



ASSOCIATION OF PENSION LAWYERS

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Climate Governance and ESG
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Dear Sirs

Amendments proposed to the Pension Schemes Bill in respect of climate-related risks

We write on behalf of the Investment and Defined Contribution Sub-Committee of the Association of Pension Lawyers of the United Kingdom ("**APL**") in relation to certain recent amendments proposed to the Pension Schemes Bill (the "**Bill**") in respect of climate-related risks.

The APL is a not-for-profit organisation whose members comprise over 1,100 UK lawyers, including most of the leading practitioners in the field, who specialise in providing legal advice on pensions to sponsors and trustees of pension funds and others, including the largest pension funds in the UK. Its purposes include promoting awareness of the role of law in the provision of pensions and to make representations to other organisations and governments on matters of interest to APL members.

General Comments

In general, it is not the role of the APL to comment on matters of policy. However, we do consider it our role to ensure that the legal and practical impact of policy points is considered.

In relation to climate-related risks, the APL recognises that these present core financial risks which pensions trustees will need to consider when setting out their investment strategy. In that respect we welcome Government guidance and legislation that will assist and encourage pension trustees to consider their potential impact as a financially material consideration to the pension schemes they are responsible for administering. Most recently the APL provided our responses on 7 October 2020 to a number of the questions asked in the Government's recent consultation on Taking action on climate risk: improving governance and reporting by

occupational (the “**August Consultation**”). Subject to a number of technical points raised, we are broadly supportive of the aims set out in the August Consultation to improve the governance and reporting of climate-related risks by pension fund trustees. We are also supportive of complementary industry initiatives including the guidance provided by the Pensions Climate Risk Industry Group.

We do, however, think it is important to highlight the significant change that would be made by the recent amendment proposed to the Bill in respect of the proposed introduction of a new Section 41AA in to the Pensions Act 1995 (the “**41AA Amendment**”).

Broadly the 41AA Amendment would require:

- all trustees of occupational pension schemes to develop, set and implement an action plan for ensuring that the investment activities (including stewardship activities) of trustees and managers align with the Paris Agreement goal (as defined) and taking account of requirements to be prescribed in regulations (the “**Mandatory Paris-alignment strategy**”);
- that the objective of a scheme’s Mandatory Paris-alignment strategy must be to achieve net zero greenhouse gas emissions by 2050 (or sooner) (the “**Net Zero investment requirement**”);
- annual reporting on the implementation of the Mandatory Paris-alignment strategy and progress against the Net Zero investment requirement (the “**Reporting requirements**”).

The Current Bill

In its current state (ie without the 41AA Amendment) the Bill would allow the Government to impose new duties on pension scheme trustees intended to ensure effective governance in relation to climate change.

These new powers could be used to require trustees to:

- review the scheme’s exposure to certain risks;
- assess certain types of assets held by the scheme (and determine their contribution to climate change);

- determine, review and (if necessary) revise a strategy and/or targets for managing the scheme's exposure to certain risks;
- measure performance against such targets;
- prepare additional documents and publish information relating to the effects of climate change on the scheme.

Our understanding of these is that the regulation-making power is limited to the imposition of requirements with a view to securing effective governance and disclosure in relation to the effects of climate change. That is our also reading of August Consultation and we have previously been reassured by the DWP that there is no intention that the regulations could be used to provide any prescription on how trustees should invest.

Fundamentally, the Bill would not we think change the basic principle that these risks must normally only be considered in the context of serving the financial interests of members. Trustees can and should ensure that financially material issues are properly taken into account (given their impact on members) but (subject to extremely limited exceptions) cannot take account of these factors independently of members' financial interests.

The 41AA Amendment

By contrast, the 41AA Amendment, the Mandatory Paris Alignment Strategy and the Net Zero investment requirement would implement a much more fundamental change.

Briefly stated, our concern is that, unlike the powers currently taken in the Bill, the 41AA Amendment would impose requirements, not just with a view to securing effective governance by trustees in relation to climate-related risks, but a specific requirement on all trustees to invest in a particular way. The extent to which this would represent a break with established legal principles (namely that trustees retain primacy in investment decision making) cannot be understated.

As the law currently stands the obligation on trustees is to take relevant factors into account in exercising their discretions. As noted above, in relation to investment decisions such factors will generally be those which are financially material to the pension scheme in question. There is no doubt that climate-related risks can (and in most cases probably will) constitute such a factor, but their materiality to the scheme in question will be scheme specific (and will generally need to be backed up by expert financial advice).

It is also true that a growing number of pension schemes are setting their own de-carbonisation and net zero targets (in some cases more ambitious than 2050) within the current legal framework. However, they should only have set such targets where the trustees have taken an investment decision on advice, that such targets are based on financial factors material to the scheme in question and for the proper purposes of that scheme – in broad terms the trustees must believe (usually with the benefit of advice) that adopting such a target is in the best financial interests of the scheme’s beneficiaries. The assessment of the weight to be ascribed to any investment factor and its materiality currently remain a matter for trustee determination in relation to the impact on and circumstances of the particular pension scheme in question and its time horizon.

A statutory intervention requiring that all trustees invest according to a Mandatory Paris Alignment Strategy and Net Zero investment requirement would represent a fundamental change to this position. Whilst it would be for Parliament to determine this as a matter of policy, it is we think important to recognise what a significant change it would be (moving away from the need to serve member interests, towards a wider consideration of factors that may cause members a detriment). Were the Government minded to support such a position we consider that it would be preferable to do so following a period of consultation and impact assessment where the legal and financial implications of such matters might be considered in further depth.

In particular, such assessment would need to consider:

- The legal ramifications of requiring trustees of private trusts to invest according to potentially conflicting statutory and common law duties (other than regarding climate change, trustees' duties would remain to invest in their members' interests).
- The implications on schemes (and wider market implications) of making pension schemes forced sellers of assets.
- Whether the corresponding purchasers of those assets might be more or less likely than pension trustees to use their voting rights and other engagement techniques to encourage the transition of investee business activities towards a low carbon economy.
- In relation to defined benefit schemes, the financial impact on the sponsors of such schemes and, in relation for example to such schemes with short to medium-term targets to buy-out, the extent to which a forced change in investment strategy could disrupt the securing of members’ benefits.
- The extent to which singling out pension schemes supports a whole economy transition, where duties might be expected to land equally on all participants in the investment chain.

- The practical difficulties in defining and measuring progress against Paris alignment and Net Zero targets (including availability of data, consideration of Scope 3 emissions etc.).
- The extent to which any Mandatory Paris Alignment Strategy and/or Net Zero investment requirement would apply to smaller schemes or whether such schemes would be exempt (noting that the August Consultation proposed that only schemes over £1bn, master trusts and collective DC schemes were intended to be in scope of the current climate governance and disclosure requirements in the Bill).

We hope that the above comments are helpful in the consideration of the Bill and the 41AA Amendment.

Please direct any reply to the APL in this matter to Stuart O'Brien at stuart.obrien@sackers.com or at the address set out above.

Yours faithfully



Stuart O'Brien

For and on behalf of the Association of Pension Lawyers