The Money Charity Response – DWP consultation on Pension Scheme Climate Change Reporting (October 2020)

The Money Charity is a financial capability charity whose goal is to empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives.[1]

We welcome the opportunity to respond to DWP's August 2020 consultation "Taking action on climate risk: improving governance and reporting by occupational pension schemes", which we see as a significant opportunity to improve the financial capability and wellbeing of pension scheme members.

In this response, we set out our Key Points, make some overall comments on the issue then answer the questions posed in the Consultation Paper. For those questions that lie outside our direct financial capability remit (Questions 6, 8, 9 and 11), we have chosen not to comment.

[1] See box on back page.

Key Points

1. Climate change reporting needs to be accessible, understandable and actionable for ordinary pension scheme members.

2. Pension schemes should be required to demonstrate substantively how the investments they make align with the Paris goals for the reduction of greenhouse gas (GHG) emissions. This is what we believe scheme members will wish to see from environmental reporting.

3. All pension schemes should be in scope.

4. As well as information meaningful to experts, schemes should report key information to scheme members in easily understandable form, using approaches that have been proven to be consumer friendly. Schemes should consumer test their reports for consumer pick-up and comprehension.

Overall Comments

We approach this DWP consultation from a financial capability and wellbeing perspective, with a particular focus on Millennials, Generation Z and current pension scheme members.

The Money Charity is a financial capability and wellbeing charity (see box on back page) whose principal activity is educating adults and young people about personal financial wellbeing, which we do via school workshops, community and workplace workshops, online delivery, teacher resources, information booklets, social media and other educational material. Our largest stream of activity is our young people workshops in secondary schools which in a normal non-Covid year reach around 20,000 participants per year.

To assist the improvement of financial capability it is important that people who wish to find out about the carbon footprint of their pension investments are empowered to do so. This applies to the full range of Environmental, Social and Governance (ESG) indicators, though for the purposes of this response we confine our remarks to the financial risks of climate change. Environmental reporting is particularly important for people in the Millennial, Generation Z and younger generations, as they will be living and drawing pensions in the post-2050 world. Someone who is twenty today will begin drawing their pension in 2065-2070 and may continue drawing a pension until the end of the century.

The Covid-19 economic downturn has given us a dramatic example of how carbon-based assets can suddenly depreciate, exactly the sort of disorderly scenario that the DWP consultation document alerts us to. This experience should have educated pension fund managers on the need to adapt their investment strategies towards a Net Zero world.

In reporting progress on meeting climate change goals, it is vital that the information be **accurate, accessible, understandable and actionable** for pension scheme members as well as for experts in the field.

Accurate reporting

As DWP will be aware, there is a risk of "greenwashing" in climate change reporting, with some companies claiming to be "green" on flimsy evidence. In our view the new regulations should be framed in such a way that accurate reporting is encouraged, and the reporting is about what substantively matters: reduction in GHG emissions on a path to meeting the Paris goals, which is what, in our view, pension scheme members would expect to see.

Accessible information

In our experience, most pension scheme members do not read past the annual members' statement they receive, and some scheme members find this hard to understand. Overall, we find in our workshops that people have a low level of awareness of their likely pension income (even their State Pension) and little or zero knowledge of what their pension funds are invested in.

For information on climate change risks to be accessible, it needs to be referred to on the top page of the annual statement sent to scheme members. Underneath the statement of the current value of the member's pot or value of their annual pension (depending on whether the scheme is DC or DB) there should be a statement along the following lines:

> If you wish to know whether your pension investments are aligned with the Paris Agreement on Climate Change, go to the following link [link]. This link also tells you how to make your pension Paris-compliant, should you wish to do so.

As well as empowering pension scheme members to make environmentally sustainable decisions, the requirement to make such a statement to scheme members is likely to have the effect of "concentrating the minds" of scheme trustees on moving their funds in a Paris-compliant direction.

Understandable information

As a financial capability charity, we have experience in translating complex financial information into terms that ordinary people can understand. At the policy level we have discussed this with the Financial Conduct Authority (FCA) and made submissions on improving the presentation of financial information. Generally, information that uses a lot of long words, in long sentences, in small print, uses a lot of maths or refers people to other reports or web sites is not effective and may create significant barriers to understanding. For example, in its consumer testing of messages on consumer interest rates, the FCA found non-comprehension rates of 30% to 80%, depending on how the messages were framed.[2]

We therefore recommend that in addition to adopting measures of environmental compliance that are meaningful to experts and withstand expert scrutiny, DWP and the industry should consider developing simpler presentations for consumers. We have suggested to the FCA that it consumer-test colour codes similar to those showing the environmental performance of appliances. Adapting this to pension fund investments, there could be a code such as this:

Green or Blue:[3] My pension scheme investments are consistent with the Paris Agreement.

Amber: Some of my pension scheme investments are not consistent with the Paris Agreement.

Red: A significant proportion of my pension scheme investments are not consistent with the Paris Agreement.

Actionable information

Once the information is accurate, accessible and understandable, pension scheme members need to be able to take effective action.

When a scheme member looks at their pension record on their annual statement and the scheme's website, they should be able to see the environmental rating of their current (default or otherwise) investments. Alongside this, there should be a choice, or choices, that are Paris-complaint.

The combined effect of pension scheme members choosing green investments and asking questions about the investment strategy of the pension scheme would, we think, be a powerful incentive to move pension funds towards investing in Paris-compliant portfolios. We think this would be particularly welcomed by younger pension scheme members in the Millennial and Generation Z age groups, many of whom express an active interest in environmental sustainability.

[2] Financial Conduct Authority, CP 18/42 Annexes, Chapter 7, page 15.
[3] Blue may be better than green for people with red-green colour blindness. Information on choosing colours for people with sight disabilities is available online.

Answers to consultation questions

Question 1: Scope

It appears from the consultation document that while the majority of pension scheme assets will be in scope, only a relatively small proportion of schemes will be in scope. From a financial capability point of view this is undesirable, as we and others would need to communicate a mixed message: "your pension fund may or may not be making environmental disclosures." In our view it would be preferable to have all schemes in scope. While this may sound administratively onerous, if systems are set up to enable the reporting of climate change risks by larger schemes, these systems of reporting (for example climate change disclosures by individual companies and assets) should make it possible for all pension schemes to report climate change risks.

Question 2: Timetable

We agree with the broad thrust of the timetable proposed, i.e. that climate change reporting should be implemented in the early 2020s. This is because climate change reporting is time sensitive. For meaningful progress to occur along a timeline to 2050, changes need to begin in the next few years. Pension scheme members with an interest in sustainable investment will wish to see reports as soon as possible.

Question 3: 2024 review with the aim of extending climate change reporting to schemes of all sizes.

As foreshadowed by our answer to Question 1, we agree with this.

Question 4: Duties of Trustees and Scheme Managers

Because of the risk of greenwashing, we would like to see an additional duty added to the proposed general duty to "maintain oversight of climate change risks and opportunities", which is that trustees should "ensure that the measures of climate change risk used by their scheme(s) accurately reflect the scale of greenhouse gas (GHG) emissions made by the companies or other assets invested in by the scheme(s)." In other words, if trustees sign off their pension scheme as "Paris compliant", it needs to be truly Paris-compliant in the sense that GHG emissions of the scheme investments are on a Paris-compliant path.

As DWP will be aware, until very recently many investment managers were either neutral on carbon investments or actively promoted carbon investments on the basis of their financial returns.[4] It is this culture that new rules on the reporting of the financial risks of

[4] For example, the writer of this response in late 2019 attended an investment seminar run by one of the leading UK retail investment platforms at which four out of five fund managers presenting were either

climate change seeks to change. Inevitably, in the early years of such a regime there will be problems with misreporting. We therefore think that introducing an "accuracy rule" would help achieve the culture change desired.

To make well-founded decisions, scheme members need accurate reporting that properly reflects the nature of their present and future pension investments.

Question 5: Trustee obligation to assess the climate change risk of their portfolios over the short, medium and long term.

We agree with this. Short-termism has been a weakness of UK investment markets for a long period of time, so we particularly welcome the inclusion of the requirement to assess climate change risk over the medium and longer terms. It may also be useful to include guidance as to what is meant by the medium and longer terms in relation to climate change risks. Given the time-sensitivity of the risks, we suggest that medium term should mean "around 2030", while "longer term" should mean "from 2040 onwards".

Question 6: Climate scenarios to include at least one scenario for world temperature rise of less than two degrees.

No comment.

Question 7: Normalising the consideration of climate change risks within corporate risk management processes.

We agree with this and note that the draft guidance makes it clear that transition risks (changes to Government policy and regulation and consumer trends) are an explicit part of the risk.

The experience with Covid-19 has given us a stark lesson in the challenges of realistic risk management when allied with the 'present bias' of human cognition. Despite the risks of a pandemic being at the top of the UK Government's official national risk register (along with hostile state actions, some impacts of climate change and a nuclear accident) investment markets placed a zero value on pandemic risk until it crystallised in March 2020, after which a drastic decline in global share prices occurred. Whether the subsequent recovery in many share prices has a solid foundation remains to be seen.

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silent on climate change risks or promoted carbon fuel investments. Only one of the five managers presenting mentioned the challenges of climate change and advocated investments in alternative energy. Since the onset of the Covid-19 crisis, the major oil companies have lost around half their market value.

Question 8: Metrics to include one GHG-related metric and one non-emissions-based metric.

No comment.

Question 9: Setting targets and monitoring progress.

We agree with the proposals under Question 9. Monitoring will assist people understand the progress schemes are making and help guide their decisions

Question 10: Climate change reporting.

We agree with these proposals, subject to the following addition: "the climate change risks report (or a summary of the report) should be easily accessible and presented in terms an ordinary pension scheme member can understand and act on", along the lines set out in our Overall Remarks at the beginning of this response.

In our view, it is very important that information on pension fund climate change risks is clear and accessible for ordinary scheme members, and that there should be options for members who wish to do so to move their personal portfolio towards environmentally sustainable investments.

As DWP will be aware, much of the statutory information that schemes and firms supply is written in long, complex documents which often require financial training to read. For the information to be usable by ordinary scheme members, summaries of the key points and options for action must be written and presented accessibly.

Question 11: Penalties

No comment.

Question 12: Impact assessment

No comment other than to say that there are huge opportunities for UK business, supported by UK pension funds, in moving rapidly toward an environmentally sustainable economy. We have seen during 2020 how the FTSE100, dragged down by old economy firms including the oil majors, has performed badly compared with the US and Chinese stock markets, which have a higher presence of sustainable energy and new technology companies.

Many UK consumers and pension scheme members want to play an active part in the transition to a sustainable economy and it is important that pension scheme regulations enable them to do so.

Question 13: Impact on protected groups

Our main fear is that, depending on how it is done, climate change reporting could be inaccessible for most pension scheme members because of the placement and presentation of the material. For this reason, we have made our suggestions above (see Overall Remarks and answer to Question 10) on making climate change reporting understandable and actionable for ordinary scheme members.

Clear and accessible reporting will assist many people in protected groups as well. We agree with the consultation document that firms should give further consideration to people with specific disabilities, e.g. vision-related, and those (for example some older scheme members) who may not be adept with online sources of information.

We recommend that the industry develop consumer-friendly metrics and reports, such as the colour code we proposed in our Overall Remarks. Such presentations should be consumer-tested for their effectiveness before being adopted, using the principles of inclusive design.

(end)

The Money Charity is the UK's financial capability charity providing education, information, advice and guidance to all.

We believe that everyone achieves financial wellbeing by managing money well. We empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.

We do this by developing and delivering products and services which provide education, information and advice on money matters for those in the workplace, in our communities, and in education, as well as through influencing and supporting others to promote financial capability and financial wellbeing through consultancy, policy, research and media work.

We have a 'can-do' attitude, finding solutions to meet the needs of our clients, partners, funders and stakeholders.

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