Investment

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

Nest's response to the 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 870,000 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 9.8 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

Nest is very supportive of the government's efforts to mandate TCFD disclosure for pension schemes. Nest has produced TCFD reports for a number of years. We see it as not just a disclosure exercise but a tool to identify gaps in our approach and help us frame our thinking around climate change risks and opportunities. This helped us pave the way to develop a scheme-wide climate change policy and set a target for net zero emissions by 2050.

But we are aware that despite these benefits, voluntary adoption of TCFD reporting remains low and therefore a mandatory approach is justified. We also believe it makes sense to focus on pension schemes as this will have a ripple effect through the industry and create positive benefits ultimately for UK savers. Asset managers will also need to think about how they address and report on these risks and opportunities to their clients, and disclosures will support investors' stewardship efforts on climate change by demonstrating to companies that we practise what we preach.

2.1 Q1: Do you have comments on the proposals to change the "reference date" used for the purposes of determining whether a scheme is in scope, or the arrangements made for schemes which obtain their audited accounts later than 1 October 2021, or 1 October 2022? Do you have comments on the draft regulations on scope and timing? Please

include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

We broadly support the proposals.

Climate change is a systemic risk and has the potential to affect schemes of all types and sizes. We do not agree with some of the responses cited suggesting that climate change risk is not a material risk for derisked schemes or that the draft regulations should only apply to risk assets. We also agree that there should be no exemptions for closed defined benefit (DB) schemes. In our view, the definition of “as far as they are able” should be sufficient for fully mature schemes to agree an appropriate level of reporting. Trustees may come to the conclusion that some asset classes are less exposed to climate change risk, but this should be highlighted in the report rather than being a reason for exemption.

While we advocated for a setting a lower threshold than £1bn of assets for schemes in scope in our response to the August 2020 consultation, we agree that a comply and explain approach for smaller schemes could have adverse impacts by creating two different standards of reporting. We believe the focus should be on how to extend the scope of mandatory reporting to smaller schemes as soon as possible. We therefore welcome bringing forward the review date to the second half of 2023, after the first reporting cycle of larger schemes.

We do not think that a 3-4 month timeframe between scheme-year end and TCFD report is too challenging. Schemes will have had a long time to familiarise themselves with the regulation and statutory guidance and will be able to prepare a significant proportion of their TCFD report in advance of the scheme year end. The key areas that will have to be included post-year end are the metrics. Nest has prepared TCFD reports for a number of years now. Our financial year end is 31 March and our TCFD report is currently published in our annual reports and accounts in July. We have always been able to get the required metrics from fund managers within 1 month of scheme year end but appreciate that this might not be applicable to all schemes. We would therefore be in favour of returning to the previous proposal of disclosure within 7 months of scheme year-end, or by 31 December 2022 in the first wave.

2.2 Q2 a). Do you have any comments on the draft regulation on trustee knowledge and understanding? b) Do you have any comments on the draft guidance? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter

We welcome the publication of the draft statutory guidance setting out expectations of individual trustees. We believe that climate change risks and opportunities should become a standard part of trustee training. Climate change is a complex and fast developing issue spanning different disciplines, we therefore do not expect individual trustees to be experts on climate change risks and opportunities but to seek appropriate advice when needed.

Q3: a). Do you have any comments on the provisions on governance in the draft regulations? b). Do you have any comments on the draft statutory guidance on governance? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

We agree that oversight of climate change risks and opportunities is fully aligned with Trustees’ fiduciary duty. We also welcome the clarification of “persons managing the scheme”. We agree that this does not directly include asset managers, but that these regulations will have a significant impact on the reporting requirements for asset managers to their pension scheme clients. We also support regulations that impact asset managers directly, as this will help raise standards across the industry, but agree that this should not be in scope of this regulation.

2.3 Q4: a). Do you have any comments on the provisions on strategy in the draft regulations? b) Do you have any comments on the draft statutory guidance on strategy? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

We agree with the proposals. In our response to the August 2020 consultation, we expressed our view that the time horizons should not be prescriptive given the different characteristics of schemes. We support the proposal for Trustees to disclose the time horizons they are considering. We would be in favour of more strongly encouraging Trustees to disclose why those time horizons have been chosen.

2.4 Q5: a). Do you have any comments on the provisions on scenario analysis in the draft regulations? b) Do you have any comments on the proposal that relevant contracts of insurance are within scope for scenario analysis? c) Do you have any comments on the draft statutory guidance on scenario analysis? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

In our August 2020 response we advocated for scenario analysis every three years or where there has been a material change. We are pleased that the government has responded to this feedback and amended the draft regulations accordingly.

In our view, any scenario analysis should have a quantitative element considering the impact on asset values of a specified temperature rise. We would like to reiterate the point made in our initial response that scenario analysis should ideally include a 1.5C, 2C and BAU (4C+) and to consider the impacts of an orderly or a disorderly transition. We welcome the statutory guidance clarifying that one scenario must be between 1.5C-2C but we do not agree that 1.5C scenarios are not widely available and this situation has improved further since the August 2020 consultation following the publication of a 1.5C scenario by the International Energy Agency.

In addition, we do not believe that adding additional scenarios would significantly increase the cost or the burden of scenario analysis but would provide helpful additional analysis to Trustees. We would therefore suggest that the statutory guidance more strongly encourages the use of a range of scenarios, if feasible.

2.5 Q6: a). Do you have any comments on the risk management provisions in the draft regulations? b) Do you have any comments on the draft statutory guidance on risk management? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

We welcome the inclusion of stewardship as an approach to risk management in the statutory guidance. We also agree that the statutory guidance should not be too prescriptive on the level of integration with existing risk management processes or the definition of materiality as this should be determined by the trustees.

2.6 Q7: a). Do you have any comments on the provisions on metrics in the draft regulations? b) Do you have any comments on the draft statutory guidance on metrics? Please include in your answer any comments on

whether you consider that they meet the policy intent stated in this chapter

We welcome the clarification in the statutory guidance that aggregation to scheme level will not be required. We think this is appropriate in the short-term as we have some concerns that efforts to aggregate could be misleading and make the reporting less transparent.

In our response to the August 2020 consultation, we also asked for additional guidance on best practice and therefore are pleased to see the inclusion of the Platform on Carbon Accounting Financials explicitly highlighted in the statutory guidance. We would welcome further work on establishing a taxonomy to ensure that there is greater standardisation and comparability.

We are in favour of the use of two GHG emissions metrics (absolute and intensity) as well as one other climate change metric. We agree that investors should obtain Scope 3 emissions as far as they are able but note that most of our asset managers are currently telling us that the coverage is relatively low, and that the issue of double counting has not been resolved by providers.

We are not convinced that “data quality” should be a potential additional metric. We believe that an assessment of data quality (to the extent that metrics are based on disclosures or estimates) should be included in all disclosures.

Finally, we previously stated that we were not in favour of quarterly measurement as the underlying issuer data is only updated once a year and therefore welcome the move to annual measurement. An additional point on timing is that due to different company and scheme reporting dates, for a scheme reporting in 2022, the majority of underlying disclosures are from 2021 but there may even be some from 2020.

2.7 Q8: a) Do you have any comments on the provisions on targets in the draft regulations? b) Do you have any comments on the draft statutory guidance on targets? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

We are generally in favour of target setting and do not believe that there is a conflict with fiduciary duty. Targets are an important tool to reduce a scheme’s exposure to climate change risks. We believe that the provisions on targets are very closely linked to those on metrics. The targets are only going to be as good as the underlying information.

We also welcome the move to annual measurement and reporting of targets.

2.8 Q9: a). Do you have any comments on the draft regulations on disclosure? b). Do you have any comments on the draft statutory guidance on disclosure? Please include in your answer any comments on you have on whether you consider that they meet the policy intent stated in this chapter

We strongly believe that public disclosure of TCFD reporting is crucial to increasing transparency and ensuring that the risks are managed. As we mentioned in our response to the August 2020 consultation, we believe a summary statement and link to a webpage with the full TCFD report in the annual report and accounts will be most suitable going forward.

We believe that the full TCFD report will be highly complex and lengthy for most schemes. We would therefore encourage the government to include further guidance on the disclosure of a simplified statement for members.

2.9 Q10: a). Do you have any comments on the draft regulations on penalties? Please include in your answer any comments you have on

whether you consider that they meet the policy intent stated in this chapter.

There seems to be some concern from Trustees that due to lack of data or resource, their reporting may be considered inadequate resulting in penalties. We do not believe that this is the intent of the regulation. In our view, it is through these disclosures that we can identify where these gaps lie and as an industry work to overcome these challenges.

Although we are not in favour of a detailed scoring/ranking system, as we mentioned in the previous consultation, we would appreciate further clarification about what would be considered an inadequate level of reporting that might result in discretionary penalties ahead of the first reporting cycle. We also welcome the opportunity to engage with TPR, but the regulator must ensure that there is a sufficient degree of transparency around this process.

2.10 Q11: In relation to the changes we have made to the original policy proposals, do you have any comments on the regulatory burdens to business and benefits, and wider non-monetised impacts which are estimated and discussed in the draft impact assessment?

As we highlighted in our response to the August 2020 consultation, we believe the most significant cost will be for scenario analysis. We expect that the vast majority of schemes will require an external consultant for this. Some schemes may also require external advice on metrics and targets, although we think that a lot of this can be obtained from fund managers and schemes can work with the managers to develop appropriate portfolio-level targets. Finally, some schemes may engage a consultant to write prepare the report.

We still believe the central estimate of £12,000 underestimates the cost of scenario analysis for most schemes. We do not think we can carry out decision-useful scenario analysis, which needs to include a quantitative element, at a cost of less than £20,000 in the first year. We do note however that due to the amended proposal of requiring scenario analysis only once every three years or when there is a material change significantly reduces the financial burden. We further think that schemes with more than one default option do not necessarily face significantly higher cost than those with a single default. In our experience the cost is more dependent on the types of assets held with schemes holding a larger proportion of alternative assets facing higher costs due to the level of bespoke work required.

Unlike scenario analysis, we believe that most of the information on metrics can be obtained from fund managers at no additional cost. We have had no issue with requesting this data from our fund managers and therefore expect that most other schemes will be able to obtain this, particularly as it becomes a regulatory requirement. However, the cost of underlying emissions metrics could escalate very quickly if commissioned directly from consultants, and if it covers asset classes where emissions need to be estimated.

2.11 Q12 Do you have any other comments you would like to raise?

No further comments.

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