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Work and Pensions Committee

Pension stewardship and COP26: Government Response to the Committee's Fourth Report of Session 2021–22

Sixth Special Report of Session 2021–22

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Work and Pensions Committee

The Work and Pensions Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Work and Pensions and its associated public bodies.

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Committee reports are published on the publications page of the Committee's website and in print by Order of the House.

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Sixth Special Report

The Work and Pensions Committee published its Fourth Report of Session 2021–22, *Pension stewardship and COP26* (HC 238) on 30 September 2021. The Government's Response was received on 6 December 2021 and is appended below.

Appendix: Government Response

Select Committee Recommendations

Recommendation 1: We recommend that the UK Government should use this opportunity to make every endeavour to build an international consensus on the role of pension schemes and other parts of the finance sector in achieving the goals of the Paris Agreement.

Government response: The Government is working to build an international consensus on the role of pension schemes and other parts of the finance sector in achieving the goals of the Paris Agreement.

The Government is committed to raising ambition on climate change globally. On 1 October 2021, the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations came into force.[1] This made the UK the first country in the world to mandate climate-related disclosures for occupational pension schemes, in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).

Last month, the Department for Work and Pensions launched a consultation on proposals to require trustees of occupational pension schemes subject to the Climate Change Governance and Reporting Regulations to measure and report a metric setting out the extent to which their investments are aligned with the Paris Agreement goal of pursuing efforts to limit the global average temperature to 1.5˚C above pre-industrial levels.[2] This could provide a common framework for the relevant occupational pension schemes to communicate their alignment with the Paris Agreement's 1.5˚C climate goal.

The Department for Work and Pensions is also consulting on proposed statutory and non-statutory guidance. One of the objectives for this guidance is to give the clarity that trustees have requested on content of the Implementation Statement and around stewardship, including voting and engagement.[3] These proposals would enable pension schemes to strengthen their stewardship practices, as they play an important role in pressing and influencing the companies they invest in and own to set robust targets and transition plans to achieve the goals of the Paris Agreement.

At COP26 the Secretary of State for Work and Pensions talked through the UK's agenda-setting progress in the financial sector—including leadership on stewardship—during discussions with international counterparts, panel events and roundtables with industry. In a keynote speech to mark Finance Day, she also outlined how the UK is leading the

1 The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (legislation.gov.uk)
2 Climate and investment reporting: setting expectations and empowering savers - GOV.UK (www.gov.uk)
3 Climate and investment reporting: setting expectations and empowering savers - GOV.UK (www.gov.uk)

world in mobilising climate finance, particularly through pension funds, to help power and transition the UK to net zero.[4]

The Government recognises that to build a global net zero emission economy and deliver the goals of the Paris Agreement, a whole economy approach to transition is needed. TCFD-aligned disclosures for occupational pension schemes are a core part of what is needed to drive the consistency and comparability of climate reporting that markets, and institutional investors need to make informed decisions on climate-related risks.

For greater effectiveness, climate-related disclosures are required along the whole length of the investment chain. The UK Government is already taking steps to address this through its proposed Sustainability Disclosure Requirements (SDR) regime. As set out in the Government's recent 'Greening Finance: A Roadmap to Sustainable Investing',[5] SDR will create an integrated framework for decision-useful disclosures on sustainability across the economy. This will enable the flow of comparable, decision-useful information on how companies and financial flows impact and are affected by sustainability factors.

Recommendation 2: We recommend that, in order to increase the prominence and accountability of this important task, a single Minister should be responsible for leading this work.

Government response: The Government does not agree with this recommendation. Global best practice on sustainability investment reporting requires co-operation and leadership from a range of stakeholders across countries.

At COP26, the Government announced the UK will be the world's first Net Zero-aligned Financial Sector. This means UK financial institutions having a robust firm-level transition plan setting out how they will decarbonise as the UK meets its ambitious and legally binding net zero targets.[6] To support this work the Government will set up a high-level Transition Plan Taskforce to establish a best practice standard for transition plans.[7]

The UK has also worked as chair of the G7, and in partnership with other G20 countries, to ensure all economic and financial decisions take the risks of climate change into account. The UK has convened over 30 advanced and developing countries from across 6 continents. This represents over 70% of global GDP to back the creation of a new global climate reporting standard by the International Financial Reporting Standards (IFRS) Foundation to give investors the information they need to reach net zero.[8]

At COP26, the IFRS Foundation announced the establishment of an International Sustainability Standards Board (ISSB) to develop comprehensive global baseline sustainability disclosure standards to meet investor need for financial relevant sustainability information.[9] Along with 40 international partners, the UK Government welcomed the establishment of the ISSB and its work to develop internationally consistent standards for the disclosure of sustainability-related information.[10]

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4 Secretary of State issues rallying cry at COP26 - GOV.UK (www.gov.uk)
5 Greening Finance: A Roadmap to Sustainable Investing (publishing.service.gov.uk)
6 Fact Sheet: Net Zero-aligned Financial Centre - GOV.UK (www.gov.uk)
7 Chancellor: UK will be the world's first net zero financial centre - GOV.UK (www.gov.uk)
8 Chancellor: UK will be the world's first net zero financial centre - GOV.UK (www.gov.uk)
9 IFRS - IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements.
10 UK welcomes work to develop global sustainability reporting standards alongside 40 international partners - GOV.UK (www.gov.uk)

The proposed SDR regime, developed by HMT, the Department for Business, Energy & Industrial Strategy and the Department for Work and Pensions, details the Government's next step in putting the UK's finance sector in a better position to achieve the goals of the Paris Agreement. As highlighted in response to recommendation 1, the SDR will create a reporting framework that brings together existing sustainability-related disclosure requirements under one integrated framework and will go further with new requirements.[11] It will cover corporates, asset managers, asset owners and investment products.[12]

It is the Government's aim for SDR to be an integrated regime that works smoothly across all sectors of the economy. Regulators and Government departments will determine the scope and timing of the requirements and reporting details. HM Treasury will coordinate the sectoral approaches centrally to ensure that the right information is made available across the investment chain.[13]

Recommendation 3: We recommend that the Government aims to secure international commitments to work towards the global harmonisation of climate-related reporting standards at COP26.

Recommendation: 4: We recommend that, as the first economy to mandate TCFD reporting for its pension sector, the UK should play an active role in encouraging and facilitating other economies to do the same. The Government should write to the Committee setting out its plans to engage internationally on this matter after COP26.

Government response: Work on consistent international climate reporting standards is underway. The Government has been proactively working with other countries to drive this forward and will continue to use international fora to progress the uptake of climate-related disclosures such as TCFD.

As highlighted in our response to recommendation 2, the Government is strongly supportive of the establishment of the ISSB which aims to introduce global baseline standards for sustainability-related reporting. These reporting standards will build on the TCFD and other leading sustainability reporting initiatives.[14] At COP26 the UK Government also secured agreement from 40 countries to support the launch of the ISSB,[15] and is the first country to commit to implementing the ISSB standards once finalised.[16] This sets an important precedent for the global harmonisation of climate-related reporting standards.

As part of the G7, the Government brought climate and environmental issues to the forefront of policy discussions between finance ministries. This was the first time these challenges featured prominently in the Finance Track. The Government worked closely with the Bank of England to secure ambitious commitments from G7 members on sustainability reporting. This included agreement to move towards mandatory climate disclosures, to support the IFRS Foundation's programme of work to develop a baseline global corporate reporting standard for sustainability, and to promote consistency in

11 Greening Finance: A Roadmap to Sustainable Investing, (publishing.service.gov.uk), p.11.
12 Greening Finance: A Roadmap to Sustainable Investing, (publishing.service.gov.uk), p.14.
13 Greening Finance: A Roadmap to Sustainable Investing, (publishing.service.gov.uk), p.17.
14 IFRS - IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements.
15 UK welcomes work to develop global sustainability reporting standards alongside 40 international partners - GOV.UK (www.gov.uk)
16 Britain to be among first to apply new climate disclosure rules | Reuters

impact reporting standards.[17]

Many of these issues were subsequently taken up in the G20, particularly by the Sustainable Finance Working Group (SFWG), of which the UK is an active member. The SFWG has driven progress on sustainability reporting and discussed approaches to align investments with sustainability goals. The UK is also a member of the International Platform on Sustainable Finance, which aims to foster consistency in environmental impact reporting.[18]

Under the Paris Agreement, Parties committed to making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. To do so, the entire financial system needs to transform, to lock financial flows irreversibly into a pathway to net zero. As set out in the 'Greening Finance: A Roadmap to Sustainable Investing', ahead of COP26 the UK Government was working closely with international partners to galvanise global action.[19]

The Government wants its domestic regulation to represent international best practice. This strong domestic action, coupled with international influencing, will ensure that the UK remains a global leader in green finance after COP26 and help to move the world towards delivering the global commitments in the Paris Agreement.

Recommendation 5: We recommend that the Pensions Regulator continuously monitor and update these guidelines.

Government response: The Government notes the Committee's concern that trustees need detailed and regularly updated guidelines to explain how they should consider the effects of climate change on pension scheme members, including guidance on TCFD reporting.

The Pensions Regulator expects guidelines on climate reporting to evolve in the next few years and will ensure its guidance adapts as climate-related reporting requirements change and more information becomes available to pension schemes.

The Government has also provided detailed statutory guidance to help trustees understand how they should carry out TCFD reporting.[20] This guidance will be reviewed at a minimum of three years from the date of its 2021 publication and will be updated when necessary.

Recommendation 6: We recommend that as far as possible the taxonomy should align with international standards, whilst also reflecting the UK context.

Government response: The Government is committed to developing a Green Taxonomy aligned with international standards as far as possible, whilst also reflecting the UK context.

This month, the Government announced that the UK will become the first 'Net Zero Aligned Financial Centre'[21] and the development of the Green Taxonomy will play an important role in achieving this commitment. The UK's Green Taxonomy will clearly set out the criteria which specific economic activities must meet to be considered

17 Greening Finance: A Roadmap to Sustainable Investing, (publishing.service.gov.uk), p. 34.
18 Greening Finance: A Roadmap to Sustainable Investing, (publishing.service.gov.uk), p. 34.
19 Greening Finance: A Roadmap to Sustainable Investing, (publishing.service.gov.uk), p. 34.
20 Governance and reporting of climate change risk: guidance for trustees of occupational schemes (publishing.service.gov.uk)
21 COP26 Finance Day speech - GOV.UK (www.gov.uk)

environmentally sustainable. This will give investors and savers useful information on the proportion of their portfolio invested in environmentally sustainable activities.

As highlighted in the 'Greening Finance: A Roadmap to Sustainable Investing', a core principle of the Taxonomy's implementation is that it is 'built for the UK to support a global transition.'[22] The Government will take an approach that is suitable for the UK market and consistent with UK Government policy.

There will also be a clear focus on the benefits of coherence and compatibility with other international frameworks.[23] For example, the Technical Screening Criteria (TSC) for the climate change objectives in the UK Green Taxonomy will be based on those of the EU Taxonomy, which the UK supported the development of whilst still a Member State.[24] However, the Government is currently reviewing these and expects to consult on UK draft TSCs in the first quarter of 2022, ahead of legislating by the end of 2022.[25]

The Government has also established the Green Technical Advisory Group (GTAG) to provide independent advice on development and implementation of the UK Green taxonomy, including any deviations from existing international frameworks.

Recommendation 7: We urge the Government to publish its consultation response within three months. In this response, it should outline its approach for developing regulations relating to climate change, alongside other environmental, social and governance factors.

Government response: The Department for Work and Pensions plans to publish a Government response to the call for evidence in 2022. The Call for Evidence was an information gathering exercise and any changes in policy would be subject to further public consultation.

Recommendation 8: We recommend that the Pensions Regulator report annually on the progress made to consolidate schemes.

Government response: Annual reporting on the progress made to consolidate schemes is already available. The Pensions Regulator DC trust scheme return data[26] and the Purple Book published by the Pension Protection Fund on DB schemes[27] provides year on year breakdowns of the number of schemes in existence, showing how the landscape is consolidating. This information is in the public domain and easily accessible.

The Pensions Regulator Defined Benefit Annual Report[28] and the DC trust scheme return data also provide a high-level snapshot of the current landscape of occupational DB and DC trust-based pension provision in the UK, including information on the number, membership and assets of schemes.

22 Greening Finance: A Roadmap to Sustainable Investing (publishing.service.gov.uk), p.22.
23 Greening Finance: A Roadmap to Sustainable Investing, (publishing.service.gov.uk), p. 22,27.
24 Greening Finance: A Roadmap to Sustainable Investing (publishing.service.gov.uk), p.27.
25 Greening Finance: A Roadmap to Sustainable Investing, (publishing.service.gov.uk), p. 27.
26 DB defined benefit annual report | The Pensions Regulator; The Purple Book | Pension Protection Fund (ppf.co.uk)
27 DB defined benefit annual report | The Pensions Regulator; The Purple Book | Pension Protection Fund (ppf.co.uk)
28 DB defined benefit annual report | The Pensions Regulator

Recommendation 9: We recommend that the Pensions Regulator define net zero alignment.

Government response: The Government understands the concerns of the Committee; however, there are difficulties associated with defining concepts which are in a state of rapid and ongoing development.

Following the publication of the recent consultation 'Climate and Investment Reporting',[29] the Department for Work and Pensions and the Pensions Regulator will work together to encourage pension schemes to align their investments with net zero targets.

The Department for Work and Pensions intends to continue its ground-breaking work in this area. As highlighted in our response to recommendation 1, the Government is consulting on measures to require occupational pension schemes to calculate and report a metric setting out the extent to which their investments are aligned with Paris Alignment goal of pursuing efforts to limit the global average temperature increase to 1.5˚C above pre-industrial levels.

These new requirements would apply to all trustees who are subject to The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.This would include trustees of occupational pension schemes with £1bn or more in relevant assets, trustees of authorised master trusts and trustees of authorised collective money purchase schemes (once such schemes are established).

Trustees would become subject to the new requirements from 1 October 2022 and have the flexibility to choose one of three types of portfolio alignment metric: binary; benchmark divergence; or implied temperature rise. While trustees will have methodological flexibility to choose which type of metric they calculate and report, we anticipate that these proposals will also provide a degree of comparability between schemes.

Recommendation 10: We encourage other schemes to consider whether they should also set net zero targets. While we recognise that any target must not undermine trustees' fiduciary duties, we believe that in many cases these will be aligned.

Government response: The Government agrees with the Committee's recommendation. The Department for Work and Pensions welcomes the ambition of a growing number of schemes voluntarily setting net zero targets and will continue to encourage pension schemes to sign up. As acknowledged in this recommendation, net zero targets must not undermine trustees' existing fiduciary duties When the Government encourages pension schemes to commit to net zero, it encourages them to do so in a way that works for them and the emerging evidence is that this is working.

Approximately 85% of Defined Contribution (DC) pension savers are in a scheme with a net zero target. Six of the top ten Defined Benefit (DB) pension schemes, equating to assets of over £250bn have made net zero commitments. In total net zero signatory pension schemes within the Department for Work and Pension's policy remit account for at least £380bn in assets under management and more than 19 million members. The pensions industry is showing great leadership in committing to robust and ambitious net zero targets.

29 Climate and investment reporting: setting expectations and empowering savers - GOV.UK (www.gov.uk)

Recommendation 11: We recommend that the Pensions Regulator should establish a working group to develop guidance for schemes looking to set net zero targets.

Government response: The Government does not agree with the Committee's recommendation. Significant progress has been made this year in encouraging pension schemes to sign up to a net zero target, and investor groups such as the Institutional Investors Group on Climate Change (IIGCC) and UN-convened Net Zero Asset Owners Alliance (NZAOA) continue to collaborate to deliver on these commitments.

The Pensions Regulator's climate change strategy,[30] published in April, also makes clear to schemes the risks of climate change to pension pots and the potential opportunities from the transition to net zero. The Pensions Regulator's climate adaptation report,[31] published in October, shows that two-fifths of DC schemes surveyed in 2020[32] took climate change into account when formulating investment strategies. The Pensions Regulator will look to draw on the experience of these schemes, via their usual lines of engagement and via the new TPR panels that have recently been announced,[33] as they develop and adapt guidance for pension schemes on climate change.

Recommendation 12: We recommend that the Government consult on the case for mandating that these default options should align to UK Government climate goals.

Government response: The Government understands the intention of this recommendation, though is concerned that mandatory alignment with climate goals might force immediate divestment from high carbon stocks, regardless of whether or not companies are making meaningful progress towards net zero. In this case trustees would be unable to engage and steward companies to lower carbon business practices. To reach net zero, we will need a whole economy transition. Pension schemes as owners and investors have an important role to play in pressing and influencing the companies in their portfolio to set out robust targets and transition plans.

The Government considers that proactive and effective stewardship can lead to a reduction in the climate risk in pension scheme portfolios and drive down real-world emissions. This is evidenced by the recent progress noted in response to recommendation 10 and is why we are consulting on new guidance to encourage effective stewardship.[34]

Recommendation 13: We recommend that the Government set out a UK climate roadmap—including sector specific pathways for meeting the Paris Agreement goals—to provide greater certainty for pension schemes and other investors, particularly for those investing in long-term investments such as infrastructure.

30 Climate change strategy | The Pensions Regulator

31 Climate adaptation report | The Pensions Regulator

32 The survey population included hybrid pension schemes with DC members. A hybrid scheme includes both DB and DC benefits. The climate change questions were directed to all schemes with more than 100+ members or which are used for automatic enrolment. For the purposes of the survey, schemes were instructed to answer questions only in relation to the DC sections of their scheme, excluding any sections offering DB benefits or DB benefits with a DC underpin. See paragraphs 22 to 26 of the Pensions Regulator's Climate Adaptation report (and related footnotes).

33 TPR to launch discussion panels on measuring risk mitigation – Pensions Age

34 "Climate and investment reporting: setting expectations and empowering savers".

Government response: The Government's Net Zero Strategy,[35] which was published on 19 October, provides a cross-economy climate roadmap on the UK's transition to net zero by 2050, including the action government will take to keep the UK on track for meeting its carbon budgets and 2030 Nationally Determined Contributions (NDC).[36]

The Net Zero Strategy outlines measures to transition to a green and sustainable future, helping businesses and consumers to move to clean power, supporting hundreds of thousands of jobs and leveraging up to £90 billion of private investment by 2030. It sets a clear direction and gives the wider financial industry the certainty they need to invest, grow, and make the UK home to new ambitious projects.

The Net Zero Strategy also shows indicative pathways to meeting carbon budgets in terms of how it sees different sectors contributing to emission reductions to meet legislated budget levels up to 2037. The sector chapters in the Net Zero Strategy set out in detail the policies to deliver these pathways. For example, in relation to the Power sector, the Government will accelerate deployment of low-cost renewable generation and will consider whether broader reform to market frameworks are needed to unlock the full potential of low carbon technologies to achieve net zero.[37]

Recommendation 14: We recommend that the Department for Work and Pensions publishes information about levels of direct investment by pension schemes in its annual report.

Government response: The Government does not agree with the Committee's recommendation.

It would not be practically feasible to publish information on direct investments. It is typical for an occupational pension scheme to have thousands of stocks in just one fund alone and for that fund to only represent a percentage of their investment portfolio.

However, the Government acknowledges the importance of assessing and reporting on the pension investment landscape of the UK and therefore brought in the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 to drive assessment and disclosure of levels of climate risk arising from investments.

Recommendation 15: We recommend that the Department set out, in response to its report, what specific steps it is taking to ensure that its policies do not incentivise divestment over good stewardship—while making clear that schemes could nevertheless consider divestment when there is no other option.

Government response: The Government agrees with the Committee's recommendation. The Department for Work and Pensions is keen to ensure that its policies do not incentivise divestment over good stewardship. The Department has set out specific steps in relation to recent policies below.

On the 1 October 2021, the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 came into force. By the end of 2022, the climate change risk to £1.33 trillion of pension savings will be assessed and, in time, published.

35 Net Zero Strategy: Build Back Greener - October 2021 (publishing.service.gov.uk)
36 Net Zero Strategy: Build Back Greener - October 2021 (publishing.service.gov.uk) p.296.
37 Net Zero Strategy: Build Back Greener - October 2021 (publishing.service.gov.uk), p.94.

On the 21 October 2021, the Department launched a consultation on proposals to require trustees of relevant pension schemes to measure and report a metric setting out the extent to which their investments are aligned with the Paris Agreement goal of pursuing efforts to limit the global average temperature increase to 1.5°C above pre-industrial levels.[38]

The Department has made clear throughout the consultation process on the TCFD measures, and in the 21 October consultation, that the Government does not advocate blanket divestment. These measures are solely concerned with ensuring proper consideration and effective governance of the risks and opportunities associated with climate change.

Guidance on the Statement of Investment Principles and Implementation Statement

The importance of stewardship has also been underlined by the Department's proposals on draft statutory and non-statutory guidance, which formed part of the Consultation published on the 21 October.[39]

The proposed Guidance focuses on the areas where existing policies and reporting by trustees appear to be weakest – stewardship and, to a lesser extent, consideration of financially material environmental, social and governance factors and non-financial factors. It sets out the Department for Work and Pension's expectations in relation to the Implementation Statement and effective stewardship best practice in relation to the Statement of Investment Principles. The proposed Guidance also provides examples of effective engagement and voting policies.

The Occupational Pensions Stewardship Council (OPSC)

The Department has also prioritised stewardship by establishing, in July 2021, the OPSC.[40] The Council was launched in response to Recommendation 16 of the report "Investing with Purpose",[41] published by the Government-led Asset Management Taskforce. This suggested that a "dedicated council of UK pension schemes should be established to promote and facilitate high standards of stewardship of pensions assets".

The Taskforce on Pension Scheme Voting Implementation (TPSVI)

The Minister for Pensions and Financial Inclusion set up the TPSVI in December 2020, to address problems in the voting of equity shares by pension schemes. The Taskforce focused on two areas to help strengthen pension schemes' stewardship activities:

(1) How to facilitate more voting and better-quality voting by occupational pension schemes by encouraging them to set voting policies.

(2) Making recommendations relevant to the changes in behaviours needed from asset managers and service providers to meet this objective.

38 DWP, "Climate and investment reporting: setting expectations and empowering savers - consultation on policy, regulations and guidance", October 2021. "Climate and investment reporting: setting expectations and empowering savers".

39 "Reporting on stewardship and other topics through the Statement of Investment Principles and the Implementation Statement: statutory and non-statutory guidance", 21 October 2021.

40 Occupational Pensions Stewardship Council - GOV.UK (www.gov.uk)

41 Asset Management Taskforce, "Investing with Purpose – placing stewardship at the heart of sustainable growth", (November 2020).

The Taskforce published its report on the 20th September 2021.[42] It includes 24 recommendations for Government, regulators, and industry. Nine recommendations are for DWP, six of which have been taken forward in DWP's consultation on draft stewardship guidance. Moreover, the DWP is setting up a government-led working group to progress the remainder of the recommendations.

42 "The Report of the Taskforce on Pension Scheme Voting Implementation: Recommendations to Government, Regulators and Industry", September 2021.