Department for Work & Pensions

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

August 2020

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Ministerial foreword

Climate change is the defining challenge of our time. Our response to climate change will determine the health and prosperity not only of the world the next generation will inherit, but the world we live in now. The impacts of climate change are already being felt around the globe. The time to act is now.

We can be proud that the UK is leading the way in meeting this challenge, as the first major economy to pass a net zero emissions law. But we cannot be complacent. We need to respond urgently to the risks of climate change, especially those affecting the financial sector and wider economy, on which so much rests. We need a financial sector that recognises these risks, and opportunities, and is stronger as a result.

To enable this change, I propose embedding in pensions law the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). I make no excuse for the work this entails – we lead the way and I expect others to follow.

Earlier this year, I was pleased to support work by the Pensions Climate Risk Industry Group to produce detailed guidance for trustees on aligning their pension scheme with the TCFD recommendations. I see huge value in the work the PCRIG has done to encourage trustees to follow the TCFD recommendations, and I thank everyone in industry who gave their time to make this happen. However, the time is now right to raise our standards and ambitions.

In my foreword to the PCRIG draft guidance, I set out my intention to take powers in the Pension Schemes Bill to require climate risk governance and TCFD reporting by occupational pension schemes. The Bill has now progressed through the House of Lords – but we need urgent action, so I intend to waste no time in publishing these proposals. A further consultation on regulations will follow before they are laid next year.

Trustees need a long-term perspective, even in their short-term decision-making. So I have set out Government's long-term plan in this document. My proposals would require trustees of schemes with £5billion or more in assets – and authorised master trusts and collective money purchase schemes – to have effective governance, strategy, risk management, and accompanying metrics and targets for the assessment and management of climate risks and opportunities from October 2021 and to report on these in line with the TCFD's recommendations by the end of 2022. This is in line with Government's Green Finance Strategy, and its clear expectation of large asset owners in relation to TCFD.

Some of these schemes have already started work in this area. I anticipate that they will set a benchmark of good practice and that their market power will help to improve the flow of data vital to high-quality climate risk governance.

With the roll out to schemes of £1billion or more in assets in the following year, more than 75% of assets, and 80% of members, would be in schemes subject to the requirements. We propose to take stock in 2024 and consult on the extension to all other schemes. No pension scheme is too small to make a difference.

The document covers one topic on which I am not immediately consulting. There is increasing momentum around the idea of reporting the 'implied temperature rise' or 'warming potential' of a portfolio. This could be a powerful tool to help trustees, and their members, to understand their scheme's exposure to climate change risk. There is substantial work being undertaken by industry to refine methodologies and enable consistent, comparable, and robust reporting. I therefore intend to consult on mandatory 'Paris alignment reporting' soon. Let me be clear, however, that none of these proposals – or future proposals –will attempt to direct trustees in their investment decisions; that discretion will remain with trustees.

I acknowledge also that for many trustees these disclosures will be a new process and a learning curve. They will be supported in this work by statutory guidance. This consultation seeks views on what that guidance should cover. Trustees will also be able to draw on the PCRIG's non-statutory guidance.

I recognise too that these proposals come as trustees are dealing with the impact of the Covid-19 pandemic. However, this is also a time of opportunity - as we "build back better", trustees must turn their minds to the transition to the low carbon economy. And we must ensure that pension scheme governance is as robust as possible to withstand the potential shocks that climate change and our response to it will bring.

Acting now to manage climate risks, and to take advantage of the opportunity of the low-carbon transition, will put schemes in a stronger position for the future. I believe that the proposals are proportionate, especially in light of the size and urgency of the threat – and the magnitude of the opportunities – posed to pension investments by climate change. I welcome trustees' and all other stakeholders' views and I ask that we all rise to the challenge.

Guy Opperman MP
Minister for Pensions and Financial Inclusion

Introduction

This consultation seeks views on policy proposals to require trustees of larger occupational pension schemes, authorised master trusts and authorised schemes providing collective money purchase benefits to have effective governance, strategy, risk management and accompanying metrics and targets for the assessment and management of climate risks and opportunities. It also invites responses on proposals to disclose these in line with the recommendations of the international industry-led Task Force on Climate-related Financial Disclosures (TCFD).

It is proposed that among the activities required would be calculating the 'carbon footprint' of pension schemes and assessing how the value of the schemes' assets or liabilities would be affected by different temperature rise scenarios, including the ambitions on limiting the global average temperature rise set out in the Paris Agreement. The disclosures would be required to be made publicly available, referenced from the schemes' Annual reports and Accounts, and pension savers informed of the availability of the information via their annual benefit statement.

About this consultation

Who this consultation is aimed at

- pension scheme trustees and managers;
- pension scheme members and beneficiaries;
- pension scheme service providers, other industry bodies and professionals;
- civil society organisations; and
- any other interested stakeholders

Purpose of the consultation

This consultation seeks views on the policy proposals.

Scope of consultation

As pensions policy is a reserved matter for Scotland and Wales, this consultation applies to England, Wales and Scotland. Occupational pensions are a devolved matter for Northern Ireland.

Duration of the consultation

The consultation period begins on 26 August 2020 and runs until 07 October 2020. Please ensure your response reaches us by that date as any replies received after that date may not be taken into account.

How to respond to this consultation

Please send your consultation responses by email to:

Bethan Livesey, Tom Rhodes, Andrew Blair, and David Farrar
Climate Governance and ESG team
Email: pensions.governance@dwp.gov.uk

Government response
We will aim to publish the government response to the consultation on the GOV.UK website.

The report will summarise the responses.

How we consult - Consultation principles

This consultation is being conducted in line with the revised Cabinet Office consultation principles published in March 2018. These principles give clear guidance to government departments on conducting consultations.

Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator, 4th Floor, Caxton House, Tothill Street, London, SW1H 9NA

Email: caxtonhouse.legislation@dwp.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team:
Email: freedom-of-information-request@dwp.gov.uk

The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the Freedom of Information Act.

Equality Act

Under the Equality Act 2010, public bodies must have due regard to the needs of people with ‘protected characteristics’. The Public Sector Equality Duty covers the protected characteristics of:

- Age;
- Disability;
- Gender reassignment;
- Pregnancy and maternity
- Race;
- Religion or belief;
- Sex;
- Sexual orientation; and
- Marriage and civil partnership – in respect of eliminating unlawful discrimination only

Having ‘due regard’ means that, in our roles as policy makers, we are required to consciously think about the three aims of the Public Sector Equality Duty:

- eliminate unlawful direct or indirect discrimination, harassment and victimisation and other conduct prohibited by the Act;
- advance equality of opportunity between people who share a protected characteristic and those who do not share it; and
- foster good relations between people who share a protected characteristic and those who do not share it.

As part of this consultation we are seeking views and evidence on the impact of our proposals on protected groups, and how any negative effects may be mitigated.

Chapter 1: Background and summary of proposals

1. This chapter considers pension scheme trustees' duties to consider climate change and the likelihood that climate change is a financially material risk, as well as an opportunity, for pension schemes. It summarises Government work to date on pension schemes and climate change, and the actions taken by trustees so far.
2. The background to the Task Force on Climate-related Financial Disclosures (TCFD) is then covered, and we explain how reporting in line with the TCFD recommendations will improve both the quality of governance and the level of action on managing climate risk. This chapter also covers the benefits of trustees reporting on the alignment of the scheme's investments with the ambitions on limiting the global average temperature increase set out in the Paris Agreement.
3. The chapter concludes with a summary of our proposals, which are explained in more detail in the rest of the consultation document.

Trustees' duties to consider climate change

4. The Pensions Climate Risk Industry Group (PCRIG) – a group with representation from all quarters of industry, civil society and government convened to provide guidance for trustees of pension schemes on integrating climate-related risk assessment and management into decision-making and reporting – have highlighted that all pension schemes face climate-related risks irrespective of the way they invest or the estimated duration of liabilities:

   "All pension schemes are exposed to climate-related risks, whether investment strategies and mandates are active or passive, pooled or segregated, growth or matching, or have long or short time horizons. Many schemes are also supported by employers or sponsors whose financial positions and prospects are dependent on current and future developments in relation to climate change[1]."

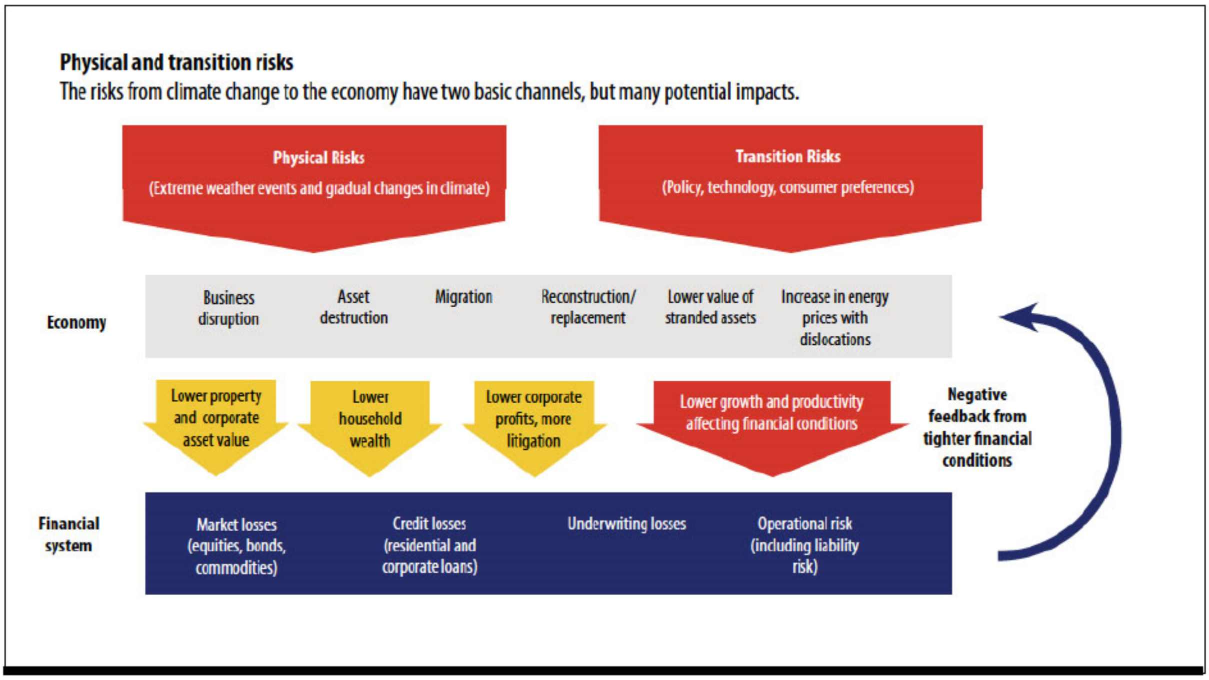
5. There is evidence to suggest that we are currently on track to see 3°C of warming by the end of the century[2]. However, recent research by the International Monetary Fund has specifically identified that stock prices do not reflect future climate risk:

[1] Aligning your pension scheme with the TCFD recommendations. The Pensions Climate Risk Industry Group. https://www.gov.uk/government/consultations/aligning-your-pension-scheme-with-the-tcfd-recommendations
[2] IPCC's Special Report: Global Warming of 1.5°C (2018). https://www.ipcc.ch/sr15/

“a sudden shift in investors’ perception of this future risk could lead to a drop in asset values, generating a ripple effect on investor portfolios and financial institutions’ balance sheets[3].”

6. Emerging evidence also suggests that some assets are in the process of being significantly repriced as their transition or physical risk is recognised[4].The mechanisms by which climate change risk affects the economy and in turn the financial system, with feedback effects for the economy, are set out schematically below[5].

Figure 1: Climate change affects the financial system through two main channels: physical risks and transition risks



7. The financial analysis relied on by the market to determine valuations is also often based on the extrapolation of short-term cash flow estimates, so longer-term risks are not necessarily priced into the market[6].

8. These long-term risks come in two distinct forms for most financial firms: physical risks and transition risks.

[3] International Monetary Fund. Global Financial Stability Report on Climate Change: Physical Risk and Equity Prices - https://www.imf.org/en/Publications/GFSR/Issues/2020/04/14/global-financial-stability-report-april-2020#Chapter5

[4] See for instance, E Campiglio, P Monnin and A von Jagow, Climate Risks in Financial Assets. Council on Economic Policies Discussion note 2019/2 - https://www.cepweb.org/climate-risks-in-financial-assets/

[5] P Grippa, J Schmittmann, and F Suntheim (International Monetary Fund). Climate change and financial risk. Finance and Development December 2019 vol 56 number 4. Reproduced with permission.

[6] All Swans are Black in the Dark: how the short-term term focus of financial analysis does not shed light on long term risks - https://www.genfound.org/media/1383/all-swans-are-black-in-the-dark.pdf

- Physical risks are those that pertain to the physical impacts that climate change is already bringing and will continue to bring in the event of a certain level of global average temperature rise (global warming). These include risks such as the rise in sea levels, with impacts such as flooded industrial sites and mass migration, as well as phenomena such as increased rate of extreme weather events which threaten physical assets and disrupt supply chains.

- Transition risks are less about 'what would happen in the event climate change is not fully addressed' and more about the risks associated with action to tackle climate change. As we seek to realign our economic system towards low-carbon, climate-resilient solutions, what regulations, behavioural changes, structural readjustment will take place and how will that affect current and future investments? Such risks include the future change in the energy mix on which the world depends or new, climate-conscious consumer trends.

9. But this is not to say that the risks are exclusively longer term – market shocks are very likely in response to inevitable regulatory policy interventions[7] and we know that, in order to meet the goal of the Paris Agreement to hold the increase in the global average temperature to well below 2°C above pre-industrial levels, annual global emissions must start to reduce with a significant annual rate of reduction thereafter[8].

10. Gambling on an inadequate response from policy makers and regulators offers trustees no reassurance either. Companies and investors face increased cost and uncertainty from both a 'disorderly' low-carbon transition and the likely accompanying - considerable - physical risks.

11. Trustees have a duty to act in the best interests of pension scheme beneficiaries[9], as well as duties to act prudently, conscientiously and with upmost good faith, seeking advice where needed. Given the nature and likely materiality of the risks posed by climate change, trustees' fiduciary duties require them to take it into account. The PCRIG 'unpacks' this duty[10] as follows:

    - Exercising investment powers for their proper purpose – trustees must exercise their investment powers for the purposes for which they were given. Trustees should consider how properly taking into account climate-related risks and opportunities will assist in delivering on the purpose of the trust (namely for the provision of pension benefits).

    - Taking account of material financial factors - trustees should always take into account any relevant matters which are financially material to their investment decision-making, whatever their source. This includes whether a particular

[7] What is the inevitable policy response? - https://www.unpri.org/inevitable-policy-response/what-is-the-inevitable-policy-response/4787.article
[8] See source in footnote 2.
[9] There is also a statutory duty on many schemes for pension scheme assets to be invested in the best interests of members and beneficiaries. See the Occupational Pension Schemes (Investment) Regulations 2005 (S.I. 2005/3378), regulation 4(2)(a).
[10] Pensions Climate Risk Industry Group. Chapter 3 of Aligning your pension scheme with the TCFD recommendations: consultation guidance https://www.gov.uk/government/consultations/aligning-your-pension-scheme-with-the-tcfd-recommendations

factor is likely to contribute positively or negatively to anticipated returns, or will increase or reduce risk. Their duties are not limited to "traditional" factors such as interest rate, exchange rate, or inflation risk.

- Acting in accordance with the 'prudent person' principle – trustee investment powers must be exercised with the care, skill and diligence that "a prudent person would exercise when dealing with investments for someone else for whom they feel morally bound to provide". In line with the prudent person principle, trustees must consider likely future climate scenarios, how these may impact their investments and what a prudent course of action might be as part of their scheme's risk management framework.

DWP and pension scheme activity on climate change

The Law Commission's reports

12. The Kay Review of UK Equity Markets and Long-Term Decision Making[11], published in 2012 identified concerns about how the fiduciary duties described in paragraph 11 above were interpreted in the context of investment. It therefore recommended that the Law Commission should review the legal concept of fiduciary duties as applied to investment, to address uncertainties and misunderstandings on the part of trustees and their advisers. The Law Commission's report[12], published in July 2014, concluded that trustees should take into account factors which are financially material to the performance of an investment, whatever their source.

13. Following guidance issued by The Pensions Regulator (TPR) in relation to managing Defined Contribution schemes (also known as money purchase benefits)[13] and funding Defined Benefit schemes[14], and a further Law Commission report on pension funds and social investment[15], Government concluded that a legislative change was required to put the need to consider the full range of financially material matters – including climate change – beyond doubt[16].

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[11] The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report - July 2012 - https://www.gov.uk/government/consultations/the-kay-review-of-uk-equity-markets-and-long-term-decision-making

[12] Fiduciary Duties of Investment Intermediaries (LC350) - July 2014 - https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/

[13] Managing DC benefits: Investment Governance – July 2016 - http://www.thepensionsregulator.gov.uk/trustees/investment-management-in-your-dc-scheme.aspx

[14] DB Investment: Investing to fund DB – March 2017 - http://www.thepensionsregulator.gov.uk/guidance/db-investment-two-strategy.aspx

[15] Pension Funds and Social Investment (LC374) – June 2017 - https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/

[16] Pension funds and social investment: interim response - https://www.gov.uk/government/publications/pension-funds-and-social-investment-interim-response

Clarifying and strengthening trustees' investment duties

14. In June 2018 we made proposals[17] for amendments to the Statement of Investment Principles (SIP) which must be prepared by most schemes with 100+ members and to the default SIP, which – subject to a number of exceptions – must be prepared by trustees of schemes with 2+ members offering money purchase benefits and a default arrangement.

15. This legislation[18] was made in September 2018 with some measures coming into force on 1 October 2019 and the remainder[19] coming into force on 1 October 2020. It includes measures to:

- require consideration of financially material risks and opportunities whatever their source, by extending the content of SIPs;
- enable comparison of the quality of SIPs and to learn from others, by requiring publication;
- minimise the risk of requirements being met with rarely-reviewed, generic 'box ticking' documents by requiring trustees of schemes offering money purchase benefits (broadly, DC and hybrid schemes) to prepare and publish an implementation statement reporting on how, and the extent to which, the SIP has been followed during the year; and
- facilitate scrutiny by engaged members by including a link to SIP and implementation statement in the annual benefit statement sent to members.

Other pensions legislation

16. Two more pieces of legislation which are relevant to climate change risk have subsequently been brought into force since the regulations described above, in accordance with European Union legislation which became due for transposition before the UK left the EU.

17. Regulations which came into force in January 2019[20] require trustees of pension schemes, subject to some exceptions, to establish and operate an effective system of governance including internal controls. They also tasked TPR with the duty to issue a Code of Practice in relation to this duty.

18. The forthcoming Code must be taken into account by a court or tribunal when determining whether the legal requirements have been met[21]. It requires, amongst

[17] Clarifying and strengthening trustees' investment duties: the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations – https://www.gov.uk/government/consultations/pension-trustees-clarifying-and-strengthening-investment-duties
[18] The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 (S.I. 2018/ 988). http://www.legislation.gov.uk/uksi/2018/988/contents/made
[19] The requirement to produce and publish an implementation statement, and to link to it from the annual benefit statement – see regulation 5(2), 5(4)(b) and 5(5)(c) of the Regulations above.
[20] The Occupational Pension Schemes (Governance) (Amendment) Regulations 2018 – SI 2018/1103
[21] Section 90(5) of the Pensions Act 2004

other things, trustees to carry out a risk assessment within 12 months of the end of the next scheme year, to begin after TPR issue the Code of Practice. This should include whether and how the trustees assess risks relating to climate change, the use of resources and the environment, and risks relating to the depreciation of assets as a result of regulatory change.

19. Separately, regulations made in May 2019[22] required defined benefit schemes to make their SIP publicly available on a website by 1 October 2020, and made a number of additions to the SIP to be incorporated by the same date. These include the requirement to explain how their arrangements with asset managers incentivise alignment of the investment strategy with the trustees' SIP and to make decisions based on medium to long-term performance of investee firms. Finally, the regulations introduced a more limited published implementation statement for defined benefit schemes, covering only monitoring and engagement with issuers, investment managers, co-investors and stakeholders, to be made publicly available on a website by 1 October 2021.

Pension scheme trustees' response

20. Reactions to the regulations have been widely analysed and reported by a range of market participants. In September 2019, in the run up to the legislation coming into force, the consultants Hymans Robertson[23] found that 96% of trustees were prepared for the regulations, despite 84% of them facing some challenges.

21. There have been other more mixed responses. The pensions law firm Sackers[24] in August 2019 found that 85% of surveyed trustees had already updated, or would update, their SIP for compliance purposes, but that only 13% had made or intended to make material changes to their investments. The Society of Pensions Professionals found[25] that for 38% of its members, the approach taken by most of their clients was tick box only, although it also found that 57% thought their clients had a genuine interest in ESG but had simply not changed their portfolio yet.

22. Collectively this research suggests that advised pension scheme trustees are complying with the letter of the law but taking their time on making decisive changes to strategy. Notably, Hymans Robertson also found that 70% of trustees were supportive of the regulations, with 27% strongly supportive, while only 7% oppose them.

23. More difficulty has been found in the smallest defined contribution schemes. TPR's DC schemes survey[26], carried out ahead of the regulations coming into

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[22] The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 – SI 2019/982

[23] 96% of Trustees prepared for new RI regulation despite 8/10 facing challenges - https://www.hymans.co.uk/media-centre/press-releases/96-of-trustees-prepared-for-new-ri-regulation-despite-8-10-facing-challenges-implementing-a-compliant-strategy/

[24] Sackers ESG survey for pension schemes – https://www.sackers.com/app/uploads/2019/09/Sackers-ESG-Survey-Summary-Report.-August-2019.pdf

[25] Putting ESG into practice: the SPP member research series https://the-spp.co.uk/wp-content/uploads/2020/01/SPP-ESG-report-paper-FINAL-January-2020.pdf

[26] Defined Contribution trust-based pension schemes research: report of findings on the 2019 survey https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/dc-research-summary-report-2019.ashx

force, found that only 21% of schemes took climate change into account when formulating their investment strategies and approaches, with the most common reasons being that it's "not relevant to our scheme" or that trustees were "not required to do this".

24. TPR's research suggests that non-compliance appear to be highest in the smallest pension schemes.

Responses to Ministerial letters

25. In October 2019 the Minister for Pensions and Financial Inclusion, Guy Opperman MP, wrote to 40 of the largest defined benefit pension schemes and 10 of the largest defined contribution pension schemes by assets.

26. The letters (see Annex 1 for full text) asked pension schemes a number of questions including:

- What substantive changes have you made to your investment strategy in the last 3 years to take account of ESG and climate change and when have you made them?
- Does your scheme make climate disclosures in line with the TCFD framework? What aspects of the TCFD recommendations do you meet? Do you plan to meet more in the next 12 months?
- Are there further specific actions Government might take to impress upon pension schemes – or others – the materiality of climate change risk and how it might be minimised. If so, what are those actions?

27. Responses, summarised below, showed significant progress in the actions taken by larger pension schemes, but indicated a need for progress in other areas with low take up of the Taskforce for Climate-related Financial Disclosure (TCFD) recommendations, even amongst the largest pension schemes.

Figure 2: Substantive changes made to investment strategy in the last 3 years to take account of ESG and climate change

34% BEST PRACTICE Close monitoring of investment managers and changing manager where appropriate, and changes in asset allocation in more than one sector – e.g. corporate bonds, property or infrastructure as well as equities.	37% GOOD PRACTICE Evidence of climate risk being a real consideration in appointment, retention and replacement of managers; ongoing monitoring of managers and changes of manager where appropriate; and changes in asset allocation in one sector.	29% DOING THE MINIMUM Some consideration of climate or other ESG risks; consideration, or conversations with consultants and/or managers, before making appointments, but no evidence of actual changes in investment decisions.

Figure 3: Making climate disclosures in line with the TCFD recommendations

13% BEST PRACTICE	29% GOOD PRACTICE	58% DOING THE MINIMUM
Carrying out whole of TCFD recommendations now, or some aspects of TCFD recommendations now with clear intention to be meeting all in next year.	Some evidence of carrying out some aspects of TCFD recommendations now or evidenced a clear intention to begin reporting in the next year.	No evidence of schemes carrying out disclosures in line with TCFD recommendations, and no disclosures planned in next year.

Further specific actions Government might take

28. In response to the question on further specific actions Government might take to highlight the materiality of climate change risk and how it might be minimised, two key themes were most frequently identified:

- The need for industry guidance and direction from the Government – we have contributed to this through our participation in the PCRIG.
- The need for mandatory TCFD reporting – this is the key theme of this consultation. 34% of the schemes that responded, called, unprompted, for mandatory TCFD reporting. A further 29% of schemes wanted to see further government action in this space but did not explicitly mention TCFD recommendations.

Wider action on greening finance

The TCFD recommendations

29. The TCFD is a global, private sector led group assembled in December 2015 at the instigation of the international Financial Stability Board (FSB), an international body that monitors and makes recommendations about the global financial system, which was then chaired by Mark Carney. Following extensive public consultation, they published their recommended disclosures in June 2017[27].

30. The recommendations were designed to be adoptable by all organisations, including both non-financial groups and the financial sector, from asset managers to asset owners, including banks, insurers and pension schemes. The TCFD designed the set of recommendations as a flexible framework for these organisations to produce decision-useful, forward-looking information on the financial impacts of climate change, which would accommodate continued rapid evolution in climate-related modelling, management and reporting.

[27] Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017). https://www.fsb-tcfd.org/publications/final-recommendations-report/

31. The final report included 11 recommendations. These are split into Governance, Strategy, Risk Management and Metrics and Targets.

Figure 4: Core elements of recommended climate-related financial disclosures

Governance
The organisation's governance around climate-related risks and opportunities

Strategy
The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning

Risk Management
The processes used by the organisation to identify, assess and manage climate-related risks

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities

The Green Finance strategy

32. Following the report of the UK Government-commissioned Green Finance Taskforce[28] in March 2018, the Government's Green Finance Strategy[29] was published in July 2019. This set out a range of actions in relation: to mainstreaming climate and environmental factors as a strategic imperative; to mobilise private finance for clean and resilient growth; and to cement the UK's leadership in green finance.

33. Amongst the announcements were:

- the Government's expectation for all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022;
- the creation of a joint taskforce with UK regulators, chaired by Government, which will examine the most effective way to approach disclosure;
- the establishment of the PCRIG[30] as an industry group to develop TCFD guidance for trustees of pension schemes. This group published comprehensive non-statutory guidance for consultation in March 2020. The

[28] Accelerating green finance: a report by the Green Finance Taskforce - https://www.gov.uk/government/publications/accelerating-green-finance-green-finance-taskforce-report
[29] HM Government. Green Finance Strategy. https://www.gov.uk/government/publications/green-finance-strategy
[30] See source in footnote 1.

consultation received 40 responses and has now closed. We anticipate that final guidance will be published at the end of 2020.

34. The Department for Work and Pensions has worked closely with other government departments and regulators, in the UK joint TCFD taskforce, chaired by HM Treasury. In bringing forward these proposals for legislation to achieve TCFD reporting by large pension schemes, DWP has aligned itself with direction across Government.

Mandating TCFD-aligned disclosures

35. The evidence from the occupational pension sector, as well as nationally and internationally, is that now is an appropriate time to move towards mandatory TCFD-aligned disclosures, beginning with larger pension schemes.

36. In the occupational pension sector itself, responses to letters from the Minister for Pensions and Financial Inclusion referred to above demonstrate that the largest schemes are already taking action, with 71% of respondents going significantly beyond statutory minimums in their activity. But they also indicated the need for a nudge, with fewer than half of schemes making any TCFD-aligned disclosures or having plans to do so in the next 12 months. The PCRIG's draft guidance has provided pension schemes with the guidance and direction to begin to take steps to report – now is the time to move towards legislation to embed the practice widely. This will also remove any 'first mover' disadvantages for schemes that have already taken action and will level the playing field.

37. Nationally, the Green Finance Taskforce called for the TCFD recommendations to be integrated throughout the existing UK corporate governance and reporting framework, and Government's Green Finance Strategy has set a clear expectation that disclosures will be made in line with the TCFD recommendations by large asset owners by 2022. The Financial Conduct Authority (FCA) have already launched a consultation on the TCFD recommendations by UK premium listed issuers[31]. Due to the Covid-19 epidemic the consultation deadline has been extended to 1 October 2020 with a Policy Statement and final rules now expected early in 2021[32]. The FCA is also currently considering how best to enhance climate-related disclosures by FCA-regulated firms, in line with its Feedback Statement on climate change and green finance last October[33] (FS 19/6).

38. Internationally, the TCFD recommendations have become a key part of the UK Government's focus and engagement with other signatories to the UN Framework Convention on Climate Change and the UN Climate Change Conference for COP26, which will take place in Glasgow in November 2021.

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[31] CP20/3: Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations - https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing

[32] Regulatory initiatives grid - https://www.fca.org.uk/publication/corporate/regulatory-intitiatives-grid.pdf

[33] FS19/6: Climate change and green finance - https://www.fca.org.uk/publications/feedback-statements/fs19-6-climate-change-and-green-finance

39. In his February 2020 speech "The Road to Glasgow", Mark Carney, the then Governor of the Bank of England and the current Finance Adviser to the Prime Minister for COP26 set out Government's intention to develop pathways to determine the best approaches to making climate disclosure mandatory[34]. This consultation forms part of that work.

The Pension Schemes Bill

40. Building on the expectations set out in the Green Finance Strategy, Government amendments were made to the Pension Schemes Bill during its passage through the House of Lords. It now[35] includes powers to make regulations:

- imposing requirements on scheme trustees with a view to securing that there is effective governance of the scheme with respect to the effects of climate change;
- requiring information relating to the effects of climate change on the scheme to be published;
- ensuring compliance with the requirements above.

41. Ministers have made clear that the provisions are intended to allow governance processes and disclosures aligned with the TCFD recommendations to be mandated[36]. This consultation is about when and how schemes should be required to adopt these enhanced governance requirements and report in line with the TCFD recommendations.

42. Government also made clear during debates in the House of the Lords that the measures will not, and cannot, be used to direct pension scheme investment:

"Let me be clear. This does not mean that it is for the Government to direct schemes or set their investment strategies. The Government never have directed pension scheme investment, and do not intend to. Our clear view is that the amendments do not permit us to do that"[37].
Baroness Stedman Scott, House of Lords Committee Stage, 26 February 2020

43. The measures can only be used with a view to securing that there is effective governance of schemes with respect to the effects of climate change and to require associated disclosures.

Benefits of the TCFD recommendations

44. In the "Road to Glasgow" speech referred to above, Mark Carney expanded on the advantages of the TCFD recommendations:

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[34] Mark Carney. The road to Glasgow. https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/the-road-to-glasgow-speech-by-mark-carney.pdf
[35] https://publications.parliament.uk/pa/bills/lbill/58-01/104/5801104_en_13.html#pt5-pb2-l1g124
[36] Mark Carney and Therese Coffey. "Pension schemes must disclose what they are doing to fight climate change" Daily Telegraph 12 February 2020 - https://www.telegraph.co.uk/business/2020/02/12/pension-schemes-must-disclose-fight-climate-change/
[37] Pension Schemes Bill volume 802, column 156 GC

"The TCFD has become the go-to standard for consistent, comparable and decision-useful and efficient information. It is comprehensive, encompassing recommendations on governance, strategy and risk management, as well as metrics and targets. And most importantly, it represents the best views of the private sector of what is decision useful, capturing the opinions of both the companies that must access finance and of the providers of capital from across the financial system.

"The TCFD has widespread public backing from across the financial sector. Every major systemic bank, nine of the top ten asset managers, all the credit rating agencies, all major accounting firms and shareholder advisory firms back the TCFD."

45. TCFD-aligned disclosures offer the opportunity for trustees of occupational pension schemes to move away from the relatively high-level disclosures prescribed in the Statement of Investment Principles.

46. It permits them to demonstrate how the consideration of climate change risks and opportunities are integrated into the pension scheme's entire decision-making apparatus.

47. Carrying out scenario analysis, reporting on appropriate metrics including greenhouse gas emissions, and setting appropriate targets, would provide valuable inputs which can inform a pension scheme's strategy. It would also allow trustees to monitor and review progress, and, where they control investments, to make amendments to the investment strategy where necessary. Disclosing this information provides greater transparency to beneficiaries about how their money is being managed.

48. The flexible structure of the TCFD recommendations also allows trustees to continuously improve climate risk governance and reporting in the light of rapidly increasing data quality and completeness and emerging best practice.

49. Many aspects of the tools and data used for climate-related analysis are still in development, but investors can take substantive action now to address climate risk and to report on it as part of their duties to scheme members and beneficiaries. Whilst investment analysis is never a perfect science, there is already enough data, analysis and tools – real change is already happening when trustees and asset owners use that investor data to act.

50. Analysis by the Transition Pathway Initiative[38] reviewed 332 corporations worldwide in 16 business sectors and showed that:

- 26% reported on climate scenario planning;
- 40% reported on climate risks and opportunities in strategy;
- 62% reported on board responsibility for climate change;
- 66% reported on processes to manage climate risks;

[38] https://www.transitionpathwayinitiative.org/tpi/publications/50.pdf?type=Publication

- 70% set public targets of some duration, with 57% setting long-term targets;
- 76% disclosed scope 1 and 2 emissions, with 61% disclosing scope 3 emissions.

Challenges to adoption of the TCFD recommendations

51. We recognise that adoption of the TCFD recommendations is a journey. Our proposed policy has been developed with a range of challenges in mind. Challenges relating to data availability are also covered in chapter 3. Challenges around publication and explaining the results are addressed in chapter 4.

Covid-19

52. This consultation comes as the UK economy is still recovering from the severe disruption of the Covid-19 pandemic. Government has recognised the distress caused to many sectors and individual businesses. But delaying decisive action on climate risk will only expose companies, trustees and pensions savers to potential turbulence in the future. It is vital we make our financial system more resilient as we look to build back better and greener.

53. However, we need a proportionate approach. This is why, in our proposals, we are excluding smaller schemes, and are giving even the largest schemes a minimum of 1 year to prepare.

Discouraging 'tick box' disclosures

54. High quality TCFD reporting will represent an essential element of good scheme governance, regardless of a requirement to publish.

55. With that in mind, the proposals in this consultation do not seek to be simply another disclosure requirement. We propose that our policy, and our eventual regulations, will make clear that these changes concern governance decisions, and the disclosure requirements should instead be viewed as part of a wider, robust governance process.

Legal liability

56. During our informal stakeholder engagement, some trustees have raised a concern that expressing their best estimates of the effects of climate change on their pension schemes may give rise to legal risk, if those estimates subsequently turn out to be inaccurate.

57. The same standards will be expected of trustees in relation to estimates and disclosures about the effects of climate change, as are expected in relation to any other estimates and disclosures that trustees make about their pension scheme. Trustees are expected to comply with their existing duties under the Trust Deed and Rules for the particular pension scheme, under general trust law and under existing pensions legislation. First and foremost, they must act in accordance with their fiduciary duties towards pension scheme beneficiaries. This means acting in their best interests and carrying out their duties prudently, conscientiously and with the utmost good faith and taking advice where specialist input is needed, for example about investment decisions and applicable legislation.

58. When taking such advice, as with any professional advice, trustees need to be able to demonstrate that their advisers are properly qualified and ensure that they,

as trustees, understand any advice they receive. Importantly, trustees do also need to be able to challenge and question professional advice to aid their understanding and be able to justify their reasons for following or not following it.

59. When drawing conclusions and making disclosures about the scheme's climate change risks, trustees will be expected to weigh up competing factors, to take all relevant factors into account and to ignore irrelevant factors, and to reach a decision about what to disclose which is reasonable, and which meets the requirements of the legislation.

60. We cannot give trustees any general reassurances on compliance with these proposals around climate change. Any questions of trustee liability would depend heavily on the particular facts of the case and the eventual regulations and both statutory and non-statutory guidance. However, trustees would be supported by both statutory guidance – the proposed contents of which are covered in this consultation – and non-statutory guidance produced by the PCRIG. Moreover, trustees can help to mitigate legal liability risk by being transparent about the approach they have taken to aspects of TCFD reporting such as scenario analysis.

61. The expectation, as with other trustee decisions, would be that the exercise of trustees' discretion and decision-making would be assessed based on the information and circumstances reasonably available at the relevant time. Trustees are expected to act in accordance with their legal duties and powers, but they are not expected to predict the future. However, a strength of the scenario analysis included within the proposals is that it allows trustees to carefully consider multiple different possible outcomes based on available data and information.

62. The usual rules would also apply in relation to exonerations and indemnities for trustees. For example, there might be provision in their Trust Deed and Rules exonerating them from personal liability in certain circumstances, although there will usually be 'carve outs' for where trustees have acted dishonestly or in bad faith. They may also benefit from an indemnity from the scheme employer, from the scheme's assets or liabilities or from indemnity insurance, which could cover their liability in certain circumstances.

How trustees respond

63. Finally, we recognise the concerns of some pension scheme trustees that scenario analysis, or disclosure of greenhouse gas emissions or other metrics or targets, may lead to increased pressure for divestment of pension schemes from high carbon sectors.

64. As highlighted above, we recognise that the ultimate decision-making on climate change risk and opportunities are matters for trustees alone. The Government's changes to the law, as set out above, have sought to provide clarity to trustees that consideration of ESG factors, including climate change, is an appropriate and important part of their duties. This message has been further strengthened by the ambitious new Stewardship Code, which took effect from 1 January 2020[39].

[39] https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf

65. The Government sees stewardship of assets, including engagement with higher carbon firms and voting at Annual General Meetings (whether directly or via asset managers), as entirely legitimate responses to the climate risk revealed through TCFD-aligned disclosures.

66. Indeed, holding such assets places trustees in an influential position to steward firms towards lower-carbon business practices, which is why Government advocates collaboration with business, as opposed to divestment, as the most effective means of holding companies to account on climate change. Government believes that selling assets to less engaged shareholders is likely to be counterproductive from a climate-risk mitigation perspective.

67. Whilst engaged members and civil society groups have an important role in facilitating scrutiny, these measures are not intended to give any support to campaign groups calling for blanket divestment from certain assets. Government continues to believe this would be the wrong approach – engagement with high-carbon companies, when done effectively, can reduce the climate risk to which the scheme is exposed. At the same time, stewarding these firms to set a plan for the transition can have a greater impact on climate change than simply selling assets to others who might not hold investee firms to account. Ultimately, Trustees have primacy in investment decisions; it is not for the Government to direct trustees to sell or buy certain assets and these proposals do not create any expectation that schemes must divest or invest in a given way.

Paris alignment and "Implied temperature rise"

68. The Paris Agreement[40] includes a commitment to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels (Article 2.1(a)). The Agreement also aims to make financial flows consistent with low Green House Gas emissions and climate-resilient development (Article 2.1(c)). Finally, it states that in order to achieve the long-term temperature goal, global GHG emissions should peak as soon as possible, with rapid reduction thereafter in accordance with best available science (Article 4.1).

69. Disclosure in line with the TCFD recommendations discussed in this consultation provides information that could help assess transition risks and opportunities associated with a selected portfolio, fund, or investment strategy. And since these recommendations were introduced, there is also increasing interest from investors and businesses in the idea of 'Paris alignment'. This may also be expressed as alignment with the transition to a 'net zero' economy.

70. One of the attractions of thinking about business and investment through the framing of Paris alignment or net zero is the focus on forward-looking assessment of potential contributions to global warming. This can provide valuable information about progress, or lack of progress, towards limiting the global average temperature rise.

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[40] The United Nations Framework Convention on Climate Change dealing with greenhouse-gas emissions mitigation, adaptation and finance signed in 2016 - https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

71. The Paris Agreement, however, was not written specifically for investors or businesses. A certain amount of work is therefore necessary in order to translate what its commitments mean for them in practice. For example, a pension scheme's 'alignment' will be dependent upon analysis of the underlying assets, their current emissions and their likely associated emissions trajectory, but different sectors and asset classes will face different challenges in relation to reducing emissions. These differences will need to be reflected in how they are assessed. In response to these challenges, a substantial amount of work is being undertaken by industry to review and assess the emerging approaches to measuring and reporting information on the position of their portfolios relative to the transition to the net zero carbon economy. This includes work by the TCFD, the Net-Zero Asset Owner Alliance[41], the COP26 Private Finance Hub and the Paris Aligned Investment Initiative coordinated by IIGCC[42].

Portfolio warming or implied temperature rise

72. One way of understanding and reporting progress towards Paris alignment which has gained traction within the financial sector is the idea of measuring 'portfolio warming' or the 'implied temperature rise' (ITR) of investment portfolios. This is also sometimes referred to as 'degree warming', 'temperature score', or the 'portfolio warming potential'. The idea is that financial institutions can model the likely global average temperature rise above pre-industrial levels with which their holdings are consistent. The outcome of this modelling is a single metric, for example a portfolio may have an ITR of 3°C.

Benefits and challenges of measuring and reporting implied temperature rise

73. The Government sees value in trustees of occupational pension schemes taking steps to understand the ITR of their portfolios and disclosing this publicly.

74. The process of undertaking the analysis to determine the ITR of their portfolios will help trustees to gain greater understanding of their associated climate risk and opportunities. For example, where a scheme's ITR is found to be 4°C, its trustees can see that it is likely to be significantly affected by public policy measures aimed at limiting the global average temperature increase to well below 2°C. This information can be used by trustees to better inform pension scheme strategy. In this respect, the value of calculating the ITR is similar to the process of scenario analysis recommended by the TCFD recommendations.

75. We also see benefit in schemes reporting their ITR. ITR is a reasonably simple representation of a complex concept. Reporting the ITR will therefore provide scheme members with a manageable metric to understand the scheme's current position in relation to addressing climate risk and we see future value in the ITR figure being reported to members in the Annual Benefit Statement. This is not to say that calculating an ITR is simple and we recognise that there would likely need to be explanation to accompany the reported value. However, the ITR figure itself is likely to be easy to understand and would provide useful information to

[41] https://www.unepfi.org/net-zero-alliance/
[42] https://sciencebasedtargets.org/#

accompany the scheme's wider TCFD reporting. This would also be valuable for TPR as a way of understanding the climate risk exposure of the sector.

76. A further benefit of reporting an ITR is that it may drive better practice across the occupational pension sector. Trustees and their advisers would benefit from sight of other schemes' reported ITR and this may stimulate improved climate-related policies and practices across the sector. As with disclosure of TCFD reports, public scrutiny has an important role to play in driving improvement.

77. One alternative way of reporting Paris alignment would be for schemes to simply state whether or not they are aligned with the Paris Agreement. However, this approach lacks some of the nuance of reporting an ITR and would provide less information to members, the sector and regulators about the extent to which schemes are exposed to climate risk. Furthermore, it may not incentivise trustees to move towards Paris alignment if a very large percentage of the sector reports as 'not aligned'. Having pension schemes report their ITR will provide useful data and case studies which would aid trustees and policymakers in improving their response to climate risk.

78. However, in order for ITR to be an effective metric to assess risks and opportunities for pension schemes, there needs to be a reliable and effective methodology, or methodologies, to calculate it. It is important that financial institutions, including pension schemes, and their stakeholders are able to rely on the output of any methodology and to trust in its accuracy.

79. At present, the available methodologies for measuring ITR are not widely considered to be sufficient. Our engagement with stakeholders working in this area suggests that there are potential risks to accuracy and reliability caused by gaps in data and in the methodologies themselves. There is also a lack of consensus around the modelling, which could lead to very different ITRs being calculated for the same portfolio/assets. This uncertainty poses a risk to the success of any policy measure related to ITR.

80. However, a substantial amount of work is currently being undertaken to review and assess these methodologies measuring portfolio alignment, including ITR. This work is likely to lead to better understanding of the existing approaches and further developments in the sophistication of the tools available to trustees of pension schemes. It is likely, therefore, that best practice in this area will continue to develop over the course of the next 12 months.

Next steps

81. In light of the above likely benefits of measuring and reporting the ITR of portfolios, the Government is minded to take steps to require that pension scheme trustees do this. However, our engagement with stakeholders suggests that the work currently being undertaken in this area will result in better methodologies which will be more useful for trustees. We are therefore not consulting on Paris alignment and ITR in this consultation but intend to do so in the near future. This future consultation may also include consideration of other ways of measuring and reporting Paris alignment.

82. The Government is supportive of leaders in the occupational pension sector who are already exploring how they can take steps towards Paris alignment.

Summary of proposals

Scope and Timing

We propose that larger schemes and authorised master trusts should disclose on the timescale shown below.

The condition	Governance requirement	Disclosure Requirements	
If	*Trustees must meet the climate governance requirements for*	*Trustees must publish a TCFD report*	*Trustees must include a link to the TCFD report from*
On 1st scheme year to end on or after 1 June 2020, the scheme has assets ≥ £5bn *Or* On 1 October 2021, the scheme is an authorised master trust *Or* On 1 October 2021 the scheme is an authorised scheme providing collective money purchase benefits	Current scheme year from 1 October 2021 to end of that scheme year. *And* [unless scheme is no longer authorised, and assets are <£500m] Next full scheme year to begin after 1 October 2021 to end of that scheme year.	Within 7 months of the end of the scheme year which is underway on 1 October 2021, or by 31 December 2022 if earlier. *And* Within 7 months of the end of the next scheme year to begin after 1 October 2021, or by 31 December 2023 if earlier.	The Annual Report and Accounts produced for that scheme year
On 1st scheme year to end on or after 1 June 2021, The scheme has net assets ≥ £1bn	Current scheme year from 1 October 2022 to end of that scheme year	Within 7 months of end of that scheme year, or by 31 December 2023 if earlier.	

The largest corporate schemes have highest governance and resource capacity, and they will have the capability to produce TCFD disclosures in the first instance. Authorised master trusts will be expected to have met minimum standards, and Government policy is to maintain a level playing field between master trusts.

On an ongoing basis, we propose that where scheme assets exceed £1bn at the end of a scheme year, the governance requirements – and the period on which trustees must report – commences from the period beginning with start of the next scheme year. Schemes would remain in scope until assets fall below £500m at scheme year end. The requirements would apply to authorised master trusts and schemes offering collective money purchase benefits from the point of authorisation, and fall away from the point of de-authorisation.

We would take stock in 2024 and consult more widely again before extending to schemes with < £1bn in assets, taking account both of the quality of climate risk governance and associated disclosures carried out to date, and the current and future costs of compliance.

TCFD Requirements

Regulations vs. Statutory Guidance

We propose that regulations require trustees to meet climate 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 steps to meet and report on TCFD requirements.

Trustees must meet the standards required by the regulations. They can diverge from statutory guidance, but they would need to be able to explain why.

Metrics, Targets and Scenario Analysis

Trustees are dependent on data from other parts of the investment chain and their investments are in a range of jurisdictions. Therefore, initially, we propose that trustees should carry out scenario analysis, calculate metrics and report against trustee-set targets 'as far as they are able'.

We recognise that the key for scenario analysis is a range of scenarios allowing trustees to analyse both transition and physical risk. We therefore propose to prescribe at least two scenarios, of which at least one must correspond to a global average temperature rise of 2°C or lower above pre-industrial levels. Other possible scenarios would be set out in statutory guidance to which trustees must have regard.

For metrics, we propose that trustees are required to obtain data from their asset managers and in turn from investee firms on emissions and other characteristics of their investments that they wish to quantify, 'as far as they are able'. This acknowledges the difficulties that schemes might face in acquiring full data for their portfolio in which they are confident.

Trustees would then be required to calculate and publish at least one metric that they use to measure, monitor and manage the climate-related risks and opportunities of the scheme. This can be either emissions-based or non-emissions-based.

The metrics trustees will be required to calculate should be measures that quantify the effects of climate-related risks and opportunities on the scheme, or the governance of those risks and opportunities. We do not plan to prescribe particular metrics in regulation. Instead we propose that trustees will be able to select those metrics from a range presented in statutory guidance, with the aim of driving consistency across the sector.

Trustees must then set at least one target. This must be a target for one of the metrics that they choose to publish.

We propose that scenario analysis must be carried out, and appropriate metrics and targets set, at least once each scheme year. In addition, underlying data for metrics and targets are obtained and calculated, and performance against targets is measured, at least quarterly. All other climate governance requirements are ongoing for the schemes to which they apply from the coming into force date of the legislation.

Integration with existing requirements

If these consultation proposals are adopted TPR will give consideration to whether those trustees who meet the requirements set out in our regulations should be deemed to have also met the standards in the forthcoming Governance code[43] insofar as they relate to climate change.

Disclosure

Publishing the TCFD disclosures

We propose that schemes be required to publish their TCFD report on their own website, or the website of the scheme's sponsor.

We propose to require that – as a key financial disclosure - TCFD reporting is referenced from the Annual Report. As TCFD Reports done well could be quite long and detailed, we do not intend that the information will need to be presented in full within the Annual Report.

Further expectations on publication to which trustees must have regard will be set out in statutory guidance.

Telling members about the TCFD report

We propose that members will be told via the annual benefit statement that the information has been published and where they can locate it. DB schemes would only be required to add the link to the annual benefit statements of members for whom they already are required to produce one.

Where schemes issue their annual benefit statement months in advance of their Annual Report they would be required to direct members to the most recent TCFD report, or in the first year, the location where the TCFD report will be published in due course.

Reporting information back to TPR

We propose to require that trustees provide TPR with the web address of where they have published their TCFD report via the annual scheme return form. We also propose to require that trustees provide a link to their SIP and (where applicable) implementation statement and published excerpts of the chair's statement in the annual scheme return form.

[43] To be issued by The Pensions Regulator under the Occupational Pension Schemes (Governance)(Amendment) Regulations 2018 relating to the requirement for an effective system of governance under section 249A of the Pensions Act 2004.

Penalties

We propose that a mandatory penalty is appropriate for complete failure to publish any TCFD report. Other penalties would be subject to TPR discretion. Penalties in relation to climate change governance and publication could be imposed without recourse to the Determinations Panel. We propose that requirements to reference the TCFD report from the Annual Report and inform members about the TCFD report's availability would be subject to the existing penalty regime in the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013[44].. Our proposed requirements to inform TPR of the web address of the published TCFD report and the web address of the published SIP, implementation statement (where applicable) and excerpts of the Chair's statement would be subject to the penalty regime in section 10 of the Pensions Act 1995.

[44] S.I.2013/2734.

Chapter 2: Scope and timing

1. This chapter sets out the Government's proposals for the scope and timing of requirements relating to pension scheme climate governance, and in relation to disclosures aligned with the recommendations of the TCFD.

2. This chapter:

   - explains how we believe we have settled on a proportionate approach to the scope, which takes account both of trustees' duty to appropriately manage climate risk as a financially material risk and the costs of TCFD-aligned reporting and underlying activities;
   - sets out our thinking behind a phased approach to our proposed governance and reporting requirements; and
   - proposes next steps on how we would review the proposed measures in 2024 before determining how and when to extend rollout to smaller pension schemes.

Costs, benefits and capacity in TCFD reporting

3. We believe that TCFD-aligned disclosures are a key mechanism by which to ensure that pension scheme trustees take account of climate risk - both by embedding it into their governance and risk management frameworks and their future strategies, and by communicating it effectively to beneficiaries and publishing it.

4. However certain parts of the TCFD governance and disclosure framework – particularly scenario analysis – will come with additional costs, and it is important to view these in the context of trustees' other duties.

5. In chapter 5, we are seeking views from respondents on our initial estimates of the costs of TCFD-aligned reporting, which are set out in the accompanying impact assessment. We expect this cost to vary with both the extent to which the pension scheme trustees are already considering climate risk and the complexity and diversification of their portfolio, which will tend to be higher in larger schemes. However, following informal engagement with a range of stakeholders, we estimate that the typical cost of putting in place additional governance requirements, to make TCFD-aligned disclosures, is around £15K per year.

6. The trustees of a scheme with £1bn of assets might have a typical spend of £5-10m per year. Approximately 90% of this might be committed to core services associated with administration or investment – meaning that the £15K cost of the proposed climate governance measures and associated disclosures might constitute 1.5-3% of their annual governance spend. We believe that this is a reasonable proportion for the oversight of a very significant investment risk and opportunity. For this exercise to be cost-neutral to pension schemes, the annual long-range return on investment – whether through enhanced return, loss

avoided, or a downward management of risk, would need to amount to no more than 0.0015% of the assets under management, or 0.15 basis points (bps).

7. Were a scheme with £100m in assets to carry out the exercise at similar cost, the break-even point would be of the order of 1.5bps, which is far from an extreme threshold. However, the upfront costs of governance and disclosure – prior to any return on the investment – might have the potential to be 15-30% of their annual governance spend, a very significant amount.

8. We therefore anticipate that schemes with significantly more than £1bn of net assets will find the process of building capacity and implementing climate governance and TCFD-aligned reporting easier.

9. This is supported by evidence collated from October 2019 in response to letters sent by the Minister for Pensions and Financial Inclusion to the 40 largest defined benefit schemes (each with more than £5bn in assets) and the 10 largest defined contribution schemes (each with £1bn or more in assets). Responses showed that 42% of respondents had already reported in line with the TCFD recommendations or planned to in the next year

10. Similarly, evidence from reporting by UK asset owners to the Principles for Responsible Investment earlier this year showed that more than 50 of its signatories – many of them large pension schemes – were reporting on TCFD-based indicators.

Our proposals on scope

Schemes with £1bn or more in net assets

11. We therefore propose that our measures for climate governance and reporting should apply to trustees of occupational pension schemes for whom the value of the net assets of the scheme is £1bn or more. We propose a 2-stage approach with a transitional threshold of £5bn in net assets in the first year.

12. MHCLG will make provision for the Local Government Pension Scheme, in line with their responsibility for the investment and governance of the LGPS more broadly. The FCA has noted that it is considering how best to enhance climate-related disclosures by firms within the scope of its regulatory responsibilities – including those offering workplace pension schemes – coordinating as appropriate with DWP and other regulators and Government departments.

13. As explained above, trustees of schemes with £1bn or more in net assets can be expected to have the resources in place to allow them to implement and report on the range of governance and assessment measures set out in the TCFD recommendations to a high standard, with a high probability of overall benefit to the members of defined contribution schemes and the members and employer sponsors of defined benefit schemes.

14. We propose that defined benefit and defined contribution schemes should both be in scope of the measures. Whilst defined benefit schemes may have de-risked to a greater or lesser extent, even the assets of de-risked schemes – whether sovereign bonds, corporate bonds, infrastructure, property, or other matching

assets - carry climate risk, through the risk of climate-induced default or downgrades. There are climate-related opportunities too, for example in the low carbon sector which has the opportunity to be upgraded as the economy decarbonises.

15. Liabilities too remain subject to significant climate change risk, through the impact of both saver longevity and yields. Even in the "end-game" of DB, the price at which pension schemes achieve buy-out or entry into a consolidator vehicle, and the risk of a buy-out provider or consolidators being able to meet its own liabilities, are also affected by climate change. Potentially most significantly, the resilience of the scheme's sponsor may be highly sensitive to different temperature scenarios, and action by governments and others to limit temperature rises.

16. By "net assets of the scheme" we mean those attributed to the scheme in the annual report and accounts, less any "external liabilities" – that is, any liabilities other than the liabilities to pay pensions and benefits.

17. In the case of hybrid schemes – whether dual section or mixed benefit – we propose that the total assets of the scheme are used for the purpose of assessing whether the threshold has been met, and that the requirements apply to the whole scheme. This creates a level-playing field, whether benefits are money purchase, non-money purchase, or a mixture of the two.

18. Until a permanent authorisation framework is set up in law, we propose that DB superfunds would be treated in the same way as any other occupational pension scheme. As we anticipate that most, if not all superfunds will over the long term manage net assets of well over £1bn, we expect the vast majority of superfunds to be in scope of the climate governance and disclosure requirements, once they have reached the necessary scale.

Master trusts

19. In addition, we propose that trustees of authorised master trusts[45] are also required to disclose in line with the TCFD recommendations and to comply with the underlying governance requirements proposed in this consultation, irrespective of the value of the assets of the scheme.

20. To be authorised by The Pensions Regulator (TPR), master trusts are expected to have met minimum standards in relation to a range of activities. In particular, TPR must take into account the systems and processes for risk management, investments and member communication[46], when deciding whether the scheme's systems and processes are adequate. In determining financial sustainability, TPR

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[45] As defined in section 1 of the Pension Schemes Act 2017. Under the proposals only schemes to which part 1 of the Act applies would be in scope. This means that schemes which fall under regulation 26 or 27 of the Occupational Pension Schemes (Master Trusts) Regulations 2018 (SI 2018/1030) ("the master trust regulations") would be excluded.

[46] Paragraphs 7, 10 and 11 of Schedule 4 to the master trust regulations.

must take into account factors including the scheme's objectives, strategy and business plan, as well as the scheme's investment strategy[47].

21. In developing the master trust authorisation framework, Government has emphasised the importance of increasing trust in the market and well-run schemes not being undercut by badly run competitors[48]. There is a strong argument for ensuring a level playing field across all master trusts, and ensuring that schemes whose trustees are implementing enhanced climate governance and reporting on TCFD are not undercut by, say, smaller exempt schemes taking an approach which does not take full account of climate considerations and exposes members to unnecessary risk.

22. In any case, the assets under management in authorised master trusts are growing quickly. Of the 37 master trusts which are authorised and continuing, the number with assets of more than £1bn has increased from 11 in 2017 to 17 during 2019[49], and despite market setbacks this year, we expect that number to increase both through ongoing contributions and through consolidation.

23. Whilst there are a few much smaller authorised master trusts, all have been through a robust authorisation process. Any relaxation of the requirements below a given asset threshold would appear to be arbitrary, for the reasons given above. However, we would welcome respondents' views on this point.

24. We propose that master trust schemes which have been established but not yet been granted authorisation should not be in scope. Otherwise the trustees of such schemes would be required to carry out a TCFD-aligned disclosure despite having no members and no assets.

25. We also propose that any unauthorised master trusts which are currently exiting the market are not in scope of these measures. Fulfilment of the requirements should not impede an urgent exit from the market and the transfer of beneficiaries' benefits to schemes which do have climate governance measures in place.

Authorised Collective DC schemes

26. We propose that the application of the climate governance and disclosure requirements referred to above in relation to master trusts should also apply to authorised schemes providing collective money purchase benefits.

27. Whilst it is less likely, at least initially, that Collective DC schemes will be in competition with one another, we note that the authorisation criteria set out in clauses 11-17 of the Pension Schemes Bill are similar to those in the Pension Schemes Act 2017 which govern the authorisation of master trusts. This includes consideration of the scheme's systems and its financial sustainability. There is a strong expectation from Government and Regulators that schemes offering collective money purchase benefits will be run in a way that meets a high minimum standard of governance if they are to be authorised.

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[47] Paragraphs 1 and 4 of Schedule 2 to the master trust regulations

[48] Master trust authorisation Impact Assessment Final stage – March 2018 - https://www.legislation.gov.uk/ukdsi/2018/9780111169261/pdfs/ukdsiod_9780111169261_en.pdf

[49] TPR estimates based on annual scheme returns.

Coverage of the pensions market

28. Based on the current market structure, by the end of 2023, these proposals would have the market coverage shown below. In practice scheme numbers might decrease through participants exiting the market or through withdrawals and asset price falls – or increase through contributions and asset price increases.

Figure 5: Schemes disclosing in line with TCFD[50]

Total	Defined contribution	Defined benefit
367	180	328

Figure 6: Memberships of schemes disclosing in line with TCFD recommendations

Similarly, 24,697,000 memberships are currently in schemes which, on current figures, by the end of 2023 would be subject to the proposed climate governance measures and reporting in line with the TCFD recommendations[51]. We expect the overall proportion to increase, due to the rapid growth of membership in the largest DC schemes.

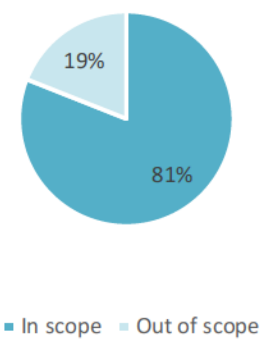
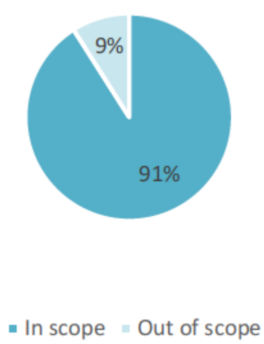
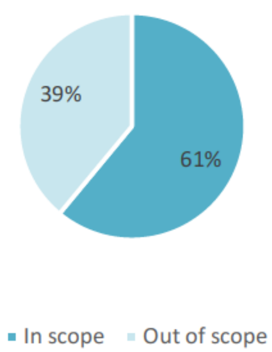
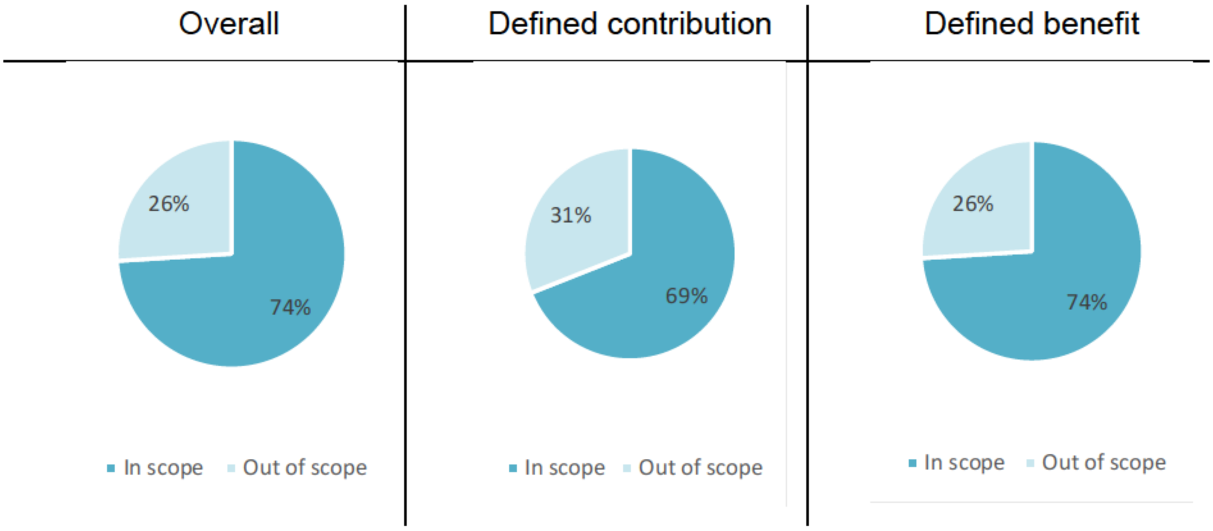
Overall	Defined contribution	Defined benefit
		

Figure 7: Assets of schemes disclosing in line with TCFD recommendations

[50] DC and DB numbers do not add up to total because a scheme with £1bn+ DB and £1bn+ DC is counted twice, as are schemes with £1bn+ DB that are also authorised master trusts.
[51] Based on membership and asset data from actuarial roll forward figures used in DB Landscape. [see p14 of DB Landscape (https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-pensions-landscape-2019.ashx] - cut from the scheme register as of 31 March 2019 and from scheme returns used in DC Trust (https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2019-2020).- taken from the scheme register as of 01 January 2020

Our proposals on scope would mean that by the end of 2023 – based on current market data – £1.33tn currently invested in occupational pension scheme assets would be accounted for by schemes complying with our proposed governance and disclosure requirements. We would expect the proportion of assets in DC schemes captured by the proposed requirements to increase rapidly due to ongoing concentration in the market, with less change in DB.



Consultation Question

Q1. We propose that the following schemes should be in scope of the mandatory climate governance and TCFD reporting requirements set out in this consultation:
(a) trust schemes with £1bn or more in net assets
(b) authorised master trusts
(c) authorised schemes offering collective money purchase benefits

Do you agree with our policy proposals?

Our proposals on timing

29. We propose a phased rollout of TCFD-aligned governance and reporting duties to non-master trust schemes, with trustees of schemes with £5bn or more in net assets required to report in line with the TCFD recommendations first. Trustees of such schemes would be required to publish a TCFD report within 7 months of their first scheme year to end after 1 October 2021 or by 31 December 2022 – whichever is earlier. This would mean that trustees of all schemes should have published a TCFD report by the end of 2022.

30. We propose that schemes would refer to their TCFD report in their annual report and accounts for the corresponding scheme year – this is explained in more detail in Chapter 4. They would also be required to comply with the proposed underlying governance activities for the scheme year, or remainder of the

scheme year to which their TCFD report relates, in accordance with the proposals set out in Chapter 3.

31. As explained above, we believe that larger schemes will have greater governance capacity, resources and capability to establish, carry out and document the necessary governance processes and disclosures to a faster timescale.

32. Government's proposal is that trustees of schemes with £1bn or more in net assets, but less than £5bn, should have an additional year in which to prepare for these measures. Accordingly, trustees would be required to publish a TCFD report within 7 months of their first scheme year to end after 1 October 2022, or by 31 December 2023 – whichever is earlier. This would mean that all such schemes should have published a TCFD report by the end of 2023.

33. We would however encourage trustees of such schemes to make efforts to begin work during the preceding reporting year, to test their approach in preparation for the governance and reporting requirements becoming legally binding.

34. In addition to allowing trustees of schemes in the asset range of £1bn to £5bn in net assets more time to prepare, we anticipate that the experience of scheme trustees in the first round of reporting would set a benchmark of emerging good practice in the sector for scheme trustees reporting in the second round to learn from and aspire to.

35. It would also enable advisers and service providers more time to develop product offerings, commoditised where appropriate, for trustees of the second round of schemes to access at a proportionate cost.

36. However, we do not propose a similar phased approach in relation to authorised master trusts or any authorised scheme offering collective money purchase benefits. Here the requirement for a similar minimum standard of governance, and the need to ensure a level playing field between master trusts is the prime consideration.

37. We therefore propose that trustees of such schemes should be required to disclose in line with the recommendations of the TCFD within 7 months of their first scheme year to end after 1 October 2021, or by 31 December 2022 if earlier, meaning that all such schemes should have published a TCFD report by the end of 2022.

Timing of the asset threshold test and the coming into force date

38. All occupational pensions operate under a scheme year, defined similarly for the purposes of a range of regulations[52]. We are mindful that occupational pension

[52] See for instance the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715), the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734), and the Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (SI 1996/1975).

schemes operate on a very wide range of scheme years. Whilst 1 Jan-31 Dec and 1 Apr-31 Mar are common cycles, many others are in use.

39. The audited accounts of occupational pension schemes are required to show a true and fair value of both the amount of the assets at the end of the scheme year, and any liabilities (other than the liabilities to pay pensions and benefits after the end of the scheme year[53]).

40. Financial Reporting Standard 102 (FRS102)[54] also requires a statement of net assets. In addition, for defined benefit schemes, the actuarial valuation or actuarial report required under section 224 of the Pensions Act 2004 requires the scheme assets to be valued.

41. Certain assets of the scheme, such as illiquid assets which are not traded on public markets, will be more difficult to value and an additional in-year valuation will add unnecessary cost. We therefore propose to use the value of the assets at the end of the first scheme year to end on or after 1 June 2020 to determine whether schemes will be subject to the proposed reporting requirements by the end of 2022.

42. Our proposal is that trustees of schemes whose net assets are £5bn or above on that scheme year end date would need to comply with most climate governance requirements which underpin the TCFD recommendations as soon as the regulations are proposed to come into force, on 1 October 2021. This would be the case even if that was part way through a scheme year. A number of the requirements – those relating to scenario analysis, the collection of data and calculation of metrics and the performance against targets should be carried out at discrete intervals through the scheme year, including part-years. This is covered in chapter 3.

43. Within 7 months of the end of the scheme year which was underway on 1 October 2021 – or by 31 December 2022 if earlier – trustees would need to produce and publish a TCFD report which explains how they complied with the governance requirements between 1 October 2021 and the end of the scheme year. This would meet Government's intention to build on the Green Finance Strategy and put the expectation of TCFD-aligned reporting by the largest asset owners by the end of 2022 on a statutory footing.

44. A second wave of schemes would follow, from an assessment of the net assets of the scheme on the next scheme year end date on or after 1 June 2021. The requirements set out above would then follow the same approach but be moved on by 1 year.

45. Our intention in proposing this timescale is to ensure that scheme trustees – especially smaller schemes who are less likely to be doing TCFD-aligned reporting already – have notice that they will be in scope of the requirements and can make preparations accordingly.

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[53] Regulation 3 of the Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (SI 1996/1975)

[54] FRS 102: The Financial Reporting Standard applicable in the UK and Republic of Ireland - https://www.frc.org.uk/accountants/accounting-and-reporting-policy/uk-accounting-standards/standards-in-issue/frs-102-the-financial-reporting-standard-applicabl

46. We have considered whether schemes with between £1bn and £5bn in net assets should be required to meet the proposed governance and disclosure requirements on the same timescale as those with £5bn or more. Whilst earlier moves to carry out TCFD-aligned reporting will likely have some benefit for DC beneficiaries and sponsoring employers of DB schemes, evidence suggests that more schemes in this size range may be less well-advanced in gearing up to implement the necessary governance requirements and to make TCFD-aligned disclosures. Earlier disclosures – whilst achievable – might well be weaker or more limited. We therefore propose to give schemes in the £1bn to £5bn range more time to prepare for high quality disclosures by the end of 2023. We would welcome respondent views on this.

47. Some trustees will already know when considering our consultation proposals whether their scheme would be in scope of the first wave because their scheme year will have ended between June and August 2020. Under our proposals all trustees would know for certain whether they are in scope of the first wave soon after the end of May 2021, by which time all possible scheme year cycles ending after the 1 June 2020 will have ended.

48. Our proposals also seek to strike a balance, by giving schemes which have less time to prepare for the climate governance requirements more time to prepare their TCFD report, and vice versa.

49. The proposed governance requirements would apply to authorised master trusts and any authorised schemes offering collective money purchase benefits from 1 October 2021. Trustees of such schemes would be required to publish their TCFD report within 7 months of the end of the scheme year which was underway 1 October 2021, or by 31 December 2022 if earlier, irrespective of their assets under management,

50. We propose that trustees of master trusts and schemes offering collective money purchase benefits that become authorised later than 1 October 2021 would be required to comply with the climate governance requirements from the date they become authorised, and produce a TCFD report annually thereafter. Trustees of schemes which have not yet been granted authorisation or which have not yet been established would have forewarning of the need to comply with the climate governance and disclosure requirements from the date of authorisation, and time to prepare whilst TPR is considering their application.

51. These proposals are summarised below.

Table 1: Timing of requirements during introduction

<table>
<tr><th>The condition</th><th>Governance requirement</th><th colspan="2">Disclosure Requirements</th></tr>
<tr><td>If</td><td>Trustees must meet the climate governance requirements for</td><td>Trustees must publish a TCFD report</td><td>Trustees must include a link to the TCFD report from</td></tr>
<tr><td>On 1st scheme year to end on or after 1 June 2020, the scheme has assets ≥ £5bn
Or
On 1 October 2021, the scheme is an authorised master trust
Or
On 1 October 2021, the scheme is an authorised scheme providing collective money purchase benefits</td><td>Current scheme year from 1 October 2021 to end of that scheme year.
And
[unless scheme is no longer authorised, and assets are <£500m] Next full scheme year to begin after 1 October 2021 to end of that scheme year.</td><td>Within 7 months of the end of the scheme year which is underway on 1 October 2021, or by 31 December 2022 if earlier.
And
Within 7 months of the end of the next scheme year to begin after 1 October 2021, or by 31 December 2023 if earlier.</td><td rowspan="2">The annual report and accounts produced for that scheme year</td></tr>
<tr><td>On 1st scheme year to end on or after 1 June 2021,
The scheme has assets ≥ £1bn</td><td>Current scheme year from 1 October 2022 to end of that scheme year</td><td>Within 7 months of end of that scheme year, or by 31 December 2023 if earlier.</td></tr>
</table>

Example 1

The Maed-Upp DC pension scheme has a scheme year running from 1 January to 31 December. On 31 December 2020 [the first scheme year end date on or after 1 June 2020] the value of the net assets of the scheme was £500m. As this is below £5bn, the scheme is not caught in the first wave of schemes to be subject to the governance and disclosure requirements.

The sponsoring employer of Maed-Upp is considering a merger with U N Reel, which has its own DC scheme with £600m in net assets. If the merger goes ahead and the members of the U N Reel scheme are transferred into Maed-Upp scheme, before 31 December 2021, the £1bn threshold is met, and the climate governance requirements would apply from 1 October 2022, with the trustees of Maed-Upp being required to produce a TCFD report by 31 July 2023, 7 months after the scheme year end date.

If, however, the transfer takes place after 31 December 2021, the Maed-Upp trustees would not be subject to the climate governance requirements or required to produce a TCFD report in 2023. The requirements would start to apply only from 1 year after the scheme year end date at which their net assets equal or exceed £1bn. This is covered in the next section.

In the unlikely event that the schemes consolidate without the company merger going ahead, Maed-Upp would become a master trust and its trustees would need to seek authorisation. The governance requirements would apply from the date of authorisation and the trustees would be required to produce and publish a TCFD report for the scheme year which was underway at that point, within 7 months of the scheme year end date.

The ongoing scope of the requirements

Schemes exceeding the asset threshold over the time

52. Clearly over time many schemes will grow in assets under management, whilst others will shrink, and new master trusts may become authorised in 2022 and beyond. We propose that from 1 June 2022 onwards, trustees of schemes whose net assets equal or exceed £1bn on the next scheme year end date should be required to implement the governance requirements, starting from one year after that scheme year end date. We also propose that trustees would be required to publish their TCFD report within 7 months of the end of the scheme year to which the governance requirements apply. They would also be required to include a link to their TCFD report in their annual report and accounts produced for that scheme year, not the current scheme year.

53. This allows time for scheme trustees to prepare to set appropriate governance measures in place. We consider that the alternative, of applying the governance requirements from the scheme year beginning immediately after the end date at which the assets met the £1bn threshold, would cause the perverse consequence whereby the trustees find part way through the scheme year – once the scheme's assets have been valued for the previous scheme year – that their net assets unexpectedly exceeded £1bn, and that they should have already been complying with the climate governance requirements. Trustees of such schemes might be in immediate breach of the legislation, with no opportunity to make amends.

Schemes falling below the threshold

54. There likely will be some circumstances in which it will be disproportionate to expect trustees of a once-large scheme to continue to produce a TCFD report when its assets become very much reduced. For example, the trustees of a DC scheme may bulk transfer all members except those who, due to the nature of the underlying guarantees at fund level, are unable to find a destination scheme. Or the trustees of a DB scheme may carry out a series of bulk annuity transactions which result in their net assets for the purposes of the annual report and accounts being gradually reduced to a very small proportion of their original amount.

55. In relation to the circumstances in which schemes fall below the threshold, we have considered two broad options, covered in turn below.

56. We might prescribe that if a scheme dips below £1bn in net assets at the scheme year end date, then the requirements fall away, but only from one year after that scheme year end date.

57. This would be a symmetrical approach, as schemes would essentially come in and out of scope of the climate governance requirements and the TCFD recommendations based on net assets on a 1-year delay. Whilst this symmetry has its attractions, we foresee some difficulties.

58. First, a small number of mature schemes will likely hover around £1bn for significant periods and drift in and out of scope with underlying movements in asset prices. For example, TPR have identified 23 schemes with net assets of between £0.95bn and £1.05bn[55] who will be particularly subject to these effects. There might even be more perverse impacts, because of the proposed one-year delay between the net assets meeting the threshold and the climate governance requirements beginning to apply. Schemes might switch between mandatory climate governance and reporting requirements on years when they had less than £1bn in net assets, and no statutory requirements when they had more than £1bn.

59. Second, more significantly, this approach suggests that these requirements are ‘all stick’. We believe that application and disapplication of a duty as a scheme crosses and re-crosses a notional threshold would distract from the benefits to the beneficiaries, relative to the costs, of reporting in line with the TCFD recommendations. Once scheme trustees have applied measures to ensure governance, strategy, risk management and the setting and reporting of metrics and targets it would be good practice to continue to apply them.

60. It may also create the perverse outcome that where a scheme’s net assets have dropped very significantly, say from £1bn to £50m, as a result of one of the events outlined in paragraph 54, the duties would not fall away with immediate effect. The trustees would be required to continue with the climate governance requirements in the subsequent year and be reporting on how they have acted on these requirements within 7 months of the start of the following scheme year, a whole 19 months on from the point when the scheme’s net assets dropped to one-twentieth of the threshold.

61. An alternative, which seeks to take account of the issues above, is for schemes which come into scope to remain in scope unless their net assets drop below £500m at any subsequent scheme year end. This reflects the fact that once the climate governance duties are in place it should become less difficult for trustees to continue to follow them and report on them. It allows engaged members to follow scheme reporting, including the results of scenario analysis, metrics and targets, over time, and avoids the perverse outcome of out of sync reporting described above.

62. Government’s proposal to review these measures in 2024 would provide an opportunity to examine the emerging effects of this proposal and any unintended consequences.

63. We therefore propose that where a scheme’s net assets do drop below the £500m threshold at any particular scheme year end, the ongoing climate governance requirements fall away with immediate effect, but scheme trustees would still be required to produce a final TCFD report within 7 months of the

[55] TPR estimates based on annual scheme returns.

scheme year which had just ended and in respect of which the underlying governance requirements will have applied.

64. The scheme would not come back into scope again unless its net assets met or exceeded £1bn on a scheme year end date.

65. The proposed policy is summarised below.

Table 2: Ongoing timing of requirements for schemes coming into scope

The condition	Governance requirement	Disclosure Requirements	
If	*Trustees must meet the climate governance requirements for*	*Trustees must publish a TCFD report*	*Trustees must include a link to the TCFD report from*
On 1st scheme year to end on or after 1 June 2021 + n (where n is any whole number ≥ 1) the scheme has assets ≥ £1bn	Next full scheme year to begin on or after 1 October 2022 + n	Within 7 months of the end of that scheme year.	The annual report and accounts produced for that scheme year

Table 3: Ongoing timing of requirements for schemes falling out of scope

The condition	Governance requirement	Disclosure Requirements	
If	*Trustees' climate governance requirements*	*Trustees publish a TCFD report*	*Trustees must include a link to the TCFD report from*
On 1st scheme year to end on or after 1 June 2021 + n (where n is any whole number ≥ 1) the scheme has assets <£500m	End with immediate effect [unless scheme is an authorised scheme].	Within 7 months of the end of the scheme year.	The annual report and accounts produced for that scheme year

Where n is a whole number of 1 or more.

Example 2

N Vented Partnership has a scheme year of 1 July-30 June. Its net assets are below £1bn on 30 June 2020 – the first scheme year end date to fall after 1 June 2020. This means it is not in the first wave, and the trustees are not required to comply with the climate governance requirements or to publish a TCFD report by the end of 2022.

Similarly, the net value of the scheme's assets on 30 June 2021 remains below £1bn, and it is therefore excluded from the second wave– trustees are not required to comply with the climate governance requirements or to publish a TCFD report by the end of 2023

However, by 30 June 2022, N Vented has £1.01bn in net assets. The climate governance requirements do not apply with immediate effect, but from the beginning of the next scheme year – 1 July 2023 to 30 June 2024. Trustees must also publish a TCFD report for that scheme year by the annual report and accounts deadline of 30 January 2025.

By 30 June 2023, N Vented Partnership's assets have dipped to £0.99bn. But this does not remove the requirement for trustees to publish the January 2025 TCFD report and the governance requirements would remain in place for N Vented unless net assets dropped below £500m at a future scheme year end.

Master trusts and CDC schemes

66. As highlighted above in paragraph 50, in relation to authorised master trusts and authorised schemes offering collective money purchase benefits, we propose a different approach to ongoing governance and disclosure requirements.

67. For these schemes we propose that the climate governance requirements should apply to trustees immediately upon authorisation and they should be required to produce a TCFD report within 7 months of the end of the scheme year in which their authorisation is granted. Again, we believe that this is a proportionate approach because of the governance expectations on authorised schemes and because trustees will have forewarning of the need to authorise and time to prepare whilst TPR is considering their application.

68. We propose that where schemes experience a triggering event[56], the duties should continue to apply. Where a scheme no longer needs to be authorised, for example, because it reverts to being a single employer scheme or ceases to offer collective money purchase benefits and had less than £500m in net assets at the previous scheme year end date, we propose that the climate governance duties and the duty to produce and publish a TCFD report fall away with immediate effect.

69. Because we do not propose a phased approach to the introduction of requirements on authorised schemes, the ongoing requirements would apply

[56] See section 21 of the Pension Schemes Act 2017 in relation to master trusts, and clause 31 of the current Pension Schemes Bill in relation to schemes offering collective money purchase benefits.

from 1 October 2021.

Table 4: Ongoing timing of requirements for authorised schemes coming into scope

The condition	Governance requirement	Disclosure Requirements	
If	*Trustees must meet the climate governance requirements*	*Trustees must publish a TCFD report*	*Trustees must include a link to the TCFD report from*
After 1st October 2021 the scheme Is an authorised master trust *Or* Is an authorised scheme providing collective money purchase benefits	With immediate effect	Within 7 months of the end of the scheme year in which they become authorised.	The annual report and accounts produced for that scheme year

Table 5: Ongoing timing of requirements for authorised schemes falling out of scope

The condition	Governance requirement	Disclosure Requirements
If	*Trustees' climate governance requirements*	*Trustees' TCFD report publishing and other disclosure duties*
After 1st October 2021 the scheme Ceases to be required to be an authorised master trust *Or* Ceases to be required to be an authorised collective DC scheme	End with immediate effect unless scheme meets the asset threshold [has ≥ £500m at end of previous scheme year].	Fall away with immediate effect unless scheme meets the asset threshold of ≥ £500m at end of previous scheme year].

Consultation Question

Q2: We propose that

(a) trustees of schemes with £5bn or more in net assets on their first scheme year end date to fall on or after 1 June 2020 are subject to the climate governance requirements from 1 October 2021 and the trustees must publish a TCFD report within 7 months of the current scheme year end date or by 31 December 2022 if earlier.

(b) trustees of schemes with £1bn or more in net assets on the first scheme year end date to fall on or after 1 June 2021 are subject to the climate governance requirements from 1 October 2022, and the trustees must publish a TCFD report within 7 months of the current scheme year end date, or by 31 December 2023 if earlier.

(c) trustees of master trust or collective money purchase schemes which are authorised on 1 October 2021 are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report in line within 7 months of the current scheme year end date, or by 31 December 2022 if earlier.

After 1 October 2021

(d) trustees of master trust or collective money purchase schemes which become authorised are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report within 7 months of the current scheme year end date.

(e) where schemes cease to require authorisation, the climate governance and TCFD-aligned reporting requirements fall away with immediate effect, unless they remain in scope via the asset threshold on the previous scheme year end date.

From 1 June 2022 onward

(f) trustees of schemes not already in scope of the requirements and with £1bn or more in net assets on any subsequent scheme year end date:

- **are subject to the climate governance requirements starting from one year after the scheme year end date on which the £1bn asset threshold was met; and**
- **must publish a TCFD report within 7 months of the end of the scheme year from which the climate governance requirements apply.**

(g) trustees of schemes in scope of the requirements whose net assets fall below £500m on any subsequent scheme year end date cease to be subject to the climate governance requirements with immediate effect (unless they are an

authorised scheme) but must still publish their TCFD report for the scheme year which has just ended within 7 months of the scheme year end date.

Do you agree with these policy proposals?

Review of measures and extension to smaller schemes

70. We recognise that, as part of their fiduciary duties, trustees should already be considering the impact of climate change risk to their beneficiaries, irrespective of scheme size and resources. In addition, active savers will typically find that employer pension contributions are conditional on using the employer's chosen scheme. Deferred members of defined benefit schemes will typically be unable to move pension rights without sacrificing valuable guarantees, whilst defined contribution savers may end up with a number of pension pots in schemes, some of which will be covered by our proposals here, and others which are not.

71. This suggests that ultimately there is a strong policy case, based on fairness to pension savers, for extending adoption of the TCFD framework and reporting requirements to trustees of smaller pension schemes.

72. However, the desirability of reaching full coverage must be weighed against other complicating factors. These include:

    - The relative cost of implementing the TCFD recommendations for smaller schemes is significantly higher, as set out in paragraphs 6-8 above.
    - There is a risk that the lack of significant in-house governance resources for smaller schemes, making them largely or wholly dependent on external advice and analysis, means that the governance activities underpinning the TCFD recommendations are less securely embedded in scheme practices.
    - The lack of exit strategies for less well-funded defined benefit schemes.
    - Whilst defined contribution schemes are consolidating, with numbers falling by approximately 9% a year[57], there remains a long tail of small schemes. DWP consulted on proposals to encourage or nudge smaller occupational DC schemes to consolidate in 2019 and intends to bring forward a consultation on policy and regulations shortly, which will help to address this. However, we acknowledge the continuing challenges with finding destinations and the treatment of guarantees.

73. We also anticipate that moves by up to 400 pension schemes to adopt and develop reporting in line with the TCFD recommendations will drive down costs. Product elements can be repurposed by advisers and service providers to

[57] The Pensions Regulator. DC trust: scheme return data 2019–2020 – table 1.2. https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2019-2020

develop offerings which are commoditised to serve all parts of the market, at a proportionate cost.

74. With these considerations in mind, and subject to the outcome of this consultation we propose that Government carries out a review in 2024 of the effectiveness of TCFD aligned reporting and governance measures implemented to date.

75. We propose that the review covers:

- The quality of disclosures to date, and the impact of the requirements on trustee decision-making;
- Whether the expectations in relation to scenario analysis, metrics and targets should be made mandatory in relation to some or all scheme assets – for example where disclosure for issuers is becoming mandatory, rather than 'as far as they are able'. And if so, on what timescale;
- How statutory guidance should be updated;
- The availability and quality of both free and paid-for tools and services, and the cost of paid-for services;
- Which requirements and on what timescale should be extended to smaller schemes.

76. The timing of this proposed review would ensure that these measures, which relate to occupational pension schemes, are responsive to development of wider UK Government policy, agreed and set by the UK joint TCFD taskforce and its co-ordination of a fit-for-purpose climate change disclosure regime.

77. We believe a holistic discussion on both the effectiveness of the legislation to date, and the marketplace for tools and services will be the best way to inform a decision on how and when to extend the requirements to schemes with less than £1bn in net assets.

Consultation question

Q3. Subject to Government deciding to adopt any of the governance or reporting requirements proposed in this consultation, we propose to conduct a review in 2024 on whether to extend the measures to schemes with below £1bn in net assets which are not authorised master trusts or an authorised scheme offering collective money purchase benefits, and if so how and on what timescale.

This review would be informed by consideration of TCFD disclosures by occupational pension schemes to-date, their impact, and the availability and quality of both free and paid-for tools and services.

We would propose also to review any regulations and statutory guidance which had been put in place to identify whether any of this needs to be strengthened or updated.

Do you agree with these proposals?

Chapter 3: Climate governance and TCFD

1. This chapter makes proposals relating to the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), focussing on what they mean for trustees of occupational pension schemes and how they should be implemented.
2. The chapter is split out into sections reflecting the areas of the TCFD recommendations – Governance, Strategy (including Scenario Analysis), Risk Management and Metrics & Targets. For each area, we make proposals about our policy, what will feature in regulations and what will feature in statutory guidance.

Our regulatory approach

3. The TCFD recommendations and its framework are now ubiquitous across the financial sector as the method for embedding climate change into the governance, strategy and risk management of the organisation.
4. This chapter outlines how we propose to make governance and disclosure in line with the recommendations mandatory for those occupational pension schemes in scope. We consider the adoption of effective climate risk management, comprehensive governance processes and techniques such as scenario analysis and calculation of metrics to be as integral to the implementation of the TCFD recommendations as the disclosures themselves.
5. Our approach, and subsequent regulations, would reflect this, requiring, where appropriate, adoption of a process for management of climate-related risks and opportunities as well as requirements to publish evidence of this. Trustees would not be able to meet the overall requirements simply by disclosing that they have no policies or processes in place.
6. The final TCFD report included 11 recommendations. These are split into four sections: Governance, Strategy, Risk Management and Metrics & Targets.

Figure 8: Core elements of recommended climate-related financial disclosures

Governance
The organisation's governance around climate-related risks and opportunities

Strategy
The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning

Risk Management
The processes used by the organisation to identify, assess and manage climate-related risks

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities

7. Whilst we propose to maintain the substance of the recommendations in final regulations, we would adapt the language of the recommendations themselves to fit with pensions terminology and legislative drafting conventions, where appropriate. The TCFD recommendations are the international industry standard and were designed to be adoptable by different sectors – we aim to maintain that consistency and comparability with other sectors in any requirements imposed for pension schemes.

8. However, in order that the regulations that will ultimately write the TCFD recommendations into pensions law are not unduly lengthy and prescriptive, we propose putting into statutory guidance a great deal of the guidance which underpins the TCFD recommendations.

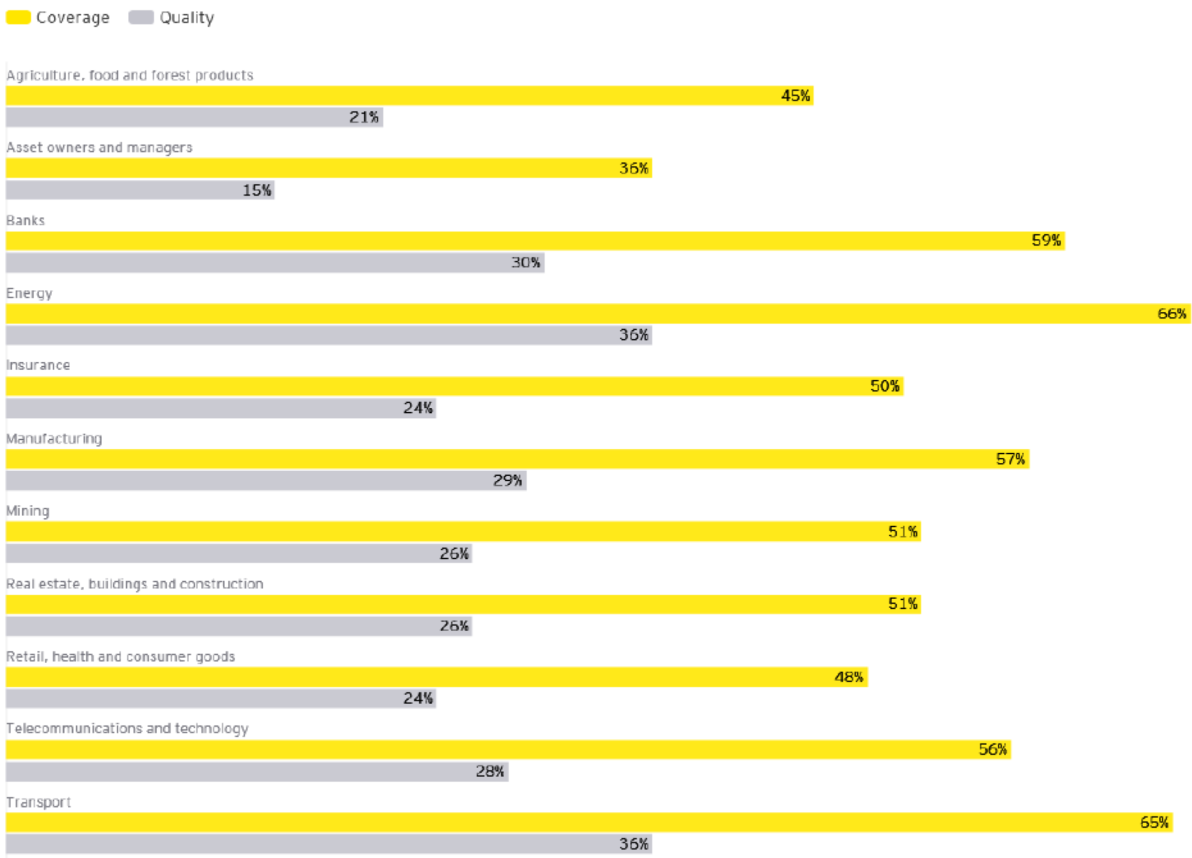
9. Our proposal is that the 11 recommendations of the TCFD, highlighted in bold in Boxes 1, 3, 5, 7, 9 and 11 below, are implemented in regulations with some adjustments to the wording as necessary to translate the recommendations into clear legislative requirements. The TCFD's supporting guidance to the recommendations – for example how schemes might set out their description of the role of the trustee board – would be included in new statutory guidance, to which the trustees must have regard[58]. This guidance would set out a number of options or examples for trustees on how to meet the requirements of the regulations, including allowing them to take their own approach. This will avoid constraining innovation and the development of future industry standards. However, as the guidance would be statutory, trustees would be expected to explain briefly, in their reporting, their reasons for any material deviations from it. This expectation would be made clear in the guidance itself.

[58] See the Pension Schemes Bill, Part 5, Clause 124, sections 41A(7) and 41B(3) (p.119). https://publications.parliament.uk/pa/bills/cbill/58-01/0165/200165.pdf

Data availability

10. Some aspects of TCFD recommendations require an evaluation of assets which is reliant on data quality and flow, from investee companies through aggregation and analysis by asset managers, investment consultants or other specialist service providers, to institutional investors. Data quality is improving, and the FCA consultation on disclosure by UK listed issuers will help to kick-start disclosures at their source[59]. Action by other regulators in other jurisdictions would have a similar effect given the international investment portfolios of UK pension schemes.

Figure 9: Coverage and quality scores for disclosures by sector[60]



11. Research by EY from 2019, shown in Figure 9, shows that progress has been made in the coverage of asset manager and asset owner climate disclosures globally and indeed, many asset managers and owners are in the process of building capability. However, the quality of current disclosures by asset managers and owners is the lowest of any sector, lower even than many carbon-intensive sectors. This may reflect underlying data flow issues. We believe our proposals

[59] https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing

[60] How can climate change disclosures protect reputation and value? Extract from the 2019 EY Global Climate Risk Disclosure Barometer - https://www.ey.com/en_gl/assurance/how-can-climate-change-disclosures-protect-reputation-and-value. Reproduced with permission.

will go some way to developing coverage and quality of such disclosures in the UK pensions market.

12. By focusing our proposed requirements on the largest schemes in the first instance, we anticipate that trustees will have the market power to require that disclosures continue to improve. Where pension schemes invest via private markets, we anticipate that the ability to carry out TCFD reporting will become a condition of contract and a point of competition for fund managers and general partners.

13. Models for estimating liabilities and implications for sponsor covenant are also evolving and improving[61]. However, we recognise that the aspects of TCFD recommendations which are typically quantitative will be subject to disclosures from a range of jurisdictions, and there will be limitations to the comparability and consistency of data which pension scheme trustees receive.

14. We therefore propose that the scenario analysis recommendation, and the requirement to obtain data for the purpose of calculating metrics and setting targets, should be complied with 'as far as trustees are able'. This is further explained below. Where there are assessments that trustees can make now, they should make them on the basis of the best data available. The financial risks of dangerous climate change to beneficiaries' pension savings, and the opportunity to limit the damage, are too great to postpone.

15. By 'as far as they are able' we mean that trustees should request data from their asset managers and make reasonable efforts to obtain the data. We do not propose that trustees should be expected to pay excessive sums for access to the data. Engagement with stakeholders has told us that trustees are sometimes able to obtain the data for free. Where necessary, some small payment may be reasonable.

16. We recognise that few, if any, scheme trustees will be able to obtain full underlying data to inform the calculation of metrics or scenario analysis across their entire portfolio in the first instance. Pension schemes are internationally diversified, and some jurisdictions will have fewer disclosure requirements for the foreseeable future. However, the number of firms voluntarily committing to TCFD reporting is increasing[62] and more and better data is becoming available.

17. A requirement for trustees to comply 'as far as they are able' will allow trustees to produce outputs from scenario analysis and calculations of metrics and targets for only part of the portfolio or using estimation or incomplete data sets. We believe that this will still be decision-useful information for trustees. The urgency of climate change means that the financial sector cannot wait until it has 'perfect' data before it starts putting it to use.

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[61] See, for instance, Institute and Faculty of Actuaries. Resource and Environment Issues: A Practical Guide for Defined Benefit Pensions Actuaries and Resource and Environment Issues for Pensions Actuaries: Supplementary Information on Resource and Environment Issues and their Implications for Sponsor Covenant Assessments.

[62] The TCFD Status Report in 2019 reviewed reports for over 1,100 reporting companies - https://www.fsb-tcfd.org/publications/tcfd-2019-status-report/

Overlap with existing requirements

18. We have considered the potential for overlap between these proposed new requirements in relation to the TCFD recommendations and those that trustees must already comply with in relation to climate change.

19. If the proposals in this consultation are adopted, TPR will give close consideration as to whether the forthcoming Governance Code it will issue under the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018[63] should provide for schemes meeting the TCFD requirements in line with our regulations to be deemed to have also met the standards in the Code, insofar as they relate to climate change. These will be standards relating to:

    - the consideration of environmental, social and governance factors as part of an effective system of governance, and
    - how trustees assess new or emerging risks, including risks relating to climate change and risks relating to the depreciation of assets as a result of regulatory change, as part of the carrying out and documentation of an own-risk assessment of the system of governance[64].

20. We have also considered whether complying with any new climate governance requirements and required publication of information would also constitute compliance with corresponding parts of the Statement of Investment Principles (SIP) or implementation statement requirements. These requirements, which were introduced by regulations made in 2018 and 2019[65] require trustees to state, among other things, their policy in relation to financially material considerations including environmental, social, governance (ESG) factors, including climate change, and to report on how and the extent to which they have followed them.

21. Ultimately, we have concluded that the information included in a SIP and implementation statement is much broader than that which would be included in a TCFD report. The requirements are also not a close fit with any individual TCFD disclosure or proposed underlying governance requirement. Disapplying the SIP and implementation statement requirements in relation to climate change on the grounds that the matter was satisfactorily covered in a TCFD report does not appear to be in members' interests – it would mean the removal of a small proportion of text from the SIP and its replacement via a link to the entirety of a potentially much longer TCFD report.

22. We have therefore concluded that any duplication which does occur is limited enough that disapplication of some requirements would be disproportionate and unhelpful to the users of the documents.

Ongoing and discrete duties

23. The TCFD reporting recommendations themselves are uniformly annual. However, there is a distinction in the underlying governance activities between those which are ongoing and might be reasonably expected to be carried out

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[63] SI 2018/1103 – see Regulation 3 'Code of Practice'
[64] See regulation 3(2)(f) and 3(8)(h).
[65] SI 2018/988 and SI 2019/982 – see regulations 4, 5 and 2, 3 respectively

continuously throughout the scheme year and those which can only feasibly be managed at discrete intervals.

24. For example, trustees should not be expected to only have oversight of climate-related risks and opportunities or ensure that the people managing the scheme assess and manage climate-related risks and opportunities a few times a year, whilst the duty falls away at other times. But it would appear disproportionate to require trustees to carry out scenario analysis on an ongoing basis throughout the year, or to calculate a greenhouse gas emission-related metric each day to reflect latest changes in the portfolio and the valuations and reported emissions of the holdings which make it up.

25. We propose that the split is as follows:

- Ongoing activities – governance, strategy, risk management
- Discrete activities – scenario analysis, metrics and targets.

26. In relation to the discrete activities, we propose that the scenario analysis is carried out at least annually. Similarly, we propose that metrics and targets are chosen at least annually.

27. We propose however that emissions and non-emissions based data are obtained and calculated, and performance against targets is measured, at least quarterly. The goal here is that monitoring and tracking metrics, and performance of key metrics against targets, should happen more regularly than in the preparation of the annual report alone. A quarterly schedule aligns with the minimum frequency of trustee board meetings and the cycle of investment performance reviews for pension schemes.

28. In the proposed requirements below, duties which we propose are ongoing or discrete are distinguished, and the proposed minimum frequencies of discrete duties are given.

Governance Proposals

29. We propose that regulations should require trustees to undertake the following activities:

Box 1a: 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.**

30. We propose that regulations should require trustees to make the following disclosures:

Box 1b: Annual Governance disclosures

G1.1	**Describe the (board of) trustees' oversight of climate-related risks and opportunities.**
G2.2	**Describe the role of those persons managing the scheme in assessing and managing climate-related risks and opportunities, only insofar as they relate to the scheme itself, and the process by which trustees satisfy themselves that this is being done.**

31. The TCFD recommendations are focussed on placing development of a robust, embedded climate governance framework at the centre of an organisation's operations. The framework itself is designed to be adoptable by all organisations and easily translatable into sector-specific arrangements.

32. For pension schemes, however, we believe that the Governance requirements in particular may require some adjustment in order to capture the varied nature of the management of an occupational pension scheme.

33. The role of the board, as described in the original TCFD recommendations[66], is easy to translate into the pensions landscape with the board representing the trustees. Ultimately, trustees are accountable for all strategic investment decisions and risk management approaches. It follows that the assessment of climate change risk and opportunities and the actions taken in relation to that assessment are the responsibility of the trustees.

34. In practice, many decisions are either informed by advice to the trustees from external advisers[67] or from employees, whether directly of the scheme or the sponsoring employer, or are delegated to them altogether. The role of such persons in assessing and managing climate change risk and opportunities is central to the trustee's attempts to fully embed climate change into their governance processes.

35. This delineation between the role of the trustees and those who manage the scheme is important; trustees might have appointed very well engaged external advisers who spend a great deal of time explaining to the scheme and its employees how they can properly manage climate change risk, but if the trustees do not take action or discuss the issue, then they are failing to address these risks and that disconnect should be highlighted. The reverse might also be true in circumstances where trustees' advisers do not adequately address climate risk despite trustees' instructions.

36. However, it is not proposed that the regulations will place any legal duties on the employees of the sponsoring employers or external advisers. Instead, the duty to put in place processes by which trustees can satisfy themselves that the persons

[66] TCFD Recommendations (June 2017). https://www.fsb-tcfd.org/publications/final-recommendations-report/

[67] Advisers include investment consultants, scheme actuaries, scheme lawyers and covenant advisers.

managing the scheme assess and manage climate-related risks and opportunities, and the duty to report on their roles in line with G2, would be placed on trustees, as well as their own role in line with G1.

37. Our proposals for the statutory guidance which trustees must have regard to when meeting this requirement are outlined in the box below:

Box 2: Statutory Guidance on Governance

In meeting the requirement for trustees to maintain oversight of climate-relate risks and opportunities, we propose that statutory guidance would outline the following matters to which trustees must have regard:

- The role of trustees as ultimately accountable for the scheme's handling of climate change-related risks and opportunities;
- Sufficient allocation of trustees' time and resources for assessing climate-related risks
- Integration of climate change into the scheme's existing governance processes, including the processes and frequency by which the trustees meet to discuss, and are informed about, climate-related issues;
- In meeting the requirements to establish and maintain processes by which trustees satisfy themselves that the persons managing the scheme assess and manage climate-related risks, statutory guidance would set an expectation that this includes:
  - employees of the scheme;
  - employees of the principal or controlling employer[68];
  - external advisers who provide services to the trustees; and
  - scheme funder or strategist (in the case of a master trust)[69];

Statutory guidance would outline the following matters to which trustees must have regard, in relation to the role of such persons and describing those roles in their TCFD report:

- Whether it is appropriate to assign climate-related responsibilities to external advisers, employees or committees within the management structure, and if so, what those responsibilities involve;
- How and when such positions or committees should report to the trustees;
- How trustees should describe/illustrate the structure of the scheme and the roles that such persons play in ensuring climate-related risks are managed; and
- The types of processes that trustees should put in place to ensure external advisers or employees of the principal or controlling employer to which

[68] As defined in regulation 12 of The Occupational Pension Schemes (Preservation of Benefit) Regulations 1991.
[69] As defined in section 39 of the Pension Schemes Act 2017

management has been delegated, are informed about and monitor climate-related issues effectively.

Statutory guidance would also set out that trustees should describe, in their TCFD Report, how they have approached each of the matters above

Where they choose to deviate from the approach set out in the guidance, trustees would be expected to describe their reasons for doing so in the relevant section of their TCFD Report.

Consultation Question

Q4. We propose that regulations require trustees to:

a) establish and maintain oversight of climate risks and opportunities, and

b) 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.

We also propose that regulations require trustees to describe:

c) the role of trustees in ensuring oversight of climate-related risks and opportunities; and

d) the role of those managing the scheme in assessing and managing climate-related risks and opportunities, only insofar as this relates to the scheme itself and the process by which trustees satisfy themselves that this is being done.

We propose that statutory guidance will cover the matters in the box above.

Do you agree with these proposals?

Strategy Proposals

38. We propose that regulations should require trustees to undertake the following activities:

Box 3a: Strategy 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.**

39. We propose that regulations should require trustees to make the following disclosures.

Box 3b: Annual Strategy Disclosures

S1.1	**Describe the climate-related risks and opportunities those persons described in G1 and G2 have identified over the short, medium, and long term.**
S2.2	**Describe the impact of climate-related risks and opportunities on the scheme's investment and, in the case of DB, funding strategy.**

40. The Strategy section of the TCFD recommendations is most focussed on the long-term. The principles of the TCFD's strategy disclosures promote continuous assessment of the ramifications of climate change for the trustees' investment strategy.

41. Following on from the governance requirements, we propose that the regulations include a requirement that trustees identify climate-related risks and opportunities over the short, medium and long-term and report those risks and opportunities and their potential impacts in the scheme's disclosures contained in their TCFD Report.

42. The time horizons used may vary by type of scheme and may be impacted by the time horizons of their liabilities. For example, closed defined benefit schemes, informed by when their members benefits will be paid, may tend to set shorter time horizons for investment purposes. Open schemes which are not proposing to wind up or consolidate, are likely to have a longer investment time horizon informed by the duration for which members' savings are most likely to be invested, up to and through retirement.

43. It is proposed that regulations will require that across all three time horizons (short, medium and long-term), trustees identify and publish the climate related risks which might impact the investment return expected, and in the case of a DB scheme, which impact the funding strategy and therefore the level of members' benefits that can be delivered over those timescales.

44. It is proposed that across the same time horizons, trustees will also be required to identify and publish the climate-related opportunities that have been identified and which they intend to take advantage of in providing a return for their members or in mitigating the climate-related risks identified.

45. It is proposed that statutory guidance will support trustees to identify such risks and opportunities by providing examples that trustees should consider and report on if material, such as:

- increased pricing of greenhouse gas emissions/carbon;
- substitution of existing products and services with lower emission alternatives;
- successful investments in new technology;
- increase in the energy/heat efficiency of buildings and infrastructure;
- litigation risk;
- extreme weather exposure; and
- others that feature in the final report published by the TCFD[70].

46. Ultimately, the materiality of these risks is for each individual board of trustees to determine but it is proposed that the guidance will include, for example, the suggestion that schemes consider and report on the likely risks split by transition and physical risks.

47. Once risks and opportunities are identified, we propose that trustees would be required to assess their impact on the scheme's investment strategy and, where relevant, their funding strategy. Trustees would then be required to disclose this assessment. It is proposed that this assessment should be carried out at a portfolio level, but also, for dual section hybrid schemes, for individual sections. For schemes with multiple DC defaults, it is proposed that scenario analysis should be carried out for each popular default. This expectation would be set out in statutory guidance.

48. The focus here should be how, for example, the potential emergence of low carbon opportunities and the decline of some traditional industrial sectors is factored into the scheme's investment decision-making. This should also include the changes that have been made because of the identification and assessment of the given risk or opportunity.

49. Our proposals for the statutory guidance to which trustees must have regard when meeting this requirement are outlined in the box below:

Box 4: Statutory Guidance on Strategy

In identifying and assessing the impact of climate-related risks and opportunities on the investment and, in the case of DB, funding strategy of the scheme over the short, medium and long-term, we propose statutory guidance would set out the following matters to which trustees must have regard:

[70] Section B, Recommendations of the Task Force for Climate-related Financial Disclosures, Final Report (June 2017). https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf

- The levels at which the identification and assessment of risks and opportunities should be carried out - for example, the individual sections of a scheme with DC and DB sections – as well as additional analysis that could be carried out, for example, in relation to different asset classes;
- How to understand and assess the scheme's climate risks and opportunities across short, medium, and long-term time horizons;
- Examples of climate-related risks and opportunities that could have a material financial impact on scheme assets;
- Definitions to help trustees understand whether the climate-related risks are transition or physical risks;
- Examples of the factors trustees might consider to determine which risks and opportunities could have a material financial impact on their investment strategy and funding strategy; and
- Guidance on how climate-related risks and opportunities could be factored into their investment strategy and funding strategy and the implementation of those strategies.

Statutory guidance would also set out that trustees should describe in their TCFD Report how they have approached each of the matters above.

Where they choose to deviate from the approach set out in the guidance, trustees would be expected to describe the reasons for doing so in the relevant section of their TCFD Report.

Consultation Question

Q5. We propose that regulations require trustees to identify and disclose the climate change risks and opportunities relevant to their scheme over the short, medium and long term, and to assess and describe their impact on their investment and funding strategy.

We propose statutory guidance will cover the matters outlined in the box above. Do you agree with these proposals?

Scenario Analysis

50. We propose that regulations require trustees to undertake the following activities:

Box 5a: Scenario analysis activities

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.

51. We propose that regulations require trustees to make the following disclosures:

Box 5b: Annual Scenario analysis disclosures

S3.1	**Describe the resilience of the scheme's investment and, in the case of DB, funding strategy, as far as trustees are able, in at least two climate-related scenarios, including at least one scenario of between 1.5 and 2°C.**

52. Scenario analysis is considered perhaps the most complex part of the TCFD recommendations for an organisation to undertake. In doing so, schemes will need to assess the resilience of their assets, liabilities and strategies to different climate-related scenarios. For DB schemes, this will also include consideration of their sponsor's covenant and how climate change may pose risks to this. We believe that, ultimately, scenario analysis is an important and useful tool for pension schemes to understand the strategic implications of climate-related risks and opportunities. Many of the medium and long-term impacts of climate change are not easily assessed with standard risk management processes and their limited time horizons. The results of scenario analysis, when plainly communicated, can help to build strategies that are more resilient to future climate-related risks and take advantage of opportunities.

53. We propose that regulations require trustees to conduct scenario analysis as far as they are able to do so and that they then publish the results. The Government is well aware that there may be some practical barriers for some schemes undertaking scenario analysis. For example, some investee firms do not yet carry out such analysis and if they do, the variety of assumptions, methodologies and scenarios used by firms may present hurdles to producing full analysis at the portfolio-level. We propose that statutory guidance will set out what trustees may be expected to do to conduct the analysis, including in circumstances where their efforts are hindered by an external factor such as a lack of available data. It is our expectation that trustees would endeavour to work around data gaps and external factors to do the best scenario analysis that they are able to, rather than deciding not to conduct any analysis at all.

54. It is notable that climate scenario analysis is being encouraged across the financial sector, even whilst acknowledging that the methodologies and data that are available are not perfect. For example, the Network for Greening the Financial System (a network of central banks and supervisors) published, in June 2020, technical guidance on scenario analysis that recommends and explains how to undertake scenario analysis whilst nevertheless recognising that "the use of climate-related scenario analysis is relatively new and methodologies are still

developing."[71] The Climate Financial Risk Forum (CFRF), co-chaired by the FCA and the PRA, has also published detailed and practical guidance for the financial industry on scenario analysis as part of its guidance on climate-related financial risk management.[72]

55. Although many large organisations are driving progress in this area, most pension scheme trustees are only beginning to explore its use. However, it is possible to assess the impact of various global warming scenarios on the strategy of an organisation without modelling and data – indeed the TCFD recommendations speak to the value of this qualitative type of analysis[73]. The Government does not propose to prescribe whether scenario analysis should be qualitative or quantitative; what matters is that trustees begin to give full consideration to the financial implications of climate change on their future strategy. This understanding will be valuable for pension scheme trustees in understanding the climate risks to which the scheme may be exposed, including in relation to their liabilities and funding strategies.

56. While we appreciate the current barriers to quantitative scenario analysis, it is our expectation that most benefit will be gained if quantitative scenario analysis is completed as soon as reasonably possible. We anticipate that, over time, many scheme trustees may decide to adopt the quantitative scenario analysis which is continuing to develop and improve. In this form, a model (or a combination of other analytical techniques) simulates the impact on the portfolio's projected performance into the short, medium and long-term of various scenarios of warming or climate transition.

57. Trustees may seek to use the services of an external provider to do this analysis. In recognition of the possible limitations, for example those caused by a lack of data or by cost, we anticipate that the proposed statutory guidance would help trustees understand the level of endeavour expected of them in seeking to carry out scenario analysis 'as far as they are able' to do so. We also propose that the guidance will set out what trustees are expected to disclose where they have faced significant barriers to conducting scenario analysis.

58. The TCFD recommends that organisations disclose how resilient their strategies are to a range of plausible climate-related scenarios. In particular, it recommends that they use a '2°C or lower scenario' in addition to others most relevant to their circumstances. In accordance with this recommendation, we propose that regulations require that two or more climate-related scenarios are considered by trustees, at least one of which must be a scenario of 2^{o}C or lower. Schemes will need to assess their assets/liabilities and investment/funding strategy against these scenarios.

59. A range of scenarios will allow trustees to capture both transition and physical risk. Transition risks occur through the shift to a lower carbon economy and arise

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[71] Guide to Climate Scenario Analysis for Central Banks and Supervisors, (p.7), https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_scenario_analysis_final.pdf

[72] https://www.fca.org.uk/transparency/climate-financial-risk-forum

[73] 'D. Recommended Approach to Scenario Analysis', Section 3 (p.27), Annex: Implementing the Recommendations of the TCFD (June 2017), https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf

from measures taken to drive change, such as policy interventions, technology changes and market shifts. Physical risks are those linked to changes in the environment as a result of climate change, such as increased flooding, droughts and other weather extremes. In a 4°C scenario, only a small amount of transition occurs in the short or medium-term so therefore the physical risks dominate. In contrast, a smooth transition to 2°C or lower still sees some significant physical risks, but the structure of the economy will change immensely and swiftly bringing very large transition risks and opportunities for pension schemes.

60. We propose that statutory guidance will help trustees understand how to select a range of possible scenarios, including by discussing the difference between 'orderly' and 'disorderly' transitions. For example, orderly transitions anticipate that global climate change goals are met in measured way, whilst a disorderly transition may meet that target only after sudden and unanticipated responses take effect. A disorderly transition may give rise to different types of risks even though it may achieve the same climate change goal as an orderly one.

61. The requirement that trustees conduct scenario analysis, as far as they are able, against a scenario that is 2°C or lower means that they must choose one scenario which represents an end warming result above pre-industrial temperatures of somewhere between 1.5°C and 2°C inclusive. The 2°C or lower target is a key consideration for schemes as it allows them to include, as a scenario, the transition to a low-carbon economy. It is also the scenario set out in the TCFD recommendations.

62. However, the ambitions of the Paris Agreement go further than this and trustees are free to select lower temperature goals for their scenarios.

63. It is proposed that the detail of the warming scenarios, such as the specific emissions trajectories or technological assumptions that schemes should use will not feature in regulations. Instead, we propose that the statutory guidance outlines examples of scenarios that are available as well as broader characteristics that schemes may use to bring out both the transition and physical risks and opportunities. This includes characteristics such as the emissions trajectory of the scenario (or, how abrupt or smooth / orderly or disorderly the transition is), as well as assumptions around the economy including the future of particular industries. We propose that statutory guidance will incorporate some of the material from the chapters on scenario analysis in the TCFD's technical supplement to the Final Report[74] and the PCRIG consultation, subject to the outcome of that consultation[75].

64. Our proposals for the statutory guidance to which trustees must have regard when meeting the proposed requirements on scenario analysis are outlined in the box below:

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[74] Technical Supplement to the Final Report on Scenario Analysis, 'The use of scenario analysis in disclosures of climate-related risks and opportunities, (June 2017), https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Technical-Supplement-062917.pdf

[75] Aligning your pension scheme with the TCFD recommendations https://www.gov.uk/government/consultations/aligning-your-pension-scheme-with-the-tcfd-recommendations

Box 6: Statutory Guidance on Scenario Analysis

In assessing, as far as they are able, the resilience of the scheme's assets, liabilities and investment/funding strategy to climate-related risks and opportunities in at least two climate-related scenarios, we propose statutory guidance would set out the following matters to which trustees must have regard:

- The levels at which scenario analysis should be carried out - for example, the individual sections of a scheme with DC and DB sections, or the individual fund-level;
- How the trustees may approach the use of scenario analysis, whether qualitative or quantitative, to understand the resilience of the investment strategy, and where relevant, funding strategy, to climate-related risks and opportunities;
- How trustees should go about selecting scenarios most appropriate to their scheme's investment horizons including references to examples of existing scenarios and scenario analysis tools which are available to schemes;
- How trustees should approach external factors which limit their ability to do scenario analysis, such as data gaps, and what is expected of trustees in terms of undertaking scenario analysis 'as far as they are able'; and
- How to use the process and outputs of scenario analysis to inform trustees' understanding of the impact of climate-related risks and opportunities on the investment/funding strategy and examples of possible steps they could take to ensure their strategy addresses risks and opportunities.

Statutory guidance would also set out that trustees should describe, in their TCFD Report, how they have approached each of the matters above.

Where they choose to deviate from the approach set out in guidance, trustees would be expected to describe the reasons for doing so in the relevant section of their TCFD Report.

Consultation Question

Q6. We propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of DB, funding strategy, as far as they are able, in at least two climate-related scenarios, one of which must be a 2°C or lower scenario and to disclose the results of this assessment

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Risk Management Proposals

65. We propose that regulations require trustees to undertake the following activities:

Box 7a: Risk Management activities

R1	**Trustees must adopt and maintain, on an ongoing basis, processes for identifying and assessing climate-related risks.**
R2	**Trustees must adopt and maintain, on an ongoing basis, processes for managing climate-related risks.**
R3	**Trustees must ensure, on an ongoing basis, integration of climate-related risks into their overall risk management.**

66. We propose that regulations require trustees to make the following disclosures:

Box 7b: Annual Risk Management disclosures

R1.1	**Describe the processes that the trustees have put in place for identifying and assessing climate-related risks.**
R2.2	**Describe the processes that the trustees have put in place for managing climate-related risks.**
R3.3	**Describe how these processes are integrated within their overall risk management.**

67. Similar to Strategy, embedding climate change risk management into the business-as-usual operations is a process of stages, and is covered by R1 through to R3 above. We propose that trustees should assess their scheme's exposure to climate-related risks and then manage the risks they identify. Disclosure should follow the same process, with reporting describing the process for identifying risks, the process for managing the risks identified and how this process is integrated or embedded within the scheme's overall risk management.

68. Risk management is ultimately about accounting for what climate change might mean for pension schemes. Scheme trustees should be asking themselves "Which climate change risks are most material to us?", "How do we take account of transition and physical risk in our wider risk management?" and "How does it affect our risk appetite?"

69. For R1, this means scheme trustees will be required to have an effective process for identifying climate-related risks and assessing their likely impact on their scheme's investment. Disclosure requirements would then mean scheme trustees have to report a description of this process. Statutory guidance will support trustees in not only ensuring they have the most appropriate processes in place but also suggesting the types of risks that trustees should be alive to.

70. Under R2, we propose regulations require trustees to put in place processes to manage the risks identified through the processes referred to in R1, if they don't already have such a process, and to disclose how this management take place.

71. Statutory guidance would then expand on this, setting out factors that trustees take into account when deciding how to prioritise the various risks that they identify based on materiality, including likelihood and financial impact. We also propose that statutory guidance should include the list of risks that the TCFD published alongside the Final Report as risks the trustees should consider[76].

72. This list includes policy risks such as limits on greenhouse gas (GHG) emissions and greater regulation of products and practices but also wider market shifts such as changing consumer preferences in favour of goods and services with a lower carbon footprint. The list also extends to opportunities that scheme trustees might want to consider and manage their exposure to. These include increasingly efficient buildings and government-sanctioned incentives for production or development of low emission goods and services.

73. The TCFD recommendations require trustees to both consider and then disclose how such processes interact with the scheme's overall risk management processes, as would our proposed regulations. This is to ensure that trustees consider mainstreaming climate risk management in the same way they do traditional, long-established forms of management of risks such as exchange rate or other investment risks. For many trustees, part of this risk management process will involve delegation to asset managers to manage the day-to-day risk. However, trustees must ensure that they understand the risks, monitor their managers and are ready to question and challenge their services.

74. Our proposals for the statutory guidance which trustees must have regard to when meeting this requirement are outlined in the box below.

Box 8: Statutory Guidance on Risk Management

With regard to processes for identifying and assessing climate-related risks, we propose that statutory guidance would set out the following matters to which trustees must have regard:

- The types of processes trustees should put in place in order to identify the climate-related risks that the scheme is exposed to, including emerging regulatory and supervisory requirements related to climate change (e.g. limits on emissions) as well as other relevant factors;
- The types of processes trustees should implement for assessing the potential size and scope of identified climate-related risks;
- How trustees should work with asset managers and others to ensure that identified risks are recognised and assessed by others in the investment chain.

[76] Section B, Recommendations of the Task Force for Climate-related Financial Disclosures, Final Report (June 2017). https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf

With regard to processes for managing climate-related risks, we propose that statutory guidance would set out the following matters to which trustees must have regard:

- Determining which climate-related risks are most material to them in terms of the financial impact they will have on their existing investment portfolio;
- The types of decision-making processes trustees should put in place to monitor, and to mitigate, transfer, accept, or control the risks identified;
- Working with asset managers and others to ensure that identified risks are managed and addressed in the investment chain; and
- Embedding climate-risk related considerations into the scheme's wider risk monitoring process.

Statutory guidance would also set out that trustees should describe, in their TCFD Report, how they have approached each of the matters above

Where they choose to deviate from the approach set out in the guidance, trustees would be expected to describe the reasons for divergence in the relevant section of their TCFD Report.

Consultation Question

Q7. We propose that regulations require trustees to:

a) adopt and maintain processes for identification, assessment and management of climate-related risks,

b) Integrate the processes described in a) within the scheme's overall risk management.

We also propose the regulations require trustees to disclose:

c) the processes outlined in part a) above.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Metrics and Targets Proposals

Metrics

75. We propose that regulations require trustees to undertake the following activities:

Box 9a: Metrics 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.**

76. We propose that regulations require that trustees to make the following disclosures:

Box 9b: Annual Metrics disclosures

M1.1	**Disclose the emissions-based metric(s) and non-emissions-based metric(s) that the scheme has calculated and that is used by trustees to assess the climate-related risks and opportunities relevant to the scheme.**
M2.2	**Describe why, if trustees have only been able to obtain partial or estimated data, their data does not cover the whole portfolio.**

77. Metrics are a crucial step towards embedding the TCFD framework. However, the Government acknowledges the difficulties involved for trustees. We propose to require that trustees produce metrics for their schemes in two areas: emissions-related (such as Weighted Average Carbon Intensity) and other characteristics, not specifically linked to emissions but related to governance, investment strategy or risk management, as described in paragraph 93 below.). This approach is reflected within M1 and M2 in the box above.

78. It is useful to consider this process as a chain. A trustee should:

- Select the characteristics that they want to quantify (for example, carbon intensity or the percentage of the portfolio in "green" investments).
- Obtain the data on those characteristics, as far as they are able (for example, scope 1, 2 and 3 emissions).
- Calculate a metric, of their choosing, to measure or communicate that characteristic using the data they were able to obtain (for example, weighted average carbon intensity or 'WACI').

And, as set out in the 'Targets' section to come:

- Consider setting a target for this metric (for example, a reduction of 25% by 2030).
- Publish the metric – and the target, if they have set one.

79. Along with scenario analysis, being able to accurately calculate emissions-related metrics for a portfolio is an aspect of the TCFD recommendations that is dependent on data flows. Similarly, non-emissions-related data, such as the level of investment in 'green sectors'[77], may need to be obtained from some asset managers.

80. Pension schemes, sitting at the top of the investment chain, require investee companies to calculate and disclose, for example, GHG emissions and for asset managers to be able to aggregate this information at the fund level in order for trustees to then aggregate emissions and other climate-related data across the portfolio. The part of the process over which trustees have control is therefore heavily dependent on others.

81. Government, along with regulators, continues to review the levers it holds to promote greater data disclosure and recognises that capabilities are developing quickly. Indeed, the FCA has signalled that it is considering how best to enhance climate-related disclosures by regulated firms, including asset managers. This work is being carried out in coordination with DWP and other regulators and Government departments. In determining its approach, the FCA will take into consideration data required by pension scheme trustees to meet obligations under the proposed statutory guidance. The FCA will clarify its position in due course. Clearly, however, this data flow remains incomplete in a significant number of cases currently.

82. To reflect this, we again propose an approach in regulation that trustees are required by regulations to obtain data on the emissions of their various investments, as well as any other data they need to calculate metrics, 'as far as they are able'.

[77] Note that any future regulation or statutory guidance is, intentionally, unlikely to clarify what is considered a 'green' sector or investment for these purposes. There is significant work underway on this internationally, including the EU taxonomy.

83. This is similar to our proposed approach to scenario analysis and is reflected in the wording in Box 9. We have considered a 'comply or explain' approach but, in the case of pension schemes, our conclusion is that this is more likely to result in some 'boiler-plate' explanations as to non-compliance by trustees that would prevent the reasoning behind partial or non-disclosure of metrics being shared. It may also discourage partial disclosures or estimates which are nevertheless decision-useful.

84. To support the effectiveness of the 'as far as trustees are able' approach, we propose that regulations will require trustees to explain in their TCFD Report why the data they have chosen to disclose does not fully cover the portfolio or extend to all scopes of emissions. We do not wish to make this an onerous or unnecessarily lengthy section of the Report but see this as key to helping readers understand the level of completeness any results represent, and any possible inaccuracies that occur as a result of estimates or modelling. Secondly, we see it as useful information for both Government and industry to gather, to understand the data issues that exist, empirically. Statutory guidance would set out the kinds of explanations it would be relevant for trustees to include, including how detailed those explanations are expected to be.

85. We do however acknowledge that some trustees will want to be ambitious and disclose emissions data or calculate metrics that do fully cover the portfolio, possibly relying on estimation where data gaps exist. This kind of innovation is something we wish to encourage and which is in keeping with the principles behind the TCFD recommendations. We propose that statutory guidance will state that trustees should be transparent about the methodologies used and detail where estimation has taken place and the various data gaps that remain.

86. To be clear, we do not propose that the requirements on calculating metrics, once data has been obtained, and disclosing them would be subject to the 'as far as trustees are able' approach. Whilst it may be difficult for schemes to acquire data that fully covers all asset classes in which they have confidence, we propose that the initial selection and the calculation of metrics on the basis of the data that is acquired, is solely down to the trustees. We do not anticipate other difficulties beyond the acquisition of data that would limit the ability to make such calculations.

87. In relation to specific metrics, we had initially considered requiring scheme trustees to calculate and report their Weighted Average Carbon Intensity (WACI). Following informal engagement with stakeholders, however, we now see less value in prescribing a specific metric in regulations. Whilst doing so could promote consistency and comparability, the underlying data and methodology used could still vary, meaning that it may be possible to calculate other emissions measures across a wider share of the scheme's portfolio.

88. However, we do recognise that WACI is more appropriate, in some respects, than other, simpler metrics. Indeed, for asset owners, a metric that adapts to the percentage of the assets or the portfolio that is invested in low or high-carbon companies is much more decision-useful than others that do not. WACI is a useful way to track the carbon intensity of a pension scheme's portfolio as influenced by strategic investment decisions, and less influenced by changes to a

company’s market capitalisation or other factors outside the control of the trustees.

89. We propose that statutory guidance will state that trustees should choose WACI as their emissions-based metric which they must calculate and disclose. As with other material deviations from the statutory guidance, should trustees decide to employ a different emissions-based metric, they would be expected to explain why they have done so in their TCFD Report.

90. When it comes to WACI or other emission-based metrics, we acknowledge that trustees are heavily dependent on the flow of data but also on disclosure by companies etc. of Scope 1, 2 and 3 emissions, described below. The latter of these, can, in many cases, be the largest.

    - Scope 1 – All **direct emissions** from the activities of an organisation or under their control. Including fuel combustion on site such as gas boilers, fleet vehicles and air-conditioning leaks.
    - Scope 2 – **Indirect emissions** from electricity purchased and used by the organisation. Emissions are created during the production of the energy which is eventually used by the organisation.
    - Scope 3 – All **other indirect emissions** from activities of the organisation, occurring from sources that they do not directly control. These are sometimes the greatest share of a carbon footprint, covering emissions associated with business travel, procurement, production of inputs, use of outputs, waste and water.

91. We propose imposing identical requirements in relation to Scope 3 emissions to those we impose for Scope 1 and Scope 2: to obtain Scope 3 emissions ‘as far as trustees are able’ to do so, and to calculate metrics using this data. We propose that statutory guidance will also highlight the difficulties with Scope 3 and encourage trustees to be transparent about such difficulties, including where estimation might be used instead, in their TCFD Report.

92. We also propose that the emissions-related metric is calculated and reported at portfolio level, separately for the DC and DB sections of dual section hybrid schemes and, where schemes have multiple DC defaults, for each popular default. As with scenario analysis, it is proposed that this expectation would be set out in statutory guidance.

93. It is proposed that statutory guidance would also lay out suggested non-emissions-related data that trustees can acquire and related metrics they can calculate, to monitor and manage their exposure to climate-related risks and opportunities. This data cannot be on just any characteristic – statutory guidance would list out the types of data and metrics that can usefully be deployed. Trustees would be expected to include a minimum of one of the metrics on the list, although generally it would be reasonable for trustees to calculate and report on more than one. It is proposed this list would include but not be limited to:

    - how many investee firms have issued an emissions target;
    - the percentage of the portfolio invested in ‘green’ opportunities;

- the level of engagement that the scheme trustees, through their asset managers, have undertaken with the companies in which they are invested on climate risk.

94. The statutory guidance would also encourage trustees to explain in the TCFD Report how they use their chosen metrics, including those linked to emissions, in their investment decision-making and to which material risks and opportunities, as disclosed under S1 and S2, the metrics relate.

95. Our proposals for the statutory guidance to which trustees must have regard when meeting this requirement are outlined in the box below.

Box 10: Statutory Guidance on Metrics

With regard to the proposed requirements for trustees to:

- Select at least one appropriate emissions-based metric and at least one non-emissions-based metric to assess the scheme's assets against climate-related risks and opportunities and review the selection on an ongoing basis;

- obtain data relating to the metrics as far as trustees are able; and

calculate and disclose the emissions-based metric(s) and the non-emissions based metric(s).

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It is proposed that statutory guidance would set out the following matters to which trustees must have regard:

- The levels at which metrics should be calculated and reported – for example, the individual sections of a scheme with DC and DB sections, or the individual fund-level;
- A list of the metrics from which at least one emission-based metric and at least one non-emissions-based metric should be selected to measure and manage climate-related risks and opportunities – including the expectation that the Weighted Average Carbon Intensity (WACI) should be used for the emissions-based metric;
- In relation to emissions-based metrics, calculating GHG emissions in line with the GHG Protocol methodology to allow for aggregation and comparability across asset classes and funds and between schemes;
- Incorporating performance metrics into remuneration policies, where this is done;
- The historical periods used in calculation of metrics to allow for trend analysis;
- Setting out reasons for any difficulties in acquiring adequate data;
- Describing the methodologies used to calculate or estimate metrics; and
- How the metrics are used in investment decision-making.

Statutory guidance would also set out that trustees should describe, in their TCFD Report, how they have approached each of the matters above.

Where they choose to deviate from the approach set out in the guidance, trustees would be expected to describe the reasons for divergence in the relevant section of their TCFD Report

Consultation Question

Q8. We propose that regulations require trustees to: **a) Select at least one GHG emissions-based metric and at least one non-emissions-based metric to assess the scheme's assets against climate-related risks and opportunities and review the selection on an ongoing basis;** **b) obtain the Scope 1, 2 and 3 GHG emissions of the portfolio, and other non-emissions-based data, as far as they are able;** **c) calculate and disclose metrics (including at least one emissions-based metric and at least one non-emissions-based metric) used to quantify the effects of climate change on the scheme and assess climate-related risks and opportunities.** **We also propose that regulations require trustees to disclose:** **d) why the emissions data that is estimated does not cover all asset classes, if this is the case.** **We propose that trustees will not be required to use a specific measure to assess the effects of climate change on the scheme's portfolio.** **We propose statutory guidance will cover the matters outlined in the box above.** **Do you agree with these proposals?**

Targets

96. We propose that regulations require trustees to undertake the following activities:

Box 11a: Targets activities

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).**

97. We propose that regulations require trustees to make the following disclosures:

Box 11b: Annual Targets disclosures

M3.1	**Disclose the target(s) selected in accordance with M3.**
M4.1	**Disclose performance measured against the selected target(s) in accordance with M4.**

98. The targets that trustees set will be related to the metrics they have used and the emissions they have disclosed. They are linked in the TCFD recommendations and we are proposing to follow that approach. Therefore, the requirement to set and disclose targets naturally flows from the requirement to determine and disclose metrics.

99. Targets are the mechanism through which trustees should convert the backward-looking or present-day metrics into forward-looking goals that set a path for the scheme's strategy, taking into account transition risks and minimising exposure to physical risks.

100. We believe that target-setting should be mandatory and propose that regulations require at least one target to be set either for emissions or emissions-based or non-emission-based metrics that the scheme has calculated. Whilst we had considered making target-setting subject to the 'as far as trustees are able' approach, we concluded that there are no additional difficulties associated with setting targets.

101. We propose that trustees should also be required to measure performance against their targets and include this measurement in their first and future TCFD reports. Of course, this, much like the data that feeds into the metrics themselves, is dependent on reliable, timely data from others and so we propose to make this requirement to measure and publish performance against targets, 'as far as trustees are able'.

102. Statutory guidance would set out the benefits to schemes of setting targets against which to measure performance, including as a clear signal to members of the trustees' intent. However, we do not propose to mandate particular metrics for which targets should be set, or the ambition or timing of targets – the setting and meeting of targets should be something in relation to which trustees set their own timetable.

103. Our proposals for the statutory guidance to which trustees must have regard when meeting these requirements are outlined in the box below:

Box 12: Statutory Guidance on Targets

With regard to the proposed requirements for trustees to set and disclose the targets used by the scheme to manage climate-related risks and to measure, as far as they are able, their performance against those targets, it is proposed that statutory guidance sets out the following matters to which trustees must have regard:

- whether the target is absolute or intensity based;
- time frames over which the target applies;
- base year from which progress is measured;
- key performance indicators used to assess progress against targets; and

The expectation that, where not apparent, trustees will provide a description of the methodologies used to calculate targets and measure performance against them, including any estimations used to measure performance.

Statutory guidance would also set out that trustees should describe, in their TCFD Report, how they have approached each of the matters above.

Where they choose to deviate from the approach set out in the guidance, trustees would be expected to describe the reasons for divergence in the relevant section of their TCFD Report

Consultation Question

Q9. We propose that regulations require trustees to:

a) set at least one target to manage climate-related risks for one of the metrics trustees have chosen to calculate, and to disclose the target(s).

b) calculate performance against the target(s) as far as trustees are able and disclose that performance.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Chapter 4: Disclosing TCFD

Background

1. This section introduces our proposals in relation to where trustees should publish their TCFD reports, and how they notify both beneficiaries of the scheme and The Pensions Regulator (TPR).
2. The TCFD's 'Final TCFD Recommendations Report'[78] emphasises the importance of including climate-related financial disclosures in an organisation's annual mainstream financial filings. Significantly, the TCFD concluded that this would "foster shareholder engagement and broader use of climate-related financial disclosures, thus promoting a more informed understanding of climate-related risks and opportunities by investors and others."
3. The report also argues that this recommendation should help organisations in complying more effectively with existing disclosure obligations by integrating them with climate-related disclosures. This is significant when considering existing statutory requirements on trustees, to publish the scheme's Statement of Investment Principles (SIP) which sets out trustee's policies on factors that are likely to have a financially material impact on investment returns, including climate change.
4. As explained in Chapter 2, the very largest schemes have the highest governance and resource capacity. We consider that not only would this enable their trustees to produce TCFD disclosures more quickly, it would also enable them to produce them to a higher standard. The largest schemes possess trustees from whom the regulator expects higher standards.
5. Therefore, the duty to publish facilitates wider industry peer-led learning, with trustees of schemes with £5bn or more in net assets setting an industry standard to be followed or, at the very least, worked towards.

Publication and explaining the results

6. Our proposed duty to publish recognises the growing government, regulatory, industry and public interest in the sustainability and wider socio-economic value of investment practices.
7. We consider that making this information publicly available would enable members to engage with their scheme's climate-related performance and its potential impact on their savings for the future.
8. However, we also recognise that there would be challenges in communicating this information to beneficiaries with a wide range of levels of engagement or pensions knowledge. We do not expect engagement from all pension scheme members. Rather, engaged members should be able to interpret and understand

[78] Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017) - Summary

trustees' disclosures, and raise concerns or queries where appropriate. Our proposed statutory guidance would cover this point.

9. Beneficiaries are not the only audience for such disclosures. Trustees and advisers should benefit from sight of one another's TCFD reports and we believe this would help to improve the quality of reporting. Where disclosures are made fully public rather than only available on request or to a sub-section of the public, this ought to drive up the quality of reporting. Public scrutiny has an important role to play in offering the encouragement to improve. Therefore, we consider that placing a publishing requirement on this information will act as a driver towards trustees producing disclosures of a high standard.

Where schemes would need to publish

10. We propose to require pension scheme trustees to publish their TCFD report, and for this to be available to all, rather than simply making them available to members on request.

11. We propose also that trustees be required to make their TCFD reports accessible for free on a publicly available website and provide a link to them in their Annual Report and Accounts. For occupational pension schemes the Annual Report and Accounts is where annual mainstream financial filings are presented and so, in line with the TCFD's recommendations, our proposal recognises TCFD reporting as a key financial disclosure which is integral to reporting on the scheme's overall performance. However, for the avoidance of doubt, trustees are not currently required to publish their scheme's Annual Report and Accounts, and we are not seeking to change this.

12. In our early engagement with industry stakeholders a significant number raised concerns around including a full TCFD report in their Annual Report. We have taken this concern into account. TCFD reports done well will be quite long and detailed, so requiring their inclusion in full would, we believe, unnecessarily add to the overall length of the Annual Report and Accounts disclosures. It would also result in the TCFD disclosures being subsumed amongst other information.

13. We are also conscious that there has been a significant increase in the number of different disclosure requirements placed on trustees in recent years. Therefore, our proposal to include a link to the TCFD report in the Annual Report provides it with a place in the structure of existing financial disclosures whilst offering flexibility for trustees in the way that they present information. Where trustees publish their scheme's Annual Report and Accounts, we believe our proposal would provide the added benefit of consistency of access for members looking to easily access the TCFD report. Our proposed approach follows a similar format to the existing requirement to publish parts of the Chair's Statement, which itself must be included in the Annual Report and Accounts.[79]

14. Our proposal would mean that trustees could still include a high-level summary of their TCFD report in their 'main' Annual Report, alongside the link signposting to where the full report can be found, either on a separate part of their website or another public website. We would deem this as an entirely reasonable approach

[79] The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (S.I. 2013/2734) – regulation 12 and Schedule 3, Part 2, paragraph 7 and Part 5, paragraph 34.

but to be clear, would not require it in regulations. Our proposals recognise that there could, for example, be significant merit in having a separate location devoted entirely to a scheme's climate change and broader sustainability considerations. This would allow beneficiaries and other interested stakeholders to view the disclosures in the same place as other topically linked information.

15. Our proposals for the statutory guidance which trustees must have regard to when meeting this requirement are outlined in the box below.

Auditing the Annual Report

16. The reasonable level of assurance provided by the auditors in their audit report relates only to the financial statements included with a company's Annual report, not to the Annual report as a whole. With limited exception[80] the auditor does not, in their audit of the financial statements, provide an assurance opinion on the 'Other Information'[81] included in the Annual Report. Therefore, trustees would not incur any additional auditing costs as a result of our proposed requirement that the disclosures be included in the Annual Report.

17. However, under ISA (UK) 720 (Revised November 2019)[82] the auditor's responsibilities relating to Other Information does require the auditor to consider whether the material contained within any Other Information is consistent with the financial statements and knowledge obtained during the course of the audit[83]. Where there is inconsistency, the auditor is required to report on this.

18. Where TCFD material is linked to within the Annual Report, it would constitute Other Information and as a result, whilst it would not be audited, it would be subject to consideration by the auditor in line with the requirements of ISA (UK) 720.

19. ISA (UK) 720[84] is clear that where Other Information is only available via the entity's website, the version of this information that is considered by the auditor is the one obtained directly from the entity itself rather than from the entity's website. As such, the auditor would require a copy of the original TCFD material prior to its publication on the entity's website in order to be able to fulfil their responsibilities in relation to Other Information. Therefore, we propose that statutory guidance should state that the original TCFD report be provided to the auditor at the same time as the Annual Report, thus allowing the auditor to fulfil their responsibilities under ISA (UK) 720 as outlined above.

20. The auditor has no additional responsibility to search for Other Information that may be on the entity's website, or to perform procedures to confirm that Other Information is appropriately displayed on the entity's website or otherwise has been appropriately transmitted or displayed electronically.

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[80] Certain elements of a quoted companies' director's remuneration report are subject to audit.

[81] ISA (UK) 720 (Revised November 2019) Paragraph 12(c)

[82] ISA (UK) 720 (Revised November 2019) – The Auditor's responsibilities relating to other information

[83] ISA (UK) 720 (Revised November 2019) Paragraph 14

[84] ISA (UK) 720 (Revised November 2019) Paragraph A19

21. In the future we will continue to consider, in consultation with other relevant bodies, whether to strengthen the auditing requirements that the proposed TCFD reports are subject to, if and when the disclosures become more standardised practice.

Telling members that it has been published

22. Our proposal to place a duty on scheme trustees to notify members of the location of the TCFD report acknowledges that climate risk considerations should be recognised as potentially significant in the investment process. This is not simply an ethical or public relations side project that investors or investment managers can undertake to rebalance other actions. Pension schemes invested in companies and assets where members are not adequately insulated against the significant investment risks that climate change poses risk a potentially significant negative impact on the retirement outcomes for DC members and significantly increasing the deficits that must be funded by DB employers through contributions.

23. The Pension Policy Institute's report in 2018[85] found that evidence of member engagement in ESG factors is increasing significantly. It is important that this engagement is facilitated further by notifying members about the scheme's TCFD reports, potentially prompting them to challenge trustees, and where appropriate their employers, to ensure that their pension contributions are being directed into schemes and underlying investments which are properly engaged with this issue.

24. DC scheme members in particular have become more interested in environment, social and governance (ESG) issues amid the coronavirus pandemic, according to the Defined Contribution Investment Forum (DCIF). Their 2020 survey[86] on responsible investment found that 82% of members surveyed felt society would change forever as a result. Rather than act as a catalyst for increased member engagement DCIF highlight that this has simply accelerated an existing trend. 70% of members have now declared an interest in responsible investment up from 61% just two years earlier, with 73% declaring they feel strongly about environmental issues and 87% feeling businesses have wider societal responsibilities beyond making a profit.

25. We therefore propose that trustees will have a duty to tell members via the annual benefit statement that their TCFD reports have been published, and where they can locate them. Trustees would be required to include a website address link to their latest TCFD report and an explanation of how the recipient may read the information or document on the website. This is in line with the existing notification requirements that fall on trustees about the availability of

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[85] PPI - 'ESG: past, present and future', https://www.pensionspolicyinstitute.org.uk/media/2398/20181002-ppi-esg-past-present-and-future-report-final.pdf

[86] The Key to Unlocking Member Engagement, Defined Contribution Investment Forum. https://dcif.co.uk/wp-content/uploads/2020/07/the_key_to_unlocking_member_engagement.pdf

information on costs and charges, the Statement of Investment Principles and the implementation statement. Similarly, we propose to require that the member be notified of the circumstances when they may request a hard copy of the report. Alignment with current notification requirements would ensure consistency for members and ought not to be burdensome for schemes.

26. We propose that for DC schemes, trustees could choose to provide a single link which points to all the relevant published information required by paragraph 5B of Schedule 6 to the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 ("Disclosure Regulations")[87], as long as the link was suitably explained and meets all the requirements specified in regulation 27(2). This would help to alleviate concerns raised during our early stakeholder engagement around the already restricted space in the annual benefit statement for additional text. The website link could direct members to a single holding page where the TCFD report, Chair's Statement excerpts, Statement of Investment Principles and Implementation Statement have all been published.

27. For DB schemes we propose only to require that a notification be added to the annual benefit statements of the members for whom trustees are already required to produce one. We propose this approach to ensure the disclosure method is consistent between both DB and DC schemes.

28. Similarly, we believe that beneficiaries of Cash Balance schemes – a money purchase benefit with some similarities to DB schemes - because they have some underpinning guarantees – should also be made aware of the website location of the scheme's TCFD report via their annual benefit statement where one is produced.

29. An alternative for notifying DB scheme members could be the annual funding statement. Regulation 15 of and Schedule 4 to the Disclosure Regulations require a 'summary funding statement' to be given to all members and beneficiaries of the scheme, where the trustees or managers of the scheme have obtained an actuarial valuation or report. It is less clear the levels of engagement members have with this document so we would welcome respondents' views on whether this would be a better notification mechanism for DB members.

30. We are aware that, should our proposals be adopted, some schemes will issue their annual benefit statement months in advance of publishing their TCFD report. In this scenario, we propose that in the first year the requirement to publish a TCFD report applies, schemes should, where possible, state in their annual benefit statement the website location where the TCFD report will eventually be published. They should also state the deadline for publication. We propose that these expectations would be set out in statutory guidance.

31. We propose that in subsequent years, regulations would require trustees to include in the annual benefit statement a link to the most recent TCFD report they have published.

[87] https://www.legislation.gov.uk/uksi/2013/2734/contents

Reporting to The Pensions Regulator

32. Rather than place a requirement on trustees to send a copy of the latest version of their TCFD report to TPR, we propose instead to require them to provide TPR with the full website address where the latest TCFD Report has been published.

33. We propose to achieve this by requiring trustees to include the relevant website address in their annual scheme return by amending regulation 3 (registrable information) of the Register of Occupational and Personal Pension Schemes Regulations 2005[88], to include this. Adding the website address of the published TCFD report to the registrable information which trustees must provide would make this a mandatory requirement of the scheme return form.

34. As with our proposals for notifying members, we are similarly aware that, should our proposals be adopted, some trustees will complete their scheme return in advance of publishing their first TCFD Report. In such cases, the requirement to include a link to the published TCFD report would not apply for that scheme return and trustees would be able to leave this field blank in the form.

35. We believe this would avoid an unnecessary duplication of efforts on the scheme's behalf to inform TPR that a TCFD report has been published. It would also release TPR from the practical supervisory burden of requesting this information separately or actively seeking the disclosure on each scheme's website separately from the issue and review of the scheme returns.

36. Based on this same rationale we also propose amending regulations to introduce a requirement that the website address or addresses where a scheme's Statement of Investment Principles ("SIP"), Implementation Statement and the relevant excerpts of the Chair's Statement are published, must also be included in the annual scheme return.

Consultation Question

Q10: We propose that, for all schemes in scope:

a) The trustees should be required to publish their TCFD report in full on a publicly available website where the report is accessible free of charge.
b) The trustees should be required to include in the Annual Report and Accounts a website link to the location where the most recent TCFD report may be accessed in full.
c) The trustees must notify all members to whom they must send the annual benefit statement of the website address where they can locate the full TCFD report – this must be set out in the annual benefit statement.
d) The trustees should be required to report the location of their most recent published TCFD report to the Regulator by including the corresponding website address in their scheme return.

[88] The Register of Occupational and Personal Pension Schemes Regulations 2005

e) The trustees should also be required to report the location of their published Statement of Investment Principles (“SIP”), Implementation Statement and excerpts of the Chair’s Statement by including the corresponding website address or addresses in their scheme return.

Do you agree with these proposals?

Is there a better way to notify members of where to find this information?

For example, for DB schemes, might the summary funding statement required by regulation 15 of the Disclosure Regulations be a more appropriate way to signpost members to this information?

Chapter 5: Penalties and Impacts

Penalties

1. This section sets out our proposals for penalty regimes which will apply where trustees fail to meet the proposed governance, publication and disclosure requirements we have set out.

2. If we place a duty on trustees to inform members, via the annual benefit statement, about the location of the latest TCFD report we propose to use the existing penalty regime, as set out in regulation 5 of the Disclosure Regulations[89], in instances where trustees have failed to comply with this specific notification requirement. The penalty regime in regulation 5 would also apply to the proposed requirement for trustees to include of a web link in the Annual Report to the location of the published TCFD report.

3. Equally, if we place a duty on trustees to provide TPR with the website address of their published TCFD report in the scheme return, the existing penalty regime, as set out in the Pensions Act 1995, section 10[90] and applied by the Pensions Act 2004, section 64 (duty of trustees or managers to provide scheme return), would apply. The same penalty regime would also apply in relation to our proposal to require trustees also provide the website address of the Statement of Investment Principles ("SIP"), Implementation Statement and the relevant excerpts of the Chair's Statement in the annual scheme return.

4. In respect of compliance with the proposed climate governance and TCFD reporting requirements, we propose to impose a separate penalty regime using the powers in new section 41C of the Pensions Act 1995, as provided for by the Pension Schemes Bill 2019/21[91]. Using these powers, we would propose to give TPR the power to issue compliance and penalty notices to both trustees and third parties.

5. To ensure a consistent approach with other similar penalty regimes, we propose to model our compliance measures on Part 4 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015[92] ("the Charges and Governance Regulations") and to largely replicate the provisions in relation to compliance notices, penalty notices and third party compliance notices set out in regulations 26 to 33.

6. This includes the provisions for the recovery and review of penalty notices and references to the First-tier and Upper Tribunals.

7. However, unlike the Charges and Governance Regulations compliance framework we are proposing to require that TPR must issue a *mandatory* penalty

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89 Disclosure Regulations 2013 – Regulation 5
90 Pensions Act 1995 - Section 10
91 Bill 165 2019-21 (as brought from the Lords)
92 SI 2015/879

only in very limited instances. This would mean that TPR are not obliged to issue a penalty notice where there has been a trivial or non-material breach.

8. Instead, a mandatory penalty would apply only for wholesale non-compliance, where trustees have not published a TCFD report at all.

9. This would mean that in relation to a given scheme, it would not be necessary for TPR to review each individual disclosure under governance, strategy, risk management and metrics and targets to assess whether it met statutory requirements and impose a mandatory penalty if any or all requirements were not met. They would simply be required to confirm that a report had not been published.

10. Government has communicated to TPR that high quality climate governance and disclosures by occupational pension schemes are a strategic priority for DWP.

11. In relation to mandatory and discretionary penalty notices issued, we propose that the penalty amount should be determined by TPR, but that the minimum fine they can issue for a mandatory penalty should be £2,500. This is proportionate when taking into account the scale of the risk posed to member outcomes by climate change, and when considering that the requirements will only fall on trustees of schemes with the largest governance resources.

12. The maximum fine for a penalty issued for the breach of any of the requirements proposed in this consultation would not exceed £5,000 for an individual trustee, or £50,000 for a corporate trustee.

13. Should the proposals in this consultation be adopted, we will keep the compliance measures under review and, as TCFD disclosures become more standard practice, will consider whether there is a need to strengthen or otherwise review the penalty regime.

Consultation Question

Q11: We propose that

a. TPR will have the power to administer discretionary penalties for TCFD reports they deem to be inadequate in meeting the requirements in the regulations.
b. There will be no duty on TPR to issue a mandatory penalty, except in instances of total non-compliance where no TCFD report is published.
c. In all other respects, we propose to model the compliance measures on the existing penalty regime set out in regulations 26 to 33 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015
d. Failure to notify members via the Annual Benefit Statement or to include a link to the TCFD report from the Annual Report will be subject to the existing penalty regime set out in regulation 5 of the Disclosure Regulations.

Do you agree with this approach?

Impacts

14. A draft impact assessment estimating the direct and indirect financial impacts on business, as well as discussing the potential benefits to others (e.g. scheme members in scope) has been published alongside this consultation. We would welcome any evidenced comments on the impact assessment.

15. We will work with pension schemes and businesses as we implement these new requirements to minimise the administrative burdens of compliance.

Consultation Question

Q12: Do you have any comments on the new regulatory burdens to business and benefits, and wider non-monetised impacts we have estimated and discussed in the draft impact assessment?

Protected groups and other comments

16. Government is required under the Equalities Act 2010 to have due regard to the needs of people with protected characteristics[93]. As part of this consultation we are seeking any views and evidence of the impact of our proposals on protected groups and the age and disability characteristics in particular – and how any negative effects may be mitigated.

17. In particular, we would welcome evidence on existing provisions made by trustees of occupational pension schemes in response to requests for information in alternative accessible formats, specifically in relation to the protected characteristics of age and disability.

18. We also welcome any other comments respondents may wish to offer about other proposals in this document which are not specifically consulted on elsewhere.

Consultation Question

Q13: Do you have

- **a. any comments on the impact of our proposals on protected groups and/or how any negative effects may be mitigated?**
- **b. any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats.**
- **c. any other comments about any of our proposals?**

[93] Set out in section 4 of the Equality Act 2010.

Annexes

Annex 1: Ministerial Letter to largest 50 pension schemes

Department for Work & Pensions

GUY OPPERMAN MP
Minister for Pensions

27 September 2019

CLARIFYING AND STRENGTHENING TRUSTEES INVESTMENT DUTIES ON ESG AND CLIMATE RISK

I am writing to you to remind you of the amendments to the Investment and Disclosure regulations which come into force on 1 October 2019. With this package, I have sought to put beyond doubt:

- the duties for pension scheme trustees to take account of financially material considerations arising from environmental, social and governance considerations, including climate change – just as they would any other financial risk;
- the requirement to have a policy on stewardship of the assets, including both engagement and voting, however the assets are held;
- the requirement to have a policy on how members' views are taken into account, although I have been clear that trustees are never obliged to take account of members' views.

I believe that the circumstances in which neither climate risks, nor ESG risks more broadly, are financially material are likely to be extremely limited – and therefore that it is part and parcel of trustees' fiduciary duties to take account of these risks when setting out investment strategy and to clearly explain that to investors. In the same way, I believe it is part of trustees' fiduciary duties to have a stewardship policy, even if that policy is limited to engagement and monitoring of the asset managers who engage with investee firms and vote on trustees' behalf. Finally, the Law Commission have twice concluded that trustees can take account of members' views where the "two step test" is met.

In light of the coming into force of the Regulations, and Government and Parliamentary interest in pension scheme investment, I am writing to ask some further questions about the actions undertaken by your scheme.

Question 1:

What substantive changes have you made to your investment strategy in the last 3 years to take account of ESG and climate change and when have you made them?

Question 2:
What substantive changes have you made to your stewardship policy in the last 3 years to ensure that the pension scheme trustees act as engaged investors?

Question 3:

Have you made any substantive changes to your policy on taking account of members' views in the last 3 years? If so, what changes have you made and when did you make them?

Question 4:

Are you planning to make any further changes to your strategies and policies on the above topics in the next 12 months?

Question 5:

Does your scheme make climate disclosures in line with the TCFD framework? What aspects of TCFD's recommendations do you meet? Do you plan to meet more in the next 12 months?

Question 6:

Are there further specific actions Government might take to impress upon pension schemes – or others – the materiality of climate change risk and how it might be minimised. If so, what are those actions?

Question 7:

Who are your asset manager/s and do you believe they are truly acting on the changes I and Government are seeking?

Question 8:

Finally, I would appreciate sight of the ESG/climate change, stewardship and non-financial factors (members' views) section of your statement of investment principles, or details of where these are published online. I am compiling a record so I can both monitor compliance and celebrate and support best practice.

GUY OPPERMAN MP

MINISTER FOR PENSIONS AND FINANCIAL INCLUSION

Annex 2: Summary of Questions

Q1. We propose that the following schemes should be in scope of the mandatory climate governance and TCFD reporting requirements set out in this consultation:

a) trust schemes with £1bn or more in net assets

b) authorised master trusts

c) authorised schemes offering collective money purchase benefits

Do you agree with our policy proposals?

Q2. We propose that

a) trustees of schemes with £5bn or more in net assets on their first scheme year end date to fall on or after 1 June 2020 are subject to the climate governance requirements from 1 October 2021 and the trustees must publish a TCFD report within 7 months of the current scheme year end date or by 31 December 2022 if earlier.

b) trustees of schemes with £1bn or more in net assets on the first scheme year end date to fall on or after 1 June 2021 are subject to the climate governance requirements from 1 October 2022, and the trustees must publish a TCFD report within 7 months of the current scheme year end date, or by 31 December 2023 if earlier.

c) trustees of master trust or collective money purchase schemes which are authorised on 1 October 2021 are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report in line within 7 months of the current scheme year end date, or by 31 December 2022.

After 1 October 2021

d) trustees of master trust or collective money purchase schemes which become authorised are subject to the climate governance requirements with immediate effect, and the trustees must publish a TCFD report within 7 months of the current scheme year end date.

e) where schemes cease to require authorisation, the climate governance and TCFD-aligned reporting requirements fall away with immediate effect, unless they remain in scope via the asset threshold on the previous scheme year end date.

From 1 June 2022 onward

f) trustees of schemes not already in scope of the requirements and with £1bn or more in net assets on any subsequent scheme year end date:

- are subject to the climate governance requirements starting from one year after the scheme year end date on which the £1bn asset threshold was met; and
- must publish a TCFD report within 7 months of the end of the scheme year from which the climate governance requirements apply.

g) trustees of schemes in scope of the requirements whose net assets fall below £500m on any subsequent scheme year end date cease to be subject to the climate governance requirements with immediate effect (unless they are an authorised scheme) but must still publish their TCFD report for the scheme year which has just ended within 7 months of the scheme year end date.

Do you agree with the policy proposals?

Q3. Subject to Government deciding to adopt any of the governance or reporting requirements proposed in this consultation, we propose to conduct a review in 2024 on whether to extend the measures to schemes with below £1bn in net assets which are not authorised master trusts or an authorised scheme offering collective money purchase benefits, and if so how and on what timescale.

This review would be informed by consideration of TCFD disclosures by occupational pension schemes to-date, their impact, and the availability and quality of both free and paid-for tools and services.

We would propose also to review any regulations and statutory guidance which had been put in place to identify whether any of this needs to be strengthened or updated.

Do you agree with these proposals?

Q4. We propose that regulations require trustees to:

a) adopt and maintain oversight of climate risks and opportunities, and

b) 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.

We also propose that regulations require trustees to describe:

c) the role of trustees in ensuring oversight of climate-related risks and opportunities; and

d) the role of those managing the scheme in assessing and managing climate-related risks and opportunities, only insofar as this relates to the scheme itself and the processes by which trustees satisfy themselves that this is being done.

We propose that statutory guidance will cover the matters in the box above.

Do you agree with these proposals?

Q5. We propose that regulations require trustees to identify and disclose the climate change risks and opportunities relevant to their scheme over the short, medium and long term, and to assess and describe their impact on their investment and funding strategy.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Q6. We propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of DB, funding strategy, as far as they are able, in at least two climate-related scenarios, one of which must be a 2°C or lower scenario and to disclose the results of this assessment

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Q7. We propose that regulations require trustees to:

a) adopt and maintain processes for identification, assessment and management of climate-related risks,

b) Integrate the processes described in a) within the scheme's overall risk management.

We also propose the regulations require trustees to disclose:

c) the processes outlined in part a) above.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Q8. We propose that regulations require trustees to:

a) Select at least one GHG emissions-based metric and at least one non-emissions-based metric to assess the scheme's assets against climate-related risks and opportunities and review the selection on an ongoing basis;

b) obtain the Scope 1, 2 and 3 GHG emissions of the portfolio, and other non-emissions-based data, as far as they are able;

c) calculate and disclose metrics (including at least one emissions-based metric and at least one non-emissions-based metric) used to quantify the effects of climate change on the scheme and assess climate-related risks and opportunities.

We also propose in regulations that trustees be required to disclose:

d) why the emissions data that is estimated does not cover all asset classes, if this is the case.

We propose that trustees will not be mandated to use a specific measure to assess the effects of climate change on the scheme's portfolio.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Q9. We propose that regulations require trustees to:

a) set at least one target to manage climate-related risks for one of the metrics trustees have chosen to calculate, and to disclose those targets(s).

b) calculate performance against those targets as far as trustees are able and disclose that performance.

We propose statutory guidance will cover the matters outlined in the box above.

Do you agree with these proposals?

Q10. We propose that, for all schemes in scope:

a) The trustees should be required to publish their TCFD report in full on a publicly available website where the report is accessible free of charge.
b) The trustees should be required to include in the Annual Report and Accounts a website link to the location where the full TCFD report may be accessed in full.
c) The trustees must notify all members to whom they must send the annual benefit statement of the website address where they can locate the full TCFD report – this must be set out in the annual benefit statement.
d) The trustees should be required to report the location of their published TCFD report to the Regulator by including the corresponding website address in their scheme return.
e) The trustees should also be required to report the location of their published Statement of Investment Principles ("SIP"), Implementation Statement and excerpts of the Chair's Statement by including the corresponding website address or addresses in their scheme return.

Do you agree with these proposals?

Is there a better way to notify members of where to find this information?

For example, for DB schemes, might the summary funding statement required by regulation 15 of the Disclosure Regulations be a more appropriate way to signpost members to this information?

Q11: We propose that:

a) TPR will have the power to administer discretionary penalties for TCFD reports they deem to be inadequate in meeting the requirements in the regulations.

b) There will be no duty on TPR to issue a mandatory penalty, except in instances of total non-compliance where no TCFD report is published.

c) In all other respects, we propose to model the compliance measures on the existing penalty regime set out in regulations 26 to 33 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015

d) Failure to notify members via the Annual Benefit Statement or to include a link to the TCFD report from the Annual Report will be subject to the existing penalty regime set out in regulation 5 of the Disclosure Regulations.

Do you agree with this approach?

Q12: Do you have any comments on the new regulatory burdens to business and benefits, and wider non-monetised impacts we have estimated and discussed in the draft impact assessment?

Q13: Do you have

a) any comments on the impact of our proposals on protected groups and how any negative effects may be mitigated?

b) any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats.

c) any other comments about any of our proposals?