Chair, Work and Pensions Committee
House of Commons
London
SW1A 0AA

For submission via Parliament website

17 June 2021

Pension stewardship and COP26

I am writing on behalf of the **Mercer** in response to the Work and Pensions Committee inquiry on Pension Stewardship and COP26.

Mercer is a global consulting leader in talent, health, retirement, and investments. In the UK, our client base includes employers and trustees providing occupational pension schemes to employees in all sectors of industry. We provide pensions advice and services to companies in the FTSE100, but we also have a large proportion of clients that are employers classed as "Small to Medium sized Enterprises", or trustees of pension schemes with sponsoring employers in this class.

Mercer was a founding signatory, in 2006, of the United Nations supported Principles for Responsible Investment (PRI).

In preparing this response, we have collected views from several senior consultants provide advice to a wide range of pension schemes and from specialist consultants in our global Responsible Investment team.

We would also be happy to have a further discussion on the topic should you feel it would be valuable. Please contact me at vanessa.hodge@mercer.com.

Yours faithfully

Vanessa Hodge

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Summary of our response

1. A reduction to climate-related risks, which may not be full net zero, or directing investment to climate-related opportunities are positive achievements and will contribute to helping to achieve the wider COP26 targets.
2. International standards that require non-UK asset managers and companies to report under TCFD will assist trustees with their assessment of climate-related risks.
3. There are an increasing number of institutional investment funds available for pension schemes that have the investment objective of being Paris-aligned but these tend to be focussed in the equity space.
4. SDFR regulations (or equivalent) will help trustees understand how embedded the aim of managing climate risks is in a particular financial product to ensure alignment with their investment beliefs.
5. The international community is looking to the UK as a leader in regulating the disclosure and management of climate related risks and opportunities.
6. Making the governance and reporting of climate-related risks mandatory for large pension schemes has helped prioritise the risk and accelerate action. The Government should look to accelerate similar measures across the asset management community and with the disclosure of climate-related risks of UK corporates.
7. Data availability, reliability and consistency remains a barrier to the success of fully managing climate-related risks and meeting climate-related targets.
8. Extending climate disclosures to non-public companies will help support investment in private market investment.
9. We have experienced challenges in assessing physical climate risk impacts on behalf of our clients.

Detailed response

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

Trustees are not climate, nor policy, experts and therefore the Government should not expect trustees to contribute to setting COP26 targets. The forthcoming climate disclosure regulations and supporting statutory guidance from the DWP is a very helpful way for trustees of (the largest) UK pension schemes to measure, monitor and manage their climate related risks and opportunities in a consistent way that complements the way other financially material pension related risks are managed.

As part of that framework, trustees are required to set a target against one of the required climate-related metrics they will monitor and we are supportive of the approach set by the DWP where targets set should be no more than 10 years into the future, including those schemes which have set a net zero target by 2050. This will help focus the attention to tangible action over the most critical period in the management of climate change risk.

In order to determine the ongoing ability of a defined benefit scheme sponsor to continue to financially support a pension scheme, the trustees will need to take into account the exposure of the sponsor to climate-related risk and understand how the sponsor is managing those risks. Therefore the response of the plan sponsor in helping to achieve COP26 targets, and the impact on covenant from either action or inaction by the plan sponsor, is important for managing overall pension scheme risk.

Net zero targets may not be appropriate for all pension schemes and, in the case of defined benefit schemes, will be driven, in part, on their underlying strategic asset allocation and long term funding objective. What is important is the identification of the climate related risks and embedding the management of that risk into trustee's integrated risk management framework. A reduction to the climate-related risks, which may not be full net zero, or directing investment to climate-related opportunities are positive achievements and will contribute to helping to achieve the wider COP26 targets.

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

International standards that require non-UK asset managers and companies to report under TCFD (in particular, reporting climate-related metrics, both emissions and non-emissions related) will assist trustees with their assessment of climate-related risks, as data availability, reliability and consistency is one of the barriers to successfully meeting a climate-related target.

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

There are an increasing number of institutional investment funds available for pension schemes to consider that have the investment objective of being Paris-aligned. These tend to be focussed in the equity space. Products in fixed income are limited and will typically have more of an exclusionary focus (no fossil fuel exposure, for example). Impact funds that have a broad focus will support the transition towards a low carbon economy rather than excluding all fossil fuel producers. Some illiquid asset

classes such as infrastructure or private debt, provide access to climate-related opportunities such as investment in renewables.

SDFR regulations will help trustees understand how embedded the aim of managing climate risks (and sustainability more generally) is in a particular financial product to ensure alignment with their investment beliefs. This only covers the European market at present, although we recognise the UK is developing similar regulation.

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

Our understanding is that the UK is well advanced in formalising and regulating the disclosure and management of climate related risks and opportunities and therefore the international community is looking to the UK as a leader in this space. International coordination of standards and practices will help support the aims and actions of asset owners. France has also led on transparency and reporting of emissions and transition related data and it is important that regulatory asks are consistent to encourage broader adoption.

5. 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?

Making the governance and reporting of climate-related risks mandatory for large pension schemes has helped prioritise the risk and accelerate action. The Government should look to accelerate similar measures across the asset management community and with the disclosure of climate-related risks of UK corporates.

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

Data availability, reliability and consistency remains a barrier to the success of fully managing climate-related risks and meeting climate-related targets. International reforms to financial reporting that improve disclosure on climate risks is required. In addition, financial reporting should extend beyond climate risk and consider broader sustainability and impact in order to help trustees meet their wider environmental, social and governance objectives. Extending climate disclosures to non-public companies will help support investment in private market investment.

We have also had challenges in assessing physical climate risk impacts on behalf of our clients. Given the hugely diversified nature of our clients' portfolios, assessing the physical risk exposures is challenging. The best data to support the analysis would be location based. Whilst some groups, like 427, are developing solutions in this areas, there are still significant gaps to the provision of this data.