Pension Schemes Bill 2019-20: House of Commons 2nd Reading

This briefing outlines the UK Government's Pension Schemes Bill ("The Bill"); how pensions can help to tackle climate change; the important amendments passed in the House of Lords to facilitate this; and the need for the House of Commons to make further amendments to this end.

Linking pensions and climate change

When the UK hosts the COP26 summit in November 2021, the world will look to the UK Government for leadership on how to address the risks and opportunities posed by climate change. Given the urgency of the crisis, and the risk it poses to UK social and economic stability, we need to raise our ambition and accelerate our action. Climate change is a systemic threat. It is not therefore within the remit of one or two Whitehall departments – any response to it must be embedded throughout the Government's agenda.

The Pension Schemes Bill presents an opportunity to put this into practice. The Bill focuses on the arrangements around collective money purchase schemes and the introduction of a pensions dashboard, as well as points around extending the powers of The Pensions Regulator, DB funding, transfer rights, the Pension Protection Fund and administration charges. Amendments passed in the House of Lords have altered the Bill to better enable pension schemes to address the financial risks of climate change, but more work is needed to ensure schemes are aligned with the interests of savers.

The Bill has potential to deliver on three key policy objectives, in relation to the Department of Work and Pensions, and the Government as a whole: **Tackling climate change**, **increasing transparency in pensions**, and **boosting pension savings**.

As this briefing will explain, climate change presents a material risk to financial assets which UK pension funds are failing to mitigate. This Bill is an opportunity to put our pensions industry on a more sustainable footing. The Government introduced amendments on scheme governance linked to climate change in the House of Lords: this briefing will outline where the Bill has already been improved by the DWP, and other areas where it could be enhanced.

Tackling climate change

Paris Alignment and TCFD reporting

The UK Government needs to ensure that UK pension investment portfolios are aligned with the UK's emission reduction targets. Pension assets total $2.9 trillion (102% of UK GDP)[1]. The size and influence of pension schemes means that they have a vital role to play in ensuring the UK meets its climate commitments, as the Environmental Audit Committee noted in its Greening Finance report[2].

UK pension funds also need to act to protect their beneficiaries' savings from the significant financial risk associated with climate risk. Research from Mercer has found for nearly all asset classes, regions and timeframes, a 2C scenario leads to enhanced projected returns versus 3C or 4C and therefore a better outcome for investors[3].

Research and analysis (including from the IIGCC)[4] is already emerging that will help pension funds with the practicalities of meeting such requirements – and more would emerge quickly as asset managers and advisors reacted to this new requirement. Initiatives such as the Asset Owner Alliance[5], which has convened some of the world's largest pension funds and insurers to report on their climate risk, shows how this could be done in practice.

However, the pensions industry's response to climate-related financial risk must improve and accelerate. The Pensions Minister has recently spoken of climate risk mattering to schemes 'more than interest rates, exchange rates, company and sector performance and inflation'[6]. Schemes need to now publish data on the scale of their exposure to climate risk, and then use this information to inform stewardship of high carbon companies in their portfolios. The Government has also launched a consultation on action on climate risk for larger occupational pension schemes[7]. The Government has therefore presented an amendment to the Bill that will require schemes to start producing this data.

Section 124: Climate change risk

- Section 124 requires occupational pension schemes to manage the effects of climate change as a financial risk to their investments and to report publicly on how they have done so. It makes amendments to the Pensions Act 1995 to:
    - Impose requirements on occupational pension scheme trustees and managers to 'secure effective governance on the effect of climate change on the scheme'; and

1 https://www.thinkingaheadinstitute.org/-/media/TAI/Pdf/Research-Ideas/GPAS_2019_final.pdf?modified=20190208104038, p. 23
2 https://publications.parliament.uk/pa/cm201719/cmselect/cmenvaud/1063/106305.htm#_idTextAnchor013
3 https://www.mercer.com/our-thinking/wealth/climate-change-the-sequel.html
4 https://www.iigcc.org/news/european-investors-launch-project-to-support-alignment-of-portfolios-to-the-paris-agreement/
5 https://wwf.panda.org/our_work/finance/?353375/Net-Zero-Asset-Owner-Alliance
6 https://www.pensionsage.com/pa/EXCLUSIVE-Climate-change-risk-largest-risk-to-pension-schemes-Opperman.php
7 https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes

- » Set out the kinds of activities trustees of pension schemes may be required to undertake to manage the effects of climate change.

» This goes further than the regulatory changes which came into force in October 2019, that require a scheme's Statement of Investment Principles to specify its policies in relation to financially material considerations (including ESG considerations) and in relation to voting rights and engagement activities.

» Section 124 requires trustees to explicitly consider climate change goals, including the Paris Agreement temperature goal, for the purpose of ensuring the effective governance of their schemes. It sets out the kinds of activities trustees and managers of pension schemes might undertake to manage climate risks.

» The requirements in Section 124 would not necessarily involve divestment from any particular sector. They would however involve trustees assessing whether the companies in their portfolios have a clear strategy for low carbon transition. . The effect of this new requirement for UK pension schemes would be to give companies a helpful new incentive to develop Paris-compliant business models and invest in low-carbon opportunities, making it easier for the Government to achieve its own emissions reduction targets.

» The reporting requirements set out in Section 124amendment are based on the Taskforce for Climate-related Financial Disclosures framework[8], which was endorsed by the UK Government in 2017[9].

Section 124 will catalyse the UK's pensions industry to start producing climate reports, and then take the necessary action to mitigate climate risks to their assets. This is long overdue. In 2019, a ShareAction report surveyed the 25 largest pension schemes of FTSE100 corporations, representing £17.5bn assets under management. The survey found great variance amongst the schemes in terms of how far they had integrated climate risk into their investment strategies[10]. Just two of these schemes had default funds (for the vast majority of their members) that were explicitly designed to reduce exposure to climate risk[11]. Section 124 will create a race to the top within the pensions industry, driving real action by pension funds to tackle climate risks.

In the House of Lords, the Government Minister Baroness Stedman-Scott made clear the objective of this section of the Bill is to raise standards within pension schemes, while ensuring they retain their powers over investment decision-making: "Operational independence, which is, of course, an important part of our system for trustees, is maintained. However, the requirement to disclose how the trustees are mitigating climate risk should also help to drive up standards of trusteeship, as well as protecting these assets and enhancing the UK's global role in tackling climate change and other related issues[12]."

8 https://www.fsb-tcfd.org/publications/final-recommendations-report/
9 https://www.gov.uk/government/news/uk-government-launches-plan-to-accelerate-growth-of-green-finance
10 https://shareaction.org/wp-content/uploads/2019/02/CorporatePensions2019.pdf, p. 21.
11 Ibid, p. 25.
12 https://hansard.parliament.uk/Lords/2020-02-26/debates/6AEE06F4-23E4-4F94-B5B4-C2BFBBD83108/PensionSchemesBill(HL)

Increasing Transparency

The pensions dashboard – information on schemes' approaches to ESG

- A key component of the Bill is the creation of the pensions dashboard. This is designed as a single public interface for savers to access information about their pension. It is designed to ensure pension schemes operate more transparently – for example, by making information on costs, fees and charges more accessible.
- There is a danger that data relating to climate risk will not be configured into the operation of the dashboard. Just as information on costs, fees and charges are important for savers to know, so too is information on how their scheme is managing climate risk and other ESG factors. The Bill should specify this to ensure the dashboard fulfils this function from its inception.
- In the House of Lords, Government Minister Baroness Stedman-Scott said they wanted to prioritise information on costs, fees and charges over ESG data. However, as the Government itself has recognised, ESG factors pose a financial risk to pension schemes, and DWP should ensure all schemes provide relevant information on this via the dashboard for the benefit of savers.
- **We encourage members to raise the above points with the Minister and to support proposed amendments at later stages to ensure that, from its inception, the pensions dashboard will provide ESG data to savers.**

Encourage diversity in pension schemes

- Numerous studies have found that diverse groups are more effective at decision-making. Recent analysis of official data suggests the gap between men and women's pension income is nearly 40%, nearly twice that of the gender pay gap[13].
- The PLSA's recent report *Diversity and Inclusion Made Simple* highlights that:
    - 83% of trustees are male (compared with 68% male FTSE100 board members)
    - Just 2.5% pension trustees are under 30
    - Just 5% of pension scheme boards have more than 50% female trustees
    - 25% of schemes have all male boards
- In the House of Lords, Baroness Stedman-Scott said that following a consultation on diversity of pension scheme boards, The Pensions Regulator "concluded that 'it would be beneficial to create an industry working group' to further investigate the profile of this important issue, with a view to developing additional guidance and supporting material to help improve the diversity of trustee boards." Whilst this is a welcome development, the working group will require data with which to work. Introducing reporting requirements for pension schemes on the composition of their trustee boards in terms of differentials such as age, gender and ethnicity will help the working group to assess

13 https://www.ft.com/content/c9b74996-b582-11e7-aa26-bb002965bce8

the situation as it stands. As a result they will be able to take more effective action to improve board diversity for the benefit of savers.

- **We encourage members to raise the above points with the Minister and to support proposed amendments at later stages to ensure pension schemes submit data to The Pensions Regulator on the diversity of their trustee boards.**

A central repository for SIPs, Chair's Statements and Implementation Statements

- Pension schemes are legally required to publish a Statement of Investment Principles (SIP). The DWP and The Pensions Regulator should create a central repository for SIPs, so savers are able to easily access and compare the investment policies of their scheme and others. The Modern Slavery Registry could serve as a model for this.
- A recent report by the UK Sustainable Investment and Finance Association found that two thirds of schemes were not compliant with their legal duty to publish their SIP[14].
- The Bill should therefore create a requirement for trustees to send a copy of the latest version of their SIP, Chair's Statement and Implementation Statement to The Pensions Regulator for publication, and a duty on TPR to create and maintain a public SIP repository.
- In the House of Lords, Baroness Stedman-Scott confirmed the Government was looking to create a SIP repository. However, to ensure this is put into action, we would urge MPs to amend the Bill so that the DWP puts the initiative on a statutory footing.
- **We encourage members to raise the above points with the Minister and to support proposed amendments at later stages to ensure the Bill guarantees a SIP repository will be created.**

Boosting savings

Create a duty for pension schemes to seek to understand members' views

- Recent DFID research into people's views on sustainable investing has shown that more than two thirds of UK savers would like their investments to be responsible and make a positive impact[15]. However, very few pension schemes routinely seek to understand their members' views; even fewer go on to design their investment strategies in ways that match their members' preferences and views.
- Seeking to understand members' views could take many forms depending on the size and resources of a pension scheme, from offering the opportunity to comment on a draft

14 https://uksif.org/2020/02/06/uksif-flags-pension-scheme-transparency-noncompliance/
15 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/834207/Investing-in-a-better-wold-full-report.pdf

investment policy, to surveys and focus groups that help schemes develop policies that reflect their members' priorities and interests. Scheme decision-makers should not be bound by the results of any consultation with their members but such efforts to understand members' view should inform decisions made for the benefit of scheme members. There is strong emerging evidence that asking members for their views on ESG issues can help increase engagement with pension saving, building a sense of ownership and potentially driving up contribution levels. In the DFID research 52% of people surveyed said they would save more if they knew their savings and investments made a positive difference in the world.

» **We encourage members to raise the above points with the Minister and to support proposed amendments at later stages to require pension schemes to submit data to The Pensions Regulator on how they have sought the views of scheme members.**

Questions for the Minister

» Does the Minister agree that the pensions dashboard could help improve the huge levels of disengagement with pensions, and will his department consider using the dashboard to highlight information about responsible investment, where evidence shows high levels of interest, particularly amongst millennials?

» Does the Minister agree with the Law Commission that pension scheme trustees are permitted to take into account the views of members in their investment approach and, if so, what steps can be taken by Government, TPR and industry to encourage this in practice?

» Given that the TCFD recommendations are applicable to banks, fund management firms and corporates, as well as pension schemes, what conversations has he had with his ministerial colleagues to ensure a joined-up approach by Government?

» What steps will he take personally to ensure that the issues around diversity in pension schemes governance (83% trustees are male, while 25% of trustee boards are all male [PLSA 2016 survey]) are resolved and can he give an update on TPR's work to drive this forward?

Annex 1 - Content of the Bill

Part 1:

» Sets out arrangements for the authorisation and ongoing management of collective money purchase schemes (collective defined contribution (CDC) schemes where contributions into the scheme are pooled and invested with a view to delivering an aspired benefit level).

Part 2:

- Sets out arrangements for the authorisation and ongoing management of CDC schemes in Northern Ireland.

Part 3:

- Extends powers of The Pensions Regulator (TPR) in relation to imposing criminal offences and civil penalties, issuing contribution notices, requiring statements on corporate transactions affecting DB pension schemes and gathering information on potential breaches of pension legislation.

Part 4:

- Sets out arrangements for establishing a pension dashboard service, including making regulations requiring information from occupational pension schemes.

Part 5:

- Requires DB scheme trustees to have a scheme-specific funding and investment strategy and explain this to TPR in a statement of strategy, and strengthens TPR's scheme funding enforcement powers.
- Allows regulations to be made to require trustees to disclose information on climate-related financial risk.
- Allows regulations to be made to limit the circumstances under which members of DB schemes can transfer to another scheme.
- Makes changes to legislation to allow a fixed pension to be treated as pensionable service for the purposes of calculating Pension Protection Fund compensation.
- Clarifies what costs fall within the definition of an administrative charge.

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