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Briefing note

Climate risk: Taskforce on Climate-related Financial Disclosures reporting to become mandatory for larger pension schemes

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- TCFD is a framework for managing and reporting climate-related risks and opportunities;
- The Government is consulting on 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 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. It seems likely that schemes will be required to calculate the Weighted Average Carbon Intensity of their portfolios;
- Pension schemes will need to publish their TCFD reports online.

The UK government has published proposals that will make reporting against the framework set out by the Taskforce for Climate related Financial Disclosures ("TCFD") compulsory for larger pension schemes over coming years. Further, the proposals will require that pension schemes put in place appropriate governance arrangements to ensure that climate risks and opportunities are being considered by pension schemes, thereby discouraging tick-box reporting.

Background

These proposals follow the draft guidance issued by the Pensions Climate Risk Industry Group ("PCRIG") in March 2020 and the subsequent introduction of powers in the Pension Schemes Bill to require climate risk governance and reporting by pension schemes. The government has also signalled a future intent to consult on "Paris alignment reporting" and the potential obligation for pension schemes to report on the implied warming potential of a portfolio.

Proposed governance requirements

TCFD is a holistic framework for the disclosure of climate-related risks and opportunities. It is currently a voluntary framework utilised to various degrees by corporate entities. The framework has four dimensions which are: governance, strategy, scenario analyses and metrics & targets.

Pension schemes will be required to follow the broad recommendations of the TCFD in framing and implementing an approach to managing climate risk, as set out below. The Government expects to issue statutory guidance on the approach to be adopted although schemes will be able to follow their own approach and explain deviations in practice in their reporting.

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
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
Scenario analysis	• At least annually, 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.
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	• Select at least one GHG emissions and one non-emissions metrics against which to assess scheme assets against climate related risks and opportunities • At least quarterly, obtain the Scope 1/2/3 emissions of the portfolio and calculate the selected emissions metric • At least quarterly, obtain the necessary data and calculate the non-emissions metrics
Targets	• At least annually, set one target to manage climate relate risk with respect to the chosen metrics and measure performance against this target at least quarterly.

Whilst metrics have not been specified, allowing trustees to select measurements which are appropriate to their own investment arrangements and governance process, statutory guidance is expected to specify the types of metric that may be employed. In particular, it is expected that the use of Weighted Average Carbon Intensity[1] (WACI) will be included in guidance as the preferred emissions-based metric.

Proposed disclosure requirements

Trustees will be expected to report on the application of their governance processes on an annual basis. The proposed form of the disclosures largely follows the various governance requirements, with the reporting being a standalone document and not necessarily repeated in full within an Annual Report.

It is noted that data availability may, in some circumstances, be limited and modelling approaches are continuing to evolve. The proposals therefore note that trustees will be expected to comply with scenario analysis and reporting on metrics "as far as they are able", recognising that the market will need to develop. It is expected that trustees will drive up standards of reporting by investment managers. Scenarios will be prescribed and must include a "global average temperature rise of 2 degrees or lower" scenario.

[1] Emissions per unit sales for each portfolio company, weighted by the size of the allocation to each company in the portfolio

Trustees will be expected to publish their TCFD report on a public facing website. Although it is not expected that the TCFD report will be included within schemes' Annual Report and Accounts, the Report and Accounts will be required to provide a link to the TCFD report.

Trustees will also be expected to notify members of the TCFD report via the annual benefit statement and provide the Pension Regulator with the website address of the TCFD report.

Who's in scope?

The proposals will initially apply to:

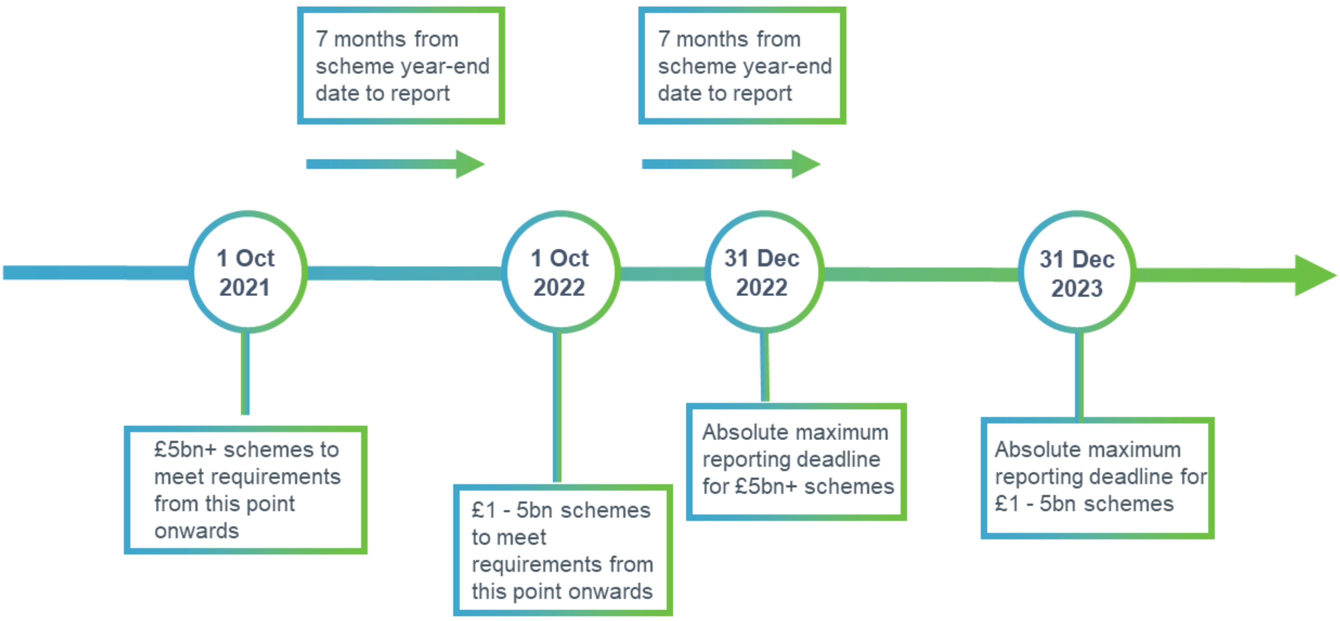
- Pension schemes with assets of at least £5bn at the scheme year ending on or after 1 June 2020; or
- Schemes which are authorised master trusts or authorised schemes providing collective money purchase benefits at 1 October 2021;

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 June 2021, this test being made annually thereafter to determine whether a scheme will fall in scope.

Once in scope, schemes will remain in scope until assets fall below £500m.

Whilst the proposals only apply to trust-based schemes, the government has noted that the Ministry of Housing, Communities & Local Government "*will make provision for the Local Government Pension Scheme, in line with their responsibility for the investment and governance of the LGPS"*. The FCA is also considering disclosure requirements for firms providing workplace pensions.

Governance and reporting timescales



Governance - schemes will be required to meet the governance requirements from 1 October 2021 to the next scheme year end and then next full scheme year. For schemes with assets between £1bn and £5bn, the requirements will come into effect on 1 October 2022 and apply for the proportion of the scheme year from that date onwards.

Reporting - schemes will be required to complete and publish a TCFD report within 7 months of the first scheme year ending after 1 October 2021, but no later than 31 December 2022. For schemes with assets between £1bn and £5bn, the report must be made within 7 months of the end of the first scheme year beginning after 1 October 2021, but no later than 31 December 2023.

Penalties for non-compliance

The Pensions Regulator is expected to be given discretionary powers to fine trustees for inadequate reporting against the requirements. Mandatory penalties will apply in respect of total non-compliance.

Consultation

The Government is seeking views on the proposals no later than 7 October 2020. We will be responding to the consultation and will publish our response in due course.

"We welcome the Government's consultation on mandating TCFD reporting requirements for pension schemes. Pension schemes can only contribute to the mitigation of climate risk by reallocating capital or by driving changes in behaviour. The continued focus on climate risk is welcome and we are particularly encouraged that this consultation steps beyond just disclosure to the underlying actions that trustees are expected to take in developing their approach. Looking beyond the risks associated with climate change to the potential opportunities to influence or create change must become a part of asset owners' mindset. The proposals may result in some schemes needing to report within relatively short timescales; trustees should therefore be familiarising themselves with these new requirements as soon as possible and work closely with their advisers to ensure they are ready for TCFD reporting."

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