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Climate Governance and Environmental Social
Governance (ESG) team

By email: pensions.governance@dwp.gov.uk

Date: 9 March 2021

Your ref: Second climate change consultation

Our ref: MUMGAAK\009000-009001

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Dear Sirs

Response to January 2021 consultation on taking action on climate risk: improving governance and reporting by occupational pension schemes

This letter sets out Eversheds Sutherland's comments on the above consultation which was issued on 27 January 2021.

Introduction

We have one of the largest teams of pensions lawyers in the UK, with over 65 specialist pension lawyers. Our clients include employers, trustees of a number of the UK's largest public and private sector occupational pension schemes and some of the country's leading master trusts, insurance companies and pension providers.

Our response represents our own views on the consultation and not those of our individual clients (unless expressly stated otherwise). However, in forming our views we have taken account of our clients' interests and concerns as well as considering the potential impact of any changes on individuals, society and the wider pensions industry.

Comments on questions raised in consultation paper

Qu1: Scope and timing

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

We have no comments on the policy intentions behind these proposals. 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).

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

The definition of "relevant contract of insurance" in the draft regulation 2(11)(i) appears to be drafted unintentionally narrowly and may give rise to issues in practice. The definition refers to contracts which "*are intended in all circumstances to fully meet the costs of specified benefits*" – we think the references to "*all circumstances*" and "*fully meet the costs*" may exclude policies which contain exclusions for certain costs or risks or intentionally exclude a particular benefit (eg an unusual discretionary benefit). We suggest referring to "*are intended to meet the costs of specified benefits*" instead.

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Rather than repeat definitions at the end of each regulation, it would be more helpful if they were included in a regulation at the beginning (and more consistent with the general style of drafting in pensions regulations).

We note the policy intent that once a scheme is in scope, in the first year it will need to comply with the relevant requirements from 1 October. This is reflected in the wording of draft Regulation 2. However, Regulation 3 requires a report in respect of a relevant scheme year. It is not clear from these two provisions 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. Otherwise the timing pressures will be accelerated even further since schemes will need to be compliant by the start of the scheme year in which the relevant 1 October falls.

Qu 2: Trustee knowledge and understanding - *Do you have any comments on the draft regulations or the guidance?*

We would suggest that the provisions in the guidance on the level of knowledge that individual trustees should have in relation to climate change issues should refer only to a "basic" level of understanding of the relevant principles relating to climate change. This would reflect the current guidance in the Pensions Regulator's (the "**Regulator's**") scope document to understand the basic principles relating to investment. In reality, complex issues around climate change are likely to be delegated to a sub-committee or working group and other trustees only need to understand sufficient to ensure that the delegation is made and the delegates are complying with their obligations.

We would also observe that it is not likely to be straightforward for trustees to obtain this knowledge and it would be useful if more specific guidance could be made available from the Regulator on the issues relevant to meeting this standard (although we note that more detailed guidance has been produced by the Pensions Climate Risk Industry Group and that trustees will not require "a mastery of technical detail").

It may also be worth considering what the appropriate requirements are in sectionalised schemes which are set up on the basis of an umbrella trust and separate sub-trusts (with their own trustees) for each section. In our experience, the umbrella trustees often have a very small role and the section trustees determine issues such as investment strategy. In this context, the level of knowledge actually required by the umbrella scheme trustees is minimal. However, we note that it is clear from the consultation paper that in such circumstances, the intention is that all of the compliance obligations rest with the scheme trustees. (We have further comments in relation to this type of scheme in Qu. 12 below).

We assume that the Regulator's scope documents will be updated to reflect the new requirements when it conducts its anticipated review of the existing TKU Code of Practice.

Qu 3: Governance - *do you have any comments on the draft regulations or draft statutory guidance?*

In paragraph 1 of the Schedule to the Regulations it would be helpful if it could be clarified that the climate change risks and opportunities referred to are those determined by the trustees as being relevant to the scheme.

Could the requirements in paragraph 2(b) of the Schedule relating to professional advisers and the climate change responsibilities for those advising on governance be limited to those advising on investment related governance issues? A large number of governance related issues (eg cyber security) should not engage any climate change related considerations.

We note that the guidance says that the TCFD report is aimed at members, the Regulator and the pensions sector generally. It is our experience that documents that are not clearly aimed at a particular target audience often fail to communicate information well to any of the intended

readers. Therefore, it would be helpful if the intended audience for the report was more clearly identified

We appreciate that the guidance addresses this to some extent by recommending that schemes should produce a plain English summary "*which is for members to read and allows them to become easily acquainted with the key findings from the report*". In our view, few if any members are likely to want to engage with this level of detail and those who do will want more information than an overview. We would therefore question whether such a summary actually serves any useful purpose. Members might be better served with a simple confirmation from schemes that they are meeting their climate change obligations.

Qu 4: Strategy - do you have any comments on the draft regulations or draft statutory guidance?

We welcome the qualification of many requirements by reference to "how far the trustees are able" and agree that this will go some way towards meeting the concerns around the availability of information and expertise.

Paragraph 37 of the guidance says that all asset types are in scope, at least as far as trustees "are able" to consider them. 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.

The Consultation Paper suggests (para 21-23) that the guidance will provide more clarity for trustees on what is meant by short, medium and long term. This is provided in paragraphs 38 onwards of the guidance. We still think that greater clarity is required as the guidance simply directs trustees to a small number of issues that they should consider. We do however support the lack of prescription.

Qu 5: Scenario Analysis

In general, we think that trustees will find this part of the new requirements particularly difficult to implement. We think that the guidance currently starts at too high a level and assumes a degree of familiarity with the concepts that trustees will simply not initially have.

We remain unclear why trustees will need to focus on the impact of climate change on scheme liabilities. In our view, appropriate actuarial assumptions are something which is wholly outside of the international climate change agenda. Taking into account climate change in relation to liabilities will not drive significant change and potentially elevates climate change above the range of other considerations that are relevant in this context.

Qu 6: Risk Management - do you have any comments on the draft regulations or draft statutory guidance?

We have no comments on these provisions.

Qu 7: Metrics - do you have any comments on the draft regulations or draft statutory guidance?

Trustees' ability to comply with these requirements will depend entirely on their ability to access appropriate third party advice. We note that assessing the metrics is qualified by reference to how far the trustees are able to do so. However, in the absence of the availability of appropriate advice (which may be difficult to source in the early stages of these new obligations), they will have difficulties in even setting the relevant metrics. It would be helpful if the Regulator would have regard to this in assessing any penalties.

Qu 8: Targets - do you have any comments on the draft regulations or draft statutory guidance?

We welcome the change to annual monitoring against targets.

Qu 9: Disclosure - do you have any comments on the draft regulations or draft statutory guidance?

We have no comments on these provisions.

Qu 10: Penalties - do you have any comments on the draft regulations or draft statutory guidance?

We would query why there are automatic penalties for failure to produce a TCFD report at all. The Regulator successfully operates a discretionary penalties regime in relation to other areas of non-compliance and it would seem more consistent for this penalty to operate in the same way.

We note that the Regulator has said that intends to engage with the industry on climate change this year. Any guidance should deal not only with its expectations around governance and risk management but also with the circumstances in which it will exercise its powers to impose penalties.

Qu11: Impacts

We cannot comment in detail on this but remain of the view that these requirements represent an extremely onerous obligation for schemes and will potentially be costly to comply with.

Qu 12: Any other comments

Whilst we appreciate that this consultation was not dealing with policy issues, as we mentioned above, we have some concerns about how the new requirements are intended to operate in sectionalised schemes where the assets are not held and controlled centrally but by the trustees of each section and the scheme trustee is only a bare trustee or has very limited responsibilities.

We would question whether it is appropriate to impose the climate change requirements in relation to the scheme as a whole in these circumstances. It would impose significant additional administrative costs and compliance requirements in relation to sections which may actually be quite small. It would also impose obligations on the bare trustee where in fact they have no powers in relation to the investment of scheme assets. Finally, as this structure is actually used for DB consolidation, it could act as a bar to the consolidation of small DB schemes as it would dramatically increase administration costs in such schemes. In consequence, we would urge the Government to consider further how such schemes should be treated in relation to the application of the climate change obligations.

Finally, we have a couple of small points on formatting:

- We think that there may be a mistake in para 126 of the guidance and that it should refer to "each DB section and popular DC default arrangement".
- After paragraph 64, "Information from asset managers" should be a bold heading.

* * *

If you have any queries in relation to any of the points raised in this letter, please contact Karen Mumgaard at karenmumgaard@eversheds-sutherland.com.

Yours faithfully

Eversheds Sutherland (International) LLP