Institute
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Aligning your pension scheme with the TCFD recommendations

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

What do you like about the guidance/What is most useful?

1. The guidance is a very good and comprehensive, yet easy to read, summary of all the detail trustees could and should be considering when seeking to align their schemes to the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).
2. The Quick Start guide is a useful accompanying document. Given the length and high level of detail in the main guidance, the Quick Start guide will be helpful for trustees who are newer to considering these issues.
3. For Defined Benefit schemes, the sections on covenant and funding are very good. The guidance in these sections will be very helpful as trustees will be able to incorporate the specifics of their own schemes.

What don't you like about the guidance?/What needs improving?

4. Many of the requirements are generic to all pension schemes and trustees are likely to need help from their advisers in applying the guidance to their own schemes. In that respect, small schemes may be less well placed and it would be helpful to have a more focused template that small schemes could follow. However, we acknowledge this creates a risk of a tick-box mentality, similar to what we see with incorporating Environmental, Social and Government (ESG) risks in Statements of Investment Principles.

Is the current structure helpful?

5. An executive summary with a road map or flow chart would be helpful to guide trustees as to what they should be doing in the short term. This could include additional actions for smaller schemes with limited access to professional advice. This would make the document more widely accessible.
6. Given the potential size of task for those starting on the full disclosures, it would be worth considering whether recommending a phased approach to implementing the disclosures should be included. For example, for trustees to focus on governance, strategy and risk management for one or two years before moving onto to metrics and targets. This should promote an emphasis on thoughtful oversight rather than a simply producing a set of numbers to go into a report.

Have we missed anything?

7. The authors may wish to include information/guidance on the following:

- Considering the carbon footprint of a portfolio. This is a good way of helping trustees to understand where their exposures lie and manage their risk, without having to deliver a great deal of scenario analysis.
- Assessing which factors are financially materially to support trustees who are newer to considering these issues and are unsure where to start. It may be helpful to refer readers to the Sustainability Accounting Standards Board Materiality Map. The Materiality Map is an interactive tool that identifies and compares disclosure topics across different industries and sectors. It is available here: https://www.sasb.org/standards-overview/materiality-map/
- Portfolio alignment with specific climate goals would be a helpful metric to consider eg helpful to know if portfolio is at 2 degrees. The guidance could include some detail around how trustees could seek to embed this awareness.
- Understanding portfolio alignment would also support discussion around risk appetites. We note there can be challenges for trustees in defining and setting their risk appetite, and then setting these into an investment mandate. Consideration of this issue in the guidance was at a quite a detailed level and we note that this may be because of the progress that has been achieved in this area. It would be helpful, as a first step, for trustees to consider what they are, and are not, prepared to be exposed to. We also not that there are the beginnings of standardisations in this area and detail about these could be provided in the guidance.

Part I - Please provide any comments on "Introduction - Understanding climate change as a financial risk"

8. Many organisations also identify liability risks. These risks may be less relevant for pension schemes but are still present, eg in underlying portfolio investments.

Part I - Please provide any comments on "The legal requirements on pension trustees"

9. It is important to note that in some instances, trustees' duties may lead to apparent conflicts with fiduciary duty, eg if they believe there is an expectation that disclosures require them to take particular actions. The document should make explicit that TCFD requirements do not impact their other fiduciary duties. Indeed, making disclosures in line with the TCFD recommendations should be seen as complementing their fiduciary duties by making visible their oversight of a critical long-term risk.

10. An addition point that could be highlighted in this section is the importance of confidentiality. Particularly in regards to the potential impact of climate risks on the sponsor and their disclosures regarding covenant risk. As with all potential conflicts and the need to respect confidentiality, it is important for trustees to take advice and adopt robust procedures for reconciling and managing such conflicts and duties.

Part II - Please provide any comments on "Defining climate-related investment beliefs"

11. This section does not make clear the distinction between belief in climate change and the impact on investment beliefs. It is important that trustees recognise climate change as a financially material risk, and that there are financial risks arising directly from climate change and from measures taken to avoid or mitigate it, such as the measures taken to transition to a net zero economy. Trustees' climate-related investment beliefs should reflect their belief about how such measures will impact on investments.

Part II - Please provide any comments on "Climate-related risks in investment strategy and manager selection"

12. This section covers generic climate-related risks that will be similar for all pension schemes. It should be acknowledged that trustees are reliant on their advisers and that some schemes will not have the resources to devote to consideration of all issues, inevitably falling back on generic off-the-shelf solutions. There is a risk that this could lead to a tick-box mentality. A fast track more focused

small scheme template for generic risks could be considered, alongside a more tailored approach to employer covenant and funding risks for DB schemes.

Part II - Please provide any comments on “Stewardship on climate issues”

13. This section also covers useful content about governance and it would be useful to also include ‘Governance’ in the title.

Part II - Please provide any comments on “Additional points for DB schemes"

14. In terms of assets under management, the majority will be connected to DB schemes, and this is one of the more important sections. It should feature sooner in the document, could be separated into two sections, one on funding and one on employer covenant. Where available, examples and case studies should be used to supplement the analysis.
15. We would suggest that the box at the top of this section acknowledges that *TPR expects* trustees to take an integrated risk management (IRM) approach and that it is not the legal requirement suggested by ‘need’. We would also clarify that IRM *includes* looking at climate risks, given IRM looks at many other risks too.

Part III - Please provide any comments on “Scenario analysis”

16. This is an important and well-structured section and we have no further comments.

Part III - Please provide any comments on “Metrics and Targets”

17. We welcome the inclusion of example metrics. A more direct reference to integrating climate-related risk metrics into the trustees’ risk register and risk management process would be helpful.

Please provide any comments on the Quick start guide

18. The Quick Start guide is a useful accompanying document. Given the length and high level of detail in the main guidance, the Quick Start guide will be helpful for trustees who are newer to considering these issues.

Case Studies - We would welcome any case studies on TCFD-aligned disclosure and integration of climate-related risk assessment and management into decision making and reporting. Please provide an overview of any case studies you wish to submit below.

19. The IFoA has recently published two collaborative papers with Ortec Finance. The papers explore how scenario analysis can be used as a tool for forward-looking assessment of climate-related risks and opportunities for financial institutions. They use Ortec Finance’s top-down modelling approach which combines climate science with macro-economic and financial modelling in order to integrate quantified climate impacts into asset-liability modelling. Three scenarios are considered: two scenarios in which the Paris Agreement climate targets are met, one in an orderly manner and one disorderly, and a third scenario in which there is a failure to transition to a low-carbon economy.
20. The first paper is titled ‘Climate scenario analysis for pension schemes: A UK case study’. It applies the scenarios to an example defined benefit pension scheme, illustrating how climate change might affect the evolution of its funding position over the next twenty years. It is available here: https://www.actuaries.org.uk/system/files/field/document/IFoA%20Paper%201.pdf
21. In the case study, ClimateMAPS, the top-down modelling tool developed by Ortec Finance in partnership with Cambridge Econometrics, was used. We have then translated the impacts of climate-adjusted GDP from this tool for the following three different climate pathways onto a wide range of financial and economic variables:
    - Paris Orderly (co-ordinated action to limit global average temperature rises to 2°C which financial markets price in gradually)
    - Paris Disorderly (same real-world outcomes as the Paris Orderly pathway, but financial markets’ reaction is delayed and abrupt)

- Failed Transition (no additional climate policies are implemented and global average temperature rises by 4°C by 2100).

22. These are just three plausible pathways and they are not intended to be "worst case". We have compared these pathways with a climate-uninformed baseline. This climate-uninformed baseline assumes no increase of physical risks due to climate change and does not make any explicit assumptions about the transition to a low carbon economy. We have modelled these impacts on the assets and liabilities of an example UK defined benefit pension scheme over the next forty years.
23. We think this would be a helpful case study to consider as climate change scenarios can help trustees and employers determine how exposed pension schemes may be to climate change and how the employer may be able to respond as climate impacts emerge. There are then a number of actions that trustees can take in order to mitigate climate risk (not explored in detail in this paper), for example:
    - Make changes to investment strategies and their implementation.
    - Engage with the employer to understand how resilient it is to climate change and which scenarios it is most exposed to.
    - Factor these risks into their funding and investment strategies and plan in advance how to react should they start to materialise.
24. The second paper explores the potential long-term effects of climate change on the economy and financial markets in more depth by providing further detail of the modelling outputs over the period to 2060. It is available here:

    https://www.actuaries.org.uk/system/files/field/document/IFoA%20Paper%202.pdf

    It examines the long-term economic and financial impacts projected by a model that combines climate science with macro-economic and financial effects to examine the relative impacts of the three different climate pathways considered in the first paper:

    - Paris Orderly
    - Paris Disorderly
    - Failed Transition

Should you want to discuss any of the points raised please contact Faye Alessandrello, Policy Manager (faye.alessandrello@actuaries.org.uk) in the instance.