



Climate and investment reporting: setting expectations and empowering savers

Isio response to consultation on policy, regulation and guidance

Chapter 1: Measuring and reporting Paris alignment

Question one

Isio response

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.

Portfolio alignment metric

Isio supports the integration of a portfolio alignment metric given there has been widespread industry take up, which is in part due to the simplicity in communicating climate alignment using this metric.

Methodology

We have some concerns related to the consistency of how portfolio alignment metrics are monitored and reported across the industry, echoing 2021 TCFD consultations. Given "black box" and divergent methodologies and assumptions are being used to calculate portfolio alignment metrics, cross-industry comparability becomes difficult.

We would encourage the consideration of guidance to improve consistency, over time, for example:

- (i) the scenario against which implied temperature rise metrics/targets are considered (the October 2021 DWP consultation is focusing on a 1.5°C scenario),
- (ii) the types of climate scenario assumptions adopted (there is industry momentum to align with the Network for Greening the Financial System, orderly and disorderly scenarios).

Requiring specific temperature alignment

The DWP consultation requires alignment reporting with a 1.5°C scenario. This diverges from previous DWP TCFD regulatory guidance in specifying which scenario pension schemes should align with. We view this positively as the focus is on the most stringent ambitions of the Paris Agreement and tracking global developments in this area. However, this may also mean a step change in thinking for pension schemes who have currently set out as their primary TCFD target to align with the Paris Agreement more generally, on a below 2°C scenario with ambitions towards 1.5°C (or in the 1.5-2°C range).

Reporting against different scenarios across metrics, targets and climate modelling may mean the absence of joined-up thinking. We would recommend sufficient time is allowed for pension schemes to engage with advisers on how this might impact on ongoing climate scenario modelling, selection of metrics and targets, and more generally to ensure consistency in climate scenarios (around 1.5°C wherever feasible). This would suggest the DWP should release guidance with sufficient time for preparation prior to October 2022.

Portfolio alignment asset class

Real asset and sovereign bonds

Under the “as far as you are able” clause, Trustees should begin to engage with portfolio alignment reporting in real asset and sovereign bonds from October 2022, as despite difficulties in doing so vs other asset classes, it is possible.

Green bonds

We disagree that green bonds should be treated the same way as other bonds from the same issuer and the focus should be on developing consistent industry approaches, to demonstrate opportunities from green bonds.

Ensuring a holistic portfolio view

Emissions metrics

Should portfolio alignment focus exclusively on a 1.5°C scenario, we would recommend that any emissions-related metrics and targets are made consistent with this (as previously outlined). A 2050 net zero emissions target is compatible with a 1.5°C scenario, but only provided sufficient upfront decarbonisation to 2025 and 2030.

Encouraging pension schemes to adopt a science-based approach helps to ensure the validity and/or external verification of pension scheme decarbonisation commitments. This could be through using the work of the Intergovernmental Panel on Climate Change (IPCC), or Science-Based Targets Initiative (SBTi), which is based in the IPCC science, and has been expanded to investors as well as companies, or otherwise, alignment with the EU sustainable finance benchmark guidance.

Targets using portfolio alignment

We note there are no requirements for setting targets on portfolio alignment. As outlined in the TCFD 2021 consultation, portfolio alignment metrics should be used with a variety of other methods, given limitations of this metric (e.g. “blackbox” and divergent methodologies and assumptions). Some focus may be warranted on ensuring no adverse and material impacts from instilling portfolio alignment-based targets, where pension schemes choose to do so. For example, on investment returns, social factors and other environmental concerns beyond climate, such as nature and biodiversity.

The DWP TCFD guidance recommends the setting of a <10-year target by pension schemes. Additional guidance may be beneficial to help pension schemes set targets for the portfolio alignment metric, to 2025 and/or 2030. (Given the metric measures global average warming to the end of this century).

Additional metrics

Climate VaR

We would recommend that where investors are selecting Implied Temperature Rise (ITR) as the portfolio alignment metric to report on, and using modelling to do so, that they do not also focus reporting on climate value-at-risk (VaR) as the additional metric. Provided a climate modelling approach, both metrics will be subject to the same underlying models and assumptions and limitations, resulting in the same “view” presented across both metrics, albeit on different bases. The 2021 TCFD consultation recommendation is to ensure that portfolio alignment metrics are used with different metrics and given ITR and climate VaR present the same “view” when developed using the same modelling approach, this would not achieve desired differentiation.

Carbon price

We are hoping for further guidance from the DWP on carbon shadow pricing approaches for investors as approaches can vary. For example, under a:

- portfolio approach: the application of a carbon price to portfolio absolute emissions to calculate revised return expectations; or,
- individual investment approach: applying a carbon price to estimated future emissions and incorporating this into cost-benefit analyses for investments or within individual investment fund returns; or,
- the development of carbon pricing within modelling: reporting the carbon price assumptions which are used to inform broader strategic thinking and climate change modelling, and how this evolves over time and under different scenarios.

It would be useful to understand which approaches the DWP guidance wants schemes to focus on.

Proportion of assets materially exposed to climate-related physical risks

We would recommend an increasing focus on physical risks in relation to adaptation to climate change. Conflating (i) physical risks resulting from the re-pricing of physical assets under the low carbon transition and (ii) physical risks from the physical impacts of climate change, within the same metric, may cause some issues, in terms of consistent reporting across the industry. We would expect different pension schemes to define and describe physical risks differently.

For those pension schemes reporting on this metric, we would recommend the isolation of these two types of physical risks, to report these distinctly. As well as further guidance examples on what would constitute a (i) physical risk resulting from the re-pricing of physical assets under the low carbon transition and a (ii) physical risk from the physical impacts of climate change.

Question two

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:

- 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

Isio response

Reporting timescales

The timescales look appropriate, so long as sufficient time is given for pension schemes and their investment managers to prepare for any new TCFD requirements. The DWP should ensure that updated guidance is published early enough to allow schemes sufficient time to organise the gathering of information in a timely fashion and integrate this into the October 2022 reporting window.

Question three

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.

Isio response

General response

We are comfortable with the requirement to report on a fourth portfolio alignment metric. We have some thoughts on the implications of adding a metric.

Additional metrics focusing on the missing piece of the puzzle - adaptation

An increased focus on adaptation within the TCFD guidance may be warranted, as we start to see an acceleration in climate-related physical risks, globally. We would therefore recommend a focus of the “additional” metric on physical risks related to adapting to climate change. This will ensure the holistic consideration of climate-related risks within pension scheme assets, beyond a sole focus on low carbon transition-related risks. This would include both acute risks from natural disaster and chronic risks from shifts in weather patterns impacting on resource availability.

This would require pension schemes, in time, to report on the resiliency of their portfolios (or underlying assets classes/sectors/geographies) in adapting to climate change. We note that this would not only impact on metrics, but possibly also targets. We would recommend the phased consideration of physical risks, to enable pension schemes to devise responses, from e.g. October 2023 or later.

Additional metrics focusing on industry advancement – data quality

Reporting on data quality may be pertinent to ongoing emphasis on improving data coverage over time, with a particular focus on increasing the proportion of data directly reported by companies. Though total data coverage remains most important, we note that some pension schemes have a differing level of comfort with using estimation approaches. We are also not sure whether data quality should constitute an additional metric or simply be a stipulation within the emissions metrics reported.

Question four

- 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?

Isio response

Defining portfolio alignment

We are comfortable with the definition of “portfolio alignment” as this aligns with the TCFD 2021 consultation on the three types of portfolio alignment metrics available (binary target measurements; benchmark divergence models; and, implied temperature rise models). This means the UK is aligning with wider global market definitions on “portfolio alignment”.

Policy intent on climate scenarios

The policy intent of the October 2021 DWP consultation is to align (captured) UK pension schemes with the increasing global ambition of a 1.5°C scenario, in line with global momentum. As noted, this diverges in policy intent from previous DWP TCFD regulatory guidance, which did not explicitly state a view on climate-related scenarios to be targeted.

Question five

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

Protected groups and other comments

Isio response

We would recommend sufficient time for captured pension schemes to engage with how this might impact on existing approaches to climate scenario modelling, metrics and targets, with a focus on ensuring alignment across these TCFD requirements in terms of climate scenarios. This would mean releasing guidance with ample time to the reporting season commencing in October 2022 and would enable schemes not currently aligned with a 1.5°C scenario to “catch up” and ensure consistency of e.g. climate strategy with modelling efforts and metrics and targets. We would in addition support the phased roll-out of any new TCFD requirements, based on the size of the pension scheme and whether the scheme is a master trust, as with the first phase of TCFD requirements.

Chapter 2: Stewardship and the Implementation Statement

Question seven

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

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?

Isio response

Vote reporting template

The introduction of a PLSA vote reporting template would be welcome in providing industry consistency in vote reporting, and in so doing, would help to reduce the regulatory burden for asset owners and asset managers, alike, given consistent information requests would ease monitoring/reporting/compilation efforts. We would expect asset managers to produce the data in this format, for compilation into scheme level reporting.

Contents of the vote reporting template

With regards to the PLSA vote reporting template, more could be done to focus on key thematic topics of stewardship priorities. The 2020 UK Stewardship Code has raised the need to consider ESG issues, and in particular systemic risks, such as climate change explicitly. We would recommend *voting statistics* be recorded across topic areas, including reporting against (i) ESG issues, as well as setting out voting records in line with the (ii) asset owner thematic priorities and asset manager stewardship priorities.

The *significant votes* section could also set out voting according to these areas. In addition, where votes are cast contrary to pension scheme and/or asset manager policies, for example related to climate or other ESG issues, these votes should be reported independently, with a similar level of detail to significant votes.

Whilst the DWP provides some guidance on what constitutes a significant vote, further clarity would be welcomed. For example, whilst votes aligned with stewardship priorities may constitute significant votes, such as climate change, it is unclear which votes related to a stewardship priority should be chosen from the pool.

Engagement reporting template

The introduction of an engagement reporting template would again help ensure industry consistency in engagement reporting, and in so doing, help to alleviate the regulatory burden of reporting efforts. We would welcome the following aspects to be considered in any template:

- (i) detailing the general approach to engagements e.g. summary of engagement policy, the engagement process, escalation processes, and under which circumstances engagements are deemed to be successful;
- (ii) a data summary of e.g. the number of companies engaged, the proportion of company engagements on environmental, vs social, vs governance grounds,

- and the proportion of company engagements aligned with asset manager stewardship priorities and asset owner thematic priorities;
- (iii) detailed case study examples, which should detail the purpose of the engagement, period of engagement, and any outcomes from the engagement for stewardship and thematic priorities. For example, reporting an environmental, social and governance case study, respectively, or multiple case studies under these pillars aligned with stewardship priorities.

Some of these suggestions draw on the [ICSWG engagement reporting template](#), which sets out the need for information to define engagements and detail on engagement outcomes.

Integrating voting and engagement templates

We would recommend the separate reporting of voting and engagement activities. Bringing together a holistic report on voting and engagement and the interplay between these, might be relatively cumbersome. These should be reported separately whether in the same template or otherwise. The exception may be the *significant votes* section, where any associated engagement activities for the top 10 most significant votes for the scheme could be detailed.

Question eight

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?

Isio response

b) Role of consultants

Whilst Trustees have ultimate oversight of all ESG and stewardship activities, it is worth recognising the role that consultants will play in enabling Trustees to meet their regulatory requirements, particularly as such requirements in the ESG space continue to expand. Consultants will play an important role in helping Trustees to meet Implementation Statement requirements, but we do agree that Trustees should continue to have ultimate responsibility for SIP and IS documents. In short, it is the Trustees' responsibility, but the consultants can play a role in providing templates and advice on best practice, for example.

c) Savers' interest

We are not convinced that Implementation Statements is the preferred location for setting out why the approach taken was in savers' interests. Stewardship beliefs and policies (within SIPs and wider policies) may be more practical for the setting set out why taking account of non-financial matters is important, such as ESG and climate change, and are in the savers' interest, with a regular review of these. Particularly in relation to the thematic priorities of pension schemes. Implementation Statements could therefore refer to where this information is held/a brief overview or more clarity could be provided to ensure the Implementation Statements themselves include the information required.

a) 2020 UK Stewardship Code disclosures

Including material from voluntary disclosures, e.g. signatories to the 2020 UK Stewardship Code, is helpful in reducing the regulatory burden of stewardship disclosures. This applies to all references to the 2020 UK Stewardship Code across these consultation questions.

Question nine

Isio response

- a) Do you have any comments on our proposed Guidance on stewardship policies?
- b) Do you have any comments on our proposed Guidance on most significant votes?

a) Stewardship policies

Content of stewardship policies

Where pension schemes do not have equity exposures (as many schemes don't), it should be clear that stewardship policies do not need to consider voting.

It would be useful for stewardship policies to provide an understanding of the stewardship process and any synergies between voting and engagement activities. Setting out the stewardship approach in detail, and any interplay between voting/engagement areas, for example, where voting against management may lead to engagements with companies based on pension scheme thematic priorities or asset manager stewardship priorities.

Defining engagements

We notice a divergence in what constitutes an engagement across various asset managers in the industry, which makes engagement comparisons across asset managers difficult.

It would be useful for asset managers to set out their definitions of engagement within public documents, to understand the exact methods for engagements, escalation processes, and when an engagement is deemed to be successful, etc. Guidance around requirements in this space could help to improve reporting.

Over time, it would be helpful for the industry to move towards a consistent definition of engagements, which the DWP can play a role in through additional guidance. For example, the Investment Consultants Sustainable Working Group (ICSWG) has come up with the definition as follows: *An engagement is defined as a purposeful, targeted communication with an entity on particular matters of concern with the goal of encouraging change at an individual issuer and/or the goal of addressing a market-wide or system risk (such as climate). Regular communication to gain information as part of ongoing research should not be counted as engagement.*

Votes against policies

As noted, it would be useful to understand where asset manager voting and engagement activities do not align with the agreed approach (between pension schemes and asset managers), or as set out within policies, with a particular focus on the thematic priorities of the pension scheme. IS guidance could set out some wording to this effect.

b) Significant votes

Expressions of wish

Given asset managers have ultimate voting responsibility, it may be useful for pension schemes to agree on any "red lines" with asset managers during the selection and ongoing monitoring of asset managers. These "red lines" may either be based on industry guidance, such as the Association of Member Nominated Trustees "The Red Lines Voting Instructions – Environmental, Social and Governance" or red lines determined by pension schemes based on their individual beliefs.

Further accountability of asset managers by pension schemes could be conducted through the ongoing monitoring and reporting of voting decisions.

On the need to acknowledge responsibility for voting policies that asset managers implement on pension schemes' behalf

We would welcome further clarity, to understand the implications for SIP and IS disclosures. For example, whether pension schemes should set out their alignment with underlying asset managers' voting policies and/or any areas in which there is disagreement and/or actions being taken to resolve areas of disagreement.

Pooled funds voting

We understand that some asset managers and third-party voting service providers are offering split voting. It would be useful to clarify regulatory expectations in this area and whether the expectation is that the UK industry should focus on progress in this area, so that by a target date this becomes a necessity for pension schemes invested in pooled funds. This would ensure market-wide collaboration to bring this about.

Engaging with asset managers

For pension schemes to be able to assess asset managers' voting record, we would recommend reporting in line with the PLSA voting template by all managers. As noted above, however, to be able to support pension scheme reviews of asset manager voting records, we would welcome asset manager disclosures on any votes not in line with the agreed policy (whether that is the pension scheme or asset manager voting policy), for thematic priorities and which are not aligned with desired outcomes. For example, a climate resolution was voted down, because decarbonisation targets were not deemed to be aligned with scientific guidance.

Question fifteen

Isio response

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?

Alignment of pension scheme and asset manager policies

We note that there may be some instances where managers with ambitious and/or market leading ESG and stewardship policies, may also be misaligned with Trustee policies. We are concerned that ambitions on such matters should not be watered down to ensure alignment with pension scheme policies. We however note there may be circumstances in which asset managers are engaged with to improve their ESG and/or stewardship policies in line with scheme policies.

Focus on medium to long-term financial and non-financial performance

We note that many ESG issues, in particular responding to the systemic risk of climate change, will require significant upfront decarbonisation action in the near-term to 2025 and 2030 (depending on short-term definitions). We would therefore recommend expanding the guidance to require considerations across all investment time horizons set out by the scheme. This will create overlap with the existing TCFD requirements which focus on the short, as well as medium and long-term time horizons of the pension scheme.

