Broadstone

General Code – Climate Change Risk

April 2024

Introduction

On 10 January 2024, the General Code was laid before Parliament, and came into force on 28 March 2024. The General Code (formerly known as the Single Code) takes 10 of the Pensions Regulator's 16 Codes of Practice and condenses them into modules. **It also introduces new requirements for trustees of all schemes, including the need to consider climate change risk**.

This briefing note details what steps trustees must take with regards to climate change risk, and what actions trustees should or may wish to take to be compliant with these new requirements. Further details on the General Code can be found in our Briefing Note 251.

Background

Trustees have been required to consider all material risks facing their pension scheme, including climate change risk, since the introduction of the Pensions Act 2004. However, this requirement has been strengthened and clarified over recent years, most notably from the following:

- **2018 investment regulations:** The Occupational Pension Schemes (Investment and Disclosure (Amendment) Regulations 2018) clarified that trustees of occupational pension schemes must disclose their policy towards financially material considerations in connection with environmental, social and governance ('ESG') issues, including the impact of climate change risk, in their Statement of Investment Principles ('SIP').
- **2021 investment regulations:** The regulations introduced new requirements for large pension schemes and all master trusts to report on how they are monitoring and managing climate change risk within their schemes in line with recommendations from the former Taskforce on Climate Related Financial Disclosures ('TCFD').

- **Department for Work & Pensions (DWP) Guidance June 2022:** The DWP issued guidance when preparing SIPs, clarifying that trustees have a stewardship duty in connection to ESG issues (including the impact of climate change) that cannot be fully delegated to a third party on their behalf.
- **The Pensions Regulator (TPR) Blog April 2023:** TPR clarified that it expects trustees of occupational pension schemes to consider ESG issues as part of their fiduciary duties.

The General Code further strengthens this direction of travel with regards to ESG issues, and explicitly sets out what trustees must consider in connection with the risk of climate change.

Requirements

Here are the requirements set out by the General Code with regards to climate change risk.

1) **Documentation** – Trustees must formally disclose their policy towards climate change risk, including considering the risk over different time horizons, trustees' views on climate change risk, how climate change risk has been taken account of when setting the scheme's funding and investment strategy, and how the trustees assess and monitor climate change risk. This policy will also be assessed as part of trustees' Own Risk Assessment ('ORA') (where required under the General Code).

2) **Investment decision making** – Under the General Code, trustees must ensure that climate change risk is being fully considered when the investment strategy is being set, either in determining the strategic allocation to asset classes and/or in the selection of an investment manager/fund.

3) **Climate change risk management** – The General Code also requires trustees to consider how they are managing climate change risk as part of an effective system of governance ('ESoG'). This includes both measuring and monitoring climate change risk, as well as clarifying that the impact of climate change risk should be assessed over different time horizons. Trustees should consider how they are monitoring climate change risk (e.g. via their risk register or monitoring reports), as well as considering whether to set any formal targets for the mitigation of climate change risk.

4) **Disclosure** – The General Code has re-clarified that occupational pension schemes should continue to disclosure any reports under the 2021 investment regulations (see above), if currently required to do so.

For those schemes which need to complete an ORA, trustees must assess how the principles and requirements of the General Code have been met. While an ORA needs to be prepared at the scheme year-end that falls on or after 28 March 2026, it needs to cover the twelve months to that year-end. Therefore, we would recommend trustees review the requirements above with a view to **putting in place any new documents or governance procedures by early 2025.**

It should also be noted that these requirements apply to **all** pension schemes, irrespective of size or circumstances, and this may be particularly relevant for those schemes who do not have a SIP in place but who now need to disclose a policy on climate change risk. However, the General Code does allow a degree of proportionality in meeting these requirements.

Actions for Trustees

We have set out below what trustees *must* do, or *should* do to meet the requirements noted above.

1) **Documentation** – A **climate change policy** *must* be formally put in place by trustees. Where a SIP is in place and already includes wording on the trustees' policy towards climate change risk, this may either need to be expanded to meet the requirements of the General Code, or refer to a separate climate change policy that has been put in place. For schemes that have recently purchased a buy-in policy, or about to purchase one, the climate change policy may need to refer to the climate change policy of the insurer itself. Similar to any other material financial risk, trustees *should* have an understanding of the potential magnitude of climate change risk and the possible options available to mitigate this (please see below).

2) **Investment decision making** – Although the General Code does not directly require trustees to put in place an investment strategy that has an explicit focus on ESG issues, trustees *should* consider climate change risk when selecting their investment strategy.

   When determining the strategic allocation to asset classes, trustees could consider a **climate change value at risk** ('VaR') measure to compare the climate change risk of different strategies in relative terms. Alternatively, trustees could consider **scenario analysis** to understand how their investment strategy might be impacted under different climate scenarios.

   Trustees *should* also consider whether the sponsoring employer has any views or policies on climate change, or is actively monitoring/reducing carbon emissions within its business, to ensure the scheme's investment strategy is aligned with the sponsoring employer's actions.

In selecting an investment manager/fund, it is important for trustees to understand how the investment manager is taking ESG issues into account when managing the assets on behalf of the trustees (this is not a new requirement but is reinforced by the General Code).

3) **Climate change risk management** – Trustees *should* consider updating their **risk register** and governance procedures in the first instance, which may require climate change risk to be set out as an explicit risk rather than included within a wider ESG related risk. **Scenario analysis** (as detailed above) can help measure climate change risk, as well as helping trustees understand how climate change risk impacts their scheme. **Climate change metrics** (e.g. carbon emissions of investments, temperature alignment with the Paris Climate Agreement, etc.) can also be useful to measure and monitor over time.

4) **Disclosure** – There are no new disclosure requirements under the General Code. However, trustees *should* consider whether to disclose any additional information to members e.g. publication of their climate change policy on a free to access website.

Ongoing Monitoring

Although the General Code has introduced new requirements from 28 March 2024, and schemes will be expected to comply with these requirements over the next year or so, the principles of the General Code require trustees to review their governance processes on an ongoing basis.

With regards to climate change risk, trustees will need to ensure that the risk is being regularly monitored and assessed. Furthermore, climate change risk is expected to continually evolve as climate change science and understanding improves over time. Trustees should therefore consider climate change risk as part of any formal investment strategy review, and in conjunction with the triennial actuarial valuation cycle for defined benefit pension schemes. Trustees should also ensure climate change risk is being regularly re-appraised within their governance arrangements e.g. whenever the risk register is reviewed and updated, or as part of regular climate change monitoring.

Broadstone Comment

The General Code has further strengthened the need for trustees to explicitly consider climate change risk in terms of governance, investment and funding. However, it is reassuring that there is a degree of flexibility and proportionality in how trustees need to consider climate change risk under the General Code, which will be of importance to small to medium sized pension schemes, as well as schemes that are in the process of, or close to, buying out their benefits with an insurer.

In terms of the immediate steps that trustees should be considering, we have set these out below. We recommend trustees consider making these steps by early 2025, which will help if trustees need to undertake an ORA.

Climate Change Policy

Trustees must put in place a policy that sets out their approach to climate change risk.

Climate Change Risk Assessment

To demonstrate that climate change risk has been assessed from an investment and funding perspective, trustees should consider undertaking a broad analysis of the impact of different climate scenarios.

Risk Register

We recommend trustees update their risk register to explicitly include climate change risk.

If you have any questions regarding the information in this Briefing Note, or compliance with the General Code, please contact your usual Broadstone investment or scheme consultant.

Find out more

For more information on how Broadstone can help you, please contact your Broadstone consultant or use the details below.

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