

## UK Pension Schemes Act 2021 – new regulations to enhance climate disclosure

In February 2021, the UK's Pension Schemes Act received Royal Assent, paving the way for fundamental change to the UK pensions landscape. The Act introduces new requirements in significant areas for occupational pension schemes including explicit provisions on governance and disclosure in relation to climate change risk and opportunities. The government's aim is to ensure the pensions industry plays its part in the UK's transition to a net zero future.

This briefing note presents a summary of the new legislation on climate governance and reporting requirements for occupational pension schemes. It highlights the steps that trustees of applicable schemes should take to comply with the new legislation, and the role that non-executive directors of sponsor companies can play to accelerate alignment between corporate climate strategy and pension scheme climate governance.

The Department for Work and Pensions (DWP) has run recent consultations on the climate governance and reporting requirements, and the legislation and statutory guidance that will implement the government's policy. The new requirements will apply to trustees of:

- Large trust-based schemes - both defined benefit (DB) and defined contribution (DC) - with assets of £1 billion or more.
- All authorised master trusts.
- All authorised collective money purchase (CMP) schemes.

DWP will review in 2023 whether to expand the scope to apply to schemes with assets under £1 billion. Those schemes currently outside the scope are encouraged to comply on a voluntary basis.

Schemes which fall under the new requirements have much work to do to put in place the required governance and reporting processes. The new laws will come into force from 1 October 2021.

### 1. What are the new climate governance requirements proposed under the Pension Schemes Act 2021?

The Act<sup>1</sup> amends the Pensions Act 1995 inserting new provisions in relation to climate change risk and opportunities, which require trustees or managers of occupational pension schemes to:

- a. Ensure effective governance of their schemes with respect to the effects of climate change, considering both risks and opportunities arising.
- b. To publish information relating to the effects of climate change on the scheme.

Under the draft regulations<sup>2</sup> and statutory guidance<sup>3</sup>, requirements for trustees include:

- **Governance and disclosure:** trustees must establish and maintain oversight of the climate-related risks and opportunities relevant to the scheme. Trustees are required to make

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<sup>1</sup> <https://www.legislation.gov.uk/ukpga/2021/1/part/5/crossheading/climate-change-risk/enacted>

<sup>2</sup> [The Occupational Pension Schemes \(Climate Change Governance and Reporting\) Regulation 2021](#)

<sup>3</sup> [Governance and reporting of climate change risk: guidance for trustees of occupational schemes - GOV.UK \(www.gov.uk\)](#)

climate change disclosures in line with recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD)<sup>4</sup> in an annual TCFD report.

- **Strategy:** identifying the climate-related risks and opportunities that trustees consider will have an effect over the short, medium and long-term on the scheme's investment strategy and, where applicable, funding strategy.
- **Scenario analysis** to test the impact of climate change on the scheme's investment and funding strategies (in at least two scenarios where there is an increase in global average temperatures, one of which is between 1.5-2°C). This must be done in the first year and at least every three years thereafter.
- **Risk management:** ensuring processes are in place to identify, assess and manage relevant climate-related risks, that are integrated into the scheme's overall risk management.
- **Metrics:** select and calculate climate-change metrics relating to the scheme's assets, including emissions metrics (scope 1, 2 and 3 emissions profiling), reviewing the chosen metrics from time to time as appropriate to the scheme.
- **Targets:** set a target for the scheme in relation to at least one selected metric, measuring performance of the scheme against it, determining whether the target should be adjusted.
- **Reporting and publication:** trustees must produce and publish their first annual TCFD report within seven months of the end of the scheme year under way on 1 October 2021. The TCFD report should be publicly available online, and members notified.
- **Knowledge and understanding:** trustees should have oversight of relevant climate-related risks and opportunities in order to carry out their duties.

## 2. Why are these new requirements being introduced and how do they relate to climate change?

There are several core reasons for introduction of the proposed regulations:<sup>5</sup>

- i. This is an important component of the Government's net zero climate policy ensuring sustainable, low carbon investment that supports a net zero carbon transition by 2050.
- ii. To address the risks and impacts of climate change as a real threat to the long-term sustainability of UK private pensions.
- iii. To direct finance towards low carbon industries and support the clean energy transition.
- iv. To address a concern that many pension trustees do not yet fully appreciate or consider the risks posed by climate change.
- v. Attempting to avoid a tick box mentality by ensuring that consideration of climate change risks and opportunities is embedded into trustees' governance of a scheme.

## 3. What is the proposed timeline for introduction of legislation in response to the Pension Schemes Act 2021?

- **January 2021:** The Pensions Regulator (TPR) published an interim response to its first consultation on the DB funding code.

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<sup>4</sup> <https://www.fsb-tcfid.org/recommendations/>

<sup>5</sup> [Taking action on climate risk: improving governance and reporting by occupational pension schemes, August 2020 UK government consultation response](#)

- **January - March 2021:** DWP consultation on the draft regulations.
- **Second half of 2021:** TPR plans to publish its second consultation considering the draft code.
- **Autumn 2021:** new powers to be available to the Regulator (subject to review).
- **From 1 October 2021:** Trustees of applicable schemes with at least £5 billion of assets, and all authorised master trusts, must comply with the new governance requirements. Trustees must produce and publish their first annual TCFD report within seven months of the end of the scheme year.
- **From 1 October 2022:** schemes with at least £1 billion of assets must comply with the new governance requirements, publishing their first annual TCFD report within seven months of the end of the scheme year.

#### 4. What are the proposed penalties for non-compliance?

The Act expands the Regulator's interview and inspection powers and ability to issue civil penalties for non-compliance, or to require information to be provided. A penalty of up to £5,000 for individual trustees or £50,000 for a corporate trustee, may be applied where regulations are breached.

The Regulator must impose a penalty of at least £2,500 if no TCFD report is published on a website. The Regulator will also be able to issue improvement notices, including in relation to trustee knowledge and understanding.

#### 5. What role can non-executive directors (NEDs) play in helping organisations prepare their pension schemes for this new legislation?

Board members play a key role in helping to ensure companies are fit for the future, and that they understand and address the business risks and opportunities of climate change. As a board develops its climate strategy, embedding robust plans and measurable action on climate change; it should view its occupational pension fund arrangements as part of this journey.

For a company with a trust-based pension scheme with defined benefit (DB) or defined contribution (DC) arrangements, it is advisable to engage with the chair of trustees for the pension scheme to understand the climate risk and governance aspects of the scheme.

Whilst pension trustees are formally independent of a sponsor company, the outside world tends to see the company and the pension scheme as very closely related. A leading company's reputation may be at risk if the trustees of its pension scheme are not managing the financial risks presented by climate change, as well as the opportunities for zero carbon investment.

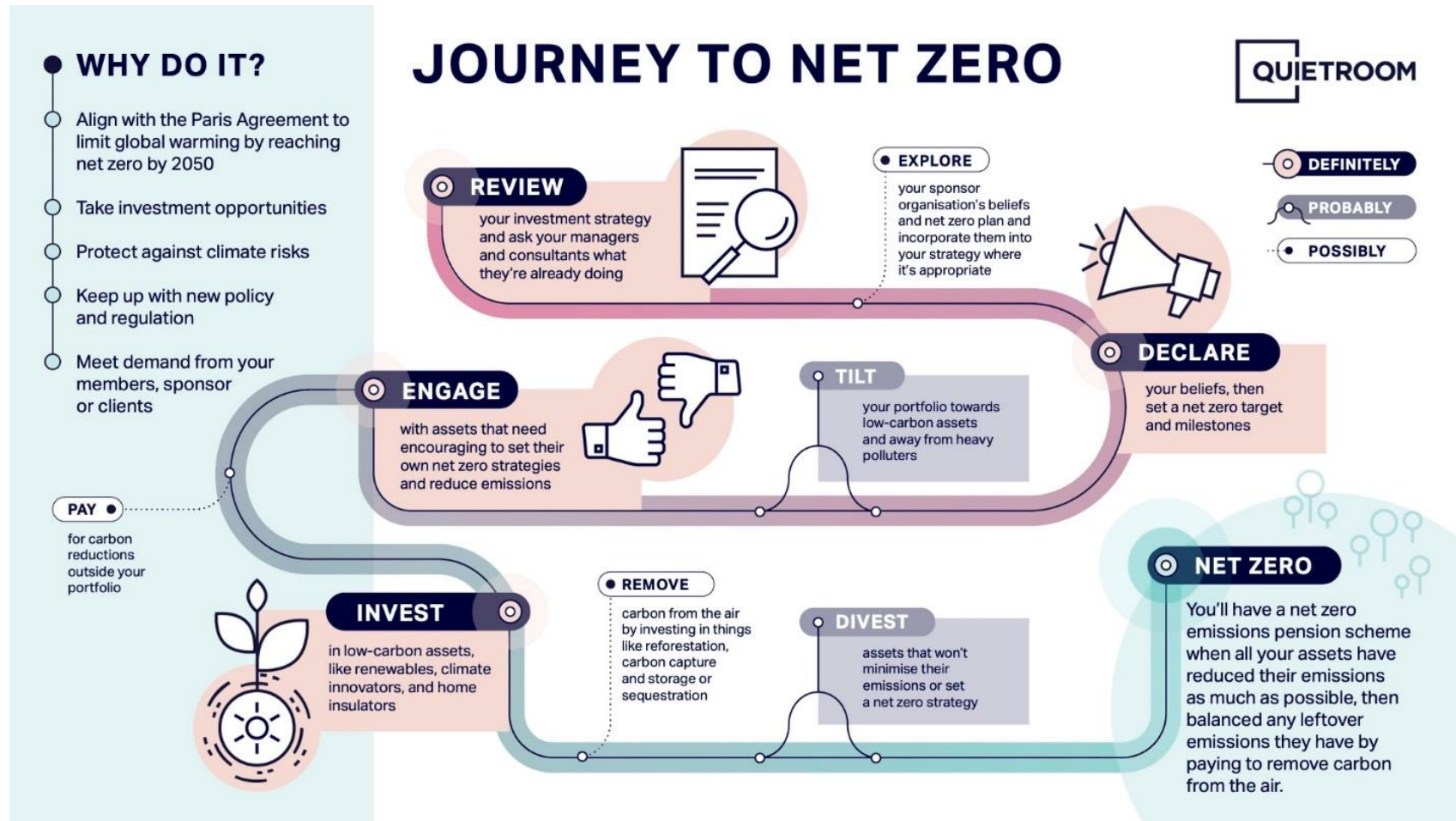
There is a clear role that non-executive directors can play to engage with pension scheme trustees to better understand the climate risk governance of the schemes their organisation sponsors; and to help support the development of a climate risk strategy for the pension fund that is aligned with that of the company. At the very least, an organisation may want to ensure that its pension scheme has its own climate change strategy, and it may want to be able to explain when this does not align with the company's own strategy.

Similarly, there is a role for pension scheme trustees to engage with the boards of sponsoring organisations to understand the company’s climate strategy when developing their own climate strategies, and to explore whether the pension fund investments can be better aligned with the strategic climate objectives of the companies it represents.

## 6. Where can I find further information and guidance?

- [Pension Schemes Act 2021](#), the original legislation, as it was enacted.
- [The Occupational Pension Schemes \(Climate Change Governance and Reporting\) Regulations 2021](#) - coming into force on 1st October 2021
- [Governance and reporting of climate change risk: guidance for trustees of occupational schemes - GOV.UK \(www.gov.uk\)](#)
- [The ESG Toolkit for Pension Chairs and Trustees \(accountingforsustainability.org\)](#)

Figure 1: Journey to Net Zero by Quietroom<sup>6</sup>: Pension trustees, start your net zero conversation here



<sup>6</sup> [Journey to Net Zero - Quietroom](#)