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Briefing note

Climate risk: The Government has responded to their consultation on the Taskforce on Climate-related Financial Disclosures ("TCFD") reporting and governance requirements

As a reminder:

- TCFD is a framework for managing and reporting climate-related risks and opportunities;
- The Government is consulting on draft regulations for mandatory TCFD reporting and compliance with climate governance requirements for pension schemes with assets of £1bn or more;
- Master Trusts and Collective Defined Contribution schemes also fall within the scope of the proposals. Consideration is also expected to be given to the requirements for LGPS funds by the Ministry of Housing, Communities and Local Government ("MHCLG");
- Governance requirements would commence on 1 October 2021 for schemes with at least £5bn of assets and on 1 October 2022 for schemes with at least £1bn of assets;
- Schemes will be required to submit their first TCFD report within seven months of their scheme year ending after 1 October 2021 (2022 for £1-5bn schemes) but no later than 31 December 2022 (2023);
- The proposals address requirements for scenario analyses and use of metrics and targets.
- Pension schemes will need to publish their TCFD reports online.

The DWP has published its response to the consultation on mandatory TCFD reporting for pension schemes and also published draft regulations for consultation over the period to 10 March 2021. The DWP has also published the updated guidance from the Pensions Climate Risk Industry Group ("PCRIG") alongside this, including a competency framework for investment consultants.

Background

In August 2020, the UK Government set out its intention to make reporting against the framework set out by the Taskforce for Climate related Financial Disclosures ("TCFD") compulsory for larger pension schemes over coming years alongside the need to meet certain governance requirements. Having consulted on these proposals, the DWP's response to the consultation was published on 27 January 2021, with a number of clarifications on their initial proposals as well as draft regulatory guidance.

Headlines from their response

The headline is that the DWP expects larger schemes (and in due course, the vast majority of pension schemes and indeed companies) to report in alignment with the TCFD recommendations.

The TCFD framework covers four key pillars that we have written about previously:

- Governance
- Strategy
- Risk Management
- Metrics and targets

There is no change to the broad thrust of the proposals by the DWP with respect to the requirements for schemes to report in line with the TCFD recommendations. The proposed legislation impacts how and when schemes implement their alignment with the TCFD recommendations, but the requirements remain largely consistent with initial proposals.

Schemes will be required to embed climate-related issues into their governance processes and report on this within their annual, public disclosures.

A notable change to initial proposals comes in the form of scenario analysis giving some flexibility to trustees on how often they carry out scenario analysis. Whilst the initial requirement to complete scenario analysis in the first year remains, thereafter trustees will only be **required** to do this every three years. They will however need to review annually whether to refresh the scenario analysis and either carry out the analysis or explain why they have chosen not to.

There have also been changes in metrics requirements; it is proposed a minimum of two emissions-based metrics (one an absolute measure of emissions, one an intensity-based measure of emissions), as well as one additional climate-related metric, needs disclosed. Guidance on metrics will be available.

Trustees still need to set at least one climate-related target. The frequency for measuring climate metrics has been reduced from quarterly to annually and performance against targets also need only be measured annually. We are supportive of this change, which was an aspect we fed back on as part of the consultation. Targets will be non-binding.

Who is in scope?

The requirements will apply to:

- Pension schemes with assets of at least £5bn at the scheme year ending on or after 1 March 2020;
- Authorised master trusts; and
- Authorised schemes providing collective money purchase benefits.

The proposals will subsequently be extended to include pension schemes with assets of at least £1bn at the scheme year ending on or after 1 March 2021, this test being made annually thereafter to determine whether a scheme will fall in scope.

For sectionalised schemes, the asset threshold is intended to apply at an overall scheme level, rather than at section level, and the duties to be imposed under the regulations are on the trustees of the scheme, rather than any governance committee appointed to manage a particular section.

Relevant assets are the net assets of the scheme, excluding relevant contracts of insurance (bulk and individual annuity contracts). For assets to be disregarded for the purposes of the threshold test, they should meet the following requirements:

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

They also note that the assets represented by annuity contracts in DC schemes, where these secure the provision of a pension in payment (“a scheme pension”), should also be excluded, as long as:

- they are entered into with a PRA-regulated insurance company; and
- that company has full and ongoing discretion over the investment of the assets used to meet its liabilities to make payments.

Schemes fall out scope through no longer being authorised and/or having assets of less than £500m. Our view, however, is that schemes should resist any temptation to regress should their assets drop below £500m.

Requirements for schemes (Changes and clarifications to the original proposals are in bold)

TCFD area	Requirements
Governance	• Establish and maintain oversight of climate related risks and opportunities. • Establish and maintain processes that allow the trustees to satisfy themselves that those managing the scheme are assessing and managing climate related risks and opportunities. **"Those managing the scheme" has been clarified as those who undertake governance activities in relation to the scheme and those who advise or assist the trustees with respect to governance activities, excluding legal advisers.** • **Trustees who are subject to the requirements must have knowledge and understanding of the principles relating to the identification, assessment and management of risks to occupational pension schemes arising from the effects of climate change.**
Strategy	• Identify climate related risks and opportunities that will impact the investment and, for DB schemes, funding strategy of the scheme over different time horizons. • Assess the impact of identified risks and opportunities on the scheme's investment and, for DB schemes, funding strategy. • **Trustees will not be required to describe in their disclosures the climate-related risks and opportunities relevant to the scheme which are identified by persons other than the trustees.** • **Trustees must disclose their chosen time horizons.**
Scenario analysis	• Scenario analysis should be undertaken to assess the resilience of the scheme's assets, liabilities and investment and, for DB schemes, funding strategy to climate related risks in at least two scenarios (including one scenario that reflects an annual temperature rise of 1.5 to 2 degrees Celsius). • **Trustees must undertake scenario analysis in the first year and every three years thereafter. In other years they must review whether or not circumstances are such that they should refresh their analysis; or, if they decide not to, explain why.**
Risk management	• Adopt and maintain processes for identifying, assessing and managing climate-related risks. • Ensure the integration of climate-related risks into overall risk management.
Metrics	• **Trustees must select a minimum of two (increased from one) emissions-based metrics, one of which must be an absolute measure of emissions and one which must be an intensity-based measure of emissions.** • Trustees must also select one additional climate change metric to calculate in respect of the scheme's assets. Draft statutory guidance suggests a range of measures, including an implied temperature rise or climate value at risk measure. • Draft statutory guidance proposes that trustees should use total emissions and carbon footprint metrics – calculating scope 1, 2 and 3 greenhouse gas emissions. • **Trustees will be required, as far as they are able, to obtain the data required to calculate their chosen metrics on an annual basis – rather than quarterly.**
Targets	• **Trustees must set a non-binding target for the scheme in relation to at least one of the metrics which they have selected to calculate.** • **On an annual basis (this was previously proposed to be undertaken quarterly) 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.**

Disclosure requirements

A common TCFD report publication deadline will apply for all schemes in scope of seven months from their respective scheme year end, both during the phasing in, and on an ongoing basis.

Trustees are required to publish their TCFD report on a publicly available website, accessible free of charge. The Chair of trustees must sign the TCFD report, although the signature itself need not be published.

Scheme trustees will be required to inform members that the TCFD report has been published and where it can be viewed:

- via the annual benefit statement for DC schemes; and
- via the annual funding statement for DB schemes.

The TCFD report need not be included in the Annual Report – however, details of where it is published must be referred to.

Trustees must provide TPR with the website address where they have published their most recent TCFD report via the annual scheme return form. Trustees who have not yet produced their first TCFD report are required to inform TPR whether the period for doing so has ended in the scheme return.

Subject to the regulations coming into force, TPR has already committed to adding the question on location of the published SIP to the scheme return form and we would expect this to be included for DC schemes in 2021.

Penalties for non-compliance

A mandatory penalty is likely to be applied for complete failure to publish any TCFD report. Other penalties would be subject to TPR discretion.

Further consultations

There are further plans for the Government and other bodies to consult on various corresponding or relevant areas of the TCFD, as noted within the DWP's response. These include:

- The FCA plan to consult on TCFD-aligned rules for asset managers and for workplace personal pension schemes in the first half of 2021. Subject to that consultation, it is proposed that final rules will be published by the end of 2021 and come into force in 2022.
- MHCLG intends to consult this year on the implementation of mandatory TCFD-aligned reporting in the local government pension scheme (LGPS) by 2023.
- The DWP will take stock in 2023 and consult more widely again in 2024 before deciding whether to extend the regime to schemes with < £1bn in assets.
- They also intend to consult in due course on a requirement for authorised super funds to undertake climate change governance and reporting, irrespective of the value of assets under management, once there is a legislative "hook" by which they can be defined. Until then, superfunds are mandated to carry out TCFD once their relevant assets reach or exceed £1bn.
- The initial consultation included a section on Paris alignment and "implied temperature rise" (ITR), though it was made clear that the DWP was not formally consulting on proposals for trustees to calculate and report the ITR of their portfolios. A further consultation on this area may follow later in 2021.