

The climate journey towards a sustainable world

How to integrate regulatory compliance with the delivery of impactful outcomes

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By **Bruna Bauer**



Sustainability has emerged as a focal point for financial institutions in the UK. An indication of this shift came through regulations imposed by the *Financial Conduct Authority (FCA)* in December 2021, mandating asset managers, FCA-regulated pension providers, specific companies and financial services organisations to disclose under the *Task Force on Climate-related Financial Disclosures (TCFD)* framework. In this context, disclosures should outline how pension schemes take climate-related issues into account in investment management and how they analyse portfolios through the lens of climate-related metrics. This movement showcases the increasing relevance of environmental, social and governance (ESG) issues in informing risks and opportunities for capital allocation, thereby shaping the decision-making process related to investments.

Now, two years later, while the increasing regulations have been recognised as a crucial step, challenges have emerged as asset owners and managers strive to align their sustainability commitments with the new regulatory framework. As highlighted during this event, asset owners and asset managers are grappling with balancing the compliance process and the delivery of impactful outcomes. As expressed by some, throughout the extensive and mandatory assessment journey, the meaningful, ESG reasons behind the reporting process can sometimes be overshadowed, turning what was intended to deliver genuine impact into a mere procedural formality. In this context, ongoing training and post-report strategy meetings have proven to be vital elements, preventing pension schemes from reducing this important process to a tick-box exercise.

In this online discussion, Graham Hook, Head of UK Government Relations and Public Policy at *Invesco*, invited Tessa Page, UK Wealth Strategy Leader at *Mercer*, to explore how pension schemes are implementing a

climate strategy and, most importantly, overcoming the challenges of building their journey towards sustainability. This discussion was complemented by asset owners who joined the conversation.

Motivations for pension funds

Rising regulations are undoubtedly the main driving force compelling pension funds to incorporate climate change into their analysis and investment decision making. However, the discussions during this event stressed three other factors influencing asset owners' sustainability disclosure:

- Risk and opportunity,
- Reputation,
- Member expectations.

In this context, schemes are actively integrating scenario analysis, metrics and targets to navigate the potential impacts and opportunities posed by climate-related factors into their portfolios.

As funds expand their understanding of risks and opportunities through the mandatory regulatory process, it fulfils compliance and unlocks the potential to embrace other interconnected factors, such as reputational concerns. Consequently, these aspects are linked, forming a comprehensive framework for decision-making as schemes gain experience in the reporting process.

"I live for the day in when we don't have a meeting agenda, where environmental, social and governance is a separate item. It would be nice if it were just part of the same conversation and naturally integrated to the decision-making process," said Tessa.

First steps funds are taking to address climate impact

The long and complicated journey of complying with the *TCFD* recommendations includes understanding the framework's functionality and how to implement the



Box 1 | Issues faced

Misallocation of effort in TCFD	Shift focus from mere regulatory compliance to real-world actions. <i>TCFD</i> reports needs to be used to identify and address tangible risks
Trustee education	Trustees need to access a broad range of information sources and not only rely on consultants. Seeking insights from asset managers, relevant organisations and events is also important. Build knowledge over time through exposure to different perspectives.
Starting with the 'why' in financial risk	Start your sustainability journey by understanding the purpose behind initiatives. Questions like "Why are we doing this?" and "How does this impact us?" can help drive discussions
Meaningful net-zero goals require nature consideration	Consider and integrate nature-related net-zero goals into decisions. Focus on one aspects of biodiversity to get started eg deforestation, water. Start small, understand 'why' and build from there for effective change.
Trustee pressure on biodiversity	There is a positive pressure from trustees to consider biodiversity.
Materiality assessment for Taskforce on Nature-related Financial Disclosures (TNFD)	Start by examining the sector's exposure and how it links to nature as an initial step. Then, identify the <i>TNFD</i> materiality of your portfolios.
Pragmatic approach to TCFD implementation	Implement <i>TCFD</i> as a framework rather than a compliance tick-box exercise for effective outcomes. A less obsessive focus on report publication allows for more impactful actions.

metrics. Although helpful in supporting pension schemes in their alignment with sustainability regulations, the *TCFD* needs to be harmonised and implemented as a continuous exercise that goes beyond mere compliance with the rules. As many funds are reporting for the first time, the complexity around gathering and preparing data poses the risk of overshadowing the real motivations behind the process. Schemes can lose their way, transforming this into a tick-box process. Ultimately, the challenge becomes keeping the framework definitions in mind and remembering the motivations behind the reporting process. But how?

In their conversation, Graham of *Invesco* and Tessa of *Mercer* touched on the necessity of all parts being aligned in their goals. Most trustees have only four board meetings a year, which exacerbates the challenge and underscores the necessity for training. Such training is crucial to facilitate trustees in speaking a common language, sharing objectives, and posing pertinent questions to advisers. Otherwise, the motivations behind the report get lost. Tessa recommended funds should start with scenario analysis, and investigate how investment returns or funding positions would respond to different climate situations. This approach can help schemes remember why they are carrying out the exercise, as it sets specific objectives as a starting point.

"Setting a carbon reduction target comes at the end, because you've got to do all that preparation work first before you are able to finally set a target," said Tessa.

The challenges

Defined benefit (DB) and defined contribution (DC) pension schemes encounter different difficulties in their sustainability journey. Funds are de-risking investments in the insurance market and corporate bonds, DB schemes have been analysing those markets in the same way they analyse asset managers. DC funds, on the other hand, although not the majority, perceive ESG funds as a long-term investment. For example, some members within this context seek security on fossil fuel assets driven by their belief in the potential for short-term performance.

A shared challenge arises from the trustee board turnover. Different trustees may have various views on the amount of time and priority that should be accorded to addressing climate change. These issues add a layer of complexity to the decision-making process across both schemes.

"This (sustainability disclosure) is not being done out of the goodness of trustees' hearts; this is because it is a financial issue that needs to be addressed," mentioned Tessa.

Lessons from TCFD reports

"My frustration with the *TCFD* reporting process is that it is a great framework but, inevitably, everyone is so worried about the reports being compliant that it becomes a checklist. People lose the sense of why they are doing this in the first place," said Tessa.

"Looking at the research we conducted at the beginning of this year on the *TCFD* report, I was surprised there were few schemes who were actually using the output of their *TCFD* report to inform investment strategy. Some of them said that that was because they didn't have enough trend data. The regulations are the regulations, we need to comply with them, but wouldn't it be great if they were actually helpful in driving investment strategy forward?" said Karen Shackleton, Chair & Founder, *Pensions for Purpose*.

"We have been doing a whole programme on biodiversity with trustees. To me, we are not going to get to these great net zero goals if we are not tackling the biodiversity challenges. So, it needs to be part of a holistic framework rather than something that is in a separate box," said Tessa.

See Box 1 and 2, which summaries the lessons learned raised by the audience.

Learn more

Read our **Impact Lens research. 'Impact investment performance - a UK asset owner & investment consultant perspective'** explores impact investment performance. **'Natural capital and biodiversity - where are UK asset owners on their journey?'** looks at how UK asset owners, particularly pension funds, are incorporating biodiversity and natural capital into their investment decision-making.

Help

How *Pensions for Purpose* helps asset owners: we offer bespoke pension committee training and facilitated workshops to help funds clarify their priorities, goals and how to achieve them. Our platform contains hundreds of articles, blogs and case studies on a variety of topics, with over 300 articles on Paris Alignment.

Further information

Interested in a further conversation on this topic? Please email Karen Shackleton at karen.shackleton@pensionsforpurpose.com or call her on 01524 389326.



[Click to read a synopsis of the event.](#)

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Box 2 | Lessons learned

These points were raised by the audience and panellists:

- It was constantly mentioned that it is vital for schemes to perceive *TCFD* beyond a mere regulatory obligation and to consistently reflect on the relevance of reporting on climate-related issues. A recommendation is to invest in continuous training and post-report workshop sessions, inviting participants to gain a comprehensive understanding of all necessary actions to achieve targets and enhance metrics (keeping in mind the scenario analysis taken as the very first step).
- Nature-based topics should be central in drawing up net-zero goals. Although the broad range of approaches to biodiversity is complex, by starting small and focusing on one specific aspect like water, deforestation or conservation, a fund can develop.

PENSIONS FOR PURPOSE'S PERSPECTIVE

Regulations on sustainability are continuously increasing, and pension schemes are taking their first steps to comply with a range of new and fast-changing rules. As this conversation showed, training has been an important component to make this journey smoother and to keep reports aligned with advances in impactful 'real-world' actions. Sustainability reports, such as the *TCFD*, should not be reduced to a tick-box exercise but should instead be part of a common goal established by the funds. "Why are we doing this?" should be continuously asked and discussed, as the metrics and targets are constantly reviewed and questioned. Building impact takes time, and, as important as good project management is, exchanging ideas and experiences with others on a similar journey is essential.

