Summary
• The pensions industry is becoming more aware of climate change and integrating it into its investment decisions, however campaigners argue there is more to be done.
• Most large providers have introduced emissions targets, but questions remain over whether these are strong enough.
• The regulator is watching closely and has identified data and climate scenario analysis as areas for improvement.
• Pension companies are hiring teams of analysts to tackle the problem and are needing to take climate impact into account when pitching for business.

Tackling climate change: Pensions' role to play

Sam Meadows considers the power and influence the pensions industry has in the fight against climate change

Extreme heat in southern Europe. Devastating fires in Hawaii. Scouts evacuated from a typhoon in South Korea.

Everywhere you look this summer, the world is coming to terms with increasingly extreme weather events – caused, at least in part, by climate change.

And while it is governments and scientists who are generally tasked with finding solutions, there is a shifting of focus within the workplace pensions industry.

With roughly £3 trillion invested in pensions in the UK, the potential power of schemes and trustees to shift the dial in investment in climate solutions is huge.

But to what extent are they wielding that power and contributing to the solution? Or are they burying their head in the sand?

There are a huge range of views on how the pensions industry – and inventors more widely – should approach the climate question.

Much of the discourse revolves around environmental, social and governance (ESG) factors, and these are very 'in vogue' in the investment industry.

But the extent to which these factors are taken seriously, and whether they properly address climate change, is up for debate.

Investors are also split over whether the best course of action is to divest completely from fossil fuel producing companies, or to push them towards investing more money in climate change solutions like renewable energy.

Make My Money Matter senior finance adviser, Huw Davies, says pension schemes are becoming more aware of the role they have to play – but he does feel more could be done.

"The industry has huge potential and a big role to play in the fight against climate change," he says. "We know that the public want healthy returns on their pensions, but they also want a healthy planet to retire in."

Pensions for Purpose is an industry group set up to promote impact investing. Its chief executive, Charlotte O'Leary, says the size of the industry means it wields "substantial influence" over markets.

Auto-enrolment has only increased this, she says.

"By making the decision to invest in green and sustainable projects or back companies that have robust environmental credentials, the pensions industry can steer the course of the business world towards a more eco-friendly direction," she adds.

What are companies doing?

In terms of action, there is plenty being done.

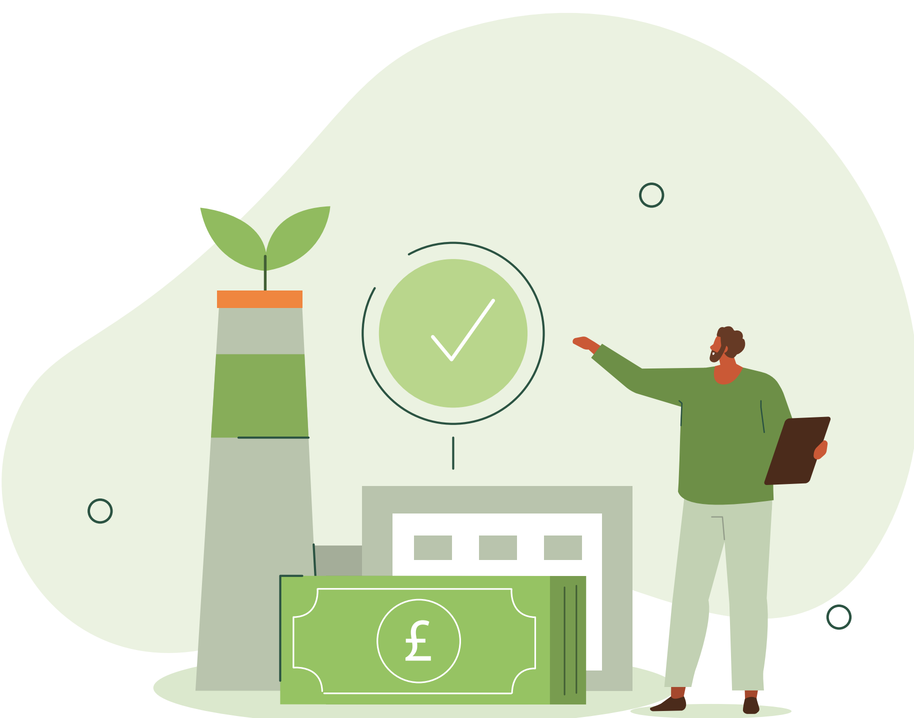
For instance, Royal London aims to halve the carbon intensity of its portfolio by 2030 and achieve net zero by 2050. It has introduced 'ESG-tilted' equities into its range of governed funds, as well as engaging with 19 companies in the past six months to improve their transition plans.

"We want pension companies to be clear to oil and gas companies that they must have real transition plans"

Its senior investment development manager, Ryan Medlock, says: "We believe in engagement over divestment, as divesting simply transfers the responsibility to other investors, who may be less inclined to influence the change we would like to see."

Meanwhile, Aviva has "enhanced the integration" of ESG factors into its default fund – as well as offering an ethical default – and also excludes investments in the 'most harmful' industries. It is targeting net zero by 2050.

Also, Scottish Widows has divested from stocks that did not meet its ESG criteria to the tune of £3 billion since the end of 2020. Like its rivals it also has targets to reduce the carbon emissions in its portfolio. And Aegon also aims to halve its carbon emissions by the end of the decade and reaching net zero by 2050, as part of its climate "road map".



More work to do?

Davies says: "It's certainly good that many of the leading providers have set targets to half their emissions this decade, which is what is needed. There's clearly a lot more focus on climate than there was a few years ago.

"But we would like to see more detailed action plans on actually making this happen."

One issue highlighted by campaigners is that firms' emissions targets usually rely on governments meeting the 1.5 °C target set by the Paris Agreement. The current trajectory, according to United Nations analysis, is closer to 2.5 °C.

Another report, published in July by Carbon Tracker, also warned that investment models used by the industry suggested a minimal impact on economic growth if temperatures were to rise by as much as 4.3 °C.

While academic estimates of the global GDP hit climate change could cause differ widely, there is concern that this could be too optimistic an approach.

O'Leary says: "Recent evidence on the problems with climate assumptions used in scenario analysis and risk modelling, are leading pension funds to believe they are in a better position than they are in reality."

Davies says that those that fail to take account of climate change factors in their investments will ultimately find it eventually damages returns.

He says: "There's clearly a risk management aspect to this. You need to understand the risk of climate change

to your portfolio and we think pension schemes really need to take action now to avoid future losses."

Amid the debate, The Pensions Regulator (TPR) has launched a new focus on climate change and ESG.

Its research finds that roughly one in five schemes had failed to provide a link to a Statement of Investment Principles (SIP) laying out their climate plans.

Even of those that did provide an SIP, the wording of some was found to be "vague and generic", the regulator says.

Corporate trustees can be fined up to £50,000 and the regulator has warned that it will consider enforcement in the area.

TPR's executive director of frontline regulation, Nicola Parish, says: "Our review of the first year of annual climate reports showed areas of emerging good practice, but also areas for improvement – not least in climate scenario analysis and data quality."

She says that the regulator recognises "the scale of the challenge", but that publication of ESG information was not good enough in 2020, leading to a greater focus from TPR.

An industry in transition

The industry is clearly in a state of transition with a growing focus on the climate crisis.

Aviva says it has a dedicated team of more than 30 ESG analysts working full time on solutions.

Aegon pensions director, Steven Cameron, says he has noticed a growing interest in climate impact both among the employers that the company pitches to and the employee benefits consultants who help employers find scheme providers.

"There's a strong feeling that the companies that take climate change seriously will be the ones who perform better and those who ignore it will struggle," he says. "It's for the 'greater good' but it also makes financial sense."

Pensions and Lifetime Savings Association policy director, Nigel Peaple, says: "Attitudes towards fighting climate change have been on an upward trajectory over the past several years, and the momentum does not appear to be easing.

"Pension firms and their service providers take climate change very seriously and invest in the expectation of a carbon-constrained future."

He adds: "Although pension schemes have a role to play in wielding influence over the companies in which they invest, climate change is not for one industry to combat in isolation and pension schemes cannot resolve these issues single-handedly.

"A system-wide approach is needed if there is to be any significant changes."

For the campaigners, the calls to action are clear. While the pensions industry has made progress when it comes to climate change, more direct, specific and robust action is needed.

Davies says: "We want pension companies to be clear to oil and gas companies that they must have real transition plans and they must not be investing in new oil and gas. We aren't seeing enough of that at the moment."

"The reality is that none of us are doing enough," O'Leary says. "We would like to see a swifter shift from fossil fuels, greater funding for green initiatives, educational resources on sustainable investing and collaboration with other financial entities would amplify their positive impact."

Written by Sam Meadows, a freelance journalist