

7.2.2 Alternatively, it may be more straightforward for trustees (and create broader market consensus earlier) if regulations required trustees to choose, calculate and measure performance against only *one* metric and set targets across their portfolio in respect of that single metric. We would suggest this be the weighted average carbon intensity (the "**WACI**") across the portfolio. Our view is that doing so would create confidence about the use of this metric across the pensions and asset management industries and therefore lead to better outcomes (i.e. because market consensus would be agreed on the input (the WACI), there is potential for earlier consensus on methodologies for performance measurement and earlier agreement on the types of targets that should be set across the industry, including how to approach meeting those targets). DWP could then review progress in 2024 and include the choosing of new, additional metrics at that stage.

7.2.3 Ultimately, without greater prescription in the statutory guidance, at least at this early stage, we are concerned that the requirements to choose metrics and set targets have the potential to be misunderstood as the imposition of discretionary non-financial factors upon investment decision making, which would put strain on the trustee-investment consultant relationship (as investment consultants will look only to financial factors in their section 36 advice and may find it difficult to advise a scheme making investment choices that are seemingly irrelevant to the time horizon of their scheme) and lead to further confusion around the law on the extent to which trustees may take non-financial factors into consideration in their investment decision making process. We think that further prescription can guard against this and strengthen the apparent policy position that climate change should be regarded as a financial factor that must be accounted for in a specific way through the TCFD recommendations, particularly by adopting a metrics and targets regime specifically around the WACI.

7.3 Data flow

7.3.1 Our concerns around data flow follow those voiced by other market participants in respect of other consultations over sustainable finance policy initiatives. We are unclear as to how trustees of pension schemes will be enabled to approach the calculation of metrics, in particular, across their portfolio as it will require: (i) engagement from the investment management industry and willingness to report available data; and (ii) changes to investment management agreements and other documentation to capture these reporting requirements and change behaviours.

7.3.2 We note that TCFD initiatives are being introduced for premium-listed issuers, and the announcement on 2 October 2020 by the Pensions Minister acknowledging the FCA's letter of 22 September 2020 setting out that the FCA will put in place TCFD reporting obligations on FCA-regulated managers and schemes in 2022, but without further detail on how the FCA will approach this, we still see issues arising as follows:

(a) *Engagement from the asset management industry and willingness to report available data will be needed*

We are concerned that the asset management industry is not yet in a position to be able to report the data required for trustees to meaningfully engage with metrics and perform calculations in respect of them.

We note the European Fund and Asset Management Association's (EFAMA) response to Question 7 of the EC Consultation on the renewed sustainable finance strategy (*Overall, can you identify specific obstacles in current EU policies and regulations that hinder the development of sustainable finance and the integration and management of climate, environmental and social risks into financial decision-making?*), and in particular:

"The assessment of the alignment with the EU taxonomy is only feasible as long as asset managers can obtain the specific data on the investee companies. ***Such data is currently largely unavailable****.* [Emphasis added.] *The NFRD review is essential for closing this data gap. However, data resulting from the NFRD review cannot be realistically expected to become systematically available earlier than in 2-3 years' time."*

Our view is that it is correct that both the asset management industry and occupational pension schemes ought to start requesting information down the chain to investee firms. However, we note that there is currently no corresponding statutory requirement for investee firms to provide TCFD reports, nor is it required of all investee firms to provide the types of information required in order for pension scheme trustees to engage in TCFD reporting themselves.

We understand that, at the EU level, a review of the Non-Financial Reporting Directive (Directive 2014/95/EU) (**NFRD**) is ongoing, largely to aid the implementation of the Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088) (**SFDR**) and the Taxonomy Regulation (Regulation (EU) 2020/852). However, part of the aim of the EU's renewed sustainable finance strategy

appears to be to extend the scope of regulation and increase the regulatory requirements on investee firms to report on non-financial information, including the types of information that would be useful to both the asset management industry to fulfil their obligations under SFDR (and which would also be useful for asset managers to meet future obligations put in place by the FCA as referenced above) but which would also aid them in passing that information along the chain to pension scheme trustees, in order that they may fulfil the requirements set out in the Consultation.

At the EU level, there appears therefore to be a drive toward deeper consistency of reporting in this area across all financial market participants (i.e., not just institutional investors and public interest entities, such as listed companies, banks and insurers). We would suggest that such consistency across all financial market participants is considered within the UK to ensure that asset managers are able to obtain relevant data and pass this along the chain to UK occupational pension schemes. Reliance on pension scheme trustees to drive this change, in our view, is inconsistent with the rapid development of reporting by all actors within the financial markets. The Pensions Minister's announcement on 2 October 2020 is useful from this perspective, but a commitment to TCFD reporting for FCA-regulated entities by 2022 does not align with the requirements set out under the Consultation, which will mean pension scheme trustees will need to report up to a year earlier than their asset managers will be required to report themselves.

Additionally, our view is that compelling a broader range of financial market participants to report on TCFD or on the types of information set out in NFRD and SFDR will encourage the adoption of quantitative approaches to the choice and measurement of metrics at an earlier stage than would be otherwise available in the market.

(b) *Changes to investment management agreements and other documentation will be needed to capture these reporting requirements and change behaviours*

Linked to the above is the fact that, should trustees be unable to obtain data across their portfolio, they will need to explain why they have not been successful in so doing. Whilst we appreciate that DWP will set out in the statutory guidance the types of explanations that will be relevant and useful, our view is that there

may be timeline implications as the requirements on trustees will impact legal documentation and there may be significant pushback from the asset management industry given the above (i.e. that they will not have to TCFD data report until a later date). We also see an issue of inconsistency: it is welcomed that asset managers will be required to provide TCFD reporting on their own portfolio, but unless this requirement extends to assisting clients with TCFD reporting on their portfolios, we see some difficulty in obtaining asset manager cooperation with reporting obligations. On the one hand, it may be that asset managers will start to obtain the types of data necessary to their pension scheme clients for trustees' own reporting through commercial pressure, but from the legal perspective, we can foresee uncertainty and additional costs associated with managers breaking down what they receive across their own portfolio into relevant data to pass on to clients.

7.4 In-house asset management

7.4.1 Our view is that these changes may in some respects be easier for in-house managers to implement into their investment management agreements and reporting to trustees. In-house asset managers (i.e. asset managers either owned by the trustee of the scheme or whose only client is the scheme) are at an advantage in terms of the fact that they have only one client (i.e. the scheme) with lines of sight across the entire portfolio of that sole client. Updates to investment management agreements and reporting thereunder should be more straightforward as, in many cases, it may be treated in a similar way as an internal compliance update rather than requiring a commercial negotiation.

7.4.2 However, with a particular focus on in-house asset managers, statutory guidance should set out the resources available to managers to obtain data across their scheme's portfolio. This would assist trustees and their in-house managers to develop meaningful reporting obligations and to choose meaningful metrics (to the extent they must choose metrics in addition to the WACI across the portfolio) to calculate and report on in their TCFD Reports. Statutory guidance on the expectations of targets in respect of those metrics would also be useful.

7.5 Quarterly reporting and measurement obligations

7.5.1 We have a concern that quarterly reporting by asset managers of data to calculate metrics by trustees of pension schemes is ultimately impossible without first requiring investee firms to provide such data on a quarterly basis.

7.5.2 Our understanding is that where the law requires reporting of the underlying data required in order to carry out calculations of chosen metrics on a quarterly basis, such reporting obligations are tied to the annual reporting cycle, rather than requiring updates on a quarterly basis (see e.g., the UK's implementation of NFRD via *The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016*).

7.5.3 As a result, we would suggest that quarterly calculation will be challenging for trustees to carry out as it will (i) incur costs as it will require trustees' investment consultants to provide input, alongside further meeting time; and (ii) not produce relevant outcomes given that the underlying data used to make such calculations is unlikely to have changed within the quarter.

7.5.4 Our view is that these calculations ought to be carried out on an annual basis or a more infrequent basis, much in the same way that trustees will typically evaluate the wider funding and investment journey plan of their scheme. The metrics and targets regime, in our view, ought to link in with trustees' endgame planning so as to ensure relevant and scheme-specific outcomes.

8. DISCLOSURE AND REGULATORY ENFORCEMENT (QUESTIONS 10 AND 11)

8.1 We broadly agree with the proposed approach to disclosure of TCFD reports and enforcement of non-compliance. Please see our comments in paragraph 3.4 above which suggest an easement to help schemes acclimatise to the regime in the first year.

8.2 In relation to disclosure, we would encourage the Department to reflect further on the potential for overlap between the new TCFD report and implementation statements under disclosure regulations.[1] For schemes which are 'relevant schemes' under the disclosure legislation, we anticipate that there could be significant duplication here where schemes have already adopted climate risk related investment policies in their SIP - particularly in the early years of the TCFD regime. More generally, the law on climate change and ESG disclosures for pension schemes will now derive from a variety of sources. In the longer-term, it would be useful for the Department consider the possibility of consolidating the various duties and reporting obligations into a single, more cohesive regime. This could be considered as part of the 2024 review of the TCFD duties, for example.

8.3 We agree that limiting automatic regulatory penalties to instances of total failure to comply, with discretionary penalties for all other breaches, is sensible. This should help avoid the inflexibilities and challenges that have arisen in respect of DC Governance Statements.

[1] Regulation 12 and Paragraph 30 of Schedule 5 to the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013, as amended.

9. CONCLUSIONS

9.1 We hope this consultation response is useful to the Department. We agree that climate change is a key societal issue and that in practice pension schemes and their advisers could have a significant role to play in the coming years. It is important to strike a balance between this policy priority and the other social and economic functions of pension schemes and their longstanding legal duties to beneficiaries. We believe the suggestions outlined in this response will help achieve this.

9.2 We would be very happy to discuss this response, or any other aspect of the proposals, further. Please contact our Pensions partners Andy Lewis (andrew.lewis@traverssmith.com) or Susie Daykin (susie.daykin@traverssmith.com) if this would be helpful.

Yours sincerely

Travers Smith LLP