Written evidence from the E3G - Third Generation Environmentalism PSC0023)

About E3G

E3G is a not-for-profit public interest organisation with offices in London, Brussels, Berlin, and Washington DC. E3G's mission is to accelerate the global transition to a climate-safe world. E3G has a track record of experience and expertise on sustainable finance and international climate finance.

Overview

The Committee for Work and Pensions is seeking evidence on how the UK Government's approach to pension scheme stewardship can inform, and should be informed by, approaches taken internationally, as well as the role of pension schemes in setting and achieving net zero targets towards COP26. This includes whether pension schemes have suitable information to assess climate risk, and how the UK can both lead and learn from international standards and best practice.

£2.6 trillion is saved in UK pensions and, as highlighted by popular campaigns such as those by Make My Money Matter, the pensions industry has a key role to play in greening the UK financial sector.[1] Transitioning the pension sector to net zero offers an opportunity to help drive systemic positive impacts. This is due both to the vast sums under ownership, as well as the unique characteristics of pensions schemes including the long-term investment horizons, and their relationship to individual pensions. However, there is still some way to go before the sector reaches net zero.

With the UK now committed to mandatory TCFD, the tides are changing when it comes to the availability of data across the supply chain on climate risk, which changes the dynamics for any FIs now looking to make net zero commitments. This has also been supported by the ongoing improvement in the quality and quantity of voluntary disclosures of climate-related financial information. The launch of the recommendations of the Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosures (TCFD) in 2017[2] was a pivotal moment in driving voluntary disclosure, as have been the subsequent market signals from investors, both on an individual level such as with BlackRock[3], and collectively as with the Glasgow Financial Alliance for Net Zero.

We welcome the UK's leadership and its aim to be the first G20 country to make climate-related financial disclosures mandatory across the economy.[4] This leadership, combined with the UK's joint Presidencies of the G7 & COP26, raises the profile of disclosure regulation on the global

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[1] **https://makemymoneymatter.co.uk/whats-the-issue/**

[2] **https://www.fsb-tcfd.org/about/**

[3] **https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter** and **https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter**

[4] **https://www.gov.uk/government/publications/uk-joint-regulator-and-government-tcfd-taskforce-interim-report-and-roadmap**

stage as a tool to help the private sector on its journey to net zero. The G7 communique also signalled that mandatory climate risk disclosures would be rolled out across the G7.[5]

This progress, however, must be rapidly scaled up to provide financial institutions, including pension companies, with the information required to transition to a net zero financial sector, to enable a real economy transition, and to ensure that individual companies can strategically address the climate-related risks and opportunities facing their operations. Disclosure regulation and guidance, on a global scale, will be an indispensable lever to delivering government and industry net zero goals. This will be supported by international harmonisation of green taxonomies, standards and accountancy rules, which the UK is well placed to lead.

In the following consultation response we call on Her Majesty's Government (HMG) to ensure that Pension companies are supported to become leaders in the race to net zero through implementing net zero targets with integrity, including short-and-medium term goals as part of their transition plans, and having access to the appropriate guidance and support on what a good transition plan looks like. HMG should also ensure that TCFD is integrated fully and to a high standard across the supply chain so that sufficient data is available for pension scheme investment decisions. The new UK Infrastructure Bank should also work with institutional investors to ensure that their needs are considered, and institutional investment can be crowded into future fit infrastructure.[6]

Our recommendations include:

- **Supporting Pension Companies to commit to further ambition ahead of COP26 by encouraging them to join the Glasgow Financial Alliance for Net Zero, under Race to Zero, and make commitments to Net Zero.**

- **Mandating the disclosure of climate transition plans for all companies including pension companies, in addition to disclosure on material climate-related risks and opportunities.** These plans should include:

    (1) 5-year plans for near-term emissions reductions targets,

    (2) Longer-term net zero target or end goals, and

    (3) Any strategies for (relating prior items with) Paris Alignment.

- **Further regulatory support and guidance to improve the quality of disclosure under the proposed TCFD pillars (i.e. using the 11 TCFD recommendations as a baseline) and for climate transition plans.**

- **The UK Green Taxonomy to be integrated across the economy to support investment decision making by FIs, including pension schemes.**

Consultation response

[5] **2021 G7 Leaders' communiqué: Our shared agenda for global action to build back better - Consilium (europa.eu)**

[6] **https://www.e3g.org/publications/national-infrastructure-bank-design/**

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

Pension companies are some of the largest asset owning entities in the world, so they have a significant role to play in terms of allocating capital for the transition and can be influential in shaping future targets and policies through engagement in key investor initiatives, such as the UN Net Zero Asset Owners Alliance, which currently includes 7 UK members.[7] Forty-three investors, with over $6.6 trillion in assets, had joined the initiative as of the June 2021.[8]

Pension schemes are also particularly well placed to support non-traditional asset classes such as infrastructure and assets with a long return profile. Conversely, they are also at significant risk from stranded assets – with UK local government pensions holding £9.7 billion of investments in fossil fuel companies in the 2019/20 FY.[9]

Given the scale of challenge ahead in tackling the climate crisis, it is crucial that all Pension companies take urgent action to align with the Paris Agreement. They also must address their climate-related risks and opportunities and embed climate-informed strategies across their businesses through TCFD and disclosing and implementing a transition plan.

Pension schemes should actively participate in the architecture to support ambition pre COP26 i.e. the Glasgow Financial Alliance for Net Zero. Race to Zero initiatives, such as the UN Asset Owners Alliance (UN AOA) and the Paris Aligned Investment Initiative (PAII) support pension schemes and provide spaces for peer-to-peer learning and to share tools and best practice. Moreover, Make My Money Matter's 'Green Pensions Charter' is calling on pensions schemes to agree net zero targets for investments ahead of COP26.[10] Greater engagement with these platforms by pension funds and initiatives will better enable the creation of guidance and tools for the pensions industry to align with COP26 targets. This process can also inform policymaking and identify any barriers to transitioning to net zero for pensions schemes.

Greening the pension industry will be one of the key milestones to achieving a net zero finance sector in the UK, supporting the creation of a sustainable global hub of net-zero finance. It is important that net-zero targets are substantiated by plans and implementation, together with an assessment of the barriers that pension schemes face in getting to green.

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

An advantage to there being global harmonization of disclosure standards for climate change is that it would simplify the ask for companies operating across jurisdictions. Having a cohesive set of disclosure requirements at a global scale would also help financial institutions operating across jurisdictions to make consistent climate-informed decisions.

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[7] **https://www.unepfi.org/net-zero-alliance/alliance-members/**

[8] **https://www.unepfi.org/net-zero-alliance/**

[9] **https://www.divest.org.uk/wp-content/uploads/2021/03/UKDivest_Report.pdf**

[10] **https://makemymoneymatter.co.uk/charter/**

A key first step in doing so is to build disclosure requirements from existing internationally applicable and utilised frameworks, specifically the TCFD recommendations. Using these recommendations as the initial basis of requirements will provide a solid foundation for global harmonization in the future. This would benefit from the growing voluntary uptake of reporting against these recommendations to date.

The TCFD roadmap announced in November indicated that all FIs including Pensions schemes will disclose against TCFD by 2025.[11] In addition to this, however, there is a need for more ambitious regulatory guidance on what good disclosure looks like across all aspects of climate disclosures, not just climate-related risks, and opportunities. This should involve harmonisation across a range of tools including national green taxonomies, international reporting standards, and accountancy rules.

Question 3 - How should the UK seek to share and learn from international best practice?

The UK should seek to be a global partner and support other countries in implementing net zero policy and regulation with integrity, encouraging meaningful stakeholder engagement. The UK leveraged its position as G7 president to support the G7 countries in 'moving towards mandatory climate-related financial disclosures that provide consistent and decision-useful information for market participants and that are based on the Task Force on Climate-related Financial Disclosures (TCFD) framework, in line with domestic regulatory frameworks.'[12]

However, the G7 Communique said nothing on taxonomy alignment. A key opportunity for progress on this topic will be under the G20 e.g. via the Sustainable Finance Working Group chaired by US and China. Given the UK's membership of the International Platform on Sustainable Finance (chaired by EU and China) which has working groups on both taxonomies and disclosure, and the UK's ability to play a leadership role in bringing together the different approaches taken so far by the EU and the US, the UK is well placed to push forward international alignment. The UK should therefore replicate its G7 success with TCFD at the G20 by encouraging international alignment on taxonomies.

Question 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?

The UK has made a series of strong announcements on climate policy – with the PRI identifying 124 new or revised policy instruments in 2020,[13] the highest number so far and 32 more than the previous year. However, this has not been replicated internationally and further cooperation is needed between countries to ensure a managed and just transition to net zero.

The following policy announcements by the UK and other countries are key examples of leadership on climate policy and offer opportunities for collaboration.

[11] https://www.gov.uk/government/publications/uk-joint-regulator-and-government-tcfd-taskforce-inter

[12] https://www.consilium.europa.eu/media/50361/carbis-bay-g7-summit-communique.pdfim-report-and-roadmap

[13] The PRI **Regulation Database** documents existing and in progress sustainable finance policies around the world

UK announcements

- **UK 6th Carbon Budget:** The adoption of the UK's 6th Carbon Budget by HMG is a strong signal, on top of the existing Net Zero and Resilience targets by 2050 and the UK's international commitment to the Paris Agreement. By accepting the CCC's carbon budget, and the associated 78% reduction in emissions by 2035, clear signals have been sent to it becomes clear that the UK must support the transition of all its sectors away from fossil fuels towards green investments. These commitments send a strong and stable signal to market actors about the direction of travel.

- **Mandatory climate risk disclosure**: Mandatory TCFD is a welcome development for the UK Government, and we welcome the consultative approach BEIS has taken to developing the legislation. This requirement should be rolled out eventually across the whole supply chain and should be accompanied by the requirement to disclose transition plans. Moreover, HMG should provide supplementary guidance to ensure these plans are taken to a high standard. Next steps include a clear expectation from HMG about extending the scope for companies who have mandated responsibility to disclose for all companies to start on the journey to evaluate and disclose their climate-related risk and opportunities, including small and medium-sized enterprises (SMEs).

- **Updates to the UK government's procurement process to mandate that companies must implement meaningful climate targets and transition plans to access government contracts:** A recent update[14] to government procurement decisions, worth up to £290bn in total every year, means that bidding companies for contracts worth over £5 million per year will have to commit to net zero by 2050 and publish credible and clear carbon reduction plans. This will send strong decisions across the economy of the need to align under net zero and represents a clear signal to the real economy and FIs of the direction of travel. This will also support pensions schemes in sourcing data and companies for their own investment purposes.

- **Potential requirement to disclose in the strategic report:** BEIS has consulted on the requirement of disclosures in the Strategic report. The Strategic report is the critical place for material climate-related financial information to be disclosed by companies. This currently only requires disclosure of information that is material to a company, so there is therefore an opportunity to strengthen disclosure of climate-related risks and opportunities by reflecting the EU's use of "double materiality" to incorporate environmental & social materiality (reflecting the impact of a company) alongside financial materiality.[15] HMG has the opportunity mainstream the reporting of climate-related financial information within the Strategic Report on a global scale by requiring this of UK companies.

International announcements

[14] **Companies must commit to net-zero emissions before bidding for government contracts (msn.com)**

[15] **https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/654213/EPRS_BRI(2021)654213_EN.pdf**

- **Spanish Climate Change and Energy Transition law:** A new law which includes a requirement for large companies (owned by the State or with a State shareholding) to have and publish climate action plans.[16]

- **EU Corporate Sustainability Reporting Directive**: Under Article 19 of the EU's new proposal for the Corporate Reporting Sustainability Directive (CRSD) companies (including small- and medium-sized enterprises) will be required to publicly disclose on the plans to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5°C in line with the Paris Agreement. [17]

- **Green Taxonomies**: The EU taxonomy will be a powerful tool to inform investment decision making which is aligned with net zero targets, and ultimately will support the greening of capital allocation by FIs. The UK has announced the launch of its own Green Taxonomy which will be essential as part of the package of regulatory tools and guidance required to support FIs and pension schemes in achieving net zero. Harmonization of these internationally will be valuable.

Question 6: Do pension schemes have suitable information to assess climate risk, or do there need to be international reforms to financial reporting?[18]

The voluntary uptake of disclosure against the TCFD recommendations to date has been a very useful step in improving the quality and quantity of information available for pension schemes to assess climate risk. It is, however, vital to acknowledge that this disclosure has been very mixed in level of detail and quality, and there is still some way to go before they are equipped with the full information. As mandatory climate-related financial reporting is rolled out nationally and across the G7, the UK Government must aim to help improve the quality and content of disclosures through developing and disseminating further guidance on what should be included within disclosures against the 11 recommendations of the TCFD. The UK should also work to ensure that the quality of data internationally is high, and useful for FIs such as pension schemes.

The importance of guidance from HMG on what to include when disclosing is underscored by a Vigeo Eiris Analysts' Study, referenced in the TCFD 2020 Status Report, that found that only 11% of companies disclosed at least one element recommended by TCFD in the Governance pillar.[19] This lag from companies that have chosen to disclose voluntarily in fully aligning with the TCFD recommendations offers a stark warning that without clear, and regulatory, guidance on 'what good looks like' disclosure from companies and LLPs is likely to be insufficient.

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[16] https://www.lavanguardia.com/natural/cambio-climatico/20210408/6635930/congreso-punto-aprobar.html

[17] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189

[18] E3G's recent consultation response to BEIS provided detail on the necessary design features required to create a robust system of climate risk disclosure for FIs. Many of the recommendations in this section reflect that consultation response.

[19] **https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Status-Report.pdf** pg. 15

TCFD disclosure must also be aligned with the upcoming roll out of the green taxonomy, Green Gilt Investment Framework and UK Infrastructure Bank Investment Principles on “what green is” to be announced in the spring and summer of 2021. Further work should also be done to streamline processes for stakeholders to access sustainability data disclosed by companies and LLPs by using data tagging.

High quality TCFD disclosure is an important step towards a Net Zero Finance System. However, assessing climate risk will be insufficient alone to support the scale and pace of the net zero transition required to align UK finance with the Paris Agreement[20] as former Bank of England Governor Mark Carney's comments earlier this year demonstrated.[21]

One final recommendation to improve the robustness of climate data and support pension funds in transitioning to net zero is an addition disclosure requirement for all companies under TCFD to disclose and implement climate transition plans. These plans should be aligned to the goals of the Paris Agreement. This will ensure companies and LLPs demonstrate they have robust science-based strategies in place to transition to a low carbon future. This would require companies and LLPs to go beyond risk focused approaches to climate disclosure and demonstrate that they have robust science-based strategies in place to transition to a low carbon future. This is a crucial next step if the UK is to meet its target of reducing emissions by 78% by 2035 and its net zero ambition by 2050. [22]

The inclusion of mandatory climate transition plans is particularly salient in the context of greening the UK finance sector, as increased transparency from companies and LLPs on their transition plans will help financial institutions make better climate-informed decisions and manage their own transition. The launch of the Glasgow Financial Alliance for Net Zero (GFANZ) in April 2021 and the associated ramp up in the quantity of net zero commitments from financial institutions underscores the need for transition plans. If these targets are to be delivered on time, then the financial sector will need expansive and robust disclosures from the companies in the real economy.

The need for mandatory climate transition plans has been recently underscored by a paper from Policy Exchange[23] and a joint paper from Grantham Research Institute on Climate Change and the Environment, at LSE, and the SOAS Centre for Sustainable Finance[24]. These papers, respectively, call for the UK to require supervised financial firms and premium listed firms on UK exchanges to adopt transition plans and for all regulated financial institutions to have to submit net zero transition plans. There has also been recent congressional approval of the Spanish Climate Change and Energy Transition law which includes a requirement for large companies (owned by the State or with a state shareholding) to have and publish climate action plans.[25] There is a growing list of companies voluntarily embracing a Say on Climate, including Unilever.[26]

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[20] https://www.ft.com/content/fbd397f9-d414-494d-9099-7cf63092f44f

[21] Carney's comments on the role of offsets in fulfilling Net Zero targets

[22] **https://www.gov.uk/government/news/uk-enshrines-new-target-in-law-to-slash-emissions-by-78-by-2035**

[23] **https://policyexchange.org.uk/wp-content/uploads/Capital-Shift.pdf**

[24] **https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2021/03/Net-zero-central-banking.pdf**

Emerging best practice on what disclosure on climate transitions plans should include, includes methodologies such as the Science Based Targets financial sector methodology[27], CA100+ Net Zero Benchmark[28] and the IIGCC Paris Aligned Investment Initiative [29]. Based on this emerging best practice, we propose that companies should be required to disclose on the following within the proposed mandatory climate transition plans:

(1) 5-year plans for near-term emissions reductions targets,

(2) Longer-term net zero target or end goals, and

(3) Any strategies for (relating prior items with) Paris Alignment.

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[25] An example of an early adopter of climate transition plans is Unilever, with its board announcing at the end of 2020 that the Unilever Climate Transition Action Plan would voluntarily be put before a shareholder vote.
https://www.lavanguardia.com/natural/cambio-climatico/20210408/6635930/congreso-punto-aprobar.html

[26] **https://www.sayonclimate.org/supporters/**

[27] **https://sciencebasedtargets.org/resources/files/Financial-Sector-Science-Based-Targets-Guidance-Pilot-Version.pdf**

[28] **https://www.climateaction100.org/progress/net-zero-company-benchmark/methodology/**

[29] **https://www.parisalignedinvestment.org/media/2021/03/PAII-Net-Zero-Investment-Framework_Implementation-Guide.pdf**