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Perspective

Why pension funds need to act now on climate-related risks

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Pension funds will be required to report the risks that climate change could have on investments under new rules and investors are demanding accountability from companies.

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It is inevitable that climate change will have an impact on investment returns over the next 30 years and more.

Now new Department for Work and Pensions proposals could require the 100 largest occupational pension schemes to publish climate risk disclosures by the end of 2022.

The UK would be the first major economy to make pension funds report on the risks of climate change by law.

The proposal would first apply to those with £5 billion or more in assets. Another 250 schemes with £1 billion in assets would have until 2023 to meet the requirements.

Guy Opperman MP, Minister for Pensions and Financial Inclusion, warned in August: "The impacts of climate change are already being felt around the globe. The time to act is now".

A consultation on the proposed changes closes on 7 October. But regardless of how the rules pan out, it is clear that trustees of larger pension funds have no choice but to take action on climate-related risks.

Here at Schroders, economists have integrated climate change into their global investment returns forecasts for the next three decades. Their research – Climate Change and Financial Markets – has uncovered the stark impact global warming is set to have in international markets.

There are three key costs to take into account. Firstly, physical costs. It might sound obvious, but a rise in temperatures will be harmful to activity in hot countries. Then there are transition costs – for instance, the impact of carbon taxes. And finally, stranded assets – fossil fuels that need to stay in the ground. Countries with unmined coal will suffer most.

Three key costs to take into account

Physical cost	Transition cost	Stranded assets

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It is shocking enough that global warming of 2 degrees above the pre-industrial average would see global economies and stock markets impacted very profoundly. That rise is baked in. But the UN's Intergovernmental Panel on Climate Change predicts temperatures increasing by 4 degrees in a worst case scenario. This is in line with Schroders' latest Climate Progress Dashboard forecast, which suggests the current pace of change will result in temperatures rising by 3.9°C above pre-industrial levels - almost twice the Paris Agreement target.

At Schroders, we have long been supporters of the international industry-led Task Force on Climate-related Financial Disclosures (TCFD). This is not binding on any company, but it is from a sound G20 institution.

The main recommendation of the TCFD is that companies should enact consistent climate-related financial risk disclosures for investors, lenders, insurers and other stakeholders.

More and more pension schemes are already moving towards TCFD reporting, but making climate-related risk disclosures mandatory would mark a real shift in how seriously pension schemes need to think about climate change.

Not only this, but investors themselves want more information and often expect the investment industry to play a role in mitigating climate change. This is something our annual Global Investor Study surveyed investors on recently.

When it comes to who people think should be responsible for mitigating climate change overall, nearly half (46%) of investors said investment managers or major shareholders have a role.

While no single organisation or group of people is responsible, it is becoming increasingly important for trustees to take a view and establish their beliefs on sustainable investing. One thing is for sure, trustees and asset managers will be held more accountable than ever.

For our Fiduciary Management clients, we have been working to make sure that environmental, social and governance (ESG) analysis is truly embedded in how we invest and that the work we do in this area as a global asset manager directly benefits our clients.

For us, this means providing bespoke training across a wide range of sustainability topics for trustees, being proactive on regulation, lobbying policymakers and being able to directly evidence the voting and engagement that we do on your behalf.

At Schroders, climate change is already having a major impact on how we invest and, by the end of 2020, we will have incorporated ESG criteria into all of our funds. We believe an active approach to managing the risks of climate change is essential.