EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (CLIMATE CHANGE GOVERNANCE AND REPORTING) REGULATIONS 2021

2021 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Work and Pensions (DWP) and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument introduces new requirements for trustees of certain occupational pension schemes with a view to ensuring that there is effective governance of those schemes with respect to the effects of climate change. The instrument also introduces related reporting and publication requirements for such trustees and confers new compliance powers on The Pensions Regulator ("TPR"). The requirements will apply to trustees on a phased basis from 1st October 2021 according to the value of relevant scheme assets, or whether the scheme has been authorised for certain purposes.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is Great Britain.

4.2 The territorial application of this instrument is Great Britain.

4.3 It is anticipated that the Department for Communities will make corresponding legislation for Northern Ireland.

5. European Convention on Human Rights

5.1 The Minister for Pensions and Financial Inclusion, Guy Opperman has made the following statement regarding Human Rights:

"In my view the provisions of the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 are compatible with the Convention rights."

6. Legislative Context

6.1 The Pension Schemes Act 2021, section 124[1] (climate change risk) inserted new sections 41A to 41C into the Pensions Act 1995. Section 41A confers powers on the

[1] https://www.legislation.gov.uk/ukpga/2021/1/section/124/enacted

Secretary of State to make regulations imposing requirements on trustees of occupational pension schemes with a view to securing that there is effective governance of the scheme with respect to the effects of climate change. Section 41B enables publication requirements to be imposed on trustees and section 41C enables the Secretary of State to make provision with a view to securing compliance with regulations made under sections 41A and 41B.

6.2 During the passage of the Pension Schemes Act 2021 through Parliament, the Government stated its intention to consult widely on regulations made under these powers at the earliest opportunity. This instrument follows that consultation. It is intended to form part of a wider package of regulations, which will also amend existing pensions legislation to introduce related disclosure and notification requirements and which will introduce new requirements about trustee knowledge and understanding of matters relating to the effects of climate change on occupational pension schemes. The Government intends that these changes will be made by the Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021, which have been published in draft alongside the Government's consultation response[2].

7. Policy background

What is being done and why?

7.1 All pension schemes are exposed to climate-related risks, irrespective of their current investment strategy. Many schemes are also supported by employers or sponsors whose financial positions and prospects are dependent on current and future developments in relation to climate change.

7.2 There is evidence to suggest that we are currently on track to see 3°C of warming by the end of the century[3]. However, recent research by the International Monetary Fund has specifically identified that stock prices do not reflect future climate risk[4]. As a result, there is a risk that, without intervention, members of pension schemes may be overexposed to the financially-material risks of climate change, which ultimately impacts their expected outcomes in retirement. Whilst trustees of pension schemes are already required to consider all financially-material risks as part of their fiduciary duty[5], the Government is seeking to clarify and strengthen the focus on climate change.

7.3 Following the report of the UK Government-commissioned Green Finance Taskforce[6] in March 2018, the Government's Green Finance Strategy[7] was published in July 2019. This set out a range of actions in relation: to mainstreaming climate and environmental factors as a strategic imperative; to mobilising private finance for clean and resilient growth; and to cementing the UK's leadership in green finance.

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[2] 'Taking action on climate risk: improving governance and reporting by occupational pension schemes – Government Response, published 8 June 2021 - https://www.gov.uk/government/consultations
[3] IPCC's Special Report: Global Warming of 1.5°C (2018). https://www.ipcc.ch/sr15/
[4] International Monetary Fund. Global Financial Stability Report on Climate Change: Physical Risk and Equity Prices - https://www.imf.org/en/Publications/GFSR/Issues/2020/04/14/global-financial-stability-report-april-2020#Chapter5
[5] The requirement to act in the best interest of another i.e. their members.
[6] Accelerating green finance: a report by the Green Finance Taskforce - https://www.gov.uk/government/publications/accelerating-green-finance-green-finance-taskforce-report
[7] https://www.gov.uk/government/publications/green-finance-strategy

7.4 Amongst the announcements was the Government's expectation for all listed companies and large asset owners, including pension schemes, to disclose in line with the Task Force on Climate-related Financial Disclosures' (TCFD)[8] recommendations[9] by 2022.

7.5 The evidence from the occupational pension scheme sector, as well as nationally and internationally, is that now is an appropriate time to move towards mandatory TCFD-aligned disclosures, beginning with larger pension schemes. TCFD-aligned disclosures, and underlying climate change governance requirements, offer the opportunity for trustees of occupational pension schemes to move away from relatively high level disclosures of policy. They are focused on trustee action, rather than just disclosure alone, and particularly are designed to produce both qualitative and quantitative data outputs that help trustees manage, and show that they are managing, climate change risk. The flexible structure of the TCFD recommendations also allows trustees to continuously improve climate change risk governance and reporting in the light of rapidly increasing data quality and completeness as well as emerging best practice.

7.6 This instrument therefore introduces requirements reflecting the recommendations of the TCFD to ensure trustees embed effective climate change risk governance activities, and report publicly on how they have done so. This includes requirements relating to governance, strategy and risk management, requirements to select and calculate climate-related metrics and requirements for trustees to set and measure performance against targets (referred to collectively below as "the governance requirements").

The governance requirements

7.7 Part 2 of the instrument specifies who is subject to the governance requirements.

7.8 The governance requirements will apply initially to trustees of trust schemes with relevant assets of £5billion or more on their first scheme year end date to fall on or after 1st March 2020. The requirements will be extended from 1st October 2022 to trustees of trust schemes with relevant assets of £1billion or more on their first scheme year end date to fall on or after 1st March 2021.

7.9 The relevant assets of a scheme are calculated by reference to the audited accounts which trustees are required to obtain in respect of the scheme year in question[10]. Separate provision is made for certain schemes, known as "earmarked schemes", in respect of which the trustees are not required to obtain audited accounts.

7.10 Trustees of authorised master trust schemes will be subject to the governance requirements from 1st October 2021, or, if later, from the date the scheme is authorised by TPR.

7.11 The governance requirements will also apply to trustees of schemes providing collective money purchase benefits (also known as collective defined contribution

[8] The TCFD is a global, private sector led group assembled in December 2015 at the instigation of the international Financial Stability Board (FSB), an international body that monitors and makes recommendations about the global financial system.
[9] Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017). https://www.fsb-tcfd.org/publications/final-recommendations-report/
[10] This requirement is imposed by regulation 2 of the Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (S.1. 1996/1975) https://www.legislation.gov.uk/uksi/1996/1975/contents

benefits), for which Part 1 of the Pension Schemes Act 2021 introduced the legislative framework[11]. Trustees of such schemes will be subject to the governance requirements from the date the scheme is authorised by TPR.

7.12 Trustees will cease to be subject to the governance requirements if the value of the scheme's relevant assets fall below £500million and, in the case of a scheme subject to authorisation, if the scheme ceases to be an authorised scheme. This is to account for circumstances in which it will be disproportionate to expect trustees of a once-large scheme to continue to produce a climate governance report ("TCFD report") when its assets become very much reduced. The governance requirements will re-apply to the trustees should the value of relevant scheme assets subsequently increase to £1billion or more.

7.13 To recognise that the availability and quality of certain climate-related data may currently be limited, but that this expected to improve over time, trustees are required to comply with a number of the governance requirements "as far as they are able". This is defined to mean that they must take all such steps as are reasonable and proportionate in the circumstances, taking into account the costs or likely costs which will be incurred by the scheme and the time required to be spent in taking such steps.

The reporting and publication requirements

7.14 Part 2 also specifies the reporting and publication requirements. Subject to limited exceptions, trustees will be required to produce a report in respect of any scheme year, or part of a scheme year, in which they were subject to the governance requirements.

7.15 Trustees must produce and publish the report on a publicly available website, accessible free of charge, within 7 months of the end of the scheme year. It is therefore expected that once subject to the governance requirements, trustees will produce and publish a report in respect of each scheme year, unless one of the exceptions applies. The information which trustees must include in their report is specified in Part 2 of the Schedule.

Compliance

7.16 Part 3 of the instrument confers compliance powers on TPR. This includes powers to issue compliance notices, third party compliance notices and penalty notices.

7.17 Where TPR are of the opinion that a person has failed to comply with the requirement to publish a report on a publicly available website accessible free of charge, they must issue a mandatory penalty of at least £2,500. A mandatory penalty is considered appropriate in such circumstances, since there has been a complete failure to comply with the publication requirements.

7.18 In all other cases, it is at TPR's discretion whether to issue a penalty where they consider there has been a contravention of a provision in Part 2 of, or the Schedule to, the instrument. This includes where a report has been published, but TPR are of the opinion that it does not meet the requirements specified in Part 2 of the Schedule. It is also at TPR's discretion whether to issue a penalty for failure to comply with a compliance notice or third party compliance notice issued under Part 3.

[11] https://www.legislation.gov.uk/ukpga/2021/1/contents/enacted

7.19 All penalties, including the mandatory penalty, are subject to maximum limits of £5,000 in the case of an individual or £50,000 in the case of a body corporate, Scottish partnership or any other person.

7.20 TPR may review notices issued under Part 3 either upon written application of the person to whom the notice was issued, or where they otherwise consider it appropriate. A person to whom a penalty notice has been issued may also make a reference to the Tribunal in respect of the notice once TPR has completed a review, or if the person has applied for a review but TPR has determined not to carry one out.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 Not applicable.

10. Consultation outcome

10.1 We put our policy proposals to a public consultation[12], held between 26 August and 7 October 2020 for six weeks. We then conducted a subsequent consultation[13] on our draft regulations and statutory guidance, held between 27 January and 10 March 2021 for six weeks. Both consultations were supported by meetings with stakeholders and smaller groups of industry and legal experts to examine the detailed proposals, the financial impact of the proposed changes and the draft regulations and draft statutory guidance.

Consultation on the policy proposals

10.2 We received 99 formal responses to the consultation itself. These were made up of 25 responses from corporate or industry-wide occupational schemes; 10 trade bodies; 9 membership bodies; 8 dedicated consultancy firms; 7 law firms; 6 civil society bodies; 5 dedicated master trust sponsors; 5 firms who offer both consultancy and master trusts; 5 investment managers; 5 Local Government Pension Scheme bodies; 3 individuals; 2 each of insurer/master trust sponsors, trade unions and data providers; 1 professional trustee firm, personal pension provider and fiduciary manager; and a statutory body.

10.3 The responses were strongly positive in relation to the principle of more effective action on climate change risk, and as a result, were broadly supportive of our specific policy proposals. However, a minority of respondents expressed concerns on availability of data key to climate risk analysis, timing of the roll-out, burdens and the materiality of climate risk for certain schemes. A very small number of respondents were opposed to any further action being taken at all.

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[12] https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes

[13] https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations

10.4 In light of the responses, we made a range of changes to our original policy proposals. Whilst these were largely technical in nature, and did not have a significant impact on the policy or its implementation, they did provide clarification on the management of data gaps, gave schemes particularly affected by the short timings an additional four months to comply, and re-iterated our position on the financial materiality of climate change risk. Evidence of burdens was incorporated into a revised Impact Assessment. Full details can be found in the Government's consultation response.

Consultation on Draft Regulations and Draft Statutory Guidance

10.5 We received 54 responses to the consultation. These were made up of 9 responses from trade bodies; 8 from dedicated consultancy firms, 2 dedicated master trust sponsors, and 4 that do both; 7 membership bodies; 6 law firms; 5 from corporate occupational schemes; 4 Local Government Pension Scheme bodies; 2 insurer/master trust sponsors; 2 civil society bodies; 2 investment managers; 1 professional trustee firm; 1 fiduciary manager and 1 think tank.

10.6 The responses were again broadly supportive of our policy proposals and the technical changes we made to our policy following our August consultation were largely welcomed by industry. The vast majority of respondents were content that our draft regulations delivered on our stated policy intent.

10.7 We made a small number of further technical changes to our policy, including allowing an additional year before trustees become subject to a requirement to collect some more difficult to obtain climate data. In addition, we made a number of other minor changes to the draft regulations and the draft statutory guidance, for clarity in light of the responses received and to ensure the regulations fully match the policy intent. Full details can be found in the Government's consultation response.

11. Guidance

11.1 In complying with the requirements of Part 2 of, and the Schedule to, this instrument, trustees are required by new sections 41A(7) and 41B(3) of the Pensions Act 1995[14] to have regard to statutory guidance prepared by the Secretary of State.

11.2 The statutory guidance "Governance and reporting of climate change risk: guidance for trustees of occupational schemes" is published on Gov.uk and will be reviewed as a minimum every three years, from the first date of publication, and updated when necessary.

12. Impact

12.1 The impact on business, charities or voluntary bodies is principally on the pensions industry, specifically Occupational Pension Schemes with £1bn or more in assets, and both master trusts ("multi-employer defined contribution schemes) and schemes offering collective money purchase benefits which have been authorised by TPR.

12.2 The Equivalent Annual Net Direct Cost to Businesses of the package of measures contained in both this instrument and the Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) 2021, which have been published in draft alongside this instrument, is £6.2m.

[14] Inserted by section 124 of the Pension Schemes Act 2021

12.3 Costs principally stem from requiring pension schemes in scope to perform scenario analysis of the effect of a range of temperature scenarios on their assets and liabilities in the relevant years, calculate a range of metrics including the greenhouse gas emissions of the portfolio, as well as producing and disclosing a TCFD report.

12.4 There is no, or no significant, impact on the public sector.

12.5 A full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 Guy Opperman MP, Parliamentary Under-Secretary of State for the Department for Work and Pensions, has made the following statement under section 28(2)(b) of the Small Business, Enterprise and Employment Act 2015.

14.2 "Having had regard to the Statutory Review Guidance for Departments published under section 31(3) of the Small Business, Enterprise and Employment Act 2015, in my view, it is not appropriate to make provision for review in the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021."

14.3 Further to this, Guy Opperman MP, Parliamentary Under-Secretary of State for the Department for Work and Pensions made a Written Ministerial Statement (WMS) on 8 June 2021 announcing the legislation. The WMS states his decision, as outlined in this Explanatory Memorandum, to not include a review clause in the regulations, invoking section 28(2)(b) of the Small Business, Enterprise and Employment Act 2015.

14.4 We recognise the importance of monitoring and evaluating the initial impact of our regulations. The legislation does not include a statutory review clause; however, we have publically committed in our consultation response to undertake a review in 2023. This will cover all the aspects normally required by a statutory review clause.

15. Contact

15.1 David Farrar at the Department of Work and Pensions Telephone: 07785 234213 or email: david.farrar@dwp.gov.uk can be contacted with any queries regarding the instrument.

15.2 Jo Gibson, Deputy Director for Private Pensions and Arms Length Bodies, at the Department of Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Minister for Pensions and Financial Inclusion, Guy Opperman at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.