

# Climate Change Governance and Reporting for occupational pension schemes

Summary of requirements from 1 October 2021  
December 2022 ( revised edition)



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# Introduction

“

**I want pensions to be safer, better and greener**

**Guy Opperman**

”



The Pension Schemes Act 2021 requires schemes to adopt and report against the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations, with the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (the “Regulations”) setting out the detailed requirements for schemes falling into scope.

Since the last edition of this publication, the Regulations along with the Statutory Guidance have been updated to require trustees subject to those Regulations to calculate and disclose a portfolio alignment metric setting out the extent to which their investments are aligned with the goal of limiting the increase in the global average temperature to 1.5°C above pre-industrial levels. This change came into force from 1 October 2022.

This publication is designed to support both defined benefit (DB) and defined contribution (DC) occupational pension scheme trustees by pulling together the requirements set out in the Regulations and key points taken from the Statutory Guidance (as amended in June 2022).

Highlights from the Climate Change Governance and Reporting Guidance published by The Pensions Regulator (TPR) have been added, and we have also set out a number of action points trustees may find useful when getting started.

With a number of climate change reports from the larger and authorised schemes now published, we then share some observations from those seen to date.



# Scope and timing

## Scheme asset threshold test... When do the rules apply?



### Asset threshold test

Where a scheme has **relevant assets** equal to, or exceeding, £5 billion on the first scheme year end date which falls on or after 1 March 2020, is an authorised master trust or collective money purchase scheme it must comply with the climate change governance requirements:

- From 1 October 2021 where the scheme is an **earmarked scheme** or
- Where the scheme is not an earmarked scheme, from 1 October 2021 or, if later, from the date on which the trustees obtain audited accounts in relation to that scheme year end date.

Where a scheme has **relevant assets** equal to, or exceeding, £1 billion on the first scheme year end date which falls on or after 1 March 2021, it must comply with climate change governance requirements:

- From 1 October 2022 where the scheme is an **earmarked scheme** or
- Where the scheme is not an earmarked scheme, from 1 October 2022 or, if later, from the date on which the trustees obtain audited accounts in relation to that scheme year end date.

Trustees must publish a Climate Change Report within 7 months of the end of the scheme year which is underway on 1 October the year the rules apply. Trustees must also include a link to the report in the annual report and accounts produced for that scheme year.

### Schemes no longer in scope:

Where a scheme's relevant assets fall below £500m on any subsequent scheme year end date, the trustees will cease to be subject to the climate change governance requirements with immediate effect (unless the scheme is an authorised scheme). However, the trustees must still publish their Climate Change Report for the scheme year which has just ended within 7 months of the scheme year end date.

The circumstances in and timing by which trustees fall in and out of scope of the requirements are further detailed in the Climate Change Governance and Reporting Regulations.

# Governance

What processes do we need in place.....



## Regulations

- Trustees must establish and maintain oversight of the climate-related risks and opportunities which are relevant to the scheme.
- Trustees must establish and maintain processes for the purpose of satisfying themselves that:
  - a) Any person<sup>(a)</sup> who undertakes scheme governance activities otherwise than as a trustee, takes adequate steps to identify, assess and manage climate-related risks and opportunities which are relevant to the governance activities they are undertaking; and
  - b) Any person<sup>(a)</sup> who is not a legal adviser of the trustees and who advises or assists the trustees with respect to scheme governance activities, takes adequate steps to identify and assess climate-related risks and opportunities which are relevant to the matters in respect of which they are advising or assisting.

## Statutory Guidance

Governance relates to how a scheme operates and the internal processes and controls in place to ensure appropriate oversight of the scheme.

When determining who those persons are who undertake governance activities, trustees should consider those external advisers who are engaged by the trustees or the sponsoring employer to advise or assist with scheme-wide decisions or occasionally make scheme-wide decisions for the trustees. For those people who are involved in governing the scheme, trustees should have clearly set out roles and responsibilities. Trustees may want to review their service level agreements to ensure any responsibilities regarding climate change are covered, and that reporting deadlines are clearly stated. However, whatever services have been delegated, trustees have ultimate responsibility for how climate-related risks and opportunities are managed.

Adequate climate-related risk knowledge and expertise is crucial and trustees may find it useful to carry out a skills audit, for example covering:

- The trustees' expertise on climate change;
- The expertise of others undertaking governance activities; and
- The expertise of those advising or assisting in respect of governance activities.

Note: (a) An asset manager would only fall into scope where they do not only manage the assets, but also provide advice or assistance with respect to a scheme's governance activities.

# Governance (cont.)

What processes do we need in place.....



## TPR Guidance

Within the Regulator's guidance, example steps are set out for trustees to consider when approaching their climate-related duties. These include:

1. Add climate-related risks and opportunities, including oversight to the remit and terms of reference to any relevant sub-committees.
2. Document the structure for making climate-related decisions in the scheme – roles, responsibilities, information inflows for example. Include oversight, and set out how this is integrated into the monitoring framework and meeting cycles.
3. Review providers' and advisers' level of expertise. Service level agreements may need to be revisited. Consider the use of the Investment Consultants Sustainability Working Group Guide which sets out five themes against which trustees should expect their investment consultants to demonstrate their climate competency.

## Comment

Most trustees will have delegated certain tasks to third party service providers and so will need a clear oversight of the governance activities being carried out. Trustees should focus on identifying who has the responsibility for notifying them of climate change issues and when this information will be provided. Clear lines of communication are essential to optimise information flow, and trustees need to be prepared to question and challenge that information where appropriate (see later on trustees' knowledge and understanding).



# Governance (cont.)

**Does the trustee board need any specific training....**



## TKU regulatory requirements

The Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 require trustees to have an appropriate level of knowledge and understanding of the principles relating to the identification, assessment and management of climate change risks and opportunities, including risks arising from steps taken because of climate change (whether by governments or otherwise) to enable them to properly exercise their duties.

## Guidance

The trustees' knowledge and understanding guidance is not statutory but is intended as best practice. Trustees are not required to be experts, but have sufficient expertise so that they properly exercise governance over climate change risks and opportunities.

Knowledge levels of the trustee board should be reviewed and advice and/or training sought from scheme advisers if necessary. Even where, in most cases, many of the activities will be undertaken by investment consultants and/or asset managers for example, trustees will still require the necessary knowledge and understanding to interpret results, question information and take action where it is required. Trustees should be able to understand results of scenario analysis, and be able to challenge assumptions and methodologies together with any other relevant information provided by third party providers.

Industry collaboration is encouraged, as is active stewardship – by engaging more with asset managers, (or entities themselves where segregated mandates held) trustees can increase their knowledge and awareness.

## Comment

If not already, climate change should be firmly set within the trustee meeting agenda, with adequate time and resource allocated. If skills gaps have been identified, then trustees should be looking to arrange adequate training as soon as it is practical to do so.

Questions to consider:

- How does the trustee board gain and maintain an appropriate level of understanding of climate-related risk and opportunities?
- How does the trustee board gain assurance over the management of climate-related risk in the organisation?

# Governance (cont.)

## What to include in the report.....



## Disclosures – Regulations

The report must describe:

- How the trustees maintain oversight of climate-related risks and opportunities which are relevant to the scheme;
- The role of any person who undertakes governance activities in relation to the scheme, in identifying, assessing and managing climate-related risks and opportunities relevant to the scheme and the process by which the trustees satisfy themselves that the person is taking adequate steps to identify, assess and manage climate-related risks and opportunities; and
- The role of any person who, otherwise than as a legal adviser of the trustees, advises or assists the trustees with respect to governance activities relating to the scheme and the process by which the trustees satisfy themselves that the person is taking adequate steps to identify and assess climate-related risks and opportunities which are relevant to the matters in respect of which they are advising or assisting.

## Disclosures – Statutory Guidance

The Statutory Guidance gives further guidelines to assist trustees to prepare these disclosures:

- How the trustees maintain oversight of climate-related risks and opportunities;
- Describe how the board and any relevant sub-committees are informed about, assess and manage climate-related risks and opportunities and the frequency at which these discussions take place;
- Any challenge by the trustees to the information provided to them by others;
- The rationale for the time and resources they spent on governance of climate-related risks and opportunities;
- The kind of information provided to them by those persons about their consideration of climate-related risks and opportunities faced by the scheme and the frequency with which this information is provided; and
- Describe the training opportunities provided for existing employees. Where trustees identified skills gaps, they should also describe whether they encouraged external advisers to undertake training opportunities.



# Governance (cont.)

## Comments..... and where to start



## Comments

Trustees already have a legal duty to manage climate-related risks. An effective climate governance structure is critical to ensure that scheme trustees properly assess climate-related risks and opportunities, take appropriate strategic decisions on how to manage those risks and opportunities, and set and then report on relevant targets.

A good starting point for reviewing governance processes and procedures is for trustees to set out their climate change and sustainability beliefs. From here, focus can then be placed on what policies are either already in place or need to be introduced. Trustees should assess whether they need a sub-committee specifically for climate change or possibly a working group and in addition, what reliance will be placed upon scheme advisers. Crucially, it is not sufficient to limit reporting on what the advisers are carrying out and what information they are supplying, but to clearly demonstrate the trustees' oversight – the monitoring, the reviewing and the challenge carried out.

To ensure effective governance, climate- related risks and opportunities and indeed all environmental, social and governance (ESG) factors that are material to the scheme, should be embedded across all scheme operations with trustees taking a holistic view of the wider impact.

It must not be underestimated the time and effort involved in collecting data and performing the analysis. Good governance with robust monitoring and oversight is essential to not only ensure compliance with the regulatory requirements, but because of the climate change actions and responses to the challenges faced and how this is accurately reported. There can be a number of risks faced by schemes who ignore the severity of the issue.

The disclosures should support the evaluation of whether climate-related risks and opportunities are receiving the appropriate level of attention from the trustee board. Schemes may well suffer reputational damage if the report is found to be lacking. Trustees should therefore consider how the regulations around climate change impact the governance of the scheme and focus on what is material, thus creating a resilient and forward-looking strategy.

# Governance (cont.)

## The importance of stewardship



## Stewardship

“Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries, leading to sustainable benefits for the economy, environment and society.”<sup>(a)</sup>

Effective stewardship can be key in delivering positive outcomes for members. The importance of good practice stewardship, relationships with fund managers and, where relevant, investee companies cannot be underestimated and occupational pension schemes should by now have increased awareness of their stewardship obligations.

Collaboration can have a real impact, and schemes should be monitoring fund managers acting on their behalf, sharing a clear picture of their stewardship priorities. Stewardship activities where schemes may be able to influence include shareholder resolutions, climate change and corporate governance. The DWP has urged schemes to join the [Occupational Pensions Stewardship Council](#) – a platform for sharing best practice and support – and both the DWP and TPR encourage schemes to become signatories to the UK Stewardship Code if they have not already done so.

In addition, trustees should be familiar with the revised [DWP Statutory Guidance](#) setting out its expectations when trustees are reporting on their stewardship activities in the scheme implementation statement. Trustees must now demonstrate a clear link between voting and investment strategies. The Guidance which applies for scheme years ending on or after 1 October 2022, will mean that trustees need to set their expectations of the fund managers and communicate them to ensure voting and engagement activity is carried out in line with the trustees’ investment beliefs and stewardship priorities.

Note: (a) As defined by the UK Stewardship Code

# Strategy and scenario analysis

**“As far as they are able”** = taking all such steps as are reasonable and proportionate in the particular circumstances taking into account costs, or likely costs, which will be incurred by the scheme and the time required to be spent by the trustees or people acting on their behalf



## Regulations

- Trustees must, on an ongoing basis, identify climate-related risks and opportunities which they consider will have an effect over the short, medium and long term on the scheme's investment strategy and where the scheme has a funding strategy, the funding strategy. (Trustees are not required to disclose why they have chosen particular time horizons).
- Trustees must, on an ongoing basis, assess the impact of the climate-related risks and opportunities which they have identified on the scheme's investment strategy and where the scheme has a funding strategy, the funding strategy.
- Trustees must, as far as they are able, undertake scenario analysis in at least two scenarios where there is an increase in the global average temperature and in one of those scenarios the global average temperature increase selected by the trustees must be within the range of 1. 5°C above pre-industrial levels, to and including 2°C above pre-industrial levels.
- Trustees must consider:
  - a) The potential impact on the scheme's assets and liabilities of the effects of the global average increase in temperature and of any steps which might be taken (by governments or otherwise) because of the increase in temperature in such scenarios; and
  - b) The resilience of the scheme's investment strategy (and funding strategy where relevant) in such scenarios.

The scenario analysis must be undertaken:

- a) In the first scheme year in respect of which the requirements apply even if the first year of application is a part year. Trustees may rely on scenario analysis undertaken on any day(s) earlier in that first scheme year provided it complies with the Regulations; and
- b) Every three years thereafter.
- c) Trustees must in each scheme year, except the first scheme year in respect of which the requirements apply, review the most recent scenario analysis they have undertaken and determine whether it is appropriate to undertake new scenario analysis. [Whenever trustees undertake a fresh scenario analysis, the three year cycle is automatically reset.]



# Strategy and scenario analysis

**What is in the Statutory Guidance to support trustees?**

**What needs to be considered?**



## Statutory Guidance

All asset types are within scope for the assessment of a scheme's investment strategy, funding strategy (where it has one) and for scenario analysis. The analysis should cover all scheme assets, including relevant contracts of insurance. In terms of scheme liabilities, an understanding of the overall impact of climate change is expected. Trustees should not start from the assumption that climate change is irrelevant for some assets or sectors.

Strategy activities (which include scenario analysis) should be undertaken at the following levels:

- For a single DB scheme or a DC scheme with no member choices: trustees should look at the level of the whole scheme;
- DB schemes with more than one DB section: trustees should look at each section. However, sections with similar characteristics may be grouped (assets, liabilities, funding);
- DC schemes: trustees should look at each popular arrangement (where £100m or more of scheme assets are invested, or which accounts for 10% or more of the assets used to provide money purchase benefits (excluding AVCs); and
- DB and DC sections: trustees should consider the two sections separately.

It is up to trustees how they determine their time horizons. However, in deciding what the relevant time horizons are, trustees must take into account the liabilities of the scheme and its obligations to pay benefits.

Trustees should also take account of the following:

- In a DB scheme or a DB section of a scheme: the likely time horizon over which current members' benefits will be paid.
- In a DC scheme or a DC section of a scheme: the likely time horizon over which current members' monies will be invested to and through retirement.

Trustees may also consider other factors such as the scheme's cash flow, investment strategy and, where they have one, funding strategy.

Trustees are not required to disclose in their report why they have chosen certain time horizons. However, they may decide to do so.



# Strategy and scenario analysis (cont.)

## What does TPR expect?



## TPR Guidance

- Make sure the investment consultant considers climate risks and opportunities in their next review of the investment strategy and its implementation.
- Add a climate-related risks and opportunities section to scheme investment performance and risk monitoring reports, including an assessment of the current investment strategy.
- For DB schemes, include consideration of climate-related risks and opportunities as part of any actuarial valuation, or as part of any ongoing monitoring or advice provided on scheme funding and covenant. Include such risks and opportunities in the scheme's integrated risk management framework.
- Consider engaging with the sponsoring employer to understand how climate-related risks and opportunities could affect the employer's covenant and find out how the sponsoring employer assesses climate-related risks and opportunities over similar time periods to those the trustees have identified.

Consider the following factors in preparing scenario analysis:

- The nature of the transition to the temperature, for example, a measured orderly transition or a sudden, disorderly transition.
- The potential effects of the scenarios that might arise in the different time periods identified for the scheme.
- The potential effect of the scenario on specific asset classes and individual material holdings.
- The potential effect of adjustments to the strategy.
- For DB schemes in particular, the potential impact on:
  - different tranches of liabilities or liabilities with different characteristics;
  - the employer's covenant: the strength of the employer, the affordability of deficit repair contributions and its ability to underwrite investment and funding risks over different time periods; and as a result
  - contingency planning or covenant monitoring requirements.

Scenario analysis may be qualitative, quantitative, or both. It might be easier to start with a qualitative approach.

# Strategy and scenario analysis (cont.)

## What does TPR expect?



## TPR Guidance (cont.)

### Developments that might trigger the updating of the scenario analysis:

- Investment strategy, for example, a higher allocation being made to matching assets following a material deterioration in the employer covenant, which reduces the trustees' risk appetite.
- The availability of data, for example, increased data availability following the development of their investment managers' climate-related data reporting capability across asset classes.
- The way the scheme's investments are invested, for example, a switch from a growth or matching structure to a dedicated cashflow-driven investment portfolio.
- Modelling techniques or capabilities, for example, after industry reaches consensus about how some currently challenging asset holdings could be better modelled.
- The scheme's liability profile (for a DB scheme), for example, after a material proportion of the scheme's liabilities is secured under a buy-in policy with an insurance company or the carve-out of some of the liabilities following a corporate transaction.
- The scheme's membership profile (for a DC scheme), for example, after a material growth in new business by a DC master trust.
- The introduction of a decumulation fund (for a DC scheme), for example, after a master trust introduces a decumulation option for members, which enables them to take their benefits in retirement from the trust rather than transferring out.
- Global policies or regulations, for example, the introduction of a carbon tax.

# Strategy and scenario analysis (cont.)

What to include in the report.....



## Disclosures – Regulations

Trustees must describe:

- The climate-related risks and opportunities which the trustees have identified and the time periods which the trustees have determined should comprise the short, medium and long term;
- The impact of the climate-related risks and opportunities on the scheme's investment strategy and funding strategy (the latter where relevant);
- The most recent scenarios which the trustees have analysed;
- The potential impacts on the scheme's assets and liabilities which the trustees have identified in the most recent scenarios they have analysed. If trustees have not been able to obtain data to identify potential impacts, they must set out why this is the case;
- The resilience of the scheme's investment strategy and funding strategy (the latter where relevant) in the most recent scenarios the trustees have analysed; and
- Where the trustees have determined not to undertake new scenario analysis outside of the mandatory cycle, the reasons for this decision must be set out in the report.

## Disclosures – Statutory Guidance

Trustees should also describe:

- Their reasons for the choice of scenarios used;
- The key assumptions for the scenarios used and the key limitations of the modelling; and
- Any issues with the data or its analysis which have limited the comprehensiveness of their assessment.

## TPR Guidance

Clearly document the analysis of what the scenarios, and the transitions within them, mean for the scheme and incorporate findings into the wider governance of climate-related risks and opportunities.

# Risk management

**Physical risks<sup>(a)</sup>:** These can be event driven (acute) for example increased severity of weather events, or longer-term shifts in climate patterns (chronic) for example sustained higher temperatures that may cause a rise in sea level

**Transition risks<sup>(a)</sup>:** Transitioning to a lower-carbon economy may entail extensive policy, legal, technology and market changes to address mitigation and adaption requirements related to climate change

**Litigation risks:** Litigation may occur where businesses/investors fail to account for physical or transition risks of climate change



## Regulations

- Trustees must establish and maintain processes for the purpose of enabling them to identify, assess and manage effectively climate-related risks which are relevant to the scheme.
- Trustees must ensure that management of climate-related risks is integrated into their overall risk management of the scheme.

## Statutory Guidance

Trustees should be aware of the material risks that the scheme is exposed to and be able to integrate climate risk into the wider risk management process already in place. To integrate climate-related risks into the scheme's risk management framework, the Guidance sets out four principles trustees should consider: interconnections, temporal orientation, proportionality and consistency.

## TPR Guidance

Example steps to take:

- Identify the climate-related risks and opportunities and assess their impact
- Develop a dashboard
- Make sure the relevant service providers and advisers report on climate-related risks and opportunities
- Include climate-related risks and opportunities in scheme documentation
- Consider how physical and transition risks, including litigation risks, affect the scheme's investments
- Speak with the scheme's employer(s)/sponsor

Note: (a) Per TCFD recommendations



# Risk management (cont.)

What to include in the report.....

## Disclosures – Regulations

Trustees must describe:

- The processes which they have established for identifying, assessing and managing climate-related risks relevant to the scheme; and
- How those processes are integrated within the trustees' overall risk management of the scheme.

## Disclosures – Statutory Guidance

Per the Statutory Guidance, trustees should also include:

- Risk tools used, and the outputs of those tools;
- How the trustees have identified, assessed and managed physical and transitional risks; and
- How the assessment has impacted the scheme's prioritisation and management of risks which pose the most significant potential loss and most likely to occur.

## TPR Guidance

Trustees may also include information on how the trustees' stewardship approach has been used, if at all, to help manage climate-related risks.



# Metrics and targets

**Metrics are a continuously evolving area, and challenges still exist.**



## Regulations

Trustees must select a minimum of:

- One metric which gives the total greenhouse gas (GHG) emissions of the scheme's assets ("absolute emissions metric");
- One metric which gives the total carbon dioxide emissions per unit of currency invested by the scheme ("emissions intensity metric");
- One portfolio alignment metric (from 1 October 2022); and
- One additional climate change metric, for example, climate value at risk or data quality, to calculate in relation to the scheme's assets and must review their selection from time to time as appropriate to the scheme.

Trustees must on an **annual basis** and **as far as they are able**:

- Obtain the scope 1, scope 2 and scope 3<sup>(a)</sup> greenhouse gas emissions of the scheme's assets and the data required to calculate their selected portfolio alignment metric and additional climate change metric;
- Use the data obtained to calculate their selected metrics; and
- Use the metrics they have calculated to identify and assess the climate-related risks and opportunities which are relevant to the scheme.

Trustees may, in the first scheme year in respect of which the requirements apply, rely on data obtained, calculations performed, and identification and assessment of climate-related risks and opportunities undertaken on any day(s) in that first scheme year, including any day before the requirements apply.

Trustees must set a target for the scheme in relation to one of the metrics which they have selected to calculate:

Trustees must on an **annual basis**:

- Measure, as far as they are able, the performance of the scheme against the target they have set; and
- Taking into account that performance, determine whether the target should be retained or replaced.

Note: (a) In the first scheme year the Regulations apply, trustees are not required to obtain the scope 3 greenhouse gas emissions attributable to the scheme's assets.

# Metrics and targets (cont.)



## Statutory Guidance

For the absolute emissions metric, trustees should use total GHG emissions and for the emissions intensity metric, Carbon Footprint should be used, but trustees can also report the Weighted Average Carbon Intensity (WACI) metric should they wish to do so.

A portfolio alignment metric means a metric which gives the alignment of the scheme's assets with the climate change goal of limiting the increase in the global average temperature to 1.5°C above pre-industrial levels.

Trustees should calculate, "as far as they are able", and report one of the three types of portfolio alignment metrics listed below in respect of the assets of their scheme:

- **Binary target measurements:** This tool measures the alignment of a portfolio with a given climate outcome, based on the percentage of investments in that portfolio with declared net zero or Paris-aligned targets.
- **Benchmark performance models:** This involves assessing portfolio alignment by comparing the performance of investments in the portfolio against one or more benchmarks based on climate scenarios.
- **Implied temperature rise (ITR) models:** Models which translate an assessment of alignment or misalignment with a benchmark into a measure of the consequences of that alignment or misalignment in the form of a temperature score.

Trustees should ensure they understand the basic methodological decisions and assumptions that will affect the results of portfolio alignment metric. Metrics should be calculated for each DB section and each popular DC arrangement. Further details can be found in the Guidance.

Targets can be percentage-based or absolute. They can be a fixed point, or a point relative to a benchmark. Target setting should be used to track progress in reducing climate-change risk and trustees should set a reference year to assess progress, the timeframe to meet the target and the methodology for calculating performance against the target set. Trustees are free to select a target in relation to the whole portfolio or only part of the portfolio – for example, in relation to a particular section, fund, sector or asset class. Any emissions target set by the trustees need not cover all 3 scopes of GHG emissions. The target is for the management of material climate-related risks and opportunities only and trustees are not expected to align their own targets with other schemes' or the Government's targets. The targets are not legally binding.

# Metrics and targets (cont.)

What to include in the report.....



## Disclosures – Regulations

Trustees must describe:

- The metrics which the trustees have calculated, and, if the trustees have not been able to obtain data to calculate the metrics for all of the assets of the scheme, why this is the case; and
- The target, or targets which the trustees have set and the performance of the scheme against such target, or targets.

## Disclosures – Statutory Guidance

For all metrics, trustees should concisely explain their methodologies and those of any asset managers or third party service providers used, and their rationale for taking the approach that has been adopted. When disclosing their portfolio alignment metric trustees should describe the key components of the methodology (for example, key judgements, assumptions, data inputs and where relevant how the chosen methodology accounts for data gaps) used to calculate their chosen metric.

If the trustees have chosen to use a metric which is not recommended in the Guidance, they should explain why.

When reporting total GHG emissions and Carbon Footprint, trustees should report the proportion of assets for which data was available. Trustees should concisely explain where data was estimated, and should indicate any assumptions that have been made that could impact significantly on the results. Where they have data of uncertain quality, trustees should again concisely explain this.

Where trustees report metrics on only a proportion of the portfolio, they should explain the proportion on which they are reporting.

When reporting total GHG emissions and Carbon Footprint, trustees should set out the Scope 1 and Scope 2 emissions of assets separately from the Scope 3 emissions of assets for each DB section and each popular DC arrangement. Trustees may additionally report the Scope 1 and Scope 2 emissions of assets separately. Emissions should be reported in amount of CO<sub>2</sub> equivalent (CO<sub>2</sub>e).

Trustees should provide a concise description of the methodology used to measure performance against the target(s), including any estimations relied upon in measuring progress.

Where trustees have replaced a target, they should briefly explain why. Similarly, where a target has been missed, trustees should offer a brief explanation.



# Metrics and targets (cont.)

Key questions....

## Comments

Trustees will face a number of challenges in gathering data – this we know from reports that have already been published.

Key questions to be asked include:

- What controls are there around the data provided?
- How is the data managed?
- Where has the data come from?
- What proportion of data has been verified / modelled / estimated?
- What is the trustees' methodology around producing the required disclosures?



# Points to note



## Sectionalised schemes

The asset threshold test to apply at scheme level, rather than at section level, with duties imposed on trustees of the scheme rather than on any governance committee appointed to manage a particular section.



## Buy-in policies

Even though excluded from the scope test, trustees must still consider them for scenario analysis “as far as they are able”.



## Longevity swaps/on balance-sheet capital backed solutions/ alternative insurance solutions

(where the cost of specified benefits is not fully met in all circumstances) are not exempt for the purposes of the asset threshold test as there remains a risk for trustees to manage.



## Schemes in wind up/ schemes in PPF assessment

The Government does not intend to lift the governance and reporting requirements for schemes in wind-up or in PPF assessment.



## Common investment funds

The Regulations do not apply to the vehicles in which trustees invest. Even where schemes which each have individual assets below the threshold invest in a common investment fund with assets in excess of £1bn, the duties do not bite on any of the investing schemes or the common investment fund itself.



## Earmarked schemes

Relevant assets for earmarked schemes are the value of the assets of the scheme represented by any policies of insurance or annuity contracts that are specifically allocated to the provision of benefits for individual members or any other person who has a right to benefits under the scheme, less the value of the assets of the scheme represented by any relevant contract of insurance.

# Audit impact

Does the Climate Change Report need to be audited.....

**01**

Auditor responsibilities towards the Climate Change Report are similar to the approach to other content of the annual report. It is read and checked for consistency with the financial statements and knowledge gained throughout the audit process. Auditors should ensure that they are familiar with the specific circumstances of their scheme and how the legislative requirements apply.

**02**

ISA (UK) 720 deals with the auditor's responsibilities relating to other information in documents containing audited financial statements and the auditor's report thereon and therefore applies to our approach in auditing the Climate Change Report. The auditor should read the other information to identify material inconsistencies, if any, with the audited financial statements.

**03**

The auditor is not expected to verify any of the other information. The audit engagement partner (and, where appropriate, other senior members of the engagement team), reads the other information with a view to identifying significant misstatements therein or matters which are inconsistent with the financial statements.

**04**

Currently there is no regulatory requirement for the Climate Change Report to be audited. In the absence of a separate requirement, the auditor's opinion does not cover other information and the auditor has no specific responsibility for determining whether or not other information is properly stated.

**05**

However, the auditor reads the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information.

**06**

The auditor may also identify misstatements of fact in other information (which is unrelated to matters appearing in the financial statements), such as incorrect statements or presentation.

# Actions for schemes now falling into scope

**01** Determine the level of relevant assets and if over £1 billion, plan a timetable for the new requirements.

**02** Define roles and responsibilities of those involved in scheme governance. Set reporting deadlines and frequency of updates to be provided to the trustees. Establish clear lines of communication.

**03** Review governance frameworks and processes currently in place - identify any gaps. Ensure sufficient time allocated for the consideration of climate change risks and opportunities.

Review existing beliefs – do these need to be revised? Consider updating risk register.

**04** Plan for data requirements and communicate those requirements to asset managers and advisers as soon as possible.

**05** Early engagement with advisers/investment managers and investment consultants is essential.

**06** Review investment manager agreements/contractual terms to ensure consideration of climate risk is included.

**07** Allocate responsibility for the Climate Change Report and plan how it will be presented so that it is clear enough for a “reasonably engaged and informed member” to understand. Decide if a short summary up front would be useful for some readers.

**08** Engage with sponsoring employer (DB schemes) and consider the impact of climate change on the employer covenant. Will access be granted to employer information? Are NDAs required?

**09** Trustees should have a good understanding of the climate-related risks and opportunities that are relevant to their scheme. If training needs are identified, talk to scheme advisers.

Ensure knowledge and understanding is sufficient to challenge information received.

**10** Remember, Climate Change Reports will be publicly available therefore open to scrutiny. Consider whether there is a need to review member communications.

In addition, consider obtaining assurance over the disclosures.





# Publication and penalties

**Where will the Climate Change Report need to be published...**



## Publication

The Climate Change Report is the output of the trustees' actions and must be published on a publicly available website, accessible free of charge. Members must also be informed via the annual benefit statement (for DC schemes) or the annual funding statement (DB schemes) that the report has been published on a website and the location where it can be found.

The report must be signed on behalf of the trustees by:

- The chair; or
- Where no chair has been appointed, or the chair has ceased to hold office as chair for any reason and a replacement has not yet been appointed, a person appointed by the trustees to act as chair in the interim period for the purpose of signing the report.

(Note: trustees are not required to publish the manuscript signature of the person who has signed the report).

A link must be included in the Annual Report and Accounts within a clear sub-titled section, alongside a short summary explaining the availability of the statement via the link. Trustees may also choose to include in the sub-titled section a short explanation of what the Climate Change Report is, why it is important, a high-level summary of the Climate Change Report findings and where members can find more information on the scheme's other ESG activities.

Trustees must provide TPR with the website address where they have published the most recent Climate Change Report via the scheme return.

## Penalties

TPR will be able to issue discretionary penalties for inadequate reporting; a mandatory penalty will only be issued for the non-production of a report. Failure to notify members via their annual benefit statements or to include a link to the Climate Change Report in the Annual Report would be subject to the existing penalty regime set out in the Disclosure Regulations i.e. up to £5,000 for an individual trustee and £50,000 for a corporate trustee.

# Publication and penalties (cont.)

**Should we be looking at assurance over the report?**

## **What about assurance?**

Assurance is all about demonstrating the quality of data. One of the TCFD's principles for effective disclosure is that "disclosures should be reliable, verifiable, and objective". Assurance can provide an independent review of this effectiveness, and although assurance is currently voluntary, we are nevertheless seeing businesses gain assurance over certain climate-related financial disclosures, and we expect market leaders to move towards comprehensive assurance over disclosures to provide maximum comfort to their investors.

Mandatory assurance appears to be an inevitable next step in the reporting process. Indications are clear that corporate reporting will face some sort of mandatory assurance over the next twelve to twenty four months, and as a natural progression, pension schemes will undoubtedly follow. Not only does the assurance performed provide piece of mind for trustees in the early stages when data can be inconsistent, incomplete and unreliable, it can also help protect the reputation of pension schemes.



# Conclusion



**A scheme that does not consider climate change is ignoring a major risk to pension savings and missing out on potential investment opportunities.**

**David Fairs, TPR Executive Director of Regulatory Policy, Analysis and Advice**



Although data sources and best practice will evolve over time, trustees must educate themselves now on the Climate Change requirements and what it means for their scheme. There is much information and guidance already available, including the [Pensions Climate Risk Industry Group's non-statutory guidance](#). With the planned implementation of the UK Sustainability Disclosure Requirements, the DWP predict further improvements in data availability and transparency.

The Statutory Guidance, states that the principal purpose of disclosure is to ensure trustees are “thorough and rigorous in taking actions required by the Climate Change Governance and Reporting Regulations”. This is in line with the Government’s intention to make TCFD – aligned disclosures mandatory across the economy by 2025.

TPR issued updated guidance earlier this year and we can expect updated supporting guidance from the Pensions Climate Risk Industry Group to aide schemes with their portfolio alignment reporting.

In a blog from TPR in June 2022, the Regulator stated that it will review published reports, and will use the findings to provide high-level observations and feedback. The review will also inform trustees and advisers of smaller schemes not in scope but who wish to improve their management of the climate-related risks and opportunities. TPR goes on to say that it does not anticipate that it will be necessary to issue any penalty notices to trustees of schemes that publish their Climate Change Reports in the first wave, other than where the report has not been published, or where it is clear the trustees have not made a genuine effort to comply with the Regulations. At the time of writing, we await this feedback from the Regulator, but it is clear that climate change governance and reporting will be a key area of focus for 2023.

Compliance with climate change reporting is a cyclical process, which will continue to develop. The introduction of the Sustainability Disclosure Requirements (SDRs) will be the next area of compliance for pension schemes, and the Taskforce on Nature- related Financial Disclosures (TNFD) is gathering momentum, with the release of its third beta framework. Here, nature is seen as an asset and trustees will be under pressure to begin consideration of the associated risks and opportunities, continuing to build on a more integrated thought process.

It is important that reporting links back to the trustees’ strategy with trustees thinking holistically how the Regulations and compliance with those Regulations drives decision-useful information for their scheme.

# Observations from published Climate Change Reports



## Governance

- Most schemes have committees / working parties with delegated responsibility
- Clear oversight by trustee board needs to be demonstrated
- Seen as a key area in the short term as data and methodologies continue to evolve



## Strategy and scenario analysis

- A wide range of scenarios have been used
- Varying degrees of explanation of what the results of the analysis mean for the scheme
- Industry collaboration needed if analysis is to be comparable



## Risk Management

- Integration into risk management framework not always adequately described
- It is key to understand how risks and opportunities are interconnected - a holistic view should be adopted
- As with Governance, a key area in the short term as we see data and methodologies evolve



## Metrics and Targets

- Not all assets covered
- Gaps in data/ estimated data not always sufficiently explained
- Targets often not challenging enough



# Key questions to ask



Are the disclosures relevant and balanced?



Is the scheme aligned with the Stewardship Code?



Are the disclosures reliable?



Are the appropriate processes and controls in place to achieve sufficient and relevant data?



Are the disclosures comparable?



Is the data consistent across all assets?



Is the reporting criteria sufficiently detailed?



# Appendix

# Appendix 1: Background: The TCFD recommendations



The Taskforce on Climate-related Financial Disclosures (TCFD) was established in December 2015 to develop disclosures drawing from existing frameworks where possible, following increased demand for transparency from organisations on risks and risk management processes. The work of the TCFD aligns with the Government's Green Finance Strategy – Transforming Finance for a Greener Future – announced in July 2019. The Green Finance Strategy has two objectives:

- Aligning private sector financial flows with clean, environmentally sustainable and resilient growth; and
- Strengthening the competitiveness of the UK financial services sector.

Three strategic pillars to achieve these objectives are:

- Greening Finance: Ensuring current and future financial risks and opportunities from climate and environmental factors are integrated into mainstream financial decision making, and that markets for green financial products are robust in nature;
- Financing Green: Accelerating finance to support the delivery of the UK's carbon targets and clean growth, resilience and environmental ambitions, as well as international objectives; and
- Capturing the Opportunity: Ensuring UK financial services capture the domestic and international commercial opportunities arising from the "greening of finance", such as climate-related data and analytics, and from "financing green", such as new green financial products and services.

In June 2017, the Final Report of the TCFD established 11 recommendations. (The table overleaf sets these out along with the 7 Principles for Effective Disclosures).

The flexible framework of the recommendations will allow pension schemes to produce meaningful disclosures around the impact of climate change on their investment portfolios.

# Appendix 1: Background: The TCFD recommendations (cont.)



## Governance

- a) Describe the board's oversight of climate-related risks and opportunities.
- b) Describe management's role in assessing and managing climate-related risks and opportunities.



## Strategy

- a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long-term.
- b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning.
- c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.



## Risk Management

- a) Describe the organisation's processes for identifying and assessing climate-related risks.
- b) Describe the organisation's processes for managing climate-related risks.
- c) Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management.



## Metrics and targets

- a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.
- b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks.
- c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.



To underpin the recommendations, the Taskforce developed seven Principles for Effective Disclosures;

1. **Disclosure should represent relevant information;**
2. **Disclosures should be specific and complete;**
3. **Disclosures should be clear, balanced and understandable;**
4. **Disclosures should be consistent over time;**
5. **Disclosures should be comparable among companies within a sector, industry, or portfolio;**
6. **Disclosures should be reliable, verifiable and objective; and**
7. **Disclosures should be provided on a timely basis.**



# Appendix 2 Glossary

**“relevant assets”** means:

- a) in the case of a scheme in respect of which the trustees are required to obtain audited accounts, the total of the amount of the net assets of the scheme recorded in the audited accounts for the scheme year less the value of the assets of the scheme represented by any relevant contract of insurance recorded in those accounts; or
- b) in the case of a scheme which is an ear-marked scheme, the value of the assets of the scheme represented by any policies of insurance or annuity contracts that are specifically allocated to the provision of benefits for individual members or any other person who has a right to benefits under the scheme, less the value of the assets of the scheme represented by any relevant contract of insurance;

**“relevant contract of insurance”** means:

a contract of insurance entered into by the trustees of the scheme with an insurance company regulated in the United Kingdom by the Prudential Regulation Authority where:

- a) the contract is an annuity contract which has secured the provision of a pension in payment to or in respect of a scheme member and, at all times before coming into payment, that pension was a benefit falling within section 181B(2) of the Pension Schemes Act 1993(d); or
- b) the contract provides for payments to be made by the insurance company which are intended, irrespective of future financial market conditions or scheme member longevity, to meet the cost of benefits specified in the contract:
  - which are not money purchase benefits under section 181(1) of the Pension Schemes Act 1993; and
  - which are or will become payable to or in respect of a scheme member.

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**Document Classification: KPMG Public**

CREATE: CRT134312D