MERCER

welcome to brighter

Taking action on climate risk

Mercer's response

Guy Opperman, Minister for Pensions and Financial Inclusion, spoke on 27 January 2021 about climate change and the new requirements for UK pension schemes. This publication provides a summary of the announcement and Mercer's comments.

The UK will be a leader in climate change requirements for pension schemes.

The UK is set to become the first major economy to require climate risks to bespecifically considered and then reported on by pension schemes.

Mercer's comment: The new measures will ensure trustees are legally required to assess and report on the financial risks of climate change within their portfolios. The commitment from the UK government is encouraging, and sets a clear signal to UK pensions trustees that decisions on their response to the new requirements should be made sooner rather than later.

Although the requirements are aimed at trust-based arrangements, we hope that a similar level of reporting will be considered for providers of contract-based arrangements.

Large schemes need to report by 2021, but smaller schemes can expect to report as soon as 2024.

Authorised master trusts and schemes with £5 billion or more in assets will be in scope from October 2021... This will allow the government to identify best practice and — subject to consultation — extend the measures to smaller schemes as soon as 2024.

Mercer's comment: We are working closely with our larger clients on their reporting requirements for later this year, but also starting to work with all clients on reporting in advance of 2024. We believe that the direction of travel is clear, and that many schemes should be able to report on some or all of the requirements sooner than 2024.

The reporting requirements are onerous, therefore we would encourage all schemes to start planning as soon as possible.

The frequency of reporting has been reduced: scenario analysis is triennial, emission-based reporting and reporting against targets will be annual.

> I have reduced the frequency by which trustees are required to carry it out ... This is not an invitation for trustees to do ... analysis and forget about it.

Mercer's comment: We are encouraged by the recognition that some of this reporting will be intensive, but it is likely that some form of annual review or response will still be expected. As this evolves over time, yearly reporting of these complex issues should become simpler.

TCFD requirements will be made mandatory across the economy.

> It would not be right to place a requirement on trustees whilst the rest of the investment chain — on which they rely for data — is not held to the same regulatory standards.

Mercer's comment: As we have seen recently in other reporting requirements, we need clarity across the industry at all levels to ensure consistent and comparable data are available as a result of these requirements.

Divestment is not the answer.

> We are not mandating that schemes commit to specified emissions reductions, and we continue to believe that divestment would be the wrong approach.

Mercer's comment: We have been working with clients for a number of years on their approach to climate change and sustainable investing. We believe that stewardship and engagement can be powerful tools, but that this area is challenging and more needs to be done to encourage asset managers to engage with the companies they invest in.

The Pensions Climate Risk Industry Group also issued non-statutory guidance on the same day. Mercer's Kate Brett was part of this group.

This will be a vital resource for trustees when considering how to improve climate change governance and make disclosures in line with TCFD recommendations.

The guidance issued helps trustees evaluate the way in which climate-related risks and opportunities may affect their strategies.

Mercer's comment: The aim of this non-statutory guidance is to assist trustees in providing high-quality responses. The guidance also references the Investment Consultants Sustainability Working Group's Guide for assessing the climate competency of investment consultants. We hope that clients find this a useful tool and a helpful affirmation of the intention of investment consultants to progress this agenda.

Open consultation on the draft legislation and statutory guidance is to enact the policy proposals, as outlined in August 2020.

This further consultation relates to some of the more practical aspects of the new legislation.

Mercer's comment: Mercer will be responding to this consultation by the deadline of 10 March 2021. We encourage clients who wish to respond to do so.

In addition to climate change, the Pensions Minister also referenced two other consultations from 2020.

Smaller schemes should prove value for members or consolidate.

> **All occupational pension schemes with less than £100 million in assets must either prove that they are offering that value or consolidate.**

Mercer's comment: The Pensions Regulator has been vocal over the last few years about its view that a number of smaller schemes do not offer good value for members. We believe that schemes with less than £100 million in assets should consider their journey plan either to consolidate or to better governance, and have a plan in place with their sponsoring employer.

The charge cap shouldn't prevent investing in illiquid investments.

> **I commend schemes that have already shown leadership by investing in infrastructure, property and private markets but we fall behind our global partners in our commitment to these asset classes and the economy as a whole suffers for it.**

Mercer's comment: As seen in our article with Mercer's response to the charge cap consultation, we welcome the work that is to come on allowing performance-related fees for DC schemes. Investments in private markets are vital to the future of pension schemes, and therefore we are extremely positive on the move to make this simpler for schemes and platforms.

Actions for trustees

- Schemes affected by the 2021 reporting requirements need to review the guidance immediately and set out a road map for compliance.
- Smaller schemes should review what reporting will be required over the next few years and consider a route to compliance.
- Build the new requirements into business plans for 2021 onwards.
- Review your current investment strategy, and consider whether this strategy is likely to meet the future requirements on climate change and sustainability.
- As regulations increase across all areas of pension legislation, smaller schemes should consider a journey plan to compliance or consolidation.

For more information, please contact your usual Mercer consultant or get in touch with one of our experts below:

Lucy Tusa
lucy.tusa@mercer.com

Charles Cowling
charles.cowling@mercer.com

Brian Henderson
brian.henderson@mercer.com

6011442-WE