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

Government response to consultation on draft Regulations

June 2021

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Ministerial foreword

I am very pleased to be publishing the Government's response to this hugely important consultation on the governance and reporting of climate risk by occupational pension schemes. I would like to thank all the individuals and organisations who responded to our policy consultation in August 2020 or our consultation in January this year on the draft Regulations and Statutory Guidance.

I welcome the broad support our proposals have received and the almost unanimous acceptance across industry that effective action on climate risk is needed. There has of course been some disagreement with certain elements of our proposed approach, and many stakeholders offered constructive feedback as to how it could be improved. Government has listened and made changes to our policy to ensure that the regulatory burden is reasonable and proportionate whilst still retaining the wider benefits of the measures.

And these are measures which will see the UK become the first G7 country in which trustees of pension schemes are statutorily required to consider, assess and report on the financial risks of climate change within their portfolios. By October 2022 we will have captured more than 70% of assets under management, and over 80% of members.

They also sit within the wider context of the UK government writing the world's most ambitious climate change target into law to reduce emissions by 78% on 1990 levels by 2035, and form a key part of the UK Government's private finance strategy in the run up to hosting COP26.

The direction is set, and we will legislate this summer. Trustees should now focus on implementing these world-leading measures. This will ensure that the vast majority of pension schemes members' savings will be invested in schemes whose trustees have a specific legal duty to actively consider the risks that a transition to a low carbon economy brings. This will ultimately improve their expected outcomes in retirement.

Managed well, the transition to an environmentally sustainable economy will become a strong driver of new work creation, upgrading existing jobs to better work. Whilst I make no apologies for focusing on environmental concerns over the past year – climate change will be the most vital challenge of the current time – it has never been my intention that climate change should be trustees' sole Environmental, Social, and Governance (ESG) consideration, not least because action on climate change is often linked to action on wider social factors. In their paper 'The Social Dimensions of Climate Change'[1] the World Health Organisation stressed that without mitigating measures, climate change is projected to further exacerbate existing

[1] https://www.who.int/globalchange/mediacentre/events/2011/social-dimensions-of-climate-change.pdf

vulnerabilities and place human health and security at risk. That is why in March I launched a Call for Evidence seeking views on the effectiveness of occupational pension scheme trustees' current policies and practices in relation to social factors. It is important that we assess how trustees seek to integrate consideration of financially material social factors into their investment and stewardship activities.

Indeed, stewardship in particular will be key to ensuring that pension schemes effectively manage the transition to a low carbon economy. An inclusive and equitable transition will only be possible if every sector of the economy is alive to the risks and opportunities it presents. Pension schemes are long-term, institutional investors, meaning they are uniquely placed to help ensure this happens through active engagement with the investments they own. That is why I've also set up a working group, the Taskforce on Pension Scheme Voting Implementation, chaired by Simon Howard, to look at how we can strengthen the trustee voice in engagement, and voting in particular. The working group will return their recommendations later this year, and taking them into account we will be considering steps needed to improve the current system.

I look forward to seeing industry engage with this forthcoming work with the same constructive vigour that they have shown on our climate governance measures. We all have a role to play as together we make our pensions safer, better and greener.

Guy Opperman MP
Minister for Pensions and Financial Inclusion

Chapter 1: Background and summary

1. This chapter provides an update on wider Government work to mandate the recommendations of the Task force on Climate-related Financial Disclosures (TCFD) across the financial sector.

2. It also includes a summary of changes to our policy proposals in response to our January consultation, and an index of changes made following consultation on our draft Statutory Guidance. The reasons behind all changes to the original proposals are explained in more detail in the rest of the consultation response document.

3. The chapter concludes with a summary of our policy as it currently stands and which we now intend to legislate on.

Wider action on greening finance

The Green Finance strategy

4. Following the report of the UK Government-commissioned Green Finance Taskforce[2] in March 2018, the Government's Green Finance Strategy[3] was published in July 2019. This set out a range of actions to: mainstream climate and environmental factors as a strategic imperative; mobilise private finance for clean and resilient growth; and cement the UK's leadership in green finance.

5. Amongst the announcements were:

   - the Government's expectation for all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022;
   - the creation of a joint taskforce with UK regulators, chaired by Government, to examine the most effective way to approach disclosure;
   - the establishment of the Pensions Climate Risk Industry Group (PCRIG)[4] to develop TCFD guidance for trustees of pension schemes. This group published comprehensive non-statutory guidance in January 2021[5].

6. In bringing forward these proposals for legislation, the Department for Work and Pensions (DWP) has worked closely with other Government departments and

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[2] Accelerating green finance: a report by the Green Finance Taskforce - https://www.gov.uk/government/publications/accelerating-green-finance-green-finance-taskforce-report

[3] HM Government. Green Finance Strategy. https://www.gov.uk/government/publications/green-finance-strategy

[4] See source in footnote 1.

[5] https://www.gov.uk/government/publications/aligning-your-pension-scheme-with-the-taskforce-on-climate-related-financial-disclosures-recommendations

regulators, in the UK joint TCFD taskforce, chaired by HM Treasury. DWP has therefore aligned its policies with the direction of travel across Government.

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

7. The UK Government has announced its intention to make TCFD-aligned disclosures mandatory across the economy by 2025, with a significant proportion of mandatory requirements in place by 2023. The UK Taskforce's Interim Report, and accompanying Roadmap[6], sets out a pathway to achieving that ambition.

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

9. The FCA's consultation on disclosure by premium UK listed commercial companies has helped to kick-start disclosures at their source[7]. Its Policy Statement 20/17 was published on 21 December 2020[8] and final rules are now in force for accounting periods on or after 1 January 2021.

10. The FCA also plan to consult on TCFD-aligned rules for asset managers and for workplace personal pension schemes imminently. Subject to that consultation, it is proposed that final rules will be published by the end of 2021 and come into force in early 2022. This will increase the flow of data that is vital to trustees to embed effective climate risk governance. The FCA have also stated in the Roadmap their intention to extend requirements to a wider scope of listed commercial companies.

11. The Department for Business, Energy and Industrial Strategy (BEIS) also consulted between March and May 2021 on proposals to mandate climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs).[9] The proposals set out in the consultation document aim to increase significantly the proportion of companies in the investment chain which are taking actions against climate-related risks and opportunities.

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

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

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

[9] Consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs)

12. DWP has worked closely with other members of the cross-government and regulator TCFD taskforce as they formulated their respective TCFD reporting proposals to ensure that there is broad consistency and comparability.

13. We also note that the TCFD itself has earlier in June published a new consultation on updated recommendations, particularly in relation to metrics. We will closely follow that work, and engage with occupational pension schemes and others to see what changes, if any, may be required to our Regulations and Statutory Guidance in due course.

Responses to the consultation

14. The consultation on our draft Regulations and draft Statutory Guidance[10] was launched on 27 January 2021 and ran for 6 weeks.

15. We received 54 responses to the consultation itself. These were made up of 9 responses from trade bodies; 8 from dedicated consultancy firms, 2 dedicated master trust sponsors, and 4 that do both; 7 from membership bodies; 6 from law firms; 5 from corporate occupational schemes; 4 from Local Government Pension Scheme (LGPS) bodies; 2 each from, civil society bodies and investment managers; and 1 each from a professional trustee firm, fiduciary managers and a think tank.

16. During the consultation, we also conducted a range of informal engagement with stakeholders, including trustees, consultants, law firms, actuaries, civil society bodies, and trade bodies and associations.

Summary of policy changes

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

18. We have also made a small number of technical drafting changes in both the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 ("the Climate Change Governance and Reporting Regulations") and Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 ("the Miscellaneous Provisions Regulations").

[10] Taking action on climate risk: improving governance and reporting by occupational pension schemes – response and consultation on regulations

Scope and Timing (chapter 2) –

We have refined the definition of a relevant contract of insurance, so that in the case of bulk-annuity contracts it does **not** require:

- an exact matching of the cost of benefits;
- the intention to meet costs in all circumstances – only irrespective of future financial market conditions or scheme member longevity; or
- the insurer having unfettered discretion in relation to the investment policy of the assets used to meet its liabilities under the contract.

We have clarified that where trustees are subject to the requirements for part of a scheme year, their report need only cover that part scheme year.

Trustee knowledge and understanding (chapter 3) – We have amended the drafting of the Miscellaneous Provisions Regulations in relation to knowledge and understanding of opportunities, to align with the language around risks. In relation to both opportunities and risks, we have clarified that the intention is for trustees to have sufficient knowledge and understanding to enable them to meet the climate governance requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations.

Governance (chapter 4) – We have amended the drafting of the Climate Change Governance and Reporting Regulations to reflect the policy intention for trustees to have in place processes to ensure that persons undertaking scheme governance activities only take adequate steps to identify, assess and manage any climate-related risks and opportunities which are relevant to the governance activities they are undertaking.

Strategy (chapter 5) – no changes.

Scenario analysis (chapter 6) – Trustees must still undertake scenario analysis in the first year they are subject to the requirements. However, we have made a slight alteration to the proposed policy to stipulate that whenever trustees undertake fresh scenario analysis the triennial cycle is automatically re-set to three scheme years thereafter. We have also made clear that trustees may rely on scenario analysis done in the first scheme year, but in advance of the date from which the requirements apply, so that trustees who are only subject to the requirements from partway through the first scheme year are not required to re-do scenario analysis for the purpose of the Regulations.

Risk Management (chapter 7) – We have amended the drafting of the Climate Change Governance and Reporting Regulations to reflect the policy intention that trustees must ensure the processes for identification, assessment and management of climate-related risks are integrated into their overall risk management of the scheme.

Metrics (chapter 8) – Trustees will not have to collect and report on Scope 3 emissions in the first scheme year that they are subject to the requirements. We

have clarified the timing of the requirements to make clear that they must be carried out in each scheme year, and that where metrics are dropped following review, replacement metrics must be selected. Where the first year of application is a part scheme year, activities carried out within the same scheme year in advance of the date of application may be relied upon to meet the requirements. Finally, we have also made clear what should happen if trustees drop out of scope and then subsequently come into scope again – they must select metrics in the same way as they are required to do in the first scheme year.

Targets (chapter 9) – We have amended the drafting of the Climate Change Governance and Reporting Regulations to make clear that target setting must take place during the first scheme year for which the Regulations apply – rather than on the first day on which the Regulations apply – and to make clear that performance must be measured in each scheme year, rather than annually. We have also clarified in the Climate Change Governance and Reporting Regulations that where trustees elect to replace the target, a new target must be set. We have made clear that performance against the target is the only criterion which trustees must consider in determining whether to retain or replace that target, although they are free to choose others. Finally, we have also made clear what should happen if trustees drop out of scope and then subsequently come into scope again – they must select targets in the same way as they are required to do in the first scheme year.

Disclosure (chapter 10) – no changes.

Penalties (chapter 11) – We have clarified that the requirement to issue a penalty notice to all trustees applies only where the penalty notice is issued to the trustees. We have also amended the wording regarding the mandatory penalty, to make clearer that it only applies where TPR are of the opinion that a person has failed to publish a report on a publicly available website, accessible free of charge.

19. We have also made a number of changes to the draft Statutory Guidance[11] in order to provide further clarity and support for trustees when complying with the requirements. Below is an index of significant changes we have made to the consultation version. Paragraph numbers refer to the final version of the Statutory Guidance published alongside this consultation response:

    We have amended the text from the previous guidance in the following paragraphs:

    Part 1: 7, 9-11, 23 **Part 2:** 1-2, 11, 18, 20-21, 26, 37, , 39 **Part 3:** 24, 26-27, 44, 51, 56-57, 71, 77, 84, 90, 92-93, 100, 103, 106, 118, 120, 124, 126, 133, 135-136, 141, 143-146, 156, 159, 161, 164, 166, 167, 172

[11] Governance and reporting of climate change risk: guidance for trustees of occupational schemes (January consultation version)

We have added the following paragraphs to the previous guidance:

Part 2: 10, 32, 34, 40-41 **Part 3:** 13-14, 22, 30-32, 63-64, 78, 85-87, 111, 119, 127-131, 153, 162, 168, 170, 178

20. The Department's rationale for the key additions and changes is detailed in the following chapters.

21. For the avoidance of doubt, Government has made clear in both previous consultations[12] as well as during debates in the House of the Lords and subsequently in the House of Commons that the measures will not, and cannot, be used to direct pension scheme investment in any way. None of our changes following the consultation on draft Regulations and draft Statutory Guidance undermine this.

22. 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 Act 2021 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.

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[12] See, for example, Chapter 1, page 9, paragraphs 13-17 of our January regulations consultation. Taking action on climate risk: improving governance and reporting by occupational pension schemes

Summary of our policy

Following consideration of the responses to the January 2021 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 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

Authorised schemes fall out of scope when they cease to be authorised and have relevant assets of less than £500m at the previous scheme year end date. Non-authorised schemes fall out of scope when they have relevant assets of less than £500m at scheme year end date.

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	End with immediate effect	Must be met within 7 months of the end of the scheme year[†]	The annual report and accounts produced for that scheme year

The scheme has relevant assets <£500m and is not an authorised scheme.		And fall away thereafter.	

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

Review

We will take stock in 2023, reviewing the effectiveness of the Regulations and Statutory Guidance for schemes in scope, including the identification of any barriers, gaps and inconsistencies; assessing whether the Regulations remain appropriate, and whether or not they should be extended to smaller schemes. We will also set the date of a subsequent review.

Climate Change Governance Requirements (chapters 3-9)

Regulations vs. Statutory Guidance

Regulations will 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 the Regulations. They are required by new sections 41A(7) and 41B(3) of the Pensions Act 1995 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 Statutory Guidance.

Ongoing and annual duties

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

Scenario analysis must be carried out in the first scheme year in which the climate change governance requirements apply to the trustees of the scheme and then at least every scheme three years thereafter. In addition, trustees must, in the intervening scheme 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. Whenever trustees undertake fresh scenario analysis the triennial cycle is automatically re-set.

Underlying data for trustees' chosen metrics and targets must be obtained, the metrics calculated, and performance against targets measured, in each scheme year.

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 any climate-related risks and opportunities which are relevant to the governance activities they are undertaking and that persons who advise or assist the trustees with respect to governance are taking adequate steps to identify and assess any climate-related risks and opportunities which are relevant to the matters they are advising or assisting on.

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 any climate-related risks and opportunities relevant to those activities and the process by which the trustees satisfy themselves that the person is undertaking such identification, 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 any 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 term, medium term 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 term, medium term 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 resilience of the scheme's funding strategy in 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 new scenario analysis if they have not done so.

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, and if they have not been able to do this for certain assets, state in their report the reasons for this.

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 the processes for identification, assessment and management of climate-related risks are 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, in each scheme year, as far as they are able, calculate an absolute emissions metric and an emissions intensity metric in respect of the scheme's assets. Statutory Guidance sets out that trustees should use total emissions and carbon footprint metrics – calculating Scope 1 and 2 greenhouse gas emissions in the first scheme year they are subject to the requirements, and then Scope 1, 2 and 3 in all subsequent years.

Trustees must also select one additional climate change metric to calculate in respect of the scheme's assets. Statutory Guidance suggests a range of measures, including a portfolio alignment metric 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, which does not conflict with trustees' fiduciary duties, in relation to at least one of the metrics which they have selected to calculate. In each scheme year 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 they have set, and the scheme's performance against it.

Trustee knowledge and understanding

Trustees must have the appropriate degree of knowledge and understanding of how to identify, assess and manage risks to occupational pension schemes arising from the effects of climate change and opportunities relating to climate change, to enable them to meet the requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations. These will be prescribed matters for the purposes of the Pensions Act 2004, sections 247 and 248 (requirement for trustee knowledge and understanding).

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 are set out in the 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 Defined Benefit 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 Statutory Guidance.

Reporting information 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.

Integration with existing requirements

TPR will give consideration to whether those trustees who meet the requirements set out in the Regulations should be deemed to have also met the standards in the forthcoming Governance code[13] 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 will 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[14].

The requirements to reference the TCFD report from the Annual Report and inform members about the TCFD report's availability will be subject to the existing penalty regime in the Disclosure Regulations[15]. 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 and (where applicable) excerpts of the Chair's Statement will be subject to the penalty regime in section 10 of the Pensions Act 1995[16].

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

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[13] To be issued by The Pensions Regulator (TPR) in accordance with the Occupational Pension Schemes (Governance)(Amendment) Regulations 2018, regulation 3. TPR consulted on their code between March and May 2021 - https://www.thepensionsregulator.gov.uk/en/document-library/consultations/new-code-of-practice

[14] Occupational Pension Schemes (Charges and Governance) Regulations 2015 SI 2015/879

[15] Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 SI 2013/2734. See regulation 5 for the penalty provisions.

[16] See section 64(2) of the Pensions Act 2004 (c. 35).

knowledge and understanding requirements. If a trustee fails to comply with an improvement notice, then they will be subject to the penalty regime in section 10 of the Pensions Act 1995.

Chapter 2: Scope and timing

Summary of responses

Policy proposals

1. In our January consultation on draft Regulations and whether these met the policy intent, we also consulted on some further policy changes.

   - We made proposals for determining the assets of “ear-marked schemes”, under which the benefits are secured by one or more policies of insurance or annuity contracts, and therefore audited accounts are not required[17].
   - We proposed changing 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. The ongoing threshold test would then apply to scheme year end dates falling on or after 1 March 2022.
   - Where audited accounts are obtained later than 1 October 2021 (first wave), or 1 October 2022 (second wave), we proposed that the requirements would apply from the date the audited accounts are obtained by the trustees.

2. We received no substantive comments on the proposals for determining the assets of ear-marked schemes. We also received relatively few comments on the proposed changes to reference date. However, all respondents expressing a view agreed with the change.

   “The [change in] reference date is appreciated as schemes will be able to know earlier when they meet the requirements and will give them enough time to prepare” **GNEISS Energy**

3. One respondent highlighted that this could potentially still cause some challenges for a very small number of schemes.

   “We appreciate your reasons for bringing forward the reference date but would observe that there will still be timing difficulties for a small number of schemes (for example where a scheme had extended its accounting reference period during the relevant year or had a 28 February year-end).” **Eversheds Sutherland**

[17] Regulation 2(2) of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (SI 1996/1975) https://www.legislation.gov.uk/uksi/1996/1975/regulation/2

4. Where respondents commented on audited accounts, they generally raised questions over the implications for scenarios where audited accounts were obtained late.

   "It appears that the exception might also be deemed to apply to cases where the accounts are due on or before 1 October but are not completed by that time (i.e. where they are completed after the 7-month statutory deadline). This may be interpreted that a breach of the statutory requirement to obtain audited accounts would automatically extend the compliance deadline for the climate change governance requirements" **Institute and Faculty of Actuaries**

5. Finally, a number of wider policy concerns were raised. Two respondents raised concerns over the treatment of sectionalised schemes, arguing that the threshold test should be applied at the section, rather than the scheme level.

6. A small number of suggestions were made for certain other asset classes (gilts and longevity swaps) to be excluded. However, in contrast, other respondents specifically endorsed the inclusion of gilts. One respondent each repeated calls for a practice run, an extension to the duties, or the exclusion of schemes in the Pension Protection Fund assessment phase. These suggestions were all previously raised in the August policy consultation and responded to as part of the January consultation.

7. One respondent suggested trustees should have more than 7 months from the end of the scheme year, at least in the early years, to produce their TCFD report. Another respondent suggested that less than 7 months was necessary.

8. Two trade bodies suggested that where schemes had a scheme year ending on or before 31 December 2021 they should be exempted from reporting for the first part year:

   "The proposals could result in some funds, in the first year, being required to produce reports on a relatively short period (three months for those with a 31 December year-end). Given the disproportionate impact on resource, it may be appropriate to consider allowing discretion to be applied for such schemes, or for the regulations to apply only after the first full year (so the first report would cover 15 months, rather than 3)." **Pensions and Lifetime Savings Association**

   "The ABI would like to see reporting requirements come into force from the start of the first day of a new reporting cycle, which for many schemes would be 1 January 2022." **Association of British Insurers**

9. Finally, a wide range of positions were set out about the review of the effectiveness of the Regulations, which is also intended to determine whether to extend the requirements to smaller schemes. Whilst the majority of respondents who expressed a view believed our decision to bring forward the review to the second half of 2023 was the right one, a few suggested it should be put back again, whereas a small number suggested it should be even sooner.

10. Other respondents suggested that certain requirements should come into force sooner, or that DWP should commit now to bring more schemes into scope in 2024.

Draft Regulations

11. Most respondents who expressed a view were content with the provisions in the draft Climate Change Governance and Reporting Regulations on scope and timing. Suggestions and concerns were raised on only a small number of topics.

Relevant contracts of insurance

12. Several respondents suggested that the definition of relevant contracts of insurance needed amendment in order to meet the policy intent.

13. A number of respondents highlighted that the definition did not appear to capture buy-ins where there was a mismatch between the benefits secured under the policy and the benefits payable under the scheme rules.

    “This would cause problems because most (if not all) bulk annuity contracts do not exactly match the benefits payable under the scheme rules owing to discretionary benefits and/or simplifications in the insurance of complex pension increase rules” **LCP**

14. One respondent raised a concern about the reference to “in all circumstances”

    “Even where it is intended to mirror the trust deed and rules, it will generally not cover those benefits “in all circumstances”. For example, in the latter case, insurers will not have taken the risk of GMP equalisation.” **Association of Pension Lawyers**

15. Three respondents referred to the lack of full and ongoing discretion in relation to collateralised buy-ins.

    “There are some circumstances where in a buy-in contract collateral is required to be posted by the insurer, and the contract will specify that these assets can only be of a specific ‘quality’ or type (and so the insurance company arguably does not have ‘full and ongoing discretion over the investment policy’)” **Association of Pension Lawyers**

16. Finally, two respondents also highlighted that insurer discretion will never be completely unfettered, as it will be constrained by Prudential Regulation Authority requirements.

Relevant assets for earmarked schemes

17. One respondent raised a concern about the definition of relevant assets for an ear-marked scheme.

    “It seems possible that this definition could lead to a negative figure for relevant assets in some cases. We are not sure whether this causes an issue from a policy perspective.” **Travers Smith**

Timespan that schemes should report on

18. Finally, one respondent noted a concern about the part of the scheme year on which the Regulations would require the trustees to report.

    "Regulation 3 [now regulation 6] requires a report in respect of a relevant scheme year. it is not clear … that a report required after 1 October will not have to cover the whole of the relevant scheme year. It would be helpful therefore if regulation 3 could be amended to make it clear that the first report will only relate to so much of the scheme year that falls after the relevant 1 October." **Eversheds Sutherland**

Government response

Policy proposals

19. Following our January consultation, we have decided to proceed with the changes to the determination of the assets of ear-marked schemes and the change to the reference date referred to in paragraph 1.

20. We note the concerns expressed that in some exceptional circumstances only a short period of time will elapse between the deadline obtaining audited accounts and the coming into force of the Regulations.

21. However, in practice this will affect very few schemes – we understand that most schemes obtain audited accounts well in advance of the 7-month deadline, and from consultation responses we note that asset values are likely to be known with a good degree of certainty fairly soon after the scheme year end.

22. In the unlikely event of there being any scheme for which the assets under management are "too close to call", the trustees will wish to ensure that they have established processes around governance, risk management and strategy in anticipation of the possible application of the duties to their scheme.

23. We confirm that where audited accounts are obtained by the trustees after the 7-month statutory deadline, this will delay the application of the Regulations for schemes other than ear-marked schemes. This is because the Regulations rely on the valuation in the audited accounts obtained by the trustees to determine whether the requirements apply in respect of the scheme. In line with regulation 2(3) of the Audited Accounts Regulations[18], where trustees fail without reasonable excuse to take all such steps as are necessary to secure compliance with the requirement to obtain audited accounts, they shall be liable to pay to the Regulator a penalty of up to £5,000 in the case of an individual; and up to £50,000 in any other case.

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

Sectionalised schemes

24. In relation to sectionalised schemes, our January consultation was clear. Trustees of the scheme, rather than governance bodies with responsibility for underlying sections, are responsible for meeting the requirements. Both sets of Regulations will apply at scheme level.

25. Where trustees to whom the both sets of Regulations will apply do not have the processes or information to meet the responsibilities set out in both sets of Regulations they should carry out the necessary steps to do so as a matter of urgency, engaging as appropriate with any governance bodies for underlying sections.

Excluded asset classes

26. We have not changed our policy on gilts. As with any other assets, it is trustees' responsibility to take account of material financial factors and to consider the impact of future climate scenarios on their investments, in line with the prudent person principle.

27. Our policy on longevity transactions also remains the same. Whilst such products share the characteristic of (in all but exceptional circumstances) irreversibility with buy-ins, buy-ins will remove from immediate trustee responsibility all risks – longevity, inflation and interest rates – which the trustee might otherwise be expected to manage. Longevity transactions do not.

Timing of reporting

28. We have maintained our policy in relation to timing. Schemes should not have more than a full year of application of the requirements without triggering the requirement to report on how they have met them. The urgency of managing climate risk means that schemes with £5bn or more in assets cannot be given until the end of July 2023 to publish their first TCFD report. We intend to maintain the requirement, along with all other annual reporting mechanisms, of a 7-month deadline for the production of a report from the scheme year end date.

Review of the requirements

29. We will proceed with our review in the second half of 2023. However, we will extend the review to cover the following items:

- The quality of disclosures to date, including best practice in reporting.
- The effectiveness of the Regulations and Statutory Guidance in achieving successful management and high quality reporting of climate risk. This will include the extent to which in-scope schemes have successfully achieved compliance, and the identification of best practice, along with any outstanding barriers, gaps and inconsistencies;
- Whether scenario analysis, metrics and targets should be made mandatory in relation to some or all scheme assets – for example where disclosure for issuers has become mandatory, rather than 'as far as they are able'.
- To assess whether the Regulations and Statutory Guidance need to be updated, or whether the objectives could be achieved in another way.

- Whether some or all of the requirements should be extended to smaller schemes. Consideration of an extension to smaller schemes will take account of the availability and quality of both free and paid-for tools and services, and the cost of paid-for services.
- The date of any subsequent review, to take place later than 2023.

30. Our review will cover the matters set out in section 30 of the Small Business, Enterprise and Employment Act 2015[19]. In line with Statutory review guidance for Government departments[20] we have therefore not included a review clause in the Regulations.

31. Rather than prejudge the extension of the application of the Regulations to some or all smaller schemes, we will make a decision about partial or full extension of the duties in the round, following the completion of the 2023 review.

Draft Regulations

Relevant contracts of insurance

32. We accept the suggestions made by several respondents to clarify the definition of a relevant contract of insurance in the Climate Change Governance and Reporting Regulations.

33. It was always our intention that the specified benefits for which the liability to make payments should be fully met were those set out in the contract, rather than in the scheme rules. We have clarified this. In light of the responses which flagged that the payments provided for under the contract will often not exactly match the level of the benefit payments which trustees are required to make, we accept that a series of payments set out in a benefit schedule or specification attached to the contract need not fully meet the trustees' liability in respect of those benefits under scheme rules. We have therefore deleted the reference to "fully" meeting the costs of benefits in the definition.

34. We have also removed the proposed requirement that the payments under the contract must be made to trustees. This is because the trustees may choose to use the insurer for administration of the payments, or redirect payments directly to the members just before beginning wind-up, as part of the move to "buy-out".

35. We have removed the reference to "intended in all circumstances". The definition now requires that the contract provides for payments to be made by the insurance company which are intended "irrespective of future financial market conditions or scheme member longevity" to meet the costs of benefits specified in the contract. This clarifies that our policy was to exclude balance-sheet capital-backed solutions and alternative insurance solutions – under which the cost of

[19] https://www.legislation.gov.uk/ukpga/2015/26/part/2/crossheading/secondary-legislation-duty-to-review/enacted
[20] https://www.gov.uk/government/publications/small-business-enterprise-and-employment-act-statutory-review-requirements

specified benefits is not intended to be fully met in all circumstances. It was not our intention that to meet the definition of a “relevant contract of insurance” the contract must provide for the insurer to anticipate and protect against changes in regulation or decisions of the courts.

36. Finally, we have concluded that the reference to full and ongoing discretion, which excluded collateralised buy-ins, is unnecessary. We have therefore removed this.

Relevant assets for ear-marked schemes

37. We do not believe that ear-marked schemes can have negative relevant assets under the requirements. The relevant assets of such schemes are defined under regulation 2 of the final Climate Change Governance and Reporting Regulations to be the value represented by any policies of insurance or annuity contracts that are specifically allocated to the provision of benefits for individual members or any other person who has a right to benefits under the scheme, less the value of the assets of the scheme represented by any relevant contract of insurance.

38. As all the benefits other than death benefits of an ear-marked scheme must be money purchase benefits, only the value of relevant contracts of insurance, as defined in regulation 2, are deducted from the assets. Broadly, this removes annuity contracts from the calculation of the relevant assets of the scheme, but not other insurance contracts such as unit-linked long term contracts of insurance.

Timespan that schemes should report on

39. Finally, we accept that, where the Regulations only apply to trustees for a part scheme year, it could be made clearer that trustees need only report on the part scheme year during which the Regulations applied.

40. Regulation 6(1) of the Climate Change Governance and Reporting Regulations now provides that within seven months of the scheme year end date of any scheme year, or part of a scheme year, in which trustees were subject to the requirements in Part 1 of the Schedule to those Regulations, they must produce a report in respect of that scheme year, or that part of a scheme year.

41. For example, trustees with a scheme year of 1 January to 31 December 2021, who are subject to the requirements from 1 October 2021, need only produce a TCFD report in respect of the period from 1 October to 31 December 2021.

Summary of changes

We have clarified the definition of a relevant contract of insurance, so that it does not require:

- an exact matching of the level of benefits specified in the contract and those payable under the scheme rules;
- the intention to meet the costs of specified benefits in all circumstances – only irrespective of future financial market conditions or scheme member longevity; or
- the insurer to have unfettered discretion in relation to the investment policy of the assets used to meet its liabilities under the contract.

We have clarified that where the requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations apply for only part of a scheme year, the TCFD report need only cover that part scheme year.

We have made other minor corrections to legislation – regulations 2 to 5 of the final Climate Change Governance and Reporting Regulations – to make clear that the requirements will continue when a scheme becomes formerly authorised, unless one of the criteria for disapplication is met. For ease of use, the provisions relating to authorised master trust schemes and authorised collective money purchase schemes are now in separate regulations, as are the definitions which apply for Part 2 of the Regulations. Our policy here is unchanged.

Chapter 3: Trustee Knowledge and Understanding

Summary of responses

Draft Regulations

1. Following our August 2020 consultation, we added to the proposals on governance to introduce a requirement that trustees must have an appropriate degree of knowledge and understanding of the principles relating to identification, assessment and management of climate change risks and opportunities.

2. There was broad support for this policy and the draft Regulations included in our January consultation raised very few concerns.

3. One respondent was unclear why regulation 2(a) of the draft Miscellaneous Provisions Regulations (on climate risks) was worded differently to regulation 2(b) (on climate opportunities) and queried whether the former was intentionally supposed to be broader.

Draft Guidance

4. Our draft non-statutory Guidance on trustee knowledge and understanding also received broad support from respondents. Nevertheless, we received some comments in relation to improving clarity in places.

Non-statutory Guidance

5. A small number of respondents questioned why the trustee knowledge and understanding section is "carved out" as non-statutory guidance and suggested it would be better to include this as Statutory Guidance.

Level of knowledge and understanding

6. A couple of respondents expressed some concern that the standard of knowledge and understanding being asked for is considerably higher than that required for other major pension scheme risks and could be disproportionate to the time and resource spent considering other major risks.

7. On a related point, some respondents wanted further clarification about what level of knowledge and understanding is required for trustees, or what the "threshold" is for satisfying the trustee knowledge and understanding requirements.

8. One respondent suggested that trustees should only be required to have a "basic" level of understanding of the relevant principles relating to climate change.

9. Another respondent suggested that interpreting the results of any analysis seems to require mastery of technical detail and was in conflict with the draft Guidance, which explicitly stated that "trustees need not master technical detail".

10. One respondent suggested that asking trustees to identify skills gaps amongst external advisers and encourage them to undertake training is unrealistic.

Verification of trustees' knowledge and understanding

11. On a related theme, some respondents wanted clarity on how trustees' knowledge and understanding will be tested or verified.

Other comments

12. One respondent was concerned that the wording on stewardship in the Trustee Knowledge and Understanding section of the draft Guidance may imply that the main purpose of stewardship was for trustees to improve their personal knowledge of climate risks and opportunities.

13. Finally, one respondent suggested that the Guidance could promote industry collaboration as best practice.

Government Response

Draft Regulations

14. We have amended the wording of regulation 2(b), so that it is more closely aligned with regulation 2(a). This is to reflect the intention that trustees should have an appropriate and equal degree of knowledge and understanding to identify, assess and manage both climate change risks and opportunities.

15. We have made additional minor amendments to regulation 2, which seek to clarify that our intention is to require trustees to have sufficient knowledge and understanding of how to identify, assess and manage risks and opportunities to enable them to meet the requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations.

Draft Guidance

Non-statutory Guidance

16. We note the arguments made for including trustee knowledge and understanding as "Statutory", rather than "non-statutory", Guidance. However, these duties lie outside the climate governance and reporting framework introduced by the

Pension Schemes Act 2021. They will instead be introduced using the powers in sections 247 and 248 of the Pensions Act 2004. This means that the requirements under the climate governance and reporting framework for trustees to have regard to guidance issued by the Secretary of State will not apply. The Guidance in relation to trustee knowledge and understanding is therefore "non-statutory". Nevertheless, we encourage trustees to follow the Guidance, as it will help them meet their statutory obligations.

Level of knowledge and understanding

17. We have noted that some stakeholders want greater clarity about the level of knowledge and understanding that is expected of trustees. We anticipate that the necessary levels of knowledge and understanding to identify, assess and manage climate-related risks and opportunities will vary with scheme complexity. We also anticipate that the exhibited level of knowledge and understanding will improve year-on-year with improving practice and the emergence of more resources. We have sought to reflect these expectations in the Guidance.

18. We also acknowledge that consideration of climate-related risks and opportunities is one type of financial risk that trustees must manage. We have reflected this in our references to proportionality in the Statutory Guidance which applies to the requirements under the Climate Change Governance and Reporting Regulations.

19. While mastery of technical detail is not required for trustees, we do not agree that the level of trustee knowledge and understanding should be "basic". Not only would it be difficult to define "basic", the low standard it implies would run contrary to the ambitious spirit of the climate governance requirements.

20. We acknowledge that the reference to expecting trustees to "interpret the results of any analysis" in the draft Guidance might denote mastery of technical detail. We have therefore replaced the word "interpret" with "understand" to clarify our intention. Trustees should be able to understand the outputs of the TCFD activities, including results from outputs like scenario analysis. Trustees could ask other people (e.g. investment adviser, the asset manager or fiduciary manager), to describe those results in a way that is understandable.

21. The final Statutory Guidance on Governance explains that trustees are not required to look for skills gaps amongst those undertaking governance activities or those advising or assisting in respect of those governance activities. We have clarified that where such gaps have been identified, trustees may encourage external advisers to provide opportunities for their employees to undertake climate risk training. The Statutory Guidance also provides that trustees "may" find it helpful to do a skills audit – this means that a skills audit is something trustees may wish to undertake but it is not expected that they do so.

Verification of trustees' knowledge and understanding

22. Some trustees are already required, in the annual Chair's Statement for DC schemes[21], to describe how the trustee knowledge and understanding requirements under sections 247 and 248 of the Pensions Act 2004 have been met during the scheme year. We do not intend to introduce any additional requirements for trustees to "verify" their knowledge and understanding. However, the disclosures made in the TCFD report will help to demonstrate whether the trustees have an appropriate degree of knowledge and understanding in respect of the climate-related risks and opportunities they manage.

23. We envisage that where disclosures are poor quality this would raise concerns to The Pensions Regulator about the trustees' level of knowledge and understanding. We have updated the Guidance to reflect this.

Other comments

24. In the Guidance on trustee knowledge and understanding, we have clarified that the main purpose of stewardship for trustees is not to necessarily improve their personal knowledge of climate change risk and opportunities. Rather, stewardship activities, including engagement and voting activities, can promote the long-term success of pension schemes by encouraging investee companies to take a long-term, responsible approach to their business strategy. Trustees may improve their personal knowledge and understanding as a result of this.

25. We agree that industry collaboration should be promoted as best practice – particularly as opportunities and resources emerge – and this is now reflected in the Guidance.

[21]Regulation 23(1)(d) of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

Summary of changes

We have amended regulation 2(b) of the Miscellaneous Provisions Regulations, to align with the wording of regulation 2(a).

We have also amended the wording to make clear that trustees must have knowledge and understanding of the identification, assessment and management of climate-related risks and opportunities only insofar as this is relevant to meeting the requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations.

In the Guidance, we have provided greater clarity about the expectations around trustee knowledge and understanding. We have clarified that the disclosures made in the TCFD report will help demonstrate whether the trustee has an appropriate degree of knowledge and understanding in respect of the climate-related risks and opportunities they manage.

Finally, we have clarified that while trustees may improve their personal knowledge and understanding as a result of stewardship activities, it is not the main purpose of stewardship.

Chapter 4: Governance

Summary of Responses

Draft Regulations

1. Our policy proposals in relation to governance were broadly welcomed. Nevertheless, respondents highlighted a small number of issues.
2. Several respondents to the January consultation raised concerns that “persons undertaking governance activities” is potentially too wide, on the basis that many schemes employ individuals for specific tasks that, while they amount to governance activities, have no relevance to climate-related risks.
3. Two respondents suggested that the wording in the second limb of paragraph 2 of the Schedule to the Climate Change Governance and Reporting Regulations mitigates this risk and could be added to the first limb.

   “This risk is mitigated in the second limb … as it only requires them to take “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”. In our view, it would be worthwhile including similar wording in the first limb.” **Association of Pension Lawyers**

4. One respondent suggested there is slight ambiguity regarding which governance activities are intended – namely, whether it applies to any or all governance activities to which climate change is relevant in relation to the scheme, or only the governance activities specified in the Regulations.
5. A few respondents suggested that legal advisers should be in scope of the Regulations, or the rationale for carving out legal advisers should be clarified. Some minor drafting issues were also highlighted to us by respondents.

Draft Statutory Guidance

6. Respondents were generally supportive of the Governance section of the draft Statutory Guidance, though some issues were flagged to us.

Scope

7. One respondent sought greater clarification in the Statutory Guidance on what is meant by “governance activities”. One respondent suggested that the scope of the governance requirements should extend to asset managers and administrators. A further respondent highlighted that the reference to fiduciary

managers in the draft Statutory Guidance, could be more specific, potentially referencing the definition of fiduciary manager or fiduciary management provider in the Investment Consultancy and Fiduciary Management Market Investigation Order 2019[22], which was made by the Competition and Markets Authority (the CMA 2019 Order).

8. One respondent suggested that the draft Statutory Guidance should provide clearer direction so as to only capture employees who are *directly* involved in making, advising or supporting governance activities.

   "The ABI believes it preferable for the guidance to provide clearer direction so as only to capture employees of scheme funders who are directly involved in making, advising or supporting such decisions. Current draft guidance could be interpreted to include those who are indirectly involved in activities such as employees providing data to decision makers." **Association of British Insurers**

Expectation of those in scope

9. We received comments from one respondent who suggested that there is an opportunity for the Statutory Guidance to clarify the processes trustees must establish to satisfy themselves that any person undertaking governance activities takes adequate steps to identify, assess and manage climate-related risks and opportunities relevant to the scheme.

Reporting

10. One respondent highlighted that the proposed governance disclosures are very extensive and more detailed than the disclosures made in UK pension schemes' TCFD reports to date. The same respondent suggested that some of the disclosures could be described as things that trustees "may" rather than "should" disclose.

11. Another respondent suggested that parts of the draft Statutory Guidance could be made more general, covering the ways in which trustees ensure that all involved in scheme governance (including the trustees themselves, and those advising and assisting) have adequate climate-related risk expertise for their role.

Other comments

12. One respondent proposed that the Statutory Guidance could be clearer on who needs to have "climate-related risk expertise and resources".

13. Another respondent noted that some references relate to "those governing the scheme", but also seem relevant to those advising or assisting with governance activities.

[22] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/812046/Order_investment_consultants.pdf

14. Finally, one respondent suggested that the Statutory Guidance should clarify that climate-related expertise is only expected to the extent necessary for that person's role.

Government Response

Draft Regulations

15. The intention behind paragraph 2(a) of the Schedule to the Climate Change Governance and Reporting Regulations, is for trustees to put in place processes to satisfy themselves that persons undertaking scheme governance activities (other than the trustee) take adequate steps to identify, assess and manage climate-related risks and opportunities which are *relevant* to the governance activities they are undertaking. In light of the concern that "persons undertaking governance activities" is potentially too wide, we have amended paragraph 2(a) of the Schedule.
16. Those undertaking scheme governance activities should not be expected to find climate-related risks and opportunities where they do not exist, so we have added the word "any" to both paragraph 2(a) and (b) of the Schedule, to reflect this.
17. We have also added the word "scheme" before "governance activities" in paragraph 2(a) and (b) of the Schedule, to clarify the parameters within which the trustee must establish and maintain processes. They are not required to establish processes for matters not related to the scheme.
18. Although a minority of respondents suggested that legal advisers should be in scope of the Regulations, we have decided not to change our policy on this point. The extent to which legal advisers provide advice or assist with investments, liabilities or covenants is unlikely to include the identification or assessment of climate-related risks and opportunities.
19. Some minor drafting changes have been made to paragraph 27(b) and (c) of the Schedule, to align with the changes made to paragraph 2(a) and (b) of the Schedule.

Draft Statutory Guidance

Scope

20. After careful consideration, we have decided not to provide more guidance on what "governance activities" mean, on the basis that we do not want to be overly prescriptive. In any event, the Statutory Guidance confirms that governance refers to the way a scheme operates and the internal processes and controls in

place to ensure appropriate oversight of the scheme. This encompasses trustees and others making scheme-wide decisions, which includes – but is not limited to – decisions relating to investment strategy or how it should be implemented, funding, the ability of the sponsoring employer to support the scheme and liabilities.

21. We can confirm that firms carrying out asset management alone would not typically be considered to be in scope of those undertaking scheme governance activities. Administrators are unlikely to be in scope unless they are undertaking activities related to the scheme to which climate-related risks and opportunities are relevant.

22. After careful consideration, we have decided not to include the CMA 2019 Order's definition of fiduciary management provider on the basis that we are not providing definitions for any other role. Moreover, the definition in the CMA 2019 Order will in due course be replaced by DWP regulations so the definitions in the Order may be updated by that legislation.

23. In relation to those "assisting" with scheme-wide decisions, we intend that trustees must establish and maintain processes to satisfy themselves that those advising or assisting the trustees have taken adequate steps to identify and assess any climate-related risks and opportunities which are relevant to the matters on which they are advising or assisting. However, this need not be a separate process for each type of advice/assistance, and an approach proportionate to the materiality of the climate-related risks and opportunities relevant to the matters being assisted with is expected.

Expectation of those in scope

24. The PCRIG Guidance[23] provides some information about how to factor climate-related risk management capabilities into the selection, review and monitoring of asset managers (section 2.7). Trustees may find this useful, more generally, when considering how to satisfy themselves that any person undertaking scheme governance activities takes adequate steps to identify, assess and manage climate-related risks and opportunities relevant to the governance activities they are undertaking. It is up to trustees whether they follow the PCRIG Guidance or not.

25. We have not set out what the governance processes should be in the Statutory Guidance, on the basis that individual trustees and schemes are best placed to decide the processes they use.

[23] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/955876/aligning-your-pension-scheme-with-tcfd-recommendations-part-2.pdf

Reporting

26. Although the governance disclosures required by the Climate Change Governance and Reporting Regulations are more detailed than the disclosures made in UK pension schemes' TCFD reports to date, the Statutory Guidance clarifies that trustees should "concisely describe" the disclosures listed at paragraph 34, to highlight that it is the quality of the information, rather than quantity, that matters.

27. We have aligned some of the other governance disclosures, so that trustees are only expected to "concisely describe", in relation to those who undertake governance activities, or advise or assist with governance of the scheme, the kind of information provided to them and the frequency with which the information is provided.

Other comments

28. The final Statutory Guidance clarifies who needs to have "climate-related risk expertise and resources". We can confirm that both those undertaking scheme governance activities and those advising or assisting in relation to scheme governance activities should have adequate climate-related risk expertise and resources.

29. We have also clarified in several instances where Statutory Guidance applies not only in respect of those governing the scheme, but also in respect of those advising or assisting with scheme governance activities.

30. Finally, we agree that the Statutory Guidance should be clear that climate-related expertise is only expected to the extent necessary for that person's role and have sought to make this clear.

Summary of changes

In paragraph 2(a) of the Schedule to the Climate Change Governance and Reporting Regulations, we have amended the wording to reflect the policy intention that trustees must have processes in place to satisfy themselves that persons undertaking scheme governance activities take adequate steps to identify, assess and manage climate-related risks and opportunities which are relevant to the governance activities they are undertaking. We have also added the word "any" to paragraphs 2(a) and (b) to reflect that persons undertaking scheme governance activities, or advising or assisting the trustees in respect of scheme governance activities, should not be expected to find climate-related risks and opportunities where they do not exist.

We have made corresponding changes to paragraph 27(b) and (c).

We have set out in the Statutory Guidance that whilst trustees must establish and maintain processes to satisfy themselves that those advising or assisting the trustee have taken adequate steps to identify and assess any climate risks and opportunities, which are relevant to the matters on which they are advising or assisting this need not be a separate process for each type of advice or assistance.

In the Statutory Guidance we have highlighted the PCRIG Guidance, which trustees may find useful, more generally, when considering how to satisfy themselves that any person undertaking scheme governance activities takes adequate steps to identify, assess and manage climate-related risks and opportunities relevant to the scheme. However, we have also made clear that there is no requirement for trustees to follow the PCRIG Guidance.

We have set out at paragraph 34 of the Statutory Guidance that the matters listed only need to be concisely described.

We have clarified our expectation that trustees should satisfy themselves that those undertaking scheme governance activities and those advising or assisting in relation to scheme governance activities have adequate climate-related risk expertise and resources, but only to the extent necessary for that person's role.

We have clarified that a number of the expectations in the Statutory Guidance apply in respect of those governing the scheme *and* those advising or assisting with scheme governance activities.

Chapter 5: Strategy

Summary of responses

Draft Regulations

Time horizons

1. The response to the provisions on Strategy in the draft Climate Change Governance and Reporting Regulations was generally positive. There was agreement with the factors that trustees should consider when setting out short, medium and long time horizons for the purposes of assessing the climate related risks and opportunities. There was also broad support for permitting trustees to decide what this looked like for their scheme. However, this did cause some stakeholders to suggest that meaningful comparisons would be difficult and subjective.

   "Differing definitions of each time horizon may make a comparison of risks across schemes more difficult, however it is prudent for trustees to decide their own definitions of short, medium and long-term to reflect the different funding level and endgame objectives of each scheme." **AXA Investment Managers**

2. There was also support for the Regulations requiring trustees to define the meaning of short, medium and long term for their scheme.

   "We support the Government's proposals that in line with the TCFD recommendations, trustees should disclose what they deem to be short, medium and long-term when it comes to effects of climate change on their schemes." **Climate Disclosure Standards Board**

Other comments

3. Only a small number of respondents made proposals to amend the wording of the Regulations. One suggested that the use of "ongoing" could create uncertainty, whilst a second suggested that only risks that have a "material" effect should need to be considered. A third suggested that the employer covenant should be explicitly referred to in Regulations.

   "Would a court interpret ['ongoing'] as meaning 'regularly' (and if so, how regularly), 'continually' (which could be disproportionate for some schemes), 'indefinitely', or as some other term? We suggest the Department considers deleting the phrase "on an ongoing basis" from the regulations." **Travers Smith**

   "As worded, the regulations could be interpreted very broadly and we would suggest paragraph 3 is changed to limit the scope to risks and opportunities which the trustees consider will have a "material" (or equivalent) effect. The

guidance allows for this when it talks about “relevant” risks and opportunities.” **Hymans Robertson**

“We would suggest ... including an explicit reference to sponsor covenant for defined benefit schemes. The draft Statutory Guidance includes covenant considerations in its definition of funding strategy, but it is not clear from reading the draft regulations in isolation that this is the intention.” **LCP**

Statutory Guidance

Time horizons

4. As with the draft Regulations, the main call was one for clarity and detail. One respondent sought clarity on whether the same time horizons should apply across all sections of a scheme.

“We can see a strong argument for allowing time horizons to vary between sections, particularly where their maturity or funding level differs (for example, DB time horizons may be shorter than DC)” **LCP**

Popular arrangements

5. Another concern related to the definition of default arrangements, which may well capture those funds which evolved as a result of taking in redirected contributions or bulk transfers without active member consent.

“For DC schemes, while the focus on popular defaults should ensure a proportionate approach we note that many master trusts will have multiple defaults in place, including those created as 'deemed' defaults for fund mapping purposes.” **Aon**

Asset classes, proportionality and materiality

6. Clarifications were also sought over whether certain asset types should be in scope and whether asset types could be excluded if they were not thought to be significantly exposed to climate change risk.

“In our view, those assets which are not “relevant assets” for the purposes of regulation 2 (such as buy-in contracts) should not be within the scope of the assets that the guidance refers to. We would also suggest amendments to the Schedule to the Regulations to take such assets out of scope.” **Eversheds Sutherland**

“We would welcome clarity with respect to how trustees should think about materiality/proportionality at scheme level. For example, if a scheme holds 0.1% of its assets in an asset class that is exposed to climate risk, can a trustee board choose to exclude that asset class from consideration because it makes up a small part of the scheme’s overall investments?” **Aon**

7. This view was implicitly disputed by another stakeholder who suggests the guidance should ensure that the all-encompassing nature of climate-related risk is covered.

   "[We] strongly encourage the DWP to include wording that more specifically addresses the system-wide nature of climate risk and how it may impact on portfolios. We are concerned that trustees will take a narrow view - some of the greatest risks lie outside the "obvious" sectors of fossil fuels and transport."
   ShareAction

Government response

Draft Regulations

8. We welcome the positive response to the Strategy proposals and we appreciate stakeholders' need for clarity. We also accept that the scheme-specific nature of the time horizons and the climate-related risks means that direct comparisons may not be possible – but these may not have been desirable in any case, as each scheme will have its own circumstances.

9. In relation to the three suggested changes to the draft Regulations, we do not believe that an amendment is necessary. It is difficult to read "ongoing process" in Part 1 of the Schedule as having anything other than its natural meaning. A replacement would likely necessitate a time specific requirement, and outright deletion could give the misleading impression that our intention is for schemes to carry out the activity once a year, or once at all.

10. Similarly altering the Schedule, so that assets which have a "material" impact are within scope would raise more questions of what a "material impact" was than it answered. Additionally, trustees cannot regard a risk as not being material until they have assessed it.

11. Also, the threshold for a material impact on returns has the potential to be quite different for a derisked defined benefit scheme when compared to an open defined contribution scheme.

12. Finally, we do not believe that it is necessary to amend the drafting to specifically refer to the employer covenant. It is sufficiently clear that a key element in assessing the impact of climate risk on the scheme's funding strategy is the ability of the employer to make the necessary payments.

Statutory Guidance

Time horizons

13. It is absolutely right that sections of the scheme which offer different benefits may need different time horizons and we have clarified this in the final Statutory Guidance.

Popular arrangements

14. We also agree that default arrangements with limited assets, which have come into existence largely as a result of bulk transfer or because of administration and mapping, should not be included within scope for reporting if they have a relatively small number of members. We have therefore changed our approach. The final Statutory Guidance states that trustees should carry out scenario analysis in relation to any arrangement in which £100m or more is invested, or in which 10% or more of the assets are invested. Where an arrangement meets either of these tests we believe scenario analysis will be proportionate and appropriate. This is true even if it is not a default arrangement since they have significant assets invested and we see no reason why its origin – whether through active member selection, automatic enrolment or trustees moving the members without their expressed consent – should preclude it from scope.

Asset classes, proportionality and materiality

15. Nor do we see a reason for moving relevant contracts of insurance such as buy-in contracts out of scope of the Strategy requirements. Trustees retain ultimate responsibility for all assets of the scheme, including the payment of benefits via insurance contracts. We do however acknowledge that trustees will have little or no control over these contracts, and our expectation is that the assessment and reporting of risks in relation to the contracts will be significantly lighter touch. In most cases trustees should be able to make use of TCFD reporting from the appropriate insurer.

16. We understand the desire for guidance on a threshold for exposure to climate related risk, however, given the diverse and scheme specific nature of the risk, any guidance would be necessarily arbitrary.

17. The need to recognise that this risk isn't limited to the "obvious" expected sectors is also why the final Statutory Guidance highlights the systemic nature of climate risk and ensures that the full range of both indirect and direct risks and opportunities are taken into account.

Summary of changes

In the final Statutory Guidance, we have:

- made clear that trustees should consider different sections within their schemes when determining time horizons.
- increased the threshold for consideration to any arrangements with either £100m in assets, or 10% of the assets, to allow arrangements with smaller numbers of savers which have accidentally evolved through bulk transfers or mapping to be excluded.
- reemphasised that climate change risk is a systemic risk which extends well beyond the "obvious" sectors.

Chapter 6: Scenario Analysis

Summary of responses

Draft Regulations

The scenario analysis cycle

1. Following our August consultation, we amended our policy proposals to permit a reduction in the frequency of scenario analysis from at a least annually to at least triennially, subject to an annual review in intervening years. This was reflected in draft Regulations which received near universal support from respondents.

   "We support the triennial frequency of scenario testing or when a significant shift in strategy occurs. This is a fair reflection of the long-term nature of schemes' investment and funding strategies." **ShareAction**.

2. Despite their support, some respondents suggested that a consequence of a fixed schedule is that trustees would likely be deterred from conducting fresh scenario analysis in the intervening years.

   "Trustees could decide to do new scenario analysis when not required and then be required to do new scenario analysis again the next or following year, even if they don't think they need to. This may make it less likely that trustees decide to do new scenario analysis out of the usual triennial cycle" **Travers Smith**

3. Other respondents also questioned whether the first wave of schemes would be forced to undertake scenario analysis in 2021 and thought this could be difficult to achieve in the short timescale.

   "For some schemes, this will mean conducting a scenario analysis for the current 2021 scheme year (i.e. for "first wave" schemes with a year end of 31 December). We think that this is likely to be challenging for first wave schemes – even with the easement of reporting seven months after the end of the scheme year." **Society of Pension Professionals**

"As far as they are able"

4. Stakeholders were also generally supportive of our proposal that trustees undertake scenario analysis "as far as they are able", but one in particular stressed that our proposed formulation may not be prescriptive enough.

   "The guidance itself anticipates that the main limitation to carrying out scenario analysis will be a lack of data, though this is not reflected in the wording of the Regulations themselves. We would therefore suggest that the "as far as they are able" qualification applies only to quantitative scenario analysis, as this would give adequate flexibility in dealing with practical barriers" **Client Earth**

Range of asset classes and reporting gaps

5. There was some discussion of asset classes such as sovereign bonds, gilts and bulk annuities with some respondents sceptical of the usefulness of such asset classes being included. Another suggested that scenario analysis would not always be possible and in these cases, trustees should be required to explain why.

   "We see no scope now or in future to undertake anything more than a high level qualitative statement on climate risk exposures to the effect that the UK Government, insurers and banks are exposed to climate risks to an uncertain extent and these exposures may or may not translate to risks to the Fund through its holdings of gilts, bulk annuities and derivative contracts." **ICI Pension Fund**

   "We think there should there be a provision mirroring the wording [for metrics] to the effect that 'if the trustees have not been able to obtain data to calculate… why this is the case'. There might be legitimate reasons why certain figures/targets/metrics cannot be specified or explained even if they 'should' be" **Gowling WLG**

6. However, most respondents were positive about the inclusion of all assets in scenario analysis, including relevant contracts of insurance, because the analysis should be as comprehensive as possible. One respondent went even further and suggested that insurance contracts should be explicitly mentioned for clarity.

   "We broadly agree with the proposal that all assets of the scheme, including relevant contracts of insurance, are within scope for scenario analysis. Trustees should be permitted to rely on TCFD reports issued by insurers in relation to assessing the impact of relevant contracts of insurance." **Herbert Smith Freehills**

7. There were also dissenting voices, suggesting that contracts of insurance should be excluded, arguing that it would be difficult for trustees to make a meaningful judgement around risk exposure.

   "We do not see there is merit in trustees including contracts of insurance in scenario analysis. Whilst an insurer will invest in a way to support its book of business, a scheme with a bulk or individual annuity policy will not have direct exposure to those assets therefore it will be challenging to understand how to model the exposure." **Mercer**

Mandatory scenarios

8. Finally, one stakeholder had misgivings around the scenarios envisaged, particularly questioning whether a scenario corresponding to a less than 1.5°C increase in temperature should be permitted.

Draft Statutory Guidance

Triggers for new scenario analysis

9. Understandably, amendments to our proposals around the frequency of scenario analysis caused respondents to focus on the Statutory Guidance, and whether the circumstances which should trigger scenario analysis are too broad.

   "One or more of these factors is likely to 'bite' in any one year, and so the guidance will be perceived by some trustees of a requirement to undertake an annual exercise by default. We suggest some relaxation to this wording, perhaps...explicitly allowing trustees to consider the materiality of the likely change to the analysis as a result of the new information." **Association of Consulting Actuaries**

Timing, purpose, meaning and proportionality

10. There were other calls for clarification around the timing, purpose, meaning and proportionality of scenario analysis.

   "For schemes already carrying out Scenario Analysis before coming into scope it would be useful to know how recent the Scenario analysis needs to be." **Pinsent Masons**

   "The purpose of undertaking scenario analysis is buried … and consequently not immediately evident to the reader. We believe this statement is important and should be better highlighted." **HSBC Bank Pension Trust**

   "The distinction made between qualitative and quantitative scenario analysis…with the former essentially being characterised as more primitive, would benefit from clarity as to what is meant by the term 'scenario'" **Shell Pensions Trust**

   "In the absence of guidance as to what is or is not 'proportionate' we feel that there is the potential for some boards to incur excessive costs to attempt to guarantee compliance. There is also the risk that boards less engaged with TCFD will accept data gaps too readily." **Law Debenture Pension Trust Corporation**

Recommended scenarios

11. Some commenters thought the Statutory Guidance should be rigid when it comes to the nature of scenarios and suggested that assumptions underlying scenario analysis should be consistent, that the need to cover physical impacts of climate change should be re-emphasised or that possible external sources for scenarios should be set out in guidance. The diverse nature of views was further illustrated by suggestions that a range of scenarios may be used.

   "Unless consistent assumptions are used, it will be difficult for trustees to compare findings. Where there is limited information available, DWP may wish to provide guidance about what underlying assumptions are used to fill the gaps to ensure a greater degree of consistency." **Institute and Faculty of Actuaries**

“Greater emphasis should be placed in the Statutory Guidance on how trustees can assess the physical impacts of climate change on their assets. Approaches for assessing transition risk have matured in recent years, the assessment of physical climate risk has presented a challenge for investors, not least as a result of a lack of available tools and a lack of decision-useful data provided by investee companies.” **Institutional Investors Group on Climate Change**

“we think it would be much more helpful for the guidance to confirm that Trustees can choose any of the scenarios that are referenced in the identified external resources referenced in the guidance (and which DWP can therefore update from time to time).” **Travers Smith**

Reliance on employers and others
Stakeholders also suggested that the Statutory Guidance could be stronger around the extent to which trustees should be able to rely on the employers and other third parties.
“It would also be helpful if the Statutory Guidance could further clarify the extent to which trustees can rely on third party TCFD disclosures (e.g. those of insurers with whom the trustees hold a policy and/or the sponsoring employers) and the steps they should take (if any) to verify the accuracy of the information, particularly metrics and scenario analysis.” **Herbert Smith Freehills**

12. There was also a suggestion that the employer’s own TCFD reporting requirement could be used by trustees, and this should be signposted in the guidance.

13. More broadly there was general agreement that there should be constructive engagement with employers on the funding strategy and strength of the covenant.

“We recommend Statutory Guidance further encourages trustees to consult with employers on scenario analysis and climate related risks to funding strategy to minimise the risks of trustee views as to climate related risks on the employer covenant being out of line with those of the employer (who may also have its own TCFD reporting obligations).” **Herbert Smith Freehills**

Time horizon and trajectory for scenarios

14. Clarification was also sought on the time horizons and how trustees should link these with forecasts and assets.

“The guidance does not provide any steer to trustees on the time horizons over which scenario analysis should be applied. It would be helpful to clarify whether the scenarios are meant to tie in with the short/medium and long-term time horizons that the trustees will need to comment on with regards to climate change risk and opportunities.” **EY**

“With many pension schemes having investment strategies that will see them largely moved towards a bond-based investment strategy by 2030 and more so

by 2050, it would be useful to see guidance on how this should be allowed for within any scenario analysis." **Barnett Waddingham**

Government response

Draft Regulations

The scenario analysis cycle

15. We welcome the positive response to the change in frequency for scenario analysis but we also acknowledge that having a fixed schedule could create a perverse incentive to seek to avoid scenario analysis in the intervening years.

16. Therefore, we have amended the scenario analysis provisions to reset the 3-year timescale by providing in the Schedule that trustees will only have to undertake new scenario analysis if they haven't done so in the last two scheme years.

17. In this way we uphold the policy intention of prompting consideration in each scheme year as to whether a new scenario analysis is required, while also ensuring that the process itself does not force trustees to do additional analysis.

18. This has the added benefit of potentially allowing DB schemes to keep the scenario analysis aligned with their triennial actuarial valuation cycle.

19. We are also aware of concerns on the part of trustees related to the first wave of schemes. We still believe that scenario analysis should take place in the first scheme year, but wish to clarify that existing analysis performed in the same scheme year ahead of the date of application of the Regulations may still be relied upon to meet the requirements. We have made specific provision for this in the Schedule to the Regulations.

"As far as they are able"

20. Likewise, we understand that requiring trustees to carry out the activities "as far as they are able" in relation to both quantitative and qualitative scenario analysis means that trustees have a degree of latitude. However, we also acknowledge that even qualitative analysis relies on data and that this data may be difficult to obtain in emerging markets or across some access classes. Therefore, we think that retaining the "as far as they are able" caveat is necessary.

Range of asset classes and reporting gaps

21. Some other assets such as gilts, derivatives and other sovereign bonds may be difficult for trustees to assess. We accept that some trustees will be unable to assess such assets – we have therefore clarified in the Schedule to the Regulations that where scenario analysis was not possible in relation to some assets trustees should explain this – mirroring the provisions relating to metrics.

22. However, this is also one of the reasons why we applied the "as far as they are able" requirement to scenario analysis. Some trustees may find that such assets

may be best assessed qualitatively – at least at first, whilst methodologies improve.

23. We acknowledge in particular that relevant contracts of insurance are not easy to include within scenario analysis. However, the majority of responses from industry participants which supported their inclusion indicates how important it is that any analysis is comprehensive. Nonetheless, we recognise that trustees may well have limited control over these contracts, and our Statutory Guidance will make clear that in most cases trustees can refer to the appropriate insurer TCFD disclosure.

Mandatory scenarios

24. Finally, in relation to a less than 1.5°C scenario, such a scenario is permitted as a scenario as long as the second required scenario reflects a temperature rise of between 1.5°C and 2°C.

Draft Statutory Guidance

Triggers for new scenario analysis

25. We accept that with the change in frequency around scenario analysis, it would make sense to be more specific about the circumstances where trustees should carry out a fresh scenario analysis within the 3-year schedule. Therefore, we have provided in the Statutory Guidance that the only circumstances where trustees should undertake new scenario analysis are a material increase in the availability of data, a significant or material change to the funding or investment strategies, or some other material change in the scheme's position. Other circumstances are listed where trustees may want to undertake new scenario analysis.

Timing, purpose, meaning and proportionality

26. In a similar vein, we have amended our original proposals for the Statutory Guidance to make clear that, while trustees must always describe their most recent scenario analysis in their TCFD report, they may also choose to describe previous scenario analysis where that scenario analysis remains relevant.

27. We also agree with stakeholders that the messaging around scenario analysis is very important. Therefore, we have amended our original proposals for the Statutory Guidance to ensure that the principle behind scenario analysis is placed at the beginning of the section and to ensure that the definition of a scenario is made clear and that it is not taken merely as a prediction of the future.

28. Whilst we understand that some stakeholders want confirmation of what is meant by proportionality, and how this will be treated by TPR for compliance purposes, we do not believe that Statutory Guidance on this point is feasible or desirable. Scheme circumstances will mean that what is proportionate will vary. The Regulations are clear that both the costs incurred, or likely to be incurred by the scheme, and the time spent by trustees, or those to whom they have delegated responsibility, are factors to be taken into account.

Recommended scenarios

29. To take account of scheme circumstances, the Statutory Guidance is permissive concerning the underlying assumptions around the scenario analysis. We do not believe that the Statutory Guidance should be too prescriptive when determining the assumptions underpinning scenarios.

30. As noted in the paragraphs above, we want to be clear that scenarios can be scheme specific and are not predictions or forecasts, which is why the Statutory Guidance should not present too strict a rubric for what scenarios are chosen. Similarly, while we agree that the physical impacts are important, this is already covered in the Statutory Guidance and we see no reason to restrict schemes by going into more detail.

Reliance on employers and others

31. We have also noted that schemes want clarification on the extent of engagement between employers and trustees regarding the covenant. We do accept that it is appropriate in some instances for trustee to challenge their sponsor and the assumption and objectives around the funding and investment strategy. We have made the possibility of challenge clear in the Statutory Guidance. However, we are not seeking to put unnecessary burdens on trustees and this challenge need only take place when considered appropriate by trustees. Indeed, trustees should be reassured that the Statutory Guidance allows them to use their sponsor's TCFD reporting.

32. We recognise that in some circumstances trustees may wish to use third party TCFD disclosures. While trustees should seek data where possible, sometimes this could be difficult – in particular in relation to insurance contracts – and it may be appropriate for the insurer's TCFD disclosures to be summarised in the trustee report. `

Time horizon and trajectory for scenarios

33. We accept that we should make clear that short, medium and long term time horizons identified under strategy could be linked to the scenarios chosen and have amended our original proposals for the Statutory Guidance to make this clear. We have also made clear that the scenarios should take account of changes in asset allocation and not simply be a "snapshot" of the same assets over time.

Summary of changes

We have amended the drafting of the scenario analysis provisions in the Climate Change Governance and Reporting Regulations to allow for the 3-year cycle to reset on each occasion that scenario analysis has been undertaken.

We have also clarified that where trustees become subject to the requirements part-way through a scheme year, they may rely on scenario analysis undertaken earlier in that scheme year, provided it otherwise meets the requirements in the Regulations

In addition, we have provided that if the trustees have not been able to undertake scenario analysis in relation to certain assets, they must explain why this is the case in their report.

We have amended our original proposals for the Statutory Guidance in a number of ways including:

- Limiting the circumstances in which trustees should undertake new scenario analysis outside the 3- year schedule.
- Ensuring that the principle behind scenario analysis and the definition of a scenario are clear.
- Making clear that – while trustees have to describe their latest scenario analysis – they may also choose to describe previous scenario analysis where that scenario analysis remains relevant.
- Reiterating that the scenarios can be linked to short, medium and long time horizons, and making clear that these scenarios should take into account expected changes in asset allocations.

Chapter 7: Risk Management

Summary of Responses

Draft Regulations

1. The proposals we set out in our January Consultation, relating to risk management, received broad support. Those proposals had not changed from our August 2020 Consultation.
2. Very few issues were raised in respect of the risk management provisions in the draft Climate Change Governance and Reporting Regulations. One respondent commented that the paragraphs of Part 1 of the Schedule which refer to climate-related risks, could usefully refer to climate-related opportunities too.

Draft Statutory Guidance

Liabilities and covenants

3. One respondent highlighted that employer covenants are a critical part of the risk management of schemes, the nature of which was, in their view, not adequately emphasised by the language in the draft Statutory Guidance.
4. Another respondent suggested that discussion of liabilities should be more extensive in the Statutory Guidance.

Classifying risks

5. One respondent noted that Part 2 of the draft Statutory Guidance had a 3-way classification of climate-related risk (physical, transition and litigation), whereas the risk management section of Part 3 had a 2-way classification (physical and transition). The respondent suggested that for consistency, these classifications should be aligned.
6. Another respondent suggested that the description of physical risks on page 29 of the draft Statutory Guidance would benefit from the inclusion of the destruction of biodiversity as a result of climate change.

Time horizons

7. Some respondents provided comments relating to time horizons. One respondent suggested that the Statutory Guidance would benefit from a recognition that there may be a breakdown of longer-term average correlations between asset classes, particularly where climate change impacts accelerate and worsen, or where policy reaction is swifter and more substantial than currently priced in by the markets.

8. Another respondent suggested that there are several references to trustees extending their time-horizons, in particular to accommodate the timeframes over which physical risks will come to bear. In the respondent's view, this was the wrong perspective and what matters for trustees in choosing the time horizon to assess risk is the timeframe over which the pension scheme will definitely retain that risk.

   "The greatest importance is in managing shorter-term risks since the greater part of pension scheme strategies are in practical terms changeable in anything other than the immediate short-term." **ICI Pension Fund**

Integrating risks

9. One respondent suggested that more guidance is needed to help trustees understand how to integrate climate-related risks and opportunities into existing risk management frameworks.

10. However, a different respondent agreed that the Statutory Guidance should not be too prescriptive on the level of integration with existing risk management processes, as this should be determined by trustees.

Stewardship

11. Respondents were broadly positive about the inclusion of stewardship as an approach to risk management in the draft Statutory Guidance.

12. One respondent suggested that the relevant paragraph of the draft Statutory Guidance, which stated that trustees 'may' include information on how their stewardship approach has helped them manage climate risks and opportunities, could be amended so that trustees 'should' include this information.

13. Another respondent noted that stewardship and engagement should be at the top of the agenda for trustees.

Other comments

14. Some additional minor points in the draft Statutory Guidance were flagged by respondents.

15. One respondent asked to see greater clarity provided in the Statutory Guidance that trustees should be taking into account systemic risk and integrate it into their investment and governance decisions.

   "The omission of system-level risks in this section is a significant one. Given that climate change is a risk that cannot be managed through portfolio construction or asset allocation alone, this section should include a discussion of both the importance of stewardship to effective risk management and – for the same reason – the need for trustees to consider the scheme's own actions to mitigate the impact of catastrophic climate change". **Client Earth**

16. One respondent noted that the risk management part of the draft Statutory Guidance was relatively short, despite risk management being of fundamental importance.
17. The same respondent highlighted that trustees should be able to rely on their sponsoring employer's management teams to help them identify and assess climate-related risks. The respondent also suggested adding an example, in the Statutory Guidance, of how trustees might rely on their sponsoring employer's management team in practice.
18. A different respondent commented that the processes for assessing risks implicitly just relates to the scheme's assets. The respondent suggested that either this is made explicit or the wording is extended to cover liabilities and covenant on the basis that trustees typically do not classify their risks as "financial, operational and strategic risks".
19. An additional respondent drew attention to the suggestion that a "risk management system will allow trustees to keep scheme assets safe and protect the scheme from adverse risks". The respondent suggested that whilst robust risk management can certainly support the identification of and mitigation or lessening of some risks, it is neither possible nor desirable to eliminate or protect from all risk.
20. Finally, one respondent suggested that, given the time and cost required to carry out the possible approaches to identifying and assessing transition risks and physical risks set out in the draft Statutory Guidance, the wording should be amended to reflect that trustees may rely on other persons to help them identify and assess climate-related risks, including advisers and asset managers.

Government Response

Draft Regulations

21. In line with the recommendations of the TCFD itself, we intend that the risk management requirements in the Schedule should refer only to risks, not opportunities.

Draft Statutory Guidance

Liabilities and covenants

22. We acknowledge that employer covenants are a critical part of the risk management of schemes and have strengthened the wording in the final

Statutory Guidance, to provide that trustees “should consider” employer covenants.

23. In response to the additional comment that discussion of liabilities should be more extensive in the Statutory Guidance, we have ensured the Statutory Guidance is more inclusive of liabilities.

Classifying risks

24. We have made the Statutory Guidance more consistent by having a two-way classification of climate-related risk. We have kept a reference to “litigation risk” in the Statutory Guidance, on the basis that this risk is often included in TCFD publications and including it in our Statutory Guidance will help keep trustees focused on it. “Litigation risk” cuts across both “physical” and “transition” risks.

25. We have included the destruction of biodiversity resulting from climate change as an example of a “physical” risk, to recognise the far-reaching consequences of this for companies, economies and societies.

Time horizons

26. We note the comments provided by some respondents relating to time horizons. The final Statutory Guidance recognises that there may be a breakdown of longer-term average correlations between asset classes, particularly where climate change impacts accelerate and worsen, or where policy reaction is swifter and more substantial than is currently priced in by the markets. This may potentially influence the time horizons selected.

27. In addition, we have set an expectation in the Statutory Guidance that trustees should also take account of the time horizon over which current members’ benefits will be paid (for DB), or for which current members’ monies will be invested (for DC), to recognise that in choosing the time horizon to assess risk, the timeframe over which the pension scheme will retain that risk is an important consideration.

Integrating risks

28. After careful consideration, we have decided not to set out in the Statutory Guidance how trustees should integrate climate-related risks and opportunities into existing risk management frameworks, on the basis that – as some respondents highlighted – this is best determined by the trustees.

Stewardship

29. We agree that stewardship should be at the top of the agenda for trustees. The Statutory Guidance makes clear that trustees *should* include information on how – if at all – their stewardship approach has helped them manage climate-related risks and opportunities.

Other comments

30. In response to the comment on system-level risk, we have included more explanation in the Statutory Guidance that trustees should view climate risk as a “systemic” risk and should integrate climate risk into their investment and governance decisions.

31. Although the risk management part of the Statutory Guidance is relatively short, we confirm that risk management is of fundamental importance to the TCFD requirements and have sought to reflect this more in the Statutory Guidance.

32. The final Statutory Guidance also explicitly acknowledges that trustees may also rely on their sponsoring employer’s management teams to help them identify and assess climate-related risks. We have not provided an example of how trustees might do this in practice, on the basis that it is up to individual trustees to determine what approach to take.

33. We have amended the wording to clarify that in relation to the scheme’s assets, the processes for assessing risks to investments should be applied at the asset-class or key sector level as a minimum and that trustee processes should also encompass liabilities and covenants.

34. We acknowledge that it is neither possible nor desirable to eliminate or protect from all risk, so we have made clear in the Statutory Guidance that a risk management system will help keep scheme assets safe and protect from adverse risks, “as far as that is appropriate”.

35. In response to the comment about the time and cost of the possible approaches to identifying and assessing transition risks and physical risks, which are set out in the Statutory Guidance, we note that the draft Statutory Guidance made it clear that trustees may rely on other persons, including advisers and asset managers, to help them identify and assess climate-related risks. Moreover, the Statutory Guidance lists a number of *possible* approaches to identifying and assessing transition risks and physical risks. Trustees do not have to follow the approaches set out.

Summary of changes

In the Statutory Guidance we have amended the wording consulted upon, to draw out the importance of employer covenants and liabilities as part of the risk management process.

We have removed the three-way classification of climate-related risk but have retained a reference to "litigation" risk which cuts across both "physical" and "transition" risks. We have also included the destruction of biodiversity resulting from climate change as an example of a "physical" risk, given the far reaching consequences of the destruction of ecosystems for the financial sector and society more generally.

In relation to time horizons, we have made some minor amendments to reflect that there may be a breakdown of longer-term average correlations between asset classes and that the timeframe over which the pension scheme will retain a particular risk is an important consideration in the trustees' management of climate risk.

We have drawn out the importance of stewardship within the risk management context. We also made some further minor amendments. We included some wording on the importance of trustees viewing climate as a "system-level risk". Finally, we have clarified that a risk management system will help keep scheme assets safe and protect from adverse risks, "as far as that is appropriate".

Finally, in the Climate Change Governance and Reporting Regulations, at paragraph 14 of the Schedule we have made an amendment to the wording consulted upon, to make clear that it is the processes required under paragraphs 12 and 13 of the Schedule which must be integrated into the trustees' overall risk management of the scheme. We have also made a minor corresponding change to the wording of paragraph 27(m) of the Schedule.

Chapter 8: Metrics

Summary of responses

Draft Regulations

1. Following our August consultation, we made a number of changes to our metrics proposals, including adding a second emissions-based metric, reducing the frequency of collection from quarterly to annually, and switching the recommended emissions metric in Statutory Guidance from Weighted Average Carbon Intensity (WACI) to Carbon Footprint. These changes were reflected in the draft Climate Change Governance and Reporting Regulations and draft Statutory Guidance included in our January consultation.
2. We received fewer comments on the metrics provisions in Part 1 of the Schedule to the draft Regulations and most changes were technical in nature.
3. A small number of respondents indicated confusion over the timing requirements in the metrics section of the Schedule, which referred to “annually”, in contrast to the scenario analysis, which referred to “scheme year”.

   “We would request that "on an annual basis" … be expressed more precisely, to give trustees certainty. For example, does it mean: once every calendar year or scheme year; around the same time every year; in the same month every year; or by the same date as the previous year?” **Society of Pension Professionals**

4. One stakeholder highlighted the possibility of older data being used for the purposes of complying with the Regulations.

   “Due to different company and scheme reporting dates, for a scheme reporting in 2022, the majority of underlying disclosures are from 2021 but there may even be some from 2020.” **Nest**

5. Another stakeholder asked whether the Regulations permit the use of different metrics for different asset classes.
6. Respondents highlighted a small number of drafting issues, including the fact that the definition of a carbon intensity metric as drafted did not permit WACI measures to be used, and that the emissions being calculated were those attributable to the assets, rather than the emissions of the assets themselves; and other minor drafting points.
7. A small number of broader policy issues were also raised.
8. As elsewhere there were concerns about data gaps, notwithstanding that the duty to obtain data, calculate metrics and use the metrics to identify and assess climate-related risks and opportunities each apply only as far as trustees are

able. There were particular concerns over the availability and reliability of Scope 3 emissions data.

“Measuring and disclosing scope 3 emissions data represents a particular challenge for companies (and hence, trustees, as the guidance already notes).” **Investment Association**

“We note that Scope 3 emissions data currently remains limited and, although the ambition to report on Scope 3 data is reasonable, it seems likely that there will be limited ability for trustees to do so for several years whilst data quality improves” **Hymans Robertson**

9. Finally, one respondent suggested a stewardship metric might also be prescribed or encouraged.

Draft Statutory Guidance

10. There was a tension in stakeholder responses between a desired flexibility for trustees to be able to select their own metrics and the benefit of a shorter list of recommended metrics. The extent to which more or less flexibility was offered in the choice of metrics was the main source of disagreement between respondents. Many organisations called for the range of metrics to be narrowed further, to aid comparability and to reduce burdens for those who would be tasked with providing the data.

“It is also important that trustees are not given a carte blanche of climate measures they can choose to report on as this would lead to extreme difficulties amongst asset managers and pension providers in setting up efficient systems to provide this data. One of the ways around this would be to offer a finite “menu of options” in the guidance from which trustees would be invited to choose the required number of metrics.” **Scottish Widows**

11. However, a similar number of respondents believed that the choice of recommended metrics was already too narrow.

“We welcome the flexibility for trustees to select their own climate change metric in addition to the two required emissions-based metrics. … Whilst this appears to provide some flexibility for trustees, we are concerned that it may stifle trustees’ ability to identify the metrics that are most suitable to their scheme and the trustees’ investment policies.” **Association of Pension Lawyers**

12. Many stakeholders also raised concerns about calculating metrics – particularly emissions-related metrics – for certain asset classes. Most often this was in respect of sovereign bonds and derivatives, but also buy-ins, green bonds, and relevant contracts of insurance.

“The guidance could more clearly address how metrics should be calculated for certain asset classes (especially sovereign bonds and derivatives), recognising

this is a rapidly developing area which applies significant qualitative judgements in relation to the underlying sovereign issuers” **Herbert Smith Freehills**

13. Linking the themes of calculation difficulties for certain asset classes and the prescription vs flexibility question, some respondents suggested that Government should set out more clearly a recommended formula and identify data sources for certain commonly-held assets where the methodology was open to interpretation.

“Will the UK Government be publishing the CO_2e per £ number for UK gilts, both vanilla and green? It seems inefficient to require all asset owners to attempt to do this. At the very least, we recommend that the guidance provides a single approach to the calculation methodology to be applied for UK government bonds” **Shell Pensions Trust**

14. This argument also reached into discussions about preferred methodologies for certain emissions intensity metrics.

“The EU style EVIC [calculation for Weighted Average Carbon Intensity] is very flawed in my opinion. EVIC is a great tool to allow one to divide up emissions between equity and debt, but it is possible to use it compounded with the revenue. This is the approach we’ll be taking in our TCFD reporting this year.” **Lothian Pension Fund**

15. Some stakeholders contended that they still preferred WACI as a recommended metric to Carbon Footprint, and did not believe Government had made a strong enough case for recommending of the latter. Others disagreed with the decision to recommend Carbon Footprint in place of WACI but welcomed the flexibility to choose a different approach.

“While we do not agree with the recommended use of carbon footprint over WACI … and note that this does not agree with the TCFD recommendations themselves, there appears to be sufficient flexibility that investors can choose their desired metric.” **Russell Investments**

16. A smaller number of respondents raised concerns over the process for estimating Scope 3 emissions where there were data gaps.

“The focus on scope 3 emissions is appreciated but we think more clarity could be further provided. Namely, what is the protocol for reporting scope 3 emissions when coverage is not available. If this is simply recorded as a zero, this could incentivise companies to simply not attempt to increase the scope of their reporting coverage” **Redington**

17. Others had views on the aggregation of metrics.

“We do not consider it appropriate to aggregate metrics where the basis of calculation differs significantly... Nor do we consider it appropriate to aggregate metrics for derivatives with metrics for other assets. This is mainly because derivatives exposure is often leveraged … Our preference is for the guidance to

state that metrics should not be aggregated in these ways, rather than just permit them to be disclosed separately." **LCP**

18. Two respondents expressed reservations over the references to the Greenhouse Gas (GHG) Protocol and whether DWP intended to accept disclosures in line with the protocol, which were in some instances less ambitious in the calculation of emissions related to investments than the Partnership for Carbon Accounting Financials (PCAF) and our own draft Statutory Guidance.

    "We would ... urge the Government to make clear that its stance on Scope 1, 2 and 3 emissions takes precedence over the (footnoted) GHG Protocol Methodology which is less clear on this point." **Client Earth**

19. Some stakeholders raised concerns, including over the reliability of the climate value at risk and portfolio alignment metrics. Finally, a small number of minor corrections to the draft Statutory Guidance were flagged.

Government response

Draft Regulations

20. We have clarified the timing of the metrics requirements. We have made clear that trustees must select metrics in the first scheme year the requirements apply to them and, where relevant. in the first scheme year the requirements re-apply to them, in accordance with regulation 3(4), 4(4) or 5(4). We have included a definition of "first scheme year of re-application" at paragraph 26 of the Schedule.
21. We have provided that trustees must, as far as they are able, calculate their selected metrics in each scheme year - this includes the first scheme year the requirements apply and a first scheme year of re-application. Trustees must also use the metrics to identify and assess climate-related risks and opportunities in each scheme year. We do not intend to be more prescriptive over when these activities take place, as long as they take place in each scheme year.
22. As a consequence of those drafting changes, we have also made clear that where trustees determine that it is appropriate to replace one of their selected metrics, they must select a replacement metric of the same type (absolute emissions metric, emissions-intensity metric, or additional climate change metric). We have moved the definition of each type of metric to paragraph 26 in the Schedule.
23. Additionally, at paragraph 21 of the Schedule, we have provided a similar easement for metrics as for scenario analysis (see chapter 7), where the requirements start to apply to the trustees partway through a scheme year. Data obtained, metric calculations performed and risks and opportunities identified and assessed in the same scheme year, but before the date from which the requirements apply, may still be relied upon to meet the requirements.

24. Trustees should use the most recent data they are able to obtain for the calculation of metrics, but we accept that this may need to relate to earlier reporting years and may well have been produced or published in an earlier scheme year. This would not represent a breach – it is only the obtaining of the underlying data and its use to calculate the scheme's metrics which must be carried out in the scheme year in question.

25. We consider that the Regulations do permit the use of different metrics for different asset classes, and indeed for different sections of a scheme. Further, the Statutory Guidance does not set any expectation that trustees should select the same metric for different asset classes or scheme sections.

26. We have amended the definition of emissions intensity metric, defining it as a metric which gives the total greenhouse gas emissions attributable to the scheme's assets per unit of currency. This broader definition allows trustees to use as the denominator in any intensity calculation:

    - the amount invested by the scheme (as used in the calculation of Carbon Footprint);
    - the revenue of the entities making up the scheme's underlying assets (as used in the traditional WACI calculation, set out in the TCFD's 2017 recommendations[24]); or
    - the value of the entities making up the scheme's underlying assets (as used in alternative more recent WACI methodologies, which use Enterprise Value Including Cash (EVIC), as the denominator).

27. We have amended the drafting to make clear that absolute emissions metrics and emissions intensity metrics are intended to report the emissions attributable to the assets, rather than the emissions of the assets themselves. We have also made a small number of minor changes.

28. Finally, turning to policy concerns raised during the consultation on the draft Regulations, we have given further consideration to the challenges associated with collecting Scope 3 emissions data. In light of the arguments we have heard, and our engagement with other regulators, we have decided to give trustees an additional scheme year before they are required to obtain Scope 3 data. We have made provision for this at paragraph 19 of the Schedule.

29. The other metrics requirements will still apply and trustees must calculate their selected absolute emissions and emissions intensity metrics in the first scheme year, but they are only required to obtain Scope 1 and Scope 2 emissions data in that first scheme year. This first year easement will apply to trustees of schemes in the first and second waves, and to trustees of schemes who first become

[24] Implementing the recommendations of the Task Force on Climate-related Financial Disclosures https://assets.bbhub.io/company/sites/60/2020/10/FINAL-TCFD-Annex-Amended-121517.pdf (page 43).

subject to the requirements after that, so that all trustees will be allowed time to prepare for the challenges presented by obtaining Scope 3 emissions data.

30. Whilst we have carefully considered the other issues raised concerning data quality, we do not intend to make further changes to the proposals consulted upon. Data quality is improving and will improve further as TCFD is increasingly adopted, not only by UK firms on the timelines set out in the TCFD roadmap, but also internationally.

31. Nor will we require trustees to select and calculate a stewardship metric. Whilst we see stewardship as a mechanism that can help to manage climate risk, we do not believe a sufficiently standardised and robust metric yet exists to justify the burden which would result from it becoming a legal duty. Trustees are however free to set and report on a stewardship metric as their chosen additional climate change metric.

Draft Statutory Guidance

32. We have noted that stakeholders took divergent stances on the topic of recommended metrics, with some calling for significantly more prescription, and others calling for more flexibility. Whilst our position has evidently not pleased everyone, the roughly similar number of voices on each side suggest that we have struck an appropriate balance, and that any narrowing or widening of the available choice of metrics would discomfort as many respondents as it pleased.

33. We therefore do not intend to change our policy. Trustees are free to choose WACI in place of Carbon Footprint as their preferred emissions intensity metric, or to choose an alternative to data quality, climate value at risk or portfolio alignment as their additional climate change metric. These will remain our recommendations, and we believe they will assist with consistency of provision and interpretation – but trustees who wish to take a different approach may do so. They will simply need to explain why.

34. On the recommendation of Carbon Footprint over WACI – a majority of respondents who expressed a preference in response to our August consultation argued for Carbon Footprint to be the recommended emissions intensity metric. The reliance on company revenue as the denominator makes a traditional WACI measure unsuitable for many asset classes other than equities, and Carbon Footprint is increasingly being used in other jurisdictions, by the Partnership for Carbon Accounting Financials, and by pension schemes for their own target setting, including via the Net Zero Asset Owners' Alliance.

35. However, we recognise that WACI is still favoured by some trustees and others, at least in relation to the asset classes for which it is suitable. Therefore, trustees who wish to continue to use WACI for part of their portfolio may do so, they just need to explain in their TCFD report their reasoning for not using Carbon Footprint.

36. In response to comments by one respondent, we have sought to be clearer that we do not have a preference for the use of revenue or enterprise value in any calculation of WACI.

37. In relation to asset classes where additional guidance for the calculation of emissions was sought:

    - We have refocused our Statutory Guidance on calculating and attributing the emissions of sovereign bonds to limit recommended methodologies to two – domestic emissions per pound of GDP, or per pound of total Government debt. In relation to UK government bonds, we have identified the sources of the necessary data to carry out the calculation. Again, trustees may use an alternative methodology, they just need to explain their reasoning. The Statutory Guidance also recognises the complexities of identifying different scopes of emissions for sovereign issuer, and permits trustees to treat Scope 1 and 2 emissions as the production-based emissions of the jurisdiction, and Scope 3 emissions as the emissions embodied in goods and services imported by the jurisdiction.
    - In relation to both corporate and sovereign Green bonds, our expectation is that the same methodology is used as for other bonds by the same issuer. Where schemes report avoided emissions for such bonds, they should where possible calculate and report these by reference to the ICMA handbook on the harmonised framework for impact reporting.[25]
    - We have highlighted guidance for certain types of derivative, but not all. The Statutory Guidance recognises that methodologies remain in their infancy and we do not expect such emissions to be readily obtainable.
    - In relation to buy-in contracts, we have set out that the emissions of the underlying assets should be calculated in line with the Statutory Guidance when the asset data is available, but we have acknowledged that, with the exception of collateralised buy-ins, it often will not be available.

38. We agree with the concern about recording unavailable Scope 3 emissions data as zero. This will not only disincentivise companies from attempting to increase the breadth of their reporting, it will also result in trustees systematically under-estimating their pension schemes' emissions. We have therefore provided in the Statutory Guidance that trustees should not assume Scope 1, 2 or 3 emissions to be zero in their calculation or reporting. When greenhouse gas emissions in relation to any assets are unavailable and cannot be estimated, for example by attributing average Scope 1, 2 or 3 emissions for the sector, trustees should make clear the proportion of the assets they are reporting on in relation to each scope.

39. On the subject of aggregating emissions across different asset classes, we do not intend to propose a detailed approach to cater for every circumstance. The

[25] https://www.icmagroup.org/sustainable-finance/impact-reporting/

combinations of asset classes, data availability and methodologies used will be too diverse to make this a useful exercise for trustees to follow. Instead, we have maintained a principle-based expectation and in the Statutory Guidance we have made clear that trustees should not – rather than need not – aggregate data, where they believe it would not be meaningful to do so. Instead “sub-metrics” should be reported accompanied by the proportion of the portfolio each sub-metric covers.

40. It was not our intention that trustees should follow the detail of the Greenhouse Gas (GHG) Protocol in relation to investments in preference to the other expectations set out in our Statutory Guidance. We acknowledge the concern that the GHG Protocol is less clear, and often unsuitable for the calculation of the emissions funded by diversified portfolios, or their eventual climate risk.

41. Finally, we acknowledge that some stakeholders have concerns over one or more of the recommended additional climate change metrics. We have provided three options in the Statutory Guidance for exactly this reason, and – to reiterate our earlier point – trustees are free to select others if they see fit. They just need to explain their reasoning in their TCFD report.

Summary of changes

In the Climate Change Governance and Reporting Regulations we have included specific provision to allow all trustees an additional scheme year before they are required to obtain Scope 3 emissions data.

We have clarified the timing of the requirements to make clear that the activities must be carried out in each scheme year. Where the first year of application is a part scheme year, activities carried out within the same scheme year but in advance of the date the requirements apply to the trustees, may still be relied upon by trustees to meet the requirements.

We have amended the definition of emissions intensity metric, to explicitly permit the three types of metric which are commonly used.

We have provided additional Statutory Guidance to clarify our expectations in relation to calculation of the carbon footprint of sovereign bonds, derivatives and buy-ins, any reporting which trustees choose to make over the avoided emissions of green bonds, and our expectations around the use of WACI. We have also acknowledged the difficulties of calculating Scope 3 emissions for sovereign bonds other than the UK, and any emissions for certain kinds of derivative and for many buy-in contracts.

We have emphasised in the Statutory Guidance that trustees should not assume any assets to have zero emissions in their calculations or reporting. Where, in relation to one or more scopes of emission, they are unable to obtain data or make estimates

for certain assets, they should make clear the proportion of assets they are reporting on.

We have clarified that trustees should not aggregate data in their reporting where they do not believe it would be meaningful to do so, and clarified that our Statutory Guidance, and the Partnership for Carbon Accounting Financials (PCAF) standard for attributing emissions, take precedence over the GHG Protocol where they are in disagreement.

Chapter 9: Targets

Summary of responses

Draft Regulations

1. Our August 2020 policy proposals in relation to targets were broadly welcomed. The most substantive policy change incorporated into our January consultation on draft Regulations was a reduction in the frequency of monitoring performance against targets from quarterly to annual.
2. The draft provisions on targets in the Schedule to the Climate Change Governance and Reporting Regulations raised relatively few concerns. As with metrics, some respondents pointed out the potential confusion arising from references to duties being on "an annual basis", and the implication for varying the time of year in which activities were carried out from one scheme year to the next, as well as for schemes with scheme years of more or less than one year.
3. On a related theme, one respondent also queried how target reporting was intended to work in the first year, when a target might only just have been set.
4. Another respondent pointed out the potential for ambiguity in the consideration of whether to retain or replace the target in the light of "the scheme's performance", and whether this included wider aspects of the scheme's performance. The same respondent suggested that DWP might wish to consider a requirement to explain any shortfall in meeting targets set by the trustees.

   "We suggest paragraph 18b [now paragraph 23(b)] should be amended (consistent with 18a [now 23(a)]) to "taking into account the scheme's performance against any target they have set" to distinguish against any non-climate-target scheme performance. We believe paragraph 18 would benefit from an additional, third component, requiring, if targets are missed, detail on why this is the case, alongside any action being considered (e.g. engaging with investee companies)." **Hymans Robertson**

5. A few respondents also highlighted continuing policy concerns. The most frequently-raised topic were the continued industry data gaps and the overall quality of data, with particular reference to Scope 3 emissions. There were also philosophical questions about trustees' responsibility for Scope 3 emissions.

   "There are many data gaps and it may be the case that not all assets are included, which can lead to a small portion of the scheme being covered by targets." **GNEISS Energy**

   "We note comments that excluding downstream scope 3 emissions in targets risks no investors being held responsible for them. Cushon believes that investors do carry some responsibility for addressing downstream scope 3

emissions … However, investors should not carry sole responsibility for downstream scope 3 emissions. These are also the responsibility of consumers and governments as drivers of change.” **Cushon**

6. One respondent raised a policy concern around target setting for the first year that schemes were in scope, particularly given the unparalleled social and economic circumstances experienced in the last 18 months.

   “We repeat this recommendation and note the challenges involved in setting targets based on metrics prepared using corporate disclosure data from the Coronavirus pandemic and recovery.” **Cardano**

Draft Statutory Guidance

7. We received relatively few comments on our draft Statutory Guidance on targets. Whilst respondents were reassured by the Department’s statements that targets were solely for the management of schemes’ own financial risk and opportunity, by far the most frequently raised comment was the need to emphasise in guidance that targets should be scheme-specific and that actions to meet them should not conflict with trustees' trusts law and fiduciary duties or the investment policies stated in the SIP.

   “We continue to see a potential dichotomy of a trustees’ legal obligation in maximising long-term risk-adjusted investment returns for plan beneficiaries versus an investment strategy driven to targeting portfolio climate metrics in isolation.” **CFA UK**

   “We recommend that the guidance clearly highlights that collecting data and comparing to targets is a way to measure performance, but portfolios should not be optimised to meet these targets. This could come at the expense of either the financial objectives of the scheme or of driving wider- and longer-term industry decarbonisation, one of the fundamental principles of the Paris Agreement.” **AXA Investment Managers**

   “We are concerned that aiming to deliver on a climate target that takes no account of the market price of, for example, carbon-light investments, might conflict with the trustees’ fiduciary responsibility. It would seem to equate to seeking to reduce one particular risk without necessarily taking into account the relative costs and benefits of doing so.” **Law Debenture Pensions Trust Corporation**

8. Respondents also flagged concerns about a reliance on long term targets alone.

   “We believe that targets should not be too long-term, for example no more than five years into the future and suggest this is added to the guidance. For example, we would not consider a target of net zero emissions by 2050 to be sufficient without interim targets.” **LCP**

9. Further to their comment above, Hymans Robertson suggested that as an alternative to a statutory requirement, an expectation might be set of explaining missed targets via Statutory Guidance.
10. Other respondents suggested providing more guidance on the types of targets that trustees might set and how these could be integrated into schemes' investment strategy, highlighted challenges with investing in pooled funds, or suggested that Statutory Guidance may make reference to consideration of the achievability of a target, and the practical and strategic aspects of getting there.

Government response

Draft Regulations

11. As set out in other chapters, we have given careful consideration to stakeholder comments made on the draft Regulations and in relation to our wider policy proposals.
12. We have amended the drafting to make clear that target setting must take place during the first scheme year in respect of which the requirements apply – rather than on the first day on which the Regulations apply – and to make clear that performance must be measured in each scheme year, rather than annually. We have also amended the drafting to make clear that the trustees must set a target in a first scheme year of re-application (as defined in paragraph 26 of the Schedule). It is not a requirement to measure performance against the target trustees have set or to determine whether the target should be retained or replaced, at the same time of year in each scheme year.
13. In relation to measuring performance, the first scheme year is no different from any other scheme year. In an extreme scenario a scheme might set a target on the final day of a scheme year – but the Regulations do not require trustees to make progress towards that target, only to report on the scheme's performance against the target.
14. We have also clarified that where trustees elect to replace the target, a new target must be set.
15. Finally, we have addressed the concern raised that there was ambiguity about whether factors other than the scheme's performance against the target must be considered in determining whether to retain or replace that target. Paragraph 23(b) of the Schedule requires trustees to take into account the performance of the scheme measured in accordance with paragraph 23(a).
16. We have decided not to require in Regulations that trustees explain any shortfall in meeting targets they have set. We believe that an appropriate level of ambition may be discouraged by an awareness of the need to explain any failure to meet it in full, given that targets may be missed for reasons wholly outside the trustees' control. It could also create confusion – whilst Government has been clear that

targets are not legally binding, a regulatory requirement to explain missed targets might lead to the perception that trustee-set targets are somehow self-binding – or that the fulfilment of trustees' fiduciary duties is somehow subordinate to meeting non-binding targets which are self-set for the purposes of managing climate risk.

17. We have addressed the concerns around data and the availability of Scope 3 emissions in chapter 8 on metrics. The draft Statutory Guidance consulted upon made clear that trustees are free to select a target in relation to the whole portfolio or only part of the portfolio – for example, in relation to a particular section, fund, sector or asset class. We have added to the Statutory Guidance, for the avoidance of doubt, that trustees are free to set targets which do not cover all scopes of emissions. However, as data quality and coverage improves, we anticipate that trustees will most likely wish to set wider targets to gain the fullest possible picture of all the assets they believe to be at risk of climate change, to ensure that they are managing those risks appropriately.

18. We have considered the suggestion that trustees might not be required to set a target for a year, but we have concluded that this is not necessary. The past 12 months have seen the highest ever number of schemes setting voluntary decarbonisation targets and there is explicit provision for schemes to revise targets annually in the light of events. Where trustees wish to set a more cautious target in early years they are free to do so.

Draft Statutory Guidance

19. We agree with the viewpoints of stakeholders who raised concerns around the primacy of an appropriate return, and the undesirability of both excess focus on portfolio optimisation to meet targets at the expense of scheme objectives, and excess focus on one risk at the expense of another.

20. We believe trustees' fiduciary duties, and our legislation, are clear. The powers taken in the Pension Schemes Act 2021, and these Regulations, are with a view to securing effective governance of the scheme with respect to the financial risks and opportunities of climate change. Portfolio climate metrics should only be targeted for the purposes of managing a scheme's financial risk. But as mentioned above, we have re-emphasised in the Statutory Guidance that targets should be scheme-specific and should not conflict with trustees' fiduciary duties under trusts law or the investment policies stated in the SIP.

21. However, we agree that a 2050 target with no interim targets is unlikely to meet the objectives of prompting schemes to consider and appropriately manage climate risk. Transition risks – and increasingly physical risks – are already affecting investment returns.

22. We have therefore set an expectation in the Statutory Guidance that targets set by trustees should not be more than 10 years into the future. We note that many schemes have voluntarily set much longer range targets, such as net zero by 2050, and we strongly welcome this. However, where trustees have set such

targets without accompanying interim goals, they should do so. As with other expectations in the Statutory Guidance, trustees are free not to set accompanying shorter range targets, but they should explain in their TCFD report why they have not done so.

23. We also recognise that setting an expectation in the Statutory Guidance for trustees to explain missed targets in their TCFD report might be helpful for savers and others in understanding the trustees' conclusions on the events or circumstances that made the target unachievable or not in members' interests. The expectation of such an explanation can serve as a useful prompt for trustees to explain their thinking. We have therefore included this in the Statutory Guidance.

24. We do not intend to issue further Statutory Guidance on targets. We see this as something on which trustees should be free to set appropriate measures. Whilst we appreciate that pooled funds present challenges, all trustees have the power of investment and many schemes investing via pooled funds have already set targets.

25. Finally, we do not intend to warn trustees of the need to consider the achievability of a target. This should be happening anyway and we would not wish to inadvertently give trustees the impression that they should only be setting targets which they have a very high level of confidence of meeting. Portfolio and other targets are for the management of risk. Just as the facts on the ground can change, so can the extent of the steps trustees might take towards meeting them, and the targets themselves.

Summary of changes

In the Climate Change Governance and Reporting Regulations we have made clear that target setting must take place during the first scheme year in respect of which the requirements apply – rather than on the first day on which they apply. Target setting must also take place in a first scheme year of re-application of the requirements, where relevant. We have also made clear that performance against the target must be measured in each scheme year, rather than annually.

We have specified that where trustees elect to replace the target, a new target must be set. Finally, we have made clear that performance against the target is the only criterion which trustees must consider when determining whether to retain or replace that target.

We have re-emphasised in the Statutory Guidance that targets should be scheme-specific and should not conflict with trustees' fiduciary duties under trusts law or the investment policies stated in the SIP. We have set the expectation that any target should not be more than 10 years into the future, and that trustees should offer an explanation for any missed targets in their TCFD report.

Finally, we have clarified that any emissions target set by trustees need not cover all 3 scopes of greenhouse gas emission.

Chapter 10: Disclosing in line with the TCFD recommendations

Summary of Responses

Draft Regulations

1. Our policy proposals outlined in August received broad support from respondents to the consultation. Most respondents to the January consultation either did not comment again on our proposals or just re-emphasised their support and agreed that the draft Regulations delivered on the policy intent. However, a small number of issues were still raised.

2. One respondent argued a prescribed list of disclosures may not be needed. Instead they suggested a principles-based disclosure framework would be a more suitable alternative to require trustees to report on how they have carried out their duties under Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations.

   "In some places, the guidance expects trustees to do things but not to report on them, so these things could easily be missed when trustees prepare their TCFD reports. It therefore seems to us that a principles-based disclosure requirement might be preferable, as well as more future-proofed." **LCP**

3. The same respondent also flagged what they regarded as a lack of clarity in the notification requirements.

   "Draft Regulation 3(1)(b) [6(1)(b) of the final regulations] regarding website publication is not imposed by way of amendment to the 2013 Disclosure Regulations[26]. It is unclear to us whether the notification requirements relating to website publication in Disclosure Regulations 27 and 28 are intended to apply. Regulations 27 and 28 seem to have wide application, rather than specifically relating to the various website publication requirements in the Disclosure Regulations themselves. Hence they could be interpreted as applying to publication of TCFD reports." **LCP**

4. Four respondents specifically supported the inclusion of the provision allowing the chair's manuscript signature to be omitted [regulation 6(3) of the final Regulations] from the published TCFD report. However, all argued that it should be replicated for the DC chair's governance statement.

   "The provision allowing the Chair's manuscript signature to be omitted from the published report is helpful…. please could a corresponding amendment therefore

[26] SI 2013/2734

be made to the DC chair's governance statement provisions (perhaps via the Miscellaneous Regulations)?” **Travers Smith**

5. A single respondent raised a concern that TCFD reports would not be considered as ‘other information’ in relation to auditing standards.

Draft Statutory Guidance

6. Similarly to our draft Regulations for disclosure, our draft Statutory Guidance on this topic received broad support from respondents. Nevertheless, we received some comments in relation to improving clarity in places.
7. The majority of respondents acknowledged that there is merit in members being able to engage with the TCFD disclosures. There was therefore support for the expectation under “Content of a TCFD report” in part 3 of the draft Statutory Guidance that trustees should include in the report a plain English summary for members which allows them to become easily acquainted with the key findings from the report.
8. However, one respondent felt that whilst the draft Statutory Guidance referred to what may be disclosed for members, the distinction between the summary of a TCFD report and the full report could be more clearly made.
9. Another respondent stated that we should actually legislate for a summary of the TCFD report to be included in the Annual Report alongside the website address where the full report can be found.

   “Trustees should be required, rather than given an option, to provide a summary of the TCFD report within the Annual Report and Accounts.” **Climate Disclosure Standards Board**

10. Two respondents queried the use of should within the definition of “should” (page 6 of the draft Statutory Guidance).

    “With regard to using "should", should this be “must” or is it not intended that this be a “hard” legal requirement (a breach of which could trigger penalties for non-compliance)? If it is intended to be a “hard” legal requirement, then we suggest that reporting against Statutory Guidance is added to the list of disclosure requirements in Part 2 of the Schedule to the regulations to give clarity and certainty to trustees.” **Society of Pension Professionals**

Government Response

Draft Regulations

11. In response to the proposal for a more principle-based disclosure regime, we favour a prescribed list of disclosures in Part 2 of the Schedule the Climate Change Governance and Reporting Regulations, as these describe both outputs – for example from scenario analysis and metrics and targets – as well as

processes, for example in relation to governance and risk management. Without this we believe it would make it harder for trustees to understand what was being expected of them, especially as to many trustees these disclosures will be completely new, and in relation to some of the underlying activities, relatively complex.

12. By prescribing the outputs our Regulations allow trustees to focus fully on undertaking them effectively, rather than being pre-occupied solely by demonstrating compliance with the activities in Part 1 of the Schedule. A principles-based approach would also make it more difficult for TPR to regulate the disclosures and conclude whether a report covers the matters it is supposed to – this would in turn mean trustees would have less certainty over whether they had met requirements or would be subject to further intervention by the Regulator. Finally, a prescribed list in Part 2 of the Schedule allows for more comparability between reports.

13. We have sought to align additional trustee oversight expectations identified in the Statutory Guidance with the corresponding reporting expectations at the end of each section of the Statutory Guidance. We have done this by ensuring that the small number of disclosure expectations mentioned in the body of the Statutory Guidance are also included in the concluding disclosure expectations for each section.

14. For the avoidance of doubt, regulations 27 and 28 of the Disclosure Regulations apply to information or documents required to be given under those Regulations (regulation 26 of the Disclosure Regulations makes this clear). Regulation 6(1)(b) of the final Regulations, provides for the publication of a TCFD report, not the provision of information or documents to members (or others) under the Disclosure Regulations. Regulations 27 and 28 therefore do not apply to the publishing of the TCFD report.

15. The amendments made by the Miscellaneous Provisions Regulations will, however, require trustees to include specified information about the TCFD report in certain documents already required to be given under the Disclosure Regulations – the Annual Report, annual benefit statements and annual funding statements. In the case of annual benefit statements and annual funding statements, the amendments will require trustees to include in those documents the information specified in regulation 27(2)(a) to (d), in relation to the most recent TCFD report published.

16. In relation to allowing the Chair's manuscript signature to be omitted from the published TCFD report, we will not be making an amendment to the Miscellaneous Provisions Regulations to replicate this for the Chair's Statement. Instead, we will consider whether a corresponding change is necessary to regulation 23 of the Occupational Pension Schemes (Scheme Administration)

Regulations 1996[27] as part of the next steps following the review of the Chair's Statement carried out earlier this year[28].

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

18. Government is supportive of trustees that wish to do this to provide further confidence that 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.

Draft Statutory Guidance

19. We welcome broad stakeholder support for the expectation in Statutory Guidance that TCFD Reports should include a plain English summary of the key findings. Member engagement on ESG factors, and climate change in particular, is increasing so there is undoubtedly an audience for the key findings to be communicated in this way.

20. Despite one respondent's request that clearer distinction be made in the Statutory Guidance between the full report and the plain English summary we do not intend to make any changes here. Page 17, paragraph 8 of the draft Statutory Guidance is clear that a plain English summary should be included in the report. Trustees may also choose to publish additional information relating to their full TCFD report separately if they see fit, an option already covered by page 48 paragraph 12 of the draft Statutory Guidance.

21. We also do not intend to amend our proposals for the Miscellaneous Provisions Regulations to require trustees to include a full summary of the report in the Annual Report. This is needless duplication and runs counter to our policy aim of not unnecessarily adding to the overall length of the Annual Report and Accounts.

22. In relation to the definition of "should" in the Statutory Guidance, trustees should explain where and why they have not followed the Statutory Guidance, but it is an expectation in the Statutory Guidance that they give this explanation, and not a requirement in the Regulations.

23. In the Statutory Guidance "must" is defined to mean something that trustees are required to do by legislation, which is not the case in relation to the definition of "should". The definition of "should" on page 6 is therefore correct.

[27] SI 1996/1715

[28] The Occupational Pension Schemes (Scheme Administration) Regulations 1996 Post Implementation Review - https://www.legislation.gov.uk/uksi/2016/427/pdfs/uksiod_20160427_en.pdf

Summary of changes

We have made no changes to the regulations on disclosure other than to address minor technical drafting points.

Chapter 11: Penalties

Summary of Responses

1. Our proposed penalty regime received almost unanimous support following our original policy consultation. We did however, receive some comments of note on the compliance section of the draft Climate Change Governance and Reporting Regulations.

2. One respondent noted that the mandatory penalty is for a “failure to publish” and recommended that instead, this should be changed to “failure to produce”. This it to avoid schemes being unfairly penalised in the event of an administrative failure in publishing the report online within seven months of the year-end.

3. The same respondent also questioned the need for a further bespoke compliance regime rather than using the Pensions Regulator’s existing powers in sections 13 and 14 of the Pensions Act 2004.

4. Another respondent helpfully flagged that draft regulation 6(5)(a) [now regulation 9(5)(a)] of the Climate Change Governance and Reporting Regulations did not distinguish between compliance notices issued to trustees and those issued to third parties.

5. Finally, a significant number of respondents restated that it will be essential for TPR to give clear guidance on what it deems adequate and its enforcement policy with regard to its new powers under the Regulations. A number of respondents stressed that, due to the new and complex nature of the requirements, discretionary penalties should only be administered in the most extreme instances of non-compliance.

   “We would hope that TPR recognises the increased workload, particularly for smaller, lower impact schemes and only penalises entities in extreme circumstances where the requirements have been wilfully ignored” **Association of Professional Pension Trustees**

6. Linked to this argument were renewed calls for TPR to adopt an engagement focus, working with industry to overcome challenges which emerge.

Government Response

7. We believe lowering the threshold for a mandatory penalty to “failure to produce” to be sub-optimal and less clear than applying a mandatory penalty only for wholesale non-compliance with the publication requirements, where trustees have not published a TCFD report at all.

8. Alternatively, raising the threshold for a mandatory penalty so its imposition requires not only a failure to publish anything, but also a “failure to produce” any kind of TCFD report would likely be ineffectual and potentially unenforceable.
9. We have amended the wording regarding the mandatory penalty - draft regulation 6(2) [now regulation 9(2)] - to make clearer that it only applies where TPR are of the opinion that a person has failed to publish a report on a publicly available website, accessible free of charge.
10. Our Regulations are clear as to when a report needs to be published and further prompt is provided by the fact trustees must report the website address of their TCFD report in the annual scheme return. If a report has not been published on a publicly available website, accessible free of charge, TPR must impose a mandatory penalty.
11. Trustees should allow for time before the end of the 7-month time limit to publish their TCFD report. Statutory Guidance (see Part 4) is not prescriptive about the location of publication, so even in the unlikely event of extended website outages, finding an alternative publishing destination ought never to be a barrier.
12. We favour a bespoke penalty regime over the existing powers in sections 13 and 14 of the Pension Act 2004. We believe, in comparison, any enforcement action taken under our regime can be done in a much more expedient and efficient way by TPR, whilst nevertheless offering trustees the right to request a review and to appeal any decisions.
13. To be clear, trustees are not intended to be liable for penalties issued to third parties. We have therefore corrected the drafting error flagged in the penalty notice provisions (regulation 9(5)(a) of the final Regulations) to reflect this.
14. TPR published its climate change strategy on 7 April 2021[29] which sets out its strategic response to climate change and how it can help trustees meet the challenges from climate change. TPR also intends to publish guidance later this year on our Regulations, ahead of the new measures coming into force.
15. In general, we agree with the regulatory approach of initially focusing on engagement and working with industry to overcome challenges. 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.

Summary of changes

We have clarified that the requirement to issue a penalty notice to all trustees applies only where the penalty notice is issued to the trustees.

[29] https://www.thepensionsregulator.gov.uk/en/document-library/strategy-and-policy/climate-change-strategy

We have also amended the wording regarding the mandatory penalty, to make clearer that it only applies where TPR are of the opinion that a person has failed to publish a report on a publicly available website, accessible free of charge.

Chapter 12: Impacts

Summary of responses

1. We received lots of constructive and valuable empirical evidence and insights in respect of our original impact assessment published alongside the August consultation, and refined it accordingly.

2. Respondents to the consultation generally believed that costs reflected in the updated impact assessment published alongside the January consultation were much more realistic. However, a number of respondents still felt that the costs associated with certain activities like scenario analysis may have been underestimated.

   "We believe that the updated impact assessment more accurately reflects the costs that trustees will incur to meet on the new governance and reporting requirements. However, we believe that the central range is likely to be an underestimate; for many schemes, the cost will likely be towards the upper end of the range quoted in year." **Aon**

   "We still believe the central estimate of £12,000 underestimates the cost of scenario analysis for most schemes. We do not think we can carry out decision-useful scenario analysis, which needs to include a quantitative element, at a cost of less than £20,000 in the first year." **Nest**

3. However, there was acknowledgement by some respondents that our decision to make scenario analysis a triennial requirement represented a material change which significantly reduces the financial burden.

4. An additional cost which two respondents felt to be underestimated is the amount of time trustees will need to allocate to climate risk governance, especially in the first year in which they are required to comply.

   "We broadly agree with the relative cost split for familiarisation, scenario analysis, metrics & targets and producing the report…..however, we do not think that the impact assessment accurately reflects the costs schemes will face in the first year of compliance. We do not agree with the impact assessment's assumption that schemes already have all the governance, strategy and risk management processes in place." **Redington**

   "In order to comply with TCFD it is important not to underestimate the amount of time which Trustees will need to allocate. There is not solely a financial cost but a governance time cost. More time will need to be allocated to TCFD both initially and on an ongoing basis." **Association of Professional Pension Trustees**

5. One respondent also noted that the additional costs around any independent assurance process that some schemes might decide to undertake, are not accounted for despite not being inconsiderable.
6. Two respondents recognised that our decision to require a proportionate approach considering costs and clarifying that trustees should adopt reasonable steps, “as far as they are able”, is helpful and should limit cost burdens.
7. A number of respondents also highlighted that the benefits of effectively managing climate risk mean the costs and regulatory burdens are justified and even outweighed.

Government response

8. Other than the figures quoted in paragraph 2 above, which are accounted for within the range of the sensitivity analysis included in our impact assessment, no new quantitative cost assessments of any of our proposals were offered. We have therefore made no material changes to our cost estimations.
9. Whilst we acknowledge that in the first year of complying with the new Regulations additional governance capacity may potentially need to be allocated to climate risk, we continue to believe that trustees adhering to their fiduciary duty should already have effective systems of governance, strategy and risk management of all financially-material risks, including climate change. Therefore – for the purposes of the impact assessment and calculating new burdens – putting trustee duties insofar as they apply to climate change on a statutory footing is already accounted for in the baseline. The costs of familiarisation with the Regulations and Statutory Guidance themselves are reflected in the impact assessment.
10. We do not deny that trustees who choose to obtain independent assurance of their disclosures would incur additional costs. However, this would be a voluntary choice by the trustee and is not a mandatory requirement under our proposals and is therefore not accounted for in the impact assessment.
11. We will continue to work with pension schemes and businesses as we implement these new requirements to understand and where appropriate minimise the administrative burdens of compliance. This will be a consideration in our planned policy review in 2023.

Annex 1: List of respondents

Association of British Insurers
Aegon
Aon
Association of Pension Lawyers
Association of Consulting Actuaries
Association of Professional Pension Trustees
AXA Investment Managers
Barnett Waddingham
Brunel Pension Partnership
Cardano
CFA UK
Client Earth
Climate Disclosure Standards Board
Cushon
Deloitte
Electricity Supply Pension Scheme
Eversheds Sutherland
EY
Federated Hermes
GNEISS Energy
Gowling WLG
Herbert Smith Freehills
HSBC Bank Pension Trust
Hymans Robertson
ICI Pension Fund
Institutional Investors Group on Climate Change
Institute and Faculty of Actuaries
Investment Association
Investment Consultants Sustainability Working Group
Lane Clark & Peacock (LCP)
Law Debenture Pension Trust Corporation
LGPS Central
Lincoln Pensions
Lothian Pension Fund
Make My Money Matter
Mercer
NatWest Group Pension Fund
Nest
Pensions Management Institute
Pinsent Masons
Pensions and Lifetime Savings Association
Principles for Responsible Investment
RBS Investment Executive
Redington
Russell Investments
Scottish Widows
Share Action
Shell Pensions Trust
Smart Pension
Society of Pension Professionals
Travers Smith
Trade Union Congress
UK Sustainable Investment and Finance Association
West Midlands Pension Fund
Willis Towers Watson