6 January 2022

Dear all,

We are very pleased to respond to the Department for Work and Pensions open consultation on ‘Climate and investment reporting: setting expectations and empowering savers-consultation on policy, regulations and guidance.’ UKSIF and our members see this consultation playing an important role in encouraging the UK’s pensions industry to more effectively respond to climate risks and take greater steps to protect their members’ savings from the serious threat these pose.

UKSIF is the membership organisation for the UK’s sustainable finance community, representing more than 270 members with over £10 trillion of assets under management, including investment managers, pension funds, banks, financial advisers, data providers, NGOs, among others committed to promoting a more sustainable and inclusive financial system that works for the benefit of society and the environment.

We are proud of the progress the UK has achieved over recent years to promote the growth of sustainable finance at home and to demonstrate global leadership. UKSIF and our members have looked to play a key role in this respect by working closely with policymakers and others to find new ways to overcome the barriers to the growth of sustainability in the UK. We will look to continue to play our part, including through our membership of the Green Technical Advisory Group advising on the UK’s ‘green taxonomy,’ and we look forward to helping ensure the UK’s taxonomy can set the highest possible standard for green investment for the rest of the world to follow.

Despite the progress achieved in recent years, we know there is much further to go to ensure the UK can meet its ambitions. An important part of this will be providing far greater visibility and transparency over the extent to which financial services firms’ investments and lending are aligned with the goals of the Paris Agreement and the UK’s 2050 net-zero objective.

We therefore very warmly welcome DWP’s proposals requiring pension schemes to measure and report a portfolio-alignment metric, which will be invaluable to communicate to clients, savers and other stakeholders the extent to which schemes’ investments are aligned with the Paris Agreement goal of pursuing efforts to limit global average temperature rises to 1.5 degrees.

Q1. We propose to amend the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 to require trustees of schemes in scope to measure and report their scheme’s Paris-alignment by adding a requirement for them to select and calculate a portfolio alignment metric and to report on that metric in their TCFD report. Do you agree with this policy proposal?

UKSIF is broadly supportive of the proposed requirement for pension schemes to measure and report on a portfolio alignment metric, and include this within their TCFD reports. A portfolio alignment metric has the potential to be a very powerful and impactful communication tool, by improving pension scheme members’ engagement with their investments, delivering greater accountability in the pensions sector and better informing investors’ stewardship and engagement activity.
While there are undoubtedly challenges that will need to be recognised and addressed by government in the final proposals, such as the continuing lack of agreed methodologies for measuring Paris-alignment, questions around the accurate picture any portfolio alignment metric can truly present for savers (e.g. with it not being able to cover and measure all asset classes in a portfolio), and the envisaged significant costs for pension schemes, UKSIF see the proposals as a positive step forward in the right direction for the UK’s pensions industry.

Q3. We propose to incorporate the requirements to measure and report a portfolio-alignment metric into the existing Climate Change Governance and Reporting Regulations so that the requirements are subject to the same disclosure and enforcement provisions as the other metrics requirements. Do you agree with this policy proposal?

As highlighted above, we support a portfolio-alignment metric forming part of pension schemes’ TCFD reports, which will be particularly important to give clarity to clients and savers and to avoid duplicative requirements for schemes.

In the years ahead, with the Sustainability Disclosure Requirements (SDR) regime being rolled out across the UK economy, careful consideration will need to be given by government to how a portfolio-alignment metric can be seamlessly incorporated into reporting against SDR in future and integrated alongside the regime’s multiple other requirements. These include reporting against the UK’s ‘green taxonomy’ and International Sustainability Standards Board (ISSB) standards.

Q4. (b) Do you have any comments on the draft amendments to the statutory guidance? Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter. We particularly welcome comments on the definition of a portfolio alignment metric and whether respondents think it reflects the policy intent?

We believe the 1.5 degrees Celsius baseline identified in DWP’s proposals for trustees to report against when considering their degree of Paris alignment is very positive. We support the inclusion of this baseline, as opposed to a 2 degrees Celsius scenario or other scenarios, given the urgency of the challenges we face on climate change and with the ambition to pursue the 1.5 degrees target now collectively recognised by policymakers and business globally as the necessary global ambition to pursue. The COP26 Summit in Glasgow provided real positive momentum behind this target, as opposed to a 2 degrees objective, and we would urge government to maintain its 1.5 degrees baseline to signal ambition for the UK’s pensions sector.

Amending the baseline to “well below 2 degrees Celsius” for example could lead to inconsistent disclosures from schemes, particularly if some report in line with a 1.5 degrees scenario, while others report in line with well below 2 degrees scenario, or a 2 degrees scenario. Separately to our views above, we believe the following areas should be considered further by DWP ahead of implementation of the final proposals.

Clarification by government on the role and purpose of portfolio alignment metrics

It will be important for government to ensure in its proposals that pension schemes’ selection of a portfolio alignment metric does not give the impression to pension scheme members, and stakeholders at large, of a set, mandatory net-zero target that must be achieved. The main purpose of the metric, as government has highlighted, should be to provide greater transparency over the progress made by schemes in decarbonising their portfolios over time, rather than committing to a mandatory 1.5 degree Celsius target at the outset, particularly with the real economy not yet aligned in this way.

DWP’s final guidance, and ministers publicly as well, should continue to reiterate that the true intention of a pension scheme’s portfolio alignment metric is not for a scheme to meet a mandatory 1.5 degree aligned target by a certain date, but instead to show investments’ evolutionary progress over time towards this goal. Its role as an additional, complementary fourth metric through which schemes can assess alignment with a more sustainable trajectory in a much more ‘forward looking’ manner should be actively stressed, rather than as the sole, or necessarily the most effective, way to measure Paris alignment.
Having this metric to report progress against will undoubtedly be positive for schemes, recognising that this will be an evolutionary process. We know that different portfolios, investment strategies, and asset classes will each have very different pathways to net-zero and will reach a specific climate or net-zero target in a very different manner. For example, the carbon intensity of a particular portfolio may fluctuate in the short and medium term significantly as a manager re-allocates capital within different sectors, while still aligning with the 1.5°C Paris Agreement goal or achieving net-zero by 2050 (reducing the carbon footprint of a portfolio will not equate necessarily to long-term temperature alignment). While this will not always follow a linear path downwards, we do expect the general trend to be lower for portfolios.

This clarification of the purpose of portfolio alignment metrics, and reassurance that the implication is not a strict approach to mandatory net-zero targets, should help better inform schemes in their communication with their members over their chosen metric, including instances where stewardship could help decarbonise high-emitting companies in their portfolios. It could help minimise the risks of stakeholders ‘naming and shaming’ schemes for not achieving a 1.5 degree trajectory by a certain date, which could pressure schemes into inadvertently adopting wholesale divestment.

**The continued importance of investor stewardship**

We want to make sure that pension schemes are not actively discouraged in DWP’s proposals from investing in transitional activities and sectors, and from engaging in active stewardship with these companies. Active engagement can be a very effective approach to convince companies to deliver progress on areas such as increasing the percentage of a company’s capital allocation to new green investments.

**UKSIF believes that DWP should continue to reiterate the vital importance of investors’ stewardship role and reflect this in its final guidance, while warning of the dangers of an exclusive focus on divestment by schemes to improve their portfolio’s temperature alignment rating.** We continue to believe a strong focus on divestment by investors will not lead to meaningful decarbonisation of the real economy in the long term.

A single portfolio level figure will arguably not illustrate a full, accurate picture for scheme members and government should be attune to the possibility of scheme trustees focusing predominantly on lowering the figure for a portfolio’s temperature rise rather than prioritising engagement. We know some of our members may score less well on certain portfolio alignment metrics compared to others as a result of their investments in more transitional activities and technologies, such as battery technology, solar supply companies or other more capital-intensive businesses that still are contributing positively to the transition, and this group should not be penalised in the proposals, especially if they are engaging actively with these companies.

**Data availability for pension schemes**

While pension schemes will, and should, engage in active stewardship to pressure companies to disclose climate-related risks and opportunities, data gaps will undoubtedly remain which the consultation positively recognises as a ‘key challenge.’

Data gaps, particularly in relation to private market activities such as private equity, will cause some complexities for schemes, particularly as some smaller schemes may not have the in-house expertise. They may rely on third-party ESG providers and tools for their emissions and temperature-scoring data, which could vary hugely. For example, data provider estimates on Scope 3 data can contrast significantly, particularly with very few companies providing this data, and there can be up to 15 categories within Scope 3 emissions to measure, with most companies reporting on one or two categories and not all reporting on the same categories of Scope 3 emissions. Estimation and proxy models are not currently able to remedy this issue, and there is the danger these could underestimate the extent to which a portfolio is aligned with the Paris goals. Estimates from third-party providers, or in-house, can only go so far in accurately assessing portfolio temperature ratings, though we expect these to improve in time.

To help remedy these issues, the final proposals should actively encourage pension schemes to supplement their chosen portfolio-alignment metric with qualitative commentary and appropriate ‘health warnings’ to provide a much more holistic picture for clients. While a portfolio-alignment metric is very positive, it should be recognised they will only provide a partial picture to investors and savers and most will want to establish a richer, more nuanced view on how their investments are addressing climate-related issues.
Addressing diversity in portfolio alignment metrics through pursuing greater alignment over time

We agree with DWP that one portfolio alignment measure should not be favoured at present by government over another, given the lack of consensus on methodologies and pension schemes’ hugely varying investment approaches and different net-zero pathways for different asset classes.

The diverse range of portfolio-alignment metrics, while positive in providing flexibility to schemes, could however lead to a series of very different approaches taken in the sector. The encouragement therefore of greater alignment of metrics over time by DWP, the regulator and industry will therefore be hugely important to help minimise confusion for clients and savers, including their ability to compare different products, and for reporting purposes. We would encourage DWP to review carefully the initial wave of reporting by schemes, with the intention of updating the list of portfolio alignment metrics that could be chosen by schemes, following consultation with the sector.

As mentioned, we expect many pension scheme trustees not to be able to obtain the underlying data needed to measure the Paris alignment of an entire portfolio, in particular for private asset classes and sovereign bonds. We therefore welcome DWP’s inclusion of the ‘as far as they are able’ principle to reflect the anticipated data gaps faced by firms in calculating a metric, and support DWP and the FCA to continue working with global regulators and bodies, such as IOSCO, over co-ordinating work on common frameworks for portfolio alignment metrics.

For our smaller pension scheme members in particular, we envisage challenges around costs and some of them will exclusively rely on free tools which unfortunately can have significant flaws, such as a ‘positive bias’ towards more profitable companies, with less profitable companies ‘punished’ by contrast despite offering solutions to the transition to a low-carbon economy. Schemes should also be able to report on the portion of their fund on which it is reporting, setting out the percentage of assets on which they are reporting and not be penalised for doing so.

In conclusion, DWP’s proposals on portfolio alignment metrics will be an invaluable starting point for pension schemes in communicating to scheme members how they intend to shift their investment towards Paris-alignment. While there will be some challenges in this process, we very warmly endorse the direction of travel set out in the proposals.

Finally, on the proposals relating to the draft Guidance to clarify expectations around the Statement of Investment Principles (SIP) and Implementation Statement (IS), we broadly welcome the proposals and hope the guidance will markedly improve trustees’ management of climate risks and boost the overall quality of SIPs, which we have voiced very strong concerns over in recent years. We support the ability for schemes to use disclosures from the UK’s Stewardship Code in the IS, which should improve consistency in reporting among schemes.

I hope you will think of UKSIF and our members as a constructive partner as you progress this important work, and I look forward to working with you and your team in this area.

Yours sincerely,

James Alexander
Chief Executive

CC: Rt Hon Thérèse Coffey MP, Secretary of State for Work and Pensions; Guy Opperman MP, Parliamentary Under Secretary of State (Minister for Pensions and Financial Inclusion)