News Alert 2020/06

27 August 2020

DWP consults on climate action by trustees

At a glance

The proposals require TCFD governance and reporting by schemes with assets of £1bn+.

The Department for Work and Pensions has launched a consultation on "Taking action on climate risk: improving governance and reporting by occupational pension schemes". It sets out firm proposals for mandating the existing Government expectation that large schemes will disclose their approach to managing climate risks and opportunities by 2022, in line with the recommendations of the Taskforce on Climate-related Financial Disclosures. This will be done using regulations and statutory guidance, as provided for through the Pension Schemes Bill currently before Parliament.

Key actions for trustees

- **Whatever your scheme size**, ensure you are managing climate-related risks and opportunities for your scheme. The draft PCRIG guidance is helpful in this regard.
- **If your scheme assets exceed £1bn**, review your climate approach against the proposed requirements to see what changes are likely to be required.
- **If your scheme assets exceed £5bn**, include implementation of a climate governance system and preparations for annual TCFD reporting in your plans for the next 12 months.

The Detail

The DWP proposes that the requirements initially apply to schemes with assets in excess of £5bn, along with authorised master trusts and collective money purchase schemes, before being extended to schemes with assets between £1bn and £5bn a year later.

Regulations will be supported by statutory guidance.

The proposals closely follow the TCFD recommendations, adapted appropriately for pension schemes. Large schemes will need to implement climate actions covering governance, strategy, scenario analysis, risk management, metrics and targets, and report annually on these actions. The headline requirements will be prescribed in regulations and supported by statutory guidance. Trustees will also be able to draw on non-statutory guidance from the Pensions Climate Risk Industry Group (PCRIG) which is expected by the end of 2020.

The consultation sets out the proposed requirements in detail and outlines areas to be covered by the statutory guidance. Trustees will need to have regard to the guidance, although will be allowed to deviate from the suggested approach if they disclose their reasons.

Failure to publish a TCFD report would be subject to a mandatory penalty, with penalties for other non-compliance at TPR's discretion. The maximum fine would not exceed £5,000 for an individual trustee or £50,000 for a corporate trustee.

Our viewpoint

The consultation confirms the Government's commitment to getting trustees to act on climate change. The proposals are detailed and well thought through, providing a clear direction of travel. If implemented as proposed, we expect they will prompt significant action by larger schemes. They will also define good practice to be followed by smaller schemes. Trustees should not be fooled by the words "governance" and "reporting". This consultation is about action.

Scope and timings of the requirements

It is proposed that the requirements will initially apply to:

- Schemes with assets in excess of £5bn on the first scheme year end on or after 1 June 2020.
- Schemes that are authorised master trusts on 1 October 2021.
- Schemes that are authorised collective money purchase schemes on 1 October 2021.

These schemes will need to have a system of climate governance, meeting the requirements set out below, from 1 October 2021 and must publish their first annual TCFD report within 7 months of the end of the scheme year which is underway on 1 October 2021, or by 31 December 2022 if earlier.

The requirements would apply to £5bn+ schemes from 1 October 2021, with their first report in 2022.

A year later, the requirements will be extended to:

- Schemes with assets in excess of £1bn on the first scheme year end on or after 1 June 2021.

These schemes will need to have a system of climate governance, meeting the requirements set out below, from 1 October 2022 and publish their first annual TCFD report within 7 months of the end of the scheme year which is underway on 1 October 2022, or by 31 December 2023 if earlier.

The requirements would apply to £1-5bn schemes from 1 October 2022, with their first report in 2023.

Other schemes will be brought into scope one year after their assets reach £1bn or when they are authorised as a master trust or collective money purchase scheme. Schemes will fall out of scope when their assets fall below £500m or they cease to be authorised.

The asset test will always be applied at scheme year ends (so that an audited value is available) and DB and DC assets will be considered in aggregate for hybrid schemes. For example, if a scheme first has assets in excess of £1bn at a scheme year end on 30 June 2022, it will have to meet the climate governance requirements by 1 July 2023, produce its first TCFD report for the year commencing 1 July 2023 (provided its assets exceed £500m on 30 June 2023) and publish the report within 7 months of the year end (ie by 31 January 2025).

The asset test would apply at scheme year ends, to DB and DC assets in aggregate.

Our viewpoint

The proposed timings seem complex because they are linked to scheme year-ends, but this link makes sense given the desirability of aligning with other scheme reporting. However, the timings for the first report are tight and potentially unworkable – many affected schemes would be required to publish their first report less than 7 months after the scheme year-end and/or report on a period that partly pre-dates the new requirements. We urge the Government to drop the constraints arising from the 31 December 2022 deadline and instead just require schemes to report within 7 months of the end of the first complete scheme year after the new requirements come into force.

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Required system of climate governance

It is proposed that trustees of schemes in scope will need to undertake the following activities, which closely follow the TCFD recommendations.

The proposed activities closely follow the TCFD recommendations.

Governance activities	
G1	Establish and maintain, on an ongoing basis, oversight of climate-related risks and opportunities.
G2	Establish and maintain processes by which trustees, on an ongoing basis, satisfy themselves that persons managing the scheme are assessing and managing climate-related risks and opportunities.
Strategy and scenario analysis activities	
S1	Identify, on an ongoing basis, climate-related risks and opportunities that will have an effect on the investment and, in the case of DB, funding strategy of the scheme, over the short, medium and long term.
S2	Assess, on an ongoing basis, the impact of the identified risks and opportunities on the scheme's investment and, in the case of DB, funding strategy.

S3	At least annually, as far as they are able, assess the resilience of the scheme's assets, liabilities and investment strategy and, in the case of DB, funding strategy to climate-related risks in at least two climate-related scenarios, including at least one scenario that represents an eventual global average temperature rise of between 1.5 and 2°C on pre-industrial levels.
Risk management activities	
R1	Adopt and maintain, on an ongoing basis, processes for identifying and assessing climate-related risks.
R2	Adopt and maintain, on an ongoing basis, processes for managing climate-related risks.
R3	Ensure, on an ongoing basis, integration of climate-related risks into their overall risk management.
Metrics and targets activities	
M1	Select at least one appropriate greenhouse gas emissions (GHG) based metric and at least one other non-emissions-based metric to assess scheme assets against climate-related risks and opportunities and review the selection on an ongoing basis. At least quarterly, obtain as far as trustees are able the Scope 1, Scope 2, and Scope 3 GHG emissions of their portfolio. At least quarterly, obtain non-emissions-based data, as far as trustees are able, which is then used to calculate the trustees' selected non-emissions-based metric.
M2	At least quarterly, calculate at least one GHG emissions-based metric (for example, Weighted Average Carbon Intensity) to assess scheme assets against climate-related risks and opportunities. At least quarterly, calculate at least one other, non-emissions-based metric to assess scheme assets against climate-related risks and opportunities.
M3	At least annually, set at least one target to manage climate-related risks for one of the metrics calculated in accordance with M2, which can be an emissions-based metric, or a non-emissions-based metric.
M4	At least quarterly, measure, as far as trustees are able, performance against the target(s).

Our viewpoint

The proposed activities, which will be set down in regulations, are in line with our expectations as the Government's intention to adopt the TCFD's recommendations was well-trailed. Notwithstanding this, they will require a step-change in the climate approach of many schemes, particularly the smaller ones within scope. In our experience, very few currently carry out climate scenario analysis, monitor climate metrics quarterly or have set climate targets, and many schemes will find these requirements demanding. Whilst some of the details may alter, we do not expect major changes and so trustees should start taking action now.

Climate change can no longer be left to a generic environmental, social and governance (ESG) policy. Nor can it be confined to investments; climate risks and opportunities should be integrated throughout scheme management, including covenant and funding for DB schemes.

Climate reporting requirements

The consultation sets out proposed climate disclosure requirements which mirror the table above, in effect implementing the TCFD recommendations for pension schemes in scope. DWP proposes that schemes are required to:

Annual reports would be published online and highlighted to members.

- Publish a TCFD report annually and make it freely available on a website; and
- Include a link to it in:
    - the scheme's annual report and accounts;
    - members' annual benefit statements (where these are required), although DWP asks for views on alternatives such as the summary funding statement for DB schemes; and
    - the annual scheme return submitted to TPR.

Next steps

- The consultation runs from 26 August until 7 October 2020.
- We expect the enabling legislation, contained within the Pension Schemes Bill, to become law later this year (although it could be delayed due to Covid-19 and Brexit).
- PCRIG is due to publish the final version of its non-mandatory guidance (applicable to schemes of all sizes) for trustees by the end of the year.
- A further consultation on the wording of the regulations will follow before they are laid next year.

Further consultations and guidance will follow.

- DWP will consult "in the near future" on additional requirements for trustees to measure and report on the alignment of their investments with the Paris climate agreement, such as the "implied temperature rise" of portfolios.
- DWP proposes to review the requirements in 2024, including considering whether to extend them to all schemes.

Our viewpoint

Climate change poses material financial risks to schemes and we agree with the Government that pension schemes should be doing more to manage these risks. We therefore support the general thrust of these proposals, even though many schemes will find them challenging, and will respond to the consultation to highlight where we believe the details should be refined to ensure they are practicable and proportionate.

Climate change is a systemic risk that can only be addressed if all parties act, yet it is clear that the scale of action (by pension schemes and others) currently falls far short of what is required. Regulatory intervention is therefore appropriate. Although many schemes and employers are struggling with the impacts of Covid-19, that is no excuse to defer action on climate change which – in the longer-term – poses a much greater threat.

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