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5th January 2022

Dear Anne, Mel, Emma, Tom, Mark and Vanessa,

I am writing to respond to the Department for Work and Pensions' consultation, *Climate and investment reporting: setting expectations and empowering savers,* on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by pension schemes and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the view of clients, beneficiaries and pension scheme members.

Measuring and Reporting Paris alignment

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?

We strongly support the proposal that trustees of pension schemes in scope measure and report their scheme's Paris-alignment.

The first step to aligning pension schemes with net-zero is closing the knowledge and transparency gap – requiring them to publish data on Paris-alignment will help achieve this. Many pension trustees we speak to want to decarbonise their portfolios but are often unsure of where to start. By driving up engagement with science-based metrics which quantify the extent to which investments accelerate global warming and lead to unsafe climate pathways, trustees will be empowered with the knowledge to make more responsible investment decisions, starting with the most damaging of their investments. Thus, trustees, and their fund managers, will have a better understanding of what actions need to be taken to ensure the emissions they finance are decarbonised in line with UK climate targets.

We especially welcome these proposed measures because they will not just empower pension trustees, but savers too. A survey conducted by YouGov commissioned by Make My Money Matter found that 61 per

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cent of adult surveyed wanted their pension to play an active role in fighting climate change, but that 80 per cent had never considered whether their monthly contributions could be contributing to global warming[1]. If savers have implied temperature pathways data readily available to them, it may encourage them to take more of an active interest in their pensions and where their money is invested. Some might argue it is difficult to truly capture the sustainability of a portfolio through a single number representing an implied temperature pathway. But from the point of view of engagement with savers, this simple metric represents a real opportunity to engage more widely and inclusively – portfolios measuring any higher than 1.5C warming being dangerous for human and planetary health is an uncomplicated concept to grasp. Furthermore, as the Paris-alignment metric will be set in the context of other TCFD disclosures, it will not be the only way to measure and understand the scheme's progress on climate change.

Finally, we support this proposal because it could improve the quality of engagement between pension trustees and savers. Some pension schemes already see the value in this – for example, Scottish Widows recently announced that their workplace pension savers will be able to use a tool to find out how environmentally friendly their investments are through an app which will assess companies' carbon footprints, waste, and board diversity. Crucially, it will also allow members to give their views on a range of investments. DWP's proposals to mandate disclosure of implied temperature pathways data is the first step to improving communications and engagement between savers and pension trustees. Of course, disclosure of data is the first step and quality stewardship as a result is not guaranteed, so The Pensions Regulator should continue to issue guidance on 'best practice' for dialogue. For example, perhaps schemes could be mandated to notify savers of their initial implied temperature pathway estimates, and then continue to communicate these, and how they change, on a yearly basis in their annual statement.

Overall, we welcome these proposals as a step in the right direction towards the end goal of pension trustees and savers having these important conversations.

Q2. We propose that:

(a) trustees who are subject to the requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations on or after 1 October 2022 (including trustees to whom the requirements are re-applied in accordance with regulation 3(4), 4(4) or 5(4)) will be required to select, calculate and report on a portfolio-alignment metric and to publish the findings in their TCFD report within 7 months of the relevant scheme year end date in the same way as they are for other metrics. This will apply to:

- **trustees of a trust scheme which had relevant assets equal to, or exceeding, £5 billion on their first scheme year end date which falls on or after 1st March 2020, and who remain subject to the requirements in Part 1 of the Schedule on 1 October 2022**
- **trustees of a trust scheme which has relevant assets equal to, or exceeding, £1 billion on a scheme year end date which falls on or after 1st March 2021**
- **trustees of all authorised master trusts and authorised collective defined contribution schemes**

After 1 October 2022

(b) trustees will cease to be subject to the requirements to select, calculate and report on a portfolio alignment metric in accordance with regulations 3(4), 4(3), 4(5), 5(3) and 5(5) of the Climate Change Governance and Reporting Regulations, in the same way as they would be for other metrics:

[1] https://www.ftadviser.com/pensions/2021/05/05/nearly-half-of-savers-would-switch-to-greener-pensions/

- **trustees of a scheme with relevant assets of less than £500 million on a scheme year end date which falls after 1 October 2022 will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must still report on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless the relevant assets on the scheme year end date were zero**
- **trustees of an authorised scheme which ceases to be authorised after 1 October 2022 (a “formerly authorised scheme”) and which had relevant assets of less than £500 million on the scheme year end date immediately preceding the scheme year in which authorisation ceased, will cease to be subject to the requirements to select, calculate and report on a portfolio alignment metric with immediate effect**
- **trustees of a formerly authorised scheme which has relevant assets of less than £500m on a scheme year end date after authorisation ceased, will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must still report on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless the relevant assets on the scheme year end date were zero**

Do you agree with these policy proposals?

We broadly agree with the wording of the draft regulations on scope and timing. We agree that it is reasonable to introduce this requirement without phasing for the reasons set out in the consultation document. However, we would recommend that DWP includes Paris-alignment reporting within the scope of the 2023 review on potentially extending the scope of the reporting requirements to smaller schemes.

We support the proposal to align these new requirements with TCFD reporting regulation as much as possible, to simplify the reporting process for pension schemes and avoid burdening them with diverging requirements. We agree that embedding their portfolio alignment metrics within existing TCFD reports seems most sensible, since this will provide relevant context for schemes’ climate-related financial disclosures.

However, to ensure savers are aware of this added metric, we think DWP should encourage schemes to make efforts to inform savers of the implied temperature pathways of schemes, rather than simply publish it in the TCFD report (which many savers might not know exists). This could be through publication of the portfolio-alignment metric on the website or in annual statements (perhaps next to the link to the TCFD report, for savers who want to find out more).

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?

We support the proposal to align these new requirements with TCFD reporting regulation as much as possible, to simplify the reporting process for pension schemes and avoid burdening them with diverging requirements.

Q4.

(a) Do you have any comments on the draft amendments to the Regulations?
(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 "portfolio alignment metric" and whether respondents think it reflects the policy intent?

We are supportive of measuring portfolio alignment with the Paris temperature goals, but we have some concerns over proposals to provide pension trustees with the choice of three metrics which can produce very different outcomes.

Whilst benchmark divergence models and implied temperature rise (ITR) models are more forward-looking, binary target measurements can open the door to greenwashing. This tool measures the alignment of a portfolio with a given climate outcome based on the percent of investments or counterparties in said portfolio with declared net-zero/Paris-alignment targets – but declared targets are very different from targets based on credible transition plans. There is a danger that schemes choosing this metric will be able to claim their portfolios are broadly Paris-aligned due to company pledges to do so, without scrutiny of companies' progress towards these goals. The number of net-zero targets has grown exponentially since the launch of the UN Race to Zero in 2019[2]. Countries with such targets now account for more than two-thirds of global GDP and one fifth of the world's 2,000 largest public companies have committed to reach net-zero emissions.[3] However, only a quarter of these companies meet the criteria set by the UN for the race to zero to be credible.[4] This includes setting interim targets and reporting on progress every year.

There is therefore a significant accountability gap, and to avoid potential greenwashing, we recommend that DWP reconsiders allowing binary target measurements, or gives preferential treatment to the other two metrics. It would be counterintuitive for schemes to invest time in Paris-alignment reporting to then choose a metric that is less comprehensive than it could be. Whilst it is true that the market has not yet coalesced around a single approach, and methodological standardisation has yet to emerge, this could be an opportunity for DWP to form a decisive stance and steer the market in the direction of more robust metrics.

At the very least, DWP could mandate certain levels of stewardship and scrutiny of companies by trustees (or their asset managers) where pension schemes have adopted the binary target measurement, to ensure binary assertions of companies being Paris-aligned are backed up by short-term climate goals.

Q5. Do you have any comments on the new regulatory burdens to business and benefits of requiring schemes to measure and report their Paris alignment?

We are very supportive of these new regulations. Given the work schemes are already expected to do in respect of TCFD reporting (including in respect of metrics), we don't believe that the additional work needed to publish implied temperature pathway data will be overly burdensome. Furthermore, we estimate it will only get less burdensome with time as schemes become adept at TCFD reporting, and increased data becomes readily available. The proposed requirements are well streamlined with TCFD reporting requirements which we support as this will save time. This proposed regulation is a natural progression from an existing framework rather than a cumbersome divergence.

We strongly agree that not having complete or wholly accurate data does not prevent schemes from taking steps now to start to assess their exposure to climate risk. Whilst data may not be perfect, it's better that pension schemes take steps now, given the urgency of the climate crisis and the power pension schemes

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[2] United Nations (2020). "Commitments to Net Zero Double in Less Than a Year". Press Release. Available online at: https://unfccc.int/news/commitments-to-net-zero-double-in-less-than-a-year [accessed 3 August 2021].

[3] Energy & Climate Intelligence Unit and Oxford Net Zero (2021). "Taking stock: a global assessment of net zero targets", page 19. Available online at: https://ca1-eci.edcdn.com/reports/ECIU-Oxford_Taking_Stock.pdf [accessed 3 August 2021]

[4] United Nations (2021). "Race To Zero Campaign". Available online at: https://unfccc.int/climate-action/raceto-zero-campaign#eq-3 [accessed 3 August 2021]

hold. The proposal that schemes act “as far as they are able” to calculate the metrics will assist trustees when there are data gaps.

That said, it would be easier for pension schemes to report more fully on Paris-alignment if Scope 3 emissions were mandated in the TCFD reporting by companies and asset managers. At present, BEIS have said Scope 3 emissions can be reported on a voluntary basis, and after gaining large support for making this mandatory in consultation responses, BEIS responded they would ‘consider’ changing this in future. Scope 3 is often the greatest share of an organisation’s carbon footprint by a significant margin – many organisations report that 80% of their emissions fall under Scope 3 and, for some, Scope 3 accounts for as much as 97% of their overall emissions[5]. If laggard companies use this loophole and fail to report on their Scope 3 emissions, this could make it more difficult for pension trustees to judge portfolio companies’ true performance.

Q6. Do you have

a. any comments on the impact of our proposals on protected groups and/or 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

No comment.

<u>Stewardship and the Implementation Statement</u>

Q7. Should DWP include a vote reporting template in its implementation statement Guidance which trustees are expected to use?

We support the inclusion of a **voting reporting template** in the implementation statement Guidance which trustees are expected to use. Voting is a binary activity and it is easy to standardise reporting and to ensure that key information is covered. Having standardised information in the market will make it easier for members, regulators and others to understand. However, trustees should be allowed to report additional information if they wish and so it would be worth making clear that any template is setting a minimum expectation.

If so, should such a template be based on the PLSA’s vote reporting template? What changes, if any, would be needed to the PLSA template if it were to be adopted?

We think that some of the PLSA’s template may be too granular for members to understand (although the information could still be provided in the Implementation Statement, in a template it may make voting disclosure look too complex for members to digest). In terms of providing clear headline information on votes, a template could helpfully cover: (1) the information set out at paragraph 63 of the draft Guidance in relation to Significant Votes (which is taken from the PLSA template’s section on Most Significant Votes); and (2) the overall voting statistics of the scheme, as set out in the “Voting Statistic” section of the PLSA’s template. If this were presented in a template, that would be helpful.

However, we are concerned that one consequence of requiring trustees to use the PLSA template to report to members may be that the template becomes the default for trustees to get information *from asset managers*. We have heard from industry that there are problems with how this is working. As we understand it, the Government's intention is to get trustees to take responsibility for thinking about why votes are cast (i.e. their policy) and which votes are significant. This is meant to be the case even if asset managers vote on the trustees’ behalf (n.b. paragraph 64 of the draft Guidance, which still sees trustees

[5] https://www.edie.net/downloads/edie-Explains--Scope-3-carbon-emissions/492

making the decision about which votes are significant). If trustees are doing this, then all they need from asset managers is the raw data on how holdings were voted. They can then plug this into a template or present it in the way that works best for them. The PLSA template does not provide the raw data and it allows asset managers to select significant votes that may not match trustees' significant votes. This will likely lead to unnecessary back and forth between trustees and asset managers as they seek to "negotiate" what counts as significant. If Government succeeds in getting trustees to engage on this area, trustees will be requesting different "significant" votes from asset managers (different to other trustees and different to the asset manager itself) and so the simplest thing would be for trustees to be given the raw data in a standardised format and to "slice" it their way.

What are your views on the adoption of an engagement reporting template? Should it be separate from any vote reporting template or integrated with it, so that – in relation to equities – both voting and engagement activities are described for the same set of assets?

On **engagement reporting templates**, we believe that there is more nuance to this element of reporting. We support DWP directing trustees towards an engagement reporting template that they can use if they wish, but we do not think this template should be mandatory. This could be included as part of the voting template - we don't feel strongly either way. However, one practical risk with this combined approach is that the voting records may become unwieldy and harder to follow or, conversely, trustees may do very brief engagement reporting to squeeze it alongside voting records.

We think that good quality engagement reporting is what is needed and this can be achieved by trustees in a number of ways. Ideally any template would give trustees a steer on what to cover but also allow trustees flexibility to report in a different way and move them away from seeing this as a tick-box exercise. To ensure that this reporting is still of a high standard, DWP could:

- Provide the template on a "comply or explain" basis so that trustees wishing to use a different approach are required to explain why this is appropriate before doing so; and/or
- Set out in the Guidance the expectation that any alternative approach cover either some minimum range of factors or cover the areas covered by the template, but with the ability to expand beyond these. For example, it could be made clear that any reporting has to cover outcomes/impact of engagement and include any next steps/escalation.

Q8. Do you have any comments on our cross-cutting proposals for the Guidance on Statements of Investment Principles and Implementation Statements, in particular that: (a) they are written for members? (b) the Guidance reiterates that these are trustees' statements, not their consultants'? (c) Implementation Statements should set out how the approach taken was in savers' interests? (d) trustees should be able to include material from voluntary disclosures, such as Stewardship Code reporting, as long as they meet the requirements in the Regulations?

We strongly agree with the cross-cutting proposals for (a) to (d).

We particularly support the proposal that "Implementation Statements should set out how the approach taken was in savers' interests". As well as helping to ensure that the IS is written with the member audience in mind, this will also inform trustees' approach to stewardship and ensure that it is linked to consideration of what is in the interests of the members of the particular scheme as opposed to being the stewardship activity their asset manager happened to be doing or a stewardship initiative that it was easiest for the scheme to join in with. This should help move trustees and schemes away from a scatter-gun approach to stewardship towards ensuring that there is a considered rationale and thought behind it.

Additionally, explaining how decisions taken are in savers' interests must work in both directions i.e. not just an explanation of why they have taken climate-positive ESG/stewardship action/decisions, but schemes must also be required to explain why a lack of stewardship, BAU, or "dirty" investment is judged to be in members' best interests. For example, a scheme must explain to members why it invests in a company

involved in new fossil fuel exploration, or a coal company – despite the non-alignment of those activities to climate science – and the financial risk involved to long-term asset owners.

Q9. (a) Do you have any comments on our proposed Guidance on stewardship policies?

ShareAction supports the draft Guidance on stewardship policies. We particularly support the following:

- **Paragraphs 16 –19** on the expectation that trustees explain how stewardship activities are in scheme members' and beneficiaries' best interests and the possibility of considering both financial and non-financial matters. Stewardship is about risk management and many so-called non-financial matters may become financial risks in the future and/or have systemic implications.
- **Paragraph 20** setting out that trustees have responsibility for the SIP and for the IS. When responsibility for these policies and documents is (wrongly) delegated to advisers it undermines the trustees' ability to learn and reflect on whether or not they are acting in their members' and beneficiaries' best interests. We believe that trustees will feel less ownership over, and less accountable for, policies and documents that have been significantly delegated. Furthermore, we have seen boilerplate-style policies used by advisers which convey less specific information and are less useful to members and TPR.
- **Paragraph 23** setting out the UK Stewardship Code definition of stewardship, which will be helpful for schemes that are less familiar with the Code.
- **Paragraph 26** setting out that stewardship goes beyond listed equities. This is in line with the UK Stewardship Code but is often overlooked.
- **Paragraph 28** setting out that it is not enough for trustees to simply report that they have delegated stewardship to their asset managers. Statements to this effect tell members and TPR nothing about the trustees' approach to stewardship, how they ensure high quality stewardship, and how they monitor and hold asset managers accountable.
- **Paragraphs 30 to 35** stating that trustees could select and summarise their stewardship priorities and how to do so. Stewardship should not just be random activity that has no identified purpose or goal - it should be part of a thought-through approach to managing risk in trustees' portfolios. Stewardship activities should flow from these. Otherwise, there is a risk that trustees (and/or their agents) undertake stewardship in a scattergun fashion, picking the activities that are easiest to engage with and joining the collaborations that are easiest to join, without thinking about the value this adds to savers.
- We believe that the steer in **paragraph 34** that trustees explain why they have selected the stewardship priorities they have, with reference to members' best interests, is a good way to focus trustees' minds and will make it easier for members to understand why stewardship is deemed worthwhile.
- We think the **table setting out options on voting (on page 8)** will be helpful for trustees, who may not have considered that there are options available for them to take some degree of ownership of voting.
- **Paragraph 44** is important because escalation can be overlooked and it is not always clear what will happen if the expectations set out via engagement are not met.
- **Paragraph 47** setting out clearly that there is an expectation to report engagement outcomes, as well as objectives. This aligns with the direction of travel in the UK Stewardship Code and best practices.
- In respect of paragraph 49 setting out overlap with Stewardship Code principles, we think that the following principles are also relevant to the IS in relation to engagement:

  Principle 4: Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system. This could be part of the reason a stewardship priority is chosen by trustees, for example because they have identified it as a market-wide or systemic risk.

Although going beyond the scope of this consultation, we think that if the Government is serious about driving up standards on stewardship it should amend the Investment Regulations setting out the

requirement to set out a policy on the exercise of the rights attaching to their scheme's investments, and on undertaking engagement activities in respect of those investments. These should be amended to set out in law the minimum standards that such policies should cover. Alternatively, the Government could take the approach of the FCA in its Conduct of Business rules and require schemes to sign up to the UK Stewardship Code or to explain why they have an appropriate alternative approach.

(b) Do you have any comments on our proposed Guidance on most significant votes?

We support the proposed Guidance on voting more generally (i.e paragraphs 50+).

On voting generally, we think it might be clearer if the Guidance sets out at paragraph 50 (which discusses voting rationales) when a rationale is most helpful. This could draw on the list in principle 12 of the Stewardship Code:

Explain their rationale for some or all voting decisions, particularly where:

- there was a vote against the board;
- there were votes against shareholder resolutions;
- a vote was withheld;
- the vote was not in line with voting policy.

On paragraph 52, we do not fully support the use of the PLSA Voting Template as something that trustees use to request data from asset managers as we understand that there are practical problems with this process (See above comments on Q.7).

Overall we wondered if some of the information in paragraphs 50 to 56 could be **presented as a table**, as use of these in the Guidance looks very effective. For example, a table could set out something like:

<table>
<tr><td>All schemes, regardless of whether undertaking voting decisions:</td><td>List votes cast
Break votes down by issue
Include rationales where:
there was a vote against the board;
there were votes against shareholder resolutions;
a vote was withheld;
the vote was not in line with voting policy.
Link votes to stewardship policies
Explain how voting and engagement has been in the members' best interests
Whether they have all the data or whether some is missing</td></tr>
<tr><td>Schemes where trustees have own voting policy but voting is controlled by someone else:</td><td>State whether that person has agreed to follow the trustees' policy
If not, explain why and include reasons</td></tr>
</table>

Schemes using the voting policy of their asset manager:	• Briefly summarise how the voting policy relates to scheme's stewardship priorities • Summarise whether the asset manager's voting aligns with the scheme's stewardship priorities • How trustees engage with asset managers on topics like significant votes

On significant votes, we agree that what is significant will vary depending on the scheme and that the link with stewardship priority is important. We have two suggestions on the Guidance:

- It would be helpful to add to paragraph 61 that there may be cases when a vote is significant but not linked to a previously chosen stewardship priority – this could be, for example, where it is relevant to changes in the market or wider societal context that have occurred since stewardship priorities were chosen. Although most significant votes will link to a chosen priority, trustees should not assume that they cannot count a vote as significant because it does not directly link to a priority.
- The examples in the table in paragraph 61 are good but it might be worth including a further one that captures the fact that sometimes a "significant vote" is not obviously a "headline" climate vote or an obvious biodiversity vote. Sometimes it is more the case that shareholders use standing management resolutions (e.g. on directors' appointments, remuneration, or the audit) to signal that they are unhappy with the way the company is being managed. In these cases there won't be an obvious vote to vote for/against on the actual issue itself so trustees will need to more tuned into (for example via advice issued by proxy advisers) to what is happening in companies.

We like the suggested minimum information to share as set out in paragraph 63 as this gives a comprehensive overview of the impact of voting.

Q10. Do you have any comments on our proposed Statutory Guidance on the information to be included in the Implementation Statement with regard the requirements under the Disclosure Regulations, Schedule 3, paragraph 30(f)(i)-(iv)?

We don't have any comments. We support the proposed Guidance.

Q11. Do you have any comments on our proposed Statutory Guidance on meeting the Implementation Statement requirements in the Disclosure Regulations relating to choosing investments?

We don't have any comments. We support the proposed Guidance.

Q12. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to investment strategy?

We don't have any comments. We support the proposed Guidance.

Q13. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to financially material considerations (including ESG and climate change)?

We support the proposed Guidance. We note that the summary box on page 46 of the consultation says that "The draft Statutory Guidance on the IS sets out that trustees should not report simply delegating all these matters to asset managers." We could not see this in the draft Guidance, but we think the statement should be included in this section.

Q14. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to non-financial matters?

We support the proposed Guidance. We like the encouragement in paragraph 93 that other schemes have a mechanism by which members may express their views. It might help to add here that this does not necessarily mean that trustees must undertake surveys of members' views – we have found that trustees often assume this is the only way to gather views and yet take-up of surveys is often low (often for the same reasons, we assume, that engagement with pensions is low). We have heard of more innovative methods such as member forums, focus groups, webinars, Q&As with members, use of fin-tech like Tumelo (for voting), a "pensions bus" that visits workplaces etc.

Q15. Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to arrangements with asset managers?

We support the proposed Guidance. However, there are a number of other parts of the Guidance earlier on that relate to arrangements with asset managers around voting and stewardship. We wondered whether trustees would find it easier to have paragraph 103 cross-refer back to earlier sections, to show that this later part of the Guidance builds on these. This is particularly helpful because this last section references principle 7 of the Stewardship Code, which is strongly linked to the earlier parts of the Guidance talking about voting and engagement policies.

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Thank you for taking the time to read through these answers. We are very willing to work collaboratively with DWP to ensure these proposals have the greatest possible success at aligning pension schemes with a climate-secure world.

Yours sincerely,

Bethan Livesey
Director of Policy, ShareAction