An international perspective
ESG and pensions guide
With the focus on environmental, social and governance ("ESG") issues increasing sharply around the world, individuals, pressure groups and in some cases governments, are encouraging pension funds (which are some of the biggest investors) to consider the ESG impact of their investments, particularly around climate change, and report to members on how they do that. With that in mind, we asked some colleagues and friends from across our global network to provide a short article on current approaches to ESG and pensions in their jurisdiction.

While there were some common themes, revealing a growing trend towards recognition of ESG factors in pensions generally, these international "snapshots" also reveal that different countries are in very different places on their ESG and pensions journey.

We hope you find this collection of articles informative. For assistance with any ESG and pensions issues, please feel free to contact us or any of the article authors.

You may also be interested in our report "Climate change and the people factor: why net zero needs the people factor to succeed." With most organisations treating climate risk as a serious business and financial issue, this survey report by Eversheds Sutherland and KPMG IMPACT focuses on the "people factor", an under-reported dimension of the global climate challenge. The report considers the potential impact on employees from reskilling and retraining to potential displacement, as well as employee activism and engagement.
An international perspective

ESG and pensions guide

UNITED STATES OF AMERICA

CANADA

THE NETHERLANDS

UNITED KINGDOM

IRELAND

AUSTRALIA
United States of America

In the US, employer-sponsored retirement plans generally are not subject to any mandatory or voluntary standards for dealing with climate change. To the contrary, climate change and other ESG-type considerations can be considered only as financial factors similar to other market-based financial factors considered by plan fiduciaries.

US employer-sponsored retirement plans are subject to laws that require investments to be chosen, monitored, and changed by plan fiduciaries in a prudent manner, based solely on the best interests of the participants in the plan. For the last two decades, the government’s guidance interpreting these standards has indicated that the interests of plan participants should be measured from a financial point of view. Societal issues, such as climate change and other governance and social issues, generally cannot be the drivers for a plan fiduciary’s investment decision, except to the extent those considerations have a financial impact on the investment. Regulations issued by the Trump administration in 2020 reinforced this standard, making it difficult to include ESG non-financial considerations even as tie-breakers. The Biden administration is not currently enforcing these regulations, and the administration proposed new regulations in October 2021 that would roll back the Trump-era rules. While these new proposed regulations do not mandate consideration of ESG factors, they do provide that ESG factors should be considered to the extent that the plan fiduciary concludes that the factors are relevant to the financial analysis of an investment option. The new proposed regulations may therefore make it easier for plan fiduciaries to consider ESG factors in determining plan investments, including default funds.

In light of the difficulty in demonstrating that climate change considerations will financially benefit plan participants, and the potential legal liability facing plan fiduciaries that are found to have inappropriately considered climate change, there has been very little appetite by plan fiduciaries to take these types of factors into account in a direct way when selecting plan investments and investment options. Similarly, there has been minimal adoption of disclosure or other types of reporting to participants about climate change risks related to plan investments, likely because of the fiduciary liability that could be incurred if the information is determined to be an improper investment consideration.

Some federal legislators proposed law changes in 2021 that would explicitly allow for climate change and other ESG-type factors to be considered by retirement plans, including allowing a default investment fund to take into account ESG factors. The likelihood of such a bill passing is questionable, but it does indicate the potential direction in the future in the US on this issue. Although employer-sponsored retirement plans have not generally taken action on climate change, certain state-sponsored pension plans have taken some preliminary steps. Both Maine and New York have indicated that their state-run pension funds will divest certain types of fossil-fuel companies over time. Several state pension funds also recently voted for the replacement of certain directors of ExxonMobil in a bid to promote energy transition and to address climate risks.

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Ireland

It has been a long-standing principle under Irish law that pension trustee investment decisions should focus primarily on financial outcomes. The prudent man test which was first set out in Learoyd v Whiteley, as elaborated on in Cowan v Scargill, has been the basis for this view. Under this test, a trustee was required to "take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for who he felt morally bound to provide" when making his decisions regarding investments. Cowan v Scargill noted that where the purpose of a trust is to provide financial benefits, which is nearly always the case with pension schemes, then "the best interests of the beneficiaries are normally their best financial interests." For many years, this case has been used in our jurisdiction to support the idea that with regard to investments, the only duty of trustees was to maximise returns.

Pension schemes now adopting standards for dealing with climate change

However, there has been a major shift in viewpoint in this area and ESG factors have become a more integral factor for Irish trustees to consider within their decision-making processes for investment. ESG factors are now seen to impact on both a company's financial performance and its long-term sustainability. Trustees are expected to balance returns against risk, and ESG factors are seen as significant in analysing the potential risk of an investment, particularly over the longer term.

Advancement in thinking in this area is reflected in two pieces of EU legislation which are in force in Ireland:

1. The European Communities (Occupational Pension Scheme) Regulations 2021 which transposed Directive (EU) 2016/2341 into Irish Law ("IORP II Regulations") on 22 April 2021; and
2. Regulation (EU) 2019/2088 on sustainability related disclosures in the financial services sector ("SFDR") which came into force in Ireland, as in other jurisdictions, from 10 March 2021.

IORP II Regulations

The IORP II Regulations provide a framework for the consideration of ESG factors by trustees in their investment strategies and decisions.

ESG factors have been included in the following aspects of the regulations: Investment Rules, General Governance Requirements, Risk Management Function & Own-Risk Assessment.

Investment rules are impacted by Regulation 26 of the Regulations which implements a new section 59AB into the Pensions Act 1990 (the "Principal Act"). It requires trustees to invest in accordance with the prudent person rule, and in doing so they may take into account "the long-term impact of investment decisions on environmental, social and governance factors."

1. Learoyd v Whiteley [1987] UKHL 1
2. Cowan v Scargill [1985] Ch 270
General Governance Requirements have been introduced under the Regulations. Trustees must put in place an effective system of governance, which shall include consideration of ESG factors relating to investment assets in investment decisions.

Risk Management Functions for trustees have also been increased by the implementation of the Regulations. Trustees must now adopt strategies, processes and reporting procedures necessary to ensure that risks are identified, measured and monitored. The heightened risk management system which the IORP II Regulations require means trustees must consider many areas while assessing risk. Most notably, they must consider ESG risks relating to the investment portfolio and the management of the investment portfolio “where applicable”.

The regulation also introduces the obligation of own-risk assessment on the trustees. This is required to be carried out at least once every three years or without delay following any significant change in risk profiles of the scheme. Where ESG factors are considered in investment decisions, an assessment of new or emerging risks, including risks related to climate change, use of resources and the environment, social risks and risks related to the depreciation of assets due to regulatory change, should be carried out as part of this risk assessment.

The IORP II Regulations, on balance, do not make consideration of ESG factors mandatory. While it may be enough for trustees to explain that ESG factors have not been taken into account and why that approach has been adopted, such an approach is becoming increasingly difficult to justify in practice.

Where trustees opt to consider ESG factors and an ESG risk assessment is done, this information will need to be disclosed to current and prospective scheme members. The Pensions Authority has confirmed that it will be publishing guidance on this, through a code of practice, shortly.

SFDR
SFDR applies to a range of financial market participants including IORPs, and to a range of financial products, including pension schemes with more than 15 members. SFDR is much more specific and developed than the ESG requirements under IORP II which were discussed above. The key obligations on pension schemes under SFDR (including IORPs) are that a number of sustainability-related disclosures are now required. Some of these requirements came into effect on 10 March 2021, however others will not take effect until later in 2022.
The disclosure obligations under SFDR encompass the “pre-contractual stage”, in other words the information to be disclosed to new members joining the scheme, periodic or annual reporting requirements, and finally the publication of certain disclosures on the trustees’ website. There are two broad heads to the SFDR disclosures which trustees must make, Sustainability Risk Disclosures and Adverse Impacts Disclosures.

Under Sustainability Risk Disclosures, trustees are required to publish on their websites information about their policies on the integration of sustainability risks in their investment decision making processes. The second limb of the Regulation, i.e. the Adverse Impacts Disclosures focus on the impact of the pension scheme’s investment decisions on the wider environment. Trustees are required to publish and maintain on their websites, information in relation to the level of their consideration of principal adverse impacts of their investment decisions on sustainability factors.

There are also product specific disclosures under the regulation and certain financial products may come within the ambit of Articles 8 and 9 SFDR. Article 8 applies to financial products (including pension schemes) that promote social or environmental characteristics, among other characteristics. Article 9 relates to any financial product (including a pension scheme) that has sustainable investment as its investment objective. These products have enhanced disclosure requirements because of their particular characteristics. The disclosure requirements applicable to pension schemes falling within these categories will be significantly more onerous than for other schemes, so it is important for trustees to assess whether their schemes might fall within the Article 8 or 9 categories.

For those Irish pension schemes which have already adopted an ESG focused strategy, and which have an interest in interrogating the sustainability of their investment strategy and their investment portfolio, SFDR is an opportunity to assess and validate that work within an EU certified framework.

Does this affect the relationship with scheme sponsors?

We do not believe this will negatively impact on the relationship between trustees and scheme sponsors. Mitigating sustainability risk is about reducing long term investment risk and generating better long term returns. In addition many corporate sponsors who are concerned about their own green credentials are encouraging their trustees to focus on making the scheme’s investment portfolio ESG compliant.

What happens if trustees don’t comply?

In relation to breaches of the ESG requirements under the IORP II Regulations, the Pensions Authority has full monitoring and supervisory powers under the Regulations.

Under Article 14 of SFDR, Member States must ensure that the “competent authorities”, designated in accordance with the sectoral legislation referred to in Article 6(3) and Directive 2013/36/EU, monitor compliance with SFDR requirements. Article 14(2) also states that the competent authorities shall have all the supervisory and investigatory powers that are necessary for the exercise of their functions under the SFDR Regulation.

The relevant authority in Ireland is the Pensions Authority as it is the competent authority for the IORP II Regulations. However, there is no local law giving the Pensions Authority specific enforcement powers in relation to SFDR, so the monitoring and enforcement machinery for SFDR is still to be clarified.

Going forward

As the IORP II Regulations and SFDR have only recently come into force, it will be interesting to see how they evolve in practice, the impact they will have on the market, how they will be regulated going forward and also to see the continued response by trustees as a legislative duty now exists for them to have regard to ESG factors in their decision-making processes.

From 1 July 2022, Irish pension schemes will potentially fall within the scope of the detailed regulatory technical standards under SFDR. It is envisaged that this will provide for more advanced sustainability-related disclosure standards which will build on the SFDR disclosure rules which came into force this year. Trustees in Ireland are now actively searching for different ways to integrate ESG into their portfolios and it is envisaged that there will be a heightened demand for further movement on this from scheme members.

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In November 2021, the Australian Prudential Regulation Authority (“APRA”) one of the main regulators of registrable superannuation entities in Australia released its final guidance to banks, insurers and superannuation trustees on managing the financial risks of climate change.

The final guidance is the Prudential Practice Guide CPG 229 Climate Change Financial Risks (“CPG 229”). A draft version of CPG 229 was released in April 2021 for public consultation and received about 50 submissions from stakeholders.

According to APRA, CPG 229 is a response to industry requests for greater clarity of regulator expectations and examples of better industry practice. The guidance covers APRA’s views on sound practice in relation to climate change, focusing on governance, risk management, scenario analysis and disclosure.

Are pension plans adopting any common standards for reporting, governance or risk management for dealing with climate change? Are these mandatory or voluntary?

There are no mandatory standards for superannuation trustees for dealing with climate change in Australia. Naturally, it follows that the approach adopted by Australian superannuation funds can vary. Nevertheless, there is a growing trend towards transparency and sustainable investment among Australian superannuation funds. For example, a large number of funds publish climate change reports1. These approaches generally align with the guidance now provided in CPG 229 (discussed in further detail below).

Some Australian superannuation funds have publicly signed up to instruments dealing with climate change. For example, 24 Australian superannuation funds are signatories to the United Nations Principles for Responsible Investment (“UNPRI”),1 and 20 are signatories to the Climate Action 100+ initiative12. Further, several trustees of Australia’s largest superannuation funds have made zero-carbon commitments, including HESTA13 (in June 2020). Cbus14 (in August 2020), UniSuper15 (in September 2020) and AustralianSuper16 (in November 2020). This activity signals growing consistency amongst Australian superannuation funds in relation to climate change. It is anticipated that there will be greater consistency now CPG 229 has been finalised.

Despite not having mandatory standards in relation to climate change, it is worth noting that directors of superannuation trustees are subject to a professional duty of care, skill and diligence11. It follows that directors must be careful that the fund’s investments are managed in a way that is cognisant of all relevant risks, which may include climate risk. More generally, all directors are also required to “focus on matters brought before [them] and to seriously consider such matters and take appropriate action”. Relevantly, this may extend to matters pertaining to climate risk. Unfortunately, there is no case law on the interaction of these director duties and climate risk in the superannuation context yet.

Which types of plans are focusing on these issues/in scope for mandatory requirements?

CPG 229 provides guidance to APRA-regulated entities, including the trustees of superannuation funds. It does not apply to trustees of self-managed superannuation funds.

As mentioned, CPG 229 does not introduce new mandatory requirements or obligations. Rather, it is designed to be flexible in allowing each entity to adopt an approach that is appropriate for its size, business mix and complexity.

Commenting on APRA’s role in this area, Wayne Byres, Chair of APRA, said: “It’s not telling them what to do, who to lend to, who to invest in, or who they can’t lend to, or who they can’t invest in ... That is a business decision every financial institution has to make. What we want, and the guidance is designed to help them in this regard, is we want to make sure when they’re making those decisions, they’re doing so in a well-informed manner.”

6. As at 30 June 2020, HESTA had 870,000+ members and AUD$552 billion funds under management (2020 Annual Report, page 2).
7. As at 30 June 2020, Cbus had 758,204 members and AUD$63.8 billion funds under management (2020 Annual Report, page 9).
10. Climate Action 100+ (CA100). CA100 is a global coalition of CEOs leading action on climate change in the business sector. CA100 is headquartered in New York and Tokyo with seven regional offices in Europe, Asia, Middle East, Africa, Latin America, Africa and India. CA100’s mission is to mobilize the world’s leading companies to take strong, urgent action on climate change (www.ca100.org).
11. Principles for Responsible Investment (UNPRI). When APRA released the draft of the guidance in April 2021, it was designed to be flexible in allowing each entity to adopt an approach that is appropriate to its size, business mix and complexity.
What do these standards involve (e.g., are they
mandatory or voluntary)?

CPG 229 does not directly address the relationship
between superannuation trustees and plan sponsors.
However, it does note that climate risks may have a
compounding effect on an institution’s reputational risk9. Relevantly, this may include a trustee’s ability to attract
and retain plan sponsors in response to changing industry
deregulations and public expectations.

Does this affect the relationship with plan
sponsors?

CPG 229 recognises that managing climate risks may
require the boards of superannuation trustees to acquire
and utilise specific expertise. It notes that a prudent board
should have:
- an appropriate understanding of, and opportunity to
discuss, climate risk at the board and sub-committee
levels, which may include appropriate training for
board members10.

It further notes that senior management would typically
be responsible for:
- ensuring that adequate resources, skills and expertise
are allocated to the management of climate risks,
including through training and capacity building
amongst senior staff11.

As noted above, this reflects APRA’s view of sound
practice, rather than a mandatory training requirement.

What do trustees disclose to members about
their approach to climate change?

Trustees are not directly required to disclose anything
to members regarding their approach to climate change.
However, many trustees have issued public statements
detailing how they consider climate change in their
investment decision-making. For example, HESTA12 has
publicly said that it conducts regular risk assessments
across its portfolio, assessing a number of potential future
climate change scenarios13.

Under section 1017C of the Corporations Act 2001 (Cth),
superannuation fund members are entitled to request
information that they need to make an informed decision
about the management and financial condition of their
fund. The application of this section in the context of
climate change was at issue in the recent case of
McVeigh v Retail Employees Superannuation Trust. While
a court’s review of this provision in the context of climate
change was keenly awaited, the parties settled the matter
before hearing in 2020. This case is discussed in further
detail below and represents an interesting development in
the law.

What happens if trustees don’t comply
with mandatory rules/certain standards
(e.g., regulatory penalties, exposure to
member claims)?

As stated above, there are no mandatory rules, and
therefore no penalties prescribed in relation to
the consideration of climate change risks by
superannuation trustees.

However, there is burgeoning interest in whether
consideration of climate change is required under the
general duties of a superannuation trustee, as foreshadowed in McVeigh v Retail Employees Superannuation Trust. Again, this will be an interesting
area of development.

Are there any other interesting developments
concerning how pension plans are affected by
climate change (and associated regulation
and taxation) in your jurisdiction?

In 2018, a member of Retail Employees Superannuation
Trust (REST)14 commenced proceedings in the
Federal Court of Australia against Retail Employees
Superannuation Pty Limited (REST Trustee)15.

Amongst other things, the member alleged a breach of:
(1) section 1017C of the Corporations Act 2001 (Cth) –
which says that a beneficiary of an entity that issues
a superannuation product is entitled to request
information that they need to make an informed
decision about the management and financial
condition of the entity; and

(2) sections 52(2)(b) and 52(2)(c) of the Superannuation
Industry (Supervision) Act – which says a trustee of a
superannuation fund must:

a. exercise the same degree of care, skill and
diligence as a prudent superannuation trustee; and

b. ensure that the processes REST has in place for
managing investments and disclosing REST’s
positions, including by undertaking scenario analysis
setting its investment strategy and asset allocation
positions, including by undertaking scenario analysis
in respect of at least two climate change scenarios
(including one scenario consistent with a lower-carbon
economy well below 2°C this century); and

actively consider all climate change related shareholder
resolutions of investee companies and otherwise
continue to engage with investee companies and
industry associations to promote business plans and
advisers comply with the above16.

Going forward, it is likely that trustees of other
Australian superannuation funds may follow suit to avoid similar
actions. The case serves as a clear marker of the move
towards enhanced disclosure and sustainable investment
within the Australian superannuation landscape, irrespective of mandatory regulation.

Prepared by Thomson Geer – Scott Charanaka (Head of
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United Kingdom

Are pension schemes adopting any common standards for reporting, governance or risk management for dealing with climate change? Are these mandatory or voluntary?

UK pension schemes are adopting common standards for reporting, governance and risk management for dealing with climate change. This is driven by mandatory standards which apply to most schemes, including some new requirements applying, for some schemes, from October 2021. The Pensions Regulator’s focus on climate change, and pressure from members and industry groups, are also prompting schemes to meet common standards as the standards receive further guidance and become better understood, industry best practice and norms are likely to appear.

There are also voluntary standards, for example under the UK Stewardship Code, which some pension scheme trustees are choosing to sign up to.

Which types of schemes are focusing on these issues/in scope for mandatory requirements?

As a result of the Pension Schemes Act 2021, from October 2021, trustees of larger occupational pension schemes, authorised collective money purchase schemes and authorised master trusts have been in scope for new mandatory requirements relating to climate-related risks and reporting (the “New Requirements”). We also discuss existing requirements for occupational pension schemes below.

The following table summarises which schemes are in scope and by when. Other (smaller schemes) may come into scope in the future.

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What do these standards involve (e.g. are they based on the recommendations of the Taskforce on Climate-related Financial Disclosure)?

Schemes in scope for the New Requirements will need to:
- adopt governance and risk management systems
- consider climate-related risks and opportunities as part of the scheme’s investment strategy and (if applicable) its funding strategy
- prepare and publish a report on a publicly available website in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (“TCFD”)

As part of the reporting requirement, in-scope trustees will need to do and report on the following:
- undertake scenario analysis: “as far as they are able”, trustees must select and analyse scenarios where temperatures rise, including one for a rise of 1.5-2 degrees Celsius. For each, the trustees must analyse the impact on scheme liabilities and the resilience of the scheme’s investment and funding strategies
- select and calculate metrics: “as far as they are able”, trustees must select, obtain data for and calculate and calculate at least three metrics – one “absolute emissions metric”, one “emissions intensity metric” and one “additional climate change metric”, as defined in the Regulations
- select and test targets: select appropriate targets and test the performance of the scheme against them

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Does this affect the relationship with scheme sponsors?
Yes – in the case of DB schemes, additional scrutiny of the employer’s covenant is required – including undertaking scenario analysis “as far as [the trustees] are able”.

Trustees should consider engaging with the employer early on climate-related issues. The employer may itself be subject to mandatory TCFD requirements and be able to offer central resources and experiences to help the trustees comply with their own obligations.

Both trustees and sponsors should consider how the increased transparency could affect how they communicate with members and the scrutiny they may face from industry groups and trade unions.

Does this affect truste training?
Yes – trustees of in-scope schemes need to have knowledge and understanding of the principles relating to the identification, assessment and management of risks and opportunities arising from climate change – including steps taken in response to climate change (e.g. from governments).

Trustees of out of scope schemes may nevertheless want to consider their knowledge and understanding of this area, in anticipation of greater regulatory scrutiny.

What do trustees disclose to members about their approach to climate change?
SIP requirements – from 1 October 2019, trustees (in most cases) had to update their statement of investment principles ("SIP") to reflect new disclosure requirements on ESG issues and whether and how they take member views into account. The SIP must include a policy on environmental considerations (including climate change) which trustees consider to be financially material.

The requirements were extended on 1 October 2020 to include disclosure on trustees arrangements with asset managers and any further engagement activities (such as the management of conflicts of interest). Trustees of most DC/hybrid schemes have also had to report on how they acted on the principles in the SIP via an implementation statement.

TCFD reports: Schemes which are in scope for the New Requirements need to publish a TCFD report disclosing how the scheme complies with the TCFD recommendations annually and make it freely available on their own (or the employer’s) website.

Schemes will also be required to confirm that this report has been published, and provide details of where it can be found online, for example in members’ annual benefit statements.

What happens if trustees don’t comply with mandatory rules/certain standards (e.g. regulatory penalties, exposure to member claims)?
Failing to meet the New Requirements can cause trustees to be subjected to:
- discretionary penalties and compliance notices: the Regulator can impose penalties and issue compliance notices. The existing disclosure penalty regime will apply if trustees fail to inform members where they can find the TCFD report. Penalties will be up to £3,000 for an individual and up to £50,000 for a corporate trustee.
- mandatory penalties: the Regulator must impose penalties of at least £2,500 for a failure to publish a TCFD report on a publicly available website. Additionally compliance notices can be issued against third parties where the Regulator considers that party is wholly or partly responsible for a failure.

Does this affect the relationship with third parties?
Whether and where third parties (including employers) are subject to mandatory TCFD requirements and to what extent their investments are aligned with the goal of limiting the rise in the global average temperature to 1.5 degrees Celsius above pre-industrial levels. The requirements will be amended to require relevant trustees to calculate and report on the extent to which their investments are aligned with the goal of limiting the rise in the global average temperature to 1.5 degrees Celsius above pre-industrial levels. The proposed requirements would start to apply from 1 October 2022.

Government consults on Climate Change and Investment Reporting
The Government has also set out proposed changes to its guidance on trustee’s annual reporting which sets out the Government’s expectations in relation to the content of implementation statements around disclosing voting and stewardship activities. Trustees will be expected to make fairly detailed disclosures in connection with voting and stewardship and to explain why their policies were in the best interests of their membership.
The Netherlands

Are pension plans adopting any common standards for reporting, governance or risk management for dealing with climate change?

Are these mandatory or voluntary?

In 2004, Dutch pension funds adopted a set of voluntary rules based on what is nowadays called ESG. Funds were encouraged to report best practices regarding their investments in line with ‘socially responsible entrepreneurship’. Since 2012, pension funds have had to report in their financial statements how their investment policy takes account of environment and climate, human rights and social relations. This reporting obligation was introduced as part of a major reform of pension fund governance.

More generally, any major amendments in investment strategies of a pension fund have to be requested by the social parties (i.e. unions and employer representatives) that are involved in the pension scheme, executed by a pension fund. Even though the funds have to report on ESG and it is part of their risk management, they can only invest according to ESG principles on request of social parties. Many of the investments are indeed focussing on climate and decarbonisation, however the Dutch rules are wider than climate change alone.

Investing in accordance with ESG principles, mainly based on European IORP II rules, has become an integral part of the risk management of pension funds. From a risk management perspective, funds have to analyse their ESG impact, whether they invest according to ESG parameters (on request of social partners) or not, and the law requires reporting to be along these ESG lines as well. That said, although they have to report on several places in the pension scheme documents how ESG has been implemented in their investment strategy, Dutch pension funds do not have to mandatorily invest according to ESG principles. It is at the request of social partners. Funds are encouraged to invest along the lines of ESG and encourage social partners to request that.

So to summarise: investing according to ESG parameters is not required by law but funds and insurance companies have to report how they align with ESG.

Which types of pension plans are focusing on these issues/in scope for mandatory requirements?

All types of pension plans have to meet the ESG requirements. The Dutch legislator does not make any distinction between pension funds and insured contracts, nor between DB or DC schemes. Since the nature of the schemes is different, which is expressed in different rules, the implementation differs per type of pension scheme or executing institution (pension fund, insurance company, DC-only vehicle).

In pension funds, there is no individual allocation to the assets (which represent 80% of the total assets in Dutch pension schemes) and, as a result, no individual measurement regarding ESG. In individual DC schemes (which only represent 5% of the assets in Dutch pension schemes), participants can very often select their grade of ESG involvement individually via different life-cycle investments and ‘shades of green’ in the portfolios. This selection is often requested by employee representatives in the company and/or by the employer.

What do these standards involve (e.g. are they based on the recommendations of the Taskforce on Climate-related Financial Disclosure)?

Most Dutch pension funds have now adopted the rules based on the EU regulation on sustainability related disclosures in the financial services sector (“SFDR”) however the Dutch legislator adopted several rules regarding ESG on risk management, reporting and member communications many years ago. Most funds have also signed the cross-sectoral voluntary rules in which the majority of the Dutch pension funds are collaborating with social organizations, trade unions and the government. Together they signed the ‘Covenant on International Socially Responsible Investing for Pension Funds (“IMBV Covenant” in 2018). With this covenant, the funds are joining forces to exert influence worldwide together with other parties and to prevent and tackle problems in the chain of those companies. They do this both in the field of human rights and the environment.

The pension funds that have signed the cross-sectoral voluntary rules opt for an approach that takes the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights as the basis for identifying and prioritizing such ESG risks and addressing them. In these rules, ESG risks mean the risks to society and the environment.

Does this affect the relationship with sponsors of the pension plans?

Before a pension fund can execute the pension scheme of a sector or company, it has to agree with the social partners in the sector or the company on the objectives of the fund. One of the major objectives is set in the objectives of a sector or company, it has to agree with the social partners (that is unions and/or employee representatives) of the fund. The board of the fund has to implement those beliefs into a concrete and precise investment policy. So the social partners (that is unions and/or employee representatives), have much influence on the investment objectives of the pension fund.

What do funds disclose to members about their approach to climate change?

The board of the pension fund has to state in the annual reports about the ESG objectives and how they are achieved. All executing pension institutions have to refer in benefit statements to the basic scheme rules including the rules regarding ESG, but not specifically regarding climate change.

What happens if funds don’t comply with mandatory rules/certain standards (e.g. regulatory penalties, exposure to member claims)?

Our supervisor has a wide range of instruments to penalise funds when they don’t comply.

Are there any other interesting developments concerning how pension plans are affected by climate change (and associated regulation and taxation) in your jurisdiction?

We see a trend that pension funds tend to look mainly at the E instead of the S and the G. As a result, we hear the news when a fund decides to step out of carbon-related investments but there are still funds which invest in ammunition industries and members do not always want to change the scope of the investments as they fear less returns. While the Dutch pension industry has a long lasting experience with ESG, there is still a long way to go before ESG is fully incorporated in the investment beliefs, rather than being incorporated purely to be compliant with the rules.

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An international perspective
ESG and pensions guide
An international perspective
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Are pension plans adopting any common standards for reporting, governance or risk management for dealing with climate change? Are these mandatory or voluntary?

In Canada, pension plans are regulated at the provincial level, with separate federal rules governing employees in certain sectors of the economy. Each jurisdiction has its own legislation that governs registered pension plans. The legislation sets out the role of the plan administrator and the statutory standard of care that applies to the pension plan and pension fund. The legislation includes general and specific requirements for investing the pension plan’s assets prudently, and in accordance with specific limits and restrictions.

Pension legislation in certain provinces expressly identifies plan administrators as fiduciaries or as owing fiduciary duties24, but even where not expressly identified, this is how the relationship is viewed in all jurisdictions in Canada including for federally regulated pension plans (“FRPPs”).

In Canada there are currently no common standards imposed on pension plans across all jurisdictions for reporting, governance or risk management for dealing with climate change specifically. However, through the prudent person rule with its focus on behaviours and processes rather than solely on outcomes, plan administrators must consider “a wide range of factors affecting their ability to prudently administer their pension plans, including risks that could impact long-term investment performance25, with the result that pension fund fiduciaries must consider or manage climate-related financial risk, as they manage pension fund assets. Recently, there have been growing calls for the Canadian Government to clarify that fiduciary duty does not preclude the consideration of relevant climate change factors26. The federal government is also being encouraged to take the lead on climate-related disclosure for FRPPs, by requiring such plans to disclose in their Statement of Investment Policies and Procedures (“SIPP”) whether and how climate issues are considered, including the rationale for any non-consideration.

Which types of pension plans are focusing on these issues/in scope for mandatory requirements?

Registered pension plans, regardless of whether the pension plan is a defined benefit, a defined contribution or a hybrid arrangement, are subject to the same basic rules relating to investments. There are no monetary thresholds (for example fund size) for application of the pension investment rules. In the pension fund context the temporal scope of the prudent person rule is measured according to short-, medium-, and long-term time horizons. An administrator must act impartially in the best interests of both present and future beneficiaries when managing and implementing investment policy. The emphasis is on inter-generational equity and balancing long-term performance of investments against present and medium-term beneficiaries is set against the pension plan’s primary risk of not being able to pay pensions and fulfill the plan’s promise to members, former members and other persons entitled to benefits under the plan. As noted earlier, in 2019 The Final Report of the Canadian Expert Panel on Sustainable Finance (“CED”) recommended that the Canadian Government clarify that fiduciary duty today does not preclude the consideration of relevant climate change factors27. In a recent report by the Institute of Sustainable Finance, that sought to measure the progress made on the CED’s recommendations, clarifying the scope of fiduciary duty in practice and law tied for the second most frequently cited need for action in the short term by participants in its survey28.

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24 See, for example, pension legislation in Alberta, s. 35(2) Employment Pension Plans Act (Alberta) and in British Columbia, s. 35(2) Pension Benefits Standards Act (British Columbia), both applied in relation to “the members and others entitled to benefits”.
**Fragmented Disclosure**
Since January 2016, for pension plans registered in Ontario, the pension regulator has required that the plan’s SIPPs include information as to whether ESG factors are incorporated into the plan’s investment policies and procedures and, if so how. These factors are incorporated: “ESG” in the context of this disclosure standard is described broadly encompassing a wide range of environmental, social and governance factors... including those environmental factors that relate to a company or industry’s interaction with the physical environment.

As noted above the CED recommended that FRPPs be required to disclose whether and how climate issues are considered in their SIPPs, including the rationale for any non-consideration. Other commentators have also recommended that the Ontario disclosure requirement be adopted with modification to include express reference to climate change.

**Taskforce on Climate-Related Financial Disclosure**
The need to adopt the TCFD has been identified by both private and public sector framework participants in Canada. In its Budget 2019, the federal government expressed its support for the framework and encouraged phased adoption by major Canadian companies and federal Crown Corporations.

On November 25, 2020, the CEOs of Canada’s eight largest pension plans joined together to issue a request that Canadian financial regulators require Canadian financial institutions to report on climate-related risks in their portfolios. These so-called “two hats” require the establishment and exercise of multiple and potentially conflicting roles with respect to the pension plan when the plan sponsor acts in its capacity as plan sponsor, on the one hand, and plan administrator, on the other.

Where the plan administrator is the also the employer who is sponsoring the plan, the employer is held to a fiduciary standard of care when the plan administrator is acting as the plan administrator. For example, in its role as administrator, it will be responsible for ensuring the pension fund is administered and invested prudently in accordance with the SIPP and other plan documents and applicable legislation.

The employer, will, however, retain certain rights and powers with respect to the pension plan when the employer acts as plan sponsor. In its employer/sponsor role it is entitled to act in its own best interests, but may be subject to an implied duty of good faith. These so-called “two hats” require the establishment and adherence to policies and procedures that set out both roles.

The CED has made a number of recommendations in relation to TCFD, including a phased comply-or-explain regime, in which the default expectation is for companies to disclose in line with TCFD recommendations (comply). A two-phased implementation approach was also recommended so that by the end of phase 2 issuers would be prepared to report on underlying assumptions, calculations, estimates and scenarios, including their use of established standards or industry-specific guidance.

The CED’s report dated in 2019 has been given TCFD adoption in Canada a marginal progress rating by the Institute for Sustainable Finance.

**Does this affect the relationship with sponsors of the pension plans?**
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