Climate Governance and ESG team
Department for Work & Pensions
Caxton House, Tothill Street
London, SW1H 9NA

7th October 2020

E-mail: pensions.governance@dwp.gov.uk

Dear team,

Railways Pension Trustee Company Limited (RPTCL) response to the DWP consultation *Taking action on climate risk: improving governance and reporting by occupational pension schemes*

I am writing to you on behalf of the Railways Pension Trustee Company Limited (RPTCL). The Trustee Company's wholly owned subsidiaries RPMI and RPMI Railpen run the railways pension schemes on its behalf.

RPMI Railpen (Railpen) is the trading name of Railway Pension Investments Limited, which is authorised and regulated by the Financial Conduct Authority (FCA). Railpen acts as the investment manager for the railways pension schemes and is responsible for the management of around c. £30 billion of assets.

Railpen's mission is to pay the pensions of our 350,000 members securely, affordably and sustainably. We welcome the opportunity to respond to this important consultation. Both the Trustee Company and Railpen undertake responsibilities attributed to asset owners and asset managers, and we have answered the issues raised in the consultation in a way which reflects the breadth of our responsibilities.

Sustainable Ownership is Railpen's approach to incorporating sustainability considerations into the investments it manages on behalf of members. Railpen's work is enabled by the Trustee's related investment belief: "Environmental, social and governance (ESG) factors materially impact long-term investment returns and must be taken into account." Railpen's Sustainable Ownership (SO) Reports for the last three years are available on our website.

Introduction

As one of the largest UK pension funds, we have long recognised the impact of climate change on our long-term investments and on the quality of world our beneficiaries retire into. We therefore seek to align our portfolio with the low-carbon transition of the global economy, in line with the Trustee's investment beliefs and our reputation as a responsible investor.

Railpen, which invests on behalf of the Trustee of the Railways Pension Scheme, is committed to integrating climate risk considerations into our investment process and – as part of our commitment to acting as an engaged steward of beneficiaries' savings – proactively encourages our portfolio companies to improve their disclosures and transition to an approach which supports the creation of a truly low-carbon economy. This includes both individual engagement and voting activity as well as playing a leading role in collaborative engagement initiatives such as Climate Action 100+ (one of the Climate

Action 100+ engagement objectives is TCFD disclosure by target companies). We also take advantage of targeted opportunities which aim to generate a positive impact alongside a financial return.

As a long-established supporter of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), Railpen has been reporting publicly to beneficiaries and stakeholders across the TCFD recommendations since our 2018 Sustainable Ownership Report. Our next report will be the second to disclose in line with the TCFD framework of recommendations. We have also been urging our portfolio companies (both public and private) to disclose using the TCFD framework.

We strongly welcome this government's clear and continued commitment to supporting institutional investors to consider the impact of climate change in their work to protect and enhance the value of members' savings, and appreciate the opportunity to engage on this important topic. We are also grateful for the willingness of the Department for Work and Pensions (DWP) to hold informal discussions both before and throughout the consultation period.

Our response focuses both on some of the specific issues raised in the paper and highlights other topics which we believe it is worthwhile covering here. We also feed through some of our own practical experiences of analysis and reporting using the TCFD recommendations, which we hope will be of use in informing the government's approach to mandatory disclosures.

Our response

As highlighted in the government's consultation, there is strong evidence to demonstrate that factors relating to climate change and climate policy will have – and are already having – financial consequences for nearly every business in every sector. Railpen therefore believes that pension schemes have a clear fiduciary duty to take steps to manage climate-related issues and act in members' best interests.

We believe that the recommendations of the TCFD provide a valuable framework to support all financial institutions – including pension schemes – to do so. We therefore support the government's commitment in the 2019 *Green Finance Strategy* to require "large asset owners" to report using the TCFD framework. We agree that a first step to raising standards of climate-aware investment is to require schemes to ensure they have an effective climate governance framework, and to disclose how they are managing and mitigating their exposure to climate risk.

We support the government's sensible and pragmatic approach to mandating use of the TCFD framework, requiring schemes to take account of the impact of climate change but allowing flexibility in the way in which they choose to do so. The government's explicit statement that trustees retain primacy in investment decisions is also welcome.

Unfortunately, despite the efforts of Railpen and other climate-aware investors to encourage better disclosure of TCFD-relevant data across a broad range of jurisdictions and asset classes, there are areas where the availability of such data remains limited. We agree that a lack of available data should not prevent action in areas where data are already fit for purpose, and we welcome government's recognition of this in its decision to take a flexible approach. We hope that this approach will continue to be reflected in future government and regulatory public statements on scheme activity in this space. This will be important to manage the expectations of various stakeholders in what can on occasion reduce to a binary debate on responsible investment.

Aligning disclosures across the investment chain

We recognise that asset owners hold a privileged position at the 'client end' of the investment chain. We have a history of using our influence as one of the UK's largest pension schemes – and as one of the few

Defined Benefit (DB) schemes with many open sections, and a significant allocation to equities and other growth assets where climate engagement can be more effective – to pull good stewardship practices, including on climate, up through this chain via our active ownership and ESG integration work. We work hard to hold our portfolio companies, external managers and other service providers to account on those issues – including environmental, social and governance concerns – which are material to our portfolio and our beneficiaries' savings.

We welcome the statement of support from government and regulators to improving the consistency and comparability of climate disclosures across the investment chain. Pension schemes need high-quality disclosures on climate from their asset managers who at present – unless they happen to be a premium listed issuer as per the recent FCA proposals – are not included in mandatory TCFD reporting requirements. We urge government and regulators to follow the recent example of New Zealand in mandating TCFD disclosures from all large investment market participants and all companies with listed equity or debt, and to do so in good time in order to help schemes to produce their own disclosures and undertake a more comprehensive, accurate analysis.

This should include extending the TCFD requirement to not only publicly listed companies, but also to those companies which have signed up to the Wates Principles. Railpen is not unusual amongst pension schemes in having significant exposure to private equity, debt and real assets. This includes the kind of illiquid or high-growth assets to which the government has in its *Patient Capital Review* sought to reduce the barriers to entry for institutional investors. However, there are currently limitations and a lack of consistency in the climate data available from private companies. Railpen is increasingly incorporating TCFD information requests and criteria across monitoring and due diligence for the larger private companies, but government action in this area could stimulate more rapid change.

Clarity on different disclosure requirements

We believe that greater transparency of how schemes are considering climate change in their investment and (for DB schemes) funding strategy can be a powerful tool for raising standards. We also think there is benefit to beneficiaries, civil society and the industry generally in being able to explore – and learn from – what schemes like ours are doing.

We also appreciate that the government is clearly committed to proceeding on disclosure requirements at a pace and in a way that acknowledges the capacity constraints on many schemes and trustee boards.

However, given the significant amount of regulatory and industry change aimed at encouraging schemes to act – and disclose how they have acted – on financially material ESG risks, including climate change, schemes are now dealing with a number of different but similar disclosure requirements. A non-exhaustive list would include not only the implementation statement requirements but also regulations coming from the EU[1] and voluntary initiatives such as the Stewardship Code and the UN-backed Principles for Responsible Investment (PRI).

Railpen is supportive of the EU's work in this space and we are a long-standing signatory to both the Stewardship Code and the PRI, as well as similar codes in other jurisdictions. However, even the very largest schemes, such as ours, with an in-house team exclusively devoted to responsible investment (or Sustainable Ownership) activities, has a finite level of resource to dedicate not only to the practice of

[1] Including the Sustainable Finance Disclosure Regulations and the Non-Financial Reporting Directive.

responsible investment, but also to the disclosure of activities and outcomes. Furthermore, although we agree that high-quality communication to beneficiaries on responsible investment issues is important and there is a growing body of evidence to demonstrate the broader benefits of doing so[2], there may be a risk of inundating beneficiaries[3] with information in a way which is counter-productive.

More generally, therefore, we would be grateful for further clarity from government across the full range of these responsible investment disclosure requirements and how they interact with each other, including where there may be areas of overlap or possibilities for cross-referencing. This could be undertaken as part of the proposed review in 2024, though our strong preference would be for this to proceed as soon as possible.

Specifically, we would also be grateful for clarity as soon as possible from government regarding the approach it intends to take to transposition of some of the Level 2 requirements of the EU's Sustainable Finance Disclosure Regulation. We applaud the government's stated commitment to matching the EU's ambition[4] on sustainable finance but would be grateful to understand what this means in practical terms for further disclosure requirements from pension schemes.

The regulatory approach to TCFD

We welcome the news that The Pensions Regulator is currently considering its approach to the supervision and enforcement of relevant climate change regulatory requirements. We would appreciate clarity on the direction of travel at the earliest possible opportunity and hope that TPR's approach will be aligned with the welcome flexibility of approach as currently outlined by the government in its consultation paper.

We also welcome the news that detailed statutory guidance will be provided. Once this has been consulted upon in early 2021, we would be grateful for the guidance to be published as soon as is practical. This is particularly the case given that the practical application of the guidance around, for instance, the level at which scenario analysis and strategy should be formulated will need to be worked through carefully by each scheme according to its own unique structure and approach.

Even though Railpen is already reporting using the TCFD framework, we support the government's decision to narrow the scope of the application of mandatory penalties to "complete non-production of a TCFD report". Although we were not one of the schemes affected by the mandatory penalties regime surrounding the Annual Chair's Statement, we believe that the design of any penalty structure and scope should not be such that it presents an obstacle to providing a clear and concise articulation of how a scheme has considered, managed and monitored climate risks.

We agree with the requirement to publicly disclose the TCFD report, including providing a web link through the Scheme Return. We have also welcomed the Regulator's previous emphasis on the desirability of concise and succinct implementation statements as this is clearly beneficial for members'

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[2] For instance, NEST's *2018 Responsible Investment Report* found that good communication on responsible investment issues could "build trust and confidence in pension savings". Franklin Templeton Investments' 2019 report *The Power of Emotions: Understanding Generation DC* found that an additional £1.2bn of employee contributions could be invested annually by those aged 22-28 if responsible investment was incorporated into their pension.

[3] We recognise that the intended audience for TCFD reports is not only beneficiaries but also regulators and other industry stakeholders. However, we believe that beneficiaries must be the most important audience for all scheme disclosures on their activity and impact and would encourage regulators and policymakers to recognise this in future initiatives.

[4] Comments from the Economic Secretary to the Treasury to the Investment Association 2020 conference, as reported in IPE, 9 September 2020 (accessed 1st October 2020).

understanding. We would hope that a similar approach will be taken to the articulation in statutory guidance of good practice for TCFD reports.

We think that there would be merit in TPR (or another similar body) holding a central register of schemes' TCFD statements. This would allow for easier scrutiny by beneficiaries, civil society and research organisations but would also allow for more convenient study by others in the industry so that they can learn from others and so that overall standards in the industry can be raised more rapidly.

The frequency of analysis (discrete activities)

We believe that scenario analysis can be a helpful tool in concentrating stakeholders' minds on the concrete impact of climate change on portfolios, as well as a useful tool for guiding investment strategy and decision[5]. The government's consultation papers notes the limitations on data for scenario analysis across a portfolio. This is aligned with the learnings from our own scenario analysis. We welcome the government's flexibility and non-prescriptive approach when it comes to what kind of scenarios to use – and agree that scenario analysis remains a useful tool for investors, despite these limitations.

However, we also note the proposal that "the scenario analysis is carried out at least annually" and the government's understanding that such an analysis will cost around £15000. Our experience – and those of other similarly sized organisations which, like us, will have been in the position to leverage size and scale in negotiations – is that this significantly underestimates the cost by a factor of between two and three times. And this costing does not include the significant internal resource and management time that schemes will need to dedicate to assess and incorporate the findings. We hope, however, that greater demand for scenario analysis will reduce the cost over time as more providers are encouraged to enter the market.

We recognise that the level of government and regulatory commitments to act on climate change across the world are growing exponentially – we welcome this development – and that therefore an out of date scenario analysis has limited usefulness. But the progression from statements of intent to activity and then impact takes time and so we do not agree that a scenario analysis would be out of date on annual basis. Taken together with the fact that long-term investors' portfolios may not have changed significantly in a year, we therefore do not believe that running an analysis annually is the best use of resource. We would suggest a broader requirement to undertake scenario analysis on the investment side *at least* every three years, or when there has either been a significant change to strategic asset allocation or the availability of data on a key part of the portfolio. The precise definitions of what would constitute a significant or material change could be set out in statutory guidance.

We also have concerns about the requirement to "[obtain and calculate] emissions and non-emissions based data… at least quarterly". Unlike financial and operational performance metrics, which portfolio companies are used to providing on a quarterly basis[6], most companies do not provide emissions and

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[5] We have used both the PACTA tool referenced in the consultation document, as well as asked a third-party provider to undertake scenario analysis on our portfolio in 2019 – this analysis covered both physical risks as well as transition risks and opportunities across different global warming pathways up to 2100. It also covered – as best as it could, given data limitations – our full portfolio i.e. not only listed equities but also real assets, fixed income (including sovereign debt).

[6] Though, as a long-term investor, Railpen has welcomed recent market developments aimed at encouraging a more long-term approach to the reporting of performance metrics

non-emissions data so frequently[7]. It would not be a good use of a pension scheme's time and resource to chase companies for this information. We would recommend that this requirement is instead placed *annually* on schemes – until such time as the regulatory requirements for companies (both public and private) require them to measure and provide update information at the required frequency.

Funding and data analysis

As the government recognises, climate scenario impact modelling on funding and covenant is still a nascent industry. We therefore appreciate the proposal to take a pragmatic approach. Once the new DB Funding Code of Practice has been published, there are plans to further develop our approach to integrated risk management which will include how we model the impact of climate change on covenant, investment and funding for the Scheme.

With regards to the proposed frequency of scenario analysis on the funding side, we believe that an annual scenario analysis is also currently inconsistent with the requirement to commission a full actuarial valuation at least every three years. We acknowledge that where schemes obtain a fuller interim actuarial report in the intervening period, it may make sense to run the analysis at this time too but Railpen is a long-term investor and so takes a long-term approach to modelling its liabilities and funding.

The level at which data must be collected

We recognise that the TCFD reporting threshold (and the report itself) will apply on a whole scheme basis and this is welcome. We also wish to respond on the nature of the statutory guidance which will set out at what level data will need to be collated – for instance for the scenario analysis, the assessment of risk and opportunities and use of metrics and targets.

The railways pension schemes have a unique structure which comprises 107 actuarially separate sections, with a different investment strategy for each section based on the profile of the liabilities, covenant strength and the views of the sponsoring employer. The Trustee also sets principles for the key aspects of section investment strategy i.e. the expected return, risk and liquidity (RRL) of investments. Each section's strategy is then implemented through investment in the appropriate mix of the pooled funds managed by RPMI Railpen for the Trustee.

We understand that there is a possibility that the statutory guidance could recommend collation and reporting of data on a per section basis (such as scenario analysis, assessment of risks and opportunities on the scheme's investment strategy and emissions-related metrics). For a scheme like ours, this could be a disproportionately costly and time-consuming undertaking. Although we recognise that the nature of statutory guidance is that departure from a given approach is allowed as long as there is reasonable justification for the alternative approach pursued, we would be grateful if the statutory guidance were to explicitly allow for different and proportionate approaches to be taken by schemes with numerous sections and in a way which aligns with how risk is managed by such schemes.

Paris-aligned reporting

As a signatory to the Montreal Pledge, Railpen has committed to disclose the carbon footprint of the Scheme's portfolios on an annual basis. While this is more straightforward to do across our listed equities allocation (and we recognise the usefulness of carbon footprinting both as a portfolio management and as a communications tool), the data are currently very limited elsewhere. We

[7] This is particularly the case for private markets and smaller firms – many of which will not have the resources to measure Scope 1, 2 and 3 emissions.

therefore support the government's decision to hold off on mandatory Paris-aligned reporting or the provision of an Implied Temperature Rise (ITR) metric until the data improves and there is more consensus around what a Paris-aligned portfolio might look like.

We strongly support – and contributed to – the IIGCC's work on the *Net Zero Investment Framework*. Although we recognise that for many schemes, taking such an approach will be difficult until the market and best practice evolves, we believe that this initiative is a powerful step towards giving investors a better idea of what a Paris-aligned portfolio might look like. We agree the time is not right to mandate consideration of (and disclosure) at this level yet, but look forward to continuing to participate in this debate in the future.

Statutory guidance

We look forward to feeding into the discussions on the draft regulation and statutory guidance in due course. However, we thought it worthwhile noting at this stage our desire to see more explicit mention in statutory guidance of the role of climate stewardship – particularly given the government's own statements on the importance of engagement and the need for schemes to act as engaged owners of savers' capital.

Although Railpen does exclude some companies from its portfolio on the basis of carbon-intensive activities[8] we believe that fulfilling our active ownership role can have a powerful and positive impact on corporate behaviour. For instance, our most recent voting policy contains tougher stances on climate, with 2019 seeing our first exceptional climate vote against directors who Railpen did not see as providing the necessary oversight or expertise on climate issues. Our intention in 2020 is to further and more explicitly scrutinise the behaviour of companies on climate change, as well as ensuring our external managers act wherever possible in line with our policies on this issue.

We refer the government back to guidance provided by the Pensions Climate Risk Industry Group (PCRIG), which noted that "although there is only one specific TCFD recommended disclosure on stewardship or engagement, it is difficult for trustees to have a meaningful and effective governance or decision-making framework without consideration of how they fulfil their stewardship role." We recognise the often binary, divestment-focused, nature of the public debate on climate and hope that if more schemes can be encouraged to act as engaged owners of their assets – and to provide a compelling narrative around how they are doing so –this can help encourage a more nuanced discussion between savers and financial institutions.

We hope that this information has been of use, but would welcome the opportunity to discuss further.

With best regards,

Chris Hannon

Chair of Trustees
Railways Pension Scheme

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[8] Further details on our approach to exclusions can be found in our Sustainable Ownership Reports which are available online.