Work and Pensions
Committee

17 April 2024

Paul Maynard
Minister for Pensions
Department for Work and Pensions
(By e-mail only)

Dear Paul,

Fiduciary duties and climate change
In light of your intention to look, including by holding a series of roundtables, at ways to clarify fiduciary duties in relation to climate change, the Committee received written evidence and held an evidence session on 21 February. This raised issues, particularly in relation to the guidance and advice available to support trustees in their decision-making, that we wanted to draw to your attention.

How fiduciary duties are interpreted
Trustees' fiduciary duties are not from a single source—the applicable body of law has developed from a combination of case law and different statutory provisions (FYD0013). We heard that the definition of fiduciary duties is 'permissive' and broad enough for suitably skilled people with the right information to make the right decisions (Q3, Q39). However, this did not mean that no change was needed. We heard that there was a wide divergence in the way trustees were interpreting their duties in this area (Q4) and that pension funds continued to invest in high emitting sectors despite the financial risks of climate change (FYD0010; FYD0004; and Q3).

There was general agreement that the Financial Market Law Committee (FMLC)'s recent paper Pension Fund Trustees and Fiduciary Duties – Decision making in the context of Sustainability and the subject of Climate Change (6 February 2024) had been helpful in clarifying trustees' fiduciary duties in relation to climate change (Qq3–7 and Qq27–8). In particular, it helped highlight that there was a strong case for trustees considering climate change and other sustainability factors as 'financial factors' in investment decision-making, both in relation to individual investments and the impact on financial markets over the lifetime of the scheme's membership (Q4, Q8 and Qq20–7).

We heard that it would be helpful for The Pensions Regulator (TPR) to put the principles of the FMLC report into guidance for trustees aimed at supporting their decision-making (Q7). As well as providing greater clarity on their duties, it could help increase trustees' confidence in the face of potential legal challenges, provided they had operated with 'the right skills, the right advice and the right process' (Q28).

Some argued that the Government needed to go further and change the law. Client Earth argued there was uncertainty that was leading trustees to construe their fiduciary duties narrowly. It recommended as a minimum: requiring pension funds to identify, assess and manage climate risks to the portfolio as a whole (including systemic risk); and ideally including a positive duty for trustees to identify, assess, manage and manage the impact of their investments on the environment and society (FYD0018). ShareAction called for an expanded definition of beneficiaries' 'best interests', to include the impact of investment decisions on the environment, the financial system and society (FYD0004). However, other witnesses were concerned that attempting to make broad changes to the definition risked confusing rather than clarifying matters and might give rise to unintended consequences and create a tension between the new objective and the fiduciary duty to act in the best financial interests of scheme members (Q3, Q20 and Q40).

1. **What are the plans for your proposed roundtables on fiduciary duties?**
2. **Will these look at how best to mainstream the principles set out by the FMLC?**

Defined Benefit schemes

Any new guidance would need to set out the issues as they apply to pension schemes of different types—Defined Benefit and Defined Contribution—and with different time horizons (Q29). In addition, as discussed in our recent report on Defined Benefit Pension Schemes, improved funding levels mean that more schemes are closer than expected to being able to enter a buy-out arrangement with an insurer (para 59). In our evidence session on fiduciary duties, we were reminded of the importance of understanding the implications of this in relation to managing climate change risks (Q29 and 32).

3. **How do the duties of insurers (in considering the climate change risks and impacts of their investments) differ from those applying to pension scheme trustees.**

Getting good advice

We heard that the economic models on the impact of temperature rises used by some investment consultants advising pension scheme trustees did not reflect the findings of the vast majority of climate scientists (FYD0010; Qq13–4 and Q27).

Carol Young, Group Chief Executive of the USS, told us this was a complex and live issue, requiring appropriate models about the impact of climate change that were kept up to date and trustees needed sufficient skill to work with and, where appropriate, challenge their advisers (Q34). Some years ago, the USS had concluded that models they were being offered did not meet their needs and decided to work with the University of Exeter to develop their own qualitative scenario analysis (Q38). Debbie Webb of the Institute and Faculty of Actuaries told us that, although many trustees delegated investment management and therefore did not need to be able to use sophisticated models themselves, they did need to be able to set the strategy and make sure they have investment managers doing the right job (Q37).

TPR has longstanding concerns about the quality of pension scheme governance. In our report on Defined benefit pension schemes, we made recommendations aimed at driving higher standards of governance across schemes, including TPR using the new trustee register to report annually on the number of trustees who have completed its Trustee toolkit (para 102 to 113). In your letter of February 2024, you said you planned to engage with key stakeholders this spring on improving trusteeship.

4. **As part of your planned work on improving trusteeship, do you plan to look specifically at how to build the capabilities and capacities trustees need to be effective in taking account of climate change risks in investment decision-making?**

A further step is needed for effective supervision of advisers in this area. In our report on Defined benefit pension schemes with Liability Driven Investments, we recommended that the Government should bring forward plans for investment consultants to be brought within the FCA's regulatory perimeter in this Parliamentary session (para 105).

5. **Given that legislation to bring investment consultants into the FCA's regulatory perimeter has not been brought forward, it would be helpful if you could explain how DWP and TPR are working with the FCA to ensure that they use appropriate models of the impact of climate change.**

I would be grateful for your response to these questions by Wednesday 1 May. As is usual practice with the Committee's correspondence, I will be publishing this letter and your response on the Committee's website.

Yours sincerely,

Stephen Timms

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