Sackers

Alert - Consultation on changes to climate and investment reporting

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Introduction

On 21 October 2021, the DWP issued a consultation seeking views on proposals to require trustees of larger occupational pension schemes, authorised master trusts and authorised collective money purchase schemes (together, "authorised schemes") to measure and report on the "Paris alignment" of their investment portfolios, as well as on new guidance in relation to SIPs and implementation statements.

Key points

- Under the proposals, with effect from 1 October 2022, trustees of occupational pension schemes with £1bn or more in relevant assets and authorised schemes would be required to calculate and report a metric setting out the extent to which their investments are aligned with the Paris Agreement goal of limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C above pre-industrial levels.

- Where the requirement to select a portfolio metric comes into force part way through a scheme year, it would apply in the part scheme year that runs from 1 October 2022.

- The consultation also seeks to address deficiencies in scheme governance in relation to stewardship and voting by proposing new draft guidance which sets out stewardship and ESG best practice in relation to SIPs, and the DWP's expectations across the implementation statement.

Background

The Occupational Pension Schemes (Climate Change Governance and Reporting Regulations 2021 ("the Regulations") came into force on 1 October 2021. They require trustees of schemes in scope to meet climate change governance requirements which underpin the Taskforce on Climate-related Financial Disclosures ("TCFD") recommendations and to produce and publish a report on how they have done so (see our Alert for details).

The Paris Agreement

In December 2015, 195 countries committed in the Paris Agreement to holding the increase in the global average temperature to well below 2°C above pre-industrial levels, and to pursuing efforts to limit this to 1.5°C.

The TCFD's recently updated guidance has now, amongst other things, recommended that financial institutions should describe the extent to which their activities are aligned with the goals of the Paris Agreement. The DWP is therefore seeking to broadly align with the TCFD's updated guidance in this area and codify such a requirement for UK occupational pension schemes.

A fourth climate metric

The Government proposes that the Regulations and current statutory guidance are amended so that all schemes subject to them must measure and report on a portfolio alignment metric in addition to the existing requirements.

The Government wants to provide trustees "with complete methodological flexibility" in its proposed measures "given that the market has not yet coalesced around a single approach", and it does "not seek to encourage the use of one portfolio alignment measure over another". Trustees will therefore have "autonomy to select a portfolio alignment tool which reflects their specific circumstances, including their investment strategy and governance capacity".

Data availability

Acknowledging that trustees may face gaps in data when calculating a portfolio alignment metric, as with many of the existing requirements trustees will be required to carry out the relevant activities "as far as they are able". The DWP explains that this means that trustees should request data from their asset managers and make reasonable and proportionate efforts to obtain it. They are not expected to pay disproportionate sums for access to the data and the DWP does not anticipate that they will have to.

Concerns over the flow of data to trustees should be alleviated by the FCA's proposal to update their rules to require disclosure of portfolio alignment metrics by fund managers on a "best efforts" basis.

Schemes already using a portfolio alignment metric

The Regulations currently require trustees to select at least one absolute emissions metric, one emissions intensity metric and one additional climate change metric. Schemes in scope from 1 October 2021 may have chosen a portfolio alignment metric as their additional climate change metric. From 1 October 2022 onwards, to remain compliant such schemes will need to select a further additional climate change metric as the portfolio alignment metric will fall into a separate category. The Regulations provide for metrics to be reviewed and replaced where appropriate.

Timing and scope

There will be no phased rollout. The new requirement will apply to all trustees subject to the Regulations on and from 1 October 2022 and trustees will have to report against the new metric within seven months of the end of the scheme year which is underway on that date.

However, as the new requirement will come into force part way through a scheme year for some schemes already in scope, it will apply in the part scheme year that runs from 1 October 2022. The existing easement in the Regulations will be extended to allow such schemes to rely on data obtained, calculations performed, and identification and assessment of climate-related risks and opportunities undertaken in that same scheme year, but before 1 October 2022.

Stewardship and the implementation statement

Stewardship (which includes shareholder voting and individual and collaborative engagement with issuers and asset managers) is described by the Government as a key tool by which trustees "can improve investment returns, by encouraging, developing, and supporting behaviours and practices that ensure long-term value for savers". "Nevertheless", it states, "it is widely misunderstood".

The Government already requires trustees of pension schemes with 100 or more members to publicly state their policy on the exercise of the rights attaching to their scheme's investments, and on undertaking engagement activities in respect of those investments, via the SIP. Trustees are also required to report on how and the extent to which they have followed this policy, and on their most significant votes, via an annually published implementation statement. In addition, DC schemes must produce a wider implementation statement covering how and the extent to which they have followed all of the policies set out in their SIP.

TPR has not published guidance on expectations around the implementation statement, and stakeholders have commented that a "lack of clarity about expectations for inclusion or for target readership" means that the implementation statement risks becoming a tick-box exercise, "rather than a positive tool for verifying and demonstrating trustees' actions".

Therefore, the DWP is consulting on draft guidance in relation to SIPs and implementation statements which aims to meet the following four objectives:

- improve the quality of SIP policies
- develop best practice for implementation statement reporting
- clarify how schemes may use disclosures from other frameworks
- improve consistency across schemes' reporting and practice.

The draft guidance in relation to the implementation statement is proposed to be statutory guidance to which trustees must have regard. In contrast, the draft guidance relating to the SIP is intended as "best practice".

Next steps

The consultation closes on 6 January 2022.

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