

DWP proceeds with ‘revolutionary’ climate change agenda

By **Benjamin Mercer** | January 27, 2021

The Department for Work and Pensions has proposed broadening the scope of climate risk analysis to cover not just the environmental impact of pension schemes’ portfolios, but also sponsor covenants and actuarial valuations.

The proposals form one part of a lengthy response to the ‘Taking action on climate risk: improving governance and reporting by occupational pension schemes’ consultation, published on Wednesday.

The document contains a wide-ranging suite of measures, which include a number of changes to those proposed by the DWP in [August last year](#).

Bulk and individual annuities have been removed when it comes to “determining whether the asset threshold at which the requirements apply has been met”, a move welcomed by Sackers partner Stuart O’Brien as it will help lend to mature, derisked schemes.

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Guy Opperman, pensions minister

Mr O’Brien highlighted a new requirement of which trustees must have “an appropriate degree of knowledge and understanding”, per the wording of the response, which he said “just reflects the reality that you need a base level of knowledge to consider properly the financial implications of climate change on a pension scheme and to fulfil your fiduciary duties”.

“That this is now enshrined in legislation though is quite symbolic,” he noted.

Some of the most extensive developments over the previous consultation concern metrics, with trustees now having to pick “a minimum of two emissions-based metrics, one of which must be an absolute measure of emissions and one which must be an intensity-based measure of emissions, as well as one additional climate-related metric”, the response stated.

However, the reporting requirement governing this data has been relaxed from a quarterly to an annual basis. Although performance will have to be measured against targets, this will likewise only have to be reported annually, and a measure to review the targets every year has been added.

Even though no change has been proposed to the timeframe within which schemes with assets under £1bn will be brought into scope, currently due for review in 2024, the DWP advised smaller schemes to begin to report on a voluntary basis before that time.

It said small schemes should look both to statutory guidance accompanying the new regulations, as well as the Pensions Climate Risk Industry Group’s non-statutory guidance, published in conjunction with the consultation response, “when considering how to improve climate change governance and make disclosures in line with the Task Force on Climate-related Financial Disclosures’ recommendations”.

There have been no changes proposed to the penalty regime, with 85 per cent of respondents to the consultation coming out in favour of the existing proposals, which give the Pensions Regulator the power to issue discretionary penalties against “inadequate” TCFD reports, but limiting the use of mandatory penalties to cases where no report has been published.

Consultation on the proposed changes will last only until March, which Mr O’Brien said is a sign that “the DWP has set its course on what is proposed and schemes should not expect significant changes”.

Opperman threatens trustees with re-education

In his foreword to the report, pensions minister Guy Opperman wrote that the measures are integral to the government’s plan for a “green industrial revolution”, which aims to cut emissions by a further 68 per cent by 2030.

He said that these new measures will allow the government to pursue ways to “revolutionise pension investment, making saving better, safer and greener”, putting pension schemes at the forefront of the “green tech and green energy revolution we will need for the transition”.

However, in what could be seen as a warning to trustees, Mr Opperman concluded by saying that an underwhelming response to the new measures would mean that re-education is needed, with “more work to be done to change mindsets”.

“Some trustees may think that these proposals are an overreaction — because they believe the market has delivered for them over the past decade, because they have seen it ride out ‘storms’ before, or because they wrongly think they have not yet seen any impact of climate change on their investments,” he wrote.

“To these trustees I say that the world is changing, the challenges are changing — you need to change.”

Trustees will also need support

Given the sheer scope of the policy proposals, which will introduce many new requirements on trustees that they have never faced before, David Fogarty, professional trustee at Dalriada, warned that trustees “will need significant support from advisers and the asset management industry to ensure schemes can approach these challenges in a robust manner”.

Michael Bushnell, managing director of Lincoln Pensions, concurred, highlighting that the extension of the risk analysis to include covenants, though it is the right move, may concern some trustees.

“Climate change will affect most, if not all sponsors, so [the] recognition by the DWP that trustees should consider how it will impact their covenant is an important development,” he said.

“Although trustees have rightly raised concerns about additional costs, the covenant is a scheme’s most material asset, so understanding it should be the focus of any pension strategy. By considering potential climate change scenarios, trustees can understand their covenant climate change risk and reflect it in their funding and investment arrangements.”

Scenario analysis relaxation ‘concerning’

Rachel Haworth, UK policy manager at campaign group ShareAction, broadly welcomed the measures announced in the consultation response, especially concerning mandatory TCFD reporting.

“[The DWP] has broken new and important ground in developing detailed regulations and guidance in this area. It is critical for pension funds to take a forward-focused approach to managing climate risk to safeguard both the financial interests of their beneficiaries and the stability of the wider world in which they live,” she said.

While hailing the “positive start”, Ms Haworth cautioned that the challenge will be tough for institutional investors to manage “on a portfolio-by-portfolio basis”, and that “economic transformation is required” to ensure the job is done properly.

“The DWP states that it has explored the methodologies available for measuring the climate impacts of pension fund portfolios, but concluded that more work is required before these can be implemented. We call on the DWP and the pensions industry to accelerate this work in line with the urgency and scale of the climate crisis,” she added.

Amer Khan, European managing director at Entelligent, picked up on the “reduced requirement” for climate scenario analyses as a cause for concern.

Mr Khan told Pensions Expert: “We have concerns that the reduced requirement for climate scenario analysis to be carried out just every three years will be insufficient, as we expect to see significant expansion in disclosure requirements that would flow through to such analysis.

“At the same time, businesses’ models are expected to continue to adapt to become more climate friendly against a backdrop of increasingly stringent carbon taxes and caps on emissions.”

UK schemes lobby ministers over climate ambitions

Some of the UK’s largest pension schemes have written to prime minister Boris Johnson and other senior politicians calling for strong action on climate change ahead of the COP26 conference in November.

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He said that scenario analyses are only valid “insofar as [their] assumptions about the future are accurate”, and that pension schemes carrying out these analyses must “ensure they remain able to perform adequately under the most up-to-date expectations on future temperature paths, as well as playing their part in mitigating the global climate crisis”.

However, Simon Jones, head of responsible investment at Hymans Robertson, suggested such a relaxation was “appropriate given data availability and the meaningfulness of such assessments”.

“We want trustees to engage with climate change and the analysis they undertake should allow them to take informed action, rather than box tick,” he said.



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