Department
for Work &
Pensions

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

Policy consultation response and Consultation on regulations

January 2021

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Ministerial foreword

The next decade will be the most important in our fight to tackle climate change. The Government recognises this and is prepared to take all the steps necessary not just to reach net zero domestically – and our new, ambitious target of reducing emissions by 68% by 2030 – but to continue leading nations on collaboration to protect the planet at COP26 later in the year. The Prime Minister's announcement of our '10-point plan' for a green industrial revolution lays out measures to scale up climate action and cut emissions faster than any major economy so far. And we are committed to doing this in a way that enables a just transition, whilst strengthening adaptation and resilience.

Climate change is a major systemic financial risk and threat to the long-term sustainability of UK private pensions. With almost £2 trillion in assets under management, all pension schemes are exposed to climate-related risks and I am committed to ensuring trustees do everything they can to limit this risk to their members' future retirement income.

I whole-heartedly welcome the Chancellor's announcement of the TCFD Roadmap in November 2020 outlining the steps that the UK Government and regulators will take towards rolling out mandatory climate reporting requirements across its regulated community.

This means that, come 2023, the vast majority of assets will be invested with pension scheme trustees, asset managers, and insurers who are disclosing climate-related financial risks and opportunities in line with recommendations by the Task Force on Climate-related Financial Disclosures (TCFD).

Trustees can be sure that the UK-regulated organisations on which they depend not only for data and information but also day-to-day management of climate change risk will be subject to the same obligations and requirements.

A key element of this plan was the Government amendments to the Pensions Schemes Bill, to introduce first-of-a-kind climate change provisions. I firmly believe the climate change measures in the Pension Schemes Bill can revolutionise pension investment, making saving better, safer and greener.

In August last year, we launched our consultation on "Taking action on climate risk: improving governance and reporting by occupational pension schemes". I acknowledge that for many trustees the proposals will be a new process and a learning curve, but mandatory TCFD-aligned disclosures will allow trustees to demonstrate better how consideration of climate-related risks and opportunities is integrated into their scheme's entire governance and decision-making processes.

Acting now to manage climate risks, and to take advantage of the opportunities presented by the low-carbon transition, will put schemes in a stronger position for the future.

Risk is the focus – but when pension scheme trustees seize opportunities to decarbonise and therefore reduce climate risk in their portfolios we unleash the productive power of our pension funds. They can be at the forefront of seizing sustainable opportunities – in the financial interests of their members – by financing the green tech and green energy revolution we will need for the transition.

I would like to thank everyone who has risen to the challenge, both those schemes who have already started to embrace this issue and respondents across the sector for the level of constructive engagement. Whilst there is widespread support for the Government's proposals in the policy consultation, pension schemes must not just comply with regulations in a box-ticking fashion. They must also show leadership and embrace the change that is occurring.

I feel there is still more work to be done to change mind-sets when I hear "climate risk is likely not the most immediate or critical risk for many schemes" from an open defined contribution scheme. Failing to ensure climate risk, the most systemic risk facing financial services, is properly considered is – in my view – a failure in trustees' duty to protect members.

Some trustees may think that these proposals are an overreaction – because they believe the market has delivered for them over the past decade, because they have seen it ride out "storms" before or because they wrongly think they have not yet seen any impact of climate change on their investments. To these trustees I say that the world is changing, the challenges are changing. You need to change.

I want every affected market participant to engage with these proposed measures and help us shape a policy that delivers the protection for members against the financial risks of climate change that I believe has come to be a central duty of trustees.

Together, we can build better, safer and greener pensions. Pension savers deserve nothing less.

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Guy Opperman MP
Minister for Pensions and Financial Inclusion

Introduction

This document contains the government's response to the August 2020 consultation – Taking action on climate risk: improving governance and reporting by Occupational Pension Schemes.

We received nearly a hundred detailed responses from a wide range of stakeholders. The views shared with us and Government's response are outlined in the appropriate chapters of this document.

The August consultation was limited to our policy proposals in relation to ensuring occupational pension schemes have – and report on – effective governance, strategy, risk management and accompanying metrics and targets for the assessment and management of climate-related risks and opportunities.

This document therefore also consults on the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, the draft Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 and draft statutory guidance, which have been produced in light of the outcome of the August policy consultation.

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 draft regulations and the extent to which these achieve their stated policy intent. It also seeks views on new draft statutory guidance. The proposals are subject to the current Pension Schemes Bill, which contains the powers to make regulations in relation to climate change risk, receiving Royal Assent.

This consultation is intended to satisfy the Secretary of State's consultation duty under section 120(1) of the Pensions Act 1995, should it subsequently apply. It is also intended to satisfy the Secretary of State's consultation duties under section 185(1) of the Pension Schemes Act 1993 and section 317(1) of the Pensions Act 2004.

Scope of consultation

This consultation applies to Great Britain. Occupational pensions are a devolved matter for Northern Ireland and it is envisaged that Northern Ireland will make corresponding provisions.

Duration of the consultation
The consultation period begins on 27 January 2021 and runs until 10 March 2021. 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:

Emma Walmsley, Tom Rhodes and David Farrar
Climate Change and Responsible Investment Team
Email: pensions.governance@dwp.gov.uk

We gratefully acknowledge the work of Bethan Livesey, Clare Wilkinson, Millie Brown and Phoebe Wright on this consultation.

Government response

We will aim to publish the government response to the consultation on the GOV.UK website. Where consultation is linked to a statutory instrument, responses should be published before or at the same time as the instrument is laid.

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 have a duty to give due regard to the needs of people with 'protected characteristics'. The 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

Paying 'due regard' means that, in our roles as policy makers, we are required to consciously think about the three aims of the 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.

Chapter 1: Background and summary

1. In our August consultation we summarised Government work to date on pension schemes and climate change, and explained trustees' duties to consider climate change and the likelihood that climate change is a financially material risk, as well as an opportunity, for all pension schemes.

2. This chapter provides an update on wider Government work to mandate the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) across the financial sector. There is also an update on the progress of work being conducted to identify a robust methodology suitable for carrying out Paris Alignment reporting.

3. The chapter concludes with a summary of our policy proposals and the changes we have made in response to the policy consultation. The reasons behind all changes to the original proposals are explained in more detail in the rest of the consultation document.

Wider action on greening finance

The TCFD recommendations

4. The recommendations of the TCFD were designed to be adoptable by all organisations, including asset owners, such as banks, insurers and pension scheme trustees. The TCFD itself 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.

Figure 1: 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

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

Mandating TCFD-aligned disclosures

6. In our August 2020 consultation we highlighted the evidence from the occupational pension sector, as well as nationally and internationally, that it is an appropriate time to move towards mandatory TCFD-aligned disclosures, beginning with larger pension schemes.

7. In the occupational pension sector itself, responses by trustees of large pension schemes to October 2019 letters from the Minister for Pensions and Financial Inclusion indicated the need for a legislative nudge, with only 42% of the largest schemes making any TCFD-aligned disclosures or having plans to do so in the next 12 months.

8. The guidance of the Pensions Climate Risk Industry Group, consulted on in March 2020 and now published in final form on the same day as this consultation, has provided pension scheme trustees with the guidance and direction to begin to take steps to report.

9. Nationally, Government's 2019 Green Finance Strategy was followed in November 2020 by the Chancellor of the Exchequer, Rishi Sunak's announcement of plans[1] to extend the UK's global leadership in green finance, including amongst other things the publication of the Government's TCFD Taskforce's interim report and roadmap for implementing mandatory TCFD aligned disclosures.

10. Internationally, the TCFD recommendations have become a key part of the UK Government's focus and engagement ahead of the UN Climate Change Conference for COP26, which will take place in Glasgow in November 2021.

11. Mark Carney, UN Special Envoy for Climate Action and Finance and the Prime Minister's Finance Adviser for COP26, published "Building a Private Finance System for Net Zero: priorities for private finance for COP26"[2] which highlights the importance of countries publishing pathways to mandatory TCFD-aligned climate-related financial reporting.

The Pension Schemes Bill

12. The Bill completed its passage through Parliament on 19 January 2021. Subject to the Bill receiving Royal Assent, we propose to use the new climate change risk powers it contains to make regulations on which we are now consulting.

13. Government made clear during debates in House of the Lords and subsequently in the House of Commons that the measures will not, and cannot, be used to

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[1] https://www.gov.uk/government/news/chancellor-sets-out-ambition-for-future-of-uk-financial-services

[2] https://www.ukcop26.org/wp-content/uploads/2020/11/COP26-Private-Finance-Hub-Strategy_Nov-2020v4.1.pdf

direct pension scheme investment in any way:

“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”[3].
Baroness Stedman-Scott, House of Lords Committee Stage, 26 February 2020

“It the Bill will bring transparency for the first time about what is happening with individual investments. This Government are not in favour of trying to force divestment of different elements of fossil fuels and similar.”[4]
Rt Hon Dr Thérèse Coffey MP, House of Commons Second Reading, 7 October 2020

14. Indeed, 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.

15. 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.

16. 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.

17. 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. The climate change risk powers in the Pension Schemes Bill can only be used to secure that there is effective governance of occupational pension schemes with respect to the effects of climate change and to require associated disclosures.

[3] Pension Schemes Bill volume 802, column 156 GC
[4] Pension Schemes Bill volume 681, column 909

UK joint regulator and Government TCFD Taskforce: Interim Report and Roadmap

18. In our August consultation we recognised that some of the TCFD recommendations, and therefore our corresponding proposals, require an evaluation of assets which relies on the quality and flow of data from investee companies through aggregation and analysis by asset managers, investment consultants or other specialist service providers, to institutional investors.

19. It is therefore hugely significant that the UK Government has now announced its intention to make TCFD-aligned disclosures mandatory across the economy by 2025, with a significant portion of mandatory requirements in place by 2023. The UK Taskforce's Interim Report, and accompanying Roadmap[5], sets out a pathway to achieving that ambition.

20. As the Roadmap document states:

    "The ambitious but proportionate strategy presented in the Roadmap will help ensure that the right information on climate-related risks and opportunities is available across the investment chain – from companies in the real economy, to financial services firms, to end-investors."

21. This will help to address understandable concerns, raised in responses to our August consultation, that a requirement would be placed on trustees to undertake scenario analysis and calculations of metrics and targets for their portfolio, whilst the sections of the investment chain on which trustees would rely for data were not being held to the same regulatory standards.

22. The FCA's consultation on disclosure by premium UK listed commercial companies has helped to kick-start disclosures at their source[6]. Its Policy Statement 20/17 was published on 21 December 2020[7] and final rules are now in force for accounting periods on or after 1 January 2021.

23. As documented in the exchange of letters between Chris Woolard, then Interim Chief Executive, and the Minister for Pensions and Financial Inclusion, the FCA plan to consult on TCFD-aligned rules for asset managers and for workplace personal pension schemes[8] in the first half of 2021. Subject to that consultation, it is proposed that final rules will be published by the end of 2021 and come into

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[5] UK joint regulator and government TCFD Taskforce: Interim Report and Roadmap - Published 9 Nov 2020

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

[7] https://www.fca.org.uk/publications/policy-statements/ps20-17-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing

[8] Correspondence between Christopher Woolard, Financial Conduct Authority, and Guy Opperman MP, Minister for Pensions and Financial Inclusion. https://www.gov.uk/government/publications/financial-conduct-authoritys-plans-for-climate-related-financial-disclosures

force in 2022. This will increase the flow of data that is vital to trustees to embed effective climate risk governance.

24. This process will be accelerated further by regulatory alignment throughout the investment chain, which, by the end of 2023, will also capture UK-registered large private companies, insurance companies and banks (many of which in the latter two groups will also be caught by the FCA's new rules for listed companies). The FCA have also stated in the Roadmap their intention to extend requirements to a wider scope of listed commercial companies, and to consult on proposed new rules in the first half of next year.

25. DWP has worked closely with the cross-government and regulator TCFD taskforce as they formulated their respective TCFD reporting proposals to ensure that there is broad consistency and comparability whilst, in line with the TCFD Interim Report, permitting the issuance of guidance or non-binding expectations for certain participants.

26. Regulatory alignment across the finance sector is vital, but we recognise that occupational pension schemes, sitting at the top of the investment chain, are dependent on investee firms producing and disclosing data and on asset managers aggregating and analysing this information at the fund or mandate level in order for trustees to aggregate and analyse across the whole portfolio. The part of the process over which trustees have control is therefore heavily dependent on other participants in the investment chain.

27. We recognise that capabilities of financial market participants are developing quickly and the Government, along with regulators, continues to review the levers it holds to promote greater data disclosure to address incomplete data flows. Pension scheme trustees must also recognise their role in unlocking and improving the flow of quality data. Trustees of the largest schemes, upon whom the requirements will fall first, are well-placed to do this

28. Nevertheless, we are mandating a proportionate approach. To reflect this challenge, we proposed that trustees would be required in regulations to carry out scenario analysis and obtain data to calculate their chosen metrics 'as far as they are able'[9].This is defined in the draft regulations[10] to mean that trustees are expected to take all such steps as are reasonable and proportionate in the particular circumstances, taking into account the costs incurred, or likely to be incurred, by the scheme and the time required to be spent by the trustees, or anyone acting on their behalf.

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[9] We also acknowledged that trustees would not be able to collect complete data on metrics - we proposed that regulations would require trustees to explain in their TCFD Report why the data they had chosen to disclose did not fully cover the portfolio or extend to all scopes of emissions. This remains our policy – see chapter 8.

[10] See paragraph 19 of the Schedule to the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations.

29. There is no expectation that trustees or those acting on their behalf should spend disproportionate amounts of time attempting to fill non-material data gaps in relation to firms which are unlikely – due to their business activities or size – to contribute to the level of climate-related risk faced by the scheme. Trustees should be prioritising engagement on persistent data gaps which are likely to make the most material difference to the level of climate risk, to ensure that data quality continues to improve. Additional information requests to fill data gaps should be made with due regard to the size and scale of the investee company in question.

Paris alignment and "Implied temperature rise"

30. In Chapter 1 of the August consultation, we included a section on Paris alignment and "implied temperature rise" (ITR). ITR is also known as "degree warming", "temperature score" or "portfolio warming potential". ITR is one way of understanding and reporting progress towards alignment with the goal on global average temperature rise set out in the Paris Agreement.

31. We were clear that we were not formally consulting on proposals for trustees to calculate and report the ITR of their portfolios. However, we set out the benefits and current challenges of measuring, and reporting, an ITR. In summary, the benefits include:

    - The forward-looking nature of the assessment, which can provide valuable information to trustees, savers and others about progress towards limiting the global average temperature rise.
    - 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.
    - Reporting an ITR could provide scheme members (and The Pensions Regulator ("TPR")) with a simple metric to understand the scheme's current position in relation to addressing climate change-related risks.
    - Trustees and their advisers would benefit from sight of other schemes' reported ITR and this may stimulate improved climate change-related policies and practices across the sector.

32. We acknowledged that challenges arise from the fact that the Paris Agreement was not written specifically for investors or businesses. We also noted that in order for ITR to be an effective metric for pension schemes, there needs to be a reliable and effective methodology, or methodologies, to calculate it. It is important that pension schemes, and their stakeholders, are able to rely on the output of any methodology and to trust in its accuracy. We referred to the work that is underway by industry to review and assess the emerging approaches to measuring and reporting information on the position of portfolios relative to the transition to the net zero carbon economy. However, we noted that the available methodologies for measuring ITR were not widely considered to be sufficient.

33. We have continued to engage with stakeholders working in this area and have found that there is still significant work to be done in the development and understanding of methodologies to measure ITR. In particular, a comprehensive review of the leading methodologies was published in November 2020 in the report "Measuring Portfolio Alignment" by the Portfolio Alignment Team[11]. This report concludes that there is a range of approaches to measuring portfolio alignment on a spectrum of sophistication – from the percentage of assets with net zero targets, to the deviation from benchmarks or targets, to degree warming metrics/ITR. As methods become increasingly sophisticated, they become potentially more decision-useful – and more complex.

34. Degree warming metrics have the potential to be a powerful tool but require further work on key methodological judgements and data inputs to make them sufficiently transparent and robust for widespread adoption. The report sets the direction and specific areas for further work, which will hopefully move the debate forward and contribute to further development and improvement of these methods.

35. In the meantime, the continuing rapid evolution of methodologies still poses the risk that different approaches could lead to different results being calculated for the same portfolio/assets. This uncertainty poses a risk to the success of any mandatory requirement related to ITR, until the methods mature.

36. Although we did not consult on proposals to introduce ITR reporting, some stakeholders chose to provide their views on ITR. This included views on our expressed intention to consult on ITR reporting in the future. Support was expressed for the concept, which was recognised as a potentially useful and powerful metric.

    "The comments of the current document about how [ITR] is a simple and comparable representation of complex information suggest that it is the sort of metric which would be welcomed by members of USS."
    Ethics for USS

    "We support the Government's intention to consult on alignment of pensions portfolios to the Paris Goals in the future."
    Institute and Faculty of Actuaries

    "We note and support the Government's intention to consult on the alignment of in-scope schemes to the policy objective of Net Zero carbon emissions in the short term."
    EY

37. A number of responses raised concerns about the methodological challenges, based on their own experience of work in this area.

[11] https://www.tcfdhub.org/wp-content/uploads/2020/10/PAT-Report-20201109-Final.pdf

"The conclusions of [our] work highlighted a number of data and methodological challenges with reporting alignment of portfolios based on an implied temperature rise metric. We are therefore cautious about the DWP proposal to require pension funds to report against such a metric in the future. However, we welcome the broader objective to encourage pensions funds to assess and report on their alignment with the goals of the Paris Agreement."
IIGCC

"We would also question whether the methodology to provide the footprinting required for an Implied Temperature Rise (ITR) exists. Working with other pension funds, USS published a report in 2018 … highlighting the challenges associated with carbon footprinting of all the asset classes likely to be held by pension funds. More work and guidance are therefore required in this area for ITRs to provide a meaningful and comparative number."
USS

"There are significant methodological challenges to introducing such an expectation at this stage that must be worked through before this is endorsed by regulators."
Investment Association

38. As there is still uncertainty and inconsistency between the methodologies used to measure ITR, it is our view that now is not the time to consult on making it mandatory for trustees to measure and report their ITR. To do so now would be to ignore the evidence that significant issues could undermine the efficacy of mandating it. However, we still recognise the potential benefits of trustees working out the ITR of their portfolios. We have therefore included the option of a portfolio alignment metric within the draft statutory guidance accompanying our proposals on metrics and targets.

39. We will continue to monitor the development of methodologies in this area and to engage with those who are closely involved in this work. We encourage interested stakeholders to do the same, including engaging with the aforementioned report by the Portfolio Alignment Team (paragraph 33) which provides helpful insights and information for those who are interested in understanding these metrics. We also support work by methodology providers in this space to help address the issues raised by the Portfolio Alignment Team's work. We continue to actively consider a further consultation on this area in 2021 when sufficient progress has been made.

Responses to the consultation

40. The consultation on policy proposals[12] was launched on 26 August 2020 and ran for 6 weeks.

41. We received 99 formal responses to the consultation itself. These were made up of 25 responses from corporate or industry-wide occupational schemes; 10 trade bodies; 9 membership bodies; 8 dedicated consultancy firms, 5 dedicated master trust sponsors, 5 firms who offer both consultancy and master trusts; 7 law firms; 6 civil society bodies; 5 investment managers and 5 Local Government Pension Scheme bodies; 3 individuals; 2 each of insurer/master trust sponsors, trade unions and data providers; 1 professional trustee firm, personal pension provider and fiduciary manager; and a statutory body.

42. In addition, we have conducted a range of informal follow-up engagement with stakeholders, including trustees, consultants, investment managers, law firms, actuaries, civil society bodies, and trade bodies and associations.

Summary of changes

43. The changes we have made to our original policy proposals are summarised below. The Department's rationale for these changes is detailed in the following chapters.

Scope and Timing (chapter 2)

We have made provision to carve out bulk and individual annuity contracts for the purposes of determining whether the asset threshold at which the requirements apply has been met.

We have also made provision for determining the assets of "earmarked schemes". We are consulting on this proposed change.

A common TCFD report publication deadline will apply for all schemes in scope of 7 months from their respective scheme year end.

The "reference date" used for the purposes of determining whether a scheme is in scope, has been changed from 1 June 2020 to 1 March 2020 for the first wave of schemes in scope, and from 1 June 2021 to 1 March 2021 for the second wave. If audited accounts for the relevant scheme year are not obtained by the date the requirements would otherwise apply, then they will apply from the date the audited accounts are obtained. We are also consulting on both of these proposed changes.

Reporting duties will not apply to trustees of non-authorised schemes where the scheme's relevant assets are zero at scheme year end.

[12] This included consulting on changes to the Register of Occupational and Personal Pension Schemes Regulations 2005 (SI 2005/597) and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734)

We have brought forward the start date for our review of the requirements to the second half of 2023.

Trustee knowledge and understanding (chapter 3) – Trustees must have an appropriate degree of knowledge and understanding of the principles relating to the identification, assessment and management of climate change risks and opportunities.

Governance (chapter 4) – We have clarified our proposals in respect of "persons managing the scheme". Trustees must establish processes for satisfying themselves that those who undertake governance activities in relation to the scheme and those who advise or assist the trustees with respect to governance activities – otherwise than as a legal adviser – are taking adequate steps to identify, assess and, where relevant, manage climate-related risks and opportunities.

Strategy (chapter 5) – Regulations will set out what factors trustees must consider in setting time horizons. Trustees must disclose their chosen time horizons. Trustees will not be required to describe in their disclosures the climate-related risks and opportunities relevant to the scheme which are identified by persons other than the trustees.

Scenario analysis (chapter 6)

Trustees must undertake scenario analysis in the first year and every three years thereafter. In other years they must review whether or not circumstances are such that they should refresh their analysis, or, if they decide not to, explain why.

We are also providing more explanation in the statutory guidance on what is expected of trustees in respect of the requirement to undertake certain activities "as far as they are able". The meaning of "as far as they are able" is defined in the draft regulations.

Risk Management (chapter 7) – No changes

Metrics (chapter 8)

Trustees must select a minimum of two emissions-based metrics, one of which must be an absolute measure of emissions and one which must be an intensity-based measure of emissions, as well as one additional climate-related metric.

Trustees will be required, as far as they are able, to obtain the data required to calculate their chosen metrics on an annual basis – rather than quarterly

The "as far as they are able" provision has been extended to include not just the collection of data, but also the calculation and use of the metric.

Targets (chapter 9) – Performance against targets is to be measured annually rather than quarterly. We have also provided for annual review of any targets, for trustees to determine whether they should be maintained or replaced.

Disclosure (chapter 10)

The website address of the published TCFD report must also be added to the annual funding statement for DB schemes to make it more widely known to members.

The Chair of trustees must sign the TCFD report, although the signature itself need not be published.

Trustees who have not yet produced their first TCFD report are required to inform TPR whether the period for doing so has ended in the scheme return.

Penalties (chapter 11) – no changes.

Summary of our policy

Following consideration of the responses to the August 2020 consultation our policy as it now stands is shown below.

Scope and Timing (chapter 2)

Schemes can come into scope on a threshold test:

The condition	Governance requirement	Disclosure Requirements	
If	*Trustees must meet the climate change governance requirements for*	*Trustees must publish a TCFD report*	*Trustees must include a link to the report in:*
On 1st scheme year end date to fall on or after 1 March 2020: the scheme has relevant assets ≥ £5bn	Current scheme year from 1 October 2021* to end of that scheme year. *And* [unless scheme's relevant assets are <£500m on the scheme year end date] Next full scheme year to begin after 1 October 2021 to end of that scheme year. And so on.	Within 7 months of the end of the scheme year which is underway on 1 October 2021†. *And* Within 7 months of the end of the next scheme year to begin after 1 October 2021† And so on	The Annual Report and Accounts produced for that scheme year
On 1st scheme year end date to fall on or after 1 March 2021: the scheme has relevant assets ≥ £1bn	Current scheme year from 1 October 2022* to end of that scheme year And so on	Within 7 months of the end of the scheme year which is underway on 1 October 2022†. And so on.	
From any scheme year end date to fall on or after 1 March 2022 The scheme has relevant assets ≥ £1bn	The beginning of the scheme year which is one scheme year and a day after that scheme year end date	Within 7 months of end of that full scheme year†	

* unless audited accounts have not been obtained in respect of that scheme year, in which case they apply from the date they are obtained.
† unless scheme's relevant assets are zero on the scheme year end date.

Relevant assets are (except in the case of earmarked schemes) the net assets of the scheme, excluding relevant contracts of insurance (bulk and individual annuity contracts).

Or via an authorisation test

The condition	**Governance requirement**	**Disclosure Requirements**	
If	*Trustees must meet the climate change governance requirements for*	*Trustees must publish a TCFD report*	*Trustees must include a link to the TCFD report from*
On or after 1 October 2021, the scheme is [or becomes] an authorised master trust *Or* On or after 1 October 2021 the scheme is [or becomes] an authorised scheme providing collective money purchase benefits	Current scheme year which is underway to the end of that scheme year. *And* [unless scheme is both no longer authorised and relevant assets at previous scheme year end are <£500m] Subsequent scheme years.	Within 7 months of the end of the scheme year which is underway. *And* Within 7 months of the end of subsequent scheme years.	The Annual Report and Accounts produced for that scheme year

Schemes fall out scope through no longer being authorised and/or having assets of less than £500m

The condition	**Governance requirement**	**Disclosure Requirements**	
If	*Trustees' climate governance requirements*	*Trustees TCFD report publishing duties*	*Trustees must include a link to the TCFD report from*
After 1st October 2021 the scheme Ceases to be an authorised master trust *Or* Ceases to be an authorised scheme providing collective money purchase benefits *And* Has relevant assets < £500m at end of previous scheme year	End with immediate effect	End with immediate effect	N/A
On scheme year end date falling after 1 October 2021 The scheme has relevant assets <£500m and is not an authorised scheme.	End with immediate effect	Must be met within 7 months of the end of the scheme year[†] And fall away thereafter.	The annual report and accounts produced for that scheme year

[†] unless scheme's relevant assets are zero on the scheme year end date

Review
We will take stock in 2023 and consult more widely again in 2024 before deciding whether to extend the regime to schemes with < £1bn in assets, taking account of the quality of climate risk governance and associated disclosures carried out to date, and the current and future costs of compliance.

Climate Change Governance Requirements (chapters 3-9)

Regulations vs. Statutory Guidance

Regulations would require trustees to meet climate change governance requirements which underpin the 11 recommendations of the TCFD, and to report on how they have done so. Statutory guidance, which trustees must have regard to, will set out how trustees should meet the requirements and report in line with the TCFD recommendations.

Trustees must meet the standards required by regulations. They would be required by new sections 41A(7) and 41B(3) of the Pensions Act 1995[13] to have regard to the statutory guidance. Where trustees choose to diverge from statutory guidance, they need to be able to explain their reasons for doing so and it is therefore expected that they set these out in their TCFD report.

“As far as they are able”

Trustees must carry out scenario analysis, obtain data, calculate and use metrics and measure performance against trustee-set targets ‘as far as they are able’. This means taking all such steps as are reasonable and proportionate in the particular circumstances taking into account the costs, or likely costs, which will be incurred by scheme and the time required to be spent by the trustees or people acting on their behalf. Steps trustees should take to meet requirements “as far as they are able” are set out in the draft statutory guidance.

Ongoing and annual duties

All duties are ongoing, except requirements to conduct scenario analysis, calculate metrics and set and review performance against targets.

Scenario analysis must be carried out in the first year in which the climate change governance requirements apply to the trustees of the scheme and then at least every three years thereafter. In addition, trustees must, in the intervening years, review whether or not circumstances are such that they should refresh their analysis, taking account of matters in the statutory guidance (including increased availability of data, or a significant change in investment or funding strategy) and either carry out fresh scenario analysis or explain in their annual TCFD report why they have decided not to do so.

Underlying data for trustees' chosen metrics and targets must be obtained, the metrics calculated, and performance against targets measured, at least annually.

Governance

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

[13] See clause 124 of the Pension Schemes Bill [HL] 2019-21.

respect to governance are taking adequate steps to identify and assess climate-related risks and opportunities.

In their annual TCFD report, trustees must describe how such oversight is maintained. they must describe the role of any person who undertakes governance activities on their behalf in identifying, assessing and managing climate-related risks and opportunities relevant to the scheme and the process by which the trustees satisfy themselves that the person is undertaking such assessment and management. They must also describe the role of any person (with the exception of legal advisers) who assists or advises the trustees with respect to governance and the process by which the trustees satisfy themselves that the person is taking adequate steps to identify and assess climate-related risks and opportunities relevant to the matters in respect of which the person is advising.

Strategy

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

Short, medium and long term are such periods as the trustees deem appropriate, taking into account the scheme's liabilities and its obligations to pay benefits.

In their annual TCFD report, trustees must describe the time periods that they have chosen for the short, medium and long term, the risks and opportunities they have identified and their impact on the scheme's investment strategy and (where it has one) the scheme's funding strategy.

Scenario analysis

Trustees must, as far as they are able, undertake scenario analysis assessing the impact on the scheme's assets and liabilities, the resilience of the scheme's investment strategy and (where it has one) the scheme's funding strategy for at least two scenarios – one of which corresponds to a global average temperature rise of between 1.5 and 2°C inclusive on pre-industrial levels.

In their annual TCFD report, trustees must describe the most recent scenarios they have analysed, the potential impact on the scheme's assets and liabilities and the resilience of the scheme's investment strategy and (where it has one) funding strategy in those scenarios, and their reason for not carrying out a new scenario analysis if they have not done one.

Trustees should carry out scenario analysis as far as they are able in relation to all the scheme's assets, including relevant contracts of insurance. We are consulting on this policy.

Risk management

Trustees must establish and maintain processes for the purpose of enabling them to identify, assess and effectively manage climate-related risks which are relevant to the scheme. They must also ensure that management of climate-related risks is integrated into their overall risk management of the scheme.

In their annual TCFD report, trustees must describe these processes and how they are integrated into the trustees' overall risk management of the scheme.

Metrics

Trustees must select and as far as they are able calculate an absolute emissions metric and an emissions intensity metric in respect of the scheme's assets. Draft statutory guidance proposes that trustees should use total emissions and carbon footprint metrics – calculating

scope 1, 2 and 3 greenhouse gas emissions. Trustees must also select one additional climate change metric to calculate in respect of the scheme's assets. Draft statutory guidance suggests a range of measures, including an implied temperature rise or climate value at risk measure. Trustees must review their selection of metrics from time to time as appropriate to the scheme.

In their annual TCFD report, trustees must describe the metrics they have calculated and if they have not been able to obtain data to calculate the metrics for all of the assets of the scheme, the reasons for this.

Targets

Trustees must set a non-binding target for the scheme in relation to at least one of the metrics which they have selected to calculate. On an annual basis they must measure performance against the target (as far as are they are able) and taking into account the scheme's performance they must decide whether to retain or replace the target.

In their annual TCFD report, trustees must describe the target or targets which they have set, and the performance of the scheme against them.

Trustee knowledge and understanding

Trustees must have the appropriate degree of knowledge and understanding of the principles relating to the identification, assessment and management of climate change risks and opportunities in respect of occupational pension schemes, for the purposes of enabling them to properly exercise their functions. These principles will be prescribed matters for the purposes of the Pensions Act 2004.

Disclosure (chapter 10)

Publishing the TCFD disclosures

Trustees are required to publish their TCFD report on a publicly available website, accessible free of charge. The Chair of trustees must sign the report.

The TCFD report must be referenced from – but need not be included in – the Annual Report.

Further expectations on publication to which trustees must have regard is set out in the draft statutory guidance.

Telling members about the TCFD report

Members must be told via any annual benefit statement they receive that the report has been published and where they can locate it. Trustees of DB schemes must also provide this information to members via the scheme funding statement.

Where the annual benefit statement is issued in advance of the TCFD report for that year, trustees should direct members to the most recently published TCFD report, or in the first year, the location where the TCFD report will be published in due course. This is set out in further detail in the draft statutory guidance.

Reporting information back to TPR

Trustees must provide TPR with the website address where they have published their most recent TCFD report via the annual scheme return form. Where trustees have not yet published their first report, they must inform TPR whether the period for doing so has ended. Trustees must also provide TPR with the website address of their published Statement of

Investment Principles ("SIP") and (where applicable) implementation statement and published excerpts of the Chair's Statement in the annual scheme return form.

Integration with existing requirements

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[14] insofar as they relate to climate change.

Penalties (chapter 11)

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, reporting and publication could be imposed without recourse to the Determinations Panel, in a similar way to the penalty regime that applies under the Charges and Governance Regulations[15].

The 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 Disclosure Regulations[16]. The requirements to inform TPR of the website address of the published TCFD report – or that the period for publishing the report has not ended – and of the website 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[17].

Under section 13 of the Pensions Act 2004, TPR are able to issue an improvement notice to a person contravening one or more provisions of that Act – this includes the trustee knowledge and understanding requirements. If a trustee fails to comply with an improvement notice, then they would be subject to the penalty regime in section 10 of the Pensions Act 1995.

[14] To be issued by The Pensions Regulator (TPR) in accordance with the Occupational Pension Schemes (Governance)(Amendment) Regulations 2018, regulation 3.
[15] Occupational Pension Schemes (Charges and Governance) Regulations 2015 SI 2015/879
[16] Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 SI 2013/2734. See regulation 5 for the penalty provisions.
[17] See section 64(2) of the Pensions Act 2004 (c. 35).

Chapter 2: Scope and timing

1. This chapter covers the Government's proposals for the scope and timing of requirements relating to pension scheme climate change governance, and in relation to disclosures aligned with the TCFD recommendations.
2. It summarises consultation feedback and sets out Government's response for each in turn of the scope of the proposals, the timing of their implementation and our proposed review of the measures.
3. After the sections on scope and timing, we also set out our consultation on proposed regulations to achieve the updated policy intent.

Scope

Background

4. We highlighted in our accompanying impact assessment to the policy consultation that many of our climate change governance requirements merely put trustees' existing fiduciary duty onto a statutory footing and did not impose new costs that trustees should not already be incurring. Where there were significant new costs, these would not typically constitute a significant proportion of governance spend for larger schemes.
5. Even following revision of some of those costs, described in chapter 12 of this consultation, the costs of ongoing climate change governance measures and associated disclosures for a typical £1bn scheme might constitute 2-4%[18] of a scheme's annual governance spend. We believe that this is a reasonable proportion for the oversight of both a very significant risk and opportunity to investment and funding.
6. We also noted that for this exercise to be cost-neutral to a typical scheme, 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 0.002% of the assets under management, or marginally under one-fifth of one basis point (bps).
7. For master trusts and schemes offering collective money purchase benefits, we pointed out that authorised schemes are expected to have met a range of

[18] In the accompanying impact assessment, we estimate the ongoing burdens to business of complying with the requirements (those which are not already part of trustees' fiduciary duty at £19K for the most common type of scheme [first year burden on business is estimated to be £26K for most types of scheme]. We previously estimated that a scheme with £1bn in assets might have a typical spend of £5 million to £10 million per year, of which approximately 90% of this might be committed to core services associated with administration or investment. This proportion of governance spend would therefore be £19K as a proportion of £0.5-£1.0M, or approximately 2-4%.

minimum governance standards, in relation to systems and processes for risk management, investments and member communication, as well as in relation to scheme objectives, strategy, business plan and investment strategy.

8. We also highlighted the importance of a level playing-field for authorised schemes, and well-run schemes not being undercut by badly run competitors who do not take full account of climate change considerations and who expose members to unnecessary risk.

We proposed that the following schemes should be in scope of the mandatory climate change governance and TCFD reporting requirements:

(a) trust schemes with £1 billion or more in net assets
(b) authorised master trusts
(c) authorised schemes providing collective money purchase benefits

Summary of responses

9. Very few respondents were opposed to the proposals in full, and a significant majority of respondents supported the concept of an asset-based threshold.

"The Co-op is supportive of measures to encourage pension schemes to consider climate risk. The initial focus on schemes that would be expected to have greater governance capacity is reasonable, and the list of in scope schemes is consistent with that approach."
Co-operative Group

"We are supportive of the policy proposals and that it is sensible to start with the largest occupational trust schemes which will have greater resources to implement these requirements (and many have already taken some steps towards these)."
Association of Consulting Actuaries

10. However, there were a range of suggestions for how the scope of the measures might be adjusted, either reducing or expanding the scope.

Excluding closed or derisked schemes, or derisked assets

11. A number of respondents identified that the value of assets under management was a broad measure, which did not necessarily reflect the level of scheme risk from climate change.

"Whilst segregating reporting requirements by size of scheme is a useful start, it could be quite a blunt tool. We do clearly recognise that climate change is still an important factor for us to consider but our main exposure will be to gilts and insurers (through the buy-ins – and the buy-ins are in effect an irreversible investment)."
Kingfisher Pension Scheme

12. Some respondents suggested that allowance might be made for closed defined benefit schemes.

“Further distinction could be around whether a scheme is open or closed. A closed defined benefit will be on a path to de-risking with half or more of its assets invested in UK government fixed rate or index linked gilts and the trend being to increase these and reduce its exposure to return seeking assets.”
Nationwide Pension Fund

13. Others argued that only the “risk assets” held by the scheme should count towards a threshold.

“Exemptions from reporting should also apply to schemes with assets in excess of £1bn where the assets of the Scheme are substantially invested in low-risk strategies…. The Trustee believes that cash, gilts (including gilt exposures gained via derivatives or repo), interest rate and inflation swaps and bulk annuities, should be excluded from the asset test.”
ICI Pension Fund

14. A further viewpoint was that fully-funded and fully hedged schemes might be excluded.

“More generally, many mature schemes are also fully funded and fully hedged – and for these schemes, with only a very short time horizon, the burden of this process may far outweigh any benefits that arise from the process.”
Association of Pension Lawyers

15. Other proposals included the suggestion that all of the measures should be comply or explain.

Changes to the proposed £1bn threshold

16. A small number of respondents suggested that the £1bn threshold should be raised significantly, at least initially.

“If the bulk of the disclosure preparation falls onto the scheme itself, then the expense will be difficult for schemes to bear the smaller they are, and the cost of doing so would not offer value for members of small DC schemes in particular. Under this scenario we believe that even the £5 billion threshold may be too low and it would be better to first apply the rules to £10 billion schemes.”
Law Debenture

17. More commonly, respondents suggested that the asset threshold should move rapidly to below £1bn.

“We ask that policy makers proactively encourage smaller schemes to manage climate risk and TCFD is a sensible framework, irrespective of size. It is unfair that some beneficiaries will have their retirement savings at higher risk just because their fund is smaller. There is an urgent need for the industry to be creative in developing solutions that are time and cost effective for small schemes.”
Brunel Pension Partnership

18. A significant number of respondents suggested that smaller schemes might be encouraged to implement the climate governance requirements voluntarily in the first instance, or perhaps on a comply or explain basis.

"Government may wish to encourage occupational pension schemes generally to voluntarily report in line with TCFD proposals as best they can (recognising that TCFD reporting can be implemented in stages) by requiring scheme's to include in their ESG polices whether or not they report in line with any TCFD recommendations".
Mercer

Treatment of small master trusts

19. Seven out of 99 responses suggested that authorised master trusts with less than £1bn in assets under management should be excluded from scope. A number of reasons were suggested:

"Not all authorised master trusts have achieved scale therefore applying the climate governance and reporting requirements to all of them could be unreasonably burdensome. Therefore, we recommend that the size criterion applied to trust-based DB and DC schemes should also be applied to authorised master trusts."
ICAS

"The cost of compliance with the proposals is likely to be a mostly fixed cost (i.e. not significantly linked to net asset size or membership) with a more significant up-front cost in the first year or two. Larger schemes will generally be able to absorb those costs much more easily."
Creative Benefits

20. However, this view was not shared by many respondents.

"We consider the proposal to not include a size threshold for authorised master trusts to be reasonable for the following reasons:
– a large proportion of authorised master trusts have assets of over £1bn and we expect that assets under management will continue to grow
– as all master trusts are subject to the same authorisation framework, we would expect them to be subject to consistent regulatory requirements. Pension scheme trustees that are in the process of selecting a master trust should not use the regulatory requirements the master trust is subject to as a factor in their decision-making process"
EY

"Given that defined contribution (DC) master trusts are where smaller DC schemes go to consolidate, especially where trustees struggle to meet increasing governance requirements, these schemes need to begin sooner rather than later."
Barnett Waddingham

Treatment of DB superfunds

21. Some respondents suggested that DB consolidators, or superfunds, should be in scope irrespective of assets under management.

    "We agree that all the above should be included, but do not see the logic of excluding superfunds with less than £1 billion of assets, given that they will have factored compliance issues into their set up costs in their business plans and will be expected to reflect high standards of governance, such that the additional cost of TFCD reporting should be easily absorbable."
    Electricity Supply Pension Scheme

Consideration of buy-ins and other potential exclusions

22. The most frequent suggestion made by respondents related to the treatment of buy-ins – where trustees choose to invest scheme assets in a bulk annuity contract that covers some or all of the liabilities under their scheme, and the bulk annuity contract is held within the scheme – and whether the assets covered by such arrangements should be disregarded for the purposes of the asset threshold test.

    "We would, however, welcome clarity on how the 'edge' cases would be treated, including schemes with significant buy-ins, where there is no expectation of surrender and where there is limited-to-no opportunity to direct the way the assets are invested. Excluding buy-in policies from the asset threshold calculation could be a pragmatic approach."
    Aon

23. Some respondents highlighted that our proposals appeared to suggest buy-ins were not considered for the purposes of the assets under management, whilst not explicitly carving them out.

    "Paragraph 54 of Chapter 2 suggests that bulk annuity contracts will reduce the net assets of schemes for the purposes of their annual report and accounts. However, since 1 January 2015 in accordance with FRS 102, we understand that pension schemes' accounts must include bulk annuity contract values in their net assets. Nonetheless, we do agree that bulk annuity contracts should be excluded from the net assets of schemes when determining whether they are above the £5bn (or later £1bn) threshold."
    Lane Clark & Peacock LLP

24. One respondent raised a query about the treatment of schemes with other insurance products.

    "Within insured schemes, which many occupational pension schemes are, the trustee owns a contract of insurance and does not own any funds, units in funds or direct investments (for instance shares, bonds, etc.)…. It is not clear in the consultation what the expectations on these trustees, or the insurers who have the contract with them, will lead to."
    ABI

25. A small number of respondents suggested other exclusions, including exclusion of schemes which were in PPF assessment, or schemes in wind-up.

26. Finally, we received queries from stakeholders on the treatment of sectionalised schemes as well as common investment funds.

Government Response

Excluding closed or derisked schemes, or derisked assets

27. We note stakeholder concerns that an asset-based threshold is a relatively broad-brush approach to defining the scope of our proposals.

28. However, the alternative approaches floated by respondents would likely be as blunt or blunter whilst typically more complex to apply. Furthermore, they would disregard the likelihood that for all types of schemes, irrespective of their status, their assets or their level of funding would be exposed to some climate change risk.

29. For example, lifting requirements partially or fully from those schemes which were closed to new accrual would disregard the higher typical allocation to risk assets in schemes which had been recently closed compared with those which had been closed many years before and had a much more mature membership.

30. Similarly, setting aside categories of assets and designating these as not contributing to the asset threshold would tend to suggest that they are not exposed to climate risk. This would be wrong. All derivatives will be exposed to climate risk in "the underlying", as well as counterparty risk like any other asset, and some commentators have set out how these risks might begin to be evaluated[19]. Tax revenues of some Governments are significantly more exposed to transition risk whilst others are more exposed to physical climate risks – both of these affect the level of climate risk in sovereign bonds. Models are emerging which seek to take account of some of these risks[20].

31. Finally, fully hedged or fully funded schemes are still exposed to some climate risk. The hedging instruments themselves carry a counterparty risk as indicated above. Full funding is based on an assessment of the returns associated with the scheme assets and the assumptions used to set the liabilities. Both of these should be tested against different climate scenarios.

32. In conclusion, it is right that large schemes which provide for the retirement of many thousands of savers should be subject to our requirements, irrespective of

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[19] Kerrin Rosenberg. "How should pension funds apply ESG to derivatives?" in Pensions Expert August 2020 https://www.pensions-expert.com/Comment-Analysis/How-should-pension-funds-apply-ESG-to-derivatives

[20] FTSE Russell. How to build a climate adjusted government bond index. https://www.ftserussell.com/research/how-build-climate-adjusted-government-bond-index
Global Footprint Network. Carbon Disclosure and Climate Risk In Sovereign Bond. December 2016 https://www.footprintnetwork.org/content/documents/2016-Carbon_Sovereign_Bonds.pdf

whether they are open, closed, fully- or under-funded and regardless of how they are invested.

33. Nevertheless, we acknowledge that analysis of the climate risk of certain assets as well as liabilities may well be qualitative, at least initially. A proportionate approach, which recognises the parts of the portfolio which are most exposed to climate risk, is also appropriate.

34. It will be for trustees, supported by their advisers and the Department's statutory guidance, to decide how to take account of these risks in such a way that complies with the legislation. But where further information is deemed necessary to fill data gaps, those requests of investee companies should be made with due regard to proportionality and the materiality of the risks that assets are likely to present.

35. We therefore also do not intend to offer trustees of schemes in scope the option to explain a lack of consideration of climate change, as an alternative to complying with the requirements. Trustees should be required to put in place appropriate systems of governance and risk management to monitor climate-related risks, identify and manage the risks they find and measure their impact over time, as well as report on what they have done. They cannot merely assert that the risks are not material for them.

36. We return to the issue of bulk annuities in paragraphs 49 to 53 below.

Changes to the proposed £1bn threshold

37. We explained above (paragraphs 5 and 6) that the proportion of a scheme's governance budget which would be drawn into assessing climate risk would be proportionate, and the enhancement to returns, loss avoided or a reduction in risk which would follow from better climate governance could, with a reasonably high degree of confidence, exceed the costs.

38. Notwithstanding the upward revisions to the costs of compliance following stakeholder feedback on our impact assessment, this argument continues to hold.

39. Our argument also holds for not moving towards a lower asset-based threshold until services become more standardised and we have a clearer view on the extent to which the associated costs will fall.

40. Whilst we can see the benefits of introducing a comply or explain regime for schemes with less than £1bn of assets, we have concluded that this undermines the benefits of a phased approach. Our intention is that, with large and authorised occupational pension schemes going first, they will set an expectation and an appropriately ambitious bar that smaller schemes will seek to follow when the duties reach them.

41. Introducing a comply or explain regime for smaller schemes before the mandatory requirements bite on them could have perverse consequences. It risks schemes adopting a low-expectation mind-set whereby they deem incomplete or

poor quality disclosures as perfectly adequate, or that they can meet their statutory obligations simply by asserting that climate change is not a material risk for them, something which is generally unlikely to be the case. In the absence of TPR or Government feedback, at a time when TPR oversight will necessarily be focused on schemes which are in scope of the mandatory requirements, this risks entrenching box-ticking approaches, which will send completely the wrong signal in advance of the mandatory application of the duties.

42. We encourage trustees to get ready for the application of the climate change governance requirements to their schemes – and remind them that it is already part of their fiduciary duty to be actively considering climate change as a likely financially material risk and opportunity, as well as a statutory requirement to report on how they are doing so in their published Statement of Investment Principles. We would encourage trustees to monitor developments and look to improve their climate governance and climate risk management processes as market practices develop. However, we do not intend to legislate for sub-£1bn schemes to adopt the requirements on a comply or explain basis.

43. We cover changes to our proposed review of the measures in paragraphs 124 to 140 of this chapter.

Small master trusts

44. Our August 2020 consultation explained our rationale for applying the requirements to all authorised master trusts, including those with less than £1bn in assets – in particular, that authorised schemes must reach a higher standard, having been found by TPR to have met minimum requirements in relation to a range of activities relating to risk management, scheme objectives, strategy and business plan and investment strategy

45. We indicated that the need for trust in the market, and the need for well-run schemes not to be undercut by badly run competitors, had informed our approach. This was especially important given that many such schemes are in active competition. Whilst we note that around half of master trusts currently have less than £1bn in assets, and a small number have significantly less, that proportion is falling, and it is essential to maintain a level playing field. Many respondents agreed with this point.

46. We therefore do not intend to legislate to undermine the authorisation standard by relaxing our proposed requirements. Even where schemes are some distance from £1bn of assets and the relative governance burden may be higher, such schemes have met TPR's authorisation process, and are therefore judged to similar standards. Where schemes are "accidental master trusts" because they service a small number of unconnected employers but are not seeking to serve a wider market, they are free to move members enrolled by all but one employer to another scheme in order to remove the authorisation requirement. All master trusts are also of course free to consolidate.

Treatment of DB superfunds

47. We do intend to consult in due course on a requirement for authorised super funds to undertake climate change governance and reporting, irrespective of the value of assets under management, once there is a legislative "hook" by which they can be defined. Until there is such a hook, we intend to treat superfunds like other non-authorised schemes and mandate them to carry out TCFD once their relevant assets reach or exceed £1bn.

48. As part of the interim regime for superfunds, TPR expects[21] those setting up and running a DB superfund to produce an integrated risk management framework including a climate risk management plan. Superfunds will be expected to develop a set of policies and processes in relation to the assessment of climate risk and set out their proposals for managing and monitoring those risks. Furthermore, we also anticipate that most superfund schemes would reach the £1bn threshold and fall into scope of our proposed legislative requirements relatively quickly.

Bulk and individual annuity contracts

49. Respondents to our consultation highlighted the conflict between our proposed treatment of buy-ins and financial accounting rules under FRS102. It was not our intention that the assets associated with buy-ins should contribute to the assets threshold and we have therefore sought to in our draft regulations to explicitly carve them out of the asset threshold calculation.

50. We recognise continued innovation in the space of insurance and hedging products and the need for clarity for trustees of the assets which contribute to the asset threshold and those which we do not. Our policy is for the assets to be disregarded for the purposes of the threshold test, they should meet the following requirements:

    - they must be a contract of insurance entered into by the trustees of the scheme with an insurance company regulated in the United Kingdom by the Prudential Regulation Authority (PRA);
    - the contract must provide for payments to be made by the insurance company to the trustees which are intended in all circumstances to fully meet the cost of specified benefits which are not money purchase benefits

51. We are similarly persuaded that the assets represented by annuity contracts in defined contribution schemes, where these secure the provision of a pension in payment ("a scheme pension"), should also be excluded, as long as they are entered into with a PRA-regulated insurance company and that company has full and ongoing discretion over the investment of the assets used to meet its liabilities to make payments.

[21] DB superfunds guidance - https://www.thepensionsregulator.gov.uk/en/document-library/regulatory-guidance/db-superfunds

52. For both individual and bulk annuity contracts, the trustees will have irreversibly surrendered control of the assets, in all but the most narrowly-defined circumstances (typically where certain narrowly-defined contractual conditions concerning insurer solvency are met). Other risks which the trustee might be expected to manage will have been removed.

53. Arrangements such as longevity swaps, or on balance-sheet capital-backed solutions and alternative insurance solutions – under which the cost of specified benefits is not fully met in all circumstances – are not exempt from the asset threshold test, as there remains a risk for the trustees to manage.

Unit-linked contracts, schemes in PPF assessment or wind-up – other queries

54. We received a number of queries in relation to other investment arrangements. The answers to these questions may be clear now that respondents have sight of the draft regulations but for the avoidance of doubt, the following points are addressed.

55. **Unit-linked contracts and fully-insured schemes** – It was always our intention that unit-linked contracts of insurance – a type of insurance policy for pension schemes under which the policyholder purchases units in a notional pool of assets and receives a return based on the performance of the notional pool – should count towards the asset threshold. These products are quite different from buy-ins – the trustees rather than the insurer bear the investment risk. The fact that the product providers are regulated by the Prudential Regulation Authority and have climate duties of their own do not justify their exclusion, just as the FCA's oversight of asset managers and their forthcoming consultation on mandatory TCFD reporting would not exclude pooled funds or segregated mandates.

56. However, where schemes' assets consist solely of unit-linked contracts or a combination of unit-linked contracts and annuities, they are not required to produce the audited accounts which we are using to determine a scheme's relevant assets (see next section on Timing).

57. For these schemes, referred to in the Audited Account Regulations[22] as "earmarked schemes", we are consulting here on the proposal that the relevant assets used for the purpose of determining whether the scheme is in scope are the value of the assets of the scheme represented by policies of insurance, less the value represented by any bulk or individual annuities ("relevant contract of insurance").

58. **Wind-up** – we do not intend to lift the climate change governance and reporting requirements for schemes in wind-up. Other governance requirements, such as the Chair's Statement, Statement of Investment Principles and Implementation Statements remain in place for schemes in wind up, which can continue for a

[22] The Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (SI 1996/1975)

number of years. Climate change risk is not purely a long-term consideration. As the scheme remains exposed to climate change risk during the wind up period, – it is appropriate that it should for the duration remain subject to the climate governance duties as well as reporting in line with the TCFD recommendations.

59. **PPF assessment phase** – neither do we intend to lift the requirements for schemes in the PPF assessment phase. Whilst the PPF assessment phase is generally shorter than for wind-up and changes to investment policy may be more restricted, climate risks can still materialise in the interim period, and other investment governance requirements such as the annual report and accounts or the statement of investment principles are not suspended during the assessment phase.

60. Additionally, entering the assessment phase is dependent on the scheme's sponsor experiencing a qualifying insolvency event. We understand that insolvency events thought to meet the qualifying criteria are sometimes found later not to have done so. In this scenario, trustees would be under the impression that the climate change governance and reporting requirements had been lifted from them, only to subsequently find that they had applied all along and the trustees were in breach for failing to meet them. This places trustees in an impossible position. We therefore do not intend to deviate from the approach taken for other governance and disclosure requirements whilst schemes are in the PPF Assessment phase.

61. **Sectionalised schemes** – the asset threshold is intended to apply at scheme level, rather than at section level, and the duties to be imposed under the regulations are on the trustees of the scheme, rather than any governance committee appointed to manage a particular section. This applies in traditional sectionalised schemes, such as DB multi-employer schemes used in former nationalised industries, and in modern typically insurer or consultant led DC or DB master trust schemes where one or more employers have asked the trustees to adopt bespoke investment approaches or segregate their funds from other funds.

62. Trustees will of course wish to engage with the governance bodies of any underlying "section" where necessary, to obtain data, share results and consider associated reporting and consequent changes to investment approach, in the usual way. Chapter 5 and accompanying draft statutory guidance makes clear how funds and sections should be treated for the purposes of strategy, scenario analysis and metrics.

63. **Common investment funds** – the proposals do not take account of the vehicles in which trustees invest. Even where schemes which each have individual assets below the threshold invest in a common investment fund with assets in excess of £1bn, the duties do not bite on any of the investing schemes or the common

investment fund itself. The relevant assets at scheme level, and the authorisation of the scheme, are the only matters that are taken into account.

Summary of changes

We have made explicit provision in our proposed regulations to carve out bulk and individual annuity contracts for the purposes of determining whether the asset threshold has been met.

We have also made provision for determining the assets of “earmarked schemes”, under which the benefits are secured by one or more policies of insurance or annuity contracts. We are consulting on this proposal.

We have not made any other changes.

Timing

Background

64. We proposed a phased rollout of the climate change governance and TCFD-aligned reporting duties to schemes which are not authorised master trusts or authorised to provide collective money purchase benefits, with trustees of schemes with £5bn or more in net assets required to report in line with the TCFD recommendations first. 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.

65. We proposed a different 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.

66. We proposed a lower asset threshold or “trapdoor” at which schemes – once in scope – would fall out again, to reflect the fact that once the climate change governance duties are in place it should become easier for trustees to continue to follow them and report on them.

We proposed that:

(a) trustees of schemes with £5 billion or more in net assets on their first scheme year end date to fall on or after 1 June 2020 were 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 £1 billion or more in net assets on the first scheme year end date to fall on or after 1 June 2021 were 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 were 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 became authorised were 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 ceased to require authorisation, the climate governance and TCFD-aligned reporting requirements fell 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 £1 billion or more in net assets on any subsequent scheme year end date:

•were subject to the climate governance requirements starting from one year after the scheme year end date on which the £1 billion asset threshold was met

•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 ceased 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

Summary of responses

67. There was broad support for phasing duties by beginning with schemes of £5bn or more in net assets before extending the requirements to schemes with £1bn or more of assets:

“The Impact Assessment highlights that the staged approach would ‘allow small/medium-sized schemes to learn from the largest schemes who set industry standards and are in a better position to meet the new requirements and disclose’ – we also share this view.”
Bloomberg

“We agree with the proposals in respect to the segmentation by scheme size.… Likewise, we welcome the ‘staircase approach’ in the timing, requiring integration of the TCFD recommendations in year 1 and public disclosure in year 2…We

believe this phased approach (both on scope and timing) provides pension schemes with solid building blocks to allow the most effective adoption of TCFD in the UK by pension schemes."
BlackRock

68. This view wasn't universally held however.

"Multiple criteria and differing deadlines for scope definition and implementation would create unnecessary challenges and potentially cause confusion; we would recommend dramatically simplifying as far as possible the scope and deadlines for implementation, ideally with a single date for implementation and accountability across schemes."
CFA UK

69. Many respondents also noted that the timescales are challenging:

"Given the potential compliance burden of the new duties ... the proposed timing of the first two phases (from October 2021 and October 2022) seems ambitious on any view."
Travers Smith

70. Other schemes identified the consequent need for early sight of draft regulations to allow time to prepare.

"The regulation/requirements should be released at the earliest opportunity if it is intended for this timescale to remain. Further, there should be strong encouragement for trustees of schemes that fall into the second reporting cycle to familiarise and/or start preparing for the upcoming requirements."
XPS Pensions Group

71. Many respondents also expressed concerns about the number of annual reporting cycles for which they would be responsible – in relation to some of the requirements – for obtaining data from fund managers who had no responsibility to give it to them.

Postponing the requirements altogether

72. A small number of schemes suggested postponing the requirements altogether, and not bringing any legal governance duties into force until October 2022.

"It would be more appropriate for the timetable to start from 1 October 2022. This will also allow industry to develop solutions to the various proposals in the meantime."
NatWest Group Pension Fund

A rehearsal year

73. A few respondents also put forward the proposal of a "rehearsal year" – a first year in which trustees should make reasonable efforts to comply, but no penalties are payable.

"One possible approach might be to introduce the new requirements without penalties, to operate as a 'pipe cleaner' for Schemes and the regulator, to help establish a set of 'norms' in terms of what it is reasonable to expect in the early days and reasonable to aspire to over time ... This would allow Schemes, the regulator, advisers and other stakeholders to develop a deeper understanding of the challenges and opportunities presented by the new regime."
BAE Systems Pension Fund

Timescale for reporting from scheme year end

74. Many respondents highlighted the challenges for schemes with certain scheme year cycles to meet the proposed backstop of reporting by 31 December 2022 when the deadline for their annual report might fall up to 4 months later.

"Our scheme year ends on 30 September, which means that we will have only three months each year to produce our TCFD report. This is likely to be very problematic in the first year of production, and to some extent every year, given inevitable time lags in acquiring data for the metrics and targets section of the report."
Friends Provident Pensions Scheme

"Aligning the proposed timings to scheme year-end reporting requirements is sensible and will help schemes align their processes. However, we think the first and second reporting deadlines of 31 December 2022 and 31 December 2023 could place undue pressure on some schemes. … Whilst the bigger schemes are better placed to deal with these new requirements, there is still a lot of work that will need to be done across the industry in order to comply with these requirements, so deadlines do need to reflect this and be workable."
Gowling WLG

75. A few respondents put forward other proposals such as giving everybody until 31 December 2022 regardless of their scheme year.

"A firm deadline of 31 December 2022 for the first workplace schemes to report and 31 December 2023 for the second group might be easier to administer and avoid any confusion."
SmartPension

Ongoing governance requirements and a lower threshold

76. A few respondents suggested the lower asset threshold – below which duties fall away – be lowered further, or abolished altogether.

"All schemes should eventually report according to TCFD. Reporting according to TCFD disclosures should be integrated as part of a scheme's risk management framework without a cut-off date ..…We suggest that once a scheme falls in scope, this marks the start to reporting in line with TCFD and once started any scheme should continue until they have paid all their benefits or have gone on to buyout their liabilities with an insurance provider."
Isio

77. A smaller number of respondents suggested that the threshold at which schemes fall out of scope should be higher.

"We agree that having a lower threshold for falling outside of the requirements is sensible to avoid schemes switching in and out of scope due to asset volatility. However, we would question whether the £500m lower threshold is reasonable. as this creates disparity with schemes in the £500m-1bn range. For example, a scheme whose asset size falls from £1bn to £550m remains in scope whereas a scheme with assets of £950m is out of scope. Shifting the £500m lower bound to say £750m may be more sensible."
Hymans Robertson

Disclosure requirements below the threshold

78. Just one respondent suggested that the reporting requirements should also fall away for the scheme year which had just elapsed if the assets had fallen below £500m.

"The scheme should [not] remain under an obligation to publish a TCFD report for the previous scheme year. It may well be the case that little or no work has been undertaken on the report at the date the assets fall below the threshold and we are not clear that any benefits of a TCFD report to members would outweigh the disproportionate governance costs associated with producing the report."
Eversheds Sutherland

79. A few respondents also suggested that schemes with zero assets should not have reporting duties at year end.

"Requiring a scheme to still meet the requirements at the end of a scheme year in which it has been subject to a full scheme buy-out seems overly onerous and would have minimal value with regard to contributing to an improved climate outcome. It may even prevent that scheme from being wound-up."
Deloitte

Master trusts

80. Very few stakeholders expressed views on the requirements in relation to authorised master trusts or authorised schemes offering collective money purchase benefits, other than broad support or suggestions that there should be a size threshold before the requirements applied to these schemes too (covered in paragraphs 19 and 20 above).

81. One respondent suggested master trusts should have assets before they came into scope.

"Until such time as they are open to business, none of the proposals set out in this paper can be applied to 'shell' Master Trusts which have become authorised but which are yet to hold members or assets."
Atlas Master Trust

Government response

Complexity of phased introduction

82. We note the concerns that the phased introduction timelines are complex and potentially confusing and a one-size fits all timeline might be preferable. However, any simpler timeline must not put any trustees into a position whereby duties are brought forward to the point that they have an unreasonably short period of time in which to prepare for climate change governance duties and publish their report aligned with the TCFD recommendations. Therefore, a simpler one size fits all timeline can only push implementation deadlines backward, effectively giving additional time to schemes which did not need it.

83. For example, one suggestion, to give all of the largest schemes until December 2022 to publish their TCFD report would not offer sufficient time for schemes with a scheme year of October to September – see paragraphs 93 and 94 below. Therefore, a fairer common publication deadline for all of the first wave of schemes would be the end of April 2023, to ensure all schemes would have at least 7 months from scheme year end to publish their report. However, this would mean schemes with a scheme year of January to December would have a full 16 months to publish their first TCFD report, covering the period October to December 2021.

84. This would considerably and unnecessarily delay an aspect of policy on which action is urgently needed.

Challenge of overall timescales

85. Similarly, whilst we sympathise with respondents who feel that a coming into force date of October 2021 is ambitious, trustees will have had indications of Government’s expectation for large pension schemes from the July 2019 publication of the Green Finance Strategy, and the proposed scope, timing and policies since August 2020, more than a year in advance of the proposed coming into force date of the regulations.

86. Now, subject to the Pensions Schemes Bill receiving Royal Assent, we have set out a largely settled policy and published draft regulations and draft statutory guidance for consultation, which reflect responses received to the policy consultation. This notice period, of 8 months in advance of the proposed coming into force date, is in line with the requests of a number of consultation respondents. We therefore consider that trustees have the information they need to take their work to the next stage of planning.

87. We also appreciate trustees’ concerns on the quality of data in the first wave of reporting, but of the 100 schemes we expect to be in scope of the first wave, many are already preparing some form of disclosure aligned with the TCFD recommendations. As referred to in Chapter 1, the FCA have committed to publish final rules for asset managers by the end of 2021 and bring them into force in 2022, subject to consultation.

88. With the majority of the first wave of schemes not reporting until July 2022 and many having until November 2022, we anticipate that many or most of the schemes in the first wave will be able to obtain data from their fund managers, and all schemes will have a statutory right to the information from the second wave.

89. Although some trustees will be relying more in the first year on asset managers who are not required by legislation to provide data, we expect that more than two-thirds of schemes in scope will have £5bn or more in assets, with consequent market power. We have made clear that trustees' duties in relation to scenario analysis and obtaining data on metrics and targets apply only insofar as they are able– we have set out in the draft regulations what this means and provided accompanying draft statutory guidance (see Chapter 6). There is also no reason why trustees should not be able to meet governance, risk management and some strategy requirements, even with gaps in data.

90. Climate change is an urgent risk. A "rehearsal year", which effectively makes the requirements voluntary for an additional year, or outright postponement of the duties will only delay action to effectively integrate climate change risk into pension scheme decision-making. As with the amendments to the Investment and Disclosure Regulations in 2018, introduced by the "ESG Regulations"[23], we do not believe that the quality of climate change governance and reporting will significantly improve until the requirements are made mandatory.

91. Except in the specific and limited ways set out in the next section, we therefore do not intend to allow more time for trustees to meet the climate change governance requirements.

Issues with certain scheme year cycles

92. We acknowledge concerns from affected schemes and their advisers about our proposals that schemes in the first wave of reporting would need to publish a TCFD report within 7 months of the end of their scheme year or 31 December 2022 if sooner. We also recognise similar concerns in relation to schemes in the second wave, where the proposed deadline was the earlier of 7 months after the end of the scheme year and 31 December 2023.

93. Further research has suggested that for 88% of schemes in scope[24], trustees will have a full 7 months from the end of the scheme year. However, 5% of schemes in scope have a scheme year end date in September, meaning that the trustees would have only 3 to 4 months at most to produce their first TCFD report and, if they are in the first wave, their second report as well.

94. We believe it is reasonable to give such schemes more time – it would undermine the intended effect of the policy if trustees are forced to rush out a TCFD report which they know could have been improved if only they had had the same

[23] The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 (SI 2018/988)
[24] TPR estimate based on scheme return responses.

amount of time as everyone else. Weaker disclosures such as this could also have an anchoring effect and become seen as an acceptable norm which schemes in subsequent waves, and even those who have already reported, level downward to match.

95. We have therefore decided to simplify this part of the requirements and allow all schemes, both during the phasing in, and on an ongoing basis, 7 calendar months from the scheme year end date in which to prepare and publish their TCFD report.

96. We have identified two other issues with our original proposals in relation to certain scheme cycles.

97. First, our policy has been to assess the asset thresholds against the scheme's relevant assets (net assets excluding annuity contracts) in the audited accounts, which trustees are required to obtain for the relevant scheme year. However, trustees have 7 months from the end of the scheme year within which to obtain audited accounts[25]. For schemes with a scheme year end date of between 1 March and 31 May, the climate change governance requirements would come into force in advance of the deadline to obtain audited accounts for the first scheme year which ends on or after 1 June 2020 (for wave 1 schemes) and for the first scheme year which ends on or after 1 June 2021 (for wave 2 schemes). For such schemes, it would therefore not be possible to ascertain whether the asset threshold has been met.

98. Second, schemes occasionally set scheme years longer than 12 months. This could mean, exceptionally, that the date on which the asset threshold test is to be applied – the first scheme year end date to fall after 1 June 2020 or 2021 – will still not have arrived when the duties come into force.

99. In the light of this, we are proposing to make two changes to our policy. This is also reflected in the draft regulations on which we are consulting.

- We are proposing to bring forward the "reference date" from 1 June 2020 to 1 March 2020. The value of the relevant assets in the audited accounts for the first scheme year end date to fall on or after this date is used to determine whether the scheme is in scope of the first wave of the climate change governance requirements. Similarly, we are proposing to bring forward the reference date used for the second wave from 1 June 2021 to 1 March 2021.

  This also means that for the many schemes with the scheme year 1 April-31 March, trustees should now have certainty over whether they will be in scope of the first wave – climate change governance duties from 1 October 2021. Many trustees in scope of the second wave will also have more time to prepare, and no scheme will have less time.

[25] See regulation 2 of the Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (S.I. 1996/1975).

- We are proposing that for trustees who have not obtained the audited accounts until after 1 October 2021 or 1 October 2022, respectively, the duties will apply from the date the audited accounts are obtained by the trustees. We are not making this change for “earmarked schemes”, described in paragraphs 56 and 57, as such trustees of such schemes are not required to obtain audited accounts.

100. An example is given below.

> **Example**
>
> Vikstushas pension scheme has a 12-month scheme year, of 1-April-31 March.
>
> Under our original consultation proposals, relevant assets recorded in the audited accounts produced for the first scheme year to end on or after 1 June 2020 would be compared against the £5bn threshold. This would mean awaiting the audited accounts produced for the year 1-Apr-2020-31-Mar-2021. Similarly, the trustees would use the audited accounts produced for the scheme year 1-Apr-2021-31-Mar-2022 to determine if they were subject to the requirements from 1October 2022.
>
> Under our revised proposals, 1 March 2020 is the first reference date. For Vikstushas, 1-Apr-2019-31-Mar-2020 is the first scheme year to end on or after 1 March 2020, and the trustees would use the relevant assets recorded in the audited accounts for that scheme year to determine if they were subject to the requirements from 1 October 2021. 1 March 2021 is the second reference date. The Vikstushas trustees would use the relevant assets recorded in the audited accounts for the scheme year 1-Apr-2020 to 31-Mar-2021 to determine whether they were subject to the requirements from 1-Oct-2022.

Schemes falling out of scope

101. We have concluded that it is appropriate to leave the asset threshold at which schemes drop out of scope unchanged. We recognise the argument that scheme assets are relatively unlikely to fall from £1bn to £500m through volatility alone. However, this lower bar is designed to reflect the fact that once trustees have put in place the necessary structures to carry out climate change governance and reporting, it will be a lower cost to maintain. Therefore, a threshold of £750m or a similar amount would not reflect the fact that a scheme with, say, £600m or £700m assets would be well able to maintain the governance structures and risk management systems and continue to report.

102. However, eliminating the threshold altogether might risk creating perverse scenarios where trustees might be required to carry out climate change governance in respect of very small numbers of members and a very low value of assets.

103. £500m as a threshold found broad support, with few respondents suggesting that it should be raised, lowered or eliminated altogether.

104. We will however review this in the second half of 2023 in the light of the falling costs of climate change assessment and, if appropriate, make proposals in early 2024 for updated asset-based thresholds at which schemes come into – and fall out of – scope. The proposed review is covered further in paragraphs 124 to 140 of this chapter.

105. We also do not intend to remove reporting requirements on trustees for the scheme year which had just ended when relevant assets drop below £500m. It should not be disproportionate for trustees to produce a report explaining how they had met requirements which applied to them in that scheme year, for the members who had been or remained invested. Requiring a TCFD report in such instances would also discourage trustees of schemes from downplaying or deprioritising consideration of climate change risk, in the knowledge that they would not have to report on it.

106. However, we agree with respondents that under our original proposals it would be possible for a scheme with zero assets at scheme year end to still be required to produce a TCFD report. Such a report would appear to offer no practical benefit to any member, as the scheme would have none, and no future liabilities. We therefore do not propose to require trustees of a non-authorised scheme whose relevant assets have fallen to zero on the scheme year end date to be required to produce a TCFD report in respect of that scheme year.

New authorised schemes

107. On the other hand, our view remains that a newly authorised master trust or scheme offering collective money purchase benefits should be required to produce a TCFD report. Such a scheme would be open to employers as a destination for their automatically-enrolled employees, and for trustees (or sponsoring employers where they have decision-making powers) considering moving some or all of their savers to another scheme.

108. The governance and risk management capabilities of the trustees, the resilience of the scheme's investment strategy to climate change and disclosure of appropriate metrics in respect of its default options are all matters of likely interest to employers, trustees and their advisers. An authorised scheme with zero assets that is open to multiple employers should be implementing and reporting on effective governance of climate change risk. A scheme with zero assets which has exited benefit provision need not be.

Summary of changes

We have simplified the requirements to allow all schemes, both during the phasing in, and on an ongoing basis, 7 calendar months from the scheme year end date in which to prepare and publish their TCFD report.

We have changed the “reference date” used for the purposes of determining whether a scheme is in scope from 1 June 2020 to 1 March 2020 for the first wave (and from 1 June 2021 to 1 March 2021 for the second wave). This will not reduce the time any scheme has to prepare, and will give trustees of some schemes more time. We are consulting on this proposal.

Where audited accounts are obtained later than 1 October 2021 (first wave), or 1 October 2022 (second wave), the requirements apply from the date the accounts are obtained by the trustees. We are consulting on this proposal too.

We will not apply the requirement to produce a TCFD report to trustees of non-authorised schemes with zero relevant assets on the scheme year end date.

We have not made any other changes.

Draft regulations on Scope and Timing

109. In our proposed Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, regulation 2 (climate change governance requirements) and paragraphs (1) and (2) of regulation 3 (climate change reporting and publication requirements) set out to whom the requirements under the regulations apply and from what date.

110. Regulation 2(1) provides for the first asset-based threshold – that trustees of schemes with £5bn or more in relevant assets at the end of the first scheme year to end on or after 1st March 2020 must meet all of the climate change governance requirements from 1st October 2021 or, if later, the date on which the trustees obtain audited accounts for that scheme year. The requirements are set out in Part 1 of the Schedule to the regulations. For trustees of earmarked schemes (see next paragraph) who do not have to obtain audited accounts, the requirements apply from 1st October 2021.

111. Regulation 2(11)(j) defines a scheme year in line with the definition of scheme year used in other pensions legislation[26], whilst regulation 2(11)(h) defines relevant assets as the total amount of the net assets of the scheme recorded in the audited accounts, less the value of any “relevant contract of insurance” recorded in those accounts. For “earmarked schemes”, since the trustees are not required to obtain audited accounts, the relevant assets are defined as the value of the assets represented by any policies of insurance that are specifically allocated to the provision of benefits for individual members or any other person

[26] See, in particular, regulation 1(2) of the Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996.

who has a right to benefits under the scheme, less the value of any relevant contract of insurance.

112. The definition of relevant contract of insurance in regulation 2(11)(i) seeks to take a principles-based approach to describing buy-ins (bulk annuities) and scheme pensions (individual annuities). For buy-ins, the contract of insurance must provide for payments to be made by the insurance company to the trustees, which are intended in all circumstances to fully meet the cost of specified benefits which are not money purchase benefits. For individual annuities, the contract must be an annuity contract which secures the provision of a pension in payment that was, at all times before coming into payment, a money purchase benefit[27]. In both cases the contract must be entered into with an insurance company regulated in the United Kingdom by the PRA and the insurance company must have full and ongoing discretion over the investment policy for any assets used to meet its liabilities under the contract.

113. Regulation 2(2) provides for a lower relevant asset threshold of £1bn for the first scheme year end date to fall on or after 1st March 2021. The requirements come into force from 1st October 2022 – again with provision made for schemes (other than earmarked schemes) where audited accounts are not obtained until after this date.

114. Regulation 2(3) provides that where trustees are not already subject to the climate change governance requirements and the scheme has relevant assets of £1bn or more on a scheme year end date which falls on or after 1st March 2022, the trustees are subject to the requirements from one scheme year and a day after that scheme year end date. This equates to the beginning of the following scheme year. So if a scheme with scheme year 1 January-31 December exceeded £1bn in assets at 31 December 2022, the climate change governance duties in part 1 of the Schedule to the Regulations would apply from 1 January 2024.

115. Regulation 2(5) makes provision for schemes falling out of scope of the requirements. Where the relevant assets fall below £500m at a scheme year end, the climate change governance requirements cease with immediate effect. This includes schemes which were in the first wave of rollout with assets in excess of £5bn, but whose assets have dropped to below £500m by the time of the second wave. Note that this does not lift the requirement for the trustees to produce a report for the scheme year which has just finished. This is covered in regulation 3.

116. A different regime applies to authorised master trusts and authorised schemes offering collective money purchase benefits – including schemes which were once authorised but have ceased to be so – as set out in regulation 2(6) onward.

[27] Defined as a benefit falling with section 181B(2) of the Pension Scheme Act 1993 (c. 48).

117. An "authorised master trust scheme" is defined in regulation 2(11)(c) as a scheme to which Part 1 of the Pension Schemes Act 2017 applies and which is authorised in accordance with section 5(4)(a) of that Act. This drafting captures schemes which do not meet the criteria set out in section 1 of the 2017 Act, but are required to seek authorisation in line with regulation 29 of the Occupational Pension Schemes (Master Trusts) Regulations 2018[28]. Similarly, it removes from scope schemes which meet the definition in section 1 but are not treated as master trusts for the purposes of any authorisation requirements, because they are excepted under regulations 26 and 27 of the 2018 Regulations.

118. An authorised scheme providing collective money purchase benefits, referred to as an "authorised collective money purchase scheme" is defined in regulation 2(11)(b) as a scheme which, or a section of which is authorised in accordance with section 9 of the Pension Schemes Act [2021] and to which Part 1 of that Act applies. These are references to clause 9 and Part 1 of the current Pension Schemes Bill.

119. Regulation 2(7) provides that authorised schemes are subject to the climate change governance requirements from 1st October 2021 or, if they are authorised later, from the date of authorisation. Regulation 2(8) disapplies the requirements where schemes cease to be authorised, as long as the relevant assets at the previous scheme year end were below £500m. Otherwise, the trustees remain subject to the requirements unless the relevant assets fall below £500m on a subsequent scheme year end date in which case the requirements are disapplied by regulation 2(9).

120. Regulation 2(10) caters for a situation where trustees cease to be subject to the climate change governance requirements in accordance with regulation 2(8) or (9), but subsequently the relevant assets of the scheme meet or exceed £1bn on a scheme year end date. In such a scenario, the requirements are re-applied and the trustees must comply with them from commencement of the scheme year which is one scheme year and a day after the scheme year end date when the asset threshold is met.

121. Regulation 3(1) provides for the publication of a TCFD report which must include the information listed in Part 2 of the Schedule. Following consultation, we are making changes to our original proposal and will allow 7 months from the scheme year end date for schemes to produce a TCFD report, regardless of the scheme year cycle.

122. The falling away of reporting requirements for trustees of non-authorised schemes with zero assets is provided for in regulation 3(2)(a).

123. Regulation 3(2)(b) disapplies the requirement to produce a TCFD report for a scheme year where trustees cease to be subject to the climate change governance requirements in accordance with regulation 2(8). In all other cases

[28] SI 2018/1030.

trustees of schemes with relevant assets of less than £500m on a scheme year end date – meaning that the climate change governance requirements cease – must still produce a final TCFD report for the scheme year which has just ended.

Consultation Question

Q1:

Do you have comments on the proposals to change the "reference date" used for the purposes of determining whether a scheme is in scope, or the arrangements made for schemes which obtain their audited accounts later than 1 October 2021, or 1 October 2022?

Do you have comments on the draft regulations on scope and timing?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Review of measures and their extension

Background

124. The tools and methodologies for assessing climate-related risks and opportunities are rapidly evolving.

125. The Government therefore proposed a review believing that it would, in the long term, be in the best interests of all occupational pension schemes to implement the TCFD recommendations and carry out the underlying climate change governance activities. The Government would encourage out of scope schemes to comply on a voluntary basis until they come into scope.

126. The review itself would enable the effectiveness and feasibility of further rollout to some or all smaller schemes to be determined. A review would also ensure that further steps would not place a disproportionate burden on smaller schemes.

We proposed:

to conduct a review in 2024 on whether to extend the measures to schemes with below £1 billion 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 also proposed to review the regulations and statutory guidance which had been put in place to identify whether any of these needs to be strengthened or updated.

Summary of responses

127. The majority of respondents were supportive of this proposal, primarily because they believed a review would help determine if the regulations and statutory guidance were still relevant and appropriate in 2024.

"It would be helpful to review regulations and statutory guidance already in place at the time, to ensure they remain appropriate. ESG disclosure obligations are relatively new to trustees and advisers alike, and the ease by which compliance can be achieved in practice is often properly understood after the obligations have come into force."
Association of Pensions Lawyers (APL)

Costs and availability of data and analysis

128. Respondents believed that TCFD reporting will become easier as time goes on and therefore regulations could in due course be applied to more schemes.

"It is sensible to undertake a review of the regulations and statutory guidance, particularly given the likelihood of further developments in data availability and modelling analysis."
Association of Consulting Actuaries (ACA)

129. However, some stakeholders highlighted that the reliance on third parties for collation and reporting could mean higher costs of TCFD reporting.

"Many firms currently reporting in line with TCFD use third-party consultancies to help collate and disclose this data. This of course comes at a cost."
Association of British Insurers (ABI)

An earlier review

130. Many respondents noted that a delay in extending coverage to smaller schemes would incur risks to savers from weaker climate governance.

"Small schemes may be regulated after 2024 which could result in a minimum of three years' worth of climate change risk being unaccounted for. We feel this may result in smaller schemes being left with stranded assets and strategies that are not aligned with a transitioning economy."
Isio

131. Some respondents therefore wanted an interim review to be carried out sooner as it would more rapidly identify any barriers to compliance that may exist, or whether further guidance is needed to assist smaller schemes in meeting the requirements. It was also brought up repeatedly that carrying out an interim review would clarify if the guidance was becoming outdated.

"A review ending late in 2024 may mean action only "biting" in late 2026 or conceivably 2027 if the lead times in this consultation were to apply. One of the way-points on Paris-alignment is to halve emissions by 2030. If we assume that the aim of this work is to cause as much of the UK pensions regime as possible

to meet the Paris objectives, then leaving regulation for any area as late as 2027 is sub-optimal."
UK Sustainable Investment & Finance Association (UKSIF)

"There would be merit in also conducting an interim review or engagement exercise in 2022/23. An interim review would allow DWP to gain feedback about the process and to identify any barriers preventing scheme compliance or need for further guidance to assist smaller schemes coming into scope. Addressing these issues following an interim review, rather than waiting until the 2024 date, will speed up compliance."
Institute and Faculty of Actuaries

The content of a review

132. Respondents stressed that we should assess whether the regulations have affected investment decisions before extending the regime.

"It will be important that before any extension is made to smaller schemes that a cost benefit analysis is undertaken to assess how much time, resource and cost has been incurred and whether or not the reporting has led to any meaningful change to asset allocations that would not have been achieved in any event. "
Nationwide Pension Fund

133. Finally, a couple of stakeholders suggested that the review might include the sharing of best practice between TPR and DWP to encourage peer learning. This might also assist with the lack of trustee knowledge highlighted in chapter 3 of this consultation response.

"DWP may wish to consider providing feedback to those who report early and/or sharing best practice from the first round of reporting. This will help to raise disclosure standards across the board."
Brunel Pension Partnership

Government Response

An earlier review

134. As set out above, we are not changing the timeframe within which smaller schemes may be brought in scope, for reasons of proportionality. However, we encourage smaller schemes not in scope to begin to report on a voluntary basis in the interim period, wherever it is proportionate to do so. Trustees of these schemes can use both the statutory guidance which will accompany our regulations and The Pensions Climate Risk Industry Group (PCRIG) non-statutory guidance, published on the same day as this consultation, when considering how to improve climate change governance and make disclosures in line with the TCFD recommendations.

135. We acknowledge the concerns about a 2024 review having the potentially dangerous consequence of future regulations not biting until much later in the decade. The threat climate risk poses to all schemes means increased risks to savers and sponsoring employers if we move too slowly.

136. Equally, the tools and methodologies for assessing climate-related risks are rapidly evolving – as the industry moves towards standardisation, the guidance may become outdated without an interim review.

137. As a result, we will to hold an interim review in the second half of 2023 that will enable identification of best practice. By the end of 2023, based on current market data, we would have sight of reports by a significant number of schemes which had disclosed for the first time, and of some schemes which had disclosed twice. This will be sufficient experience to draw upon in order to determine whether to extend to smaller pension schemes from late 2024 or early 2025.

The content of a review

138. Measuring the impact of the regulations will be difficult quantitatively speaking. However, by the end of 2023, we will have a large amount of data by which to qualitatively assess the impact of regulations and statutory guidance thus far. This will be sufficient to determine the effectiveness of the regulations and statutory guidance for schemes already in scope, as well as whether or not they should be extended to smaller schemes.

139. The Government aims to support 'peer learning' where possible, especially in introducing regulations on an entirely new area, as in this case. Our policy of applying these requirements to schemes with £5bn+ in relevant assets initially, followed by those with £1bn+ a year later, is driven by this motivation.

140. DWP commits to explore ways of highlighting best practice in TCFD reports to schemes as part of the proposed 2023 review.

Summary of changes

We will begin an interim review starting in the second half of 2023 that will enable us to assess how effective the regulations have been, allow identification of best practice, and will determine whether to extend the requirements to smaller schemes from late 2024 or early 2025, following consultation.

Chapter 3: The TCFD requirements – trustee knowledge and understanding

1. This chapter summarises consultation feedback we received in relation to the strategic split between regulations and statutory guidance.
2. It also explains the requirement contained in our draft regulations that trustees must have appropriate knowledge and understanding of the principles relating to identification, assessment and management of climate change risks and opportunities.

Regulations vs. Statutory Guidance

Background

3. In our consultation we proposed 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.
4. Sections 41A(7) and 41B(3) of the Pensions Act 1995, inserted by clause 124 of the Pension Schemes Bill would require trustees to have regard to guidance prepared from time to time by the Secretary of State.
5. Statutory guidance to which trustees must have regard and a draft of which is being consulted on here, sets out steps to meet the governance requirements and the requirements to report in line with the TCFD recommendations, set out in the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.
6. Where trustees choose to diverge from statutory guidance, they need to be able to explain their reasons for doing so and they should set these out in their TCFD report.

Summary of responses

Statutory Guidance

7. A great number of respondents welcomed the Government's proposals to issue statutory guidance and spoke to the importance of such guidance in assisting trustee compliance with any forthcoming regulations.

   "We support the proposal for statutory guidance to give clear instruction on how trustees might manage these expectations."
   ABI

8. However, some offered caveats to the Government's approach to guidance. One particular concern was that the guidance, being only guidance, would lead to many schemes deviating from the suggested approach.

   "Statutory guidance in relation to the mandatory governance and disclosure requirements allows schemes to take their approach as long as an explanation is provided explaining material deviations from the suggested approach … it must be made clear to trustees that the requirements are mandatory and any failure to report will require clear and evidence-based justification."
   Client Earth

9. The level of detail in statutory guidance was also discussed by a number of stakeholders. This centred around two conflicting points of view: that guidance should contain a high level of detail on specific elements to drive up standards and consistency, but also that guidance should not be too detailed, in order to allow for innovation and development.

   "We have seen the value of regulatory prescription and codes of practice in driving best practice in a number of areas for pension schemes and we consider that it has a role in this case."
   Electricity Supply Pension Scheme

   "If regulation and statutory guidance is too detailed too soon, achieving the objectives could be undermined by a rush to produce finely detailed, but not necessarily accurate or helpful, analysis."
   Stephen Beer (Central Finance Board of the Methodist Church)

Government response

Statutory Guidance

10. The Government welcomes support for the issuance of statutory guidance. We agree with respondents who articulated that the guidance needs to strike a balance between prescription on the one hand, reflecting the nascence of understanding in this area, and flexibility on the other, allowing for divergence where trustees wished to innovate. Subsequent sections of this document outline the contents of the draft statutory guidance on the topics of governance, strategy, risk management, and metrics and targets.

11. Statutory guidance will be invaluable in ensuring that consideration of climate change risks and opportunities is embedded into trustees' governance of a scheme, and does not become a tick box exercise. It will also assist in producing disclosures which are useful for members. The Government would also point trustees to the guidance produced by the Pensions Climate Risk Industry Group, published on the same day as this consultation, as another helpful resource.

Trustee Knowledge and Understanding

Background

12. The Pensions Act 2004 (section 247(4)) places a duty on trustees to have knowledge and understanding of pensions law and the principles of investments and funding. Section 248(5) makes corresponding provision for corporate trustees. Sections 247(4)(c) and 248(5)(c) each enable knowledge and understanding of other areas to be prescribed in regulations.

Summary of responses

13. A number of stakeholders who responded to the consultation suggested that trustees lacked the necessary knowledge of climate change as a topic and as a risk type, including how it should be assessed or managed.

    "We believe that the level of trustee knowledge and understanding of this important issue is not yet at a sufficient level across the board for trustees to implement the proposed governance arrangements effectively."
    ICAS

    "Trustees may not be equipped with the skills or knowhow to interrogate effectively the climate risk information and advice they receive, or to know what systems of climate risk oversight and supervision to put in place and whether these are working, at least in the early years of the regime."
    Travers Smith LLP

14. Some respondents offered solutions to this problem, linking the lack of trustee knowledge to low levels of compliance, something DWP and TPR should look to head off.

    "We would suggest that The Pensions Regulator extend the Trustee Toolkit to include climate change/risk as a module and require that trustees have the knowledge and understanding to complete the requirements."
    Hymans Robertson

15. Other respondents suggested trustee knowledge and understanding would help schemes prepare and manage climate risk and opportunity.

    "Trustees do not have to become expert in climate change but must seek appropriate advice… the message to all pension providers must be that climate-related work is coming and they must prepare for it."
    UKSIF

Government Response

16. We recognise that some trustees' knowledge of climate change and the TCFD recommendations is low at the present stage. Many stakeholders recognised that

this is likely a result of the developing understanding of climate change risk management and strategy, with the TCFD recommendations only partially voluntarily implemented in UK financial services at present.

17. We acknowledge that the proposals will introduce new requirements of trustees in an area that is currently developing rapidly and may require upskilling or training.

18. Our proposed Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 would therefore supplement the new climate change governance and reporting requirements. The regulations would prescribe that trustees who are subject to those requirements must have knowledge and understanding of the principles relating to the identification, assessment and management of risks to occupational pension schemes arising from the effects of climate change.

19. Trustees would also be required to have knowledge and understanding of the principles related to the identification, assessment and management of opportunities relating to climate change for occupational pension schemes. In the case of corporate trustees, the company would be required to secure that any person exercising its functions as trustee has the requisite knowledge and understanding.

20. The level of knowledge and understanding of these matters must be appropriate to enable the trustee, or in the case of a corporate trustee the person exercising its functions, to properly exercise the trustee's functions[29].

21. The policy intent here is that trustees understand the outputs of activities such as conducting scenario analysis and calculating emissions-based metrics and can incorporate such activities into their new climate change risk management processes. We are not proposing to require that trustees must be experts on climate change or its financial implications, but they must have sufficient expertise to allow them to properly exercise governance over the risks and opportunities it presents. We are not requiring that trustees are able to carry out highly technical climate risk assessments themselves, but they need to understand the principles of the activities sufficiently to be able to commission them, interpret them and act on them.

22. In drawing out knowledge and understanding of the principles of identification, assessment and management of climate change risks and opportunities, we would again emphasise that this is in relation to the materiality of climate change as both an investment and funding risk and opportunity – one in relation to which trustees already have fiduciary duties and will in due course be subject to requirements in regulations.

[29] As required by the Pensions Act 2004, section 247(5) in the case of individual trustees and section 248(6) in the case of corporate trustees.

23. The fact that we are prescribing specific trustee knowledge and understanding requirements in respect of these matters is in acknowledgement both of the lower level of current reported knowledge and understanding, and the significance of the risks climate change poses to pension savings and the financial system more broadly.

24. In addition, the time sensitivity related to climate change – and the financially material risks accompanying this – demands that we take steps to ensure trustees have a sufficient level of knowledge and understanding to appropriately manage these risks. Prescribing specific trustee knowledge and understanding requirements is likely to result in trustees gaining a better level of knowledge and understanding of climate change risks to occupational pension schemes and of opportunities for pension schemes arising from climate change, which will enable more effective governance and make their TCFD disclosures more impactful.

Summary of changes

We have added to the proposals on governance to require trustees to have an appropriate degree of knowledge and understanding of the principles relating to identification, assessment and management of climate change risks and opportunities to properly exercise their functions.

Draft regulation on Trustee Knowledge and Understanding

25. Regulation 2 of the accompanying draft Statutory Instrument, the Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021, would prescribe the following matters for the purposes of sections 247(4)(c) and 248(5)(c) of the Pensions Act 2004:

    - the principles relating to the identification, assessment and management of risks arising to occupational pension schemes from the effects of climate change, including steps taken because of climate change (whether by governments or otherwise); and
    - the principles relating to the identification, assessment and management of opportunities relating to climate change for such schemes.

26. Regulation 2 provides that these matters are only prescribed in the case of trustees who are subject to the climate change governance and reporting requirements in Part 2 of our proposed Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

27. The effect of the regulation 2 would be that individual trustees, who are subject to the climate change governance and reporting requirements, are required to have an appropriate level of knowledge and understanding of the matters prescribed to enable them to properly exercise their functions. In the case of corporate

trustees, the company would be that they are required to secure that persons exercising trustee functions have the appropriate level of knowledge and understanding of the matters prescribed.

28. In line with the other trustee knowledge and understanding requirements, the compliance powers set out in section 13 of the Pensions Act 2004 would apply. TPR may issue improvement notices where trustees contravene the requirements, and they may issue civil penalties under section 10 of the Pensions Act 1995 where trustees fail to comply with an improvement notice.

29. We have also produced draft non-statutory guidance in relation to trustee knowledge and understanding of climate change-related risks and opportunities. This includes, amongst other information, guidance on:

- The matters about which trustees are expected to have knowledge and understanding trustees
- The level of knowledge and understanding trustees are expected to have
- How trustees can keep their knowledge and understanding of climate-related risks and opportunities up-to-date

Consultation Question

Q2

a). Do you have any comments on the draft regulation on trustee knowledge and understanding?

b) Do you have any comments on the draft guidance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Chapter 4: Governance

Background

1. Governance of climate risks and opportunities is one of the four key aspects of the TCFD recommendations. In our policy consultation, we proposed that trustees should be required to establish and maintain: their own oversight of climate risks and opportunities; and processes for satisfying themselves that persons managing the scheme are also assessing and managing such risks and opportunities.

We proposed that trustees:

a) establish and maintain, on an ongoing basis, oversight of climate risks and opportunities

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 proposed that regulations require trustees to describe:

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

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 also proposed that statutory guidance will cover the matters in box 2 of the August consultation.

Summary of responses

Trustees' oversight of climate-related risks and opportunities

2. A large number of stakeholders agreed that management and assessment of climate-related risks and opportunities fall naturally within trustees' ongoing responsibility as 'chief governors' of the scheme.

   "Ultimate responsibility for managing climate risks and opportunities should sit with the trustees."
   Aon

   "Appropriate identification and management of climate risks and opportunities is fully aligned to trustees' fiduciary duty, and should be a core part of trustee

scheme oversight.”
Willis Towers Watson

3. However, a few stakeholders proposed that climate risks should not be given ‘special status’ but treated proportionately along with other risks that trustees must oversee.

   “Climate change risk is not the only risk schemes face across different time horizons and as such, the management and required disclosure should be proportionate to the materiality of the risk to members’ financial outcomes.
   Redington”

   “I would not want to see climate risk taking precedence over other forms of risk.”
   Pensions Management Institute

Assessment and management of climate-related risks and opportunities by persons managing the scheme

4. The proposal to require trustees to put in place processes in order to satisfy themselves that others are managing the climate-related risks and opportunities relevant to the scheme received support. Many agreed that it was appropriate for the duty here to be placed on trustees rather than directly on the other persons.

   “Appropriate identification and management of climate risks and opportunities is fully aligned to trustees’ fiduciary duty, and should be a core part of trustee scheme oversight.”
   Travers Smith LLP

5. Some stakeholders supported this proposal because, at present, they felt as if the degree of oversight of other persons’ capability to manage climate-related risks and opportunities of the scheme may be lacking.

   “Formalising clear responsibilities of trustees and other persons managing the scheme will increase accountability.”
   Zurich Financial Services

6. Others believed that this responsibility should not be for the trustees but for those managing the scheme to ensure that they are embedding climate-related risks and opportunities into their investment practices. The most common proposal on this topic was for a specific duty to be placed directly on asset managers, given that, according to many respondents, management of climate-related risks and opportunities falls more naturally within their purview.

   “Greater clarity is needed in roles of both trustees and managers. We recommend that the DWP and FCA work together to delineate the role and duties that asset managers would play to support these requirements.”
   BlackRock

“Trustees would welcome clarification on any requirements on asset managers to support with disclosures.”
EY

Definition of ‘persons managing the scheme’

7. Whilst the overall response was that trustees should have oversight of persons managing the scheme when it comes to the effects of climate change, a number of respondents stated that they thought the definition of persons managing the scheme was not clear.

   “It may be helpful to be more prescriptive in setting out who the persons managing the scheme may be, to avoid any confusion.”
   Association of Pension Lawyers

   “We propose that further clarification is provided around the ‘persons managing the scheme’.”
   XPS Pensions Group

8. Of these respondents, several suggested ways in which the definition could be narrowed to be made more specific, including naming groups of persons they thought should explicitly be excluded or included.

   “Where services are provided by an employer, the trustees appear to be required to consider the suitability of individual employees. We consider that this is impractical and it would be better to require them to consider whether the corporate entity as a whole has the appropriate knowledge and experience.”
   Eversheds Sutherland

Government Response

Trustees’ oversight of climate-related risks and opportunities

9. The majority of those who responded to our proposals about trustees’ governance of climate-related risks and opportunities were supportive, and agreed that ultimate responsibility and ownership of the climate-related risks to the scheme should sit with the trustees of the scheme. This is central to the Government’s intention with this policy and proposed regulations – given the systemic nature of risks associated with climate change, trustees must be subject to explicit duties to account for them.

10. A small number of respondents questioned the Government’s intention, explaining that standalone duties on the subject of climate change risked complicating trustees’ duties to deliver returns for their members.

11. We wish to be clear – the governance duties we plan to introduce do not supersede fiduciary duty. In fact, the Government is seeking to ensure trustees

are able to carry out their duty to deliver the returns for their members. Without effective governance of climate-related risks, the retirement incomes of millions of savers are in unnecessary danger. It remains out policy that consideration of investment impacts on the planet, or other environmental impacts are only required to be taken into account by trustees insofar as they are a financially material risk to the scheme. We agree with the Law Commission's conclusions[30] on this point. We do not intend to make any changes to this policy.

Assessment and management of climate risks and opportunities by persons managing the scheme

12. Most respondents agreed with the Government's rationale for splitting out trustees' own responsibilities on climate-related risks and opportunities on the one hand, and the duty on the other hand for them to put in place processes to satisfy themselves that other persons who manage the scheme are also managing such risks and opportunities effectively. In doing so, we expect accountability for such risks will likely become part of the contractual terms which trustees agree with those who assist in management of their scheme.

13. Whilst most respondents recognised that asset managers are not in scope of these requirements, nor classified as persons managing the scheme, some believed that the ultimate delivery of effective governance of such risks would hinge on the relationship between trustees and asset managers. Accordingly, many of those took the opportunity to call for duties to be placed on asset managers themselves.

14. The Government has been working closely with the FCA, which has oversight of asset managers, on both a bilateral basis and a multilateral basis, as part of the UK Government and Regulators Taskforce on TCFD. This culminated in the exchange of letters referred to earlier in this document between the Minister for Pensions and Financial Inclusion and the Interim Chief Executive of the FCA in which both organisations agreed to work closely together in developing TCFD rules.

15. Trustees are ultimately responsible for managing climate-related risks to the scheme. Nevertheless, trustees will typically rely on asset managers for data and information. For most schemes, asset managers undertake day-to-day management of the assets and will be able to provide insight into the climate-related risks of different assets under management; the trustee should use this information to manage risks to which the scheme as a whole is exposed.

Definition of 'persons managing the scheme'

16. We agree with respondents that the meaning of 'persons managing the scheme' is not completely clear. To address respondent's concerns, we have split

[30] Law Com No 350 "Fiduciary Duties of Investment Intermediaries" and Law Com No 374 "Pension Funds and Social Investment".

‘persons managing the scheme’ into two categories: those who undertake governance activities in relation to the scheme; and those who advise or assist the trustees with respect to governance activities relating to the scheme. The inclusion of this second group captures the varied characteristics of the management of an occupational scheme and reflects the day-to-day reality –as highlighted by several respondents – that the trustee is reliant on a number of external advisers to help them with governance activities. In determining who falls within scope, the focus should be upon the activity those in each group are carrying out, rather than their occupation. However, our proposed regulations do make specific provision to exclude legal advisers because this group does not provide advice relating to investments, liabilities or covenants.

17. Each of these persons should be covered by processes put in place by the trustees to ensure that they are identifying, assessing and, where appropriate, managing climate-related risks and opportunities.

18. A small number of stakeholders expressed concerns about the use of the word ‘persons’ here as a reference to individuals. The intention here is for both individuals and organisations providing services to be in scope. Nevertheless, the trustee should focus on the role the organisation or individual has played and whether they are satisfied that they have taken adequate steps to identify, assess and manage climate-related risks and opportunities. It is possible for the TCFD report to provide information on how the *role* of any individual employee, or individual engaged by the trustees, has been carried out, rather than focusing on the individual personally. It is not the Government’s intention that trustees should need to identify individuals.

19. Since asset managers are responsible for managing some or all of the scheme’s assets – rather than undertaking governance activities, or advising or assisting the trustee with governance activities – they are not captured by the wording of the draft regulations. An asset manager would only fall into scope where they not only manage assets but also provide advice or assistance with respect to the scheme’s governance activities. We have sought to provide further explanation in the draft statutory guidance.

Summary of changes

We have clarified our proposals in respect of “persons managing the scheme”. Trustees must establish processes for satisfying themselves that those who undertake governance activities in relation to the scheme and those who advise or assist the trustees with respect to governance activities – otherwise than as a legal adviser – are taking adequate steps to identify, assess and, where relevant, manage climate-related risks and opportunities.

We will use statutory guidance to give examples of persons who would be regarded as undertaking governance activities in relation to the scheme for the purpose of the regulations.

Draft Regulations on Governance

20. Paragraph 1 in Part 1 of the Schedule (Climate change governance etc. requirements) requires trustees to establish and maintain oversight of climate-related risks and opportunities which are relevant to the scheme.

21. Paragraph 2(a) requires that trustees must establish and maintain processes for the purpose of satisfying themselves that any person who undertakes governance activities in relation to the scheme – other than as a trustee – takes adequate steps to identify, assess and manage climate-related risks and opportunities which are relevant to the scheme.

22. Paragraph 2(b) requires that trustees must establish and maintain processes for the purpose of satisfying themselves that any person – other than a legal adviser of the trustees – who advises or assists the trustees in respect of governance activities, takes adequate steps to identify and assess climate-related risks and opportunities which are relevant to the matters in respect of which they are advising or assisting.

23. Paragraph 21 (a) in Part 2 of the Schedule requires trustees to include in their TCFD report a statement describing how trustees maintain oversight of climate-related risks and opportunities, as required by paragraph 1 in Part 1 of the Schedule, whilst paragraph 21(b) requires trustees to describe the role of any person who undertakes governance activities in relation to the scheme in identifying, assessing and managing climate-related risks and opportunities the process by which trustees satisfy themselves that the person is undertaking that identification, assessment and management. Paragraph 21(c) requires trustees to describe the role of any person who, otherwise than as a legal adviser of the trustees, advises or assists the trustees with respect to governance activities relating to the scheme and the process by which the trustees satisfy themselves that the person is taking adequate steps to identify and assess climate-related risks and opportunities which are relevant to the matters in respect of which they are advising or assisting.

Draft Statutory Guidance on Governance

24. We have produced draft statutory guidance in relation to trustees' compliance with paragraphs 1, 2 and 21(a), (b) and (c) of the Schedule, in relation to governance of climate-related risks and opportunities. This includes, amongst other information, guidance on:

    - How trustees can ensure adequate oversight of climate-related risks and opportunities
    - How trustees can ensure other persons involved in governing the scheme on a day-to-day basis, or advising or assisting on governance, have oversight of climate-related risks and opportunities

- Examples of persons ‘undertaking governance activities’ or ‘advising or assisting with respect to governance activities relating to the scheme’
- How trustees should work with and engage the persons undertaking governance activities in relation to the scheme – or advising or assisting on these matters – on climate-related risks and opportunities
- Which governance processes should be disclosed by the trustee and included in the TCFD report.

Consultation Question

Q3:

a). Do you have any comments on the provisions on governance in the draft regulations?

b). Do you have any comments on the draft statutory guidance on governance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Chapter 5: Strategy

Background

1. We proposed that regulations bring the TCFD's recommendations on strategy into law for occupational pension schemes within scope, in a way that makes them applicable and relevant to these schemes. The principles of the TCFD's recommendations on strategy promote continuous assessment of the ramifications of climate change for trustees' investment strategy and, for DB schemes, the funding strategy.

We proposed that:

Regulations require trustees to identify, on an on-going basis, 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, in the case of DB schemes, funding strategy.

We proposed statutory guidance will cover the matters outlined in box 4 of the August consultation.

Summary of responses

2. The majority of respondents supported the proposals.

"Climate change can no longer be left to be addressed as part of a generic environmental, social and governance (ESG) policy. Nor can it be restricted to a consideration of investments only; climate risks and opportunities must be integrated throughout scheme management, including covenant and funding for DB schemes."
Lane Clark & Peacock LLP

Assessment and disclosure of climate-related impacts on the covenant

3. One of the most consistently raised issues related to the reference to "funding strategy", which will include assessment of the effect of climate-change on a DB scheme's covenant. A number of respondents expressed concern about the requirement to include the covenant within the assessment. A few comments related to the practicality of undertaking such an assessment.

"Only a handful of covenant advisors have the capability to do this at present."
Association of Professional Pension Trustees

"This would suggest that trustees may need to do assessments in relation to the climate change exposure of sponsors and could even require an additional formal

covenant review."
Eversheds Sutherland

4. However, the majority of concerns expressed in relation to the covenant centred on confidentiality, highlighting the sensitive nature of the issue of climate change impact on many sponsoring employers.

   "We would want to ensure that trustees and sponsors are able to engage constructively in this area, and would want to avoid covenant conversations being limited in their scope and usefulness for fear of public disclosure requirements around commercially sensitive information."
   Willis Towers Watson

   "The details from funding discussions between trustees and sponsor can often be market sensitive information and it is therefore important any disclosure requirements on trustees contained in the regulations should not conflict with other information sharing requirements on trustees or sponsors."
   Association of Consulting Actuaries

5. However, there was significant support for applying the proposed analysis to the covenant, with a number of respondents emphasising how fundamental the covenant is to the viability of a DB scheme.

   "The employer covenant is currently standing behind at least 23% of all DB pension scheme obligations. This is likely an order of magnitude higher than any one scheme investment. Although trustees can do little to directly remove climate change risks facing their sponsor, they are able to seek additional funding for protection against them and to manage their other risks commensurately, as long as the risks to the sponsor are understood."
   Lincoln Pensions

   "The sponsor covenant is a key (potentially the most key) risk trustees face and as such could be called out explicitly."
   Moody's

Time horizons

6. The proposals referred to trustees identifying and assessing the impact of climate-related risks and opportunities over the "short, medium and long term". Where this element was mentioned it was usually to seek greater clarification on the terms. A small minority of respondents expressed a more substantial concern or suggested that the focus not be so closely tied to such time horizons.

   "We would approach this more cautiously. The short/medium/long term is currently difficult to disentangle."
   Russell Investments

   "An alternative might be to assess immediate risks and long-term risks, as opposed to three distinct, but not well-defined periods."
   Isio

7. A respondent suggested that trustees be required to disclose their chosen time horizons.

   “We also recommend that trustees are required to disclose the approximate time periods against which they are working. Short, medium and long term are likely to be interpreted quite differently by different schemes, and it is important to have clarity about the time periods trustees are considering.”
   ShareAction

Data and methodology concerns

8. A recurrent theme in responses, even where respondents expressed overall support for the proposals, related to concerns about obtaining data. This was a concern that was also raised in relation to Question 6 (scenario analysis), Question 8 (metrics) and Question 9 (targets).

   “Although data quality is improving and we expect will continue to do so, coverage and consistency across multiple jurisdictions and focus areas remains uneven which poses significant challenges for schemes when evaluating global asset portfolios. TCFD reporting for private markets will pose further challenges, as even though trustees of large schemes will have collective market power to mandate such requirements at a point of contract, fund managers and general partners are likely to vary greatly in their approach and methodology.”
   BP Pension Scheme

9. Some respondents’ concerns about data related to the way in which many schemes invest or to what trustees would be expected to do with data once received from asset managers.

   “Many schemes hold heavily diversified pooled funds…As such funds are often invested in thousands of companies, obtaining the necessary information to meet the new requirements would be difficult, even for larger schemes, as would assimilating the data and presenting it in a meaningful way.”
   Sackers

Liabilities

10. Two respondents who did not want to be quoted in the Government’s response indicated that they had concerns about how the proposals would work in relation to assessing schemes’ liabilities. They felt that there is no well-established view within the sector on how to assess climate risks to liabilities.

11. However, another flagged that it is valuable to consider liabilities.

    “The impact on liabilities must also be considered. We are equally supportive of the proposal for an integrated risk management approach, whereby assets, liabilities and covenant are all considered when assessing climate related risks and opportunities.”
    Deloitte

Further guidance and clarification

12. Many respondents asked for greater clarification on the terms used in the proposals or suggested further points for the statutory guidance to cover. These requests covered elements including:

    - What is meant by "opportunities";
    - What is meant by "material" risks; and
    - Further guidance related to the suggested time horizons.

13. Some suggestions sought help to reduce the perceived burden on trustees.

    "Some schemes have DB and DC elements (and hybrid elements). In DC there may be various default arrangements. We would suggest that trustees of such a Scheme like ours should be able to produce one response to this requirement, albeit that response might need to contain an annex to cover differences between the different elements of the Scheme."
    BAE Systems Pension Fund

14. Some respondents suggested that the proposals should be qualified by some form of "reasonableness" test.

    "It might need to be further emphasised that the identification is plausibly only going to be "likely" climate change risks and opportunities and "likely" impact on investment strategy/funding strategy. We cannot know all of the risks and opportunities for certain as yet."
    PPF

    "The proposal does not indicate any standard to which trustees must adhere. We presume that a reasonableness test will apply? Note Q6 uses the term 'so far as they are able'. There is an almost limitless amount of analysis that could be done and this phrase would point to significant expenditure."
    BAE Systems Pension Fund

Government Response

Assessment and disclosure of climate-related impacts on the covenant

15. The Government acknowledges the concerns raised about the inclusion, through reference to DB schemes' funding strategy, of the covenant in the proposals on strategy. However, there was also strong support for the covenant to be assessed in relation to climate change, with respondents recognising the significance of the covenant to the overall viability of DB schemes. For many schemes, the strength of the covenant is key to their funding strategy and, therefore, it is important that trustees understand the potential impact of climate

change – and related policy change, for example, moves towards the Government's net zero target – on the covenant.

16. In relation to questions about the practicality of this exercise, we note that, as a result of the proposals the Government published in its Roadmap towards mandatory climate-related disclosures, many large companies will, subject to consultation, be required to publish their own TCFD reports. This will make a significant amount of information about sponsoring employers publicly available. However, even in the absence of such information, trustees who have taken the time to understand why climate change poses risks and opportunities for their sponsor, and the nature of these, can have a meaningful conversation with the sponsor to identify relevant physical and transition risks that pose challenges to the sponsor's business, and how the sponsor is responding.

17. If schemes find reasons to be concerned about the impact that climate-related risks could have on the future strength of the covenant, there are actions that they can take, including adopting a more prudent approach to funding and investment, seeking additional security over assets and exploring market opportunities for risk transfer, such as effecting a buy-in of tranches of liabilities or accelerating the timescale to fully secure the scheme's benefits with an insurer or consolidator.

18. Therefore, the Government will continue with its proposal to include consideration of the covenant as part of trustees' assessment of the funding strategy.

19. We acknowledge the concerns about disclosure of information relating to the covenant and the sponsoring employer. It is not our intention to limit the sharing of information or otherwise impact the willingness of sponsors to engage with trustees. Confidential information about the sponsor can be covered by a non-disclosure agreement, as is used for sensitive financial information. Trustees should disclose information about this in their TCFD reports in a high-level way that does not compromise such sensitive or confidential information. For example, trustees could disclose broader, more qualitative information.

20. As sponsor companies start to publish their own TCFD disclosures, in line with the Government's Roadmap towards mandatory climate-related disclosures, trustees may find they are able to publish more specific information.

Time horizons

21. The Government agrees that it is useful for trustees to have greater clarity on what is meant by "short, medium and long term" time horizons. We believe that, subject to this further clarification, these are the simplest and best terms to use. They are also most closely aligned to the TCFD's recommendations.

22. The proposals suggested that further information would be set out in the statutory guidance. It remains our view that this is the most appropriate approach because it allows for the necessary flexibility in interpretation by trustees, given the

differing characteristics of pension schemes. However, our proposed regulations set out the factors trustees must consider when determining their time horizons.

23. We agree with the suggestion that it would be valuable for trustees to be required to disclose the time periods they choose as their relevant time horizons. This will provide greater clarity for stakeholders and TPR on the context in which trustees have considered the effects of climate change on their schemes.

Data and methodology concerns

24. Government recognises respondents' concerns about the availability and quality of data and those related to the practicalities of understanding and aggregating data. These concerns are particularly relevant in relation to scenario analysis, metrics and targets. We proposed that trustees must meet the relevant requirements 'as far as they are able'. However, in respect of the strategy element of the proposals (excluding scenario analysis), we do not see data as such a significant barrier. The strategy proposals (excluding scenario analysis) require trustees to plan strategically at a higher level about the climate-related risks and opportunities that will have an impact on their scheme over the different time periods. We do not think that trustees need extensive or granular data to do this in a meaningful way. For this reason, we do not propose to add an element of proportionality or "as far as they are able" to our original proposals. We have sought to provide guidance on our expectations in this respect in the draft statutory guidance.

Liabilities

25. We believe that it is part of trustees' duties to understand the impact of climate change "in the round", including in respect of their schemes' liabilities.

26. However, we accept that this presents challenges, for example in understanding the effects on longevity and discount rates. We accept, therefore, that trustees may need to take a proportionate and high-level approach. If trustees do not feel able to act on the strength of their analysis, because of concerns about robustness, it is acceptable for trustees not to do so. This does not, however, mean that trustees should start from the position that they should not even explore the impact on liabilities. This is set out in draft statutory guidance.

Further guidance and clarification

27. Many of the points raised by respondents are covered by draft statutory guidance published alongside this consultation. For example, this draft guidance points to examples of climate-related opportunities and suggested time horizons. However, the guidance will not cover every possible question trustees may have and trustees must take their own view on what is appropriate for their scheme. The Government wants to see trustees showing that they grasp the possible impact of climate change on their scheme and understand what they may do to mitigate

this. A solid appreciation of this is more important than exhaustive analysis or rigid definitions of factors such as “materiality”.

28. In relation to questions about the levels at which trustees should make the assessments, we have set out more detail in the draft statutory guidance. In summary, for DC schemes, trustees should look at the popular default funds. For a single section DB scheme – or for a DC scheme with no member choices (just 1 default and no self-select funds) – trustees should look at the level of the whole scheme. For a scheme with more than 1 DB “section”, trustees should look at the level of each section. However, sections with similar characteristics in relation to assets, liabilities, and funding may be grouped. For schemes providing both DB and DC benefits, the two benefits should be considered separately. However, if DC assets are solely attributable to Additional Voluntary Contributions, we do not propose that trustees should assess this. Trustees may, however, choose to assess self-select funds and AVC arrangements.

29. In the consultation we proposed that the trustees must identify the climate-related risks and opportunities that will have an effect on the scheme’s investment strategy and, where relevant, funding strategy. However, in the related disclosure obligation, we referred to the trustees disclosing not only the climate-related risks and opportunities they had identified but also disclosing those identified by other persons managing the scheme.

30. We have now simplified this requirement, and brought it into line with the other requirements, by removing reference to “persons managing the scheme” so that the regulations place an obligation on trustees to identify the risks and opportunities and to describe what they have identified. This does not prevent, in practice, persons other than trustees being responsible for identifying the risks and opportunities.

Summary of changes

Our proposed regulations specify the factors trustees must consider in setting their time horizons. The proposed regulations also require trustees to disclose their chosen time horizons in their TCFD report.

Trustees will not be required to describe in their TCFD report climate-related risks and opportunities which are identified by persons other than the trustees.

Apart from adding to the matters covered in our proposed statutory guidance, we have made no other changes.

Draft Regulations on Strategy

31. In the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, paragraph 3 in Part 1 of the Schedule requires trustees, on an ongoing basis, to identify climate-related risks and opportunities

which they consider will have an effect on the scheme's investment strategy and, where the scheme has a funding strategy, on the funding strategy.

32. Trustees are required to identify these risks and opportunities over the short, medium and long term.

33. Paragraph 4 of the Schedule requires that trustees must take into account the scheme's liabilities and its obligations to pay benefits when determining the short, medium and long term time horizons for their scheme.

34. Having identified the relevant climate-related risks and opportunities, paragraph 5 requires trustees, on an ongoing basis, to assess the impact of these on the scheme's investment strategy and, where the scheme has a funding strategy, on the funding strategy.

35. Paragraph 21 in Part 2 of the Schedule requires trustees to describe, in their report required by regulation 3:

- The climate-related risks and opportunities the trustees have identified (over the short, medium and long term) (paragraph 21(d));
- The time periods they have chosen for the short, medium and long term (paragraph 21(e)); and
- The impact of these climate-related risks and opportunities on the scheme's investment strategy and, where the scheme has a funding strategy, the funding strategy (paragraph 21(f)).

Draft Statutory guidance on Strategy

36. We have produced draft statutory guidance relating to trustees' obligations in relation to strategy. This includes, amongst other information, guidance on:

- Assessing the scheme's time horizons (short, medium and long);
- Examples of climate-related risks and opportunities;
- Definitions of 'physical' and 'transition' risk in relation to climate change; and
- Assessing the impact on the investment strategy and funding strategy.

Consultation Question

Q4:

a). Do you have any comments on the provisions on strategy in the draft regulations?

b) Do you have any comments on the draft statutory guidance on strategy?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Chapter 6: Scenario Analysis

Background

1. To enable trustees to publish disclosures in-line with the TCFD's recommendations, we proposed that they be required to carry out climate-related scenario analysis. The consultation document acknowledged that this is one of the most complex parts of the recommendations.

We proposed that:

Regulations require trustees, at least annually 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 proposed statutory guidance will cover the matters outlined in Box 6 of the August consultation.

Summary of responses

Frequency of scenario analysis

2. The most frequently raised concern related to the proposed frequency of the scenario analysis and the expectation that it be carried out annually.

   "Implementing meaningful actions on the basis of the analysis (e.g. introducing a new mandate) will take a considerable amount of time, potentially longer than a year, by which time the analysis would be renewed."
   Unilever UK Pension Fund

   "We do not agree that a scenario analysis would be out of date on an annual basis. Taken together with the fact that long-term investors' portfolios may not have changed significantly in a year, we therefore do not believe that running an analysis annually is the best use of resource."
   Railways Pension Trustee Company Limited

3. A number of respondents suggested alternative timeframes for scenario analysis. There was strong support for a three-year cycle with a number of respondents suggesting that this could be accompanied by a requirement for trustees to review, on a more frequent basis, whether they needed to do a fresh analysis.

   "We propose modifying this to requiring scenario analysis to be carried out at least once every three years or sooner if there is a major change to the scientific evidence or international agreements (using similar language to the SIP reviews).

However, the first such review should be conducted in line with the 2022 deadlines."
Nest

"For the majority of schemes carrying out an analysis at the point of their triennial valuation, a review/change of their default offering or when significantly changing their investment strategy is more appropriate and would ensure they can align the exercise with various other regulatory requirements e.g. their funding plan."
PLSA

Identifying climate scenarios

4. The proposals would require trustees to use "at least two" climate-related scenarios. Some respondents welcomed the implied flexibility.

   "Given that there are an increasing number of free resources available, it is reasonable to expect trustees to assess resilience in two climate-related scenarios and it should enable trustees to make more informed decisions."
   Federated Hermes

   "We welcome that the proposals are not prescriptive in terms of scenarios to be used, and indeed would strongly suggest that this remains the case, noting the benefits we have observed that this brings in terms of the depth of trustee engagement with and interrogation of the scenarios employed."
   Willis Towers Watson

5. However, many respondents explored further the idea of what these scenarios should be. There was significant support for schemes' resilience to be tested against three scenarios specified as modelling an "orderly" transition to 2°C, a "disorderly" transition to 2°C, and no transition (or a higher global temperature increase).

   "We would suggest applying stronger encouragement to use three strategies – two to capture different transition risk scenarios (one for a more orderly transition, and one for a disorderly or "shock" transition) and one to capture a limited transition leading to greater physical risks as a result of much higher temperature."
   PPF

   "We feel this scope is too narrow, and would prefer at least 3 scenarios to provide improved breadth of understanding of potential climate-related impacts."
   Hymans Robertson

6. In a related point, respondents often focused on what the temperature rise of the scenarios should be. The proposals require "at least one scenario that represents an eventual global average temperature rise of between 1.5 and 2°C on pre-industrial levels" and many respondents gave their view on this. A few felt that the proposals could require a 1.5°C scenario.

"In our view, any scenario analysis should include a 1.5°C scenario. The TCFD recommendations which include a scenario of 2°C or lower were published before the IPCC Special Report on Global Warming of 1.5°C. Since then, a number of governments, including the UK have set targets in line with limiting warming to 1.5°C, and such targets have quickly evolved into best practice."
Nest

7. On the other hand, a minority of respondents pointed to the risk of specifying the temperature rise in legislation.

"Proposing a specific 2°C or lower scenario at this point of time may run the risk of becoming outdated in the near term …We recommend to use language guiding towards a "central scenario" which would have a longer remit, given that this scenario is open to change as needed."
CFA UK

"Reference to "2°C or lower scenario" in our view will lead to a degree of 'group think', with most asset owners taking this as guidance to use a 2°C scenario."
Hymans Robertson

8. Where respondents focused on this part of the proposal there was vocal support for a higher temperature scenario to be part of the proposals.

"We would also recommend the consideration of a 4℃ scenario as the comparator climate-related scenario. The 4℃ pathway is a helpful and realistic scenario to consider and to make informed investment decisions alongside the 2℃ pathway."
The Society of Pension Professionals

Scenario analysis on the covenant

9. In line with responses to the proposals on strategy, a theme across responses emerged in relation to the reference to "funding strategy" and, therefore, the inclusion of the covenant.

"Disclosing information covering liability profiles and covenant strength may be sensitive and require comprehensive consultation with corporate sponsors, while also attracting material increase in advisory fees to support such assessments."
Barclays Bank UK Retirement Fund

"We consider that [the sponsor covenant] is a very different type of risk than investment risk (which TCFD is primarily aimed at). We therefore consider there is an argument that employer covenant risks should be excluded from "normal" TCFD reporting requirements (at least to being with) and to the extent covered at all should be subject to separate requirements and/or guidance."
The Society of Pension Professionals

10. However, as with the proposals on strategy, there was also positive endorsement of the idea that the covenant be included in scenario analysis.

"As the scheme's sponsor will also be subject to climate change risks, trustees should be explicitly required to understand the extent of current and future potential reliance on the sponsor covenant and on the climate risks the sponsor covenant is exposed to."
EY

"The climate change scenarios should be applied to the employer covenant for DB schemes. This is often the most significant asset the trustees can access and understanding whether the covenant is affected in a similar or different way to the assets and liabilities of the scheme by climate change could be very significant."
Cardano

11. A few respondents flagged that the covenant could be covered by qualitative or more high-level analysis.

"A quantitative assessment of the impact of these scenarios on the strength of employer covenant is likely in many cases to be challenging and/or spurious, and so a qualitative assessment will be more appropriate in many cases."
Co-operative Group

Liabilities

12. The issue of how trustees would analyse their liabilities was also raised by a minority of respondents,

"Whilst an assumption could be made that interest rates (and therefore the discount rate for liabilities) will be lower in the worst case carbon scenario, thus leading to higher liabilities, this assumption cannot be relied on with a high degree of certainty. Furthermore, there are a number of other factors to consider besides interest rates (mortality rates, for example) and the prognosis on these in different climate scenarios is even more subject to guesswork at the present time. In the absence of further guidance, CFA UK would suggest that the liabilities are initially not subject to different stresses in the two scenarios. This could be an area for further consultation."
CFA UK

"[It] would require the scheme actuary to calibrate longevity and mortality assumptions to different climate pathways. We understand this is being considered by industry bodies including the IFoA and so would look to them to lead on this, however the impact of climate change scenarios on UK mortality is highly uncertain, but changes in parameters may have material impacts on the expected funding journey of a scheme."
HSBC Bank Pension Trust

"As far as they are able"

13. Respondents generally welcomed the proposal that trustees undertake scenario analysis "as far as they are able", but a number stressed the need for greater guidance on what this means.

"It is imperative that the meaning of this phrase is made clear in the regulations and / or the supporting guidance."
Sackers

Data and methodology concerns

14. As with the proposals on strategy, concerns were raised about the practical challenges associated with scenario analysis. A range of different factors were raised, including concerns about the availability of data (and, in particular, the need for a joined-up approach across the investment chain), the challenges posed by different asset classes, and concerns about possible inconsistencies in the models used.

"There is a need for company level data with consistent information being provided by all companies. This risks a lack of credibility for early reports or may not incentivise the behaviours Government wants. Where gaps in the reporting are being filled by proprietary third party firms' algorithms, proxies and assumptions, unless all market participants use the same models the information will not be consistent."
Barnett Waddingham

Further guidance and clarification

15. Many respondents asked for further clarification on the nature of the proposed duties or made suggestions for further points that could be set out in statutory guidance. These requests covered elements including:

- Starting with a narrower set of asset classes for analysis, for example equities and bonds;
- Looking for industry-wide analysis or solutions, recognising that schemes have similar asset mixes; and
- Greater clarity about the level at which the analysis should be carried out, the assets in scope (noting that trustees have a limited role in stock-picking) and that scenario analysis needs to be practically useful for trustees.

Government Response

Frequency of scenario analysis

16. Government acknowledges the concerns expressed about the burden and usefulness of annual scenario analysis. As methodologies and data are evolving rapidly, we see value in schemes regularly refreshing their scenario analysis.

17. However, we agree with the suggestion that this intention can be met by requiring scenario analysis less frequently. We have therefore made changes to our original proposal and will require that scenario analysis must be carried out in the first year that trustees are subject to the requirements and every three years thereafter. In the intervening years, trustees must do an annual review of their

scenario analysis and carry out fresh analysis where they consider it appropriate to do so. There will be various circumstances in which schemes will benefit from the information gained by fresh scenario analysis. For example, this is likely to be appropriate if any of the following occurs:

- A material increase in data availability;
- A significant/material change to the investment and/or funding strategy;
- The availability of new or improved scenarios or events that might reasonably be thought to impact key assumptions underlying scenarios; or
- A change in industry practice/trends on scenario analysis.

18. Further detail on these factors is included in the draft statutory guidance which sets out that trustees should refresh their scenario analysis in the face of one of these changes. Trustees will also be required to disclose the outcome of their most recent scenario analysis in their annual TCFD report and, where trustees decide not to undertake a new scenario analysis in an intervening year, they will be required to explain why they have not done so.

19. We expect that there will be some external factors which should lead most trustees to conclude that they need to re-do scenario analysis. For example, once asset managers are making mandatory TCFD-related disclosures, trustees who had previously carried out scenario analysis, as far as they are able, without this information would be expected to reasonably conclude that the increase in available data warrants new scenario analysis.

Identifying climate scenarios

20. The Government welcomed the level of engagement by respondents on the appropriate scenarios that schemes should use. We are content that requiring trustees to undertake analysis in “at least two” scenarios sets an appropriate minimum and allows trustees the flexibility to go further should they wish.

21. We agree that, at present, best practice suggests that trustees should model scenarios consistent with an orderly transition, disorderly transition and no or limited transition. It is important that the chosen scenarios enable trustees to test their schemes against transition and physical risks, as relevant to their time horizons.

22. However, we believe that statutory guidance is the appropriate place for this detail to be set out, as it allows trustees the necessary flexibility to choose what is relevant to their scheme and their time horizon. In the draft statutory guidance, we signpost trustees to the scenarios set out by the Network for Greening the Financial System, a group of financial supervisors. This approach is preferable to setting scenarios out in the regulations as there is a risk that if the regulations are too specific, they will become outdated as best practice develops. For the same reason, we do not propose setting more specific higher or lower temperature rises to be used in scenario analysis in the regulations. Furthermore, we do not propose to impose a requirement to do scenario analysis for a 1.5°C temperature

increase because these scenarios are not widely available. However, we hope that rapid progress will be made in this respect by industry, allowing trustees to select these scenarios.

Scenario analysis on the covenant

23. We understand concerns about undertaking scenario analysis on the covenant. However, we agree with those respondents who noted that it is important that trustees understand the impact of climate change on the sponsor and the covenant. Scenario analysis can be a helpful way to do this.

24. The Government signalled in its proposals that qualitative scenario analysis is acceptable and therefore believes that this could be appropriate for analysing the covenant, for example by questioning how the sponsor would be impacted by a particular scenario, whether it could respond to this and what it would need to do before such a scenario arises to manage the risks. The scenario analysis provisions are also subject to the "as far as they are able" provision, which will be helpful to trustees who face significant barriers in obtaining information about the sponsor.

25. In respect of concerns about disclosure of confidential information, the Government's position is as set out in chapter 5, paragraphs 19 and 20 above in relation to the strategy provisions.

Liabilities

26. As set out in our response to our proposals on strategy and the concerns raised about assessing the climate risks to liabilities, we believe that it is part of trustees' duties to understand the impact of climate change "in the round", including in respect of their schemes' liabilities.

27. We recognise that this may be challenging and, therefore, our proposed regulations provide that trustees must carry out their scenario analysis – which includes their analysis in relation to the liabilities – "as far as they are able". Trustees may also choose to do qualitative scenario analysis aimed at exploring "what if…" questions. As further best practice develops in this area, trustees' approach may become more sophisticated. This is set out in draft statutory guidance.

28. Furthermore, as set out in relation to strategy, if trustees do not feel able to act on the strength of their analysis, because of concerns about robustness, it is acceptable for trustees not to do so.

Data and methodology – "As far as they are able"

29. In the consultation document, the Government recognised that there may be some practical barriers for schemes undertaking scenario analysis, including that some investee firms do not carry out such analysis and if they do, the variety of assumptions, methodologies and scenarios used by firms may present hurdles

for schemes producing full analysis at the portfolio level. In the main, respondents' concerns in this area echoed this, with respondents producing more detail about the issues relating to data and methodologies.

30. We are content that the provision for trustees to undertake scenario analysis "as far as they are able" will assist trustees when confronted with these issues. Our view is that trustees' understanding of the risks posed by climate change will be increased by the process of attempting to undertake scenario analysis, even in cases where they face issues with data and cannot produce it for their full portfolio.

31. The Government's Roadmap towards mandatory climate-related disclosures sets out a pathway for widespread TCFD reporting across the economy, which will improve the availability and quality of data, and the expertise within the sector.

32. We have set out in the draft statutory guidance more detail about what is expected of trustees. The Government has also defined what is meant by "as far as they are able" in the draft regulations and provided further explanation in the draft statutory guidance, as requested by some respondents.

Further guidance and clarification

33. The statutory guidance is the right place for much of the clarification that respondents sought. In particular, the draft statutory guidance contains further explanation about the level(s) at which the analysis should be carried out.

34. However, the Government does not propose to exclude any particular sector or asset class from the overall duty to undertake scenario analysis. Climate change may have an impact on all of the main asset types in which trustees invest. If there are issues relating to the data obtainable for a particular asset class, this is covered by the "as far as they are able" provision. It would therefore be disproportionate to exclude whole asset classes from the start.

35. This would include assets that have been excluded from scope of consideration of a scheme's "relevant assets", for example buy-ins (see chapter 2) for the purpose of the asset threshold test. However, these assets would still be subject to the "as far as they are able" provision when it comes to the requirement to carry out scenario analysis. We would be interested in stakeholders' views on this.

36. We have provided further explanation on the level at which the analysis should be carried out in draft statutory guidance. However, in our Impact Assessment (covered in chapter 12) we also welcome feedback in relation to costs for schemes with multiple default funds. It is our proposal that these schemes will need to conduct scenario analysis for each popular default.

Summary of changes

We have changed our original proposal on scenario analysis so that trustees must undertake scenario analysis in the first year they are subject to the requirements and every three years thereafter. In the intervening years they must review, on an annual basis, whether or not circumstances are such that they should refresh their analysis, and either carry out new scenario analysis “as far as they are able” or explain in their TCFD report why they have not done so. Further guidance is set out in draft statutory guidance.

We have also provided more clarity on what is expected of trustees in respect of the requirement to undertake scenario analysis “as far as they are able”. The proposed regulations define what is meant by “as far as they are able” and further guidance is included in the draft statutory guidance.

Draft statutory guidance also provides more information in relation to the scenarios that trustees may want to use and expectations in relation to analysis of the funding strategy.

Draft Regulations on Scenario Analysis

37. In the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, paragraph 6 in Part 1 of the Schedule (Climate change governance etc. requirements) requires that trustees undertake scenario analysis, as far as they are able, in at least two global average temperature increase scenarios, one of which must be within the range of 1.5°C above pre-industrial levels, to and including 2°C above pre-industrial levels.

38. Paragraph 7 sets out that the matters which the scenario analysis must consider, for the trustees’ chosen scenarios. The matters are:

    - the potential impact on the scheme’s assets and liabilities of the effects of the global average increase in temperature and of any steps which might be taken (by governments or otherwise) because of the increase in temperature;
    - the resilience of the scheme’s investment strategy in the scenarios;
    - and, where the scheme has a funding strategy, the resilience of its funding strategy in the scenarios.

39. Paragraph 8 sets out the requirement that trustees undertake this scenario analysis in the first scheme year that the requirements apply and then every three years thereafter.

40. In the years where they are not required by paragraph 8 to undertake scenario analysis, paragraph 9 requires the trustees to review whether or not they should nevertheless undertake new scenario analysis to ensure their understanding is up to date. If they decide this is necessary, paragraph 10 requires them to undertake new scenario analysis, as far as they are able.

41. Paragraph 19 defines the meaning of “as far as they are able”.

42. Paragraph 21 in Part 2 of the Schedule (Information to be included in the report) requires trustees to describe their scenario analysis. In particular, they are required to describe:

- The most recent scenarios they have analysed (paragraph 21(g));
- The potential impacts on the scheme's assets and liabilities they have identified in their most recent scenarios (paragraph 21(h));
- The resilience of the scheme's investment strategy and, where the scheme has a funding strategy, its resilience, in their most recent scenarios (paragraph 21(i)); and
- Where they have decided in an intervening year not to do new analysis, their reasons why (paragraph 21(j)).

Draft Statutory guidance on Scenario Analysis

43. The draft statutory guidance sets out further detail relating to trustees' obligations in relation to scenario analysis. This includes, amongst other information, guidance on:

- Approaching scenario analysis, including the levels at which to make the assessment, available resources and selecting scenarios;
- Considering, and disclosing, climate change impacts in relation to the covenant/sponsoring employer;
- Trustees undertaking scenario analysis "as far as they are able"; and
- The factors that may trigger new scenario analysis.

Consultation Question

Q5:

a). Do you have any comments on the provisions on scenario analysis in the draft regulations?

b) Do you have any comments on the proposal that relevant contracts of insurance are within scope for scenario analysis?

c) Do you have any comments on the draft statutory guidance on scenario analysis?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Chapter 7: Risk Management

Background

1. Risk management is a key element in the TCFD recommendations. Ultimately, trustees hold sole responsibility for management of the risks to the scheme, including the physical and transitional risks associated with climate change. We proposed that trustees should identify, assess and manage climate risks, as well as ensure that they integrate climate risks into their wider risk management processes.

> We proposed that trustees:
>
> 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 proposed the regulations require trustees to disclose:
>
> c) the processes outlined in part (a) and how they have integrated these within the scheme's overall risk management.
>
> We proposed statutory guidance will cover the matters outlined in box 8 of the August consultation.

Summary of responses

Highlighting stewardship

2. It was pointed out by respondents that stewardship is a critical element of risk management yet it was not widely discussed in the risk management section. Trustees have a duty to manage climate risks which are a financially material risk to the scheme, so engagement with companies, particularly those exposed to greater climate risks, is very important in order to help mitigate risks and drive the low carbon transition.

   "We note that there are few references to stewardship in the consultation. In our view stewardship is a critical element in the management of climate risk. We would like to see the importance of using shareholder voting rights, engagement and advocacy emphasised in the statutory guidance as a key tool for trustees to manage climate risk."
   Lane Clark & Peacock LLP

Guidance on integrating climate-related risks into wider risk management

3. Many respondents asked for further guidance in order to address integration of climate-related risks into wider risk management. This was the most frequent response.

"For smaller schemes specifically, we suggest further thought and guidance is provided on how climate related risk considerations could be integrated into wider monitoring processes."
BT Pension Scheme

Clarification on defining financial materiality

4. A clearer definition on what is material or non-material to a scheme and help in determining which risks are the most material was requested.

   "We would welcome clearer guidance on how to integrate and embed climate change risk (and opportunities) into existing frameworks as well as better defining what constitutes material or non-material."
   Nationwide Pension Scheme

Government Response

Highlighting stewardship

5. We have accepted this comment; the TCFD recommendations provide supplemental guidance for asset owners which state that engaging with investee companies enables better disclosure practices and data availability. This in turn improves the ability of assets owners to assess climate risks. We have set out brief suggestions on stewardship in relation to risk management in the draft statutory guidance.

Guidance on integrating climate-related risks into wider risk management

6. We have accepted this point and set out suggestions and expectations in the draft statutory guidance of how trustees should integrate risks within their schemes' wider risk management process.

7. Ultimately, it is up to trustees to integrate climate risks as they see fit, as they are in the best position to set appropriate risk management processes, understand which climate risks are material to their scheme and how these interact with existing risks.

Clarification on defining financial materiality

8. We have not amended the original policy proposals in light of this comment. Trustees should already be aware of the range of material risks the scheme is exposed to. To engage with investment managers and hold them to account accordingly, trustees should have a good understanding of the drivers of these risks and whether a risk is likely to impact the delivery of members' benefits. There is unlikely to be a one-size fits all materiality threshold for schemes – some schemes will have a much lower tolerance for deviations in risk or return than others, and not all risks can necessarily be usefully set a numerical value.

9. We consider that if we attempted to introduce a concept of financial materiality for the purpose of the requirements this would likely be excessively prescriptive for some schemes.

Summary of changes

We have not made any changes to the original policy proposals on risk management.

The draft statutory guidance on which we are consulting sets out brief suggestions on stewardship in relation to risk management, and outlines how trustees should integrate their processes for identifying, assessing and managing climate-related risks within their overall risk management of the scheme.

Draft Regulations on Risk Management

10. Part 1 of the Schedule, paragraphs 11, 12 and 13 impose requirements on trustees in respect of risk management. Paragraph 11 requires trustees to establish and maintain processes that enable them to identify and assess climate-related risks which are relevant to their scheme.

11. Paragraph 12 requires trustees to establish and maintain processes that enable them to manage effectively climate-related risks which are relevant to the scheme.

12. Paragraph 13 requires trustees to ensure that management of climate-related risks is integrated into their overall risk management of the scheme.

13. Trustees must also meet the reporting requirements in Part 2 of the Schedule.

14. Paragraph 21(k) in Part 2 of the Schedule requires trustees to include in their report a statement describing the processes which they have established for identifying and assessing climate-related risks to the scheme and paragraph 21(l) requires trustees to describe the processes which they have established for managing effectively climate-related risks to the scheme. Paragraph 21(m) requires trustees to describe in their report how those processes are integrated within the trustees' overall risk management of the scheme.

Draft Statutory guidance on Risk Management

15. The draft statutory guidance sets out further information to help trustees meet their risk-management obligations including:

- Definitions and examples of climate-related risk types, including transition risk and physical risk
- Possible approaches trustees could use to identify and assess climate-related risk
- Possible risk-management tools and frameworks trustees could use to manage climate-related risks
- Key principles trustees could take into account when integrating climate-related risks into the scheme's overall risk management framework

- Considerations trustees should take into account including, the risks most material to the scheme, the time-horizons for managing risk and the potential size and scope of risks.

Consultation Question

Q6: **a). Do you have any comments on the risk management provisions in the draft regulations?** **b) Do you have any comments on the draft statutory guidance on risk management?** **Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.**

Chapter 8: Metrics

Background

1. Metrics are a crucial step towards embedding the TCFD framework. For trustees, metrics can help to inform their understanding of the scheme's exposure to physical and transition risks as well as progress on taking advantage of climate change opportunities. This enables trustees to better assess the positioning of their overall portfolio in respect of their management of climate change

> We proposed that trustees were required 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) on a quarterly basis, 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 quarterly and annually disclose metrics (including at least one emissions-based metric and at least one non-emissions-related metric) used to quantify the effects of climate change on the scheme and assess climate-related risks and opportunities.
>
> We also proposed 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 proposed that trustees would not be required to use a specific measure to assess the effects of climate change on the scheme's portfolio.
>
> Statutory guidance would cover the matters outlined in box 10 of the August consultation.

Summary of responses

Flexibility of both "as far as trustees are able" and no mandatory metric

2. A great number of respondents welcomed the Government's proposals for requiring trustees to obtain data "as far they are able" and the decision not to mandate a specific metric.

   "We agree not to mandate a range of metrics at this stage, as these are continuously evolving."
   ABI

"[We] agree that a lack of available data should not prevent action in areas where data are already fit for purpose, and we welcome government's recognition of this in its decision to take a flexible approach."
Railways Pension Trustee Company Ltd

"Most UKSIF members are looking to develop work on scope 3 emissions, but the vast majority caution that it is currently difficult. We welcome the language used about the difficulty and the direct linkage to "as far as they are able" wording."
UKSIF

Difficulties assessing and aggregating certain asset classes

3. Whilst there was broad support for the requirement to calculate and report emissions-related metrics, a significant number of stakeholders offered caveats to the proposal. Many stated that good data sources are limited to public equity and corporate debt. Obtaining data for assets and funds that have low levels of climate change reporting, such as derivative-based investment strategies, private market investments and property funds, poses significant challenges in aggregating measures across asset classes to describe an impact at portfolio level.

"Aggregation across different portfolios or assets can be highly challenging and on occasion impossible."
London CIV

"Gathering meaningful data will be difficult for some assets. While there are a number of sources of data for public equities and exchange traded debt, obtaining data for private assets such as real estate and private debt is likely to be problematic."
RAC Pension Scheme

4. Some stakeholders suggested excluding certain asset classes which are difficult to assess in this respect. It was also recommended that further guidance on how to calculate GHG emissions for these asset classes should be published alongside the regulations.

"It may be sensible to explicitly exclude some asset classes (for example, gilts and insured de-risking products) from the requirement – as we suspect that many trustees will simply not include emissions data for those asset classes in any event."
Association of Pension Lawyers

"It would be valuable for schemes to receive guidance on calculating GHG intensity for generic assets such as cash, Gilt/ ILG, derivatives (Gilt Repo, interest rate swaps / inflation swaps) and bespoke assets such as property and insurance buy-in contracts."
CFA UK

Lack of standardised methodologies for calculating and reporting GHG emission-based metrics

5. Many respondents stressed that an underlying issue related to the lack of data is the lack of commonly agreed standards and definitions in relation to normalising emissions (by revenue, market cap or enterprise value) estimation of scope 3 emissions and aggregation across different asset classes. Differences in methodologies will add to the difficulty from limited data in making consistent and meaningful reporting and could lead to significant differences in the estimates that schemes produce. It was also noted that differences in methodologies between asset managers pose challenges to schemes in calculating these metrics, especially if trustees are looking to aggregate across different funds.

   "An underlying issue similar to the lack of data is the lack of commonly agreed standards and definitions."
   BlackRock

   "Data limitations, access to data/look-through capabilities and differences in methodologies all pose some considerable challenges to schemes in calculating these metrics, especially if they are looking to aggregate across different portfolios or assets."
   Pensions Protection Fund

6. Others recognised the important of standardisation in climate metrics, as with other statutory requirements.

   "We recommend that standardised metrics be developed, and that schemes be required to report on all of them, or the most relevant.... Standardisation is a common principle behind other types of compliance and there is no solid justification given to take a different approach here."
   Destination0

7. As a solution to the above problems, many respondents called for the Government's proposal to require investee companies and asset managers to provide the data using agreed and consistent methodologies, creating a standardised approach. Other respondents believed that schemes should be transparent about the methodology they have used in the disclosures to support consistency and comparability at both asset and portfolio level.

   "There is a need for consistency in the regulations across the investment chain: underlying asset managers, and the companies and assets that the managers invest in need to have similar (or more stringent) obligations and requirements compared to pension funds."
   Barclays Bank UK Retirement Fund

   "It will be in the best collective interest of schemes to share these methodologies and data inputs used in delivering the final metrics as far as is practically possible. This will also ultimately lead to higher-quality reporting across schemes as peers will learn and grow their knowledge of this new requirement by learning

from one another along this journey towards optimal implementation."
CFA UK

Frequency of obtaining data and calculating metrics

8. A significant number of respondents opposed obtaining and calculating emission and non-emission based metrics on a quarterly basis. They stated that climate change data relies on corporate disclosures which are currently made on an annual basis. Coupled with the fact that there is little decision-useful variation for most climate metrics over the course of a year, quarterly reporting was deemed to be both time and resource-intensive for limited added value.

   "Quarterly monitoring of any metrics seems unrealistic in so far as the underlying data from investee companies is commonly taken from their annual reports and hence will not be updated quarterly."
   BAE Systems Pension Fund

   "We do not believe quarterly analysis and reporting is helpful in supporting long-term value creation and encourage short-termism."
   Legal & General Investment Management

9. Of these respondents, all suggested that obtaining and calculating emission and non-emission based metrics should be on an annual basis.

   "Annual reporting is more appropriate because of the long-term nature of the matters being considered. Quarterly reporting should be at trustees' discretion."
   BP Pension Trustees Ltd

   "We would recommend DWP amends this calculation to be on an annual basis."
   Legal & General Investment Management

Number and range of metrics

10. A large number of respondents welcomed the Government's proposals to require trustees to select at least one GHG emission-based metric and at least one other non-emission-based metric.

    "We agree that schemes should be required to set a greenhouse gas emission metric and at least one non-emissions based metric."
    Aviva

    "We agree with the proposal to include at least one GHG emissions-based metric and at least one non-emissions-based metric."
    Brunel Pension Partnership

11. However, an even larger number of respondents stressed the need for a larger range of metrics to get a balanced view of climate risk exposure. A key view was that a figure for total emissions would enable trustees to set a baseline for climate action. This would help trustees understand the climate impact of their loans and investments across all asset classes.

"We would like to see disclosure of total emissions alongside the other metrics … it is important to tackle total emissions if trustees want to manage climate-related risk, and therefore disclosing total emissions from a portfolio as far as practicable is important (particularly for the largest schemes)."
Lane Clark & Peacock LLP

"Guidance should also encourage schemes to consider additional metrics as relevant to their scheme and investments. We believe that given the challenges around data quality and coverage, using a range of metrics is preferable. There are also asset-class specific metrics that schemes could use."
Nest

"We recommend that the DWP requires trustees to calculate and disclose against the following three GHG emission-based metrics for disclosure: Total Carbon Emissions, Carbon Footprint and Weighted Average Carbon Intensity. We believe that better comparability and consistency could be obtained by extending the requirement to these three common metrics listed above. This would also be in line with the incoming EU sustainable finance disclosures."
State Street

12. Of the respondents, several believed that the proposal to steer trustees towards choosing Weighted Average Carbon Intensity (WACI) as their emission-based metric would not be appropriate. Respondents argued that given the challenges around data quality and coverage for a number of asset classes, attempting to aggregate to portfolio level would be unrepresentative considering WACI only covers listed equities and corporate bonds. Respondents also questioned the ability of one metric to provide a balanced view of climate risk exposure.

"Reporting requirements should apply (initially at least) to each asset class individually (with comparisons made against asset class specific benchmarks) and not at the total portfolio level."
Cardano

"The Partnership for Carbon Accounting Financials (PCAF) offers some methodological advantages in the calculation of Scope 3 emissions and is supported by a number of large US banks. The TCFD Taskforce will soon publish a consultation proposing replacing WACI with PCAF. Given the importance of common methodology and limiting overall compliance costs, the PRI recommends removing the direct reference to WACI."
PRI

Double Counting and scope 3 emissions

13. Some respondents highlighted the risk of trustee's double counting GHG emissions, if for example, one owns both the equity and debt of the same issuer, or through scope 3 emissions.

"We believe that there are some challenges in calculating metrics once data has been obtained. For example, schemes will have to decide how to apportion

carbon emissions at entity level if they hold both a share of the equity and debt in the issuer to avoid double counting. We do not believe that the Greenhouse Gas Protocol entirely addresses that challenge."
Nest

"Trustees [should] also draw out the potential for double counting within any aggregated figure e.g. a portfolio may hold investments in an oil and gas company, an electricity generator who uses that gas and a manufacturer who uses the electricity. All of these could include the impact of the same gas with different scope i.e. scope 3, scope 1 and scope 2 within this example."
Aviva

Government Response

Flexibility of both "as far as trustees are able" and no mandatory metric

14. The Government welcomes the level of support from respondents for its proposal that trustees obtain data "as far as they are able" and its proposal not to mandate any specific metric in regulations.

15. We agree that, at present, that there is a potential lack of readily available information, that it will take time for investee companies to build up their disclosures and that metrics are a continuously evolving area. However, trustees' understanding of the risks posed by climate change will be increased by the process of obtaining data and calculating metrics required by our policy, even in cases where they face issues with data and cannot obtain it for their full portfolio.

16. We acknowledge that whilst trustees are responsible for managing climate change risks for the scheme, they will typically rely on asset managers for data and some interpretation. Asset managers will be able to provide increasing volumes of data and insight into the sections of the portfolio which they manage as increased climate change competence and statutory duties begin to unlock data flow.

17. However, given the challenges this still presents in the near-term, we have amended our policy so that all activities above and beyond the selection of metrics are subject to the "as far as they are able" provision. This includes not just collection of the underlying data, as originally proposed, but also the calculation of the selected metrics using that data, and the identification and assessment of climate-related risks and opportunities using the metric.

18. We have made this change to reflect the fact that the trustees' ability to calculate the metric and to make assessments of climate-related risks and opportunities will be limited by the quality and completeness of the underlying data that they are able to obtain.

19. Our regulations will also require trustees to explain any data needed to calculate metrics for the scheme that they have been unable to obtain.

20. As explained earlier, ‘as far as they are able’ is defined in the regulations to mean taking all such steps as are reasonable and proportionate in the particular circumstances, taking into account the costs, or likely costs, which will be incurred by the scheme and the time required to be spent by the trustees, or anyone acting on their behalf.

21. As explained in paragraph 29 of chapter 1 there is no expectation of disproportionate investment of time in filling non-material data gaps in relation to firms which are unlikely – due to their business activities or size – to account for a high proportion of overall scheme emissions or climate-related risk. Additional information requests to fill data gaps should be made with due regard to the size and scale of the investee company in question.

Difficulties assessing asset classes and portfolio level reporting

22. We recognise the concerns a number of respondents have raised about aggregating measures across asset classes to describe an impact at portfolio level. However, the requirement for trustees to obtain and calculate greenhouse gas (GHG) emissions for all asset classes only “as far as they are able” already allows for flexibility in this regard,

23. It remains the Government’s view that a portfolio-level metric, covering all asset classes (or a section level metric for schemes with multiple sections, or popular defaults in the case of defined contribution schemes), would be preferable for comparison purposes. However, we are persuaded by the observation that currently aggregation across different portfolios or assets can be highly challenging and on occasion impossible. We address this in the draft statutory guidance, making clear that trustees are free to calculate and report emissions-based metrics at the asset class or fund level as well as the level of the portfolio (or section or popular default, as appropriate).

24. In particular, the draft statutory guidance recommends the carbon footprint as an emissions intensity-based metric that allows comparison at asset class and fund level as well as portfolio level. We have removed weighted average carbon intensity (WACI) as our recommended intensity metric.

Lack of standardised methodologies for calculating and reporting GHG emission-based metrics

25. We acknowledge respondents’ concerns that the lack of commonly agreed standards and definitions, and differences in methodologies between asset managers, could lead to significant differences in the estimates that schemes produce.

26. The draft statutory guidance makes recommendations for greater data integrity and encourages trustees to engage with significant emitter companies as well as asset managers to disclose complete and verifiable emissions data.

27. The draft statutory guidance also highlights the Global Carbon Accounting Standard for asset managers, asset owners and banks to measure and report GHG emissions tied to their lending and investment portfolios. Developed by the Partnership for Carbon Accounting Financials (PCAF), its purpose is to provide a common methodological foundation, across asset classes (equities, corporate debt, sovereign debt, real estate, etc.) By following the methodology for each, trustees will be able to measure or estimate GHG emissions for each asset class or fund and produce disclosures that are consistent, comparable, reliable, clear, and efficient.

28. We also encourage trustees to be transparent about their methodologies and those of their asset managers to support consistency and comparability at fund, asset class and portfolio level. Greater data disclosure will also help highlight any notable gaps in the analysis in terms of coverage and data quality. This is covered in the draft statutory guidance published alongside this consultation.

Frequency of obtaining data and calculating metrics

29. We acknowledge concerns expressed about obtaining emissions and other data on a quarterly basis.

30. As methodologies and data are evolving rapidly, we see value in schemes regularly updating their calculations to ensure consistency and attention to risks and opportunities. However, we acknowledge, as a number of stakeholders themselves highlighted, that the underlying data from investee companies is taken from their annual reports and hence will not be updated quarterly. Therefore, requirements to calculate GHG emission-based metrics on a quarterly basis would run the risk of being unhelpful and burdensome.

31. We note that the majority of respondents were in agreement that obtaining and calculating emissions-based and other metrics should be on an annual basis. We agree there is a strong case for being aligned with the annual reporting of issuers. We have therefore decided that all data collection and calculation should be done on an annual basis.

Number and range of metrics

32. We acknowledge the support for our proposals to require trustees to select at least one GHG emissions-based metric and at least one other metric. However, there was also strong support for a larger number of metrics to get a wider and more balanced view of climate risk exposure.

33. We remain supportive of using a range of metrics. We have therefore made changes to the original policy proposal so that the policy is both flexible with the

emergence of PCAF and other standards, and reflects the views of consultation respondents.

34. As highlighted above, we recognise concerns about the proposal to steer trustees towards Weighted Average Carbon Intensity (WACI) as their emissions-based metric, given the challenges around data quality and coverage, and the impracticality of aggregating to portfolio level. We have therefore decided not to use WACI as the recommended metric in the draft statutory guidance, and instead we recommend carbon footprint as the emissions intensity metric. The carbon footprint metric gives funded tonnes of CO_2 equivalent emissions per £m invested.

35. However, a key view was that a figure for total GHG emissions would enable trustees to set a baseline for action on managing climate change risk. An absolute measure of emissions is simply an addition of all of the emissions of the assets of the scheme.

36. We have therefore made changes to our original proposals so that trustees will be required to select at least two emission-based metrics, one of which must be absolute and one which must be intensity-based, as well as one additional climate-change metric. The Government has set out its expectations in this respect in the draft statutory guidance, published alongside this consultation

Double Counting and scope 3 emissions

37. We recognise the concerns expressed by some respondents about double counting of GHG emissions. This form of double counting cannot be avoided, but can be made more transparent by separately reporting the scope 1, 2, and 3 emissions. Statutory guidance sets out that for the recommended total emissions and emissions intensity metrics, trustees should report scope 1 and 2 data separately from their scope 3 data, or explain why they have not done so. They are also encouraged to report their scope 1 data separately from scope 2.

38. Government expects trustees to take a common-sense approach to ensuring that double counting is minimised by trustees using the correct attribution method, and has set out its expectations in this respect in the draft statutory guidance published alongside this consultation.

39. However, for pension scheme trustees to identify where their exposure is concentrated, scope 3 emissions data is clearly necessary. Without it upstream and downstream emissions which could affect the profitability or viability of pension scheme investments are disregarded, and without scope 3 disclosure, end-consumer usage of high carbon products is not counted by any investor at all.

40. Therefore, whilst scope 1 and 2 emissions data is more robust, with clear boundaries and a standardised methodology, it provides only a limited view – scope 3 data, despite the reliance on a high degree of estimation, provides a

fuller picture. The TCFD's 2020 status report[31] indicated that scope 3 emissions were rated as "very useful" by investors and lenders.

41. We have therefore set out in our proposed regulations that trustees should – as far as they are able – obtain scope 1, 2 and 3 emissions.

Summary of changes

We have changed the proposals in respect of metrics so that trustees must select at least two emission-based metrics, one of which must be absolute and one which must be intensity-based, as well as one additional climate-change metric. This is reflected in the draft Regulations.

We have extended the "as far as they are able" provision so that it applies not just to the collection of emissions data, but also to the calculation and use of the metrics.

We have not made any changes to the proposal not to mandate a specific metric. However, we decided not to proceed with our proposal to reference WACI in statutory guidance as the recommended metric.

We have made changes to our proposals on the frequency of obtaining and calculating emissions-based and additional metrics, so that trustees will be required to do this annually rather than quarterly – this is reflected in the draft regulations.

Draft statutory guidance provides more information on a range of topics including the calculation of absolute emissions metrics (where we recommend total emissions) and intensity-based metrics (where we recommend carbon footprint); our expectations around consistency and comparability in calculating and reporting GHG emission-based metrics; and separate disclosure of scope 1, 2 and 3 absolute emissions and emissions intensity metrics, to minimise double counting.

Draft Regulations on Metrics

42. In our proposed Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, paragraph 14(a) in Part 1 of the Schedule states that trustees must select a minimum of one metric which gives the total greenhouse gas emissions of the scheme's assets ("absolute emissions metric"), whilst paragraph 14(b) would require trustees to select a minimum of one metric which gives the total carbon dioxide emissions per unit of currency invested by the scheme ("emissions intensity metric"). Finally, paragraph 14(c) would require trustees to select a minimum of one other metric relating to climate change ("additional climate change metric"), to calculate for the scheme. Paragraph 14 also provides that trustees must review their selection from time to time as appropriate to the scheme.

[31] https://www.fsb.org/wp-content/uploads/P291020-1.pdf

43. Paragraph 15(a) of the Schedule would require that trustees must on an annual basis, and as far as they are able, obtain the scope 1, scope 2 and scope 3 greenhouse gas emissions of the scheme's assets. Paragraph 15(b) would require trustees to use the data obtained to calculate their selected emissions metric and intensity emissions metric as far as they are able. Paragraph 15(c) would require trustees to use the metric they have calculated to, as far as they are able, identify and assess the climate-related risks and opportunities which are relevant to the scheme.

44. Paragraph 16(a) of the Schedule would require that trustees must on an annual basis, and as far as they are able, obtain the data required to calculate their selected additional climate change metric. Paragraph 16(b) would require trustees to use the data obtained to calculate the additional climate change metric as far as they are able. Paragraph 16(c) would require the trustees to use the metric they have calculated to, as far as they are able, identify and assess the climate-related risks and opportunities which are relevant to the scheme.

45. Paragraph 21(n) in Part 2 of the Schedule would require trustees to report the metrics they have calculated in accordance with paragraphs 15 and 16 and, if the trustees have not been able to obtain data to calculate the metrics for all of the assets of the scheme, they must to explain why this is the case.

Draft Statutory Guidance on Metrics

46. Statutory guidance sets out further information and guidance in relation to trustees' compliance with paragraphs 14, 15, 16, and 21(n) of the Schedule. This includes, amongst other information, guidance on:

- the types of metrics trustees should or could select, calculate and report;
- the level of granularity – portfolio, section, fund, asset class – at which the selected metrics should or may be calculated and reported
- what is expected of trustees to support consistency and comparability in calculating and reporting GHG emission-based metrics

Consultation Question

Q7:

a). Do you have any comments on the provisions on metrics in the draft regulations?

b) Do you have any comments on the draft statutory guidance on metrics?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Chapter 9: Targets

Background

1. Target-setting is a useful tool for trustee boards to track their efforts to reduce climate change risk exposure and maximise climate change investment opportunities.
2. The targets that trustees set will be related to the metrics they have selected to calculate.

We proposed that trustees:

a) at least annually, set at least one target to manage climate-related risks for one of the metrics trustees have chosen to calculate, and disclose the target(s).
b) at least quarterly measure performance against the target(s) as far as trustees are able and disclose that performance annually.

Statutory guidance would cover the matters outlined in box 12 of the August consultation.

Summary of responses

Frequency of measuring and reporting

3. As with metrics, many respondents stated that it would be disproportionate to require quarterly monitoring against targets, given investee companies would only be expected to disclose sustainability-related information to the market on a yearly basis. There was unanimous agreement that annual monitoring would be more suitable.

   "The proposal to measure quarterly is overly prescriptive at this stage given both the ability to capture data accurately but also the potential additional resourcing burdens that this places on schemes until such time as the ability to undertake measurement is more readily available."
   West Midlands Pension Fund

   "Practically, much of the data used in the monitoring assessment (e.g. carbon emissions) will be updated less frequently so quarterly monitoring is likely to yield little additional added value relative to, say, annual monitoring."
   Hymans Robertson

Limitations and benefits of setting targets

4. Respondents highlighted that setting targets may be of limited benefit to schemes with a clear end game that have specific, short term investment goals or where they are constrained in the targets that can be achieved.

"Metrics and targets may be of limited benefit to schemes with a clear end game and which have specific, short term investment goals (e.g. achieving buy-out) or where they are constrained in the targets that can be achieved (e.g. where a substantial proportion of assets are invested in bulk annuities)."
Eversheds Sutherland

5. Others believed that setting targets for reducing a specified metric could result in a lower overall return for members and therefore risk a challenge to trustees' compliance with their fiduciary duties.

"Requiring annual targets to reduce emissions intensity could potentially trigger significant unintended consequences, including investment decisions that erode member value, a reduction in appetite for positive engagement with companies and the potential for trustees' fiduciary duties to become compromised should investment choice be juxtaposed with members' financial outcome."
HSBC Bank Pension Trust

6. However, the majority of respondents were supportive of this proposal due to the general consensus that targets set a direction of travel, propelling action on the management of climate change risk, and encourage both positive behaviours and engagement with asset managers.

"Monitoring [targets] will help people [beneficiaries] to understand the progress schemes are making and help guide their decisions."
The Money Charity

"In our view there is little merit in reporting on a metric without any concrete targets in place aiming to improve performance against this metric."
Isio Group

Government response

Frequency of measuring and reporting

7. We note that the majority of respondents are in agreement that quarterly monitoring of performance against a set target would be too frequent and overly prescriptive, given that investee companies would only be expected to disclose sustainability-related information to the market on a yearly basis.

8. The Government agrees with the suggestion that annual reporting would be more suitable and this is reflected in the draft Regulations on which we are now consulting.

Limitations and benefits of setting targets

9. The Government acknowledges the concerns raised about targets having limited benefit to schemes with a clear end game and that they could be seen to challenge trustees' compliance with their fiduciary duties in some circumstances.

However, we are keen to reiterate that the proposal to require trustees to set at least one target to manage climate-related risks for one of the metrics calculated would not impose a legal requirement on trustees to set targets to reduce their absolute emissions or emissions intensity, or to set targets that are not achievable or that erode member value.

10. Nor are any trustee-set targets legally binding. In emphasis of that point, we have also amended our original proposal to provide an annual prompt for trustees to consider whether the target remains appropriate. Each year trustees must determine whether to maintain or replace their target, having considered the scheme's performance against it.

11. It is our considered view that targets will help to set a direction of travel, propelling action on the effective management of climate change risk, and will encourage both positive behaviours and engagement with asset managers and investee firms. Therefore, the Government will continue with its original proposal to require that trustees must set targets for their scheme.

Summary of Changes

We have amended our original proposal of quarterly performance monitoring against a set target to an annual requirement

We have also provided for annual review by the trustees of any targets, to determine whether they should be maintained or replaced.

We have not made any other changes to our proposals for target setting and monitoring.

Draft regulations on Targets

12. In our proposed Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, paragraph 17 in Part 1 of the Schedule provides that trustees must, set a target for the scheme in relation to at least one of the metrics which they have selected to calculate.

13. Paragraph 18(a) would require trustees to, on an annual basis and as far as they are able, measure the performance of the scheme against the target which they have set, whilst paragraph 18(b) would require trustees to, on an annual basis, take into account the scheme's performance and determine whether the target should be retained or replaced.

14. Paragraph 21(o) in Part 2 of the Schedule would require trustees to describe in their TCFD report the target(s) they have set in accordance with paragraph 17 and the performance of the scheme against such targets, which the trustees have measured in accordance with paragraph 18(a).

Draft Statutory Guidance on Targets

15. The draft statutory guidance sets out further information and guidance in relation to trustees' compliance with paragraphs 17, 18 and 21(o) of the Schedule. This includes guidance on the types of targets trustees could set, maintain and assess progress against.

Consultation Question

Q8:

a) Do you have any comments on the provisions on targets in the draft regulations?

b) Do you have any comments on the draft statutory guidance on targets?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Chapter 10: Disclosing in line with the TCFD recommendations

Background

1. The TCFD's Final Recommendations[32] emphasised the importance of including climate-related financial disclosures in an organisation's annual mainstream financial filings. Therefore, we proposed to require pension scheme trustees to publish an annual TCFD report, and for this to be freely available to all, rather than simply making them available to members on request.

2. Recognising the growing evidence that member engagement on ESG factors, and climate change in particular, is increasing, we proposed that engagement was facilitated further by notifying members about the scheme's TCFD reports in the Annual Benefit Statement.

3. We also proposed streamlining the TPR notification process as part of our disclosure framework by requiring that the website address or addresses where a scheme's TCFD report, Statement of Investment Principles ("SIP"), Implementation Statement and the relevant excerpts of the Chair's Statement are published are included in the annual scheme return.

We proposed 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 TPR 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.

We also asked if there was a better way to notify members of where to find this information. For example, for DB schemes, whether the summary funding statement

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

required by regulation 15 of the Disclosure Regulations[33] would be a more appropriate way to signpost members to this information.

Summary of Responses

Where schemes would need to publish

4. A large majority of respondents were in agreement that TCFD reports should be made publicly available, with a number citing the essential merits of increased accountability and opportunity for scrutiny.

   "It is important for the success of the proposed TCFD regime for schemes to make their TCFD reports publically available (and not just available to scheme members). Public disclosure will allow a higher degree of scrutiny and accountability of the actions taken by trustees."
   Herbert Smith Freehills

   "It is important that the full TCFD report be publicly accessible to ensure proper transparency and accountability."
   Electricity Supply Pension Scheme

5. However, there were a very small number of respondents which disagreed with making TCFD reports publicly available.

   "Pension schemes are not public trusts or public bodies and there should be no requirement to disclose publicly. Disclosure to the wider public is an invitation for those without an interest in the trust to try and influence trustees and members."
   BAE Systems Pension Fund

6. A large majority of stakeholders were also in complete agreement with the proposal to include a link to the TCFD disclosures in the Annual Report and Accounts.

   "We agree that the proposals are broadly appropriate, and build well on the existing disclosure infrastructure to minimise additional costs to schemes."
   Aon

7. A small number suggested that they should be able to include the report in full or as a link. A number of respondents also proposed that the link should be accompanied in the annual report by some form of summary or simplified version of the TCFD report which provides a narrative to the reader.

   "We believe that including a summary of the TCFD report in the scheme's annual reports and accounts and including a link to the more detailed report on the

[33] The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (S.I. 2013/2734).

website would strike an appropriate balance."
Nest

8. Only two respondents submitted comments on the absence of proposals to require auditing of TCFD reports, and their proposed status as 'Other Information'.

   "Some schemes will wish to seek independent assurance over their TCFD disclosures, which will have cost implications."
   Institute of Chartered Accountants in England and Wales

Telling members it has been published

9. The proposal to require trustees to notify members of where they can view their scheme's TCFD report had almost universal agreement from respondents, but a significant number questioned whether the Annual Benefit Statement is the most suitable channel.

   "We think there are better ways of notifying members of the availability and where to access regulatory documents such as TCFD reports rather than using annual benefit statements… Increasingly members are signing up to view their pension online and receive communications by email. We could provide links to the TCFD report and other regulatory reports in newsletters and [business as usual] member communications."
   Aegon

10. Some respondents also raised concerns over whether a full TCFD report would be the best way of informing beneficiaries.

    "Members may not be aware of reporting requirements placed on schemes and the information contained in the report may not make sense to them. Therefore, in addition to providing the link to the TCFD report, we encourage DWP to encourage trustees to include messaging which is more targeted to this audience within annual benefit statements."
    Institute and Faculty of Actuaries

11. There was an even split in opinion between respondents who commented on the suitability of using Annual Funding Statements to notify members of DB schemes where they can view their scheme's TCFD report. Those in favour cited the advantage of reaching more members through adopting this approach.

    "We agree that the Summary Funding Statement would provide information to a broader group of pension fund members than just those who receive annual benefit statements as it would also cover the deferred and retiree populations".
    Proctor & Gamble

12. However, those opposed raised concerns about the levels of engagement with the document and whether tonally it is a suitable document to use to link to a TCFD report.

"We think it would be more appropriate for the summary funding statement to remain focussed on schemes' funding."
BP Pension Scheme

Reporting to The Pensions Regulator

13. Not a single respondent raised any objection to our proposal for schemes to notify TPR via the annual scheme return of the location of their published TCFD report. The only engagement we received on this proposal was a request for assurance that TPR had the ability to implement the changes necessary to the annual scheme return process.

"We are comfortable with a more focused annual scheme return on TPR's Exchange system, but DWP should first check that TPR has the ability to meet this requirement at their end. We could fill pages of this response with some of the idiosyncrasies of already existing report formatting issues via Exchange."
Stagecoach Group

Overlap with existing disclosure requirements

14. A small number of stakeholders observed that trustees are now required to include information on ESG or climate change or responsible investment in a number of disclosures. Some questioned the value of this and opined that this is excessively burdensome and duplicative.

"Given the number of other required scheme disclosure obligations there is likely to be material overlap, notably if a trustee's climate risk policy is disclosed in the SIP."
HSBC Bank Pension Trust

"It would be useful for the Department consider the possibility of consolidating the various duties and reporting obligations into a single, more cohesive regime."
Travers Smith LLP

Government Response

Where schemes would need to publish

15. We note that the majority of respondents are in agreement that schemes' TCFD reports should be made public and accessible free of charge on a website.

16. As a number of stakeholders highlighted themselves, this approach has the essential merits of increased accountability and opportunity for scrutiny. This is vital, given the significant financially material risk that climate change poses to occupational pension schemes and their beneficiaries. It is for that same reason that we do not believe the arguments presented by a small minority of respondents for not making the disclosures public are credible.

17. We also acknowledge the majority of respondents support our proposal to require that the website address of the published TCFD report is included in the Annual Report and Accounts and we do not intend to make any changes to this proposal.

18. We are supportive of the link being accompanied by a short summary of the TCFD report in the Annual Report. This will provide a narrative signpost for the reader and prevent the link from being buried, insufficiently signposted, in the report. We have recommended this approach in our draft statutory guidance on how to present TCFD disclosures and suggested a number of things this summary could include by way of best practice.

19. We acknowledge the point made by two respondents that trustees may still seek to have their TCFD reports audited. Government is supportive of trustees that wish to do this to provide further confidence that they their disclosures are both accurate and complete. However, we are keen to reiterate that the TCFD reports' status as 'Other Information' means that there is no legal requirement for trustees to secure additional auditors assurance, as a result of including a link to it in the Annual Report.

Telling members it has been published

20. We recognise the concerns that some respondents have raised about the suitability of using the Annual Benefit Statement as the only way to notify members of a TCFD report. Linked to this are concerns about whether extremely detailed TCFD reports would be the best way of providing information to members.

21. Indeed, there are valid concerns about how the average member, without relevant knowledge or expertise on the subject matter, might engage with a full TCFD report when parts of it may generally be difficult for them to interpret.

22. However, it is important to stress that our proposal was concerned with setting a minimum standard for member notification. Not all scheme members will engage with TCFD reports fully, but it is essential that they are given the opportunity to do so. Beyond setting this minimum notification standard Government does not seek to be prescriptive about how member engagement is conducted. Trustees should already possess the necessary expertise and experience to make decisions on how to do this effectively. Where trustees think there are additional and more engaging ways of informing members about TCFD reporting and other related climate change issues, such as digital newsletters, they should continue to employ them.

23. Despite similar concerns being raised about the suitability of the Annual Funding Statement as a notification vehicle, we are persuaded by the observations that this will increase the number and types of members who are notified about where to find their scheme's TCFD report. Therefore, following our core rationale of making the disclosures more widely known to members, we have decided to add

this requirement to our original proposals. To be clear, this will be in addition to the requirement to notify members via the annual benefit statement.

Reporting to The Pensions Regulator

24. We recognise that not a single stakeholder raised any concerns with trustees being required to include the website address of their TCFD report – as well as the location of their published Statement of Investment Principles (“SIP”), Implementation Statement and excerpts of the Chair’s Statement in their annual scheme return. We therefore do not intend to make any changes to this proposal, other than to require that where the trustees have not yet published a TCFD report, they must declare to TPR in the scheme return whether the period within which they are required to publish the report has ended.

25. As explained further in paragraph 38, if our proposed regulations come into force they will introduce additional items of “registrable information”, meaning these items must be required by TPR when issuing scheme return notices and provided in the scheme return by the trustees. Subject to the regulations coming into force, TPR has already committed to adding the question on location of the published SIP to the scheme return form and we would expect this to be included for DC schemes in 2021. The addition has also been agreed in principle for this year’s DB scheme return form, although the data platform may not be in place in time to support the change for DB schemes until 2022.

26. We would expect TPR to allocate the necessary resources to ensure delivery of any additional changes required by our regulations.

Overlap with existing disclosure requirements

27. Finally, some shared the view that these proposals, which were broadly supported by stakeholders, may overlap with existing requirements for trustees to have and to state policies on environmental, social and governance (ESG) factors as part of the SIP, and how they have been followed under the Implementation Statement.

28. The Government sought to separate, in the policy consultation, TCFD and climate change risks and opportunities from the broader concept of ESG. Climate change is unique in both the severity of investment risks associated with its impact and the pervasiveness of such risks. We believe that this fact, along with the pre-eminence of TCFD, a reporting framework on the effects of climate change, justifies the ‘special treatment’ granted to climate change.

29. Some stakeholders reflected that some information on consideration of environmental factors, the ‘E’ of ESG, might be better covered in a TCFD report. Whilst ESG factors, and requirements to state policies on them, refer more to material risks associated with specific investments, the Government also commits to consider reviewing, as part of a wider review of these proposals in the second half of 2023, whether some aspects of ESG reporting might be combined for ease of production and communication, or relaxed to avoid duplication with TCFD

reporting. We do not expect there to be any significant overlap, hence our decision not to propose such relaxation now, but we will keep the situation under review.

30. However, as explained in the policy consultation, TPR will give consideration as to whether the forthcoming Governance Code it will issue under the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018[34] 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.

31. We would also stress that the TCFD recommendations and the proposals the Department has made for occupational pension schemes are about more than reporting a policy and implementation of that policy. The proposed regulations would require trustees to put in place processes of governance and risk management, to assess the impact of climate change on their investment strategy and (where applicable) funding strategy and to conduct scenario analysis and calculation of metrics, including setting targets. These activities are all about trustee action, not just disclosure and therefore do not materially overlap in terms of intent with existing ESG policy disclosure requirements.

Summary of changes

We have added the requirement that the website address of the published TCFD report is added to the annual funding statement for DB schemes to make it more widely known to members.

We have added a requirement for trustees who have not yet produced their first TCFD report to inform TPR whether the period for doing so has ended.

Draft regulations on disclosure

32. Regulation 3 of the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 sets out the climate change reporting and publication requirements and who is subject to them. It introduces Part 2 of the Schedule to the Regulations, which sets out the information the TCFD report must contain.

33. Regulation 3(1)(a) requires trustees to produce a report (the TCFD report) in respect of any scheme year in which they were required to comply with the climate change governance requirements in the Regulations. The report must be produced and published within seven months of the end of the relevant scheme year. Regulation 3(1)(b) requires trustees to publish their TCFD report on a publicly available website where the report is accessible free of charge.

34. Regulation 3(2) specifies the circumstances in which trustees are not subject to the requirements to produce and publish a TCFD report in respect of a scheme

[34] SI 2018/1103 – see Regulation 3 ‘Code of Practice’. ↩

year, even though they were subject to the governance requirements in the Regulations in respect of that scheme year.

35. Regulation 3(3) requires that the TCFD report must be signed by the Chair of Trustees, or, where there is no Chair, the person appointed by the trustees to act as interim Chair for the purpose of signing the TCFD report.

36. Regulation 3(3) also stipulates that there is no requirement to publish the manuscript signature of the person who has signed the report. This is to alleviate any concerns trustees may have around potential identify theft. However, trustees retain the option to publish the TCFD report with the Chair's signature, if they wish to do so. We will consider whether a corresponding change is necessary to regulation 23 of The Occupational Pension Schemes (Scheme Administration) Regulations 1996[35] as part of a review of the Chair's Statement to take place this year.

37. The definition of "chair" for the purposes of regulation 3 is at regulation 3(4)(c).

38. Regulation 3 of the draft Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 amends the Register of Occupational and Personal Pension Schemes Regulations 2005 ("the Registrable Information Regulations") to add to the "registrable information" prescribed for the purposes of section 62(1)(h) of the Pensions Act 2004. The amendments would mean that TPR must require, via scheme return notices, that trustees provide the website address where their most recent TCFD report has been published as well as the website address of their published Statement of Investment Principles ("SIP"), Implementation Statement and excerpts of the Chair's Statement. Trustees would then be under a duty to provide this information in their scheme return to TPR.

39. New inserted regulation 3(1)(k)(ii) of the Registrable Information Regulations would require that where trustees have not yet published their first TCFD report they must inform TPR whether the period within which they are required to publish the report has ended.

40. Regulation 4 amends the Occupational and Personal Pension Schemes (Disclosure of Information Regulations) 2013 ("the Disclosure Regulations"). Regulation 4(2) inserts new paragraph 34A into Part 5 of Schedule 3 to the Disclosure Regulations to add to the "information that applies to the scheme", so that it includes the website address where the most recent TCFD report is published. This would mean that the trustees are required to include the website address in the Annual Report in accordance with regulation 12(1) of, and paragraph 7, Part 2 of Schedule 3 to the Disclosure Regulations.

41. Regulation 4(3) inserts new paragraph 10 into Schedule 4 to the Disclosure Regulations, to add information about the most recently published TCFD report to

[35] SI 1996/1715

the information which must be included in summary funding statements given in accordance with regulation 15 of those Regulations.

42. Regulation 4(4) inserts new paragraph 6A into Part 2 of Schedule 5 to the Disclosure Regulations, to add information about the most recently published TCFD report to the information which must be included in annual benefit statements of non-money purchase benefits for active and deferred members, which must be given in accordance with regulation 16 of those Regulations.

43. Regulation 4(5) inserts new paragraph 5C into Part 1 of Schedule 6 to the Disclosure Regulations, to makes corresponding provision for annual benefit statements sent to members in respect of money purchase benefits, in accordance with regulation 17 of the Regulations.

Draft Statutory Guidance on Disclosure

44. We have produced accompanying draft statutory guidance in relation to both presenting TCFD disclosures and ensuring they are easily accessible. This includes, amongst other information, guidance on:

- How to signpost the TCFD report in the Annual Report, including suggestions for what a short narrative summary could include;
- How to ensure the TCFD report is publicly available, easily searchable and freely accessible;
- How to appropriately sign-post the link to the TCFD report in the Annual Benefit Statement and Annual Funding Statement; and
- The steps trustees should take if they have to produce their Annual Benefit Statement in advance of their TCFD report being published.

Consultation Question

Q9:

a). Do you have any comments on the draft regulations on disclosure?

b). Do you have any comments on the draft statutory guidance on disclosure?

Please include in your answer any comments on you have on whether you consider that they meet the policy intent stated in this chapter.

Chapter 11: Penalties

Background

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

We proposed that

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

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

In all other respects, we would 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.

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

Summary of Responses

2. Over 85% of respondents were in agreement with the proposed penalty regime as a whole and believed the balance between mandatory and discretionary to be proportionate.

   "[The policy that] mandatory penalties would only apply for total non-compliance is reasonable from our perspective. Discretionary TPR penalties for inadequate reports also seems proportionate and otherwise the existing penalty regimes for compliance and signposting are acceptable."
   Creative Benefits

3. Some of the small group of respondents who did not agree with the mandatory penalty cited issues with the supervision of Chair's Statement requirements.

4. However, a number of respondents specifically welcomed that, unlike the penalty regime for the Chair's Statement, mandatory penalties were only included for total non-compliance.

   "We support the provision of a mandatory fine being restricted to wholesale non-compliance (i.e. not producing a report) and agree that TPR should otherwise have discretion as to whether to apply a penalty."
   Sackers

"Limiting automatic regulatory penalties to instances of total failure to comply, with discretionary penalties for all other breaches, is sensible. This should help avoid the inflexibilities and challenges that have arisen in respect of DC Governance Statements."
Travers Smith LLP

Role of The Pensions Regulator

5. Responses to the penalty regime proposals focused heavily on the role TPR will play in supervising it and how they will exercise their discretion.

6. A significant number of respondents called for TPR to produce guidance ahead of the new measures coming into force, and for the guidance to be clear on what they would deem inadequate when reviewing TCFD reports.

"It will be important for TPR to provide guidance and clarity about its expectations if it will be subjectively determining the inadequacy of reports."
Institute and Faculty of Actuaries

7. A small number of respondents suggesting going further, recommending that DWP and TPR explore the feasibility of developing a scoring or ranking system for pension scheme TCFD disclosures.

"We recommend DWP and TPR investigate the feasibility of developing a scoring or tiered system for pension scheme TCFD disclosures."
Mercer

8. Amongst the responses there were also a number of calls from stakeholders for TPR to recognise the infancy of TCFD disclosures and have an engagement focus when monitoring compliance.

"We would also encourage the Pensions Regulator to engage with schemes directly and make its expectations for improvement clear before imposing fines - particularly for first round of schemes."
Eversheds Sutherland

9. Some respondents also questioned whether TPR have the sufficient resource and capability to monitor compliance, especially as there may be a need to upskill to regulate new disclosures effectively.

"We are yet to see any indications of how TPR is planning to supervise the quality and adequacy of the disclosures, nor how it is equipped to undertake enforcement action where necessary. It must be in a position to identify and act swiftly when enforcement action is required."
Client Earth

Government Response

10. We note the significant level of support for the penalty regime and do not intend to make any changes to our proposals above.

11. As recognised by a number of stakeholders, the supervision of TCFD reports will differ markedly from that of Chair's Statements with the threshold for a mandatory penalty being much higher.

12. We also note the focus from a number of stakeholders on the role TPR will play in monitoring compliance, and in particular the calls for guidance on the approach they will take.

13. DWP has produced draft statutory guidance and has worked with wider industry to finalise the Pensions Climate Risk Industry Group Guidance. We agree that there is a strong case for TPR to set out their regulatory expectations publicly and we will continue to work with TPR as they consider this. We are not however in agreement with the suggestion that DWP or TPR should produce some form of scoring or ranking system. Reports will not be strictly comparable - for example, we expect that quality disclosures for a derisked defined benefit scheme will look very different from those for an authorised defined contribution master trust. It follows that it would be more helpful, at least initially, for pension scheme trustees to develop an approach which works for them and for their beneficiaries rather than be distracted by their appearance on a Government, or Regulator, sanctioned "league table". Civil society groups or other bodies such as research organisations are of course free to develop such benchmarks, where they believe it will be useful. Government will also – as explained in chapter 2 – carry out a review in the second half of 2023, which will cover the effectiveness of the requirements to date, which will necessarily include consideration of the quality of scheme disclosures.

14. In general, we agree with the regulatory approach of initially focusing on engagement. However, there are limits to that approach. Both DWP and TPR are also keen to communicate a strong expectation that schemes seek to comply fully as soon as the requirements are introduced. Climate change – and associated policy developments towards net zero – require action sooner rather than later.

15. In relation to some of the requirements, especially in the first year, some schemes may have legitimate reasons for slower action – for example where data is not forthcoming from others in the investment chain. In these kinds of circumstances, engagement with TPR may help to remediate a specific issue without the need to issue a penalty notice. However, we consider that other requirements, such as the requirements around governance and risk management, should be achievable within the initial timescale for compliance.

Summary of changes

We have not made any changes to our proposals for the penalty regime.

Draft Regulations on Penalties

16. Part 3 (Compliance) of our proposed Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 sets out a penalty regime which gives TPR the power to issue compliance and penalty notices to both trustees and relevant third parties.

17. This largely replicates the provisions in relation to compliance notices, penalty notices and third party compliance notices set out in regulations 26 to 33 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015[36] ("the Charges and Governance Regulations").

18. However, as outlined in our proposals we have taken a different approach in relation to the issuance of a mandatory penalty. Under regulation 6(2) it is only mandatory for TPR to issue a penalty where it is of the opinion that a person has failed to comply with the requirement in regulation 3(1)(b) to publish a TCFD report, because they have not published a report on a publicly available website free of charge.

19. Regulations 11 and 12 make provision for service of notices and other documents. These regulations would make corresponding provision to the Pensions Act 2004, section 303 (service of notifications and other documents) and section 304 (notification and documents in electronic form), which apply in respect of Part 4 of the Charges and Governance Regulations[37].

Consultation Question

Q10:

a). Do you have any comments on the draft regulations on penalties?

Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter.

[36] SI 2015/879
[37] See regulation 33 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015

Chapter 12: Impacts

Background

1. We asked for any comments on the regulatory burdens and wider non-monetised impacts estimated and discussed in the draft impact assessment. This included specifically requesting relevant evidence to accompany responses where possible.

> We asked:
>
> 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?

Summary of responses

The regulatory burden and total costs of the proposals

2. Numerous stakeholders responded recognising the potential benefits of the proposals in the consultation relative to the burdens associated with them.

   "We believe that the regulatory burdens are proportionate given the potential benefits, and, conversely, the potential damages if left unaddressed."
   Aon

   "We agree with the Government's assessment that the benefits of this regulation (in terms of risk management) far outweigh the costs."
   ShareAction

3. Despite minimal objections raised concerning the burden of activities themselves, a notable minority of respondents indicated that they anticipated occupational pension schemes in scope of the requirements would need to spend more on the described activities than was suggested in the consultation document and impact assessment.
4. Many of these cost-related responses contained, as requested, useful evidence that has been integrated into the next iteration of the impact assessment. These responses are discussed further below.
5. Many respondents, anticipating greater expenditure than detailed in the impact assessment, had referenced costs for the following broad types of activities:
   - activities not included in the impact assessment as they are explicitly in the stated baseline of assumed compliance with pre-existing regulations and fiduciary requirements;

- activities whereby a scheme understood the requirements to mean going ‘above and beyond’ what was set out in the policy, and ultimately spending more; and
- activities that may be more challenging for certain schemes in initial years, but that fail to account for the “as far as trustees are able” requirement, which is set out in the regulations.

6. These activities do not form part of the costs accounted for in the original or updated versions of the impact assessment. They are discussed further below.

7. Some respondents acknowledged and agreed with the baseline assumptions regarding existing requirements in paragraph 47 of the impact assessment: “costs associated with meeting fiduciary duty are assumed in the baseline, and not double counted in this impact assessment”.

   “We agree that the governance activities proposed under the new regulations would simply codify existing fiduciary requirements of trustees and as such it is only the incremental cost of TCFD reporting that is additional.”
   Lane Clark & Peacock

8. Other respondents believed that there would be additional governance costs, over and above the baseline, and subsequently included these costs in their assessment of the likely burden.

   “We anticipate that the costs of putting in place additional arrangements for governance and disclosure will be higher in the case of larger pension schemes, which hold complex and diversified portfolios (e.g. containing private market assets and direct property).”
   100 Group Pension Committee

9. As respondents had a wide range of interpretations as to the activities which were relevant to the impact assessment costs, the activities included in expenditure estimates resulted in a wide range of proposed total costs. This range of responses on anticipated costs included suggestions of costs which were materially higher but of the same order of magnitude:

   “The £15k anticipated cost to Pension schemes appears low on a per annum basis once implemented. We anticipate implementation costs to scheme to be significantly higher than this in the short term.”
   Institute and Faculty of Actuaries

   “In our opinion the cost will be significantly higher. … £20k to £50k is a better estimate.”
   Smart Pension

10. However, some respondents anticipated spending many times more than the estimated costs:

"We believe that the costs could be as much as 10x larger."
Aviva Staff Pension Scheme

"Underestimated by a factor of 50X. … Employing 10 to 30 managers means a rough estimate of £50k to £300k per annum."
Cardano

11. The specific details raised in these and all responses are discussed in greater detail below.

Board of trustees and hourly wages

12. Multiple respondents stated that the number of trustees per scheme and the respective hourly wages were not representative of the large occupational pension schemes in scope of these proposed requirements.

"All trustees would be involved (6-8 per scheme) … Most large schemes have at least one professional trustee…. A cost of £250 per hour is more realistic."
Cardano

"We believe that the vast majority of pension schemes with >£1 billion of assets and all authorised master trusts would employ professional trustees that will charge well in excess of the £29.11 per hour quoted in the consultation impact assessment."
Creative Benefits

"Reference is made to each scheme in scope having on average three trustees. Our scheme has eight trustee directors, and we believe this is typical for the industry, and certainly for large schemes. …The hourly wage rates used do not reflect the level of skill and knowledge, and therefore wages of those likely to be involved in preparing and reviewing reports."
Friends Provident Pension Scheme

Reporting and disclosure costs

13. One cost element respondents specifically referred to as underestimated in the initial impact assessment was the costs for Reporting & Disclosure.

"We note the estimated costs for ongoing reporting total less than £1,000 per scheme per year. However, the TCFD report is a bespoke report with significant technical content which will require specialist knowledge to prepare. We would therefore anticipate a much higher cost to schemes than currently estimated. We would anticipate its costs to be more like the costs of producing an annual Chair statement which is typically several thousand pounds."
Lane Clark & Peacock

“We believe costs could be significantly higher for ‘Ongoing – Reporting and Disclosure’”
Isio

Cost of upskilling and/or training trustees

14. One cost element that some respondents felt had not been accounted for, especially in early years, were the anticipated costs of upskilling trustees for different aspects of compliance with the regulations.

“In our experience, a typical large (£5bn+) scheme would likely incur the following: [..] a training session led by an expert; guidance will be read, as well as thought pieces from scheme lawyers and investment advisers; several trustees will attend seminars on this topic and read articles in the pension press…. it would be more reasonable to expect a total of 5 – 10 hours to be spent per trustee on familiarisation.
[on metrics and targets] trustees of a large (£5bn+) pension scheme would probably go through the following process (as a one-off) to establish the metrics they would use: training session from an industry expert; commission specialist advice from their investment adviser considering the options available for emissions and non-emissions metrics and targets and the potential impact on the investment portfolio; consultation with the sponsor; discussion (probably on more than one occasion) to agree the metrics and process for production of the data As an estimate, the initial process to agree metrics and targets is likely to cost £30k - £50k in advisory fees and trustee time cost.”
Cardano

“The cost estimates do not appear to consider the further costs of various advisers’ input and training ... Therefore, the costs in the impact assessment are likely to be materially understated.”
BP Pension Fund

Scenario analysis costs

15. Only a small number of trustees commented specifically on the scenario analysis unit costs included.

“On scenario analysis, we recognise there is a range of approaches and there will be a wide range of costs depending on particular scheme circumstances. However, we believe your estimate of £12,000 in a scheme’s first year and £10,800 per scheme per year in following years is reasonable.”
Lane Clark & Peacock

“We believe that the estimated cost for carrying out scenario analysis is optimistic. From our experience, consultants currently charge c. £20,000 or more for portfolio-wide scenario analysis.”
Nest

Metrics and targets costs – obtaining data

16. Only a small number of respondents specifically addressed the metrics and targets related unit cost figure.

    "Regarding metrics and targets, a cost of £2,500 may be reasonable for some schemes where the [trustees are] able to easily obtain information from their managers. However, for schemes with lots of different managers, this will be much a more intensive exercise."
    Lane Clark & Peacock

17. However, some feedback concerned respondents' concerns around the resource/cost to obtain the sufficient data.

    "We remain concerned over the ability of funds to source the significant amount of data required by the regulations."
    Natixis

Passing costs on to members via charges

18. A small number of respondents noted that the increased costs of compliance could in some instances be passed on to members of defined contribution schemes.

    "The DWP has carried out an impact assessment, but it is unclear if there is any acknowledgement that the increased regulatory burden could increase member charges."
    Aegon

Higher costs for schemes with atypical structure or portfolios

19. A small number of respondents noted that schemes with certain structures, unusual covenants or with atypical portfolios may experience particularly higher costs than their industry counterparts.

    "In our view the workload on trustees will be significant, and will be much higher depending on the structure (not the total assets under management) of the scheme. For example, the number of asset managers employed is likely to be of particular significance."
    Association of Pension Lawyers

    "If a scheme is split between DB and DC, this will drive up costs due to different approaches to compliance for both."
    Barnett Waddingham

Avoiding box-ticking

20. A small number of respondents commented on the importance of engagement with the requirements beyond a ‘box-ticking’ exercise whereby all schemes adopted a ‘bare minimum’ approach of ‘just complying’.

    “There seems to be a mismatch between this cost estimate, which assumes a minimum amount of time and resources to prepare a TCFD report, with references in the main consultation materials to the adoption of TCFD reporting as being a journey. If the costed "minimum" approach is adopted, we would expect the resulting TCFD reporting to be of limited value.”
    Aviva Staff Pension Scheme

    “We believe that the costs to schemes of the proposals – particularly where schemes meaningfully engage with the recommendations of TCFD rather than simply look to complete a tick-box style report – are significantly higher than those outlined in the consultation. [However] it is our strong conviction that schemes should engage meaningfully with the TCFD recommendations and that there is significant positive value in them doing so which would far outweigh the costs involved.”
    Willis Towers Watson

Government Response

21. The majority of those who responded to this question in the consultation provided constructive and valuable empirical evidence and insights enabling the further refinement of the impact assessment. The impact assessment has been updated accordingly to reflect evidenced feedback as appropriate.

22. **Board of trustees and hourly wages** – given the evidenced feedback, the second iteration of the impact assessment reflects more accurately the size and composition of an average board of trustees for the schemes in scope of these proposed requirements.

23. **Reporting and disclosure costs** – feedback has also been taken on board here. Whilst previous industry engagement yielded estimates of reporting costs ranging from ‘a few hundred pounds’ to ‘£20,000’, the evidenced feedback in the responses post-consultation will allow the costs of a scheme complying with the requirements to be reflected more accurately, and aligned more closely with the scale of costs associated with a report such as the annual Chair’s Statement.

24. **Costs of upskilling and training** – exemplary schemes seeking to engage and invest significantly in their trustees’ abilities to fully integrate the requirements into their existing decision-making and practices is welcomed. However, the aforementioned ‘above and beyond’ upskilling beyond the (updated) familiarisation costs would be at the discretion of the scheme and not a regulatory requirement to be costed in the impact assessment. Trustees already have fiduciary duties to manage climate related risks where these are financially

material risks. Similarly, statute – in particular sections 247 and 248 of the 2004 Pensions Act - requires trustees to have knowledge and understanding of the law relating to pensions and trusts, and the principles relating to both the funding of occupational pension schemes, and the investment of the assets of such schemes. For the purposes of the impact assessment and calculating new burdens, this – as with putting trustee duties insofar as they apply to climate change on a statutory footing, as set out in chapter 3 above – is already accounted for in the baseline.

25. **Scenario analysis costs -** The impact assessment has been updated to reflect the policy in this area concerning frequency of conducting scenario analysis.

26. **Metrics and targets costs – obtaining data** – the impact assessment has also been updated to reflect the policy in the area around metrics and targets.

27. With regards to challenges obtaining data or covering an entire (potentially complex) portfolio, the "as far as trustees are able" provision (included in the draft Occupational Pension Schemes (Climate Change Governance and Reporting Regulations) should be noted. Similarly, around data-flow concerns, the FCA plans to introduce TCFD reporting requirements for asset managers, subject to consultation, which should result in such challenges being eased considerably for many of a scheme's holdings.

28. **Passing costs onto members via increased charges** – as illustrated in paragraphs xx-xx of chapter 2, the ongoing administrative costs of ~£19,000 (as initially estimated) are not very large relative to typical governance spends by the size of scheme in scope. Furthermore, given the estimated assets in scope of these requirements, an extremely small basis point improvement in the industry-wide Return on Investment would make up for the cost. As a result, there is no reason a scheme in scope should be required to increase member charges, and any such response would be a choice made by the scheme.

29. **Higher costs for schemes with atypical governance structures and portfolios** – feedback concerning higher costs of compliance for certain schemes such as hybrids (and Master Trusts with multiple default funds) is also reflected.

30. With regards to covenant structures and multiple managers, the Government recognises that trustees might experience issues gathering and collating data on greenhouse gas emissions and other areas from all of their investments or asset classes. This is why we proposed the 'as far as they are able' approach, to ensure trustees do not go to excessive or disproportionate effort or cost to estimate or gather data for all sections or all funds. However, the FCA's announcement of plans to consult on TCFD measures for asset managers should help to improve the availability and quality of data across funds, asset classes and investee firms.

31. However, the second iteration of the impact assessment has also made adjustments for the increased costs that hybrid schemes would encounter as a

result of the Government’s draft guidance that metrics, targets and scenario analysis should be done separately for DB and DC.

32. **Avoiding box ticking –** with regards to responses concerning the importance of avoiding ‘box-ticking’ and a ‘minimum approach’, we recognise and welcome that some schemes may wish to go beyond the requirements of the regulations in applying the TCFD recommendations. However, the impact assessment does not measure this; it is intended to set out the impact of the new activities the regulations would require, estimating the additional regulatory costs for business to comply, and describing the benefits of doing these activities.

33. Given this approach, exemplary schemes going ‘above and beyond’ the requirements are not included in the impact assessment of business costs. And as discussed in paragraph 5, the baseline assumption set out explicitly in the impact assessment is that schemes in scope are fully complying with all pre-existing regulations and fiduciary requirements – this is done to avoid the double counting of any regulatory impacts.

34. Nevertheless, in the areas outlined above where there has been well-evidenced feedback suggesting that compliance with the new requirements may be more expensive than estimated in the first consultation stage impact assessment, the Department has updated its cost estimates accordingly.

35. An updated draft impact assessment estimating the direct and indirect financial impacts on business, and the potential benefits to others has been published alongside this consultation. We would welcome any evidenced comments on the impact assessment.

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

Consultation Question

Q11:

In relation to the changes we have made to the original policy proposals, do you have any comments on the regulatory burdens to business and benefits, and wider non-monetised impacts which are estimated and discussed in the draft impact assessment?

Protected groups

Background

37. We asked for any comments on the impact of policy proposals on protected groups and how any negative effects might be mitigated. This included requesting any evidence on existing provision made by trustees in response to requests for information in alternative accessible formats.

We asked for:

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

Summary of responses

38. A low number of the 99 respondents offered any comments on the impact of proposals on protected groups. Those who did suggested that there would be no adverse impact on any particular group.

    "We expect the proposals to impact protected groups to the same extent as all people. As is the case currently, we would expect trustees to provide information in alternative accessible formats where requested to address the needs of protected groups. Therefore, in our view, no additional provisions are necessary to mitigate negative effects on protected groups or provide for information in alternative accessible formats."
    Lane Clark & Peacock LLP

    "It is not clear to us that the proposals impact on protected groups in any way."
    Smart Pension

39. Very few stakeholders offered views on the question of accessible formats. Those who did believed that trustees would be expected to provide information in an accessible format to members.

    "We do not envision any impact on any protected groups, as long as Annual Reports are issued in accessible formats."
    Hargreaves Lansdown

    "Given the amount of technology in use, we would expect schemes to be able to accommodate those members who need information in alternative accessible formats, such as audio formats as they have done for Chair's statements and SIPs, for example."
    Gowling WLG

Government Response

40. We agree with the assessment emerging from the consultation responses that the measures proposed are unlikely to have a disproportionate impact on any protected groups.

41. As acknowledged by some stakeholders, many schemes already provide documents to members in alternative formats where necessary. The draft statutory guidance sets out Government's expectation that trustees should prepare and publish their TCFD reports in accessible formats.

Consultation question

Q12 **Do you have any other comments you would like to raise?**

Annex 1: List of respondents

100 Group Pensions Committee
Association of British Insurers
Aegon
Airways Pension Scheme
Aon
Association of Pension Lawyers
Association of Consulting Actuaries
Atlas Master Trust
Aviva
Aviva Staff Pension Scheme
BAE Systems Pension Funds Trustees
B&CE
Barclays Bank UK Retirement Fund
Barnett Waddingham
BlackRock
Bloomberg
BP Pension Fund
Brunel Pension Partnership
BT Pension Scheme Management
Cardano
Stephen Beer, Central Finance Board of the Methodist Church
Ceri Sullivan
CFA UK
Client Earth
Co-operative Group
Creative Group
Deloitte
Destination0
Electricity Supply Pension Scheme
Ethics for USS/Divest USS
Eversheds Sutherland
EY
Friends Provident Pension Scheme
Gowling WLG
Hargreaves Lansdown
Herbert Smith Freehills
Federated Hermes
HSBC Bank Pension Trust
Hymans Robertson
ICAEW
ICAS
ICI Pension Fund
Institutional Investors Group on Climate Change
Association of Professional Pension Trustees
Institute and Faculty of Actuaries
Investment Association
Investment Consultants Sustainability Working Group
Isio
Johnson Matthey Employee Pension Scheme
Legal & General Investment Management
Lane Clark & Peacock
National Grid UK Pension Scheme
The Law Society of Scotland
The Law Debenture Pension Trust Corporation
Lincoln Pensions
Local Authority Pension Fund Forum
London CIV
Kingfisher Pension Scheme
Mercer
Moody's
Nationwide Pension Fund
Natixis Investment Managers UK
NatWest Group Pension Fund
Nest
New Airways Pension Scheme
Northern LGPS
Paul Meins
Pension Protection Fund
Pensions Management Institute
Pinsent Masons
Pensions and Lifetime Savings Association
Principles for Responsible Investment
Procter & Gamble
RAC (2003) Pension Scheme
Railways Pension Trustee Company
Redington
Russell Investments
Sackers
Share Action
Smart Pension
Society of Pension Professionals
Stagecoach Group Pension Scheme
State Street
Squire Patton Boggs
Surrey County Council Pension Fund
Taunton Extinction Rebellion, Advocacy and Lobbying Group
The Money Charity
Travers Smith
Trade Union Congress
UK Sustainable Investment and Finance Association
Unilever UK Pension Fund
UNISON
UNISON South West LGPS Committee
The Universities Superannuation Scheme
West Midlands Pension Fund
Willis Towers Watson
XPS Pensions Group
Zurich Financial Services

1 other occupational pension scheme respondent requested anonymity.

Annex 2: Consultation questions

Question 1

Scope and Timing

Do you have comments on the proposals to change the “reference date” used for the purposes of determining whether a scheme is in scope, or the arrangements made for schemes which obtain their audited accounts later than 1 October 2021, or 1 October 2022?

Do you have comments on the draft regulations on scope and timing?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 2

Trustee knowledge and understanding

a). Do you have any comments on the draft regulations on trustee knowledge and understanding?
b). Do you have any comments on the draft guidance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 3

Governance

a). Do you have any comments on the draft regulations on governance?
b). Do you have any comments on the draft statutory guidance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 4

Strategy

a). Do you have any comments on the draft regulations on strategy?
b). Do you have any comments on the draft statutory guidance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 5

Scenario Analysis

a). Do you have any comments on the provisions on scenario analysis in the draft regulations?

b) Do you have any comments on the proposal that relevant contracts of insurance are within scope for scenario analysis?

c) Do you have any comments on the draft statutory guidance on scenario analysis?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 6

Risk Management

a). Do you have any comments on the draft regulations on risk management?
b). Do you have any comments on the draft statutory guidance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 7

Metrics

a). Do you have any comments on the draft regulations on metrics?
b). Do you have any comments on the draft statutory guidance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 8

Targets

a). Do you have any comments on the draft regulations on targets?
b). Do you have any comments on the draft statutory guidance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 9

Disclosure

a). Do you have any comments on the draft regulations on disclosure?
b). Do you have any comments on the draft statutory guidance?

Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

Question 10

Penalties

Do you have any comments on the draft regulations on penalties?

Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter.

Question 11

Impacts

In relation to the policy changes we have made, do you have any comments on the regulatory burdens to business and benefits, and wider non-monetised impacts which are estimated and discussed in the draft impact assessment?

Question 12

Any other comments

Do you have any other comments you would like to raise?