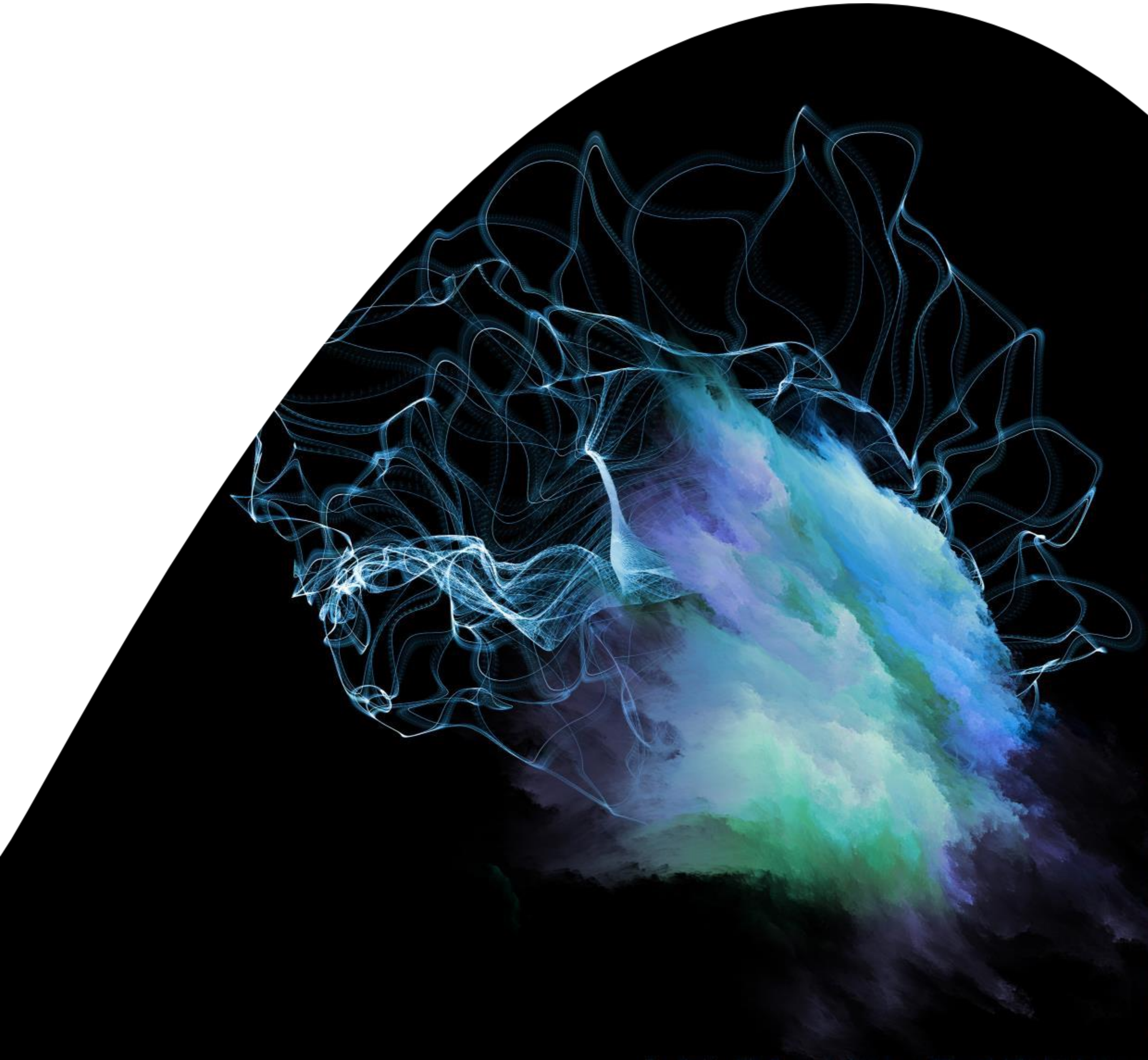
Pinsent Masons

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

January 2021 consultation on regulations



Pinsent Masons LLP
30 Crown Place
London
EC2A 4ES

To: Emma Walmsley, Tom Rhodes, Andrew Blair, and David Farrar
Climate Change and Responsible Investment Team

Email: pensions.governance@dwp.gov.uk

10 March 2021

Introduction to Pinsent Masons LLP

Pinsent Masons LLP is an international law firm. We have one of the strongest pensions teams in the UK. Spanning our UK offices, the team has around 80 specialist lawyers, paralegals and independent trustee administrators dealing with pensions. We are dedicated to providing clear, practical, cost-effective advice for our clients. We advise trustees, sponsoring employers and providers on the full range of pensions issues. We have considerable experience in advising trustees on investment matters, including strategies dealing with the financial risks of climate change.

Our response

We are very supportive of what the government is trying to achieve and of its approach. We believe that the proposed regulations and statutory guidance will help trustees navigate the risks of climate change by providing them with some real focus and support - and that, in turn, will empower them to drive the further development of the data and tools needed for trustee decision-making.

We have not felt the need to address the consultation questions individually, since we are largely in agreement with what is proposed. Instead, we have focused on a few specific points, but we have indicated which of your consultation questions our points relate to:

Question 1 - Scope and Timing

Do you have comments on the proposals to change the "reference date" used for the purposes of determining whether a scheme is in scope, or the arrangements made for schemes which obtain their audited accounts later than 1 October 2021, or 1 October 2022? Do you have comments on the draft regulations on scope and timing? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter.

In our view, it is potentially confusing to legislate for compliance with the climate governance requirements from 1 October 2021 (or 1 October 2022 for schemes in excess of £1bn+ assets) or if later, the date on which the trustees obtain audited accounts in relation to that scheme year end date. It is unclear why compliance should be tied in with the approval of audited accounts since compliance with the climate governance requirements is essentially an internal audit function that forms the basis for producing the TCFD report.

A newly-authorised scheme with zero assets that is open to multiple employers is required to implement and report on effective governance of climate change risk. Although such a scheme should have robust and appropriate governance processes in place, we believe that compliance should be on a "comply or explain" basis, particularly in relation to producing a TCFD report. Unless and until employers on-board into these trusts, trustees are unable to assess the materiality of climate change risk in relation to assets under management or establish a proportionate approach to compliance. It is impossible for trustees to set meaningful and appropriate default arrangements without first assessing the size and demographic of the scheme's membership.

Question 2 - Trustee knowledge and understanding

a). Do you have any comments on the draft regulations on trustee knowledge and understanding? b). Do you have any comments on the draft guidance? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter

Page 18 of the statutory guidance urges trustees to identify skills gaps amongst external advisers and to encourage those advisers to undertake training. This seems unrealistic – we would not expect any external advisers to admit to skills gaps, which could reflect on their competency and undermine contractual relationships with the trustees.

Question 3 - Governance

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

Under paragraph 2 of the schedule to the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, trustees must have processes in place to ensure that any person who "undertakes governance activities" or who "advises or assists the trustees with respect to governance activities" takes adequate steps to identify, assess and manage climate-related risks and opportunities. "Governance activities" is not defined. Without a definition, trustees would need to ensure that anybody who undertakes any form of delegated trustee function needs to be able to identify and assess climate change risk. This is wholly impractical for a large occupational pension scheme and trustee-led business which has several hundred (sometimes thousand) people carrying out scheme functions, spanning services outside the remit of scheme investment, eg scheme secretariat, administration, diversity training, communications and HR. We therefore recommend that "governance activities" be defined so that they are limited to activities that relate to the management of climate-related risks and opportunities. Paragraph 11 of the draft statutory guidance is not enough to achieve this. The definition should be included in the regulations.

Question 4 - Strategy

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

As far as strategy activities (including scenario analysis) are concerned, sections 16-22 of Part 2 of the statutory guidance states that trustees of DC schemes should assess climate risk and opportunities for each “popular default fund” and for a DB scheme with more than one section, trustees should look at the level of each section. However, trustees of DB schemes may group their assessment of sections with similar characteristics in relation to assets, liabilities and funding.

In our view, trustees of DC schemes should be given similar flexibility to group default funds that have similar asset allocation and membership profile into one assessment. This is particularly important for DC master trusts whose structure is based on all funds being default arrangements, and this would serve to limit the granularity of assessment to enable trustees to adopt a reasonable and proportionate approach. For DC schemes, there is the additional complexity of needing to assess climate risk and opportunities across each stage of a default arrangement (given the different asset allocations as members approach retirement), which adds further complexity and granularity of assessment. It would also be useful if the DWP clarified that by “default funds”, it means a “default arrangement” – ie. a fund or group of funds for members who have not allocated a choice, to avoid any misconception that trustees need to assess each underlying fund within a default arrangement.

In addition, ''section'' is not defined. The assumption is that "section" means a section of a sectionalised scheme - but schemes that are not formally sectionalised can have different sections for different categories of members. Since the statutory guidance requires analysis at section level, there needs to be clarity around the meaning of ''section'' (incidentally, it's not very helpful for ''section'' to be in quotation marks in the guidance). Further, the guidance should make it clear that it is for the trustees to decide whether sections can be grouped together.

In paragraph 92 of the statutory guidance, you refer to the Pensions Regulator's IRM guidance. This is helpful. It would also be helpful to refer to the Regulator's guidance on "Assessing and monitoring the employer covenant" in paragraph 49.

Question 5 - Scenario Analysis

a). Do you have any comments on the provisions on scenario analysis in the draft regulations? b) Do you have any comments on the proposal that relevant contracts of insurance are within scope for scenario analysis? c) Do you have any comments on the draft statutory guidance on scenario analysis? Please include in your answer any comments on whether you consider that they meet the policy intent stated in this chapter

Under the draft regulations, trustees are required to carry out their scenario analysis in the first scheme year in respect of which the requirements apply in accordance with regulation 2 (the threshold requirements for climate governance). That regulation applies on the first scheme year end date which falls on or after 1 March 2020, whereas the climate governance requirements apply from 1 October 2021 or if audited accounts are produced later, the scheme year end. Trustees therefore need to carry out scenario analysis by the end of the scheme year underway on 1 October 2021. In our view, this drafting needs to be revisited and clarified. For those schemes already carrying out scenario analysis and TCFD reporting, it would also be useful to know how recent the scenario analysis needs to be.

Question 6 - Risk Management

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

Paragraph 102 of the statutory guidance says that trustees ''may'' include information on how their stewardship approach has helped them manage climate-related risks and opportunities. This reference is in response to the consultation – see, for example, page 85 of the consultation response. In our view, stewardship is part of the management of transitional and physical risks and, therefore, is something that scheme ''should'' implement under para 101. If the contrary is intended, paragraph 101 needs to be amended to clarify that management, for these purposes, does not include stewardship activities.

Question 12 - Any other comments

Do you have any other comments you would like to raise?

There is a risk of a potential disconnect between what trustees will require from their asset managers to meet the TCFD reporting requirements and what those managers are obliged, or indeed able to disclose to trustees under FCA rules or legislation.

We still await new FCA rules for asset managers covering TCFD. These rules will be of fundamental importance if pension scheme trustees are to comply with the new requirements. The delay in these rules is concerning. The requirements for trustees need to be reflected in the disclosure obligations of asset managers and their investee companies.

Please contact Carolyn Saunders (carolyn.saunders@pinsentmasons.com) if you have any questions about this response.