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# PENSIONS WATCH – NOVEMBER 2020
## WHAT'S BEEN HAPPENING AND WHAT'S ON THE HORIZON IN THE WORLD OF PENSIONS

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The first in a new regular series, Pensions Watch highlights current issues in the world of pensions and why they matter. This month we focus on ever more stringent **Environmental, Social and Corporate Governance (ESG) and climate risk disclosure requirements and pension schemes increasingly committing to net zero...**

## 1 October

To many, 1 October is an innocuous date. However, 1 October celebrates many things, not least the UN's international day of older persons and North America's national homemade cookies day to name but a few. It's also a date with which occupational pension scheme trustees have become oh so familiar. After all, 1 October 2019 was the date when the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR) required trustees' SIPs[1] to outline how trustees approach "financially material considerations" – ESG risk factors, including climate change, principal among them – in the selection, retention and realisation of scheme investments.

Fast forward 12 months and many trustees were already ahead of the 1 October 2020 deadline by which time they were required to ensure their SIPs documented the extent to which their asset managers aligned with their schemes' investment policy, and how each of their asset managers are incentivised, evaluated and remunerated over the envisaged term of their respective mandates. Trustees have also been busy preparing their first annual implementation statements[2] for their annual reports, confirming the extent to which they believe their schemes' policies on stewardship have, and the SIP more generally for Defined Contribution (DC) schemes has, been followed throughout scheme year. In short, trustees have had to ensure they're walking the walk, not just talking the talk.

Of course, a trustee's work is never done. By 1 October 2021, DB trustees must produce and publish, on a publicly available free-to-access website, their annual report on voting and engagement. In addition, post the recent second reading of the Pensions Schemes Bill in Parliament and the, recently closed, DWP consultation on climate change disclosures, £5bn+ trust-based schemes will likely be required by 1 October 2021 to make climate detailed disclosures, per the TCFD recommendations framework,[3] followed by £1bn-£5bn schemes on 1 October 2022.

Interestingly, while the FCA has yet to enact equivalent ESG and Stewardship reporting requirements for the contract-based schemes it regulates, it has outlined a timeframe to align climate risk reporting requirements with those flowing from the Pension Schemes Bill for trust-based schemes. Crucially, the FCA's proposals will also ensure that asset managers report on their assets' climate risks in line with the TCFD recommendations framework. Indeed, research by investment consultant Redington[4] in September revealed that more than one third of asset managers are still not engaging on climate change. The research on 104 managers showed 39% were unable to provide evidence of an engagement effort over climate change related risks. Of course, trustees are only going to be able to comply with the increasing ESG disclosure obligations imposed on them if there is a corresponding obligation on all managers to provide the required data and reporting to trustees.

[1] A SIP is the written statement which sets out the trustees' investment policy. Schemes with fewer than 100 members and certain local authority and public sector schemes are not required to prepare a SIP.
[2] See: Implementation Statement Guidance for Trustees. PLSA. July 2020.
[3] Making disclosures in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) will mean considering the risks and opportunities associated with climate change – and the transition to a lower carbon economy – in relation to a scheme's assets. See: https://www.sackers.com/multimedia/webinar-esg-climate-change-and-stewardship-update-october-2020/
[4] Redington Investment Survey 2020. Redington. September 2020.

## *Why does this matter?*

*Given the plethora of directives, regulation and guidance that have been issued to strengthen the integration of ESG risk factors within the investment processes of all asset owners, policymakers, financial regulators and professional bodies all have ESG risks firmly in their sights. And for good reason: well-governed companies with strong credentials in managing these risks could potentially deliver more sustainable returns by not being so materially exposed to operational, regulatory and reputational risk.*

*However, despite changes in regulation strongly encouraging trustees to become more informed on ESG issues, it appears that many schemes may find it difficult to go beyond the minimum regulatory requirements. Trustees don't always have the available information, or the information framed and explained in such a way to make an informed decision about what constitutes a coherent ESG risk management policy. This has to change.*

## Pension schemes increasingly committing to net-zero

With ever more stringent ESG disclosure requirements – and the clear indication from the DWP that climate change should be considered within the definition of ESG – comes an ever greater commitment by increasing numbers of public and private sector DB schemes to support the Paris Agreement's 2015 goal of keeping global temperature rises within 1.5°C of pre-industrial levels by 2050.[5] Some schemes are prepared to go further though, looking to achieve net-zero GHG emissions across their respective portfolios, far in advance of the UK government's own 2050 net-zero commitment. In particular, the Net Zero Asset Owner Alliance of insurers and pension funds has, as part of its strategy, pledged to achieve a reduction of portfolio emissions of between 16% and 29% by 2025 compared to a 2019 baseline.

## *Why does this matter?*

*Climate change is the biggest systemic risk to confront humanity. The potential impact of the transition and physical risks stemming from climate change on both DB and DC schemes are very real, not least because of the increasingly probable risk of financial assets being materially repriced far in advance of company balance sheets, physical assets and the real economy being impacted. Moreover, a failure to act on the sources of climate change more decisively could result in a deeply impaired economic and financial system. This would, in turn, severely inhibit the ability of asset managers to generate and asset owners to derive sustainable investment returns and expose asset owners to unacceptably high and largely unmanageable risks. Therefore, trustees and IGCs need to think ahead of the curve about prospective pre-emptive mitigating actions.*

## And finally…

Did you know that 71% of global GHG emissions between 1988 and 2015 have been generated from fossil fuels extracted by just 100 companies?[6]

[5] See: A changing climate: how pension funds can invest for the future. PLSA. October 2020.
[6] https://fullfact.org/news/are-100-companies-causing-71-carbon-emissions/

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