

**IIGCC response to the Department for Work and Pensions consultation – Climate and investment reporting: setting expectations and empowering savers**

**About us**

The Institutional Investors Group on Climate Change (IIGCC) is the leading European membership body enabling the European and UK-based investment community in driving significant and real progress by 2030 towards a net zero and resilient future. IIGCC's 370+ members (including over 60 UK-based asset owners), representing €50tn assets under management, are in a position to catalyse real world change through their capital allocation decisions, stewardship and engagement with companies and the wider market, as well as through their policy advocacy.

For more information visit [www.iigcc.org](http://www.iigcc.org) and [@iigccnews](https://twitter.com/iigccnews).

**Executive summary**

IIGCC welcomes DWP's proposals to require pension schemes to measure and disclose against a portfolio alignment metric. Through the Paris Aligned Investment Initiative (PAII) and the development of the Net Zero Investment Framework (NZIF), IIGCC has undertaken significant work with members on metrics and indicators to capture forward looking alignment for portfolios. We therefore recognise the importance of these metrics as a powerful tool for communication and engagement.

Moreover, we are strongly supportive of the decision to use 1.5 degrees as the baseline for trustees to measure and report against. As noted in the 2021 Global Investor Statement, limiting the global temperature rise to 1.5 degrees is essential to avoid the worst impacts of climate change, and there is now firm recognition by policymakers, investors and corporates that this is the ambition we must collectively pursue. The proposals represent a key milestone in enabling pension schemes to communicate how they will align their portfolios with the Paris Agreement, as well as supporting the wider UK commitment to reaching net zero by 2050.

IIGCC is pleased to be able to provide feedback on DWP's proposals. While we are broadly supportive of DWP's approach, we wanted to take this opportunity to highlight a number of areas where we and our members believe further refinement of the proposals are required:

- We advise against distinguishing between the three types of portfolio metrics proposed in the consultation, as in practice metrics may incorporate elements of each. IIGCC instead advocates for a "portfolio coverage" approach, which incorporates features of the three proposed metric types.
- We are concerned about recommending any single alignment metric, in particular an implied temperature rise metric, in the absence of reporting other actions in relation to alignment (such as those set out in NZIF).
- Consideration of potential sequencing challenges (e.g. trustees reporting against alignment metrics before this data is made available by asset managers), and the need to manage these challenges accordingly.

- Supporting trustees in managing transitional data and methodological challenges, and recognising the need for flexibility on areas such as enforcement during the initial implementation period.
- Providing guidance on how trustees can align their engagement and stewardship activities with net zero commitments.

We would be happy to discuss further any aspect of our response and look forward to hearing from you.

### **IIGCC response to selected consultation questions**

*Consultation question 1: We propose to amend the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 to require trustees of schemes in scope to measure and report their scheme's Paris alignment by adding a requirement for them to select and calculate a portfolio alignment metric and to report on that metric in their TCFD report. Do you agree with this policy proposal?*

IIGCC supports requirements for trustees to measure and report the Paris-alignment of their portfolios with reference to forward-looking metrics and welcomes DWP's decision to require trustees to align these metrics with a 1.5C baseline. However, we note that distinguishing between the three types of metrics, as outlined by the TCFD, is somewhat misleading as metrics may in practice incorporate elements of each of the proposed metrics. IIGCC instead recommends a "portfolio coverage" approach, which incorporates features of the three proposed metric types. We are also concerned about recommending any single alignment metric, in particular an ITR, in the absence of reporting other actions in relation to alignment as set out in the NZIF.

Through the PAII, the development of NZIF, and the Climate Action 100+ Net Zero Company Benchmark (CA100+ Benchmark), IIGCC has undertaken significant work with members on metrics and indicators to capture forward-looking alignment for portfolios and companies. This work has also enabled us to understand some of the main challenges associated with the development of forward-looking alignment metrics, and particularly the challenges relating to calculating a meaningful aggregate ITR and targeting a single number (either ITR, or an emissions intensity target). We would note that targeting a single number to improve a portfolio's temperature alignment could incentivise the wrong behaviours. For example, trustees may focus on lowering this figure through divestment rather than engagement with transitioning assets, or may feel discouraged from investing in transitional companies or sectors if such investments could have an adverse impact on their portfolio temperature score. However, IIGCC acknowledges that forward-looking assessments of alignment for assets and measuring portfolio performance are critical for achieving the transition to net zero, and that with further development and standardisation ITR metrics could have value in future as a communication tool and lever for engagement. Should trustees choose to use an ITR, IIGCC proposes that the metric should meet the minimum recommendations and considerations set out by the TCFD's Portfolio Alignment Team<sup>1</sup> to minimise these challenges.

In addition, emissions intensity metrics which are normalised by sales can also create a misleading picture by penalising companies which may be low-emitters, but generate comparatively less revenue than higher-emitting, high margin companies. These metrics are also highly sensitive to

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<sup>1</sup> Measuring Portfolio Alignment: Technical Considerations, available [here](#).

changes in product pricing; for example, a carbon-intensive company experiencing revenue growth would see its carbon intensity fall independent of any change in business practice or strategy.

Binary targets based only on assessing a company's target, while more straightforward to assess, do not provide a full picture of an asset's alignment potential or likely performance. A similar challenge can be identified in the context of benchmark divergence models, which may not provide sufficient recognition of the various options for decarbonising available within different sectors.

IIGCC also notes that the proposed guidance requires trustees to understand the basic methodological decisions and assumptions that will affect the results of alignment metrics. However, we feel it is important to ensure that information on the methodologies used to calculate metrics are also disclosed in TCFD reports, to provide users of these reports with relevant context and information on the decisions and assumptions underpinning the metrics.

The portfolio coverage approach adopted by NZIF supports the assessment of the alignment or alignment potential of underlying assets within a portfolio. This allows investors to hold assets that are expected to align to net zero over time, rather than reallocate to assets that are already less carbon intensive and therefore have little/no impact on real world emissions reductions. For listed assets, for example, PAII uses a number of forward-looking indicators to provide a more holistic view of alignment potential for assets in high impact sectors,<sup>2</sup> including short- and medium-term emissions reduction targets, capital expenditure and whether a credible decarbonisation strategy is in place to achieve targets.<sup>3</sup> The forward-looking metrics that underpin this approach were designed with input from a large number of investors to be useable for a wide range of institutional investors, including pension schemes. IIGCC therefore recommends that trustees seeking to align their portfolios with net zero should adopt this approach, as far as they are able, by disclosing the metrics and targets established by NZIF, which can be reported in line with the TCFD framework.<sup>4</sup>

While we support measurement of alignment and reporting relevant associated metrics, we would also note that achievement of an alignment metric or target, is unlikely to capture or incentivise the range of actions that would be beneficial for investors to take to maximise their contribution to the achievement of global net zero emissions. We therefore continue to encourage investors to adopt a comprehensive strategy towards net zero, as set out in NZIF, and would encourage DWP to be mindful of this in requiring a focus on any single metric as a measure of contribution towards net zero.

*Consultation question 2: We propose that:*

- *In-scope trustees will be required to select, calculate and report on a portfolio-alignment metric and to publish the findings in their TCFD report within 7 months of the relevant scheme year end date falling after 1 October 2022 in the same way as they are for other metrics.*
- *Trustees of schemes with assets of less than £500m on a scheme year end date falling after 1 October 2022 will cease to be subject to the requirements to select and calculate a portfolio alignment metric with immediate effect, but must report on the selected alignment metric*

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<sup>2</sup> Companies on the Climate Action 100+ focus list; companies in high impact sectors consistent with Transition Pathway Initiative sectors; banks; and real estate are considered high impact under NZIF.

<sup>3</sup> See pages 16-17 of NZIF, available [here](#).

<sup>4</sup> For more information, see [NZIF](#), p.23.

*for the scheme year which has just ended, unless assets on the scheme year end date were zero.*

- *Trustees of authorised schemes which cease to be authorised after 1 October 2022, and with assets of less than £500m on the scheme year end date immediately preceding the scheme year in which authorisation ceased, will not be subject to requirements to select, calculate and report on a portfolio alignment metric.*
- *Trustees of a formerly authorised scheme with assets of less than £500m on a scheme year end date after authorisation ceased, will no longer be subject to the requirements, but must still report on their selected portfolio alignment metric in their TCFD report for the scheme year which has just ended, unless assets on the scheme year end date were zero.*

*Do you agree with these policy proposals?*

IIGCC notes that the proposed sequencing will mean some trustees are required to report against alignment metrics before asset managers in scope of the FCA's TCFD regime are required to report them (e.g. by 30 June 2023). In order to measure the Paris alignment of their portfolios, trustees will rely on the data provided to them by their asset managers. It will therefore be important for DWP and the FCA to mitigate these potential sequencing issues by establishing mechanisms to support the flow of information on alignment metrics from asset managers up to trustees. Similarly, while the FCA has signalled its intention to reference the proposed metrics in its final rules, it will be essential to ensure that asset managers are required to disclose these metrics on the same basis as trustees to prevent the emergence of material data gaps.

*Consultation question 3: We propose to incorporate the requirements to measure and report a portfolio alignment metric into the existing Climate Change Governance and Reporting Regulations so that the requirements are subject to the same disclosure and enforcement provisions as the other metrics requirements. Do you agree with this policy proposal?*

IIGCC supports the disclosure of alignment metrics within the TCFD report. However, while IIGCC acknowledges DWP's expectation that schemes should comply fully with the Paris alignment reporting requirements once introduced, we are concerned that ongoing data and methodological challenges could make this difficult in practice (particularly for smaller schemes with fewer resources and less in-house expertise). In the absence of data from asset managers and companies, trustees would need to rely on estimates and proxy models, which will not be able to provide a complete picture of a portfolio's alignment with the Paris Agreement. We therefore suggest that DWP encourages trustees to complement reporting against a portfolio alignment metric with qualitative disclosures that can provide context to clients, including in relation to transitional challenges such as data gaps.

Forward-looking metrics remain a work in progress, and best practice is still evolving. Given these challenges, and the likely need for a 'bedding in' period, IIGCC proposes that The Pensions Regulator (TPR) should, at least initially, administer discretionary penalties relating to the measurement of portfolio alignment only in the most extreme instances of non-compliance. Additional guidance from TPR on its general expectations on measuring portfolio alignment, and its enforcement policy around this topic, would also be welcome.

We would also highlight the need to consider how best to integrate portfolio alignment metrics into the forthcoming Sustainability Disclosure Requirements (SDR) regime, which will be rolled out

alongside TCFD. This should include consideration of how the metric will interact with requirements to report against the UK Green Taxonomy and the International Sustainability Standards Board's upcoming standards.

*Consultation question 4: (a) Do you have any comments on the draft amendments to the Regulations? (b) Do you have any comments on the draft amendments to the statutory guidance?*

*Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter. We particularly welcome comments on the definition of a portfolio alignment metric and whether respondents think it reflects the policy intent?*

IIGCC supports DWP's definition of a portfolio alignment metric and welcomes the decision to use 1.5C as the baseline for trustees to measure and report against when assessing the Paris alignment of their portfolios. However, in line with our response to Q1, we believe the categories of alignment metrics proposed by DWP are insufficient for measuring alignment, and that a portfolio coverage approach, such as the approach developed by NZIF, would better support the policy intent. In addition, IIGCC recommends that the broader range of alignment metrics recommended by NZIF should also be incorporated into the statutory guidance to support a more holistic assessment of portfolio alignment.

IIGCC notes that it is not yet possible to use the proposed metrics across all the asset classes outlined in the draft statutory guidance. For example, the Paris Agreement Capital Transition Assessment (PACTA) only covers equities and corporate bonds in a limited range of climate-relevant sectors. We would also flag that assessing alignment of exposures gained through derivatives such as synthetic ETFs by 'looking through' to the underlying assets is problematic, given the difficulties in attributing ownership of emissions where the investor is several degrees removed from exposure to the underlying asset. In relation to real estate, IIGCC recommends that trustees calculate the alignment of their assets using the Carbon Risk Real Estate Monitor tool (CRREM).<sup>5</sup> The CRREM tool is currently the recommended methodology for assessing the net zero alignment of real estate holdings under NZIF.

## **2.2 Stewardship and the Implementation Statement**

*Consultation question 7: Should DWP include a vote reporting template in its implementation statement guidance which trustees are expected to use? If so, should such a template be based on the PLSA's vote reporting template? What changes, if any, would be needed to the PLSA template if it were to be adopted? What are your views on the adoption of an engagement reporting template? Should it be separate from any vote reporting template or integrated with it, so that – in relation to equities – both voting and engagement activities are described for the same set of assets?*

IIGCC welcomes efforts to introduce greater standardisation of voting activity disclosures via a voting template, which could be based on the PLSA template. IIGCC would support the extension of disclosures made via this template to cover engagement activities. Engagement-related disclosures should be outcomes-oriented, distinguishing between engagements with clear objectives that seek

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<sup>5</sup> For more information, see [www.crrem.eu](http://www.crrem.eu) and [www.crrem.org](http://www.crrem.org).

change, and those which focus on information gathering. These disclosures should enable asset owners to understand:

- the nature of discussions between asset managers and investees
- approaches to/participation in collaborative engagement initiatives (e.g. Climate Action 100+)
- the objectives of engagement activities and outcomes achieved
- investment implications
- escalation actions where progress is not forthcoming.

IIGCC proposes that where trustees are seeking to align with net zero, they should develop voting policies and engagement strategies that align with NZIF and undertake stewardship activities that support the alignment of assets with net zero by 2050 or sooner.<sup>6</sup> To support asset class-level alignment, NZIF recommends that investors set engagement goals to ensure that at least 70% of financed emissions in material sectors<sup>7</sup> are either assessed as net zero, aligned with a net zero pathway, or the subject of direct or collective engagement and stewardship actions. This threshold should increase to at least 90% by 2030 at the latest. IIGCC would support the inclusion of information in voting/engagement templates that can enable trustees to assess progress against these targets and company performance against relevant forward-looking alignment indicators.

In addition, IIGCC is developing a Net Zero Stewardship Toolkit (NZST), which builds on, and aligns with, the recommended targets and stewardship actions established by NZIF. Given the limited resources available to many trustees, the NZST could provide trustees with a foundational framework and guidance to enhance voting and engagement policies/activities to deliver the rapid acceleration in decarbonisation required to reach net zero. IIGCC would welcome the opportunity to discuss with DWP how the NZST could support the disclosure of more and better information on net zero-aligned voting and engagement, including via prescribed templates.

*Consultation question 8: Do you have any comments on our cross-cutting proposals for the Guidance on Statements of Investment Principles and Implementation Statements, in particular that: (a) they are written for members? (b) the Guidance reiterates that these are trustees' statements, not their consultants'? (c) Implementation Statements should set out how the approach taken was in savers' interests? (d) trustees should be able to include material from voluntary disclosures, such as Stewardship Code reporting, as long as they meet the requirements in the Regulations?*

IIGCC supports DWP's cross-cutting proposals for the Guidance on SIPs and the IS.

*Consultation question 9: (a) Do you have any comments on our proposed Guidance on stewardship policies? (b) Do you have any comments on our proposed Guidance on most significant votes?*

IIGCC supports the draft guidance on stewardship policies. As noted in the draft guidance, what constitutes a stewardship "priority" will vary from scheme to scheme. However, IIGCC is of the view that climate change and the net zero transition are increasingly being seen as stewardship priorities

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<sup>6</sup> See p.18 of [NZIF](#) for more information.

<sup>7</sup> Material sectors are defined as those in NACE code categories A-H and J-L. For more information, see p.10 of NZIF.

for all trustees.

As noted above, where trustees seek to align their portfolios with net zero, they should undertake and disclose against the engagement and stewardship recommendations developed by NZIF. In addition, the NZST sets out a package of components that, considered together, should help with the development of a net zero stewardship policy, covering:

- Undertaking portfolio analysis and development of a stewardship prioritisation framework
- Setting net zero alignment criteria, time bound company level objectives and portfolio goals
- Development of an engagement strategy for priority companies
- Development of a baseline engagement and voting policy approach for all companies
- Asset owner and manager alignment.

IIGCC proposes to support the draft guidance on most significant votes. Where trustees have made net zero commitments, these commitments should inform the types of votes they deem to be most significant, including votes on company climate transition plans (or 'Say on Climate') votes. Where companies submit transition plans for approval, IIGCC's NZST sets out clear minimum standards for support related to the net zero criteria being used to determine alignment.

IIGCC would welcome the opportunity to engage with DWP on how the NZST could support the proposed guidance on stewardship and voting best practice.

*Consultation question 13: Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to financially material considerations (including ESG and climate change)?*

IIGCC agrees that trustees should set investment beliefs on ESG factors, including climate change, and integrate these beliefs into their investment decision-making processes.

Trustees seeking to align their portfolios with net zero should, as far as they are able, implement the recommendations established by NZIF to support this process, including the Governance and Strategy recommendations.<sup>8</sup> Under these recommendations, trustees should define beliefs relating to net zero alignment, set investment strategies to underpin these beliefs, and establish mandates/performance objectives for their asset managers to ensure assets are managed to reflect the net zero investment strategy. In addition, trustees should undertake climate financial risk assessments in line with TCFD recommendations.

*Consultation question 14: Do you have any comments on our proposed Guidance on meeting requirements in the Investment Regulations and Disclosure Regulations relating to non-financial matters?*

IIGCC supports the draft guidance on non-financial matters, particularly in relation to the development of mechanisms by which members can express their views on the scheme's investments and stewardship activities.

*Consultation question 15: Do you have any comments on our proposed Guidance on meeting*

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<sup>8</sup> See p.9 of [NZIF](#) for more information.

*requirements in the Investment Regulations and Disclosure Regulations relating to arrangements with asset managers?*

IIGCC supports the draft guidance on arrangements with asset managers. Where trustees are seeking to align their stewardship activities with net zero, IIGCC's NZST outlines a process checklist to ensure alignment of engagement priorities and objectives between asset owners and asset managers. This includes recommendations around how trustees can reconcile and refine engagement priority companies, alignment frameworks and milestones, and voting and escalation actions with their asset managers. IIGCC would welcome the opportunity to engage with DWP further on this topic.