Written evidence from the Pensions and Lifetime Savings Association PLSA (PSC0020)

About the PLSA

We're the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with 20 million members and £1 trillion in assets, across master trusts and defined benefit, defined contribution, and local government schemes. Our members also include some 400 businesses which provide essential services and advice to UK pensions providers. Our mission is to help everyone to achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings, and to build the confidence and understanding of savers.

Executive summary

- Pension schemes of all sizes are alert to, and responding to, the climate emergency we face. Increasingly schemes are setting ambitious targets for themselves in response.

- Forthcoming climate reporting requirements – Task Force on Climate-Related Financial Disclosures (TCFD) – for schemes should, over the long-term, give us a clear picture of the risk to pension scheme investments of climate change, and the climate impact of underlying investee companies. However, this is dependent on the full investment chain, including fund managers and companies, reporting to a similar standard.

- In considering the sector's response to this emergency, it is important that policy makers consider the different situations that schemes face – for examples in scheme size, type and maturity. All of these factors can have a significant impact in a scheme's vulnerability to, and ability to respond to, climate change.

- There has been considerable progress in recent months in establishing global standards on climate reporting, in keeping with PLSA's recommendations in our report, "A Changing Climate: How Pension Funds can Invest for the Future" (Please see Annex 2 for the Executive Summary).[1] We believe the UK should continue to do what it can to be a leader in this area.

- We hope the UK can make progress on a green taxonomy as soon as possible, as the lack of consistent standards is resulting both in concerns about green washing, and in a feeling by pension fund investors that the products they need – to meet climate expectations and their fiduciary duties – are in limited supply. The recent announcement by the UK Government of a Green Taxonomy Advisory Group is a positive step.

[1] https://www.plsa.co.uk/Policy-and-Research/Document-library/A-changing-climate

- We support the issuance of the first UK Government green gilt later this year, and hope fund managers will also look at how to provide more investment vehicles that meet the needs of pension fund investors.

- We welcome the Committee's inquiry into this important policy area, and would be happy to provide any further evidence as needed.

- **QUESTIONS**

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

In the summer of 2020, the PLSA undertook a substantial engagement project with our membership to better understand their desires and frustrations around climate aware investing. We spoke to more than 80 representatives in detail and, as a result, produced the report, "A Changing Climate: How Pension Funds can Invest for the Future"[2], setting out our findings.

We found that there was almost universal agreement both that our sector wants to invest in a way that takes into account the climate change challenges we face, whilst also delivering value for our beneficiaries, and that this is achievable. A survey we conducted found that only 1% did not believe that climate change would have an impact.[3] We also found that this reflected the views of the entire investment chain, including asset managers and advisers.

At the moment, as the sector reflects on the forthcoming mandatory Task Force on Climate-Related Financial Disclosures (TCFD) requirements – the largest schemes will be required to report from October 2021, and the remainder over the coming years – there is also growing awareness of the climate emergency among savers and beneficiaries, and of the COP26 summit in November. We are seeing an increasing number of schemes set themselves ambitious net zero targets. A number of larger pension schemes, for example, have signed up to groups such as the Net Zero Asset Owners Alliance and the Paris Aligned Asset Owners Group, which both require a commitment to achieve net zero by 2050. The PLSA welcomes this ambition, and our policy priorities aim to ensure the conditions are in place to maximise the number of schemes that feel comfortable setting such targets.

For others, especially those schemes that are smaller and less well resourced, the lack of infrastructure in place to support this has resulted in a more cautious approach. In our report, we set out a number of challenges that we believe can hinder pension schemes' abilities to invest in a climate aware way (particularly where there is a target to achieve). These include: a lack of universal definitions and standards resulting in 'greenwashing'

[2] https://www.plsa.co.uk/Policy-and-Research/Document-library/A-changing-climate
[3] https://www.plsa.co.uk/Policy-and-Research/Document-library/A-changing-climate

concerns; a lack of 'green' investment products; poor quality (or non-existent) data; a lack of expertise in climate issues; and the complex nature of the investment chain.

There has already been considerable progress made in relation to a number of these recommendations since we released the report last October, and we very much welcome the direction of travel. We believe that this progress made will result in increased ambition across the pensions sector with regards to climate investment.

The TCFD regulations, recently published by the Department for Work and Pensions (DWP) (subject to Parliamentary approval), will require pension schemes with assets in excess of £5 billion, and all authorised Master Trusts, to produce a TCFD report within seven months of the regulations coming into force on 1 October 2021. The regulations set out a number of requirements of trustees, including that three metrics are reported on and monitored, one of which ought to be in relation to climate emissions, and that three yearly climate scenario analysis testing ought to be conducted. Though we have some concerns about the practicalities of this in the initial years (pension schemes will be dependent on asset managers and companies for this data, the majority of which will not be required in law to provide by the time schemes require it), we welcome the Government's ambition and believe that, in the long-term, this will result in a much more comprehensive picture of how UK's pension investments are at risk from or impacting climate change.

It is also worth noting the important role played by pension schemes as responsible and active asset owners, often in collaboration with each other, in engaging with companies to hold them to account on climate targets, and use their influence through voting and stewardship to encourage more ambitious targets. Clearly the transition needs to be a whole economy approach, and this is something pension schemes are mindful of in protecting their assets. Many pension funds have also long been active, at both global and local levels, in initiatives to encourage governments to do more on climate reporting.

We have not undertaken or participated in any work on what targets ought to be set at COP26 by national governments, but we will of course ensure that full consideration is given to how the pension sector can, and should, respond to the outcomes of the conference.

The Committee might also wish to refer to the Pensions Policy Institute's research on the sector's response to climate change, supported by the PLSA.[4]

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

Given the large percentage of investments made by UK pension funds internationally – recent research suggests only around 2% of FTSE shares are held by UK pension funds[5] – the

[4] https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2021/2021-02-18-engaging-with-esg-climate-change/

[5] https://www.orientcap.com/doc/insights/OC-Foreign-Investors.pdf

international standards are extremely important in enabling trustees to monitor and report on the impact of climate change on, and by, their investments.

Again, we recognise the progress that has been made in relation to this in recent months. The recent commitment by the G7 to introduce mandatory climate reporting is hugely welcome. As set out above, pension funds abilities to monitor and influence climate change is dependent on data being made available by companies in which they are invested. We therefore welcome the efforts by the UK Government to make TCFD a universal reporting requirement.

In our 2020 report, we also referred to the lack of standardised information, and recommended a global sustainability reporting standard and board. Again, since the report was published, the International Financial Reporting Standards (IFRS) Foundation have consulted on these measures, and confirmed an intention to proceed with both. We believe this will have a significant and positive impact. We hope that consideration will be given to ensuring that reporting is holistic; we note that, though companies are now starting to explain credible climate stories in the financial narrative at the front of their Report & Accounts, this is not always reflected in their Financial Statements.

Finally, though the EU's Sustainability Finance Disclosure Regulation has not been adopted by the UK, we recognise that it is a step in the right direction in terms of ensuring consistent standards in products marketed as being "green" or "sustainable". In line with the recent recommendation of the Treasury Committee,[6] we hope that the UK equivalent will progress at speed, to ensure that investors can have confidence that the products they invest in are not subject to "greenwashing". The Government's recent announcement of a Green Technical Advisory Group hopefully indicates that progress is being made.

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

Based on our engagement with pension schemes, we do not believe that there are currently enough suitable products.

During a series of roundtables in 2020, we heard both that it is hard to find climate assets that have the impact they are marketed to have, and that it is difficult to find assets with the appropriate income (or characteristics and structure) to enable trustees to meet their fiduciary duties. This is particularly the case in the fixed income space, including in sovereign bonds.

We have also heard some feedback that, despite the interest in ESG at the moment, it has taken fund managers a little longer to provide investment vehicles that combine the characteristics needed by pension fund investors to meet their dual obligations, albeit, we

[6] https://committees.parliament.uk/work/96/decarbonisation-and-green-finance/

recognise that this is developing quickly. Of course, as the economy transitions, it is likely that investment opportunities will increase, but at the moment many schemes feel that the scale and volume of appropriate products is lacking. Additionally, this imbalance in supply and demand is driving up costs, therefore creating some less attractive options, given the need to ensure value for money for underlying savers.

We therefore welcome the UK Government's confirmation of the first issuance of a UK green bond later this year. We also welcome the Chancellor's confirmation, in November 2020, of the launch of a UK taxonomy. We hope that we will quickly move to UK standards being adopted, as has already happened in the EU.

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

In terms of sharing, as set out in Q2, pension fund investors work on a global basis and so any role the UK can play in encouraging the same ambitious targets we've set ourselves to be adopted globally is very welcome – we would largely agree that the UK is leading the way in this respect. This is especially the case when it comes to company reporting on climate impact. We believe that reporting, by institutional investors, fund managers and companies, on a global basis will play an important role in us meeting the Paris Agreement. The recent commitment by G7 countries to improve climate reporting is a significant step, and one we welcome.

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

Our comments on this are set out in Q2.

ANNEX 1 – PLSA RESOURCES

Stewardship Guidance and Voting Guidelines 2021

Engaging with ESG: Climate Change, 2021 (PPI/PLSA supported research)

A Changing Climate: How Pension Funds Can Invest for the Future, 2020

Climate Indexes Made Simple, 2020

Implementation Statement Guidance, 2020

Engaging the Engagers: A Practical Toolkit for Schemes to Achieve Effective Stewardship through their Managers, 2020 (PLSA/Investor Forum)

ESG & Stewardship: A Practical Guide to Trustee Duties, 2019

ESG Made Simple Guide, 2019

ESG risk in default funds: Analysis of the UK's DC Pension Market, 2017

More Light, Less Heat: A Framework for Pension Fund Action on Climate Change, 2017

Stewardship Disclosure Framework

ANNEX 2 – EXECUTIVE SUMMARY OF THE PLSA'S "A CHANGING CLIMATE: HOW PENSION FUNDS CAN INVEST FOR THE FUTURE" (2020)

“ There is universal appetite among pension schemes and their service providers to take climate change seriously and to invest with a sense that a carbon-constrained future is coming. We sought out the views of dozens of trustees, and investment professionals, involving them in roundtables and in smaller discussions of the issues. Even the rare individual who is sceptical about the causes of climate change accepts that pension funds need to invest recognising the economic risk caused.

“ While there is appetite to invest in a climate- aware way, and some schemes have already taken a proactive and leading position, those investors identified a series of barriers to their being able to do so. In some cases, these are about an immature infrastructure around climate- aware investing, such as inconsistent definitions and language; limited or poor quality data; or lack of products with a full range of necessary characteristics. Other challenges arise from limited expertise and training on climate change issues across the investment chain, including the senior decision-makers at pension schemes (most notably on trustee boards). In other cases, the issues are around structural challenges in the investment chain and the need for better alignment of duties and disclosures along it.

“ None of these issues is fundamental or insurmountable, but they do need system-wide change to be overcome. The PLSA is willing to play its part to help the pensions industry address them, and to work with other parties in the investment chain to deliver the necessary change.

“ This report sets out our analysis of the barriers impeding climate-aware investing and identifies key recommendations for action designed to overcome them. These are set out under each of the relevant issues we have identified:

Issue 1: Clarifying definitions of climate-aware investment

“ Analysis: There is substantial confusion about what climate-aware investment actually involves, and whether particular approaches can appropriately be referred to as relevant responses to climate change. Definitions differ, language is used inconsistently, and confusion is often the only real outcome.

- The PLSA:
  - Recommends a joint-industry/ government review to examine the wide range of competing standards and definitions that currently exist, any initiatives already underway to achieve harmonisation, and to identify a framework to achieve a common language and taxonomy. The review should be established with the goal of delivering a common framework ahead of COP26 and take into account the views of employers, savers, pension schemes and intermediaries.

Issue 2: Addressing poor-quality climate data and information

- Analysis: Significant issues arise because there is little consistency in the availability of data and less in how information is presented. There are gaps in the disclosure of information by companies, especially outside the largest public companies in European markets, and there are also gaps (some, but not all, a consequence of these gaps in corporate disclosure) in the information provided by fund managers. This hinders pension funds' ability to invest intelligently for a carbon- constrained future.

- The PLSA will:
  - Encourage the government and regulators to move towards more widespread adoption of the TCFD recommendations, applying them not just to premium-listed companies but to all issuers of debt and equity, and to all major banks, asset managers and insurers.
  - Support measures to increase equivalence of climate reporting or regulatory obligations from the top to the bottom of the investment chain, for example, by the FCA applying new duties for Authorised Fund Managers that are analogous to those placed upon Independent Governance Committees, or the recent proposal from the IFRS Foundation to consider sustainability reporting standards. In particular, we will support the proposed creation of a new Sustainability Standards Board.

Issue 3: Delivering greater climate expertise and education

- Analysis: Few in the investment industry have experience in considering and dealing effectively with climate change risks and its implications for portfolios. Among others, few trustee boards and their traditional advisers have sufficient skill appropriately to address the challenges which climate change brings.

- The PLSA will:
  - Encourage more industry-led ESG training and education, and encourage schemes to consider adding trustees with climate change expertise, particularly those with experience of

    - managing
the implications of climate change for investment risk and opportunity.
    - Work with TPR to ensure guidance for schemes is suitable; that the Trustee Toolkit contains ESG training and that standards for professional trustees are stretching in respect of climate awareness.
    - Support the FCA in working to design explicit climate (as well as stewardship, and responsible investment more generally) conduct expectations in its forthcoming regulatory regime for investment consultants.

Issue 4: Articulating requirements on investment managers more explicitly

- Analysis: If pension schemes are to deliver on an intention to invest in a climate-aware fashion they need to articulate that intention clearly enough that it will be delivered by their agents, including in investment mandates, RFPs, DDQs and service level agreements – and they need to hold their agents to account for delivery against those intentions.

- The PLSA will:
    - Work with the International Corporate Governance Network (ICGN) in revising and renewing its Model Mandate. Ensuring that the new version continues to reflect the long-term investment expectations of pension asset owners will be important, including a need to add further detail regarding the challenge of climate change.
    - Produce guidance, templates and best practice material for members and trustees with regards to areas such as manager reviews, RFPs and DDQs, including with regard to climate change issues.

Issue 5: Enabling better climate stewardship

- Analysis: Stewardship is a key element of the tools of a responsible investor. Exerting influence through stewardship will often be the best way to give effect to beliefs in respect of climate change.

- The PLSA will:
    - Develop guidance for members on what good practice expectations ought to be with regard to stewardship services. This might form part of work in relation to the Model Mandate, or otherwise.
    - Work with the investment industry and regulators to find solutions to the challenges schemes face when exercising stewardship and voting ‘rights’ in pooled funds.
    - Continue to encourage schemes and managers to adopt the Stewardship Code, and to play a pro-active role in industry Stewardship groups. This will include further developing our

Voting Guidelines so that they put forward additional recommended ways in which pension schemes could vote to reflect their climate change investment beliefs.

Issue 6: Improving supply of appropriate climate 'products'

- Analysis: Pension funds continue to express frustration about the investment vehicles that are in practice available to them. Among other things, there are concerns that the substantive financial characteristics of many climate- aware investment products do not suit pension fund needs.

- The PLSA will:
  - Continue to make the case to Government for the issuance of a Green Gilt by the UK Government.
  - Develop principles for asset management funds/products to adhere to on responsible investment generally, or specifically with regards to climate.

Issue 7: Communicating and explaining climate aware investment

- Analysis: Communication to beneficiaries and stakeholders remains a challenge for the pensions industry. Delivering such communication successfully is made harder by the scale of change across financial services and wider society, as well as practical issues such as data quality issues of data quality and lack of common definitions that have been discussed earlier. One answer may be to avoid jargon altogether and simply to discuss what has been done, both in terms of integrating climate change considerations into investment decisions, and in terms of stewardship activity.

- The PLSA will:
  - Explore the feasibility of creating a Pension Quality Mark for ESG – either as a stand-alone standard or as an extended module of an enhanced PQM qualification. Such an ESG PQM would offer a way for schemes to demonstrate they are hitting certain standards around the governance of their approach to climate and responsible investment generally.
  - Build on our work on implementation statements to consider how best to support members in their communications with beneficiaries, including on climate and other ESG matters.

June 2021