Tackling climate change: The role of defaults

Jon Cunliffe explains why default funds must be at the heart of any climate change strategy

There can be no doubt that the issue of climate change and its impact on the future of the planet is of huge importance to many people.

What's also very clear is that millions of us are making changes to our lifestyles with the aim of reducing our impact on the environment. We recently commissioned YouGov to ask more than 2,000 adults in the UK what they were doing to combat climate change and it was apparent that some life changes are easier to adopt than others. Our survey found that nearly eight in 10 people consider the issue of climate change important, with a similar proportion saying that they recycled in a bid to reduce their personal impact on climate change.

Nearly six in 10 have reduced their energy consumption, while a third say they are driving less. However, just two per cent of those polled say they have opted to move their pensions savings to a fund which is socially, environmentally or morally responsible – and that's even though nearly half of those polled say that they want their pension company to invest ethically on their behalf.

It is estimated that £2.6 trillion is tied up in UK pensions. Trustees who run pension schemes like ours are bound by a fiduciary duty to act in the best interests of all members when making investment decisions, and there is a firm belief climate change is a financially material concern. This means it's becoming an increasingly important factor in their consideration of this duty, as well as the thinking of both our industry and savers, particularly those who are engaged with their pensions.

The results of this survey didn't come as a surprise to us because our members have, for a long time, told us how important ESG issues – and the environment in particular – are to them. But it is also a fact that, in line with industry trends, the vast majority of our 5.4 million members remain invested in our default fund. In addition, firms scoring the highest in terms of ESG tend to be better at managing the non-financial risks of their business activities and are consequently often rewarded with a higher valuation by the market. As a result, there is evidence that better ESG scores can align with higher risk-adjusted returns.

That's the key point here – we know that many of our members want us to invest their retirement savings responsibly without sacrificing returns, and we don't think members should have to take it upon themselves to switch funds to make that happen. This has led us to focus hard on the ESG aspect of our default fund, which has recently been recognised by ESG ratings provider, MSCI. The growth phase of our default fund has been rated AA for ESG, meaning that it is now classed as a leader in managing the non-financial risks these issues represent.

This is great news because it demonstrates to savers just how effective our default option is.

Last month, the world's most influential people descended on Glasgow for the UN Climate Change Conference (or COP 26) where strategies were developed for tackling one of the biggest issues we are likely to ever face. In readiness for this much heralded event, the government unveiled a series of measures designed to put a greater climate focus on the nation's pensions.

Chancellor Rishi Sunak announced plans to implement Sustainability Disclosure Requirements (SDRs) that will see the financial services industry, including pension schemes, having to tell their savers about their sustainability-related risks, opportunities and impacts.

Then came the announcement of plans to ensure pension trustees measure and report on how their investment portfolios are aligned to the Paris Agreement.

Much of the important work is already being done by the pensions industry, which includes us. For instance, we have already taken steps to reduce our portfolio's net emissions by applying carbon reduction requirements on a portion of assets in a number of our funds. This reduces carbon emissions intensity and potential emissions from fossil fuel reserves by at least 50 per cent for those assets, but there is more to do and we are exploring ways of making further reductions.

We believe that climate change is a material financial risk to members' pension savings, meaning we are seeking to manage climate risk across the whole portfolio. Because the vast majority of our members are invested via our default fund, we are passionate that, rather than expecting savers to move their money to climate specific funds, all pension providers should operate in the best interest of savers by ensuring their default funds invest responsibly and work to tackle climate change effectively. We also believe that this will have the most impact in aiding the transition to a net-zero economy.

Written by B&CE, provider of The People's Pension, managing director, investments, Jon Cunliffe

In association with the people's pension