Climate change and pension funds: Act now or risk losses

February 2019

PENSIONS FOR PURPOSE

www.pensionsforpurpose.com

This blog, by Karen Shackleton, originally appeared on Mallowstreet and is reproduced here, with their permission.

The recent protests by school children over climate change highlight the very real concerns that young people have about the world they will be inhabiting in the future. The issue is so important to them that, in over 60 towns across the UK, these youngsters were prepared to miss school in order to make their point to their local councils.

Pension fund investors are also becoming increasingly concerned about climate change. Not only does this stem from a concern about the world into which we will retire, but there is an ongoing debate as to whether exposure to carbon emissions, in a pension fund portfolio, represents a financial risk.

Yet, surprisingly, a report published in 2018 by law firm Pinsent Masons noted that only 5% of UK pension funds had a policy on climate change, despite 74% of respondents acknowledging the risks that climate change poses in an investment portfolio.

Indeed, only 12% of pension funds were measuring the sustainability of their investments, on top of which remains a proportion of trustees who are still sceptical.

At a recent conference, 8% of trustees present said that they did not believe climate change was an issue.

Where does this leave us?

The starting point has to be education around this topic.

The PLSA, in association with campaign group Client Earth, published a framework for pension funds on climate change, which sets out the regulatory framework and the fiduciary responsibilities of trustees on climate change.

It points to the need for a strong governance framework to assess, monitor and manage climate risks. Importantly, it stresses the need for expert advice on this topic and for an ongoing education process.

This is not a question of a one-off training session; the guide recommends that “time should be allocated to reviewing climate-related risk and opportunity at governance body meetings on at least an annual basis”.

Review managers' climate risk approach

The next step is to review and challenge fund managers on their approach to assessing and managing climate risk. One difficulty is a lack of standardisation in approach. Comparing Manager A with Manager B is not necessarily a straightforward task. The PLSA's guidance recommends incorporating managers' responses on climate change into any manager selection process.

Engagement on the issue of climate change remains a key tool for pension fund trustees. As responsible investors with sizeable assets, collaborative initiatives such as the LAPFF can point to demonstrable effectiveness in negotiating with, for example, energy companies over climate risks.

Revisit your investor beliefs

Investment strategy is the final area of focus for pension fund trustees. This involves a more challenging discussion around investor beliefs. Topics such as divestment from fossil fuels, low carbon strategies and impact investing (e.g. intentionally investing in renewable energy funds) need to be debated and agreed upon by the trustees, taking member concerns and fiduciary responsibilities into account.

There are a few trailblazers when it comes to climate-aware pension funds. Pension schemes such as the Environment Agency Pension Fund have been happy to share their journey with others, publishing case studies so that other funds can learn from them. This can also benefit smaller schemes where governance resources are more limited.

The bottom line is that all funds should be looking to introduce a climate policy in 2019.

Now is the time to act upon this world issue, for no other reason than outlined in a report by the University of Cambridge Institute for Sustainable Leadership: “If no action is taken to limit warming to 2°C, a conservative portfolio with a 40 per cent weighting to equities (typical of a pension fund) could suffer permanent losses of more than 25 per cent within five years after the shock is experienced.”