Investment

Taking action on climate risk: improving governance and reporting by occupational pension schemes

Nest response to the open consultation

1 About us

Nest was established in 2010 as part of the auto enrolment programme to help people save for retirement. Unlike any other pension scheme in the UK, Nest has a legal obligation to accept any employer that wishes to use us to discharge their auto enrolment obligations. Over 819,000 employers have signed up to use Nest.

Over the last decade, Nest has grown to be one of the largest pension schemes in the UK. We are operating at scale as a high quality, low cost pension scheme helping over 9.2 million members save for their retirement. Many are low to moderate earners who may be saving into a pension for the first time. A typical Nest member earns around £20,300 per year and nearly half our members are aged under 35 years old.

Nest is built around the needs and behaviours of our members, from our approach to responsible investment to our focus on customer service. We now occupy a place in the market as a major Master Trust, helping to drive up standards and best practice across the industry. Nest has great potential for delivering pensions to mass market consumers for many years to come, leveraging our scale to deliver value through the combination of low costs, our market leading investment strategy and modernised services all overseen by strong trustee governance.

2 Response

2.1 Question 1:

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

a) trust schemes with £1 billion or more in net assets

b) authorised master trusts

c) authorised schemes offering collective money purchase benefits

Do you agree with our policy proposals?

Response

We agree with the Pensions Climate Risk Industry Group (PCRIG) that all pension schemes are exposed to climate-related risks irrespective of their investment strategies and time horizons. We are therefore in favour of achieving the greatest possible scope and believe that pension schemes with assets lower than the suggested threshold may still be in a position to provide detailed TCFD reporting.

We would therefore be in favour of asking schemes with assets above £100 million but below £1 billion to disclose in line with the TCFD recommendations as far as they are able, which in most instances would mean asking their fund managers and consultants to provide this information to them.

2.2 Question 2

We propose that:

a) trustees of schemes with £5 billion or more in net assets on their first scheme year end date to fall on or after 1 June 2020 are subject to the climate governance requirements from 1 October 2021 and the trustees must publish a TCFD report within 7 months of the current scheme year end date or by 31 December 2022 if earlier
b) trustees of schemes with £1 billion or more in net assets on the first scheme year end date to fall on or after 1 June 2021 are subject to the climate governance requirements from 1 October 2022, and the trustees must publish a TCFD report within 7 months of the current scheme year end date, or by 31 December 2023 if earlier
c) trustees of master trust or collective money purchase schemes which are authorised on 1 October 2021 are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report in line within 7 months of the current scheme year end date, or by 31 December 2022

After 1 October 2021:

d) trustees of master trust or collective money purchase schemes which become authorised are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report within 7 months of the current scheme year end date
e) where schemes cease to require authorisation, the climate governance and TCFD-aligned reporting requirements fall away with immediate effect, unless they remain in scope via the asset threshold on the previous scheme year end date

From 1 June 2022 onward:

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

are subject to the climate governance requirements starting from one year after the scheme year end date on which the £1 billion asset threshold was met

must publish a TCFD report within 7 months of the end of the scheme year from which the climate governance requirements apply

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

Do you agree with the policy proposals?

Response

We would prefer a simplified roll-out, ideally with a single date for implementation across all schemes in scope. While we recognise that the proposed requirements will place a significant burden on smaller schemes, we believe that most schemes will be able to get this information from their fund managers and through their investment consultants at little to no additional cost. We note that under the current proposal, fewer than half of UK pension schemes are estimated to be covered by phase one, compared with nearly three quarter of schemes in phase two. A single deadline for implementation by 31 December 2022 would have a catalytic impact on increasing climate change governance and disclosures in the entire investment chain. We note that this would also align with the five-year implementation timeframe proposed by the TCFD when it was launched in 2017.

2.3 Question 3

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

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

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

Do you agree with these proposals?

Response

We agree with the proposal of conducting a review for all schemes not in the initial scope, although we have a preference for a wider initial scope as noted in the response to Question 1.

2.4 Question 4

We propose that regulations require trustees to:

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

We also propose that regulations require trustees to describe:

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

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

Do you agree with these proposals?

Response

We agree with the proposals.

2.5 Question 5

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

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

Do you agree with these proposals?

Response

Yes, we agree with the above proposals. We agree that the guidance should not prescribe what short-, medium- and long-term horizons Trustees should use given the different characteristics of their scheme, but that the guidance should make it clear that the reasons for considering the time horizons should be clearly defined.

2.6 Question 6

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

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

Do you agree with these proposals?

Response

We broadly agree with these proposals but have a number of comments:

- As stated in Chapter 3 paragraph 16 obtaining full underlying data to inform the calculation of metrics or scenario analysis across their entire portfolio in the first instance will be a challenge. We also agree that we shouldn't wait for "perfect" data to start considering climate change risk. We would welcome further clarification of what "as far as they are able" looks like for scenario analysis.
- We believe that requiring scenario analysis to be carried out annually may be excessive. The cost of bespoke scenario analysis is currently upwards of £20,000. Most schemes that have attempted scenario analysis across their portfolio have taken several months for this exercise. While future runs may not take as long, climate change models are highly complex and expected to evolve quickly, making this a very resource-intensive process. We propose modifying this to requiring scenario analysis to be carried out at least once every three years or sooner if there is a major change to the scientific evidence or international agreements (using similar language to the SIP reviews). However, the first such review should be conducted in line with the 2022 deadlines.
- In our view, any scenario analysis should include a 1.5C scenario. The TCFD recommendations which include a scenario of 2C or lower were published before the IPCC Special Report on Global Warming of 1.5C. Since then, a number of governments, including the UK have set targets in line with limiting warming to 1.5C, and such targets have quickly evolved into best practice. We therefore do not think that the guidance should follow the TCFD recommendations to the letter on this.
- We also believe the guidance should make specific reference to a "business-as-usual" scenario of 4C or more. In our experience, the difficulty is in finding an appropriate methodology with sufficient coverage. Scenario analysis is based on macroeconomic models which usually allow for a range of different temperatures making it possible to run more than two scenarios.
- We would encourage the government to define what is meant by "resilience" in the statutory guidance. We consider this cover both transition risks resulting from climate change and the impact of physical climate change risks.

2.7 Question 7

We propose that regulations require trustees to:

a) adopt and maintain processes for identification, assessment and management of climate-related risks
b) integrate the processes described in a) within the scheme's overall risk management

We also propose the regulations require trustees to disclose:

c) the processes outlined in part a) above

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

Do you agree with these proposals?

Response

Yes, we agree with the above proposals. While we agree that schemes should endeavour to integrate climate change risk management in the wider risk management process, we expect this to be a gradual

process and would appreciate clarification in the guidance of what best practice should look like and would welcome further consultation and discussion about the detail to be placed in regulation.

2.8 Question 8

We propose that regulations require trustees to:

a) select at least one greenhouse gas (GHG) emissions-based metric and at least one non-emissions-based metric to assess the scheme's assets against climate-related risks and opportunities and review the selection on an ongoing basis b) obtain the Scope 1, 2 and 3 GHG emissions of the portfolio, and other non-emissions-based data, as far as they are able c) calculate and disclose metrics (including at least one emissions-based metric and at least one non-emissions-based metric) used to quantify the effects of climate change on the scheme and assess climate-related risks and opportunities

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

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

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

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

Do you agree with these proposals?

Response

We broadly agree with the proposals, but we believe that quarterly calculation of emissions-based metrics is excessive. Climate change data relies on corporate disclosure which is currently made on an annual basis and we therefore do not believe that quarterly calculation would add value. We propose changing this to annual.

We have a number of additional comments:

- Schemes like Nest who do not manage any assets in-house have two options to obtain emissions-related data. The first option is to request this data from the asset managers. This is the approach we have chosen, however, due to a range of different methodologies we are not currently able to aggregate the data. The second option is to procure the data directly. The cost of this is around £15,000 for equity and fixed income data alone, and more for other asset classes which usually requires a more bespoke service. Our preferred approach is the first option and we would appreciate clarification in the guidance as to whether this would be appropriate as methodologies develop and how we could report methodologies by our different fund managers without our TCFD report becoming overly long and fragmented.
- We believe that there are some challenges in calculating metrics once data has been obtained. For example, schemes will have to decide how to apportion carbon emissions at entity level if they hold both a share of the equity and debt in the issuer to avoid double counting. We do not believe that the Greenhouse Gas Protocol entirely addresses that challenge.
- We believe that the statutory guidance should set expectations for both the emissions-based metric (WACI) and the non-emissions-based metric or highlight examples of best practice.
- While we agree with proposal to set a number of mandatory metrics, we believe that the guidance should also encourage schemes to consider additional metrics as relevant to their scheme and investments. We believe that given the challenges around data quality and coverage, using a range of metrics is preferable. There are also asset-class specific metrics that schemes could use.

2.9 Question 9

We propose that regulations require trustees to:

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

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

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

Do you agree with these proposals?

Response

In line with our response to question 8, we would appreciate some clarification as to whether schemes are required to set one target across the portfolio, or whether it will be permissible to set targets for underlying funds if this covers the entire portfolio. While we have set a portfolio-wide long-term target of net zero emissions by 2050, we have taken the latter approach for short to medium term targets, as we have some concerns about aggregating metrics at portfolio-level.

2.10 Question 10

We propose that, for all schemes in scope:

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

Do you agree with these proposals?

Is there a better way to notify members of where to find this information?

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

Response

We agree with the above proposals. In the past, Nest has published its TCFD report in its annual reports and accounts. However, we anticipate that the TCFD report will continue to increase in length which will make inclusion in future reports challenging. We also believe that including the TCFD report on a website will make it easier to find for different stakeholders. On the other hand, the TCFD recommends that disclosures are made in mainstream financial annual filings. We therefore believe that including a summary of the TCFD report in the scheme's annual reports and accounts and including a link to the more detailed report on the website would strike an appropriate balance. We further believe that due to the complex and detailed nature of reporting, schemes should think about how they can make the information contained in the TCFD report more accessible to members. We would welcome further guidance on reporting directly to members.

2.11 Question 11

We propose that:

a) The Pensions Regulator (TPR) will have the power to administer discretionary penalties for TCFD reports they deem to be inadequate in meeting the requirements in the regulations
b) there will be no duty on TPR to issue a mandatory penalty, except in instances of total non-compliance where no TCFD report is published
c) in all other respects, we propose to model the compliance measures on the existing penalty regime

set out in regulations 26 to 33 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015
d) failure to notify members via the Annual Benefit Statement or to include a link to the TCFD report from the Annual Report will be subject to the existing penalty regime set out in regulation 5 of the Disclosure Regulations

Do you agree with this approach?

Response

Yes, we agree with this approach, but we would appreciate further clarification about what would be considered an inadequate level of reporting.

2.12 Question 12

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

Response

We believe that the estimated cost for carrying out scenario analysis is optimistic. From our experience, consultants currently charge c. £20,000 or more for portfolio-wide scenario analysis. We do not believe that free tools such as PACTA are sufficient for the objectives of the regulations. We anticipate that the costs may decrease as more providers enter the market and more “off the shelf” solutions are developed.

On risk management, we do not believe that the majority of schemes already include climate change in their standard risk management processes, if they consider it at all. We believe that there could be additional costs of developing their risk management approach that are not currently included in the draft impact assessment.

We also believe that the modelled cost of obtaining data to develop metrics in targets is too low, unless all of this data can be obtained from fund managers (which raises the challenge we have highlighted above of not being able to aggregate the data). Our experience is that carbon emissions data for a diversified portfolio costs c. £15,000 per annum.

2.13 Question 13

Do you have:

a) any comments on the impact of our proposals on protected groups and how any negative effects may be mitigated?
b) any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats
c) any other comments about any of our proposals?

Response

There is an increasing reporting burden on pension schemes which could be challenging for smaller schemes. We would welcome a further review into the potential scope of combining different reporting requirements, for example implementation statements.

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