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Pension Investment Academy

ESG - Regulation Developments, Practical Implications and Trustee Issues

27 January 2021

Stuart O'Brien

Pension Schemes Bill

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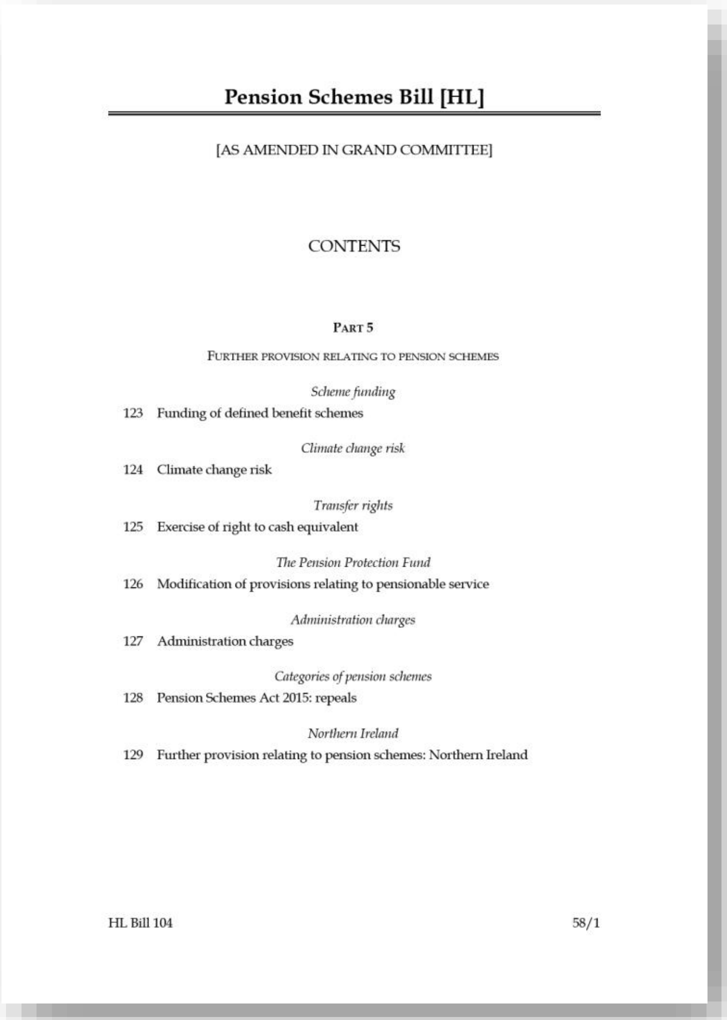

Pension Schemes Bill [HL]

[AS AMENDED IN GRAND COMMITTEE]

CONTENTS

PART 5

FURTHER PROVISION RELATING TO PENSION SCHEMES

HL Bill 104 58/1

Government tabled an amendment to the Pension Schemes Bill in January 2020 which seeks to amend the Pensions Act 1995. It sets out that:

- Regulations may impose requirements on the trustees or managers of an occupational pension scheme of a prescribed description with a view to securing that there is effective governance of the scheme with respect to the effects of climate change

- Regulations may require the trustees or managers of an occupational pension scheme of a prescribed description to publish information of a prescribed description relating to the effects of climate change on the scheme

DWP Consultation (October 2020)

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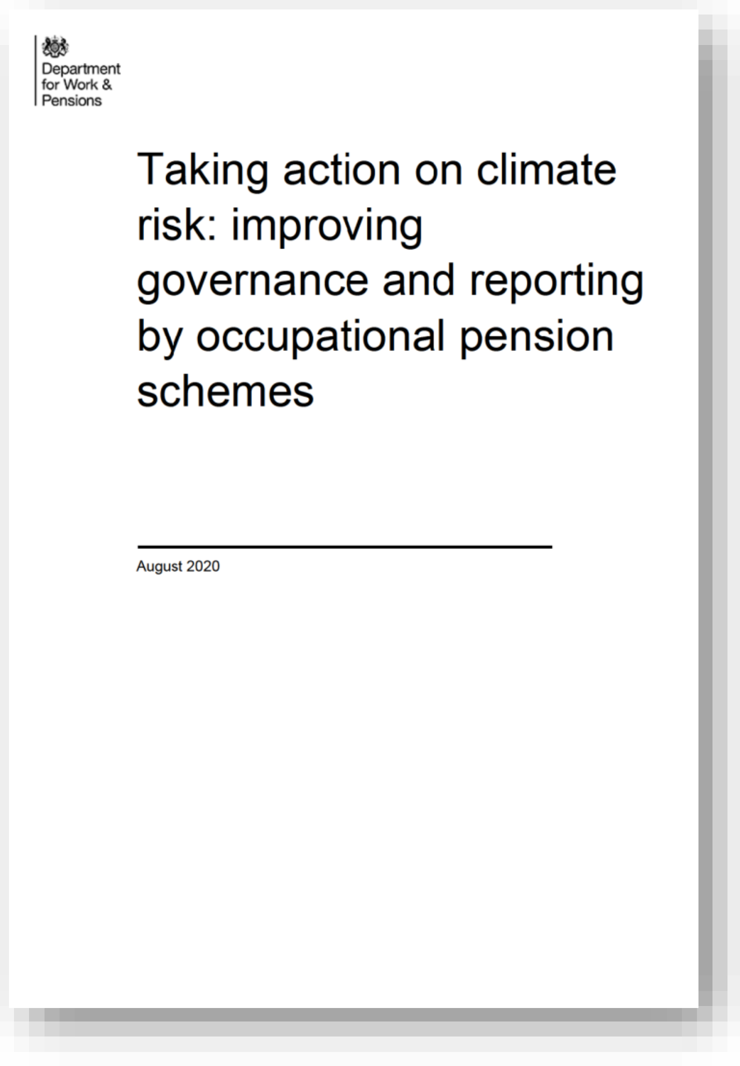
Department for Work & Pensions

Taking action on climate risk: improving governance and reporting by occupational pension schemes

August 2020

DWP Consultation launched on 26 August 2020

- Pre-cursor to regulations to be made under the Pension Schemes Bill
- Seeks views on policy proposals for larger schemes to put effective governance measures in place for managing climate risks and opportunities and then reporting on them
- Consultation closed on 7 October 2020
- 99 Consultation responses received by DWP

Consultation on draft Regulations and Statutory Guidance
27 January 2021

New consultation:

- Draft regulations under the Pensions Schemes Bill 2021
- Draft statutory guidance
- Consultation closes on w/c 8 March 2021

Regulations vs. Guidance

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- Regulations would require trustees to meet climate change governance requirements which underpin the 11 recommendations of the TCFD, and to report on how they have done so.
- Statutory guidance, which trustees must have regard to, will set out how trustees should meet the requirements and report in line with the TCFD recommendations.
- Mandatory penalty for complete failure to publish any TCFD report. Other penalties would be subject to TPR discretion.
- PCRIG Guide sets out voluntary industry-wide guidance to complement the statutory requirements.

Which schemes are in scope (and when)?

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Earlier of 7 months from scheme year-end date and deadline to report

Earlier of 7 months from scheme year-end date and deadline to report

1 Oct 2021
£5bn+ schemes

1 Oct 2022
£1bn - £5bn schemes

31 Dec 2022
Reporting deadline for £5bn+ schemes

31 Dec 2023
Reporting deadline for £1bn - £5bn schemes

What's noteworthy in the new regs?

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- Reporting deadline is now a simple w/i 7 months of scheme year end (ie no 31 December deadlines)
- Bulk and individual annuity contracts carve out for the purposes of determining whether the asset threshold at which the requirements apply has been met
- No dispensation for schemes in wind-up or PPF Assessment
- "[N]ow is not the time to consult on making it mandatory for trustees to measure and report their Implied Temperature Rise" (ITR)
- Brought forward the start date for DWP review of the requirements to the second half of 2023 (previously 2024)
- Intend to consult in due course on a requirement for authorised super funds to undertake climate change governance and reporting, irrespective of the value of assets under management

The TCFD Recommendations

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- **Governance** – Disclose the organisation's governance around climate-related risks and opportunities
- **Strategy** – Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning
- **Risk Management** – Disclose the processes used by the organisation to identify, assess, and manage climate-related risks
- **Metrics and Targets** – Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities

DWP Consultation - Governance

2020 Consultation:

- Establish and maintain, on an ongoing basis, oversight of climate-related risks and opportunities
- Trustees to satisfy themselves that “persons managing the scheme” are assessing and managing climate-related risks and opportunities.

Draft Regs (2021):

- Statutory guidance gives examples of persons who would be regarded as undertaking governance activities in relation to the scheme for the purpose of the regulations.
- Trustee knowledge and understanding – Trustees must have an appropriate degree of knowledge and understanding of the principles relating to the identification, assessment and management of climate change risks and opportunities. Guidance is “non-statutory” as far as TKU is concerned.

DWP Consultation - Strategy

2020 Consultation:

- Identify, on an ongoing basis, the climate-related risks and opportunities that will have an effect on the scheme’s investment and, in the case of defined benefit (DB) schemes, funding strategy, over the short, medium and long term
- Assess, on an ongoing basis, the impact of the risks and opportunities identified on the scheme’s investment and, in the case of DB schemes, funding strategy.
- Conduct scenario analysis for at least two climate-related scenarios, including at least one scenario that represents an eventual global average temperature rise of between 1.5°C and 2°C on pre-industrial levels.

DWP Consultation - Strategy

Draft Regs (2021):

- In their annual TCFD report, trustees must describe the time periods that they have chosen for the short, medium and long term. Regulations set out what factors trustees must consider in setting time horizons.
- Trustees must undertake scenario analysis in the first year and every three years thereafter. In other years they must review whether or not circumstances are such that they should refresh their analysis, or, if they decide not to, explain why.
- Statutory guidance sets out information on assessing the impact on funding strategy

Scenario analysis - some key points

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- Requiring trustees to undertake analysis in “at least two” scenarios sets an appropriate minimum.
- Best practice suggests that trustees should model scenarios consistent with an orderly transition, disorderly transition and no or limited transition [*see also PCRIG Guidance*]
- Important that DB trustees understand the impact of climate change on the sponsor and the covenant… qualitative scenario analysis is acceptable and could be appropriate.
- Includes analysis in relation to DB liabilities.
- Would include assets that have been excluded from scope of consideration of a scheme’s “relevant assets”, for example buy-ins
- Applies separately to sections of sectionalised schemes (although sections with similar characteristics in relation to assets, liabilities and funding may be grouped) and each “popular” DC default.

DWP Consultation - Risk Management

2020 Consultation:

- Adopt and maintain, on an ongoing basis, processes for identifying, assessing and managing climate-related risks.
- Ensure integration of climate-related risks into overall risk management.

Draft Regs (2021):

- No material changes

DWP Consultation - Metrics and Targets

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2020 Consultation:

- 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 and 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, obtain non-emissions-based data, as far as trustees are able and calculate non-emissions-based metric to assess scheme assets against climate-related risks and opportunities.

DWP Consultation - Metrics and Targets

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Draft Regs (2021):

- Trustees must select a minimum of <u>two</u> emissions-based metrics:
  - one absolute measure of emissions - **Recommended metric: Total GHG emissions**
  - one intensity-based measure of emissions - **Recommended metric: Carbon footprint**
- Guidance also provides for an additional “optional” emissions intensity metric: Weighted Average Carbon Intensity
- Trustees must select one additional climate-related metric.
- Trustees to explain in their TCFD Report where data they have chosen to disclose does not fully cover the portfolio or extend to all scopes of emissions.
- Performance against targets is to be measured annually rather than quarterly. Also provides for an annual review of targets, for trustees to determine whether they should be replaced.

“As far as they are able”

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- Trustees must carry out scenario analysis, obtain data, calculate and use metrics and measure performance against trustee-set targets ‘as far as they are able’.

- This means 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 scheme and the time required to be spent by the trustees or people acting on their behalf.

- Steps trustees should take to meet requirements “as far as they are able” are set out in the draft statutory guidance.

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