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ESG & Climate Change UK pension schemes

Pension schemes & ESG – the legal angle

- An increasing compliance burden We have seen an explosion in regulatory requirements, ministerial and regulatory statements and voluntary initiatives and guidance, on ESG and climate change over the past 2-3 years. With further legislation to come, trustees need to have a clear understanding of their ESG-related compliance obligations
- Beyond compliance Trustees' need to adopt a broader strategic approach which looks beyond the narrow compliance lens. The trustees' strategy should:
  - be driven by their fiduciary duties - exercising the investment power for its proper purpose (see box below)
  - take account of the provisions in the investment regulations around security, quality, liquidity, profitability and diversification, and in a DB scheme, the need to take account of the scheme's liability profile.

How can we help?

- We can work with you to ensure that your investment arrangements not only comply with your regulatory obligations but are consistent with your broader legal duties.
- In particular, we can review and provide input on your ESG/climate change strategy and related documentation, including:
  - your Statement of Investment Principles – does it appropriately reflect the legislative requirements?
  - your implementation statement – *does it comply with best practice guidance?*
  - your investment mandates – *do they give you the powers you need to ensure that your ESG/climate change policy is met?*
  - your strategic objectives for your investment consultant
  - your new "own risk assessment" (see next page)
- We can then work with you and your investment consultant in developing and implementing a forward-thinking ESG strategy which anticipates future regulatory developments.

The purpose of the investment power depends on the nature of the scheme:

DB schemes
To ensure that you have sufficient assets to pay the benefits which are, and become, due under the scheme

DC member choice
To provide a range of investment options which is suitable for the members' requirements

DC default
To provide a pot of money which the member can use to provide benefits on retirement

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The TCFD regime

Under the Pensions Schemes Act 2021, trustees of larger occupational pension schemes, authorised master trusts and authorised collective money purchase schemes must:

- Put in place effective governance, strategy, risk management and accompanying metrics, along with targets for the assessment and management of climate risks and opportunities; and
- Publish climate risk disclosures in line with the recommendations of the TCFD for disclosing climate-related financial information.

Single Code and own risk assessment

- The Single Code requires trustees to carry out and document an own risk assessment of their system of governance in order to gauge the effectiveness of the scheme's risk-management system.
- ESG-related risks form an important part of the own risk assessment, which must cover how the trustees assess:
  - investment risks relating to climate change, the use of resources and the environment; and
  - social risks to the scheme's investments.

Although the single code is in draft, we expect the ORA to form part of the finalised code.

Dates and milestones

Date from which TCFD obligations apply	Master trusts and schemes with net assets >£5m – 1 Oct 2021
	Schemes with net assets between £1-5bn – 1 Oct 2022
	Smaller schemes - 2024 (potentially – to be determined)
1st TCFD report due	Master trusts and schemes with net assets >£5bn – within 7 months of the 1st scheme year end after 1 Oct 2021
	Schemes with net assets between £1-5bn – within 7 months of the 1st scheme year end after 1 Oct 2022
1st implementation statement due	DC/hybrid schemes – 1 Oct 2020
	DB schemes – 1 Oct 2021
1st own risk assessment due	Within 12 months of the Single Code coming into force

Implementation statements – stewardship

Trustees must publish an implementation statement on a publicly available website and on members' benefit statements. The content of the statement differs between DB and DC schemes. For DB schemes, the statement must set out how the scheme's policies have been followed and describe the voting behaviour by, or on behalf of, the Trustees. Whereas, for DC schemes, the statement must (i) set out how the SIP has been followed, (ii) describe any formal review of the SIP and explain any change made to the SIP, (iii) provide the date of the last review (if no review was undertaken during the scheme year) and (iv) describe the Trustee's voting behaviour (as per the DB statement).