News Alert 2020/03

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Climate guidance for trustees published

At a glance

Today the Department for Work and Pensions published for consultation draft guidance, along with a quick start guide, to help trustees evaluate the ways in which climate-related risks and opportunities may affect their schemes. The guidance – which was developed by an industry group – provides comprehensive suggestions covering scheme governance, strategy, risk management and disclosure. Whilst the guidance is non-statutory, it signals a further step-change in expectations of trustees in relation to climate change.

Key Actions

Trustees

- Read the draft quick start guide.
- If you have not already done so, undertake training on climate change and how it might affect your scheme, and clarify your investment beliefs in relation to climate change.
- Schedule time at forthcoming meetings to discuss climate change with your investment managers and advisers, and to review your approach to scheme governance, strategy, risk management and disclosure.

Scheme sponsors

- Ensure the trustees are taking appropriate action to understand and manage your scheme's exposure to climate-related risks, including managing the potential reputational risks of insufficient action.
- For DB schemes, include information on your organisation's approach to identifying and managing climate-related risks in covenant reporting to the trustees.

The Detail

The guidance has been produced by a Government-backed industry group

In its Green Finance Strategy published in July 2019 (see Pensions Bulletin 2019/27), the Government announced that the Pension Climate Risk Industry Group (PCRIG) would produce guidance for pension schemes on climate-related practices across governance, risk management, scenario analysis and disclosure. PCRIG is chaired by Stuart O'Brien of law firm Sackers and has 26 other members drawn from Government, the Pensions Regulator (TPR), pension schemes, advisers (including LCP's Claire Jones), investment managers, industry bodies and civil society organisations.

There has been a great deal of recent activity focussed on how pension schemes should respond to climate change. A swathe of new legislation and regulation has emerged, including new requirements for statements of investment principles, implementation statements, and updated TPR guidance. There is also the UK Stewardship Code 2020 and the 2018 governance regulations (which in turn await a Code of Practice from TPR).

The focus now switches back to the implementation of the Government's Green Finance Strategy. On 12 March 2020, PCRIG launched a consultation on its draft guidance, which runs until 2 July 2020. The main guidance is 104 pages long and makes use of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD – see LCP's briefing note for more information). It is accompanied by a short quick start guide. The intention is for the final version of the guidance to be published in the autumn.

There is a short quick start guide in addition to the main guidance

This development follows the Government tabling significant amendments to the Pension Schemes Bill on 11 February 2020, which will require occupational pension schemes to address climate change risks and opportunities and to publish climate-related information (see Pensions Bulletin 2020/06). Details will be set out in regulations and trustees will need to have regard to statutory guidance. The Government has indicated that it is likely to consult extensively this summer on the content and timing of these new requirements and will respond to the consultation within a year of its launch.

More formal requirements are expected fairly soon via the Pension Schemes Bill

Our viewpoint

PCRIG's draft guidance is timely, given the clear signs that policymakers, regulators and scheme members expect trustees to be taking climate change seriously and acting accordingly. Its comprehensive suggestions will help trustees to respond to these rapidly-increasing expectations.

We understand that the Pension Schemes Bill amendments are intended to give effect to the Government expectation, set out in the Green Finance Strategy, that large pension schemes will disclose in line with the TCFD recommendations by 2022. PCRIG's guidance supports this aim but goes beyond it by providing guidance to schemes of all sizes and by focusing on climate-related practices that schemes might adopt, not just what they should disclose.

Scope and structure of the guidance

PCRIG's guidance is intended for the trustees of occupational pension schemes, both defined benefit and defined contribution, of any size. It notes that all trustees have fiduciary duties to take account of financially material factors and to act prudently, and all

The guidance is aimed at DB and DC schemes of all sizes but the very smallest schemes have to specify and disclose their policies on climate change (see LCP's guide to responsible investment requirements).

The guidance provides a suggested framework for schemes to develop climate policies and integrate them into trustee decision-making. It also covers disclosure, but PCRIG suggests that trustees use the guidance to prioritise the adoption of robust governance procedures as a first step, with public disclosure as a second step.

The guidance provides a framework for developing climate policies and integrating them into trustee decision making

The guidance is in four parts:

- Part I provides introductory information on climate change as a financial risk to pension schemes, the legal requirements on pension trustees to consider climate-related risks and the TCFD recommendations.
- Part II sets out a suggested approach for the integration and disclosure of climate risk within the typical governance and decision-making processes of pension trustee boards. This approach is aligned with the TCFD recommendations.
- Part III contains technical details on recommended scenario analysis and climate-related metrics that trustees may wish to consider.
- We expect Part IV of the final version post-consultation to set out next steps.

Each chapter starts with a summary box and each chapter in Part II ends with a table of suggested trustee actions and recommended disclosures.

Our viewpoint

Whilst the length of the guidance may seem offputting, the quick start guide is much shorter and provides an accessible entry point for trustees. Once trustees are ready to consider climate action in more detail, the guidance provides comprehensive suggestions. Its summary boxes and tables of suggested actions will help trustees to pick out the information they need.

Content of the guidance

Part II of the guidance provides comprehensive suggestions for embedding climate-related risks and opportunities into pension scheme governance, strategy and risk management. This includes:

Part II covers governance, strategy and risk management in detail

- Defining climate-related investment beliefs, ensuring that trustees have enough understanding of climate change to do so.
- Formalising roles and responsibilities in relation to climate change for the trustee board, sub-committees and any executive staff.

- Considering climate-related risks in setting and reviewing investment strategy, with the help of scenario analysis.
- Determining how climate-related risks are incorporated into investment portfolios.
- Identifying ways of reducing exposure to climate-related risks and investing in climate-related opportunities when developing investment mandates and selecting pooled funds.
- Factoring climate change considerations into manager selection and monitoring.
- Undertaking stewardship on climate issues or overseeing managers' stewardship activities in this area.
- Reporting in line with the TCFD recommendations and communicating with members about climate change.
- For DB schemes, considering the implications of climate change for the sponsor covenant and integrated risk management.

Part III provides more detailed information about using scenario analysis to assess the resilience of the pension scheme to different climate-related scenarios. It recommends that trustees consider three scenarios: orderly transition (keeping within 2ºC or lower); abrupt transition (keeping within 2ºC or lower); and no transition (a pathway to 4ºC or higher). It suggests that trustees ask their asset managers, consultants or a third party provider to carry out the analysis or do it themselves using free-to-use tools.

Part III has more technical information on scenario analysis and metrics

Part III also suggests metrics that trustees can use to monitor and report on climate change, covering both outcomes (such as their portfolios' greenhouse gas emissions and investment in low carbon opportunities) and processes (such as scheme governance, voting and engagement). It also covers target-setting for schemes to improve their climate exposures and processes over time.

Next steps

A good starting place for trustees who want to get ahead are the five areas set out in the quick start guide:

- Set your climate-related investment beliefs.
- Consider climate risks in setting investment strategies, reviewing and reporting.
- Clarify how stewardship fits into your investment strategy and how it helps you meet your climate-related objectives.
- (Defined benefit trustees) consider how climate risk impacts employer covenant and funding as well as investment strategy through integrated risk management.
- Consider the best method to report disclosures and communicate with members.

Our viewpoint

PCRIG's suggestions go far beyond the current practices of most pension schemes. Whilst the guidance is non-mandatory and subject to consultation, more formal requirements in this area seem inevitable. Trustees should consider what actions they are going to take, particularly "large" schemes (not yet defined) which are expected to report in line with the TCFD recommendations by 2022.

Trustees should review their climate change approach in light of the draft guidance

LCP can help trustees with the areas covered by PCRIG's guidance. We will be developing our services further in light of the guidance, including streamlined approaches for reporting on portfolios' climate-related exposures and carrying out climate scenario analysis (covering all asset classes and, for DB schemes, liability impacts). We are also working with an investment manager on the design of a new low-carbon passive equity fund, to be launched mid-2020, that we believe meets trustees' needs better than the pooled funds that currently exist.

It seems likely that pension schemes' approach to climate change will be subject to scrutiny, not only by TPR, but also by members and civil society organisations that are concerned about climate change. Trustees and sponsoring employers should be mindful of the reputational risks of being seen as laggards in this area. Schemes should take particular care when publishing information about their climate approach, for example in their Statement of Investment Principles and associated implementation statements.

Schemes should be mindful of the reputational risks of being seen as climate laggards

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Lane Clark & Peacock LLP
London, UK
Tel: +44 (0)20 7439 2266
enquiries@lcp.uk.com

Lane Clark & Peacock LLP
Winchester, UK
Tel: +44 (0)1962 870060
enquiries@lcp.uk.com

Lane Clark & Peacock Ireland Limited
Dublin, Ireland
Tel: +353 (0)1 614 43 93
enquiries@lcpireland.com

Lane Clark & Peacock Netherlands B.V. (operating under licence)
Utrecht, Netherlands
Tel: +31 (0)30 256 76 30
info@lcpnl.com

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