Climate and your employer covenant

Climate considerations have brought unprecedented challenges for companies and pension schemes.

pwc

What is the challenge?

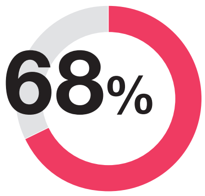
Climate risks create a perfect storm, from:

A **massive investment need** to drive innovation and develop new technologies to grasp the significant prizes in a fast evolving market or face being left behind.

Concerns surrounding the reliability of sustainability reporting make it difficult for investors (including pension schemes) to make informed decisions regarding their portfolios.

Pension schemes are maturing and, if not brought under control in the next 5-10 years, they will have an acute need for cash to provide members with promised benefits.

We are supporting clients to identify and understand climate-related risks and opportunities to their employer covenant to drive better decision making around their scheme strategy.



More than two-thirds of pension funds have a commitment to net zero alignment in place
Source: PLSA survey (November 23)

“We have left it too late to tackle climate change incrementally. It now requires transformational change and a dramatic acceleration of progress.”

Professor Tim Lenton, Chair in Climate Change and Earth System Science at the University of Exeter (‘The Emperor’s New Climate Scenarios: Limitations and assumptions of commonly used climate-change scenarios in financial services’, Trust, Joshi, Lenton, Oliver (July 2023))

“Climate change is no longer simply a social responsibility issue. It is a core financial risk impacting broadly across business, the economy and markets. Climate change is a risk to long-term sustainability that pension trustees need to consider when setting and implementing investment strategy, while many schemes are also supported by employers whose financial positions and prospects for growth are dependent on current and future policies and developments in relation to climate change.”

Charles Counsell, Former CEO, the Pensions Regulator (‘Climate change joint statement’, the Pensions Regulator (July 2019))

New DB Funding Code

In July 2024, tPR issued its new DB Funding Code. Covenant is now a legal requirement and Trustees are required to assess:

- The employer’s current and expected future cash flow.
- The prospects of the sponsoring employer.

Climate-related risks may impact an employer’s cash generation, the level of cash available to the scheme (affordability), and the period over which trustees can be reasonably certain of the employer’s cash flow to fund the scheme (covenant reliability).

*Source:
‘Act now: From recovery to growth’ (PwC, 2021)

Employer’s current and expected future cash flows

Cash generation and uses of cash
Physical and transition risks from climate change (such as asset damage and repair costs, transition costs, supply chain challenges, etc.) could impact employer financial performance and visibility over future performance. By contrast, leading the way in sustainability could be a market differentiator and enhance performance.

Access to capital
Our research* shows >70% of lenders are more likely to extend financing to businesses with clear, demonstrable ESG propositions.

Employer prospects

Covenant longevity
Physical and reputational risks at a corporate and sector level could threaten ongoing operations and the likelihood of an employer insolvency event occurring. Trustees will need to assess the employer’s resilience to climate-related risks and the possible timing of when risks might crystalise under certain scenarios. This will help form a view on how long the scheme can be reasonably certain that the employer will be able to support it (covenant longevity).

Endgame planning
Employer prospects in relation to climate change will also shape decision-making surrounding different endgame solutions, such as buyout and potential run-off.

How can we help?

Whether you're looking to understand how climate change could affect your long-term journey plan, you're preparing for TCFD reporting, or you would like to understand how your targets and progress compare to peers, we'll be right there alongside you, bringing sustainability, covenant and sector expertise to provide the insights you need.

We are able to support our clients in the following areas:

Covenant risks and opportunities

Combining PwC UK's sustainability and climate change expertise with deep sector insights and our market-leading covenant experience, we support our clients in identifying the most significant climate-related risks and opportunities facing their employer covenant over the short, medium and long term. We use these insights to form a view on the resilience of the covenant to climate-related risks and, where needed, can suggest actions to mitigate risk and optimise member outcomes.

Ongoing covenant monitoring and peer benchmarking

We monitor how a DB pension scheme's sponsoring employer's exposure to climate-related risks and opportunities changes over time. This includes measuring progress against climate-related targets and performing peer benchmarking. This is conducive to timely decision-making to protect the resilience of the pension scheme and helps to achieve long-term journey plan objectives.

TCFD Reporting

Working alongside our sustainable reporting team and sector experts, we support our clients to prepare their TCFD reports. Our multidisciplinary team offers an integrated approach such that TCFD reporting can be used as an important tool in effective risk management and help deliver meaningful change. Our team is also well-equipped to advise on the covenant aspects of TCFD reporting, including risks and opportunities and how these affect the resilience of scheme funding and investment strategies.

Why do trustees and corporates alike need to act now?

Pace of change

Climate change and the challenges it brings are here to stay. There is significant upside potential for corporates and trustees that act quickly, such as exploring new market opportunities for corporates and investment opportunities for schemes, as well as the potential for efficiency savings and increased resilience. However, it could be incredibly costly for those that ignore the issue, with potential risks to a corporate's prospects and possible weakening of the scheme funding position.

Regulation

Given the potential significance of climate change on covenant, assessing climate-related risks and opportunities is now an expectation of the Pensions Regulator (tPR) for all trustees. Larger schemes (£1bn+) are required to report in line with the Task Force on Climate-related Financial Disclosures ('TCFD'), which addresses a scheme's exposure to climate-related risk and opportunities and how these are being managed. Expectations have increased for corporates too as hard targets are set by the Government, which is looking for the UK to reach net zero by 2050.

Delivering members' benefits

As schemes increasingly focus on securing their long-term journey plans, it's critical to get the approach to funding and investment strategies right, informed by risk assessments and action to mitigate downside risks, including climate change. If schemes get it wrong, not only will the cost of benefits be higher for employers, the likelihood of members getting their benefits will be lower.

£1.1tn

Assets invested by UK private sector DB schemes with critical investment decisions to be made.

Source: ONS as at 30 September 2023

>400

Schemes with >£1bn assets requiring TCFD disclosures from October 2022.

Source: Pension Funds Online

Contact us

We have worked with a range of stakeholders to support with climate considerations in the UK pensions space and would be delighted to share our experience with you. If you would find this valuable, please get in touch with our contacts below:

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