Consultation on climate change regulations and guidance

Alert | 27 January 2021

Introduction

On 27 January 2021, the DWP published its response to the August 2020 consultation, "Taking action on climate risk: improving governance and reporting by Occupational Pension Schemes" (see our Alert), together with a consultation on draft regulations and statutory guidance ("the Regulations" and "the Guidance", respectively) which are intended to implement its revised proposals.

Key points

- Trustees will be required to meet climate change governance requirements which underpin the Taskforce on Climate-related Financial Disclosures ("TCFD") recommendations and to produce and publish (on a publicly available website) a report on how they have done so ("the Report").
- The new requirements will be phased in. Broadly, trustees of occupational pension schemes whose net assets (excluding bulk and individual annuity contracts) ("relevant assets") are £5bn or more at the end of their first scheme year to end on or after 1 March 2020, authorised master trusts and authorised collective money purchase schemes must comply from 1 October 2021 and produce their Report within 7 months of their scheme year end date. Schemes with £1 billion or more of assets will be in scope from the following year.
- Members will have to be informed via the annual benefit statement (DC schemes) or the annual funding statement (DB schemes) that the Report has been published and where they can locate it.
- With the aim of ensuring that trustees will be able to understand the outputs of activities such as scenario analysis and calculating emissions-based metrics, and to incorporate them into their new climate change risk management processes, an addition is made to the TKU requirements for trustees of schemes which are in scope.

TCFD recommendations

In 2017, the TCFD published 11 recommendations for all organisations, aimed at identifying, assessing, managing and disclosing climate-related financial risks and opportunities. In March 2020, the Pensions Climate Risk Industry Group launched a consultation on guidance on applying the TCFD recommendations to a pension scheme (see our ESG guide). The final guidance was also published today.

The Regulations will require trustees to satisfy the 11 recommendations of the TCFD, and to report on how they have done so. When meeting certain of the requirements, trustees must have regard to the Guidance, with any deviations explained in the Report. Otherwise, the Guidance is intended to assist schemes, both in and out of scope of the Regulations, with carrying out climate change risk governance and reporting.

The Regulations will require trustees to:

- **Governance** - establish and maintain, on an ongoing basis, oversight of the climate-related risks and opportunities which are relevant to the scheme. They must also establish and maintain processes for the purpose of satisfying themselves that persons undertaking governance on their behalf, are taking adequate steps to identify, assess and manage climate-related risks and opportunities which are relevant to the scheme and that persons who advise or assist the trustees with respect to governance are taking adequate steps to identify and assess climate-related risks and opportunities.

- **Strategy** - identify and assess, on an ongoing basis, the impact of climate-related risks and opportunities which they consider will have an effect over the short term, medium term and long term on the scheme's investment strategy and (where it has one) the scheme's funding strategy.

- **Scenario analysis** - as far as they are able, undertake scenario analysis assessing the impact on the scheme's assets and liabilities, the resilience of the scheme's investment strategy and (where it has one) the scheme's funding strategy for at least two scenarios – one of which corresponds to a global average temperature rise of between 1.5 and 2°C inclusive on pre-industrial levels. This analysis must be carried out in the first year in which the requirements apply to the scheme and at least every three years thereafter. Where a scheme has both DB and DC sections, separate scenario analysis will be required for both the DB section(s) and the DC default fund(s). The Guidance also sets clear expectations that DB scheme analysis will need to cover the sponsor covenant and the potential implications of different climate scenarios on actuarial assumptions, and not only the assets.

- **Risk management** - establish and maintain, on an ongoing basis, processes for identifying, assessing and effectively managing climate-related risks which are relevant to the scheme and integrating them into the trustees' overall risk management.

- **Metrics** - select at least one absolute emissions metric and one emissions intensity metric, as well as one additional climate change metric. Trustees will be required, as far as they are able, to obtain the data required to calculate their chosen metrics on an annual basis and their selection must be reviewed from time to time, as appropriate to the scheme.

- **Targets** - set a non-binding target for the scheme in relation to at least one of their chosen metrics and, as far as they are able, measure performance against it on an annual basis. The scheme's performance will be a factor in determining whether the target should be retained or replaced.

- **TKU** - have an appropriate degree of knowledge and understanding of the principles relating to the identification, assessment and management of climate change risks and opportunities in respect of occupational pension schemes.

"As far as they are able" is defined as trustees taking all such steps as are reasonable and proportionate in the particular circumstances taking into account the costs, or likely costs, which will be incurred by the scheme and the time required to be spent by the trustees or any people acting on their behalf. Examples are set out in the Guidance.

Timing

The Regulations will be phased in, with larger schemes being the first to comply. As noted above, they now carve out bulk and individual annuity contracts for the purposes of determining the asset threshold of a scheme; a welcome change from the August 2020 consultation.

Trustees of schemes with relevant assets ≥ £5bn at the end of their first scheme year to fall on or after 1 March 2020:

- must meet the climate change governance requirements for the current scheme year from 1 October 2021 to the end of that scheme year, and

- must publish a TCFD report on a publicly available website within 7 months of the end of that scheme year, and a link must be included in the Annual Report and Accounts for that scheme. (The ultimate deadline of 31 December 2022 which was proposed in the August 2020 consultation has been removed.)

For schemes with relevant assets ≥ £1bn the above requirements apply one year later.

Schemes cease to be subject to the climate governance requirements with immediate effect when they are no longer authorised and / or have assets of less than £500 million. However, they must still publish their Report for the scheme year which has just ended in the usual timescale. Only non-authorised schemes with zero relevant assets at scheme year end will be excluded from reporting.

The position for smaller schemes will now be reviewed in the second half of 2023, with proposals to be published in early 2024.

Trustees will be required to provide TPR, via the scheme return, with the website address(es) for their most recent Report, their SIP, implementation statement and relevant excerpts of the Chair's statement (as applicable).

Penalties

TPR will have discretion to administer a penalty for a Report it deems to be inadequate in meeting the requirements, but there will only be a mandatory penalty (of at least £2,500) where a Report is not published.

Failure to notify members of the Report's availability, or to include a link to the Report in the scheme's annual report will be subject to the existing penalty regime on disclosure of information (civil penalties of up to £5,000 for an individual and up to £50,000 in any other case).

Next steps

The consultation runs until 10 March 2021, with the Regulations due to come into force on 1 October 2021.

Schemes likely to fall within the first wave (compliance from 1 October 2021) should start the necessary preparations now, and those likely to be in the second (compliance from 1 October 2022) should not be far behind. Bearing in mind trustees' fiduciary duty to be actively considering climate change as a likely financially material risk, those comfortably outside of scope (for the time being) should consider whether to voluntarily adopt some or all of the requirements.

If you have any questions on any of the above, please speak to your usual Sackers contact.

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