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UK's Pensions Regulator Pushes for Further Climate Scenario Analysis

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In August 2023, the UK pensions regulator's climate and sustainability lead, Mark Hill, **authored an article** setting out how trustees can improve the climate-scenario analyses used by their schemes, in order to make them more "decision-useful." While Hill acknowledged that the sector had made progress on its climate journey, "data and analytical gaps and imperfect models seem to present considerable challenges."

Earlier this year, The Pensions Regulator's (TPR) Executive Director **raised concerns over the integrity of some climate scenarios** and warned in-scope schemes that enforcement action may be taken against them for failure to comply with TPR's requirements to, among other things, publish a statement of investment principles (SIP). A scheme's SIP should set out its investment policy and include considerations of financially material ESG factors including, but not limited to, climate change.

In his piece, Hill stated that since Parish voiced the TPR's concerns in April, the regulator had seen schemes' climate scenarios drawn further into question in media articles and in a report by the Institute and Faculty of Actuaries entitled **"The Emperor's New Climate Scenarios,"** which highlights the drawbacks of current models and scenario analysis, and casts doubt on the validity of some published outcomes. Addressing those reports, Hill said "[t]hey rightly question the validity of some published outcomes, which appear to seriously underestimate the financial risk from climate change and are at odds with the established earth and climate science."

Hill considered how trustees can help drive the change required in climate scenario analyses and outlined TPR's expectations of trustees:

- have an appropriate level of knowledge and understanding of climate issues;
- undertake regular training and ask for additional training if required;
- regularly review climate-related capabilities of service providers and consider whether there is a need for additional or specialist advisers;
- be able to understand the narratives underlying climate scenarios, the limitations of those scenarios and the assumptions made in their constructions;
- broadly rationalize the outputs from those scenarios for their scheme; and
- consider with advisers the use of stress testing and tail risk analysis to complement their climate scenario input to investment strategy decision making.

In closing, Hill stated that one of TPR's aims as part of its climate change strategy was to influence debates around pensions and climate change. The regulator will continue to encourage more debate ahead of the Department of Work and Pensions' (DWP) review of the TCFD recommendations, when it will consider whether the UK's Climate Change Governance and Reporting Regulations ought to be amended so as to encompass the TCFD recommendations.

Taking the Temperature: This latest call by TPR for schemes to improve the way they analyze potential ESG risks and opportunities is by no means the first. In May 2023, TPR undertook a review of the disclosures published by more than 71 UK pensions schemes and highlighted several areas for improvement, including that disclosures of strategy and scenario analysis did not always satisfy guidance issued by the DWP. We have also discussed TPR's intention to tighten regulation around ESG data published by trustees.