

Briefing

Climate change: the time to act is now

RISK | PENSIONS | **INVESTMENT** | INSURANCE



This is a pivotal moment as climate-aligned investment takes centre stage in company pensions. As the government consults on measures embedding climate change into pensions law, we take a look at what's coming next for schemes.

What's coming (and what we reckon)

Taking a look at the Department for Work and Pensions (DWP) consultation published at the end of August 2020, we can see what's coming next for governance and sustainability in UK pensions. Covid-19 and the UK lockdown had enormous repercussions that will be felt across the economy for years to come. But despite early optimism around plummeting carbon emissions, the impact on our climate has been minimal.

To build back better and greener in the long-term and establish an economy that is more resilient, fairer and low carbon, improving quality of life and rebuilding livelihoods, climate change considerations need to be bedded into pension scheme governance.

Under the new proposals, trustees will have to understand and assess how their pension scheme is contributing to climate change, how exposed it is to climate risks, and make decisions based on these considerations. They will need to calculate the 'carbon footprint' of their pension scheme.

Trustees must have effective governance, strategy, risk management, and accompanying metrics and targets for the assessment and management of climate risks and opportunities from October 2021, and to report on these in line with the Task Force on Climate-related Financial Disclosures (TCFD's) recommendations by the end of 2022. They'll need to assess how the value of the schemes' assets (and liabilities) would be affected by different temperature rise scenarios.

Mandatory reporting is proposed for schemes over £5bn and authorised schemes like DC master trusts first of all. It will then be extended a year later to >£1bn schemes and authorised schemes like DC master trusts (with a review in 2023 to look at extending the requirements to other schemes and avoid creating a cohort of members who don't benefit from the changes).

This will all be disclosed publicly, providing increased transparency for members who previously might have been in the dark about how their contributions were impacting the planet.

We can expect civil society to take an interest too. Members along with activist groups and charities may look to hold trustees to account when they can see exactly how their pension is being managed and how much it is contributing to the rise in global temperature.

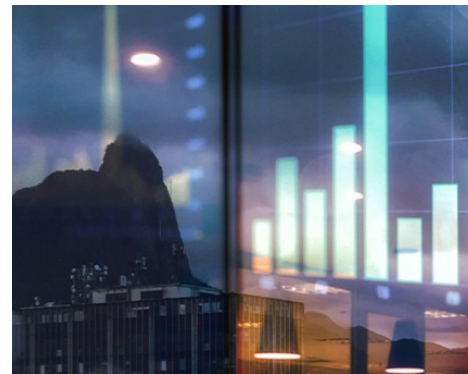
Given that defined contribution (DC) master trusts are where smaller DC schemes go to consolidate, especially where trustees struggle to meet increasing governance requirements, there's a good argument master trusts should be doing this earlier rather than later. Certainly market leaders in ESG are already adopting these ideas.

These coming requirements should improve trustee investment governance, along with the sustainability of pension schemes as the UK seeks to meet its Paris Agreement targets.

Achieving Net Zero by 2050 is already law in the UK. Right now is an opportunity for trustees to get a head start managing the risks as well as taking advantage of the opportunities stemming from climate change and the transition to a low carbon economy, shifting capital and changing behaviours.

This should have an impact on outcomes. Better informed trustees can better manage exposure to climate change risks, and be in a better position to take advantage of investment opportunities that emerge during the transition to a low carbon economy. And the proposals could also increase engagement with pension savings.

Instead of being a theoretical pot or pension sometime in the future, communications about the impact members' money is having today can be more interesting. Campaigns like 'Make My Money Matter' are gaining momentum and more members will be asking how their money is building the sort of world they want to retire into.



As the UK moves to Net Zero, can your portfolio perform under the changing economic conditions that will result?

For more info, see our briefing note on climate change and the actions you can take [here](#)

As for compliance, TPR will be overseeing implementation, with penalties required where no TCFD report is forthcoming and discretion for the regulator to act in other situations.

Managing the transition to Net Zero

Since the UK parliament declared a climate emergency in May 2019 and became the first major economy in the world to pass laws to end its contribution to global warming by 2050, it's been clear major change is coming in the way we look at climate change across the whole economy, including for pension investments.

In the Green Finance Strategy, the government set out plans to require reporting on climate change beginning with the largest companies and pension schemes. And now we have the DWP's policy proposals.

With powers in the Pension Schemes Bill currently going through parliament, the proposals in the consultation spell out where things are headed for trustees. While these changes focus on the largest pension schemes, we can clearly see the direction of travel for investment governance.

These proposals, with a focus on climate change and the transition to a low carbon economy, build on existing investment governance and risk management requirements and practices while bedding in the TCFD recommendations for pension schemes.

TCFD CORE ELEMENTS



Source: www.tcfdhub.org/recommendations/

TCFD is a framework to help companies and investors consistently measure, manage, and report their climate-related risk exposures. The recommendations are for everyone to use in their financial reporting – public and private companies, asset managers, insurers and asset owners, including pension schemes.

TCFD covers governance, risk and strategy, all areas familiar to pension trustees, along with scenario analysis and metrics. These are the developing areas those running schemes need to adopt to help them manage the transition to a low carbon economy, undertaking effective stewardship through collaboration and engagement with their investments.

With a range of potential climate scenarios and highly complex impacts reaching far into the future, few trustees will have developed concrete plans to quantify and address the risks of climate change or capitalise on the opportunities of the transition to Net Zero.

The process of carrying out TCFD reporting, should lead to better-informed decision-making on climate risks, while improved transparency should improve accountability and provide decision-useful information to investors and ultimately, beneficiaries.

The process will help trustees evaluate the way in which climate-related risks and opportunities may affect their strategies, empowering them to adapt and respond.

What will trustees need to do?

>£5bn* and authorised schemes; e.g. DC master trusts and collective DC schemes. Must have governance in place by **October 2021** and report within seven months of scheme year-end date.

>£1bn* must have governance in place by **October 2022** and report within seven months of scheme year-end date.

Other schemes will be phased in following a review in the second half of **2023**.

Schemes' assets at the reference date of **1 March 2020** determine whether they are in scope for **2021**. Once the requirements apply, schemes fall out of scope only when assets are below £500m.

* Excluding bulk and individual annuity contracts



Governance

- Appropriate degree of knowledge and understanding of the principles relating to the identification, assessment and management of climate change risks and opportunities
- Effective oversight of climate-related risks and opportunities
- Describe the role of trustees and others assessing and managing climate-related risks and opportunities
- Ensure those who undertake governance activities in relation to the scheme and those who advise or assist the trustees with respect to governance activities – otherwise than as a legal adviser – are taking adequate steps to identify, assess and, where relevant, manage climate-related risks and opportunities



Strategy

- Identify and assess the impact of climate-related risks and opportunities on investment (and funding for DB schemes) over the short, medium and long-term
- Identify and disclose their chosen time horizons:
 - DB scheme - the likely time horizon over which current members' benefits will be paid
 - DC scheme - the likely time horizon over which current members' monies will be invested to and through retirement



Risk

- Effective identification, management and integration of climate-related risks – include physical risks as well as transition and liability and risks



Scenario Analysis

- Assess resilience as far as trustees are able of assets, liabilities and investment strategy (and funding for DB) to climate-related risks in at least 2 climate-related scenarios, including at least one scenario that represents an eventual global average temperature rise of between 1.5 and 2°C on pre-industrial levels
- For example:
- a measured, orderly transition
 - a sudden, disorderly transition
 - a "hot house world"
- Undertake in first year then every three years, explaining why in other years they have decided not to refresh the analysis



Metrics

- Select a minimum of two emissions-based metrics, one absolute measure of emissions and one intensity-based measure of emissions, as well as one additional climate-related metric
- Calculate and report annually



Targets

- Set at least one target related to the scheme's metrics and measure performance against the target annually
- Annually review any targets with trustees to determine whether they should be maintained or replaced



Annual disclosure

- Annually review any targets with trustees to determine whether they should be maintained or replaced
- Describing effective oversight and roles
- Describing risks, opportunities and impacts over the short, medium and long term
- Risk identification, management and integration processes
- Metrics (explaining if trustees have only been able to obtain partial or estimated data, why their data does not cover the whole portfolio)
- Scheme targets and performance
- Publish in the annual report, on a publicly available website, communicate to members in the annual benefit statement (and in the annual funding statement for DB schemes) and provide the link to the website to TPR in the annual scheme return
- Signed by the chair

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:



Amanda Latham

Policy and Strategy Lead

✉ Amanda.Latham@Barnett-Waddingham.co.uk

✉ info@barnett-waddingham.co.uk

☎ 0333 11 11 222

www.barnett-waddingham.co.uk

Barnett Waddingham LLP is a body corporate with members to whom we refer as "partners". A list of members can be inspected at the registered office. Barnett Waddingham LLP (OC307678), BW SIPP LLP (OC322417), and Barnett Waddingham Actuaries and Consultants Limited (06498431) are registered in England and Wales with their registered office at 2 London Wall Place, London, EC2Y 5AU. Barnett Waddingham LLP is authorised and regulated by the Financial Conduct Authority. BW SIPP LLP is authorised and regulated by the Financial Conduct Authority. Barnett Waddingham Actuaries and Consultants Limited is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.