

THE ROLE OF PENSION FUNDS IN ADDRESSING THE LOW-CARBON TRANSITION: KEY TAKEAWAYS FROM CHATHAM HOUSE MEETING, 1 JULY

On 1 July 2019, as part of the UK's inaugural London Climate Action Week 2019, Sustineri, Pensions for Purpose and The Prince's Accounting for Sustainability Project (A4S) co-hosted a roundtable at Chatham House. The purpose of the gathering was to highlight major challenges and discuss pragmatic solutions in the UK pension fund industry in order to help drive systemic change in addressing climate-related risks and opportunities in pension portfolios. We convened senior representatives from Local Government Pension Schemes (LGPS), occupational pension schemes and the policy/regulatory community – including a keynote speech from Parliamentary Under-Secretary of State for Pensions and Financial Inclusion, Guy Opperman, and scientific insights from Professor Jim Skea, Chair of Sustainable Energy at Imperial College and Co-Chair of the IPCC Working Group III.

In a rich and varied discussion, policymakers heard from pension funds about what would help them to deliver on the climate goals. Pension funds also heard from government about what they can do to enable us to reach our common goals.

The key takeaways from the discussions were:

1. Climate change poses a systemic and material risk to portfolios

The science is clear and irrefutable. It is vital for trustees of pension funds to address climate risk as part of their fiduciary responsibility. Climate change should not be treated as something separate, but should be assessed with equal importance to other economic risks. Recent regulatory changes have underlined the expectation that climate risk is treated as a financial risk, but this is not universally acknowledged among pension funds.

2. Pension funds are responding, but more urgency and awareness is needed

A growing number of pension funds are addressing climate risks for example through low-carbon funds, investment exclusion policies and TCFD-aligned disclosure and reporting. However, participants noted that many trustees are not 'climate competent' or aware, putting their portfolios at risk.

3. Investing to achieve net zero emissions by 2050 while building in resilience to address physical risks

Reducing the carbon exposure of funds, and testing whether portfolios are consistent with limiting the increase in global average temperatures to 1.5 degrees, is important. At the same time, pension funds need to invest in resilience to protect their investments from the physical risks of climate change as far as possible. These two goals can be mutually reinforcing.

4. UK's 2050 net-zero target

Participants welcomed the UK Government's 2050 net-zero target. But investors need a joined up response across government, with policies adopted in the near term to help deliver that target, such as a coherent renewables policy and stronger carbon pricing.

5. The need for policymakers and regulators to be more joined up

LGPS and occupational pension schemes are currently governed by different government departments and regulatory regimes, and would benefit from a more consistent policy approach. In addition, there was a view that there needs to be coordinated action across each relevant regulator covering business and the wider financial community, for example around reporting requirements along the investment chain.

6. Opportunities of the transition

Pension funds should focus on the opportunities arising from the transition to a low carbon economy, as well as the risks. This includes a recognition that private markets are becoming more important for investors (taking into account the challenges that private markets pose, such as a lack of transparency).

7. Looking beyond carbon and energy

The low-carbon transition is not just about the carbon and energy sectors. There will be impacts on other sectors such as the heavy industry and automotive sectors, land use and agriculture (note the IPCC will be publishing a special report on land use and food security in the autumn). More guidance is needed to help pension funds understand and respond to risks and opportunities in these sectors.

8. The collective strength of pension funds

Pension funds have real power to influence other actors in the investment chain on the low carbon agenda, including asset managers and investment consultants. This influence is significantly enhanced when collective action is taken and pension funds share insights with one another. Market signals from investors matter, including on engagement such as shareholder voting at AGMs. In addition, pension funds should demand more granular reporting and transparency on climate-related risk factors from their investment/asset manager at fund-specific level.

9. Challenges when investing in pooled funds

Specific challenges exist for pensions investing primarily in pooled funds, with trustees finding that they are unable to influence the engagement and voting policies of funds in which they might be invested.

10. Importance of civil society action

Civil society is mobilising on climate change, as evidenced by the school strikes and the rise of Extinction Rebellion. Beneficiaries (although many need to get further engaged) are also attaching greater importance to where pension funds are investing their money. Investors and companies who lag behind are increasingly vulnerable to being called out for inaction.