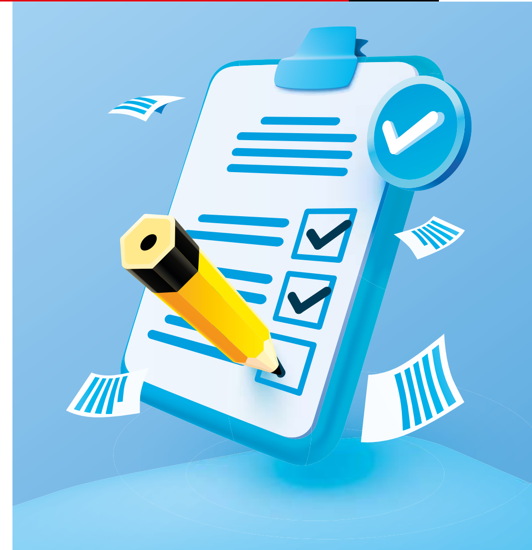
Beyond the tick box

Abigail Williams explores the effect of TCFD reporting on pension schemes



The Pensions Regulator's (TPR) recent review of the first round of Task Force on Climate-Related Financial Disclosures (TCFD) reports identified several areas for improvement. So, with the next round of TCFD-aligned reporting requirements upcoming and further Paris-aligned disclosure requirements introduced from October 2022, what are the key considerations for pension scheme trustees and what improvements are still needed to address TPR's reporting concerns?

Promoting better engagement

For UKSIF's head of policy and communications, Oscar Warwick Thompson, some areas for improvement identified by TPR in its recent review are welcome, including its encouragement for schemes to 'consider new ways to effectively communicate the content of TCFD reports to scheme members'. That said, he observes that TPR and schemes will need to work together to "promote this trend, and to consider how decision-useful disclosures can be highlighted and drawn to the attention of those members with a particular interest in climate change risks".

"We hope to see a more consistent approach adopted in time, which should help ease the understanding of schemes' approach to addressing climate risks, recognising that for many schemes, they will be at the very start of their TCFD reporting journey. There is potential we hope for reporting to be used more and more as a tool to promote better engagement between schemes and their members," Warwick Thompson says.

He also welcomes TPR's recognition of the importance of avoiding a compliance and 'tick-box' mentality, and observes that, in some respects, a key outcome of reporting against TCFD is an awareness that the process is "sometimes less about the final report, and more the new thinking and internal processes facilitated within firms, as they have engaged in this reporting".

Elsewhere, Pension for Purpose research analyst, Cameron Turner, points out that one key recent development is the mandating of portfolio alignment metrics, which moves reporting requirements "beyond backward-looking metrics and focuses minds on aligning portfolios with decarbonisation goals, rather than just emissions statistics, which may not decrease linearly, especially given the data will improve over time".

"TPR has been vocal about its awareness that sometimes scenario analysis projections to investment returns may not be accurate to the likely world we will see with three or four degree-warming. They have said they will be lenient with initial reports, but they are likely to get stricter over time with the outputs. Our analysis found that standardisation is needed for pension funds to get more value from scenario modelling," he says.

Areas for improvement

For LCP head of responsible investment, Claire Jones, the most important areas for improvement mentioned by TPR are: The interpretation of the information presented – reporting on the 'so what' – and giving specific examples of activities during the reporting year, as well as greater focus on actions to mitigate climate risks, because "reporting is not an end in itself". In her view, although the requirement to provide evidence of what has already been done through reporting is useful, it is the 'doing' that is more important.

"The essence of TCFD is the identification, assessment and management of climate-related risks and opportunities, with the desired outcome that those risks and opportunities are better managed, leading to better outcomes for scheme members," she says.

"It's important not to get bogged down in the detail of the requirements and lose sight of that overarching aim. TCFD is not a one-off exercise. The requirements are ongoing and improvements are expected over time. Trustees, advisers and investment managers are all on a journey to better understand and manage climate-related risks and opportunities," she adds.

Turner stresses that trustees need to plan well in advance and think about the timeline for TCFD report preparation, as well as their data sources, who will prepare the report, and how much work will be outsourced, for example to managers or consultants.

"They also need to consider how the report might help inform their investment approach to climate action. It could be argued that the regulations focus too much on 'what are my portfolio emissions?'" he says.

"Instead, trustees should look at how they are going to decarbonise the world, as well as the fund. This means looking

at their portfolio alignment and engaging with climate laggards to improve this metric, and considering investment in climate solutions to positively contribute to global decarbonisation," Turner adds.

In terms of improvements needed moving forward, he argues that, although it may not be TPR's concern, TCFD reporting requirements should also include a focus on climate solutions to encourage capital to flow towards them. There is currently no specific requirement for funds to outline their investment in climate solutions, meaning that some investments, for example those in renewable energy that may initially be carbon-intensive, "would show the fund to look worse in their emissions statistics".

"As a result, we have seen funds looking to include carbon emissions that are offset and avoided in their carbon accounting methodologies. It can be problematic at this stage of global decarbonisation if funds can use this approach to mask the emissions of underlying investments," he says.

"There should also be a focus on 'impact and dependencies,' which focus on the portfolio's impact on climate change and the dependencies of the portfolio's investments on the avoidance of climate catastrophe, rather than just risks and opportunities," Turner adds.

Lack of clarity

Jones predicts that a lot of improvement should occur naturally as expertise, data and tools improve and points out that much effort is being put into this across the industry.

"Data is raised as a concern, time and time again. As data gaps are filled and the quality of data improves, we need to turn our attention to ensuring that the metrics collected, and the way they are presented, are decision-useful and genuinely inform the actions taken by trustees and their investment managers. The current requirement for four metrics, whilst challenging, gives only a very limited picture of the risks and opportunities," she says.

"Climate scenario analysis, particularly the realism of the results for higher temperature scenarios, is another widespread concern. The modelling will improve, but will inevitably always have limitations due to the real-world complexities and uncertainties. Trustees and their advisers therefore need to focus more on narratives and qualitative insights, ensuring that these are consistent with the latest climate science," she adds.

As identified in the TPR review, Warwick Thompson observes that data quality does remain a challenge across the investment chain and confirms that UKSIF "continues to have questions over the decision-usefulness of certain data and data sets, particularly on sustainability factors beyond climate change alone".

"The work of the UK's Taskforce on Social Factors is promising in this respect. One main objective for the taskforce will be to actively highlight high-quality data that can be leveraged by trustees and others to assess material social risks and opportunities on behalf of beneficiaries. This will be important as schemes and other investors are expected to report on social considerations and their social impacts increasingly," he says.

"Appropriate sequencing of reporting requirements is also an important consideration. Good underlying corporate disclosures continue to be absolutely critical to facilitate schemes and other investors' ability to evaluate their holdings, and fulfil their reporting obligations. The continued lack of clarity in the UK on its upcoming approach to corporate disclosures is an issue that needs consideration swiftly," Warwick Thompson adds.

Reporting framework

Climate change continues to be an important area of focus for independent asset manager Wellington Management, and the company remains aligned with the TCFD's mission to improve and increase reporting of climate-related financial information. In this context, Wellington Management climate transition risk analyst, Julie Delongchamp, observes that inadequate data and the absence of a standardised framework for disclosure can hamper investment teams' ability to 'evaluate the impacts of climate change, positive or negative, on client portfolios.'

In September 2019, Wellington Management issued what it refers to as the 'Physical Risks of Climate Change (PROCC-1) framework,' a how-to guide for companies to disclose their physical risks to climate change, and Delongchamp notes that some of its ESG and investment analysts have used this in its engagements with companies.

"A couple of years later, we published PROCC-2 as a public call for all companies to disclose the physical location of owned or operated assets. This PROCC-2 framework was supported by CDP, IIGCC and Ceres, and we have referenced this in our consultations with regulators and standard setters such as EFRAG, ISSB, and SEC," she says.

"As more data and disclosure becomes available, we are working diligently to incorporate it into our investment dashboards in order to help inform the decision-making ability of various investment teams across our platform. Our integrated approach to climate research has resulted in climate science research collaborations and the expansion of our proprietary climate risk technology and tools to help investment teams assess physical and transition risk and to synthesise data and insights at the portfolio level," she adds.

Written by Abigail Williams, a freelance journalist

In association with WELLINGTON MANAGEMENT®