



### Summary

- Research highlights an emerging divide in climate ambition between larger and smaller schemes.
- Smaller DB schemes often face resourcing constraints and practical challenges to setting net-zero targets.
- For schemes nearing buyout, climate-aligned targets may be seen as less relevant to their investment horizon.
- ESG sentiment is also shifting in the global political landscape, while some commentators suggest policymakers could do more to support smaller schemes.
- Trustees can take practical steps now, supported by emerging initiatives and an evolving UK sustainability reporting framework.

It has been more than a decade since the Paris Agreement was adopted by countries across the world, in a bid to limit global temperature rises and reduce the worst consequences of climate change.

Since then, temperatures have continued to rise. 2024 was crowned the hottest year on record globally, and in the UK, 2026 has already seen the highest-ever May temperature surpassed on two consecutive days.

As the risks of climate change have become more apparent, pension funds have increasingly sought to align their portfolios with global temperature goals, including net-zero targets.

However, research by XPS Group – which analysed a sample of UK pension schemes’ Task Force on Climate-related

## Behind the net-zero divide

**► A widening gap is emerging in UK pensions’ climate ambition. While the largest schemes push ahead with net-zero targets and delivery plans, smaller DB funds are struggling to keep pace. Is this down to limited resources and regulatory reach, or a deeper question of relevance as many schemes edge towards their endgame?**

Financial Disclosures (TCFD) reports – has signalled an emerging divide between the climate ambition of larger and smaller schemes.

The review found that while just over half (54 per cent) of the smaller schemes in the research (£1-5 billion) are now targeting net-zero, almost all (96 per cent) of the largest schemes (£5 billion plus) have a net-zero target in place.

Smaller schemes are also lagging in implementation, with just 33 per cent having a credible net-zero implementation strategy, compared to 88 per cent of the larger cohort.

All the schemes in the report have been reporting under TCFD requirements since at least 2022, while the larger schemes began a year earlier. Meanwhile, schemes with less than £1 billion in assets do not currently fall under the scope of the requirements.

Commenting on the findings, XPS Group head of ESG research, Alex Quant, says: “TCFD reporting has undoubtedly brought climate risk into the mainstream for pension schemes, and parts of the market have fallen into a steady-state pattern.

“Larger schemes are increasingly translating targets into investment strategy, while many smaller schemes are yet to take the practical steps required.”

### Barriers for smaller schemes

But what is stopping smaller defined benefit (DB) schemes following in the footsteps of the first movers?

In many ways, these results are unsurprising, given that the biggest schemes have greater resources and governance budgets to address climate-related risks.

There are also practical constraints on smaller schemes’ ability to implement a net-zero target, including aligning their investment portfolio, explains LCP head of responsible investment, Claire Jones.

“Smaller schemes are more likely to invest in pooled funds and need investment managers to offer suitable funds that are net-zero aligned,” she says.

“Conversely, larger schemes are more likely to use segregated mandates, so have more flexibility in the instructions they give to investment managers,” Jones adds.

Nuveen head of UK institutional, Sophie Ballard, adds that there is also an “access gap when it comes to private real assets, which is one of the most effective ways of making a real-world impact but has historically been harder for smaller schemes to reach”.

There is growing interest in structures that combine liquidity with exposure to private real assets, she says, offering smaller schemes a more practical way to turn net-zero ambitions into reality.

### Road to endgame

For many smaller DB schemes, the issue is less a lack of commitment to climate goals and more a question of relevance and practicality, acknowledges Hughes Price Walker director and actuary, Ray Hughes.

“A large proportion are already focused on securing member benefits through buy-in and buyout over the next few years because running on independently may not be viable at their scale.

“In that context, setting formal net-zero targets for 2030 or 2035 can feel somewhat disconnected from the scheme’s actual investment horizon, particularly where assets are expected to transfer to an insurer well before then,” he says.

Similarly, smaller DB schemes are more likely to be closed than their larger peers, and therefore inherently more risk averse in their investment strategies.

Although Pensions UK head of DB, LGPS and investment, Tiffany Tsang, points out the release of DB surplus may be an “interesting game changer” in what DB schemes can do with their endgame options in future years, including investing in more climate change opportunities.

### Anti-ESG backlash

There have also been significant setbacks for the low carbon transition at a government and industry level over recent years, most notably in the US where President, Donald Trump, withdrew from the Paris Agreement and pulled back on green policies, and many large US investment managers withdrew from net-zero initiatives.

In the UK, political consensus on net-zero has become more fragmented, and although it is still early days, changes in the makeup of Local Government Pension Scheme (LGPS) Pension Committees, following the arrival of Reform UK councillors in certain areas, may lead to increased scrutiny on these issues.

“Many schemes are taking pause given the lack of progress at the government and policy level, explains Quant. “Trustees are sceptical of setting strong climate commitments that may be out of line with the wider pace of the transition.”

### Policy-led change

UKSIF head of policy and regulatory affairs, Oscar Warwick Thompson, argues that the imbalance among schemes, demonstrated in the report, supports the case for why policymakers should go further in addressing the challenges holding back some smaller schemes from setting and progressing towards net-zero goals.

“We have advocated for regulators, including The Pensions Regulator (TPR), to evolve their guidance on sustainability-related risks and opportunities over time to support trustees in fulfilling their duties,” he says.

UKSIF has also recommended, “certain types of streamlining measures to the UK’s sustainable finance reporting architecture for pension schemes, particularly for smaller schemes,” he adds, which could promote “longer term strategic thinking and sustainable investment approaches”.

Warwick Thompson says he hopes the forthcoming DWP guidance on fiduciary duty for trust-based schemes positively impacts smaller schemes’ engagement on climate change and other systemic risks.

### Practical steps and support

Trustees of smaller schemes have a role to play in responding to climate risks and supporting the UK’s transition, and there are practical steps they can take.

“Climate risk is not going away,” says Quant. “Recent geopolitical tensions have reinforced that the transition will be shaped by energy security and inflation resilience as much as climate objectives.”

He says trustees should focus on practical action: understanding their highest risk holdings, making greater use of forward looking metrics, and challenging managers on how they are engaging with companies that are misaligned with the transition.

Pensions UK head of strategic policy, George Dollner, highlights some initiatives to support smaller schemes,

such as the association’s Stewardship and Voting Guidelines, which provides a framework to drive responsible investment and influence positive corporate behaviour globally. And the Vote Reporting Template, that provides standardised information on how asset managers are voting on certain issues and how they are enacting schemes’ views on sustainability.

Pensions UK also participated in TPR’s Transition Plan Working Group to develop and test a voluntary net-zero transition plan template for occupational pension schemes.

“For a pension scheme, having centralised reporting solutions, like a template, that you can use and fill in is much easier than having to do all that thinking independently,” Dollner says.

### Reporting system changing

Looking ahead, an important consideration for schemes of all sizes is that the UK’s sustainability reporting system is changing.

The UK is moving beyond TCFD-style disclosure towards a system focused on driving real-world decarbonisation. The government is reviewing pension scheme sustainability reporting, including whether to update existing climate disclosure rules and how UK Sustainability Reporting Standards (SRS) could be incorporated. It is also exploring the introduction of mandatory transition plans, which set out how net-zero commitments will be delivered.

Dollner says: “The challenge will be how larger schemes adapt the way they report, and how smaller schemes recognise that the system is changing and that they need to adapt as well.

“It’s an opportune moment to ensure that when UK SRS/transition plans are rolled out, they are done in a way that has support bedded in from the start.”

 **Written by Ellie Carric, a freelance journalist**