Written evidence from UK Sustainable Investment and Finance Association (UKSIF) (PSC0001)

Introduction

The UK Sustainable Investment and Finance Association (UKSIF) is the membership organisation for those in financial services committed to the growth of sustainable and responsible finance in the UK. We look to promote a more sustainable and inclusive financial system that works for the benefit of the environment and wider society.

UKSIF represents a very diverse range of financial services firms committed to these aims, and our 270+ members include investment managers, pension funds, banks, financial advisers, research providers, NGOs, among others.

UKSIF and our members are pleased to have played a prominent role in embedding sustainability in UK policymaking over recent years, including in the pensions sector. Recently, UKSIF worked closely with policymakers during the passage of the Pensions Scheme Act to ensure pension schemes consider the Paris Agreement goals when ensuring effective climate change governance and report against the Task Force on Climate-related Financial Disclosures (TCFD) framework. Separate to this, we strongly welcomed the government recently committing to adopt our proposal for a central registry of Statement of Investment Principles (SIPs) to improve scrutiny of pension schemes' environmental, social and governance (ESG) policies, and we look forward to helping this operate effectively.

We know however there is much more government, industry, regulators and others can do to encourage the pensions sector to more effectively manage sustainability risks and opportunities, and ensure that pension schemes have policies in place to effectively manage these risks today. We therefore welcome the Work and Pension Committee's inquiry into the UK's approach to pension scheme stewardship, and how we can better support schemes to make more sustainability-conscious investment decisions.

How should pension schemes contribute to setting COP26 targets and helping to achieve the targets once agreed?

A key focus for UKSIF continues to be to support and encourage the UK's pensions sector and our members to set ambitious net-zero targets and commitments, including interim milestones, and we believe this will increasingly be the expectation of pension schemes' members.

Through our membership of the UK COP26 Finance Coalition Coordination Mechanism (FCCM), UKSIF is pushing for new commitments from our membership and guiding them in these efforts. This includes hosting a series of private roundtable discussions with our members, exploring some of the common approaches and challenges for firms in moving towards implementing commitments, and we will be looking to continue to help the sector move forward in this respect.

Separately to this, UKSIF is strongly supportive of initiatives supporting the objective of net-zero emissions by 2050 and of efforts to support investment and lending portfolios aligned with net-zero by 2050 or sooner. This includes the Net-Zero Asset Owner Alliance, Net-Zero Asset Managers Initiative, as well as Make My Money Matter's 'green pensions charter' calling on pensions schemes to agree net-zero targets for investments ahead of COP26.

We believe that once targets have been agreed by pension schemes and others, that the focus should turn towards quickly implementing targets and evaluating the barriers which UKSIF will be helping to identify on behalf of the sector in the coming months.

As part of strategically implementing net-zero commitments, firms will need to consider some of the following factors: whether their targets are credible and meaningful, linked to factors such as executive pay and capital expenditure, whether they can be effectively implemented during the tenure of company executives and accompanied by clear implementation plans, as well as whether interim milestones are being seriously considered. **UKSIF supports financial services firms considering nearer-term interim targets and milestones for net-zero, including for 2025 and 2030**, given the scale of the challenge we face. Agreed methodologies around interim targets will be needed, as well as measurement of progress against these targets and auditing of commitments; we consider that near-term targets can help inform capital allocation decisions, and improve accountability within firms, particularly if set within the tenure of company executives.

Schemes will also need to exercise active stewardship with investee companies to help deliver progress on their commitments. We know that good stewardship can lead to meaningful results, such as companies better reporting the financial impact of climate change or outlining steps they will take to move to net-zero emissions over time. It should be recognised that wholesale exclusionary approaches, including divestment, by investors in the short term will not be an effective approach for the real economy to transition. UKSIF believes all industries will need to play their part to support a sustainable transition and schemes, and others, should continue to highlight that those companies playing a larger role in contributing to global warming should act with much greater urgency. As part of this, there are a number of effective stewardship tools, with voting rights just one of these, that investors can leverage to drive positive change within companies.

In terms of voting rights specifically and their role, UKSIF believes climate transition plans and climate disclosure should now become more prominent voting issues and **we support the principle of advisory shareholder votes on companies' TCFD disclosures and transition plans**. We believe the frequency of shareholder votes should be driven by investors in dialogue with company management. We would encourage investors to link their voting policies to these issues, and we would welcome a signal of support for this from government in principle ahead of COP26, noting the backing of the UN's Special Envoy for Climate Action and Finance, Mark Carney.

What role should international standards have in supporting pension schemes to assess climate change risks when considering scheme investments?

UKSIF and our members believe that the role of international standards-setters, and rules emerging from their initiatives, will be vital in supporting pension schemes and financial services more widely to assess climate change risks and opportunities in investments.

For example, more robust and consistent global sustainability reporting regulations and data will be significant to allow schemes to take effective action to respond to climate risks, and take advantage of the opportunities. We therefore strongly support the IFRS Foundation's plans for a Sustainability Standards Board (SSB) ahead of COP26 to deliver more meaningful sustainability data. Current sustainability disclosures remain inconsistent across companies and do not provide our members with the data necessary to make well-informed financial decisions. We see the creation of the SSB as a potential turning point in sustainability-related disclosures for our members and society more broadly, and we will continue to lend our support to the Foundation's work, calling for swift progress to be made by building on existing frameworks and in time broadening out to wider sustainability factors.

The role of international standard-setters could play a part in helping improve the operation of TCFD for pension schemes and the wider sector. In future, global initiatives such as the Foundation could help address some of the shortcomings with TCFD; TCFD requirements could be adapted in time by UK policymakers and the government should be prepared to look at how global standards could be applied in the UK and swiftly introduced when appropriate. Drawing on 'best-in class' standards could ensure greater granularity within TCFD reports in future, including more decision-useful data for our members. One way to encourage more granular TCFD disclosures could be to mandate that disclosures make reference to the Sustainability Accounting Standards Board (SASB) metrics and include specific milestones and KPIs.

More broadly, **UKSIF sees international standards, and the UK taking steps to align in the long term with world-leading rules, as vital in creating an effective regulatory framework for the pensions sector**. We will continue to call for the UK to lead the way in shaping the development of global sustainable finance standards, including in relation to reporting standards and taxonomies, and believe the UK can be a useful contributor by bringing its more principles-based perspective, grounded in evidence, and allowing companies to find innovative pathways to achieve sustainability goals.

Are there suitable financial products to enable pension funds to make climate-conscious investments? How should such investment be facilitated and supported?

In recent years, the financial sector has come some way in developing and offering to pension funds, and other clients, climate-conscious financial products and funds.

For example, many UK investment managers now offer a wide range of responsible investment products, such as ESG exchange traded funds (ETFs) and climate-change funds that seek to mitigate the risks of climate-change and social impact funds. Increasingly, we are seeing new funds being launched by UKSIF's members that seek to specifically address biodiversity related risks and opportunities. This includes HSBC Global Asset Management's series of natural capital funds in partnership with Pollination and Invesco's Water Resources ETF, aiming to channel billions of pounds into the long-term preservation and protection of nature, seeking to mainstream natural capital as an asset class.

While the sector is well placed to meet the challenge of responding to the changing values of clients and facilitating more sustainable investments, **a number of challenges remain to the further growth of this market, including a lack of common definitions and clarity for investors on sustainable investment products**. There is a significant need to provide greater confidence to individuals in what they are purchasing, and improve clarity and comprehension of objectives of sustainable investment products. We welcome the FCA's ongoing work in this area, including the development of its 'guiding principles' for the design and disclosure of ESG funds, which UKSIF continues to contribute towards.

The UK's approach to the implementation of EU rules, including the Sustainable Finance Disclosure Regulation, will also play an important role and we would like UK policymakers to adopt a more principles-based perspective that can ensure the sector can provide meaningful and clear disclosures to clients. The UK's approach to SFDR, while remaining broadly consistent with the EU's, should develop an approach that can minimise the risks of 'greenwashing' for savers and help them identify who are genuine leaders on sustainability. For example, one major issue is the definition of sustainable investment products under Article 8, which in its current version is problematic as the scope of products falling under this category is incredibly broad and could mislead clients.

How should the UK seek to share and learn from international best practice?

UKSIF and our members strongly believe the UK should take an active leadership role in sharing and learning from best practices on sustainability from different jurisdictions abroad. In our recently published 'Policy Vision,' which outlines the steps for the UK government to adopt to advance UK leadership on sustainable finance, we call on the UK to 'lead the way' in the development of global sustainable finance standards, which recognise the urgency to act and scale of action needed.

We argue the UK should prioritise 'a race to the top' and seek to play a proactive leadership role to develop ambitious UK rules. One example we highlight is shaping initiatives on 'green taxonomies', such as the work of the International Platform on Sustainable Finance; the UK could be a useful contributor in these discussions with countries by bringing its more principles-based perspective, grounded in evidence, and allowing companies to find innovative pathways to achieve sustainability goals. Our Policy Vision stresses the importance of the UK drawing on the standards set by leading standard-setting bodies, rather than indefinitely accepting rules from a specific jurisdiction, such as the EU, which would limit our ambition.

Our report also encourages the UK to take a leading role and share knowledge on the creation of social standards, which are increasingly being recognised as key drivers of value, and on the operation of TCFD, seeking ways to make this more effective going forward.

What regulatory changes or other government action has been most effective in delivering change in the UK; and what changes on the part of Governments elsewhere should the UK learn from?

The UK government and regulators have in a number of ways led the way in driving forward the sustainability agenda, most notably with the UK becoming the first major economy to legislate to cut emissions to net-zero by 2050. The UK has been a leader on climate disclosures, as the first G20 country to make TCFD-aligned disclosures mandatory across the economy. The UK's regime for good stewardship, particularly essential for the transition to net zero, is also very well respected internationally and been effective in advancing progress towards the UK's sustainability ambitions. This includes our Stewardship Code, which we believe should be highlighted by policymakers to other jurisdictions seeking to improve their stewardship practices, including the Code's focus on outcomes. Another welcome development has been Treasury's recent announcement on ensuring the mandates of the financial regulators have regard to the UK's net-zero target, which we strongly endorse and we would support HMT making a similar commitment to its policymaking.

In terms of policy changes that the UK could learn from, this includes acting swiftly in response to the EU's sustainable finance package, and specifically its development of a taxonomy of sustainable economic activities and disclosure regulations for products. **There will be a number of lessons for UK policymakers to learn from the EU's taxonomy and SFDR**, including: ensuring government clearly communicates the purpose of the taxonomy and what functions it does and does not intend to play; making sure the technical screening criteria for the taxonomy is not diluted by competing sectors; and adopting an approach to the disclosure regulations that minimise greenwashing risks and recognises the true leaders on sustainable finance.

More specifically on the taxonomy, the UK could consider the following over the long term: setting its thresholds at a level accounting for more economic activities (including transitional activities) and products, emphasising greater usability for its end users, containing greater shades of 'green', and having more flexibility to respond to changes in the global economy, for example with a regular update of the UK taxonomy each year.

The UK could also learn from the experience of some countries now considering integrating biodiversity considerations into financial services. For example, France has recently required all firms to disclose biodiversity-related risks as well as climate-related risks, and the UK could examine this development as it consider its own approach on biodiversity, making sure that there is robust data on biodiversity to ensure firms can measure and disclose these risks. The UK can also learn from, and partake actively in, global initiatives such as the Taskforce on Nature-related Financial Disclosures, and take steps to embed this framework at home.

This includes actively encouraging industry to become signatories and considering ways to integrate the framework with existing reporting requirements for firms. The framework could be an excellent starting point to provide a clear nature related financial risk framework to encourage better corporate disclosure and help redirect financial flows towards nature-positive outcomes.

Finally, the UK could learn from the EU on an approach to embedding 'double materiality' in the years ahead into sustainable finance legislation, such as corporate reporting. Although we are at an early stage in this debate, we see this as a natural step with finance and business increasingly expected to consider the impact of their investment decisions on the environment and society. Availability of data, and agreeing on common measurement, will be among the challenges in reporting on the broader non-financial impact of investment decisions, but this should not limit a longer-term ambition. UKSIF will lend its support to initiatives seeking to advance progress in this area.

Do pension schemes have suitable information to assess climate risk, or do there need to be international reforms to financial reporting?

While the availability and quality of sustainability-related information and disclosures have markedly improved in recent years, **there continues to be significant gaps in data for pension schemes and investors.** For example, there remains a need to strengthen the quantity, and quality, of climate disclosures, with some listed companies continuing not to fully disclose against all four pillars of TCFD. We have seen some companies choosing to 'cherry-pick' their disclosures, focusing on scope-1 emissions and neglecting scope-2 emissions. We believe a majority of listed companies continue to not provide adequate disclosures for pension schemes and other stakeholders' scrutiny; indeed, TCFD's most recent status report noted much more progress was needed by existing signatories.

It is clear international reforms will be needed in the coming years, with more detailed reporting standards needed given the principles-based nature of frameworks like TCFD. The work of the IFRS Foundation in developing a Sustainability Standards Board (SSB) is promising and we hope it can effectively deliver consistent global sustainability reporting standards to meet the pressing demand from our members for meaningful sustainability data**. Other regulatory changes such as the EU's Corporate Sustainability Reporting Directive will also play an important role in relation to data**, and the UK should be prepared to look at how global ESG standards could be applied in the UK and swiftly introduced when appropriate. This move would help ensure robust and consistent disclosures in different jurisdictions, and serve as a positive signal to our members who invest in companies and assets across the world.

Domestically, the UK government will need to ensure its policy changes can encourage a greater flow of sustainability data across the investment chain. **For example, the UK's approach to the implementation of TCFD for publicly quoted and large private companies should be more ambitious**, and consideration should be given by BEIS to extending the scope from the outset to companies with 250 or fewer employees, particularly vital for those companies operating in high carbon-intensive sectors. An extended scope for companies would ensure greater visibility over how all companies manage climate-related risks and identify the opportunities of the net-zero transition, and help many pension schemes fulfil their own regulatory obligations such as the requirement to produce TCFD reports from next year.

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