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DWP consultation
Climate and investment reporting: setting expectations and empowering savers

Insight Investment response

January 2022

Insight INVESTMENT

BNY MELLON | INVESTMENT MANAGEMENT

Executive summary

Insight Investment is one of the UK's largest investment managers, managing over £836bn in assets, primarily for UK defined benefit pension funds, as well as insurers, sovereign wealth funds and financial institutions[1]. The majority of Insight's assets under management are in risk management solutions (primarily liability-driven investment, or LDI) and fixed income.

Climate change is one of the greatest challenges of our time. Governments and businesses are grappling with the implications, and responsible investors seek to discern how climate change might affect investment risks and opportunities. Insight is a committed responsible investor and was a founding signatory to the Principles for Responsible Investment (PRI) in 2006.[2] We believe that all risks, including environmental, social and governance (ESG) risks, can affect the value of an investment – and so any initiative that seeks to improve risk disclosures is a positive and constructive development.

We welcome the DWP's consultation on this important topic. Key themes that we draw out in our response are summarised below:

- **We believe it is premature to require trustees to report on the Paris alignment of their pension scheme's portfolio.** Current data is of variable quality, with different approaches followed by different providers, and their application and relevance varying according to asset class. Putting such a requirement in place now may also have negative performance and risk impacts for portfolios.
- **We do not agree with the proposal that pension schemes split their first year's reporting period, reporting different metrics within those periods.** We recommend pushing the implementation date back by one year to October 2023 so this is not necessary.
- **We believe templates can be very useful in helping to standardise reporting for service providers.** We note that templates should be appropriate for the asset classes they cover because sustainability challenges and opportunities will vary. Current templates seem designed for equity investments, rather than fixed income or other asset classes.

We would be delighted to engage further with the DWP on these issues, and to discuss our response in greater detail.

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[1] As at 30 September 2021. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. Figures shown in GBP. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Insight Investment International Limited (IIIL), Insight Investment Management (Europe) Limited (IIMEL) and Insight North America LLC (INA), each of which provides asset management services.
[2] More information on Insight's responsible investment approach and activities is available at https://www.insightinvestment.com/investing-responsibly/.

Questions and answers

Chapter 1 – 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 welcome the proposal that trustees be required to report on their scheme's Paris alignment. However, we believe it is premature to put this into force.

Current data is of variable quality, with different approaches followed by different providers, and their application and relevance vary according to asset class. Most industry alignment methodologies are focused on equities. Their usefulness and applicability to fixed income, the predominant asset class for UK pension schemes, is short of where it needs to be to support Paris alignment transparency for clients.

We believe requiring trustees to report metrics based on inconsistent or unreliable data may lead to inappropriate investment decisions. Doing so may also lead to unintended consequences – for example, trustees may feel obliged to adjust portfolios to be fully Paris aligned, leading to excessive divestment from many sectors (rather than engagement with entities to encourage improvements in operations) and highly concentrated portfolios.

Aside from these broader concerns around data, in its consultation document, the DWP has suggested three approaches to measure Paris alignment. There are difficulties with each:

- **Binary target measurements:** This tool measures the alignment of a portfolio with a given climate outcome based on the percentage of investments or counterparties in that portfolio that (a) have declared net zero/Paris-alignment targets and (b) are already net zero/Paris aligned.

  Commitments to targets are not reliable, but focusing only on entities that "are already net zero/Paris aligned" will limit the usefulness of this tool.

- **Benchmark divergence models:** These tools assess portfolio alignment by comparing the forecasted emissions performance of investments or counterparties in the portfolio against one or more benchmarks.

  Deciding a suitable benchmark, and the source of forecasted emissions, presents significant questions.

- **Implied temperature rise (ITR) models:** These tools translate an assessment of alignment/misalignment with a benchmark into a measure of the consequences of that alignment/misalignment in the form of a temperature score.

  This is arguably the most suitable metric: it is simple to understand and limiting a rise in global temperatures is the ultimate goal of Paris alignment. However, measuring the ITR of a portfolio is in its infancy, with differing approaches to doing so.

Of the metrics available to measure Paris alignment, we believe **carbon intensity** is appropriate for the short to medium term, until there has been further development of alternative metrics. We note that the updated TCFD framework includes a long list of alternate metrics, which we believe should be reflected in DWP guidance.

Aside from the specific approach selected, there are currently three main providers of relevant data. If, to allow trustees freedom of choice, asset managers are required to provide data on multiple methodologies using data from each of the three providers, the result is a significant range of data points for each potential investment. This would be complex and burdensome for asset managers to provide.

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; and - 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: - trustees of a scheme with relevant assets of less than £500m 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 £500m on the scheme year end date immediately preceding the scheme year in 51 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 are concerned with these proposals. October 2022 may be within some pension schemes' first reporting period. The DWP consultation has considered this, but we are concerned that the proposed approach – splitting the first year's reporting period into a portion where these rules are not in effect, and a portion where these rules are in effect – is overly complex, with trustees required to report different metrics for different portions of the year.

We recommend pushing the implementation date back by one year to October 2023, so that schemes reporting after that date can switch to the new methodology for the full reporting year.

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 agree that any requirement should be embedded within the existing Climate Change Governance and Reporting Regulations in line with the 'as far as they are able' approach. However, please see our response to question 1 outlining our reservations over mandating a portfolio alignment metric prematurely.

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 a portfolio alignment metric and whether respondents think it reflects the policy intent?

To summarise our answers given to questions 1, 2 and 3:

- We believe it is premature to require trustees to report on the Paris alignment of their pension scheme's portfolio. Current data is of variable quality, with different approaches followed by different providers, and their application and relevance varying according to asset class. Putting such a requirement in place now may also have unintended consequences.
- We do not agree with the proposal that pension schemes split their first year's reporting period, reporting different metrics within those periods. We recommend pushing the implementation date back by one year to October 2023 so this is not necessary.

- We support the proposal to incorporate the requirements to measure and report a portfolio alignment metric into the existing Climate Change Governance and Reporting Regulations.

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?

Given current data is of variable quality, based on different methodologies, and of mixed relevance to different asset classes, we believe that if using such metrics is mandated prematurely the output would be of limited value, while the requirement would be burdensome on pension schemes and asset managers. These factors would also limit the comparability of this output across different portfolios, and potentially the same portfolios over time.

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?

We have no comments.

Chapter 2 – Stewardship and the Implementation Statement

Q7. 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?

We believe templates can be very useful in helping to standardise reporting for service providers, however it may be more appropriate for the industry work on a template rather than it be prescribed by DWP. We note that templates should be appropriate for the asset classes they cover. Current templates seem designed for equity investments, rather than fixed income or other asset classes.

We note that voting data and broader engagement data are sourced separately, and therefore can be included within templates separately.

It may not be possible for smaller asset managers to provide this level of engagement data. Ultimately, this could lead them to withdraw from the market for asset classes where they do not have capacity to provide this information. This could lead to a reduced selection of asset managers for pension schemes, and reduced competition in this market.

Q8. Do you have any comments on our cross-cutting proposals for the draft Guidance on Statements of Investment Principles and Implementation Statements, in particular that: (a) they are written for members? (b) 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 have no comments. We agree with the proposals.

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

We believe requiring pension scheme trustees to compile this information will be helpful in engaging with asset managers on which topics are most important to them, helping to guide the evolution of asset managers' engagement policies. We would encourage pension schemes to ensure their stewardship policies reflect the particular asset classes in which they invest.

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 have no comments.

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 have no comments.

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 have no comments.

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 this further engagement opportunity with asset managers, which can help to improve behaviours along the value chain.

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 have no comments.

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 this proposal, and we believe this work is already undertaken by pension schemes’ investment consultants.

Contact

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