Upping the ante

Summary
- Pension schemes have been coping with regulations introduced last October around the implementation statement, but adoption has been relatively boilerplate.
- Further challenges lie ahead of the upcoming TCFD disclosure requirements, particularly in relation to knowledge and data, but progress is being made.
- Industry experts are concerned over the burden of further climate-related reporting regulations, but broader government direction could result in further pressure for pension schemes to take more action to address climate change.

Ahead of the introduction of further climate-related regulations in October 2021, Sophie Smith considers how pension schemes have coped with the requirements already introduced and how they can prepare for even more in the future

Pressure around climate change, and the role the pensions industry can play in addressing the issue, has been ramping up for some time, with numerous requirements introduced over recent years and a new update seemingly round the corner every October. "It's easy to lose track of which October legislative updates made which changes," says Sackers partner, Stuart O'Brien, adding however, in relation to the October 2020 changes, largely implementing the Shareholder Rights Directive, there is a sense that schemes made the required changes "without much fuss".

"Although I think it's fair to say that most tended to introduce somewhat 'boilerplate' style wording to cover the points required," he says. "The real test is what trustees are making of the new requirements to produce annual implementation statements setting out how they have implemented their statement of investment (SIP) policies and describing their voting behaviour. It's still early days but I think we will see a bit of a mixed bag in this first year."

Research from the UK Sustainable Investment and Financial Association (UKSIF) has also supported this, revealing that only one-third of trustees have complied with the legal transparency requirements, and that most trustees have adopted "thin and non-committal" policies. Furthermore, whilst PTL MD, Richard Butcher, says that pension schemes are coping, he agrees that the first wave of implementation statements may not say anything of much significance.

"That's because you tend to approach these things on a compliance basis in the first instance, and next time round you tend to put in a bit more creative thought to try and see what else you can do that will be meaningful and useful," he says.

Rolling with the changes

But trustees will have no time to waste as further changes lie ahead, with larger pension schemes and master trusts expected to face new climate-related governance and disclosure requirements from October, which will require schemes to report on these issues in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.

These changes are expected to be "very significant for schemes in scope", according to LCP head of responsible investment, Claire Jones, who highlights the fact that the TCFD requirements are scheme-wide as a particularly big change, with existing requirements instead focusing on investment.

For larger schemes, Jones suggests they check when they become subject to the requirements, before carrying out a gap analysis to see how their current climate practices stack up against DWP's proposals and work out a plan of action.

"The priority is to address those actions with a 1 October deadline – putting in place ongoing arrangements for governance, strategy and risk management," she says; clarifying that whilst periodic activities are not expected to be needed until the first year-end after 1 October, these are complex tasks and should be started in good time.

And whilst smaller schemes might be forgiven for thinking they can keep their heads down, O'Brien warns that The Pensions Regulator (TPR) has made its expectations clear, and that all trustees should be considering climate as a financial risk to their schemes. "As scenario analysis becomes commonplace for larger schemes, I can see a rapid trickle-down to smaller schemes as part of their risk and strategy approach," he says.

"I think two things will really drive change here though," he adds, highlighting the need for trustees to set targets in relation to their climate metrics, as well as the public disclosure element, which includes more prescriptive content requirements.

Butcher, however, warns that the reporting requirements risk adding another layer of disclosure to members in already weighty chairs' statements, suggesting instead that improvements could be made if these were directed towards an informed reader, such as TPR or an employer governance committee.

"It sounds like a small and trivial point, but we spend hours labouring over the language that we use to try to make it accessible to members, so I think that would be one simplification that would make the whole process more efficient and therefore optimal," he continues.

There are benefits to the more prescriptive requirements though, as O'Brien explains that they expected to apply to a smaller number of schemes initially, which is in turn expected to make it a more manageable task for a resource constrained regulator to review the first ones to be published, with a supportive approach expected from most.

"Where schemes fall short in their first year, I suspect TPR will be keen to educate rather than enforce, with fines being reserved only for those schemes which fail to publish anything meaningful at all but we will have to see," O'Brien says, emphasising that TPR's *Climate Change Strategy* certainly made clear their intention to take this seriously.

Echoing this, Jones adds: "I would hope that TPR will use their enforcement powers sparingly while climate practices are at a relatively early stage of development. However, it's important for trustees to know that TPR is willing to use its powers where appropriate and that it is training its staff so they can include climate change in their supervisory discussions."

Despite the warm reception to the inclusion of climate considerations in TPR's strategy, industry experts have been quick to warn against further regulation, as Butcher argues that this could risk detracting from good governance, as trustees are "so busy" reviewing their activities they do not get time to consider how to improve member outcomes.

PLSA deputy director of policy, Joe Dabrowski, agrees: "We do not think now is the time for more regulation, given the significant changes that have happened in the past one to two years, and is expected following the Pensions Schemes Act which will need to both bed in, and may need some rationalisation in future."

Hurdles in the road

Continuing, Dabrowski argues that whilst climate-aware investing is a major focus, there are practical issues still to overcome, as recognised by the government and regulators, stating: "At the moment there is a risk that schemes will not be able to fully report or monitor climate risk due to lack of information from investee companies, standard metrics and a common understanding of climate risk. More broadly, there are a number of barriers that will also need to be overcome within the industry, including the need for greater resources, knowledge and greater training."

AXA Investment Managers solutions Strategist, Bruno Bamberger, also highlights the need to collectively understand what is required to both protect against the emerging risks of climate change and to deliver a positive impact on the wider environment as a further initial challenge. These concerns are shared by Jones, who notes that there can be a challenge in finding sufficient time to understand and address such a complex topic, particularly when juggling it alongside other priorities, such as financial difficulties due to Covid-19.

"While difficult," Bamberger clarifies, "these challenges are not insurmountable and will involve the collective efforts of trustees, consultants, asset managers and others working together to break down the challenges one by one."

Jones also reports a welcome level of activity and innovation in light of the need for pension providers to match, and ideally anticipate, the rapidly changing needs of trustees, employers and members, emphasising "lots of work is underway to meet these challenges".

"And there is an upside to all this," adds Butcher, "it is driving trustees to behave in a particular way, and it is causing transparency. We will have to disclose our executed votes, even if we aren't doing the voting, and that light being shone under the bonnet will create a market imperative for the fund managers, the secondary fund managers and the tertiary fund managers to change their behaviour, and that is a genuine driver for improvement."

Accelerating the pace

This imperative looks set to grow even stronger, with Glenmont Partners co-founder, Peter Dickson, highlighting the government's recent announcement to slash carbon emissions by 78 per cent by 2035 as a welcome step towards the full decarbonisation of the economy, predicting that this will accelerate the divestment of carbon intensive industries from pension schemes into renewable technologies. But there is some scepticism, with Butcher warning that much of the government messaging appears geared towards "putting on a good show" ahead of COP26, despite the sense that change may be coming. "The reality is to achieve the targets they've set we need to make tangible changes very soon, and I expect what that means is that the regulators are going to up the ante on us," Butcher predicts, adding that whilst the government has shied away from compulsion before, this too could change in light of such aggressive targets, warning that "all of the rules could change".

Indeed, in a recent exclusive with *Pensions Age* for Earth Day, Pensions Minister, Guy Opperman, teased hints of further action, stating: "We need a whole economy transition. And better stewardship by pension schemes of high carbon companies will be particularly important. You can expect government action on this in the coming months – watch this space."

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