Avoiding pitfalls in your climate-related financial disclosures

A guide for occupational pension schemes

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Disclosure Principles

In the UK, disclosures per the Taskforce for Climate-Related Disclosures (TCFD) framework became mandatory for the largest pension schemes (£5bn+ assets), authorised master trusts and CDC schemes (once established) in October 2021. Smaller schemes (£1bn+) will need to comply from 1 October 2022.

TPR has developed guidance for pension schemes to follow when making their climate-related financial disclosures, which complements the DWP's Statutory Guidance issued July 2021. The Statutory Guidance includes the recommendation to comply with each of the TCFD framework's seven principles for effective disclosure. We acknowledge this is not an easy process for many pension schemes, and that there may be unforeseen obstacles along the way that require time and expertise to overcome.

Below, we explore some of the possible pitfalls on the path to effective climate-related financial disclosures and consider what pension schemes can do to avoid these.

Seven principles for effective disclosure per the TCFD framework:

- Represent relevant information
- Be specific and complete
- Be clear, balanced, and understandable
- Be consistent over time
- Be comparable among companies within a sector, industry or portfolio
- Be reliable, verifiable and objective
- Be provided on a timely basis

Developing Reporting Criteria

A valuable tool in preparing effective disclosures are scheme-specific reporting criteria. These will guide the contents of disclosures. Each scheme should develop reporting criteria based on the regulatory requirements and DWP guidance; the TCFD recommendations and guidance; and the scheme's own specific features and needs.

Developing internal reporting criteria will be invaluable for:

- Ensuring that your disclosures cover all material areas;
- Ensuring that your disclosures are consistent over time; and
- Assisting your preparers to produce verifiable disclosures.

Best practice in reporting criteria for climate-related financial disclosures will emerge in the coming years. To give one example of emerging practice, the International Sustainability Standards Board (ISSB) opened consultation on their draft climate standard[1] on 31 March 2022. We recommend looking at this when considering your reporting criteria. It provides a good foundation to understanding the details of climate-related financial disclosures. However, we note that, at the time of publication, the standard is not yet finalised.

[1] IFRS - ISSB delivers proposals that create comprehensive global baseline of sustainability disclosures

Below, we explore how pension schemes can avoid potential pitfalls when preparing climate-related financial disclosures across the four pillars of Governance, Strategy, Risk Management and Metrics & Targets.

Governance

Disclose the scheme's governance around climate-related risks and opportunities.

Trustees must:

- Establish oversight of relevant climate-related risks and opportunities
- Build knowledge of climate-related risks and opportunities and their management
- Describe:
  - Oversight processes
  - Roles of all those involved in governance processes

Strategy

Disclose impacts of climate-related risks and opportunities on the scheme's strategy, and financial planning.

Trustees must:

- Select different time horizons
- As far as possible, undertake scenario analysis in at least 2 scenarios every 3 years
- Describe:
  - Choice of scenarios
  - Key modelling assumptions
  - Impacts on assets, investment and funding strategies
  - Strategy resilience

Risk Management

Disclose how the scheme identifies, assesses, and manages climate-related risks.

Trustees must:

- Integrate climate-related risks into the overall risk management of the scheme
- Describe:
  - Processes for identifying, assessing and managing risks
  - How processes are integrated within overall risk management of the scheme

Metrics & Targets

Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities.

Trustees must:

- Calculate an absolute emissions metric, an emissions intensity metric, a portfolio-aligned metric, and another climate change metric
- As far as possible, report Scope 1, 2 & 3 emissions of the scheme's assets
- Measure scheme performance annually and set/update targets
- Describe:
  - Metrics and methodology
  - Targets & assumptions

Sources: DWP regulations, TKU regulatory requirements, TCFD reporting regulations

	Condensed Requirements and Guidance for pension schemes' climate-related financial disclosures[2]	Possible pitfalls	How to avoid them
Governance	**Regulations** • Describe how the trustees maintain oversight of climate-related risks and opportunities. • Detail people/ advisors who undertake relevant governance activities, and how the trustees satisfy themselves that they are performed adequately. **Guidance** • Describe how, and how frequently, the board is informed about, assesses and manages climate-related risks and opportunities. • Describe how the trustees challenge this information. • Detail the time and resources spent on governance of climate-related risks and opportunities. • Describe relevant training taken by trustees, employees and/or external advisors.	The following factors could lead to poor disclosure against the Governance pillar: • Unclear reporting lines to trustees. • Lack of clarity over management's and/or advisors' responsibilities. • Lack of evidence of governance responsibilities in schemes' internal documents such as policies, mandates, or the Statement of Investment Principles (SIP). • Insufficient time in trustee meetings, leading to a lack of trustee challenge. • Insufficient reporting made to trustees to enable challenge. • Lack of evidence of trustee discussions, decisions, and upskilling practice which could lead to difficulties in disclosing these details. • Insufficient expertise at trustee, management and/or advisor level.	To avoid these pitfalls, schemes should consider the following mitigations: • Allocate responsibilities and reporting lines clearly and integrate these into the scheme's internal documentation. • Set agendas for trustee meetings that include discussion of climate-related issues, and keep detailed minutes of discussions. • Conduct skill gap analyses at trustee, management and advisor level and ensure training is in place to close gaps, maintaining attendance records. • Revisit internal audit function's mandate to ensure that it captures the scheme's climate-related activities, and introduce necessary controls to ensure the integrity of respective disclosures.
Strategy and Scenario Analysis	**Regulations** • Describe the climate-related risks and opportunities identified over short, medium and long time periods, and define these periods. • Describe the impact of risks and opportunities on investment strategy and funding strategy (the latter where relevant). • Describe the most recent scenarios analysed and the potential impacts on assets and liabilities. Explain reasons for any areas where data was not obtainable. • Describe the resilience of the investment strategy and funding strategy in the most recent scenarios. • Where scenario analysis is not performed outside of the mandatory cycle, explain the rationale. **Guidance** • Explain the rationale for the scenarios used. • Describe the key assumptions used in the scenarios and the key limitations of the modelling. • (DB schemes) Describe how the employer covenant is impacted by climate-related risks and opportunities.	The following factors could lead to poor disclosure against the Strategy pillar: • Inappropriate or inaccurate base data used for scenario analysis. • Unreliable information provided by asset managers. • Incompatible information provided by different asset managers, making it difficult to identify scheme-level risks and opportunities and conduct scheme-level scenario analysis. • Insufficient trustee and management understanding of the data provided by asset managers, making it difficult to plan to close data gaps. • Irrelevant or poorly executed scenario analysis performed by third parties. • Poor understanding of the relevant time horizons leading to poor linkage to the scheme's strategic investment planning horizons. • Inadequate integration of climate-related risks and opportunities into the investment strategy and funding strategy. • Insufficient trustee and management understanding of the processes behind the scenario analysis, which could lead to vague or irrelevant disclosures. • Insufficient trustee and management understanding of TPR's expectations and recommendations, leading to incomplete disclosures.	To avoid these pitfalls, schemes should consider the following mitigations: • Open communication with any relevant parties (administrators, investment advisors, fund managers, employer entity etc.) to discuss the data underpinning scenario analysis and modelling. • Maintain effective communication channels year on year as disclosures are made. • Require detailed and appropriate reporting of climate data from investment advisors and fund managers. • Develop controls to ensure the completeness and accuracy of base data. • Perform a data gap analysis and plan to close any identified data gaps. • Integrate scenario analysis findings into the investment and funding strategy to demonstrate the climate-resilience of the scheme's strategies. • Upskill the trustee and management as required to ensure the scheme benefits from appropriate competency in scenario analysis. • Engage early with the Regulations, Statutory Guidance, and TPR expectations and plan to meet them.

[2]For full details of requirements and guidance, see Pension schemes and the Taskforce on Climate-related Financial Disclosures

	Condensed Requirements and Guidance for pension schemes' climate-related financial disclosures[2]	Possible pitfalls	How to avoid them
Risk Management	**Regulations** • Describe processes for identifying, assessing and managing climate-related risks, and how those processes are integrated within the scheme's overall risk management. **Guidance** • Describe risk tools used, and the outputs of those tools. • Describe how the risk assessment has impacted the scheme's management of high impact, high probability risks.	The following factors could lead to poor disclosure against the Risk Management pillar: • As with the Strategy pillar, inappropriate, unreliable, or incompatible data from asset managers could lead to inaccurate assessments of the impact and probability of climate-related risks. • Ineffective communication with relevant parties (administrators, investment advisors, fund managers, employer entity etc.) could lead to insufficient processes to manage identified risks. • Poor integration of climate-related risk management into overall scheme risk management. For example, failure to include climate-related risks on the risk register. This would make it difficult to disclose the key risks identified by the scheme. • Poor integration of climate-related risks into covenant monitoring could lead to unidentified funding risks, possibly affecting going concern.	To avoid these pitfalls, schemes should consider the following mitigations: • As with the Strategy pillar, implementing an effective communication plan with relevant parties will support clear messaging on risk identification, assessment and management. • Include climate-related risks on the scheme risk register. • Include climate-related risks in covenant monitoring. • Ensure the risk management approach is aligned with the scheme's SIP.
Metrics and Targets	**Regulations** • State the results of the metrics for the disclosure period. • Describe the methodologies used, including the basis for estimations. • Explain the rationale for the metrics chosen. • Explain the reasons for any areas where data was not obtainable. • State the target(s) and performance against them. **Guidance** • Explain for any replaced targets. • Explain for any missed targets.	The following factors could lead to poor disclosure against the Metrics and Targets pillar: • Not disclosing metrics required by the Regulations. • Use of irrelevant metrics, which do not feed into the investment or funding strategy. • Failure to communicate with asset managers to close data gaps. • Inappropriate methodologies used by asset managers or investment advisors to calculate metrics. • Inability to set relevant targets due to inaccurate data. • Use of targets that are not aligned to the latest pension industry recommendations.	To avoid these pitfalls, schemes should consider the following mitigations: • Plan ahead to gather the data needed to disclose the metrics required by the Regulations. • Conduct materiality analysis to inform the choice of metrics needed to monitor material topics. The choice of metrics should reflect the data assessment performed in the strategy pillar. • Integrate the use of the disclosed metrics into the management of the scheme. For instance, metrics can be used to monitor the success of investment and funding strategies. • Ensure effective communication with asset managers and investment advisors over the calculation of metrics. • Implement controls over the data used in metrics and target setting to ensure its accuracy and completeness.

The role of third party assurance

Pension schemes may also consider external assurance as part of managing the quality of climate-related financial disclosures. Your assurance provider would conduct procedures to provide assurance that data is accurate, and that scenarios and assumptions have been applied appropriately and consistently with business decisions to be made.

Pension scheme trustees can seek climate-related financial disclosures assurance services from their statutory auditors, as these services are permitted under the FRC's Revised Ethical Standard for Audit and Assurance 2019. Indeed, there is a strong argument that assurance from a qualified, independent auditor is beneficial for both the robustness of the assurance provided, and for gaining efficiencies in these complementary services.

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