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DWP plans for climate risk governance

The DWP has consulted on proposals to require pension schemes to have effective governance, strategy, risk management, and accompanying metrics and targets, for the assessment and management of climate risks and opportunities.

These proposals are initially intended to only apply to the very largest schemes, although with climate risk becoming ever more prominent in all areas of life, the direction of travel seems very clear.

The consultation closed on 7 October 2020.

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Background

The Task Force on Climate-related Financial Disclosures (TCFD) has developed voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. It published its recommendations in June 2017.

The TCFD's 11 recommendations are split into four different areas: governance, strategy, risk management, and metrics and targets. They are designed to be adoptable by all organisations, including both non-financial groups and the financial sector, from asset managers to asset owners, including banks, insurers and pension schemes. The recommendations are meant to act as a flexible framework for organisations to produce information on the financial impacts of climate change, which would accommodate continued rapid evolution in climate-related modelling, management and reporting.

The government has previously confirmed it expects all listed companies and large asset owners to disclose in line with the TCFD recommendations and that TCFD guidance would be developed for pension schemes. Draft non-statutory guidance was consulted on earlier this year and it is expected the final guidance will be published before the end of 2020.

The 11 TCFD recommendations

	Recommended disclosures
Governance (Disclosure of the organisation's governance around climate-related risks and opportunities.)	• Describe the board's oversight of climate-related risks and opportunities. • Describe management's role in assessing and managing climate-related risks and opportunities.
Strategy **(**Disclosure of the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.)	• Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term. • Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning. • Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.
Risk management (Disclosure of how the organisation identifies, assesses, and manages climate-related risks.)	• Describe the organisation's processes for identifying and assessing climate-related risks. • Describe the organisation's processes for managing climate-related risks. • Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.
Metrics and targets (Disclosure of the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.)	• Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process. • Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks. • Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

The Pension Schemes Bill

The government feels that it is now time to move towards mandatory TCFD-aligned disclosures, and the Pension Schemes Bill currently progressing through Parliament provides for regulations to:

- impose requirements on trustees to ensure that there is effective scheme governance concerning climate change;
- require information about the effects of climate change on the scheme to be published; and
- ensure compliance with these requirements.

These provisions are intended to allow governance processes and disclosures aligned with the TCFD recommendations to be mandated. The consultation is about when and how schemes should be required to adopt these enhanced governance requirements and report in line with the TCFD recommendations.

The government is clear that the measures will not, and cannot, be used to direct pension scheme investment.

The Pensions Minister has recently spoken of his expectation that the Bill will receive Royal Assent by the end of this year. It remains to be seen whether that timescale can be met, but it is expected that a further consultation on draft regulations to supplement the provisions in the Bill will follow shortly after it becomes law.

What is the DWP proposing?

Regulations are proposed that will require trustees to meet climate governance requirements which underpin the 11 recommendations of the TCFD, and to report on how they have done so. These will be underpinned by statutory guidance, which trustees must have regard to, setting out steps to meet and report on TCFD requirements.

Trustees of large schemes will be required to meet the minimum standards required by the regulations. While they can diverge from the statutory guidance, they would need to be able to explain their reasons for this.

The reason for targeting the largest pension schemes first is that they have the highest governance and resource capacity and will have greater capability to produce TCFD disclosures in the first instance.

Schemes with assets of more than £5bn[1], authorised master trusts and authorised collective money purchase schemes

Trustees of these schemes must publish a report setting out their compliance with the TCFD recommendations within seven months of the end the scheme year that starts on or after 1 October 2021 (or by 31 December 2022, if earlier) and then within seven months of the end of the next scheme year (or by 31 December 2023, if earlier).

The requirements would apply to authorised master trusts and schemes offering collective money purchase benefits from the point of authorisation and fall away from the point of de-authorisation.

Schemes with net assets of more than £1bn[2]

Trustees must publish a report setting out their compliance with the TCFD recommendations within seven months of the end the scheme year that starts on or after 1 October 2022 (or by 31 December 2023, if earlier). Pension schemes would remain in scope until assets fall below £500 million at scheme year end.

In both cases, a link to the TFCD report must be included in the trustees' annual report produced for the year in question.

The DWP is planning to take stock in 2024 and consult more widely again before extending to schemes with less than £1 billion in assets, taking account of both the quality of climate risk governance and associated disclosures carried out to date, and the current and future costs of compliance.

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[1] On the first scheme year to end after 1 June 2020

[2] On the first scheme year to end on or after 1 June 2021

Disclosure of information proposals

The TCFD report

It is proposed that schemes will have to publish their TCFD report either on their own website, or the website of the scheme's sponsor.

Further expectations on publication will be set out in statutory guidance, but it is anticipated that the rules will closely follow the framework currently existing for the online publication of schemes' statements of investment principles.

Member disclosure

It is expected that members will be informed of the TCFD reports via their annual benefit statement, along with details of how they can locate it. Defined benefit pension schemes are under no statutory requirement to automatically provide annual benefit statements and would only be required to add the link to the annual benefit statements of members who request a benefit statement.

Where schemes issue their annual benefit statement months in advance of their annual report, they would be required to direct members to the most recent TCFD report, or in the first year, the location where the TCFD report will be published in due course.

Pensions Regulator reporting

The DWP is proposing that trustees will be required to provide the Regulator with the web address of where they have published their TCFD report via the annual scheme return form. This requirement will also apply for the other documents which are required to be published on line, such as the statement of investment principles, implementation statement, and relevant excerpts of the chair's statement.

Proposed penalties

The DWP is proposing that a mandatory penalty should be imposed for the complete failure to publish a TCFD report, as currently applies to the production of a chair's statement. Other penalties would be subject to the Regulator's discretion.

Requirements to reference the TCFD report in the annual report and inform members about the TCFD report's availability would be subject to the existing penalty regime in the existing disclosure of information legislation – which would see maximum penalties of £5,000 for individual trustees and £50,000 for corporate trustees for non-compliance.

Buck comment

The issue of climate change risk is becoming a key concern for businesses and following the changes to trustees' statement of investment principles and the imminent introduction of implementation statements detailing the environmental, social and governance considerations of pension schemes, the government is clearly keen for trustees to focus more on how their consideration of climate risks can improve their scheme governance.

Trustees should familiarise themselves with the draft guidance published earlier this year on assessing, managing and reporting climate-related risks in line with the TCFD, which is expected to be finalised in the next few months.

While the DWP is proposing to stagger the introduction of the reporting on compliance with the TCFD requirements and has not set any date for schemes with assets of less than £1bn to comply, it seems unlikely that the proposed review of progress in 2024 will not coincide with the requirements being extended to smaller pension schemes.