Written evidence from Association of Consulting Actuaries (ACA) (PSC007)

The ACA is the representative body for UK consulting actuaries. Our members are all qualified actuaries – mainly Fellows of the Institute and Faculty of Actuaries. Members provide advice to thousands of employers and pension schemes with assets exceeding £1 trillion, including most of the country's largest schemes as well as thousands of smaller arrangements. Increasingly consulting actuaries are now involved in a wide range of additional areas including investment consulting.

Our submission represents the views of our Climate Risk Group, who represent our members in this important area. We feel it important to indicate our views as a collective group with significant influence in the pensions industry.

Our comments on specific questions raised in the consultation are set out below.

Association of Consulting Actuaries (ACA) response to Work and Pensions Select Committee inquiry: Pension stewardship and COP26

General Comments

The ACA is supportive of the Government's drive to encourage pension schemes to engage with environmental, social and governance (ESG) concerns as asset owners and to provide greater transparency in this area. It is important that any new requirements on pension schemes are applied consistently with the other duties and responsibilities of pension scheme trustees and managers, and that they focus on achieving positive outcomes rather than be seen primarily as additional compliance reporting.

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

Our view is that the current policy of using risk assessment, disclosure and setting / monitoring of pension scheme targets is the right approach at this stage to taking account of all the risk factors facing the scheme, rather than Government intervening in trustees' responsibility to set the investment strategy in a one-size fits all approach.

In terms of setting COP26 targets, most pension scheme trustees are unlikely to be experts in this area and we suggest it is the role of Government (advised by experts) to set and provide guidance on appropriate COP 26 targets. However, pension scheme trustees do have a significant role to play in helping achieve the targets by engaging with asset managers and advisers and developing a strategy appropriate to their scheme and asset holdings that is consistent with their duties and fiduciary responsibilities. Targets set and acted upon by trustees need to be driven from a perspective of managing risk and returns which in part will depend on Government action to decarbonise business. In addition, for defined contribution schemes, trustees will want to ensure members can access the appropriate funds reflecting their personal views on climate change and acting on their behalf in the design of default investment arrangements. We would also expect pension schemes to focus on effective stewardship and engagement, and not simply disinvestment.

For defined benefit schemes, trustees will also need to consider the scheme's reliance on the sponsor covenant and the climate change and transition risks associated with that sponsor. For the vast majority of schemes that cannot secure their liabilities through bulk annuity contracts in the

short term, Trustees cannot 'disinvest' from their sponsor and so will need to engage positively with their sponsors to assess and understand how they are responding to climate related risks, including policy changes that will affect the sponsor.

We expect Government to engage with the pensions and asset management industry to understand and remove barriers to achieving its aims, for example on the availability of adequate emissions data across different asset classes and consistency of language and reporting. In addition, pension schemes are, and will continue to be, significantly buyers of gilts and the climate targets relating to this major pension scheme asset class is within Government's control.

In addition, we suggest there is an opportunity for pension scheme members (particularly in defined contribution schemes) to influence achievement of COP26 targets. Complying with new and existing climate-related disclosure requirements should not be at the expense of clear, straightforward communications and positive engagement with pension scheme members in relation to assessing and acting upon climate related risks.

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

For sound risk management reasons, UK pension schemes invest across a wide range of asset classes and across global investment markets. They will also be reliant on asset managers in the UK and internationally – both small and large. The sponsors of defined benefit schemes are also wide ranging from small to large employers, including listed companies, private companies, partnerships and not-for-profit organisations and institutions. Many sponsors are UK subsidiaries of international and overseas parent companies.

As a result, consistency in international standards on data, taxonomy and ideally, regulatory requirements and disclosure expectations, is vitally important in helping a pension scheme consistently and effectively assess climate related risks in its investment strategy and, for defined benefit schemes, sponsor covenant. In turn this will facilitate better decision making in relation to managing those risks and ultimately should lead to better outcomes in meeting climate risk targets.

Robust, consistent standards (that are subject to independent audit) should also help to reduce 'green washing' and the potential for regulatory and reporting arbitrage across different standards / territories and types of organisation.

International standards also have a role to play in supporting pension schemes in ensuring a proportionate and consistent approach is taken when considering the E, the S and the G of ESG. Whilst current activity has been perhaps more heavily focused on climate risks and governance, a holistic strategy is important across all aspects of ESG. Trustees are understandably cautious about embarking on significant programmes of work in relation to climate risks, only to find that a repeat exercise is required on social and / or governance considerations.

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

The capital markets are continuing to adapt to the increased demand for climate-conscious investments. In some cases, the challenge for pension scheme trustees is product proliferation and the ability and cost of spotting 'green washing'. Small pension schemes, in particular, may struggle to access and assess appropriate assets. There is also concern around the "green premium" in price

(both in terms of asset prices and fees) and it will be important for schemes to ensure that decisions are taken bearing these factors in mind.

As noted above, however, effective stewardship in relation to existing assets, rather than simple disinvestment, can play a significant role in helping to achieve COP26 targets. This assumes schemes can get hold of adequate and consistent climate related data on the underlying assets.

The Government has a role to play here: stimuli for green investments and financial products would accelerate transition. However, the ACA is wary of inadvertently creating asset bubbles in doing so. Government policy focussed on stimulating underlying green business would be a more natural fit and capital markets will find ways to access these as efficiently as a free-market economy allows. Whilst there is a potential link to the Government's patient capital initiative, we would advocate keeping the policies separate, as climate change needs more radical and quicker action with greater emphasis on R&D investment.

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

The UK has one of the largest pensions markets in the world (outside of State pensions) with defined benefit schemes making up the majority of invested assets. The majority of our members' experience is in relation to UK defined benefit pension schemes. More generally, we have seen only a handful of countries appear to have taken any significant action in respect of climate change risk impacting defined benefit pension schemes.

For example, the Netherlands was early in incorporating climate-related risks into pension scheme governance, and there may be some useful lessons to be learned from this experience. One area in which the Netherlands may differ from the UK is that, initially, it took more of a social responsibility, rather than investment, perspective to climate-related risks. In our view, the UK is now taking the lead in facilitating an environment that supports assessment and action to manage climate related risks and is conducive to the development of relevant investment products.

Organisations like the Institute and Faculty of Actuaries, the International Actuaries group, and potentially the Pensions and Lifetime Savings Association can help to share with and learn from international counterparts.

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 various new regulations aimed at ESG, carbon emissions and stewardship that have been introduced in recent years have not always achieved effective change. However, they have gradually led to a wider conversation in the industry and increased demand from pension scheme clients for advice and assets. They will also have helped to give those Trustees with strong views in this area, the ability to push fund managers more than they may have previously.

We anticipate that the forthcoming introduction of mandatory TCFD requirements for the largest UK pension schemes will lead to considerable improvements both in the governance of climate-related risks and in their disclosure to regulators and pension scheme members. We expect these new requirements will lead to innovation in the methodologies and technologies used by investment managers seeking to meet the requirements of larger schemes, which will then start to filter down and adapt to smaller schemes.

This will be a significant change to be implemented and the accuracy of the underlying data and best practice approaches will develop significantly over the first few years as experience and knowledge

grows. We suggest it is important that these new requirements are given time to bed-in before considering the introduction of further requirements unless absolutely necessary. We see the Pensions Regulator as having a role to help in sharing best practice examples as they emerge over time to help inform and shape how industry responds to the new requirements. We also see the importance of Government consulting with stakeholders over the next few years to ensure that barriers to accessing data are addressed.

Lastly, the future markers outside of the pensions industry (e.g. removal of internal combustion engine sales, Ultra Low Emission Zones, phasing out of coal fired power stations) help make it clear what the direction of travel is and make this a priority for schemes.

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

Currently there is not enough information on this, although we note it is improving inevitably in listed markets more quickly than other markets. We are also concerned that certain aspects of climate risk (e.g. carbon emissions) are getting increasing focus, but other elements less so – there is a danger that the focus is disproportionately directed to these aspects.

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