

The Department for Work and Pensions

By email to: pensions.governance@dw.gov.uk

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06 October 2020

Dear Sir / Madam,

The Department for Work and Pensions' ("DWP") consultation on Taking action on climate risk: improving governance and reporting by occupational pension schemes (the "Consultation")

Lincoln Pensions Limited ("Lincoln Pensions" or "we"), the leading specialist provider of employer covenant advice to sponsors and trustees of UK defined benefit ("DB") pension schemes, is pleased to respond to the Consultation which was issued by the DWP in August 2020.

About Lincoln Pensions

Our clients are responsible for around £200bn of scheme assets in aggregate, including some of the largest DB pension funds in the UK and many with material exposure to climate change risks. We advise clients on all aspects of employer covenant and are part of the Cardano Group, the purpose-built investment and risk specialist, operating in the UK and the Netherlands. This submission is made by Lincoln Pensions. Cardano Risk Management Limited has provided a separate response.

We welcome the DWP's recognition of the significance of climate risk to DB pension schemes, noting that failure by trustees to understand and respond to these risks could mean that members do not receive their promised benefits. We are already working with a number of our trustee clients to help them better understand the impact of climate change on their scheme's covenant (including through stress testing) and advising them on appropriate actions to help respond to this risk.

We confirm that you may publicly acknowledge our response to the Consultation.

Our response to the Consultation

We have not responded to the questions raised in the Consultation as they largely relate to pension investments and so are not directly relevant to our experience.

This is our core objection to the Consultation: other than a passing reference to the employer covenant (Chapter 3, clause 52) there is little focus on the need for DB pension trustees (recognising that the scope of the Consultation goes beyond only DB pension schemes) to understand the potential impact of climate change on the employer covenant provided by the sponsor.

In its consultation on 'Security and Sustainability in Defined Benefit Pension Schemes', DWP noted:

*"The strength of the employer covenant is an important element in scheme funding and a key part of the risk assessment process."*¹

The employer covenant is every DB pension scheme's most material single asset and brings significant idiosyncratic risks to each scheme (including in relation to climate change). As at 31 March 2019, it was estimated² that the average funding level of all UK private sector DB pension schemes was c.77%. This means that the employer covenant is currently standing behind at least 23% of all DB pension scheme obligations. This is likely an order of magnitude high than any one scheme investment.

Although trustees can do little to directly remove climate change risks facing their sponsor, they are able to seek additional funding for protection against them and to manage their other risks commensurately, as long as the risks to the sponsor are understood.

For example, where trustees identify that climate change (both its direct and indirect impacts) is a material risk to the covenant, we would typically expect them to be more prudent in their approach to funding and investment, to ensure that correlated risks are minimised and full funding achieved in an appropriate timeline. Where the climate risk is so significant that it could ultimately risk the viability of the sponsor, trustees should consider targeting an insurance buyout over time to remove remaining reliance on the sponsor before that point.

Given the materiality of both DB pension schemes' continuing reliance on their sponsors and the climate change risks they face, it is essential that trustees act now to understand the possible impact of climate change on their covenant and what actions they should be taking in response.

Therefore, in terms of the Consultation's specific questions 4 to 7, **we believe that it is essential that the proposals are extended to specifically require trustees of in scope DB pension schemes to also understand the impact of climate change on the employer covenant.**

Understanding the impact on invested assets alone will ignore a material risk for DB scheme members.

We hope our comments are helpful and we would be pleased to discuss our response with the DWP.

Yours faithfully,



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¹ Department for Work and Pensions, 'Security and Sustainability in Defined Benefit Pension Schemes', February 2017

² The Pension Protection Fund, 'The Purple Book 2019', published January 2020