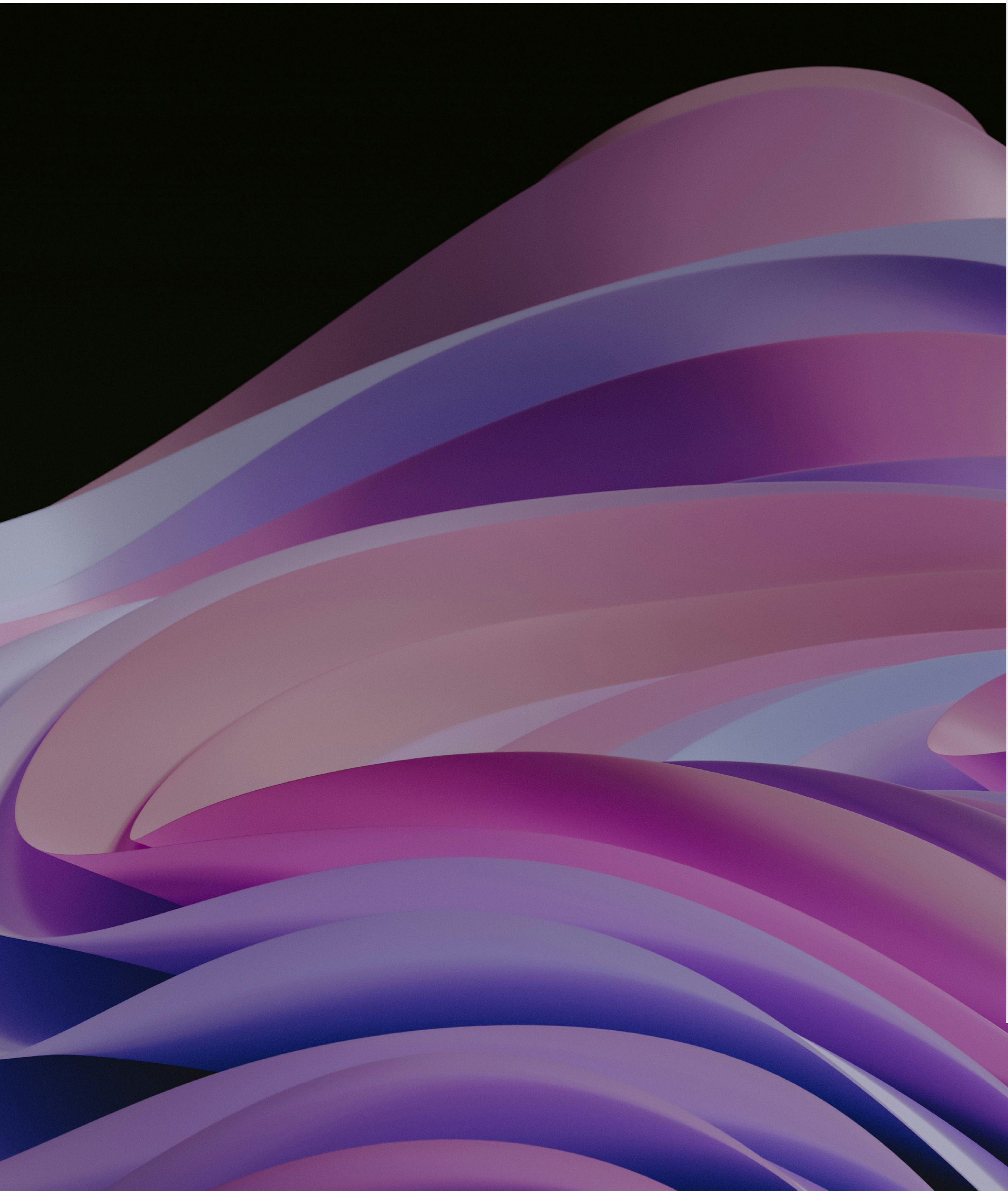
April 2024

ESG HOT TOPICS



Taskforce on Nature Related Financial Disclosures (TNFD)

What you need to know

The Taskforce on Nature Related Financial Disclosures published its recommendations for reporting on nature-related risks towards the end of last year.

The recommendations follow a similar format to those set out by the Taskforce on Climate related Financial Disclosures (TCFD) with four disclosure pillars:

- Governance
- Strategy
- Risk & impact management
- Metrics

For entities that are already reporting in line with the TCFD recommendations, you are likely to already be 60-70% of the way there to meeting the TNFD recommendations.

What actions/decisions are required?

None at this stage.

There is no regulatory requirement currently for UK pension schemes to report in line with the TNFD disclosure recommendations, but some schemes may choose to do so voluntarily.

We expect that data availability will be a challenge at this early stage but would encourage Trustees to **ask their investment managers whether they would be able to report on the metrics recommended by the TNFD as a first step and their expected timescales for being able to do so.**

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Taskforce on Social Factors (TSF)

What you need to know

Social factors are considerations about an investment that relate to people – from workers and suppliers to customers and communities. This means looking at both the impact of social factors on an investment along with the social outcomes and impacts of an investment.

The Department for Work & Pensions (DWP) has published a guide for pension trustees based on work undertaken by the Taskforce on Social Factors on assessing and monitoring the impact of Social Factors.

As part of this guidance the DWP has set out a "baseline" that Trustees should seek to meet summarised in th table below. Alongside this we have included the "current approach" that most of our clients have adopted to date.

Baseline practice	Current approach
Trustees to ask their investment consultants how social factors are integrated into their advice on asset allocation and fund research and selection.	**We assess investment managers approach to ESG broadly which will include assessment of social factors.**
Trustees to include social factors-related questions/ requirements into their selection, appointment and monitoring of investment managers, including regular review meetings.	**Currently covered as part of broader ESG monitoring, and monitoring of voting/ engagements.**
Trustees to increase their knowledge and understanding of social factors, including training sessions on social factors.	**Further training could be considered**

What actions/decisions are required?

The Trustee has already agreed ESG policies/beliefs that are consistent with these baseline requirements in our view, however, these policies could be reviewed in the context of the latest guidance.

The Trustee has also agreed stewardship priorities which include a "social factor" when assessing voting/engagement undertaken by the appointed investment managers.

There is a greater emphasis on how social factors will be monitored in regular reporting (including how clients assess their investment advisers). We consider Social Factors as part of broader ESG considerations in our assessment and monitoring of the investment managers. We will reflect on how our reporting could be updated and **trustees may wish to review their scorecards for assessing advisors as part of the usual annual advisor review process**.

The guide includes the following questions for trustees to consider for their investment advisers:

- How are social considerations integrated into their investment advice?
- How do they consider a manager's approach to social issues (including use of data) in evaluations and recommendations?
- How can they help trustees to determine which social issues matter most to them and to their beneficiaries?
- To what extent are they engaged with public policy and best practice debates and discussions on social factors?

TCFD and Climate Scenario Analysis

TCFD update

The Taskforce which first published its recommendations in 2017 has fulfilled its remit and disbanded. The FSB has asked the IFRS foundation to take on the monitoring of progress of companies' climate-related disclosures.

There are several workstreams including the UK Investment Consultants Sustainability Working Group (ICSWG) seeking to agree a consistent approach for reporting emissions on derivative positions. We expect to be able to provide an update on this later in the year.

Climate Scenario Analysis

In the pension regulators review of climate reporting by UK pension schemes a key area of feedback was in respect of climate scenario analysis. The regulator noted several articles which challenged the scenario analysis used by pension schemes arguing that:

- **many scenario models used in financial services significantly understate climate risk; and**
- **the key model limitations, judgements and assumptions were not well understood.**

The regulator noted a wide range of outcomes for DB and DC schemes under a "hot house/no transition" scenario (with temperature rises well over two degrees Celsius and severe physical impacts). While a range of results could be appropriate, it is important that trustees understand what is included (and not included) in their modelling. As an example, the regulator noted that the scenarios produced by the Network for Greening the Financial System (NGFS) do not allow for all physical risks, nor for tipping points.

What actions may be required?

There are several ongoing industry initiatives in relation to the improvement of climate scenario analysis. There is a requirement to undertake scenario analysis at least every three years (or following any significant changes) and trustees may decide to re-run scenario analysis to take account of the latest developments.

The regulator also noted that covenant considerations under each scenario should be considered/explained by trustees to support comments on resilience of the overall funding strategy.

We have worked with Ortec Finance to support the scenario analysis work undertaken by our clients and Ortec remain at the forefront of development with respect to climate scenario analysis. Given the spotlight on scenario analysis **we recommend that clients consider repeating the climate scenario analysis based on the latest scenarios from Ortec Finance** with a focus on understanding:

- **how the Ortec scenario have evolved since the scenarios were first assessed;**
- **the limitations of the scenarios; and**
- **any changes in the output compared to the initial analysis.**

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