

# Small schemes, big actions?

## Adam Gregory asks whether the green agenda is relevant for small/medium size schemes

As the world awaits the political promises from COP26 in Glasgow, trustees are already trying to make sense of the deluge of climate-related information and thinking what practical actions they can take, if any.

### The impact of climate change on investments is real.

The IPCC (Intergovernmental Panel on Climate Change) recently concluded that the human influence on the observed warming is 'unequivocal'. The big question that remains is how quickly and deeply the world cuts its carbon emissions and how pension schemes, irrespective of their size, can respond to the threats posed and opportunities created.

### Regulations will increase the flows towards more sustainable companies.

The 2021 Pensions Act was just the latest step in the ESG journey, making it mandatory for the largest schemes to report on climate exposures. All else being equal, these investments should rise in value as markets increasingly price in climate risk.

### Political will is strong, but national priorities and political disruption will slow progress.

The agreement across most countries to limit warming to below two degrees illustrates the strong political will to tackle the climate crisis. However, politics can change quickly and talk isn't always followed up with action.

Having pulled out of the Paris Agreement under Trump, the US is now

keen to lead the climate agenda. As is the UK, where the government is keen to be a global leader in green finance. But we can't talk seriously about Paris Alignment without China, the world's largest polluter, and still growing fast. The action it takes is fundamental.

It seems likely that collective political pledges and actions will fall short, so unless the private sector moves faster than policy makers, warming is likely to exceed the target, leading to increased short-term physical risks and medium-term knee-jerk policy responses. Trustees can, and should, plan for these today.

### Time to act

Whilst the world of climate science is complex, trustees of small- to medium-size DB schemes should not fear being decisive. Indeed, inaction may be the worst option.

Making your portfolio more sustainable doesn't necessarily mean giving up returns. In most cases, it should mean better, more sustainable businesses (and therefore profits). Here are my top tips for trustees navigating the investment landscape given the climate situation:

- Your timeframe matters. You don't have much climate exposure if you are close to buyout and invested primarily in gilts. However, schemes aiming for returns are exposed to the risk of investments being re-priced (which could happen sharply and at any time), so the reality is most trustees have some exposure they need to consider.

- Analyse your exposures to climate risk. There are different approaches available; from scenario analysis and stress testing, to high-level qualitative analysis and simply reviewing data from your fund managers. The depth of analysis should match your scheme circumstances and tie in with your assessment of how resilient the covenant strength is to climate change factors. Even very small schemes should undertake some level of analysis to inform decision-making.

- Focus on low-hanging fruit. Restructuring some investments can offer some quick wins, such as:
  - long, active (concentrated) global equity fund managers focussed on sustainable businesses
  - passive equity indices that tilt towards companies with stronger ESG credentials
  - funds that clearly prioritise sustainable long-term returns

Switching funds can be done relatively quickly if you use an investment platform to access funds (as many smaller schemes now do).

- Beware greenwashing. Fund managers will be keen to market their approach as sustainable, so proper due diligence is needed. The good news is that investment consultancy firms like ours can do this for you, so it is not a barrier to acting.

Whilst the politicians at COP26 will grab the headlines, the trustees we are speaking to are taking practical and pragmatic steps as the storm clouds gather. Everyone else should follow suit.



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