Written evidence from Make My Money Matter (PSC0012)

In March 2021, the Minister for Pensions and Financial Inclusion announced that "world leading regulations" will come into force ahead of COP26, following the Government's consultation, "Taking action on climate risk: improving governance and reporting by occupational pension schemes – response and consultation on regulations", which ran from January to March 2021 [Government response: Taking action on climate risk: improving governance and reporting by occupational pension schemes - GOV.UK (www.gov.uk)]

Ahead of COP26 the Committee is seeking views on how the UK Government's approach to pension scheme stewardship can inform—and should be informed by—approaches taken internationally.

Introduction to Make My Money Matter (MMMM)

Make My Money Matter (MMMM) is a people-powered campaign working for a world where we all know where our money goes, and where we can make sure it's invested in a way that is aligned to our values in order to build a better future.

Our surveys, and those of others, show that people understand very little about their pensions and how they work, but consistently the majority of people want a sustainable pension, one that does not harm people and planet (March 2021 MMMM YouGov survey - Two thirds (61%) of pension holders say that they want their retirement savings to help fight climate change and over half (53%) explicitly say that they want their pension to do good for people and the planet. 80% of pension holders that we surveyed have never considered whether their pension could be contributing to climate change.)

We have previously welcomed the efforts that DWP is making to improve climate risk governance and reporting by occupational pension schemes. In order to tackle climate risks, meet member concerns and align pension funds with the UK government's ambition on net zero, we have been calling on all UK pension funds to align their portfolios to the 1.5 degree pathway, requiring net zero emissions before 2050 and a halving of emissions before 2030. Increasingly, leading UK pension funds from Nest to Scottish Widows, BT to Brunel, and Aviva to Smart Pensions, are doing so. They are doing so because they see it as their fiduciary duty, while noting too that their members want action to tackle the climate emergency.

Effective stewardship by pension fund trustees is a crucial part of enabling the true power and potential of our pensions to come through.

Summary

Make My Money Matter welcomes government's legal commitment to net zero, the recently announced increase in ambition, the government's 10 point plan, the commitment to mandatory TCFD disclosure and the sustained efforts of government to increase reporting from pension funds on climate and wider ESG concerns.

However, despite the voluntary progress made by leading pension funds to a robust net zero, including halving emissions before 2030, we estimate only £420bn of assets under management, some 25m pension pots, will be aligned. This leaves almost £2.2tr of UK pension funds driving the climate emergency, including the potential of future events which will create catastrophic and irreversible tipping points. Urgent action is required. This includes:

1. Mandatory alignment of UK pension funds, and the wider financial industry, to a robust net zero, in line with government's commitment and vision on net zero.
2. More active and effective stewardship of assets in order to drive the transition to net zero.
3. Greater transparency to members on pension fund alignment to net zero, wider ESG impacts, and greater consideration of member views and values.

<u>Responses to questions posed</u>

1. **<u>How should pension schemes contribute to setting COP26 targets and helping to achieve the targets once agreed?</u>**

- We believe that COP26 targets should be largely the accountability of governments, and science, and should include mandatory climate disclosures (TCFD), transition plans and alignment to 1.5 degrees. Targets should be set based on what trajectory of change is required of all sectors (including finance) in order to limit climate warming to 1.5 degrees agreed at the Paris conference
- The main role for pension funds is to ensure that their portfolios are aligned to these targets in a coherent and transparent manner. Net Zero targets must be robust and include halving of emissions before 2030, backed up by transition plans, and regular reporting to members on progress. This is what MMMM is calling for from all pension schemes, ahead of COP26
- Schemes must also play a strong stewardship role, working with their investee companies to use their influence to help drive the green transition, including a just transition. It will also include ensuring company influencing and lobbying, including through membership of industry bodies, does not undermine a rapid alignment to 1.5 degrees. This includes active engagement, AGM voting, and divestment where necessary. Stewardship will also include an assessment of long-term company transition plans which should also include short term targets, 7-8% emissions reduction annually, no deforestation, executive compensation linked to progress in delivering the plan, with annual performance reporting to shareholders.
- We have seen positive examples on Net Zero commitments from large DC Mastertrust/GPP providers such as Aviva, L&G, and Scottish Widows, but there is more to be done across the industry. This must include DB schemes, where the bulk of AUM still resides, DC single-employer trust schemes, LGPSs, and the SIPP market. Each sub-sector will have its challenges in reaching the required targets, and it is incumbent on the sector to make this a strategic priority and assess how best to achieve it whilst acting within wider

fiduciary duty. To do this, they must be supported by clear guidelines, best practice, and regulation where appropriate.

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

- As a starting point, it must be ensured that trustees are fulfilling existing legal requirements in relation to ESG, that this is not a "tick-box" exercise, and that they are keeping up with regulation in this field as it changes
- From 2019 trustees were obliged to produce – and publish - a statement of investment principles (SIP) setting out their policies on financially material ESG considerations and their policies on stewardship. However, a report from UKSIF in February 2020 showed a low level of adherence to rules regarding ESG disclosure Changing course: how pensions are approaching climate change and ESG. - UKSIF
- In terms of assessing climate risk, standardised and consistent metrics are vital. This requires international frameworks, on what to include, how to measure, and common (minimum and best practice) standards – and ultimately better quality, usable, data
- It is important that international, science-based, frameworks are used (examples include the Institutional Investors Group on Climate Change Net Zero Investment Framework, Net Zero Asset Owner Alliance 2025 Protocol, and Science Based Targets Initiative), so that whilst scheme strategies will differ, there can be confidence in their robustness and as much comparability as possible. As more companies and pension schemes make Net Zero commitments, it is important that these are held to account both in terms of their robustness, and also their progress and implementation
- There is much work happening across the sector on climate risk/opportunity, and net zero transition strategies (UNPRI has produced this summary of some of the major work The investor guide to climate collaboration: from COP26 to net zero | Reports/Guides | PRI (unpri.org). Ideally we would like to see credible initiatives come together around a core set of science-based approaches. This could help provide further clarity and also help provide guidance to schemes where capacity and/or knowledge is lacking
- IFRS leadership on standardised sustainability accounting standards could help allow the development of proper and consistent ESG standards, as well as wider impact disclosure – bringing global standardisation. Improved data quality and provision will help provide a better platform for trustees and asset managers to make informed decisions, and to ensure sufficient oversight
- That being said, perfect should not be the enemy of good, and a lack of perfect information shouldn't be a reason to not make substantive progress or fully engage on the topic. The timescales involved mean that we cannot wait to act.

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

- As well as mainstreaming ESG management of investments, engagement, and divestment where appropriate, we would like to see pension schemes acting to ensure that their investments are providing real impact in climate solutions
- We would like to see creative discussion between trustees, industry, and government in terms of how to enable greater levels of investable climate (and social) positive impact opportunities, with suitable risk/return profiles to align with fiduciary duties, as part of wider plans for building back better/just transition/levelling-up alongside public investment. This discussion should not be solely limited to UK opportunities, but also include investment opportunities in developing and emerging markets
- As demand grows, there will need to be a matching growth in supply of investable opportunities. The government has a role to play in this ecosystem as identified in the recent open letter signed by 457 investors, from The Investor Agenda. Real commitments by governments need to match the 1.5c pathway, and governments need to act to ensure that data available to investors is consistent and mandatory.
  IN-CONFIDENCE_EMBARGOED_2021-Global-Investor-Statement-to-Governments-on-the-Climate-Crisis-1.pdf (theinvestoragenda.org)

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

- The government has set out ambitious targets on Net Zero, and its green finance strategy. There now exists an opportunity for the City of London to be a global leader of green finance, but as part of this it should look for examples of best practice around the world
- Collaboration and knowledge sharing is important, at a global level but also right down to the sharing of approaches and challenges between pension schemes. The pressures of the required transition can be daunting if not addressed in a collaborative way
- In relation to pensions, an example of potentially useful international practice is the US, which has greater transparency in disclosure of pension investments. It is mandatory for investment companies to publish their full holdings within 60 days of each quarter end. We would like to see total transparency mandated for investment funds and pensions in the UK, with them required to publish their full holdings in a timely fashion, and in a way that is easily accessible to individual pension members/investors
- We believe it is important that pension scheme members are given clear and understandable information on how their pension is performing in relation to net zero, and wider ESG impacts. Complex information must be translated into member focussed documents (and/or as part of statements), perhaps with standardised fund 'ratings' on key topics. This is crucial so that pension members are not unwittingly investing in activity that is contrary to their values.

5. **<u>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?</u>**

- The UK government has led on strong Net Zero commitments, and the government and DWP have been strong on requiring TCFD disclosure, which is welcome.
- Similarly, strong stances such as banning sales of new petrol and diesel cars by 2030 send a signal to the market, helping to set timeframes for action – and investment
- Now there is a need to follow through on more detail, building on the 10 point plan, and providing stronger direction and firm actions which align to the commitments
- The most recent UN emissions gap report states both the risk and the opportunity now facing us, https://wedocs.unep.org/xmlui/bitstream/handle/20.500.11822/34461/EGR20KM.pdf?sequence=17
    - *"despite a brief dip in carbon dioxide emissions caused by the COVID-19 pandemic, the world is still heading for a temperature rise in excess of 3°C this century – far beyond the Paris Agreement goals of limiting global warming to well below 2°C and pursuing 1.5°C. However, a green pandemic recovery can cut around 25 per cent off the greenhouse emissions predicted in 2030 and put the world close to the 2°C pathway. Governments should pull out all the stops to implement a green recovery and strengthen their pledges before the next climate meeting in 2021."*
- It also highlights, as MMMM does with the pensions industry, that it is now crucial to commit to short-term action

    "the growing number of countries committing to net-zero emissions goals by mid-century is the most significant climate policy development of 2020. To remain feasible and credible, these commitments must be urgently translated into strong near-term policies and action and reflected in NDCs."
- We believe that, whilst industry engagement and the positive power of the market responding to risks/opportunities can bring change, this now needs to sit alongside stronger regulation to mandate swifter action in order to avoid climate tipping points, manage climate risk effectively, and drive greater investment in green opportunities. This is necessary to align activity to timeframes which minimize the risk of future 'handbrake' actions being required from governments around the world, which in turn would likely be more disruptive and painful for industry and finance, and for pension savers. Prepare for disorderly shift to low-carbon era, firms and investors told | Greenhouse gas emissions | The Guardian
- To this end, it could be said that no government is truly acting quickly enough at the moment, and we would encourage the UK government to lead on this global challenge with further ambitious, firm, real-world steps
- Historic interventions such as banning smoking, mandating seat belts, outlawing drink-driving, and banning elements of plastic usage, show the power of regulation to drive change in short timescales. This can help to

create new societal, cultural, and industry norms which would likely have not happened as quickly if left to other forces of change

- For the finance sector, including pensions and investments, this requires a quick step on from mandatory TCFD disclosure, to mandatory Net Zero transition plans, and their implementation. DWP and industry can work together to agree appropriate international frameworks, standards and sanctions, as well as the need to build trustee capacity to manage the new context and deliver on their duties. At the same time, the government should work with industry to discuss the interpretation of fiduciary duty – currently understood to be to maximise risk-adjusted returns – to also consider other aspects of "members' best interests" which could also include retiring in a world worth living in, and where costs of living (given climate change) are commensurate with savings. Disclosure in itself is helpful, and provides transparency on which to act, but without firmer pressure for concrete plans it is unlikely to decarbonise the sector (and others) at the pace required by external environmental realities and their consequences.

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

- Our answer to question 2 refers to improving data, and the use of consistent frameworks, and it highlights potential evolution of IFRS to explicitly include climate factors and standardised accounting for sustainability. It also notes that whilst current data is not perfect, this should not be an excuse to delay substantive action and engagement with the issue
- As well as emissions, climate risk also needs to join up with biodiversity/nature loss risk, including through the nascent TNFD, and find ways to quantify and include the risk to climate, and ecosystems (and therefore also to human society and financial risk). One example of this is the role of deforestation, and considering how the finance sector ensures that a Net Zero aligned investment strategy is not investing in deforestation which in turn increases climate risk, and potentially material financial risk to the investments
- In terms of asset classes, for many pension schemes bonds will form a substantial part of their investment strategy. So, as well as understanding the risks and opportunities for equities, adequate climate information is required on all asset classes including sovereign debt (and for those government bonds to be aligned to Net Zero in a robust manner). An industry working group is underway to look into this [BTPS develops tool to assess govt bonds' climate change exposure - ESG - Pensions Expert (pensions-expert.com)]
- We recognise the heavy workload placed on the pensions industry, and that for many schemes there will be major challenges of capacity, knowledge gaps, and concern as to what they are able to do within the boundaries of fiduciary duty. Put simply, some pension schemes may not know where to start. It is important that we address this and ensure that trustees and advisors in the sector are equipped for success, to fulfil their important role. We have highlighted in our response to the consultation on social factors that there should be consideration of how to ensure appropriate capability and resource to deal with today's challenges – including disclosure of the

composition of trustee boards. Consideration should also be given as to how to ensure that all trustees are fully aware of the issues involved in the climate science, government expectations and policy, and how this translates to potential investment strategies

- In addition to trustees, other parts of the industry e.g. investment consultants, and advisors, need to become part of the solution. For example, moving to NetZero advice as a baseline
- We believe that there could be value in creating more spaces for understanding the barriers faced by different aspects of the pension sector. For example, there may be similarities but also differences, between DC, DB, and LGPS schemes, as well as the advisors who work with schemes. This could enable collaboration, co-creation of solutions, and also specific issues where government intervention is required.
- Finally, and importantly, pension scheme members must be provided with easily understandable emissions data (or e.g. implied temperature rise data) to show how their pension scheme and investments perform, how they are doing compared to commitments, and what this means. Members need to know whether their scheme is driving the climate emergency or solving it, so that they can hold it to account. They must be provided with easily accessible updates on progress, including digitally. This transparency on climate impact will help create member engagement, and demand, so that they can make their money matter.

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