House of Commons

Work and Pensions Committee

Oral evidence: Pension Stewardship and COP26, HC 238

Wednesday 30 June 2021

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Watch the Meeting

Members present: Stephen Timms (Chair); Shaun Bailey; Siobhan Baillie; Nigel Mills; Selaine Saxby; Chris Stephens; Sir Desmond Swayne.

Questions 1 - 35

Witnesses

I: James Alexander, Chief Executive Officer, UK Sustainable Investment and Finance Association; Tony Burdon, Chief Executive Officer, Make My Money Matter; and Andrew Ninian, Director of Stewardship and Corporate Governance, Investment Association.

II: Morten Nilsson, Chief Executive Officer, BT Pension Scheme; Paul Bucksey, Managing Director, Smart Pension UK; Mark Fawcett, Chief Investment Officer, Nest; and Sam White, Group Sustainability Director, Aviva.

Written evidence from witnesses:

James Alexander

PSC0001: UK Sustainable Investment and Finance Association

Morten Nilsson

PSC0003: BT Pension Scheme

Paul Bucksey

PSC0009: Smart Pension

Andrew Ninian

PSC0010: Investment Association

Sam White

PSC0011: Aviva

Tony Burdon

PSC0012: Make my money matter

Mark Fawcett

PSC0013: Nest Corporation

Examination of witnesses

Witnesses: James Alexander, Tony Burdon and Andrew Ninian.

Q1 **Chair:** Welcome, everybody, to this meeting of the Work and Pensions Select Committee and to the first of our evidence sessions in our inquiry into pension stewardship and COP26. A particularly warm welcome to the witnesses who have joined us this morning. Thank you all very much for being with us.

I will ask each of you to briefly introduce yourself to the Committee and to others who are watching, starting with Tony Burdon.

Tony Burdon: Good morning. My name is Tony Burdon. I am the CEO of a campaign called Make My Money Matter.

Andrew Ninian: Andrew Ninian. I am director of stewardship and corporate governance at the Investment Association. We represent UK-based asset managers.

James Alexander: Good morning; thank you for the invitation. I am James Alexander, chief executive of the UK Sustainable Investment and Finance Association, which brings together the community of people and organisations working on sustainable finance in the UK.

Q2 **Chair:** Thank you all for being with us. I will start by asking each of you—we will do it in the order you have just spoken—to what extent you think pension schemes have now committed to plans for net zero. Do you think that the fiduciary duties imposed on schemes should be broadened to include net zero considerations or do you think the duties as they stand are fine?

Tony Burdon: We are seeing growing momentum with pension funds committing to align to net zero. Since we launched our campaign last year, we have seen 16 UK pension funds announce robust commitments to net zero. By "robust"—that also includes halving emissions in this decade. That is around £425 billion of assets under management—some 28 million pension pots—that have been committed to be aligned to net zero. UK pensions are around £2.6 trillion in total, so there is obviously a lot more to do. Globally, there is $50 trillion invested through pensions, so again a big challenge.

We are seeing growing momentum. The Race to Zero and the Glasgow Financial Alliance for Net Zero that Mark Carney and others have been leading are helping drive that momentum. We are calling on all pension funds in the UK to commit to net zero before COP26, but there is still a serious challenge and we need to see more ambition and pace of commitments.

It is good that you mention fiduciary duty, because I think for many trustees that is a constraint, particularly for smaller schemes where trustees are heavily reliant on investment consultants. If you look back, it is 36 years since the Cowan *v.* Scargill judgment was made. There was a challenge around pension investment, and the judgment said that the best interests of beneficiaries are normally their best financial interests. Subsequent interpretations of fiduciary duty, including work a few years ago by the Law Commission, have allowed for non-financial considerations as long as the majority of members agree with the issue, and as long as there is no significant detriment to return.

A lot has changed since 1985, when that judgment was made. England beat Germany at football—that is one thing. Mark Carney notes that pension funds in the UK have been contributing to around 3° of warming, so contributing to the climate emergency. That is why some are now aligning to net zero.

The climate emergency, as we have seen, is causing floods and fires. Yesterday in western Canada and the western US, temperatures reached were 50° C, so roads were buckling and power lines were melting. We all know that we are entering a period of climate tipping points that will grow more extreme if climate change continues in this way. Climate risks and the climate emergency will have huge impacts on members' best interests—on the returns they get from their savings, but also the condition of the world that they retire into and how far their savings go in that world, where it might not be possible to insure your house, food prices could be extremely high, and so on.

In our view, fiduciary duty should be adjusted to take into account net zero and these other aspects of members' interests, such as the climate emergency. It is not in members' best interests to retire in a world of floods, storms, damage to agriculture and high food prices. Our view is that it needs to be a process to engage with industry and others to review how to adjust the interpretation of fiduciary duty to take into account these other interests that members have.

Andrew Ninian: I would agree with Tony on the momentum point. We have seen some clear commitments from a number of pensions through a number of initiatives, including net zero asset owners. We are seeing clear demand for specific climate-related products from asset owners, and the evidence from my members as asset managers is that engagement on climate-related issues—people either asking for advice or asking questions about how their portfolios are being managed and how the transition is being managed in those portfolios—is increasing.

Obviously, the requirements on climate change in the Pension Schemes Act will have an impact and will help to address those that are earlier on in their journey in terms of making commitments to net zero. Our industry has a role in supporting pension funds in that, in terms of setting out the options, giving clear information around how their money is being managed, and ensuring that they are getting a clear understanding of some of the actions that are being taken on their behalf with investee companies.

On the fiduciary duty point, in the current requirements of the SIP there are clear requirements to set out how financially material factors, including ESG considerations, are being taken into account in the way the pension fund is being managed. We think that is clear. Obviously, climate change is a clear material impact that is going to have significant impacts across the economy in all companies in which pension funds are investing. We think that link is sufficient to require the pension funds to take action.

There is an economy-wide commitment in law to hit net zero by 2050, and we think that helps and strengthens the need for all actors in the investment chain, from pension funds through to asset managers through to investee companies and other assets, to take action to meet the net zero commitment. One actor cannot do it alone; we all need to work together to create the change to deliver on these commitments that the Government have set. I am sure we will come on to how we do that in practice, but it is the whole investment chain that needs to take action.

Q3 **Chair:** Just to be clear, is your view that the fiduciary duties should be left as they are, given that background context?

Andrew Ninian: Yes.

Q4 **Chair:** Thank you. James Alexander.

James Alexander: To agree with what has been said about the enthusiasm and momentum of the drive towards net zero, we are seeing lots of schemes committing to net zero and to ambitious targets. They are joining the Net-Zero Asset Owner Alliance and asset managers are joining the equivalent asset managers' net zero alliance. They are signing up to Make My Money Matter's green pensions charter. Part of that is that pension savers are also changing their views. We see increasing research and momentum showing that savers are interested in where their money is invested and the impact that money has on the world around them and, of course, the world that those pension savers will retire into and the effect that that investment could have, positive and negative, on that.

Even for those pension schemes that have not yet made net zero targets, we know there is an awful lot of work going on behind the scenes to consider what net zero would mean for their fund and how they can drive towards that. Setting the target is obviously one key part of that. Creating the plan for how to deliver that target is another important component of that. That includes not just long-term targets for 2050 but near-term targets over the period between now and 2050.

Something that our members are very certain of, though, is that a net zero target is not the same as divestment. There is a huge amount of work that needs to be done around stewardship of investments to try to transition the economy and the investments that we have now towards providing value and continuing to add value as we progress towards net zero as a society and an economy. That crucial bit of work around stewardship is very important.

That is one of the reasons we are slightly nervous about things like mandatory net zero requirements or fiduciary duties being extended. We worry that they could lead to a kneejerk divestment away from the parts of the economy that, from a macroeconomic perspective, need to rapidly transition to providing the goods and services of a net zero economy. The danger is that that pulls those institutions that actually care about those assets—that want to see those assets transition—out of those sectors and perhaps towards safer sectors that do not have strong emissions.

The other thing is that we know that pension funds and schemes are already considering climate change as a key consideration in investment decisions, but we do think they have to be given the freedom to act in the best interests of their pension savers, which we know does include climate change consideration.

Q5 **Nigel Mills:** Can I ask what the panel mean when they say that pension schemes should adopt net zero? Are you saying that individual pension schemes should ensure that the portfolio of investments they invest in themselves hit net zero—that if you have an investment in a company that is causing some carbon emission, you have to find an offset in your portfolio somewhere else—or are you saying that they should just be committed to playing a part in the country's overall ambition to get to net zero?

Tony Burdon: From our perspective it means that the pension fund needs to look across their entire portfolio and align it to net zero. That includes—

Q6 **Nigel Mills:** But what does "align" mean? That is the question, isn't it?

Tony Burdon: Fortunately, there are international frameworks that help guide pension funds in doing this. The Net-Zero Asset Owner Alliance is one that has just recently published 2025 protocols. Members of the Net-Zero Asset Owner Alliance are now setting out their emissions reduction targets and approach up to 2025, which is great because you are focusing on early actions and pace. It is actions in this decade that are important. You also have the Institutional Investors Group on Climate

Change, which has a net zero framework that some asset owners are also using.

There are international frameworks that guide the approaches that pension funds adopt, and they all agree that a priority is to drive out emissions where possible and then tackle hard-to-abate sectors like steel or cement through offsetting later, because technologies are developing in those industries that will help them move themselves to much lower emissions. It is about driving out emissions and offsetting for remaining hard-to-abate sectors.

I agree with James that this is not about divestment. A lot of this can only be delivered by pension funds using their pension power, which is their shareholder power, to drive transition in the companies they partly own by voting at annual general meetings and on company transition plans to get to net zero, and holding directors to account.

They can drive that transition in a way that you can see with, say, BP, which has net zero commitments. BP has lots of people working for the company and lots of capital invested. There is a way to transition that company to become a renewable energy provider that preserves jobs, preserves capital and transitions staff from project management of oil rig construction to doing the same on wind farms. There are ways that pension funds as shareholders can also help drive that transition in companies.

James Alexander: Thank you for that question. It raises an important question about defining what a net zero pension or a net zero fund looks like. There is a lot of work going on internationally around this, and lots of people are working on it.

There have been calls to start shaping and creating a net zero financial services industry, or a Paris-aligned financial services system, in the UK. The concept sounds great. The challenge is that the devil is in the detail of what this means. For us there is a key question. We, as the sustainable finance industry, want to work with Government, regulators and others to start shaping the definitions around what a Paris-aligned financial services system looks like and to start getting a shared, coherent understanding of that so we can all be working towards driving in the same direction. One of the key parts of that is for the Government to outline what the 2050 net zero economy of the UK actually looks like. How do we travel? How do we heat our homes?

These fundamental questions of how we live in a net zero world do not yet have answers. The Government need to work rapidly to start helping us answer some of those questions so that we can shape investments in that direction and start reinforcing how that economy might look through the investments that we make.

Q7 **Nigel Mills:** I am still slightly confused. I presume what Government policy will do is create a load of carbon charges or offsets or something and say to business, "Either you have no net carbon emissions yourself, or, if you do, you have to pay a huge carbon tax and then we'll go and deal with the offset for you, or you need to deal with an offset yourself to get out of the charge." We do not need the pension industry to deliver that because Government regulation will force everybody operating in the UK to get there anyway.

We seem to be suggesting that somehow pensions should be driving the economy to do something different to what it is going to do anyway. I wonder whether a pension scheme's commitment to net zero is a nice thing to have but does not really involve them changing anything, unless what we are saying is they should commit to their portfolio of investments having half of the emissions by 2030 that they do now, in which case they either achieve it by a divestment from dirty things or by hoping that all their investments reduce by half over that time. What are we expecting pension schemes to do by signing up to being net zero on an individual basis? Are we saying they need to drive change in their portfolio or are we saying they just need to be committed to their portfolio and doing what they are going to have to do anyway?

James Alexander: It is a very good question, and it revolves around who holds the levers that can make the change. What we are seeing here is that the financial services industry is willing and committed to playing its part in helping that drive towards a net zero future, because it is an enormous challenge and everybody is going to have to play their part through the levers that they have.

Of course, you raise the important point that the Government have big, powerful levers and they need to be using those. Some of them are being used, and setting targets is an important thing to do, but everybody must be using all their levers. There is no room in this transition for people to sit by while others do all the work.

What we are suggesting—I speak for UKSIF members, at least—is that we, as the financial services industry, are keen to play our part in helping to shape that transition to the sustainable finance future, but we need others to play their part. The real economy, citizens, the Government—every actor—needs to do what they can and, ideally, do it all in co-ordination so that we are pushing in the same direction.

Andrew Ninian: I think there is also a point about opportunities. Businesses are going to have to change and take some long-term strategic decisions about the types of products that they offer to their consumers. To make those quite significant shifts, they are going to need the support of their shareholders that this is the right strategic direction. This is how I, as a company, am going to make money in the future. I need the support of my shareholders, which ultimately, through the ownership, is the pension funds. They have great power in both supporting and incentivising companies to make the right long-term decisions to meet that net zero target.

I agree with James that having the Government setting out particular sector pathways—changes that are likely to happen in particular sectors—is quite important so that the investment industry can support and encourage those changes in the way that companies behave and the products they are offering to UK consumers.

Q8 **Chris Stephens:** I am going to start with Tony, seeing as he politely reminded us that England beat Germany. Tony, I had forgotten all about that.

In all seriousness, do you believe that pension schemes have suitable information to assess the climate risk of their investments, or is the information that is currently available problematic or inconsistent?

Tony Burdon: I think—others will answer as well—that they have some information but it is not sufficient. We have seen good progress recently on TCFD disclosure, and the UK did well at the recent G7 to agree among the G7 that this should become mandatory. We are going to get a lot better climate disclosures in the coming months and years, but there is more to do there. I think there is a reasonable amount of information but it just needs to get better. That should not prevent action. The perfect should not be the enemy of the good.

Also important at the G7 was the agreement that the IFRS will develop accounting standards for sustainability. What that means is that when businesses do their financial accounts in future, they will also do their impact account, looking at the wider impacts of their business, accounting for that and disclosing that information. That will allow pension funds and other investors to understand the nature of the business that they are investing in, and the climate and other impacts that that business has. Overall, there is some information, it is not enough and it needs to improve, but a lot of work is going on to enable that so that there is much better data in future years for pension funds.

Q9 **Chris Stephens:** Andrew, presumably you would agree with that.

Andrew Ninian: Yes, we support TCFD reporting. We have been encouraging companies to start reporting against TCFD ahead of the legal requirements coming in from next year. There needs to be a recognition, though, that pension funds invest in many assets. TCFD reporting has started with equities, so premium listed companies in the UK. The Government have made announcements and have been consulting on widening that to other private companies, but it is important to recognise that pension funds invest internationally—only a third of equity holdings are in the UK—so they need that G7 alignment and they need TCFD reporting internationally.

They also need TCFD reporting for other assets, such as fixed income, where a company is issuing a bond. We need to make sure those issuers are also providing TCFD reports so that we can get an understanding of the impact of our bond portfolios. Increasingly, more money is being managed through bonds than equities; it is now nearly 70% of DB funds.

There is a need to make sure that the TCFD reporting reflects the make-up of the individual pension fund portfolios.

James Alexander: I broadly agree with the comments others have made. We have been calling for TCFD disclosure across the economy for a very long time and I am pleased to see that that is starting to happen. Of course, we want to see it extended. Currently, the plan is for companies with 500 or more employees. We want to see that extended to companies with 250 or more employees.

To Andrew's point, there is also obviously a global dimension to investment and to pension holdings, so we support the work of the IFRS in creating a sustainability standards board. We think that is going to have a big impact. Much as we compete globally on lots of different things, international standards on ESG should not be one of them. We should be working collaboratively on creating these standards.

That is potentially a role for the leadership position that the UK Government has this year with COP26 in Glasgow. We have the opportunity to start pushing some of these points and building on what happened at the G7 to create further international consensus on joint standard setting across the world. We are looking already at creating a UK taxonomy and thinking about how that can align with other taxonomies that have been developed across the world, about disclosure and about TCFD.

The next step, though, has to be how we make this disclosures decision useful for investors and for pension schemes. As time goes on, we need to be reviewing these disclosures to make sure that they are, first of all, capturing everything that is relevant and, secondly, able to be used by investors in making investment decisions. The questions for us are: do we have the right skills in the industry to do that, and are the TCFD disclosures presented in a useful way that is allowing them to be used to make those investment decisions?

To Andrew's point around fixed income, lots of pensions are invested in fixed income—in gilts and bonds and other things. How are they covered? What is, for example, the TCFD report of a UK Government gilt? The answer to that is not immediately clear, so we need to start thinking through some of those fixed income questions as well.

Q10 **Chris Stephens:** Thanks, James. You have anticipated my next two questions and answered them, so I can now concentrate on Andrew and Tony.

Andrew, James has just highlighted the international sustainability standards board. Will your organisation be associating with that board? What role do you think the board will play in developing standards for the assessment of climate risk?

Andrew Ninian: The starting point is that we feel that global harmonisation of reporting standards is important. At the moment, my members feel that they are not getting sufficient disclosures from companies that are comparable and allow them to take account of climate change and other sustainability risks in their investment and stewardship decisions. There is a need for better reporting standards that are globally harmonised. As global investors, we want a consistent basis.

We support the IFRS ISSB as the starting point. There has been a lot of work leading up to it, from SASB through to GRI and other initiatives. We think it is important that the ISSB uses the work that has already been done as building blocks to build on that global standard. We think the IFRS is the right place to do it because it can bring everyone together and have global support. We welcome the support from the securities regulator, IOSCO, last week, which put its weight behind the IFRS initiative.

From our perspective, it is about using the building blocks—using the work that has already been done—but ensuring that appropriate investor views and voices are fed into the process as they develop those standards, so that these reports are useful for investors who will use it as part of their investment and stewardship decisions.

Q11 **Chris Stephens:** Tony, I saw you agreeing with a lot of what Andrew said there. Will your organisation be associating with the sustainability standards board, and is there anything you want to add about its role going forward?

Tony Burdon: We are strongly supportive because we need this detailed disclosure of information. It is not just useful for investors; it is also useful for pension savers. We have a problem of greenwashing, where we get overblown claims of being more environmentally conscious or limiting climate impact. When we get proper standardisation of disclosures, as Andrew was describing, then we will get standardisation of ESG, of information around the impact of investment, and that ultimately should be communicated to pension savers so that they know the impact of their pension, their savings and their money on people and on the planet. It is vital work for investors but also for savers and consumers.

Q12 **Chris Stephens:** You also heard James talk about a common taxonomy and labelling scheme. Is there a role for major pension schemes themselves to develop such a scheme, or is it better for Government agencies to impose such a scheme?

Tony Burdon: Industry should always be involved in developing these approaches, countered by other views—by Government and by specialist researchers, scientists and so on. You need practitioners to understand how to apply and how to use data, but you also have an overall direction that the Government are leading, and we need to make sure that these tools and instruments support that as well. You need the collective effort to get the best approach and, again, not go to the lowest common denominator. We need ambition. This Government have ambition on net zero. How are all these tools that we are using helping to drive industry in the direction that the Government and overall society want?

Q13 **Chris Stephens:** Andrew, I will turn to you on common taxonomy and labelling schemes. Should it be the major pension schemes themselves that develop that, or should Government agencies impose such a scheme?

Andrew Ninian: A couple of years ago, our industry, through our organisation, developed a responsible investment framework to try to get some commonality of what was meant by the different terminology and types of funds that were being used so that there was some consistency in approach and terminology. That was the industry coming together and getting some consistency so that we were being clear while talking with each other but also to clients. I think that has been a really important basis.

That needs to progress and develop. Obviously, the Government and their perspective will bring some consistency of approach on this. There is a need to get clear consistency on terminology and approach so that clients and pension funds know what type of fund they are buying when they are buying into it, and are clear what services they are getting for a particular product.

Tony Burdon: I will add one quick thing. That definition—that taxonomy—is key. What is green? Toyota has lobbied hard for hybrid cars to be seen as green, but of course they are not; they are just petrol cars that have better consumption figures than others. There has been an argument in Europe about whether gas-fired electricity generating stations are classified as green, but they are high emissions. Five or 10 years ago, gas was seen as a good fuel to move to from coal—something that was cleaner than coal. Different bits of industry will lobby for their own interests. That is why you need a balanced approach across all this. Ultimately, consumers need to know whether their pension is green or not, and how they know that it is.

James Alexander: I appreciate the questions on the taxonomy. It is an important piece of policy that is currently under development. I have been appointed to the Government's green technical advisory group, which is tasked with providing the Treasury with advice and guidance on the implementation and development of the UK's green taxonomy, along with a number of other industry taxonomy users. We are pleased that this group exists and is providing that advice.

From the UKSIF perspective, the input we are providing is that we have to learn the lessons from the EU taxonomy to avoid some of the challenges Tony mentioned. If the taxonomy is used only for the purposes for which it is designed, rather than being almost a catch-all for every piece of Government policy, we think that will remove some of the industry lobbying that has challenged the EU taxonomy.

We want it to be science based. We want it to incorporate things like the transition and potentially give sunset clauses for different components that are currently at the top of technology but are not yet the ultimate green solution. Tony gave the example of hybrid cars, which were once seen as green but are no longer seen as green. Lots of other technology is in that development stage. We also want the taxonomy to capture as much of the market as possible, which means that it should include lots of transition activities up front, such that we drive gradually towards that 2050 vision.

Chris Stephens: Thanks, gentlemen; that has been very helpful.

Q14 **Shaun Bailey:** Could I take a step back to the TCFD disclosures? Obviously, the Government have set out their road map for incorporation of TCFD disclosures for larger occupational pension schemes. The smaller pension schemes are not currently planned to be part of that regime. The Government have planned to review that position in 2023, but I would be interested to hear your view about how that extension should take place and the challenges that are involved in extending that to smaller occupational pension schemes.

We have had examples in written evidence of issues around data collection for some of these schemes, and perhaps pressures on professionals to become almost climate experts in terms of the investments they are trying to undertake on behalf of these schemes. I would be interested to hear some of the challenges of extending those disclosures to smaller occupational pension schemes.

James Alexander: It is an important question. We think that it is right that it should be gradually extended to smaller schemes, and we have called for that to happen. We are pleased that that review is being brought forward.

We have to balance that with some of the issues around data that we talked about, but this has to start somewhere. The starting point of TCFD is going to be messy; it is not going to be as smooth as possible, because different parts of the economy are reporting at different times and different rates. Ultimately, it requires all the investments to be reporting together in order for this to work perfectly on day one. It is not going to work perfectly, but that is not a good reason not to start it. These are important disclosures that should be an important steer for how pension schemes are investing, and we support that.

That also has to be balanced. We have to be very mindful of the burden that this places on schemes themselves and on the staff in schemes. The more form filling that schemes have to do, the less strategising they are able to do, so we have to be very mindful of that.

On the point you raised around climate expertise, we do think there is a need for ESG expertise on trustee boards. ESG considerations, particularly climate, are going to be extremely fundamental in how pension funds invest and the returns they are able to generate.

Developing that expertise and making sure that schemes have that expertise readily available is a very important part of the future, and we want to see that expertise grow and develop.

Tony Burdon: I agree with James: we need to get on with this and, obviously, for smaller schemes, where there is lower capacity and capability, to do it as quickly as feasible. Investment consultants can step up a bit on this because they are advising lots and lots of schemes across the board, both small and large. That should help.

On trustee boards, like James said, we know there are challenges around diversity and skills. These boards also need to adapt to where we are. Consolidation of smaller schemes will also help, because we will have more larger schemes that have much more capability and capacity to tackle some of these challenges.

Andrew Ninian: I would just reiterate the points that we are on a journey here and everyone, from FTSE 100 companies all the way through to the small caps, is learning how asset managers report against TCFD and then asset owners. I agree with the comments that we need to start on that journey, but we do need to be proportionate and quickly build up the knowledge, capacity and capability so that across the whole investment chain we are getting the right reporting, we are getting informative reporting, it is not boilerplate and it helps with both investment and stewardship decisions so that it creates change. It is about making informative information and upskilling across the investment chain so that people do the right things with that information, and that will apply to the small schemes as well. How do we build up the capability, capacity and expertise?

Q15 **Shaun Bailey:** That is very helpful. Perhaps one of the issues we may have, particularly with smaller schemes, if we are trying to get buy-in on this is that they might be quite daunted by what seems to be quite a big task in terms of this data collection and expertise. What do you feel the Government should be doing to try to encourage that buy-in from those smaller schemes once they have committed to that review? Clearly, the big thing here is making sure that people are on board with this and understand the importance of getting these reporting mechanisms right. You talked about what is going to need to happen, but how do we get the buy-in from those schemes to ensure that it does?

James Alexander: It is a very important question. The buy-in is important but there is also the reality that this is part of where we are. These things need to be embedded; these changes are coming. It is not going to be straightforward. I think Andrew made the point that everybody is learning; everybody is on a journey here. We have to accept that this is going to be a journey and it is not going to be perfect on day one. There should not be huge penalties for not getting this perfect first time round. In fact, what we want to do, because we are all learning, is to make sure that there is room for trying things out—for innovation—and that people are not penalised for not getting it spot-on on the first attempt, particularly if there is a good reason for trying something out and doing things a different way. We should accept that we are on a journey, but that is not an excuse for not building up those skills now.

What we would say, particularly to smaller schemes, is to start looking at the skills you have on your trustee boards and with your advisers, and make sure that you are getting the right advice to allow you to make these decisions and capture this information and data.

Tony Burdon: I agree with James; those are all good points. Buy-in also helps because this is a major issue across British society. We have COP26 and the Race to Zero; this is a daily concern for British people. I think that will help with buy-in as well. What we know is that this is what pension members want. They want action on climate, and TCFD will be an important ingredient of that. It is what employers who provide schemes want as well, because they know that is what their staff want. As businesses that are also trying to transition to net zero, they want their staff pension scheme to be doing the same. Trustees are aware of that growing demand and I think that will help them get buy-in as well.

Andrew Ninian: I agree with that point in terms of ensuring that it is clear why it is important and why it is being done—the member views. To reiterate something that Tony said, the advisers and the asset management industry have a role to support the small funds with their reporting requirements. In a climate change position paper from last year, we said that we would work with our clients to help them meet those reporting obligations, recognising that the whole investment chain needs to upskill and respond together because we are all learning.

Q16 **Shaun Bailey:** Obviously, reporting is great, and it is vital in the work that needs to be done, but what wants to be encouraged is behavioural changes, particularly in attitudes towards what funds are investing in. How do we bridge the link between the reporting standards and encouraging those behavioural changes so that we get the end goals that we are looking for?

James Alexander: You are right: the work that Tony and his organisation are doing to highlight what pension savers are thinking about how their funds should be invested is really important in demonstrating that this is a cross-economy thing. The work that we want to see, which is going to come out towards the end of the year, on where the UK economy is going and setting net zero targets—these things make an important difference in how people perceive and consider the importance of this agenda.

As we have talked about previously, it is about having global agreement on standards to make this as easy as possible, and ensuring that the advisers and the asset managers are all in this together and that everybody is pushing forward from the same angle, including regulators, Government and policy makers—the whole industry. That is then going to respond to what pension savers, the ultimate beneficiaries here, are thinking about where their pension funds should be invested.

Tony Burdon: Part of these disclosures is understanding where you are, and the next step is how you manage the risks from different exposures across the portfolios. Then you ask, "How do we manage that? What is our plan to manage that? What is our plan to align to net zero?", and then you get to delivery of the plan. All those things just go in a sequence. With industry doing that, coupled with pension members understanding more clearly the impact of their pension on climate and growing demand for their pension not to be causing a climate emergency but helping to solve it, we will get pressure on alignment, industry movement to align, and then we will get to the place where we want to be.

Andrew Ninian: One of the key drivers of change is how stewardship works in practice. Are the pension funds asking their asset managers about how their money is being managed, how they are setting the expectations of the companies they are investing in, how they are engaging with those companies to get change and how they are using their rights and their votes at companies' AGMs to ensure that they are getting companies to move to net zero? Then, from the asset managers, that moves on to the investee companies. The real behaviour change is making sure that stewardship is embedded through the investment chain and that it is driving the net zero agenda.

Q17 **Sir Desmond Swayne:** I am going to cover ground that we have already addressed, but nevertheless, there is clearly a tension between the traditional understanding of the fiduciary duties of trustees and the wider interests of the beneficiaries, which Tony drew attention to in his opening answer about the effect on the planet. How do we best bridge that tension between the two? Is it regulation, is it training, is it nudge, or what? Don't all speak at once.

Tony Burdon: It is really nice to see you again. I used to call you "Minister" not long ago when I worked in DfID.

I said earlier that I think the interpretation of "fiduciary" needs to be adjusted to take into account members' best interests, seen as both financial but also living in a world where there may be a climate emergency or not, depending on the impact of the investments that pension funds make. I think that adjustment needs to be made.

The efforts that we have talked about in terms of requiring greater disclosure, and the efforts for better standards of data collection and information provision and disclosure, will all really help to understand the impact of investment—both the risks and the impacts.

The next step is, what do you do about that? Our view is that this needs to be mandatory. I understand what James has said. The risk with mandatory alignment to net zero is that some schemes may just quickly dump high-emissions stocks and then be in a better place straightaway. If you think of members' best interests, members' best interests are that there isn't a climate emergency. That means that pension funds need to consider the real economy and the wider economy as well. It is no good just divesting but those stocks remaining with someone else who is less interested in the issues around climate change. It is important that we have mandatory net zero, but a big chunk of delivering that is this engagement, as shareholders, to help drive the transitions of companies that pension funds invest in.

We need a mix of reinterpreting fiduciary duty, mandatory alignment and then that aggressive drive to reduce emissions, primarily through the shareholding of companies that pension funds have through their fund managers. Then we will get to a place where members' interests will be best satisfied.

Q18 **Sir Desmond Swayne:** My understanding is that in 2019, the regulations for SIPs—the duties on trustees for SIPs—changed precisely to include those other decisions that can affect investments. Has that made any impact, or is it too soon to tell?

James Alexander: SIPs are a really important component of this. We did a study that showed that they were not quite having the full impact that we had hoped. We are pleased to see the Government taking on board our recommendation to publish a register of SIPs. I think that will help us to ensure that SIPs are more publicly available and that pension savers are able to review them, comment on them and understand the investment principles on which their own pension funds are invested. I think that greater transparency will help that.

Of course, we want to see that register be as useful as possible for the regular pension saver, who does not necessarily have a great amount of time to spend understanding their pension. Therefore, we want to make sure that that register is as useful as possible and provides good information. Broadly, the principle of transparency of these SIPs is important, as is the creation of SIPs in the first place. Highlighting how funds are taking account of climate and other ESG risks is what is so important about these documents. Pension funds are taking them seriously, and that is a key component of how pension funds are considering climate risk in their investment strategy.

Andrew Ninian: It is quite early, but there is a lot of focus on how member views are identified and then taken into account through the process. There is a lot of work going on to make sure that you can identify them and on how they flow through into the investment process. The changes in the SIP wording have sparked that debate. That is why I say I think it is relatively early to give concrete examples. People have identified that this is an area that needs more work and needs to be developed for it to work properly and be able to feed individual or collective views about funds through into the investment beliefs and the way that the pension fund's money is actually managed.

Q19 **Sir Desmond Swayne:** Tony, can I put a question to you? You have advocated a change to the fiduciary duties. Is there a form of words that you would argue ought to be adopted here? What is the specific change you want to see?

Tony Burdon: I do not have a form of wording to propose right now. I think we need a process of discussion across industry and with other groups to look at whether reinterpretation is the right thing to do and what that would look like. For us, at the moment, you have, "Are investments driving a climate emergency?" One of our discussions around that is about disclosure of information, statements of investment principles and so on. If you look at all the evidence around aligning to 1.5°, there are huge fears that we are not on track at all to achieve that. That means we will go into climate tipping points with irreversible, catastrophic consequences, so we need urgent action.

If we were looking at disclosure five years ago, we would be in a situation now where we had great depth of understanding of the impacts of investment and much better information on making decisions. We cannot wait, so we need to move to action very, very rapidly. That is our key worry. If we are just driving returns while managing risks, that may not be sufficient to ensure that members' interests are satisfied in terms of what the world will look like in the future.

As big as your pension pot might be if we just looked at returns, what would be its value when you could insure your house or food prices were really high because we had a drought every two years? These things need to be thought about. We are in a different world now than we were when some of this interpretation was first developed. I think we need a process to review fiduciary duty and see whether it best serves members' interests in the way it is interpreted now.

Q20 **Selaine Saxby:** Good morning, everyone. What is the risk of creating a green asset bubble?

James Alexander: This is something that the Committee should be mindful of. Some of our pension fund members are already saying that they are being outbid, particularly on green energy projects. They are not getting the risk/return that they would like to see. That would perhaps be an interesting question to ask the next panel, of pension funds. This links to the previous question from the Chair: an unintended consequence of funds feeling compelled to divest or to rapidly move from one sector into the green sector could further risk a green asset bubble. That is something we have to be extremely mindful of if we are to consider things such as a mandatory component or changes to fiduciary duties.

It is important to monitor asset prices in the green space. We are not there yet, but there is a risk, so it is an important question for the Committee to be considering. I will leave it at that.

Andrew Ninian: I would agree. We have talked about two things already that would help mitigate that risk. One is disclosure: "Where are we now? What is the situation now? What is the risk of a particular asset, and what pathway are the Government are going to take, what levers are they going to pull, or what requirements will they place on different sectors?" That means that the market is more informed as to where we are now and the direction of travel, which will mean that assets can be appropriately priced. We would go back to getting a clear idea of what the situation is now—getting clear disclosure as to the situation now—and then of what actions the Government would expect to take and the impact on different sectors, so that we can get a fully priced-in market.

Tony Burdon: I am sure that the next panel will have a lot of expertise in this. All I would add is that if we are successful at COP26—and we have strong leadership from Alok Sharma and a big team on this, with Mark Carney, Nigel Topping and others—we will have commitments for the whole world to align to net zero before 2050, and that means businesses across all geographies globally.

There may be bubbles now. There will be constraints. How much lithium is there for batteries? How much copper is there for the wiring that is needed? There are some issues there with constraints. There are not enough companies to invest in or investible deals. This huge demand, as investment realigns to a net zero world, will also drive the creation of more companies with investment resources that can flow. I think there needs to be a bit of navigation around it. We are going in a certain direction, and we should not be deterred by a worry about a bubble.

I reflect a bit on the dotcom bubble years ago. When you look now at the different stock exchanges, tech stocks make up a big chunk of investible businesses, so I think we should not be deterred by a worry about a green asset bubble.

James Alexander: That is why it is so important that we get this transition moving as quickly as possible. The more that we transition the companies in the real economy, the more they are part of the green economy and the economy of the future. The bigger the green economy, or the economy that is aligned to 2050, becomes, the less of a bubble it will be. It will become a greater part of the investment universe. That is why this transition, and of course what investors can do to help drive the transition as well as wider policy levers, is such an important component of this work.

Chair: That brings us to the end of our first panel. Thank you all very much for joining us. You have given us lots of very useful information to reflect on and we are grateful to you all for being with us.

Examination of witnesses

Witnesses: Morten Nilsson, Paul Bucksey, Mark Fawcett and Sam White.

Q21 **Chair:** We move now to our second panel, to whom we bid a warm welcome. Can I begin, as I did with the first panel, by asking each of you in a sentence to introduce yourselves to us, starting with Morten Nilsson?

Morten Nilsson: Good morning. My name is Morten Nilsson. I am the CEO of the BT pension scheme.

Mark Fawcett: Good morning. I am Mark Fawcett. I am chief investment officer at Nest. Nest was set up in 2010 as part of the auto-enrolment programme and we currently have around 10 million members and 900,000 employers signed up to use Nest.

Sam White: I am Sam White. I am the sustainability director at the insurer Aviva. I am responsible for the design of the net zero by 2040 plan.

Paul Bucksey: Good morning, and thanks very much for the invitation. I am Paul Bucksey. I am managing director at Smart Pension, a multi-employer master trust. We have around 800,000 members and we look after close to £2 billion in assets. My main responsibility is for the commercial and strategic management of that master trust.

Q22 **Chair:** Thank you all very much. Could you tell us, for each of your schemes, how environmental, social and governance factors influence your investment decisions and, within that, how you take account specifically of climate change? Can I put that to each of you in the same order, starting with Morten Nilsson?

Morten Nilsson: We have for many years been incorporating ESG into our investments, and we were one of the founding members of the UN Principles for Responsible Investment.

We started to consider climate change back in the mid-2000s and we have been doing these Mercer studies, in 2011, 2015 and 2019, where we have been assessing how climate change might impact our investment outcome. Early last year, we changed our overarching investment principle from a "finance first" principle to a principle around creating long-term sustainable value. That was very much driven by climate change, which we saw had gone from a long-term potential risk to an immediate and clear risk to our ability to deliver on our long-term obligations to our members. We also asked our members—we have asked them twice—what they think about environmental, social and governance issues. It is very clear that they expect us to use our investments and invest in a way that has a positive impact on the environment and society.

In October last year, we agreed to have a goal of achieving net zero for our entire £57 billion portfolio by 2035. In doing that, we are planning on reducing the emissions from our portfolio but also on supporting transition to a new low-carbon economy and investing in assets. We have a large investment in Fallago Rig, a large wind farm in Scotland, so we are continuing those types of transitioning assets. We have been reporting in line with TCFD for the last three years and supported that on a voluntary basis, and we have begun to structure our mandate and the rest of our portfolio to support this net zero target. That is a bit about how we consider it.

Mark Fawcett: Similar to BT, we have been integrating ESG into our portfolios since we were set up in 2010 and started investing in 2011. We do that at the asset allocation level. We do that in selecting our fund managers. They have to pass certain standards and continue to evolve the sustainability practices, and we take a very active role in stewardship and trying to steer companies to improve ESG standards.

Specifically on climate change, we have introduced climate aware equity portfolios—climate tilts. We started doing that back in 2016. We committed to net zero last year. We were the first master trust to commit to net zero. We have since been working with our fund managers across all the asset classes to evolve their methodology and philosophy of investing to take climate change into account.

We recently appointed three infrastructure managers, and one of those is dedicated to renewables. Not only are we managing climate change risk across our portfolios, but we are actively contributing to the transition to a low-carbon economy.

Sam White: Much like the other two speakers, we began our journey of incorporating ESG into investment decisions in the 1990s and onwards. It has been an evolution for us, as well as for everyone else on this journey.

As a pension provider, Aviva manages thousands of companies' pension schemes for 5 million individuals in the UK, as well as investment funds through our asset management arm and retirement products like annuities, so we see this from a lot of places. We understand that the primary duty of these pension schemes is to benefit their members and provide income for retirement, but we agree that you cannot possibly do that adequately without taking into account the very material risks posed by climate change and the transition to a low-carbon economy. That is absolutely core. We would agree with the points made by Tony Burdon earlier that it is also in members' interest not to retire into a world with extreme climate chaos.

For context, we are a 325-year-old British company, so we have a sense of thinking in the long term on this. When you think about managing people's pensions, a 25-year-old who is auto-enrolled, possibly without their knowledge, this week has a one in three chance of living to 100. We could be looking after their money for 75 or 80 years. When we talk about the most extreme impacts of climate change not happening until the year 2100, we have customers alive today who will probably be affected by that.

We see it as absolutely systemic. We see it as the largest market failure. We see it as immediate. As an insurance company, we are seeing it turn up in the other half of our business. We are seeing extreme weather events becoming more common, with more costs of flooding. It is making insurance more unaffordable for more people. Extreme hail in Canada, firestorms in places, subsidence—it is hitting from every angle.

This led our CEO to ask me what it would take for us to provide some real global leadership on gripping climate in the financial services industry. That led to us producing our 2040 net zero plan. We were the first UK major financial services company, bank or insurer to go net 40. I do not think we will be the last. I think that is going to be the direction of travel for more organisations.

We do that primarily through active ownership. There was a good debate earlier about divestment. Divestment is a last resort. We believe that we use the ownership we have in companies to meet them, to make clear asks of them, to vote at their AGMs and to drive the transition. If we are going to manage to meet the challenge of climate change in a way that is good for the economy, it is going to be transition, transition, transition. Just divesting in the first instance is not a good solution.

We have a range of climate products. We have experts in infrastructure and things like that. In terms of how we think about it in our schemes, we have been reporting on TCFD, the Task Force on Climate-Related Financial Disclosures, since the beginning. We have two broad buckets of looking at assets. We have the inside-out measures about how our company's actions and investments are affecting climate. That would look at things like the carbon intensity of our investment pool, but also more forward-looking measures like global warming potential. We would also look at the outside in: how are climate change, transition risks, physical risks, litigation risks affecting the value of the funds we are looking after? We have been publishing those for a number of years in our TCFD reports.

Paul Bucksey: I feel like an old-but-young upstart representing Smart Pension relative to what has just been said, in terms of our genesis. We started in 2015, on a mission to transform the experience of both employers and members. What we are really about is using technology to help members build the best relationship with their pensions.

Of course, it is a well-known fact that getting people to engage with the reality of saving for retirement—building your own pay cheque for when you want to stop work—is a challenge. Getting people to focus on that among the hurly-burly of everyday life is quite difficult. We think that sustainable, responsible investing, dealing with the climate transition piece, gives us a great opportunity to get our members to take more ownership and more interest in building a better financial future. I think we start there.

We are trust based, of course, so it helps that we have had a very diverse and forward-thinking board of trustees who very quickly realised that the best interests of members would be served if our investments were managed in that responsible way, integrating ESG and climate transition into our portfolio. Getting to a high level of ESG integration is something we began doing at the beginning of last year. We have made tremendous progress doing that.

We have a social impact fund that is getting ready to be added to the portfolio. We also think that there are some societal issues that are—I am getting a bit of an echo, so apologies. I think it might be on the system rather than this end.

It is also about making sure that we are exploring all of those risks. Echoing the points that have been made, I think the Make My Money Matter campaign is a fantastic initiative. We have signed up to that, to TCFD, the UN PRI and, finally, the Occupational Pensions Stewardship Council. Again echoing some of the points that have already been made, we are less about exclusion for the sake of it, although we do exclude certain things from our portfolio. We think there is a great role to play in terms of advocacy and trying to green up some of those browner assets, rather than stranding them.

Q23 **Nigel Mills:** I want to explore something I was asking earlier. When your pension schemes sign up to net zero, what change, in practice, does that drive in your behaviour? I think you have all said that you are not necessarily looking to make your own investment funds net zero in the short term, but you are trying to encourage them to go on the journey and improve their performance. Is that a fair summary of the behaviour that you think this commitment drives in your investments?

Morten Nilsson: We were working on climate change without a target before we set the target, if I can put it like that. When we measured our portfolio last year, we could see that our emissions from both global equities and bonds were much better compared with the global indices. What really changed when we set the target was that it gave us clarity; it gave us a framework that we could work out from.

I would also say, as a side remark, that this is the one thing that we have done that our employees have been most excited about. It also gave us a chance to engage with our fund managers and say, "This is what we expect from you." It gave us an opportunity to engage in a different way with Government. It gave us an opportunity to engage in a different way with our peers and industry organisations across the world.

After we set that target, we looked at four pillars. The first one was our portfolio construction, so our overall strategy, and how we can implement this—how we can cut this 15-year target into five-year targets and measure and evolve that. We looked at where we came from—the baseline we have—and we could see that 80% of our emissions come from less than 20% of our assets, so it gave us a starting point, which was very valuable.

It also gave us a chance to really evaluate how we can achieve this target. One of the key points we would like to make is that this is not just about making green investments, because green investments are highly priced and there is a huge demand for that. It is actually also about taking brown companies and making them green and supporting that transition, and engaging with those companies and following that engagement through those companies. If we do that, that will be a very big part of the solution and it will give us good investment outcomes.

For us, it was partly creating that vision for our strategy for the investment portfolio, engaging with our managers and setting up climate scorecards and other things so we can measure how well our managers are doing against this. It was about stewardship, so making sure we are a good steward of the assets we own, and then we engage with those companies and the managers we have engaged on our behalf and manage those assets well. And it was about advocacy, so we could create global collaboration, work with our peers, and try to set global standards.

On that, one example we are working on right now, which we think is hugely important, is how we can assess sovereign debt. That is a very big asset class that is very difficult to assess for investors. We have spearheaded that and some of the largest international investors are joining that. We have supranationals interested in that work. That is something we need to do. So, it has changed a lot for us.

Q24 **Nigel Mills:** Are you not tempted, when you say that 80% of your portfolio emissions come from 20% of the investment—I think was the statistic you quoted—to think, "At some point we're going to have to get rid of those, because there's just no way steel," or whatever else is in that portfolio, "can become green enough"? Do you not get tempted to hit an easy target by just swapping those investments out for some that are not so brown?

Morten Nilsson: That is a good question. To make it very practical, 50% of our emissions come from six companies in our equity portfolio, which is, of course, oil, energy and some chemical companies. The easiest thing we could do is just to divest, as you say, and then problem sorted. But when we look into those companies—I will give you two examples. One is a company called WEC Energy and the other is Xcel Energy—two US large-scale utility companies. Both of them are high emitters today. They have set targets to reduce their emissions by 80% or 70%—one is 80%, one is 70%—by 2030. We have seen huge progress so far and they have committed to reducing to net zero by 2050.

Those two examples are quite interesting because what is driving that change is local state policies, which have net zero targets. They are really being supported by the regulations. We think that the UK Government can help to create investment opportunities like that. For us, as a corporate, we see that as a company that we are helping to transition towards a green economy by making our capital available, but also as something that will give us good returns, because if they succeed in this transition, they are likely to be very valuable. We see those as quite positive examples of this.

Paul Bucksey: I would echo that. In my opening remarks I talked about the importance of stewardship. Yes, there will be some companies that you have to exclude, but it is very much about using partnerships and technology to solve some of the biggest challenges, and that includes climate.

The other comment I would make is that the other way of doing it, which I think was mentioned in the first session, is buying offsets. Of course, that is technically a way that you can be seen to be doing something. We do not think that is the right way to go. We think that does not really decarbonise the economy. Our strategies will continue to be exploring avenues and innovations that seek to respond to those challenges and actually decarbonise the economy rather than just kicking the can down the road.

Sam White: To your original question, we do not think that you can get to a net zero portfolio today. You can get on to the right trajectory to align your portfolio to hitting net zero at the right time. As I mentioned, we measure a number of metrics to see how much carbon intensity there is in our portfolio. Carbon intensity is the backward-looking one. It is saying, "If we add up all our companies and our share of them, we can work out a carbon score for those companies." That has been falling over recent years through action we have taken and action they have taken. We have things like global warming potential, which looks at what global warming the companies we invest in will contribute to if they execute their plans, as set out, over the next five years. The FTSE 100 is something like 3.5° or more of warming, if you just bought FTSE 100s as a tracker. Our shareholder assets for credit and equity are about 2.8° or 2.9°. That is still too high—we are trying to get down to that 1.5°-aligned thing—but you can see that we are already better than if we just did a passive FTSE 100 tracker. We are tilted, we are engaged, and we own some assets that we are making cleaner.

A couple of colleagues have made the point about active ownership and stewardship, which is the most important thing. I think Morten made the point that we could probably halve the carbon emissions from our equities by the weekend if we really wanted to, just by dumping stuff, but that would not make any difference to the ability of the world to transition to low carbon.

What is going to make a difference is owners who turn up at the AGMs, vote in favour of climate resolutions, engage with the management teams and say, "You, management team, need to understand that this is a material risk to your organisation—to your company—and it is possible the largest transfer of capital ever. If you are unable to understand and engage with that, we cannot support you. We cannot vote for you as directors of this company. We cannot support your remuneration policies" and so on. It is that sort of engagement.

I am very proud of our asset management arm, who, in February this year, launched something we are calling the climate engagement escalation programme—it is catchy. They identified the 30 most systemic emitting companies in the world and set out time-bound, specific asks for those companies, giving them between 12 and 36 months, depending on the context, saying the sorts of things we want to see them do, including committing to net zero, size-based targets and setting out a transition plan to show how they are going to make the change from their current position to one aligned to Paris.

Q25 **Nigel Mills:** I just want to make sure I have this right. You are saying that you want your portfolio to be net zero by a certain date. Are you saying that your investments are mandated to be carbon zero, or are you saying that they themselves have to do some offset? Are you saying that if they cannot get their activity to be completely carbon neutral, they have to do some offset and get themselves to net zero, or are you saying that as a portfolio you would want to be doing the offset so you could have some carbon-positive investments that would offset some carbon-generating ones? Or are you saying that each individual investment has to get itself to be not emitting any carbon by a certain date or you will disinvest it at some point?

Sam White: That is a great question. When we get to the net zero world, whenever that is—2030, 2050—what does the portfolio look like? No one knows exactly yet. Some of it is going to be through decarbonising—reducing the carbon emissions as low as possible in all the companies. Let us not forget that we are large investors in Government debt, so it is also about nation states decarbonising to hit net zero.

There are some companies that are already committed to being net negative before 2040. Take a company like Microsoft, which has a very impressive net zero strategy. It has significant scope for emissions; I think it is 16 million tonnes. Its plan by 2030 is not only to have got to zero in that portfolio but to have gone negative. Owning Microsoft in 2030 will count as a negative on your carbon asset balance sheet if it executes its plans.

There may be other things that will be negative then. Bioenergy carbon capture and storage, which there are a number of plans to roll out in the UK in the second half of the 2020s, should be carbon negative. Drax has plans to do that. We have taken dirty brown buildings and turned them into, under current building rules, net zero buildings. There are plenty of things we can do.

Whether we would ever pay to remove carbon on behalf of one of our assets is a very difficult question. We would be more likely to put pressure on those entities to do it themselves. When we talk about offsets, we are very clear that old-school offsets where you are just paying someone else to emit a little bit less or avoid emissions, are fine today but they are not really part of the net zero world. In the net zero world you have to be paying for actual carbon removals. A tonne of carbon in the air today has to be stored for the long term through nature-based solutions or negative emissions technologies.

Mark Fawcett: I echo many of the thoughts that we have already heard. The importance of stewardship cannot be overstated. The fact that all four of us are aligned on the importance of that and are part of collaborative groups putting pressure on companies to be very clear about their transition plans to a net zero economy is crucial.

Even more important, probably, is the fact that the big index managers are now joining in and we are beginning to have an impact. If you look at votes at Exxon, Shell, Barclays, the whole of the infrastructure around mining, oil and financing fossil fuel extraction, the pressure is clearly on. That is really important. There is a very clear message from asset owners and asset managers that companies do need to transition.

With regard to your initial question, we are not just encouraging our fund managers to align with our net zero targets; we are working with them. There are probably going to be different approaches for different asset classes, but we are actively working with our managers so that they can align their philosophy and methodology for investing with that net zero target. It is in the future; again, we are all on a journey here. Our plan is to halve carbon exposure by 2030.

In terms of divestment, there are a few assets we are already divesting: companies exposed largely to thermal coal, arctic drilling and oil sands. Those are not part of a low-carbon future and have no place in the portfolio now. The big oil and gas companies need to transition to net zero but that is going to take more time.

Q26 **Chris Stephens:** I will start with you, Paul, because I have some specific questions for some of our other panellists—and welcome to them. Paul, a simple question: are there suitable financial products to make climate-conscious investments?

Paul Bucksey: There are products. I think it is getting better. It is a good challenge to call out. A slightly different question in the world that we operate in, where there is a huge focus on cost and charges that you levy on managing member pots, is that the prices of some of these assets can be quite eye-watering. That is one of the constraints that we have not spoken about yet, but we need to balance off the need to do the right thing with a significant cost constraint.

For many years in the world of defined-contribution pensions, employers have often been swayed not necessarily by the quality of the offering for both themselves and their employees, but by the cost of the arrangement in absolute terms. There has been quite a race to the bottom, you might say, in terms of pricing. Smart Pension has a significant advantage over a lot of our competitors, in the sense that we have a purpose-built platform. It is highly efficient, so our admin cost is very low. If you then load on to that very expensive investment costs, you run the risk of being uncommercial. You also run the risk of exceeding the charge cap, which is 0.75% per annum. There are some challenges there.

What might help with that is innovation in the sector as more and more products become available, and acceptance that some of the fee-charging shapes—things like performance fees—might need to be part of this, not just for climate transition but more broadly with some of these more esoteric, you could call them, types of investment.

Scale was mentioned in the first session. There is huge pressure at regulator level on some of the smaller schemes to do more for their members. This is clearly one of the key areas. There are others: data quality, charges, admin, and all that kind of thing. If consolidation continues at its current pace—we have seen quite a few schemes merge or consolidate with Smart Pension—that gives us more scale. By collectively going after the asset managers and the fund managers, and putting them under pressure to innovate and come up with products, we will get a better portfolio to invest in.

The short answer to your question is yes, there are products, but there are also some challenges to overcome.

Q27 **Chris Stephens:** Thanks, Paul. That brings me nicely to my question to Sam and Morten. Welcome, guys.

Nest has advised us that it does not believe that climate-conscious investments should be offered as separate products from mainstream financial products. Can I get a view from both Aviva and BT? Morten, can we start with you, please?

Morten Nilsson: Could I have the question again, please?

Chris Stephens: Nest has advised us that it does not believe that climate-conscious investments should be offered as separate products from mainstream financial products. Does BT have a view on that? What is your opinion on offering alternatives like that?

Morten Nilsson: If I may just start somewhere else, to your first question, we think there are too many products that are labelled "climate aware" that are really just investing in companies that are doing what they have always done and are not changing any of their footprint. That is a bit problematic.

I think there is a big opportunity in the brown-to-green that we talked about earlier, and we are investing quite heavily in real estate, in Kings Cross and in Birmingham, Manchester, Leeds and Bristol, where we have similar projects where we are trying to do that.

We think that it is critical to get this green taxonomy right so that we have a standardised way of thinking about all this, but it is important that that is done on a scientific basis and it is not too purist, so that we find a way of avoiding greenwashing but we also have a chance to invest in these browner assets that are turning green. For us, that is the main thing. I hope that answers your question.

Q28 **Chris Stephens:** Thanks, Morten. Sam, what is your company's point of view?

Sam White: I agree with Morten. That is a pretty good point. We have funds that are very "climatey" funds, but we are also mainstreaming it. In Aviva's commitment to net zero by 2040, we mean everything. Everything we can do—our operations, our supply chain, but also all our investments and all our funds—will be there by 2040. We cannot do that today because there are many funds where we have contracts with people who will not behave according to the criteria, but over this 20-year period we will be making more and more products that are net zero-aligned, climate impact funds, climate transition funds and, wherever possible, defaulting people into them.

Think about auto-enrolment: 95% of auto-enrolled people drop into the default fund offered by whatever their scheme is. What we are doing is making our default fund net zero-aligned. We are going with the wisdom of auto-enrolment: if you get a pension and you don't think about what kind of pension you get, you get one that is climate net zero-aligned. I think that is very important. Aviva would like to see the Government do more to mandate default schemes to be net zero-aligned. I think you could make a huge difference there, in the members' best interests but also in the best interests of the climate.

Lastly, we have a few funds that do specific things. We have something called the climate transition range, where they screen out some of the worst stuff straightaway. They invest in two universes. One is companies that are well set up for a low-carbon world; maybe they are making solar panels. The second batch is companies that have brilliant transition plans, so they may not be perfect today but they have thought through how they are going to transition. Danone was an early favourite in that fund. As you can see, it is helping people be much more active in driving climate transition than just opting out.

Q29 **Chris Stephens:** Thank you. Mark, you are welcome to come in. Do you have any further comments from a Nest point of view on the issue of separating financial products that are so-called climate-conscious funds as opposed to mainstream financial products?

Mark Fawcett: Yes, 99% of our members are in our default fund, and our youngest member is 16 years old. We are going to be investing for her in the default fund for 40 or 50 years, possibly longer, and we think it is just part of our fiduciary duty to take into account climate change risk and manage those portfolios for all our members, not just the few members who have actively engaged and chosen some climate-specific products. We have a focused-fund choice, but as most of our members are in the default fund and 70% of them tell us that they want us to invest responsibly and take into account things like climate change, we think that should absolutely be the focus of our investments in climate-aware investing.

Chris Stephens: Thanks for that, Mark. Paul, you have your hand up.

Paul Bucksey: Just very quickly. We are no different. Yes, 95% are in the default fund, so that is where they key focus is, but we have done quite a bit of work with our members to try to get insight. That is one of the things we do at Smart. We do a lot of testing and research. We had a member webinar in April. We had a couple thousand of our members join us and we asked them some very specific questions. One of them was, "How important is it to you that your pension savings are invested in a way that specifically benefits people and the planet?" and 91% of people said that it was important or very important, and only 9% said it was not important. We had some people saying, "We don't care," which is a shame.

We also asked questions about whether we could invest to tackle other societal issues to do with social housing, ageing, diversity and that kind of thing. Again, with that, we asked, "Would you be willing to accept a slightly lower return on your pension if it meant you were creating a better world?" Again, we were impressed. We had 87% saying they were willing or very willing, and only 13% saying they were not. There are some good data points in that.

With one thing that we are about to pilot, we want to dig into that in a bit more detail. The question is whether people are not self-selecting because the fund options available to them are just a bit too dull, they are not interesting and they do not align with their personal beliefs. We think that giving them the ability to filter their choices by their beliefs on aspects such as the climate, LGBT or broader diversity might be a quite interesting piece of research that could lead us to a situation where we give members the opportunity to personalise the way they are invested. Yes, it needs to be net zero, because we have made that commitment too, but within that construct of being net zero, are there any other tilts or tweaks that members would find interesting or compelling that might ultimately encourage them to take more interest, pay more money in, and build a better future?

Q30 **Chris Stephens:** Thanks very much. I have a final question to all the panellists, in two parts. First—Morten touched on this—is there an onus on the major players in pension schemes, such as yourselves, to develop a common taxonomy and labelling scheme? Secondly, should there be more proactive encouragement or incentive for pension funds to be managed in a more climate-conscious way, or is the UK stewardship code sufficient?

Mark Fawcett: In terms of a taxonomy, I think it needs to be a collaborative effort between the industry and Government. James was talking about that. I think that makes sense. Having a clear taxonomy is important, and not just in the UK. Having some consistent standards across the world—we invest globally; we have managers located in different geographies—and trying to make sure we are talking a common language, with reduced risk of greenwashing and so on, is important.

As far as the stewardship code is concerned, combined with things like principles for responsible investment, managing climate change risk is part of people's fiduciary duty. If you sign up to things such as the stewardship code and PRI, that should be sufficient now. We know that some people are struggling. With the previous panel, you were discussing whether fiduciary duty was strong enough. We absolutely believe it is. I think it would be an abrogation of fiduciary duty to not take climate change risk into account in your investments.

Q31 **Chris Stephens:** Sam, is there anything you want to add?

Sam White: That broadly covers the point. There are huge gaps at the moment in data, metrics, methodologies and standards on this stuff. There is some impressive work happening in industry. The Net-Zero Asset Owner Alliance , which was convened by the UN and involved the WWF as well as a host of asset owners such as ourselves and, I think, BT and others, has been doing some excellent work trying to work out how you measure the carbon impact in asset types. At the moment, there is no methodology for sovereign debt, but when we are backing people's annuities, they are almost entirely backed with sovereign debt. Until we find out the proper methodology to measure that, the net zero targets are aspirational. We do not know how to rate a large part of our asset pool. That is a very important role that industry is developing itself, but there will be a point where it almost needs the blessing of some sort of global standardisation.

Morten Nilsson: I will start with the last point, which I very much agree with. Pension funds own a lot of Government debt and a lot of UK gilts and we need to be able to assess that, so that is quite critical for us. That is an asset class that is part of our net zero commitment but one we find quite hard to assess. Perhaps the UK Government could adopt TCFD-style reporting, which would be hugely helpful for everyone.

Other than that, to your other questions, as international investors we need international standards on the taxonomy. I can only echo what colleagues have said.

On giving incentives, our view is that pension funds should have a net zero target, but we also think that applies to investment managers and advisers. Smaller funds will have challenges with resources in getting to that point, but they need to be able to put the burden on the advisers and the investment managers that they use to support them in doing that.

We think it is also critical from a fiduciary standpoint that this needs to firm. However, if such requirements are set, it is quite important that Governments stay away from trying to set the investment strategies for these pension funds. That is very dangerous territory, which we have seen go awfully wrong in many other countries. I am a firm believer in the net zero commitment.

Chris Stephens: Thank you. I am conscious of time, so I will hand over to colleagues.

Q32 **Selaine Saxby:** Good morning, everyone. What is the risk of creating a green asset bubble?

Mark Fawcett: In the listed markets, there are so few pure green stocks that I think it is a very real risk. We talked earlier—the other panel talked about it too—about divestment versus engagement. Things like compulsory net zero might force divestment from dirty companies and force people into so-called green companies in the listed markets, and that would just exacerbate that potential issue.

In the unlisted space—renewables, for example—Morten has already said that some of them are quite highly priced, and we have certainly seen that in things like offshore wind, where the big oil companies have been trying to hoover up assets. You need managers who can navigate their way through this. The IEA has written that we need £4 trillion of annual investment in renewable energy if we are going to do the net zero transition. That is tens of trillions over the coming decade. I think that creates an opportunity. It is a massive amount of money and it will create opportunities in renewable energy. There may be pockets of bubbles, but I think over the long term those bubbles, if they exist, would dissipate.

Sam White: I agree with that analysis. Any time a market slips out of sync with the fundamentals of supply and demand, you can have bubbles created. It is always a risk. We have to be conscious of that. Each new piece of scientific data that comes in from IPCC on the climate stuff suggests that the greater risk is the brown asset bubble. Many of those assets are still massively overpriced and have not taken into account the fact that if we are going to address climate change, there will be regulation, pricing mechanisms—there will be things that change the value of these companies and their assets.

Mark just referenced the IEA in respect of the amount of green investment needed. Its report that came out last month was incredible. The IEA was set up to guarantee oil supplies in the 1970s, so it is no green, airy-fairy organisation, but its report last month said that in order to get a credible pathway to 1.5°, there have to be no new oilfields from today, no new gas fields from today, and obviously no new coal mines from today, yet there are still oil companies that see a share price increase if they have a new find of an oil reserve. That is just not realistic. If they burn 20% of those reserves, I would be surprised.

Q33 **Selaine Saxby:** Thank you. Paul or Morten, do you want to add anything?

Paul Bucksey: From Smart's perspective I go back a bit and talk about how cost plays a big role in the world of defined contribution. We, and our trustees, are very focused on value for money and cost transparency and all those kinds of things. What that has tended to mean is that there is a huge reliance on indexed funds, or passive management versus active. Of course, then, you are choosing indices to track, whether that is a world low-carbon type index or a more generic ESG index. You would expect some safeguards when talking to managers and the index providers, that might mitigate against some of those things, but I guess in any area of the economy, whether it is the tech bubble that has been mentioned or, arguably, Bitcoin right now, there will always be elements of the economy where people seek to take advantage. I guess that stresses the need to do your due diligence very carefully as an asset owner, a pension fund, a fund manager or an index provider.

Morten Nilsson: As Sam said, we see it as a demand and supply issue. Demand is very high right now and we believe that demand will continue, and supply is not big enough.

What the Government can do here is to help create a long-term, stable and consistent policy that has cross-party support, which reduces the political risk. That will help create more investment opportunities for investors like us. We think that the supply will increase over time, and it needs to increase. If it does not, we will have a real climate problem on our hands, so that will have to happen.

I also think, as has been said, that private markets play quite a big role in this. We have to be able to invest in unlisted products and in early-stage ideas, which will have a higher risk but possibly also higher reward. The transition from brown to green is a critical part of this also. Again, there is a lot of money available to be invested in that transition, and we need that transition, because that is what is going to happen.

Of course, we are in a shift that is probably the biggest challenge the world has ever been in, and that might very well mean that there will be market corrections coming out of this. As a pension fund, we have a long-term horizon. That gives us a challenge, but it also gives us the opportunity to see through some of those changes in the markets as they come through. Of course, it does mean we need to consider quite carefully how we manage the climate risk for our portfolios.

Mark Fawcett: Could I add one point? There is an important distinction between buying operating assets—a solar farm or a wind farm that has already been built—where there is a risk of short-term bubbles, and financing the construction of new plants, which is basically the cost of the land and the raw materials, and then operating it. At Nest we are financing, through both debt and equity, the construction of new wind farms and new solar farms, which are much needed. Then, as Morten says, there are new technologies, which you probably want to put a rather smaller proportion of the portfolio in, but some of those new technologies will be important as we transition, for example, to electric vehicles and so on. It is really important that we use our assets to finance new construction and do more than just buying existing operating assets.

Q34 **Siobhan Baillie:** On COP26, it is obviously a point of pride for the country that we are hosting it, and an opportunity to lead, but worryingly, it is also viewed as a fix-all event in tackling climate change. The COP26 President, Alok Sharma, has talked about the COP26 finance action plan, and insurers and pension funds are very much involved with the Task Force on Climate-Related Financial Disclosures. There is quite a lot going on in this space. How are pension schemes contributing to setting the COP26 targets, and how are you being engaged in the process, if at all?

Sam White: COP26 is incredibly important. It is a wonderful opportunity to get the global motor we need for this decade of change. We have been as involved as we can be in helping, talking to multiple Governments and international institutions about our ideas on what could be done. We have found the UK Government good to engage with. Mark Carney, in particular, has been excellent, and the GFANZ initiative—the Glasgow Financial Alliance for Net Zero—is very welcome.

We have a number of suggestions. Very briefly, we think the international architecture—the Bretton Woods architecture—should be looked at again, to make sure it has both the mandate and the resources to help drive the world to net zero. That is something the G20, or COP, could agree in October/November.

We think the OECD, which was, after all, set up to rebuild Europe—the Marshall plan, second world war stuff—should be repurposed specifically to rebuild the world, or at least parts of it, on a net zero basis.

Critically, we would like to see mandated climate transition plans for major financial institutions at least. That was a recommendation from the Climate Change Committee.

All the disclosure stuff, and TCFD being mandated, is great—disclosure is really important—but I can weigh myself as many times as I like, but if I do not have a plan to eat better and exercise more, I am not going to get very far with my diet.

We are not saying that Governments have to tell us how we do it; we are saying they have to require us to do it and mandate the publication of transition plans with net zero targets that are science based and map your business plan and your capital expenditure to your stated commitments. That way, we can understand what these companies are doing and continue to invest in companies that might be brown today but have good plans to be green tomorrow. That is the big win.

Paul Bucksey: That is a good point. I think this might have been mentioned before: we support mandating that default options should align to that UK goal, at least, of net zero by 2050. I think greater representation of pension professionals across various industry initiatives and forums would be helpful. There is one we quite like, the Green Finance Institute. I think it could benefit from having more representation from across the pensions industry on its team.

More broadly, I suppose, is just looking at the skills that are required to inform, so bringing insight from industry about the challenges and joining up the various initiatives at regulator level. I have touched a couple of times on the need to be cognisant of all the pressures on trustees, for example, on value for money, on fiduciary, on net zero, on responsible investing. In the round, it is more than just COP26. Very important though that is and very supportive though we are of COP26, it is a broader issue that we need to solve for.

Morten Nilsson: I think COP26 is a great opportunity. Government have used it to set ambitious targets and I think other organisations have used it to do that as well. I can only agree with what Sam said about what we would like to see.

The other thing I can add is that international standards and more data are key requirements, and I would like to go back to the point about sovereign debt because it is critical that we see progress on that.

Another thing that is really important for us as an investor is not COP26 but what happens after COP26—that these plans and ideas are followed through and we have clarity. Again, stability is important for us. The more we see that the policy framework is stable, the easier it is for us to invest. The more unstable it is and the less political consensus there is behind it, the more political risk we have to factor into the investments we make. Stability and that forward look, having a real road map going forward, are key for us.

Mark Fawcett: We have engaged with officials on COP26. Our renewables manager, Octopus Renewables, is going to be presenting around COP26 and we have offered our services to support it. Defined-contribution schemes in the UK typically do not invest in renewables—they do not invest in illiquid investments—whereas if you look at Australia, the vast majority of the big super funds, their defined-contribution system, do invest in illiquid assets. We want to show how this is done and support the industry. We all need to be pulling in the same direction, and helping to finance that transition is going to be an important role for pension funds. We are happy to be part of that and to share our knowledge.

Q35 **Sir Desmond Swayne:** When I was a Minister, I was continually frustrated by the international standards with which we had chosen to abide. I had a number of suggestions for improving them but was constantly defeated by the time and energy that it required to get the

OECD to change them. What should be the role of international standards in helping us to assess the climate change risks of investments, and what difference would it make if our standards were different from international standards?

Mark Fawcett: The challenge around different international standards is that they create friction in the system. We have asset managers based in a variety of countries. If they are trying to juggle and report against fundamentally different standards, it is extra work, it loads up the cost, it creates extra cost in the value chain, and that is ultimately not good for members and investors because the net charges across the system will go up.

At the same time, the UK Government have led from the front here on TCFD in particular, which is a great framework that is being increasingly recognised around the world. If that sort of framework was the basis for reporting, that would be a great leap forward. It is unrealistic to expect that standards around the world are going to be exactly the same, but if they could at least be broadly aligned, and not too much different data collection was required in order to report against them all, that would make everyone’s life easier and the system more efficient.

Sam White: Can I give a concrete example of that? We have put a great deal of effort into our TCFD-aligned reporting as one of the best-practice mechanisms. We issued our report—it is detailed, it has a host of different metrics, it explains governance strategy and all this stuff—and then one of our largest shareholders called us up and said, “Yes, but you haven’t reported according to SASB”, the Sustainability Accounting Standards Board. You just end up thinking how much additional people, work, bureaucracy and cost you add with each new set of standards that somebody asks you to report against. We think that if we can pull together something for IFRS, for the Sustainability Accounting Standards Board, based on TCFD, that is great. I do not think I could use more abbreviations in one sentence if I tried, but I think you know what I am trying to say.

Paul Bucksey: I think that is absolutely right. At Smart we use a bunch of fund managers, all in different jurisdictions, and it is just complex and layering on cost if we are constantly checking whether they comply with the various regulations. I think an international standard would work really well. TCFD absolutely helps, but we have been here before on things like disclosing transaction costs in share statements and it took quite a long time to get some kind of consensus on the standard way of defining that. Until it was defined, nobody really wanted to risk doing lots and lots of work only to find that it was not quite far enough or maybe too far. I think it would be helpful. It would be helpful in encouraging more and more pension schemes to do the right thing, so making it as simple as possible and as agreed as possible could only be helpful in moving it forward. We would be very supportive of a taxonomy but also an international standard.

Morten Nilsson: I agree with my colleagues here that different standards add complexity. For us, there is also a point about the great not being the enemy of the good, if you like. The more we can standardise things, the more we can have common frameworks and get to a point where we have good standards internationally, the better.

For us it is also a lot about international collaboration. We are members of the Net-Zero Asset Owner Alliance and we see that collaboration as quite key. I do understand that it is very time consuming, but one of the things we are seeing, and have seen over the last couple of years, is that there are so many initiatives that we are drowning in them. That is dragging a lot of resource away from changing our portfolios as we want to, because we have to spend so much resource on all these frameworks and discussions and assessing them. If we could simplify it, that would be really helpful.

All that being said, I still think there is a leadership role for the UK to take here, but if that is based on using as much as possible of the common standards that can be agreed internationally, that would be a great outcome.

Chair: Thank you all very much. That brings us to the end of our questions. You have given us some very helpful insights and information. Thank you all very much for joining us. If anything else that you would like us to be aware of occurs to you afterwards, please do send us an email. We would be keen to hear further if you would like to say anything more. We are very grateful to all of you for the contribution you have made to our work this morning. That concludes our meeting.