3rd September 2021

Dear Sir/Madam,

RPMI Railpen (Railpen) response to FCA's Consultation Paper CP21/17 on enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers: June 2021

About Railpen

RPMI Railpen (Railpen) is the investment manager for the railways pension schemes, and is responsible for managing c. £32 billion of assets. Railpen is authorised and regulated by the Financial Conduct Authority (FCA) and falls within the OPS firm definition. The Trustee's mission is to pay the pensions of its 350,000 members securely, affordably and sustainably. The Trustee, and its subsidiary Railpen, undertake responsibilities attributed to asset owners and asset managers.

Unlike many UK Defined Benefit (DB) schemes, the railways pension schemes include many open DB sections, which means that the Trustee expects to be paying the pension of an eighteen-year-old who is their first job today out to 2100 and beyond. Our investment time horizon is, accordingly, very long and we welcome the FCA's work on enhancing climate-related disclosures – a vital component in assessing climate risks in investment portfolios for pension scheme investors.

Introduction

Investors like Railpen need accurate reporting of corporate and investment data including on climate, which they can rely upon to provide a true and fair view of a company's long term financial health, to support them in making investment decisions and acting as engaged stewards of their members' assets. Along with being one of the first UK pension schemes to act on climate change more broadly[1], Railpen has specifically been a long-standing supporter of TCFD. This has included our membership in initiatives that proactively support TCFD (e.g. Transition Pathway Initiative, Climate Action 100+) , our long-standing encouragement of portfolio companies to report in line with TCFD, and our own reporting using the TCFD recommendations for a few years (refer to the Climate Disclosure Report 2020). We recognise the important role that TCFD has played in framing and driving corporate and investor climate change disclosures and in putting climate change on the agenda for company and investor leadership teams.

This response builds upon our prior responses to the DWP consultation on TCFD (Oct 2020) and the TCFD Forward-Looking Financial Sector Metrics Consultation (Jul 2021) as part of the TPI Steering Committee. Both of these can be found on our website.

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[1] This includes as one of the first UK schemes to publicly announce our intention to vote against companies where we do not consider directors to have sufficient climate expertise, or where climate risk is not appropriately reflected in the financial accounts. We were also an early mover on excluding companies from our portfolios on climate grounds. Further information on our activity can be found in our December 2020 Climate-related Disclosure.

Our response
Our response includes the answers to many questions raised in the consultation (in Appendix A) and highlights two key issues relevant to us in our capacities as an FCA-regulated entity and a user of climate data in our internal and externally managed portfolios.

1. **Scope of requirements and application to occupational pension schemes**
   The FCA guidance is clear that the proposals only apply to FCA-regulated firms – asset managers, life insurers and personal pension providers and not to DWP-regulated occupational pension schemes, (as per 3.15). However, some occupational schemes have in-house fund management firms which are FCA regulated. Under the current proposals, these firms would be required to report both publicly and on demand. While the FCA clarifies that reports could be combined and cross-referenced, including between FCA-regulated firms and DWP-regulated entities, there are question marks on how useful or proportionate this dual reporting would be. This is especially because OPS firms only hold assets on behalf of an occupational scheme, and most schemes with an OPS firm use a mixture of in-house and external fund management – so reporting would be a duplication of the sponsoring scheme, in relation to a subset of the assets along with the additional resources and cost implications for the scheme from this duplication. We would urge the FCA to take this away and give this more thought, in conjunction with the DWP.

   We note that there is precedent for consideration and discussions on recognising the unique nature of OPS firms in FCA regulation and applying carve-outs especially through the regulations for investment consultants in the wake of the CMA investigation and proposals. We would recommend a similar approach for TCFD reporting requirements as applying to FCA-regulated entities.

2. **Climate Data**
   <u>Reported and Estimated Data</u>
   As a user of climate data for our internally and externally managed portfolios, we recognise that there are significant issues and limitations in the way climate data is currently reported, estimated and disclosed in an unregulated manner by third party data providers. We also see that TCFD has now achieved the status of a *de facto* standard-setting body on climate-related disclosures; that is, if TCFD recommends disclosure of an indicator or other information, that recommendation is treated similarly to a disclosure request from a regulatory agency. While we are unequivocally supportive of climate disclosure and broadly supportive of standard-settings, we would like to highlight the current landscape of climate data, estimation methodologies, lack of volatility estimates around the same, significant risk of errors around these estimations and most importantly the lack of liability from the data providers, resulting in risks to stakeholders including pension savers from the same.

   The FCA acknowledges the existence of data gaps at the investee company levels both for instruments not traded in public markets and in-scope firms that do not produce primary disclosure since relevant climate related-disclosures may not be mandatory. In such situations, the Consultation in point 3.36 suggests:

   > *"we consider they may use proxy data or make assumptions to address any gaps. Where proxy data or assumptions are applied, these must be transparent and the methodologies briefly set out, providing relevant contextual information and explaining any limitations of the approach".*

   This is further substantiated in point 3.37 where the Consultation states:

"We also recognise the data limitations in respect of instruments that are not traded on public markets, where reporting and capabilities are less advanced. Similarly, we consider that in-scope firms may use proxy data or make assumptions to fulfil their disclosure requirements, with the additional explanations as set out above".

The FCA consultation query four relates to challenges in using proxy data or assumptions to address data gaps. We agree that proxy data, assumptions and estimated methodologies are certainly one helpful means to fill data gaps and move the reporting process along while disclosure improves. However, it is crucial to highlight additional risks, associated with the complexity and uncertainty with estimation methodologies, model assumptions, climate data projections and outputs, currently not being taken into account. There is no current requirement to include simple and specific information of the extent of use of estimation methodologies in climate risk assessment of portfolios, nor on the variability around this estimation. Furthermore, climate data providers expressly do not take responsibility for the accuracy of their own estimation methodologies, projections and data outputs and metrics. A review of an excerpt from the disclaimer of a climate data provider commonly used by asset owners indicates that the entire risk of all climate information including but not limited to, estimated data, estimation methodologies, related projections and outputs and any analysis of the same, lies solely with the user of the data i.e. the asset owner using this information (the detailed disclaimer excerpt is in Appendix B). Furthermore, the climate data provider transfers all liability related to this data to the asset owner while explicitly advising them to not rely on this information for investment decisions.

We agree that availability of perfect data should not be a limiting factor in climate disclosure implementation, and absent reported data, estimated data may be the next best proxy. However simple high level numeric disclosure on the use of estimation methodologies and estimation risk is key for any stakeholder, whether investment manager, Trustee or saver, to clearly differentiate and interpret climate metrics relying heavily on high variability estimates versus reliable reported data.
Therefore, in line with the FCA's agenda of enhancing climate disclosure, we recommend the use of climate metrics based on estimated data, with a mandatory addition of clear and simple numeric disclosure on estimated versus reported data use, and variability measures around the same.

<u>Material Emissions Sectors</u>
Along the same lines of providing high level disclosure on estimated data and confidence intervals on the same, we believe that providing a high level representation of material emissions sectors are a significant disclosure item for stakeholders as well.

Material emissions sectors especially in energy, utilities and transportation generally are the highest contributors to emissions in investment portfolios. In many cases, especially public equities portfolios, a significant portion of emissions arise from exposure to emissions-intensive sectors. While disclosure on emissions with in-scope companies are positive, simple high level disclosure on exposure to high versus low emissions sectors, similar to estimated and reported data, will be crucial to understand a fund's exposure to emissions intensive activity and contextualise its respective emissions footprint both on an absolute basis and relative to other funds and portfolios. Unlike the complexity of the other metrics being required, we see this as fairly straightforward to report while adding immense clarity and perspective around the overall climate disclosure. We have also provided specific answers to the questions raised in the consultation and is in Appendix A.

We hope that our response has been helpful and would be happy to discuss further any of the issues above.

Yours faithfully,

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APPENDIX A

Below are also specific answers to some of the questions raised in the consultation:

- Do you agree with our proposed scope of firms, including the £5 billion threshold for asset managers and asset owners? If not, please explain any practical concerns you may have and what scope and threshold you would prefer. **Given it covers 98% of UK asset owners as per the FCA document, this is a reasonable threshold to start. As things progress, disclosure improves, this can progress to the smaller schemes as well.**

- Do you agree with our proposed scope of products? If not, what types of products should, or should not, be in scope and why? **Broadly yes, but we think a high level product scope differentiation / classification on high emissions sectors (versus no/low emissions sectors) might simplify the process/costs/implementation for many asset managers/owners (for example ones who do not have any exposure to high emissions sectors)**

- Do you agree with our phased implementation and timings? If not, what approach and timings would you suggest and why. **Yes. In agreement on the phasing based on AUM. However, implementation success with asset owners and managers is directly dependent on the success with corporates especially in high emissions sectors and exposure of the asset owner to the same. The phased approach can be based not just on AUM but also AUM by high emissions sector exposure and SAA (AUM in public markets where disclosure is already better) as the earliest / highest priority so systemic issues can be quantified / addressed first**

- Would there be significant challenges in using proxy data or assumptions to address data gaps? If so, please describe the key challenges and implications as well as any preferred alternative approach. **Proxy data and assumptions are based largely on unverified methodologies, so can create unforeseen risks and challenges which include actual emissions data being vastly different from estimates. The approach itself does not need to be altered massively but the preference could be to focus on high emissions sectors first in public markets (where disclosure and data quality is better) and also having asset owners report the % of portfolio using proxy data and assumptions (in addition to confidence intervals around that estimated data). This would provide a meaningful high level snapshot of the extent of impact of proxy data and / or assumptions.**

- Do you agree with our proposals for the provision of a TCFD entity report, including the flexibility to cross-refer to other reports? If not, what alternative approach would you prefer and why? **Yes this would be preferred especially across asset classes and security types like debt and equities.**

- Do you agree with our proposed approach to governance, strategy and risk management, including scenario analysis? If not, what alternative approach would you prefer and why? **Broadly yes. We would recommend the use of confidence intervals or volatility measures around the scenario results being produced to contextualize the robustness and the potential variability across these scenario results.**

- Do you agree with our proposals for AFMs that delegate investment management services to third-party portfolio managers? If not, what alternative approach would you prefer and why?. **Given it is the AFM's responsibility to produce the entity level TCFD report, as long as the AFM**

can track, monitor and report the climate risks and impact of purchases of the 3rd party portfolio managers (or make it part of the IMA).

- Do you agree with our proposals for asset owners to cross-refer to group-level, third-party or delegate reports, where relevant? If not, what alternative approach would you prefer and why? **Yes but similar to 8, would be important for the asset owner to at the least standardize the reporting around their various portfolios and managers and/or including it in the IMAs in terms of specific reporting guidelines and format.**

- Do you agree with our proposed requirements for product or portfolio-level disclosures, including the provision of data on underlying holdings and climate-related data to clients on demand? If not, what alternative approach would you prefer and why? **Yes but we can see this as being onerous as well for various smaller asset owners (even 5bn and above) and data gaps leading to less than meaningful results. Hence we would recommend disclosures starting with high emissions sectors, highlighting the %, emissions, highest emitters, reported versus estimated data (and confidence intervals on the estimations for the same) as Level 1 reporting and Level 2 moving to all other sectors and asset classes, highlighting the %, emissions, highest emitters, reported versus estimated data (and confidence intervals on the estimations for the same). The segregation of Level 1 and 2 will give Trustees and the regulator a clearer picture of high emissions sector and company exposure, reported data availability, estimated data and confidence intervals on the same.**

- Do you agree with the list of core metrics, including the timeframes for disclosure? If not, what alternative metrics and timeframes would you prefer and why? **Yes. We also advocate highlighting not just averages but the tail risk (either via distributions or top 50-70% emissions exposure concentrations) and confidence intervals around these metrics.**

- Do you agree that firms should calculate metrics marked with an asterisk according to both formulas set out in columns A and B of Appendix 3? If not, please explain why, including any challenges in reporting in accordance with either or both regimes. **Scope 3 is still an under-researched data field so the metric can be excluded until its understanding estimation and data availability becomes better.**

- Do you agree that, subject to the final TCFD guidance being broadly consistent with that proposed in the current consultation, our proposed rules and guidance should refer to:
    a. The TCFD Final Report and Annex in their updated versions, once finalised
    b. The TCFD's proposed guidance on metrics, targets, transition plans and the proposed technical supplement on measuring portfolio alignment
    c. If not, what other approach would you prefer and why? **Comments 1-12 and 14 summarise the changes we would like to see.**

- Do you agree with our approach to additional metrics and targets? If not, what alternatives would you suggest and why? **No. The cost benefit of these additional metrics may not be justified in terms of decision usefulness due to their complexity, excessive use of assumptions and costs for members. These metrics can be left to individual asset owner discretion based on the findings from their initial metrics.**

  Do you agree with our approach to governance, strategy and risk management, including scenario analysis at product or portfolio-level? If not, what alternative approach would you prefer and why? **A lot of the concentration issues and exposures can be resolved using the Phased Level 1 / Level 2 approach described above, including tail risk concentrations (or distributions) and confidence intervals around the same.**

- Do you agree with the analysis in our CBA? If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage. **Contextual information about your firm's size and structure would be helpful. Broadly yes, it would be helpful to understand cost data sources especially for Climate VaR.**

APPENDIX B

An excerpt from the disclaimer of a climate data provider commonly used by asset owners is below:

- "The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.[2]
- Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or wilful default of itself, its servants, agents or sub-contractors.
- Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.
- The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons."

[2] The disclaimer is directly from the data provider website and includes the language in uppercase letters