It's not easy being green

Summary
• There is growing pressure for pension schemes to urgently support efforts to combat climate change, but official frameworks remain unclear and greenwashing concerns continue to present a challenge.
• Upskilling, greater transparency and an open dialogue with asset managers to ensure that pension scheme investment strategies are appropriately aligned can all help to assuage greenwashing concerns.
• Standardisations will also help address greenwashing fears, but must have scope to evolve in future as technology improves and regulations progress.

Whilst pressure for pension schemes to combat climate change has continued to grow, the UK taxonomy defining what exactly green looks like remains unclear. Sophie Smith explores how pension scheme trustees can best navigate this uncertainty and address greenwashing fears

With research from the Intergovernmental Panel on Climate Change warning of "unprecedented" and "irreversible" changes to the climate, it is clear that the pressure for the world to take action against climate change shows no signs of wavering; and for institutional investors, including pension funds, this research has acted as a stark reminder of the essential role they can play in the transition to net zero.

This pressure has been compounded by further climate disclosures, coming into force in October 2021, and recent comments from The Pensions Regulator (TPR) stating that pension schemes "can and must make a difference" in the transition to a net-zero economy.

Yet recent research from Quilter found that there are still concerns around responsible investment, the biggest of which was greenwashing, as 44 per cent of investors were concerned that an investment might not be what it claims.

Growing expectations, and concerns

XPS investment consultant, Alex Quant, agrees that greenwashing remains a "significant issue for the investment markets", explaining that with the large amount of capital being deployed into responsible funds there is a clear risk that managers misrepresent their investment approach. "We have observed a pattern of good intentions at a firm-wide level not consistently feeding through to all funds managed by investment managers, or in some cases any of the funds they manage," he adds.

This is echoed by UK Sustainable Investment and Finance Association (UKSIF) chief executive, James Alexander, who says there is no denying that greenwashing is a challenge for the industry, and one that needs tackling.

"It reduces confidence in our ability to take action and it encourages more cynicism," he says, "and it suggests that we have some unscrupulous actors

who have tarnished the reputation of certain people in the industry and have suggested that addressing climate change is more something you put into your marketing literature."

Pensions and Lifetime Savings Association (PLSA) director of policy and advocacy, Nigel Peaple, suggests that both greater disclosure and standardisation have an important role to play in tackling greenwashing concerns, highlighting the upcoming climate disclosure requirements as "big strides in the right direction".

More standardisation is still needed, however, as Peaple notes that dialogue with PLSA members has revealed differences in understanding of what climate-aware investment actually involves, and whether certain approaches can appropriately be referred to as relevant responses to climate change.

"There are many different ways of describing climate-aware investment approaches, and the same words are used to mean different things by different investment providers," he says. "There have been a range of initiatives seeking to provide definitions and models for framing an understanding of climate-aware investment risks and opportunities.

"However, the numerous alphabets of abbreviations that remain are likely adding to confusion."

Indeed, AXA Investment Managers (AXA IM) solutions strategist, Bruno Bamberger, notes that whilst future climate-related disclosures will "undoubtedly" provide greater insights into where assets are invested, it will also bring "yet another round" of definitions and acronyms for trustees to understand.

However, he points out that greater standardisation across the industry in terms of green bond definitions and sustainable product requirements could shift the conversation more towards how to implement and monitor strategies.

"Increased transparency can only be a positive for end investors to allow them to more easily appreciate how green or net-zero aligned their investments are," he explains, clarifying that, as with many aspects about investing responsibly, the trajectory of scores and metrics is often more important than the starting point.

The UK's taxonomy will also help address greenwashing concerns, as Redington head of sustainable

Communicating climate efforts

Queries around greenwashing are becoming increasingly prevalent amongst consumers as individuals look to do their part and reduce their carbon footprint; and with many corporations coming under fire for alleged greenwashing activities, there are concerns that similar accusations could soon land at pension scheme doors.

Recent research from the PLSA found there remains a lack of understanding among savers as to how pension schemes are taking action against climate change, revealing that three-fifths of workplace pension holders (59 per cent) do not know if schemes are taking any action, and just over one in seven (15 per cent) workplace pension holders think schemes are.

Those messages that do reach savers often centre around divestment, rather than engagement.

"We see engagement as one of the most important tools that the financial services industry has, whether that's pension funds or asset managers," says UK Sustainable Investment and Finance Association (UKSIF) chief executive, James Alexander, "and so we are quite worried when there are popular calls for divestment, and for leaving polluting industries altogether because through engagement we can drive the transition in the real economy."

Rather than a divestment focus, he suggests that pension funds and asset managers should use their shareholder power to make changes and to transition the real economy into the viable economy they want in the future.

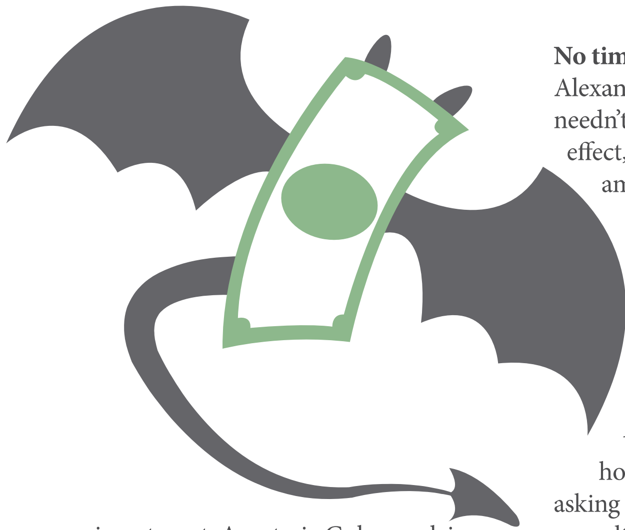
"Now that's of course important in terms of these companies continuing to add value for the for the pension fund, and it's also important in terms of those economies providing the goods and services that we're going to need in the 2050 post net-zero economy," he explains.

Agreeing, XPS investment consultant, Alex Quant, warns that pursuing a portfolio that has a lower carbon footprint where this is not accompanied by considering a company's direction of travel does relatively little to benefit the transition, describing engagement as a "critical and a more effective tool than disinvestment for addressing the real-world climate change risks". Alexander adds that there are some "amazing things" happening with stewardship, warning however that there are challenges as to how the public perceives this, and what they, and what pension savers more broadly, think of as investor engagement.

"I think perhaps as an industry we need to look at what we can do to make people more aware of the successes of engagement, the importance and how positive the impact can be, but also the circumstances where engagement doesn't work, and what happens when a company refuses to change."

SEI defined contribution director, Nigel Aston, agrees that a lot of the work and efforts on engagement, voting and stewardship are not being articulated well enough, suggesting that whilst it is much easier for pension plans to communicate divestment news, that isn't often the right answer, particularly amid a growing agreement that "good stewardship trumps divestment".

Aston also notes that better communications on climate efforts could encourage members to take more ownership over their pension, by showing people that their money is making some contribution towards the world they want to live and retire in.



investment, Anastasia Guha, explains that it will "level the playing field on what constitutes green for all market players, whether you agree with all the details or not".

No time to waste

Alexander clarifies, however, that trustees needn't wait for the taxonomy to take effect, stressing that there is a "huge amount that can be done now", including upskilling trustee boards and working with asset managers to ensure their investment approach is aligned with their climate objectives.

Furthermore, Bamberger suggests that as trustees know that further disclosures are on the horizon in the UK, it is well worth asking the questions to their investment consultants and asset managers now on how their investments are managed and the latest requirements; indeed, recent research from AXA IM also found that now is "potentially one of the cheapest times" for climate factor integration.

Quant agrees that any action by trustees now is a good thing, as delaying to allow the picture to develop would only "kick the can down the road".

"The main equity and credit markets are already well developed in terms of carbon data provision, so trustees should be well placed to understand their current carbon footprint and there is no reason to delay doing that," he says, explaining that while scope 3 carbon data reporting is expected to move, this is not expected to materially change most conclusions that trustees would make based on scope 1 and 2 reporting.

"With green washing, there's no substitute for old fashioned due diligence," he continues. "Trustees need good quality analysis on their investment managers' approach to ESG and to hold managers to account." Adding to this, Guha argues that greenwashing becomes a risk when pension funds make commitments without clear plans on how to achieve them.

"I don't mean pension funds need to provide details, but we need to see what trajectory they are on and what steps they are likely to take on a best-efforts basis," she explains, continuing: "Trustees are ultimately responsible for capital allocation and so it is right that they contribute by allocating toward climate solutions and away from polluters.

"However, this is a complicated fast-moving field – the experts don't agree on everything – so it is important to plan decarbonisation in five-year increments.

"Start with the lowest hanging fruit – set baselines and targets – and leave the market and standard setters to come to consensus on things that are tricky now. In three to five years when you are ready for your next plan – you can be sure solutions and standards will exist. New problems will no doubt have emerged, but trustees can think about those in the next plan!"

Written by Sophie Smith

Learning from neighbours

Whilst the UK's taxonomy is still in development, the EU taxonomy has been in place for over a year. But what can pension scheme trustees, and the UK itself, learn from the EU's example?

"The EU taxonomy is a really useful tool and has helped to establish consistent terminology for managers to market their funds and engage in conversations with consultants and trustees," says Quant. He clarifies, however, that there remain a spectrum of approaches that can be taken, even within the defined EU "Articles", emphasising that due diligence is still required to fully understand the approach taken by a given manager.

"After all, disclosing information is only the first step in actually delivering on sustainable promises," he says, suggesting that the same is likely to apply to the UK taxonomy and that there remains a critical role for asset managers to clearly articulate the approach taken by a given fund in respect of ESG and sustainability, and for consultants to assess their suitability for pension scheme investors.

Adding to this, UK Sustainable Investment and Finance Association (UKSIF) chief executive, James Alexander, argues that there is an opportunity for the UK to create more principles-based regulation rather than the prescriptive route that the EU has pursued, as this could help bring new solutions and innovations.

Another consideration highlighted by Alexander is whether the extent of the market that is covered by the new taxonomy can be expanded, particularly in relation to transitional activities, as he explains that while some options may not be the "ultimate green outcome", it is the best technology available at this moment in time, and so is regarded as being green for a certain time.

"But we also want to see that future looking perspective, that will allow people to have that forward certainty of how regulation is going to change or how the taxonomy is going to change as we anticipate technology developing", he continues. "The EU taxonomy also looks like it might be moving slightly away from the science, and it's really important that we focus on the science in the UK green taxonomy."