NOVEMBER 2024
CORPORATE-ADVISER.COM

corporate adviser

ROUNDTABLE

SUSTAINABILITY THROUGH PENSIONS: ACHIEVING REAL-WORLD IMPACT

– CLIMATE: MAKING A REAL-WORLD IMPACT
– TIME FOR A NEW APPROACH TO FIDUCIARY DUTY?

IN ASSOCIATION WITH

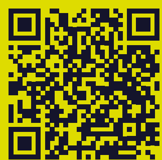
now:pensions

now:pensions

now: that's *impactful*

At **now:pensions**, we're committed to helping everyone save for a more financially secure future. We're fighting for a fairer pension system which enables everyone to save for the retirement they deserve.

Find out why thousands of employers trust us with their workplace pension.



NP/DO333

LEADERSHIP ON CLIMATE: PENSIONS CAN'T GO IT ALONE

John Greenwood
john.greenwood@definitearticlemedia.com

DC workplace pensions have been playing their part in tackling climate change, setting ambitious net-zero targets and decarbonising portfolios.

But reducing carbon footprints is only part of the story. To mitigate climate change, providers need to go beyond portfolio metrics and reinvent stewardship. This requires coordinated action between industry players to be successful, but crucially, it must also be underpinned by support from policymakers.

Umbrella coalitions and shareholder campaign groups, such as Climate Action 100+, are part of the way the UK DC sector can amplify its voice on a global stage, even if the effectiveness of these organisations may be limited by some US asset managers withdrawing from them.

By contrast, Australian superannuation funds, which collaborate on a range of stewardship issues, could offer a more optimistic blueprint for the UK sector's future development.

Participants at the roundtable covered in this supplement highlighted the importance of engaging policymakers to establish frameworks that drive systemic change. They called for UK government policies to support the transition to net zero through a joined-up approach to regulation, subsidies, and tax incentives (and disincentives).

To date, this has not materialised. The chancellor has expressed a desire to boost DC investment in the UK economy, particularly in start-up technologies and green infrastructure. Yet, simultaneously, she is freezing fuel duties, effectively subsidising the fossil fuel industry.

Currently, many DC schemes are investing for a future where temperature rises are limited to 1.5 degrees Celsius. This could see capital flowing into sustainable projects, carbon capture and storage facilities, and green technology and infrastructure. However, without policy support, some experts warn that schemes may need to pivot from 'transition' to 'adaptation' portfolios to protect members' interests. These portfolios could prioritise investments that are better positioned to withstand severe climate impacts and a more disorderly transition. In simple terms this could mean less money into wind farms and more into sandbag manufacturers — which won't change the dial on climate change.

This, of course, raises the recurring question of fiduciary duty: are trustees solely focused on the financial interests of their members, or are these interests inextricably linked to wider social issues such as climate change?

It is easy to slip into doom-monger mode when discussing climate, but it is important to note that investments made by pension schemes are already having a tangible impact—whether by combating deforestation or supporting the energy transition in emerging markets. UK DC providers are demonstrating that focused engagement can deliver real-world results. However, scaling these efforts will require greater collaboration and a more supportive legislative and regulatory environment.

If the government matches the industry's ambition with bold policies, the UK pensions sector could become a global leader in financing a sustainable future.

INSIDE

REPORT

18 REAL-WORLD IMPACT ON CLIMATE
Divestment can only do so much to address climate change. So how can targeted interventions help? Emma Simon reports

22 TIME FOR A NEW APPROACH TO FIDUCIARY DUTY?
Are current rules around fiduciary duty doing enough to reflect the consequences of a warming planet, asks Muna Abdi

22 MAKING A REAL-WORLD DIFFERENCE TO THE CARBON TRANSITION
Martyn James: how targeted interventions can have an impact

SUSTAINABILITY: ACHIEVING REAL-WORLD IMPACT

CLIMATE: MAKING A REAL-WORLD IMPACT

Decarbonising pension portfolios can only do so much to address climate change. But targeted interventions can bring about meaningful change. **Emma Simon** reports

UK pension providers have set stretching net zero targets — with many already making significant progress towards 2050 goals by reducing carbon emissions. But how much influence can decarbonising portfolios have, when it comes to making a 'real world impact' that can shift the dial on climate change?

This was the key question debated at a recent Corporate Adviser round table event, looking at sustainability and ESG strategies in the pensions sector.

Those attending agreed stewardship was likely to be far more effective than simply reducing the carbon footprint on a pension portfolio. However, the sustainability experts attending the event said this activity needs to be supported by action from government and policymakers — and warned that without this, the global economy could face a more disorderly transition with higher temperature rises.

Carbon metrics

When it comes to sustainability in pensions the focus in recent years has been on decarbonising portfolios, with climate change being the dominant ESG issue.

This has been supported by legislative change, with pension schemes now required to publish TCFD reports which include a carbon footprint metric — showing the tonnes of carbon emitted per £1m investment in their default funds.

However those attending the debate were not convinced about the effectiveness of this metric, particularly as a way of comparing schemes and their sustainability credentials.

LCP's head of responsible investment (systemic stewardship) Claire Jones says one of the basic problems is that if schemes divest shares in high-emitting companies — going underweight in oil, gas, airlines and mining for example — they are invariably selling these listed holdings to someone else. "The risk is these stocks just get bought by investors who are not as focused on aligning with transition plans, and less likely to pressure companies to change business models."

TCFD reports can encourage schemes to divest from these areas, to lower their own carbon footprint, but this doesn't necessarily lead to any real-world reduction in these emissions she said.

Julius Pursaill an independent consultant who has NatWest Cushon as a client said, that the relatively small size of the UK DC market, meant divestment was a less effective lever for change, particularly when there remain larger sovereign states and wealth funds happy to pump money into oil and gas, he said.

now: pensions director of investment Martyn James said this basic carbon footprint metric can also lack context — and doesn't reflect the totality of action necessarily being taken to reduce future emissions.

Hymans Robertson head of DC investment and master trust Alison Leslie agreed. "A scheme could have high carbon emissions because it is investing in assets [like offshore wind farms or green infrastructure] which have the potential to have a huge real-world impact on emissions five or 10 years down the line." A successful transition is likely to need significant investment into such carbon-emitting assets now she added — not just in the UK, but across the globe.

Laura Hillis, head of stewardship at the Church of England pointed out that the converse can also be true: portfolios with a low carbon footprint typically have lower exposure to oil, gas and mining firms but are often overweight in banking stocks for example. "But banks are some of the biggest fossil fuel funders in the world," she pointed out.

Despite recognising these potential limitations, most at the event agreed carbon footprint remains a useful metric. Jones said that collating this data on individual holdings, to give an overall portfolio view, can help trustees and

Martyn James

Julius Pursaill

providers to identify 'hot-spots' within their portfolio — which can inform stewardship activity.

She said these carbon footprint figures need to be viewed in conjunction with more forward-looking metrics. "My personal favourite metric is the alignment maturity scale: what proportion of a portfolio's holdings are already aligned with a net-zero pathway, which are committed to align [but have yet to publish detailed plans] and what proportion have yet to make these commitments." These alignment plans can include firms signed up to the Science-Based Targets initiative (SBTi).

There was general support for such forward-looking metrics, particularly as these tend to reflect transition progress made by underlying holdings, and the economy in general — not just how an individual portfolio is positioned. However, there was some disappointment with the effectiveness of the scenario-analysis figures that are included in many TCFD report

Hillis said: "I was a fan of the idea of scenario analysis at the outset. But I've found the majority of the analysis done to date to be fairly useless." Hillis said problems lie with the underlying modelling, and the fact this doesn't adequately integrate transition, physical, societal and political risks.

Pursaill agreed saying it this metric was largely "a complete waste of time". He added disclosures within the TCFD report should support portfolio resilience, helping schemes identify future risks.

Now: Pensions head of sustainability Keith Guthrie said that from a provider point of view it was important to look at practical and qualitative approaches alongside these quant models.

"I think there needs to be a common sense approach. If we are looking at scenario of three degree warming then this is going to be a worse financial outcome for members than a world with one and a half degree warming. If we want to affect this, and deliver better outcomes then stewardship becomes the most important thing to focus on."

Stewardship versus divestment

While those attending the event agreed divestment did not necessarily lead to real-world reductions in emissions, most said it was still a useful tool for providers and asset managers in the DC space.

Jones said: "I am a strong proponent of engagement over divestment, but to be credible engagement needs to be backed with a threat of divestment."

Done correctly divestment can have impact Hillis said. "The Church of England is well known for a number of very loud and public divestments." This can be effective she said, pointing out she agrees with the rule of thumb offered by an academic acquaintance at Cambridge University. "If you have more fame than money you should divest, and more money than fame you should engage."

Pursaill agreed that divestment and ambitious carbon reduction programmes can send important signals to the market. "Cushon initially announced it was going to cut 80 per cent of its emissions by 2030. This helped force a lot of conversations within organisations about what they were doing about climate.

"This announcement I would argue made a real impact. It was a rallying call and it got a huge amount of coverage and helped drive this agenda forward."

Effective stewardship

Those attending the event agreed stewardship remains the most effective way of driving down real world emissions. However they said effective engagement needs to encompass more than discussions with individual corporates about net zero targets.

Hillis said the focus needs to move to better engagement with policymakers, and the industry had not focused enough on this to date. "We need to get the right policy and regulation in place to make the transition happen. We've come to the ▶

conclusion we should be spending most of our time on policy engagement — and the engagement with companies should specifically focus on their policy engagement, because they have such an outsized voice in shaping policy."

She pointed out there is often a disconnect between some company's transition plans "often printed on shiny paper with beautiful photos" and the more negative lobbying that goes on behind the scenes, often via industry associations to protect narrower interests.

"This is rarely transparent. Firms might be giving millions to these associations who are lobbying to protect their own interests. Even if you can't convince firms to change, then it would be good to encourage transparency around this."

Many on the panel agreed a more robust legislative and regulatory framework would support stewardship action taken by pension providers — particularly with the government now looking at new disclosures related to nature and biodiversity.

Hillis added: "It's been interesting to see the conversations we are now having with policymakers around nature. It feels like we are back on the merry-go-round that we went on with climate.

"The government starts by saying we need action on an issue, but then finds regulation isn't easy, particularly as there are various interest lobbying against such change."

Instead she says they often look to "mobilise finance" to try to solve the problem, by launching forums, and getting investors excited talking about disclosure and data. "I think we get a little distracted by this, and we forget to go back to government and say we also need the policies that will shift the economy on these issues."

One example given was the recent Budget decision to continue to freeze fuel duty — further evidence that subsidies continue to underpin fossil fuel industries. Pursaill agreed that "subsidies are flowing in the wrong direction".

He warned that without government action, investor behaviour could change: with some potentially looking to redirect funds away from a "successful transition portfolio" to invest in "adaption portfolios" instead. This may starve some parts of the economy from the finance it needs to effectively combat climate change.

Laura Hillis

Real world impact in action

Despite this rather bleak outlook, those at the event gave positive examples of how stewardship in the DC sector was already achieving real world impact even on a relatively small scale.

Guthrie said: "I've been encouraged by how much we are able to have an impact. We've had success with issues like biodiversity, particularly through satellite intelligence initiatives."

This he said enables the company to compile exact data on where deforestation is happening, particularly in relation to the palm oil industry. "This has opened the door to having meaningful conversation with companies like Unilever or Nestlé — where we might not ordinarily get much of an audience with."

Continuing the theme of transparency, Guthrie said the company was being "loud and proud" about this unique data and engagement, helping to maximise potential impact.

There was also discussion about how portfolio construction can make a difference. Much of the debate focused on the need to boost funding towards emerging markets, where, according to Hillis, around 95 per cent of emission growth is coming from.

This highlights the mix between environmental and social challenges. As she pointed out, this rise in carbon emissions is coming in part from the need to build hospital, roads and schools in these emerging economies. "If the OECD investors in the room aren't having these discussions and helping those countries move through these challenges then I think there a chance a transition by 2050 will fail."

Pursaill said one the proudest moments of his career was delivering an investment strategy while at Cushon that reflected many of these issues. This included an actively managed debt portfolio, that included portfolios designed to support airlines and oil companies with transition plans alongside private markets.

"We also designed our own index. It was not perfect because it was in listed equities but it was a lot better than the MSCI world index."

Tackling climate change remains a huge global challenge — one that has not got easier with the result of the recent US election. Stewardship and decarbonisation are now entrenched in investment strategies across the UK DC sector. But those in the industry say this needs to be supported with action from government to ensure strategies devised today remain appropriate for the future and deliver for their members. ■

Invest in *tomorrow*

Climate change is reshaping the world
and its economies like never before.

We believe our members and the people
they care about should enjoy a better future
in a planet that is thriving and secure.

We're powering this change by investing in
and engaging with companies committed
to transitioning to a more sustainable future.

now:pensions

Find out how we invest in the future.

NP/DO334

SUSTAINABILITY: ACHIEVING REAL-WORLD IMPACT

TIME FOR A NEW APPROACH TO FIDUCIARY DUTY?

Are current rules around fiduciary duty sufficient when it comes to looking at the potential financial consequences of a warming planet. Muna Abdi reports

As the demand for climate-conscious investment strategies intensifies, traditional interpretations of fiduciary duty are coming under scrutiny. Trustees are facing the challenge of balancing long-term financial performance with the urgent need to address climate change. At a recent Corporate Adviser round table event, delegates debated whether the definition of fiduciary duty should be broadened as a result, to include climate risks and sustainable investment goals.

A key part of this debate was whether asset managers should be taking a more active role when it comes to climate action, or whether current industry initiatives were sufficient to drive change on this issue. Those at the event agreed on the importance of collaboration when it comes to global challenges like climate change, and how this will be a key issue for the UK DC sector, given its relatively small size on a global scale. There was also discussion on the need for private markets to establish a credible climate narrative that effectively incorporates sustainability into future investment decisions.

Fiduciary duty

Julius Pursaill, an independent consultant who has NatWest Cushon as a client, made the case that fiduciary duty has to be expanded, especially in light of climate risks and sustainable investment objectives. He contends that the way fiduciary duty is currently interpreted, which places emphasis on the fund's size at retirement, restricts trustees' capacity to fund projects that might have longer-term, more extensive advantages.

He explained: "The current interpretations of fiduciary duty, which focus on the size of the fund at retirement, are very narrow. You can take into account some subsidiary and ancillary factors, but ultimately the trustees are being told they need to focus on the size of the fund at retirement."

He said trustees could support investments in climate transition projects,

Keith Guthrie

even if the financial outcomes remain uncertain by expanding fiduciary duty to include members' quality of life. However, Pursaill acknowledged that trustees remain hesitant to take such steps at present, despite examples, like investment into local authority social housing, proving to be successful.

Not everyone on the panel agreed that regulations needed to change. LCP head of responsible investment (systemic stewardship) Claire Jones, said that opinions on the interpretation of fiduciary duty differ, and there is certainly scope within the current framework to push boundaries further. She said this may be necessary if pension schemes are going to be able to tackle climate change more effectively.

She said: "The people who are saying that the current interpretation is sufficient are probably people who don't appreciate that to deliver on long-term member outcomes requires going beyond the boundaries of what is currently possible within fiduciary duty."

She believes this will ultimately lead to broader conversations about integrating quality of life considerations into

Claire Jones

fiduciary duty, allowing trustees to explore more sustainable and impactful investment opportunities.

Hymans Robertson head of DC investment and master trust Alison Leslie said she was uncertain that regulation alone would bring about change, arguing instead that progress comes when people take bold actions, which gradually set boundaries, similar to legal precedents. She pointed out that many are hesitant to lead but mentioned LGPS as "a great example of an impactful perspective" because of their flexible, long-term strategies.

She said: "The difficulty is being first out of the gate because people never want to be the ones taking those first steps. So I think when you've got some bold movers you then start to get the boundaries expanding."

Now: Pensions and Cardano UK head of sustainability Keith Guthrie, addressed the challenge of balancing fiduciary duties with climate objectives, particularly in the context of achieving the 1.5-degree transition. Guthrie noted that fiduciary duty could conflict with the need to promote positive environmental change, but that trustees can work to influence a positive climate outcome even if those choices don't always align with short-term financial goals.

Meanwhile Martyn James, director of investment at Now: Pensions, pointed out that failing to meet climate targets could harm the global economy, thus negatively impacting investments like stocks and bonds. This, he argued, meant that trustees already have a fiduciary duty to manage assets in a way that avoids such risks, and there is already some alignment between trustees' financial and environmental goals over the longer term.

Pursaill noted that ongoing fossil fuel exploitation by sovereign nations can make some scheme's individual climate initiatives ineffective. He argued that robust policy support is essential for meaningful progress, stating: "I think this point about policy and policy engagement versus decarbonisation targets, is a really important one."

Jones agreed with Pursaill but said she is worried about the challenges facing the UK DC industry. According to her, there is a chance that investments made along a 1.5-degree pathway will have worse financial results than those made in scenarios with greater temperatures. She feels that trustees should prioritise stewardship and use their power to facilitate the transition without compromising a significant amount of short- to medium-term financial gain.

Leslie added that while current policies and targets may not be perfect, it was important to start taking action on this issue. She said: "You have to start somewhere. It puts a line in the sand and then you start measuring something and as thinking evolves, you realise you might not be on the right path, but it moves you in the right direction."

Collaboration

One of the key takeaways from these discussions was the importance of collaboration. Head of stewardship at Church of England Laura Hillis emphasised that group actions have a greater impact than individual action, and this is especially true when looking at relatively small areas of the global financial market, such as the UK DC sector. She emphasised how strong stewardship and market signalling can propel industry change, and she thinks asset owners may have a bigger say in policymaking, including pushing for a move away from fossil fuels.

She said: "There is an opportunity to build trust with asset owners in a different way, that we maybe haven't done yet: collectively building a sense that we want to see policy, we want to see regulation, that can shift markets. This is what it would take to build market confidence in climate solutions and pull the market away from fossil fuels."

Pursaill pointed out that pension schemes are unable to interact with each company on an individual basis because of resource constraints. He said working together increases both influence and power helping to ensure that more businesses or sectors are taking climate action, allowing for a wider impact.

Jones said that in order to maximise impact, a coordinated strategy is required, particularly when interacting with the UK government and other stakeholders. She said: "You need the collectives, but then all the collectives need to come together to actually push upwards."

Pursaill added though that some in the DC sector were not always willing to collaborate, particularly on stewardship issues. He said he had tried to co-ordinate such activity with four master trusts, on both stewardship and non-stewardship issues. Although the non-stewardship ▶

initiatives made some headway, he said there was no reaction when it came to the stewardship initiatives.

According to his view on this, master trusts may have been worried about anti-monopoly laws or competitive advantage, which could have hindered coordinated action.

Hillis highlighted the Australian model, the Australian Council for Superannuation Investors (ACSI), which involves super funds paying fees for voting advice, collective stewardship, and policy engagement. It is a member-driven initiative, overseen and with governance by asset owners.

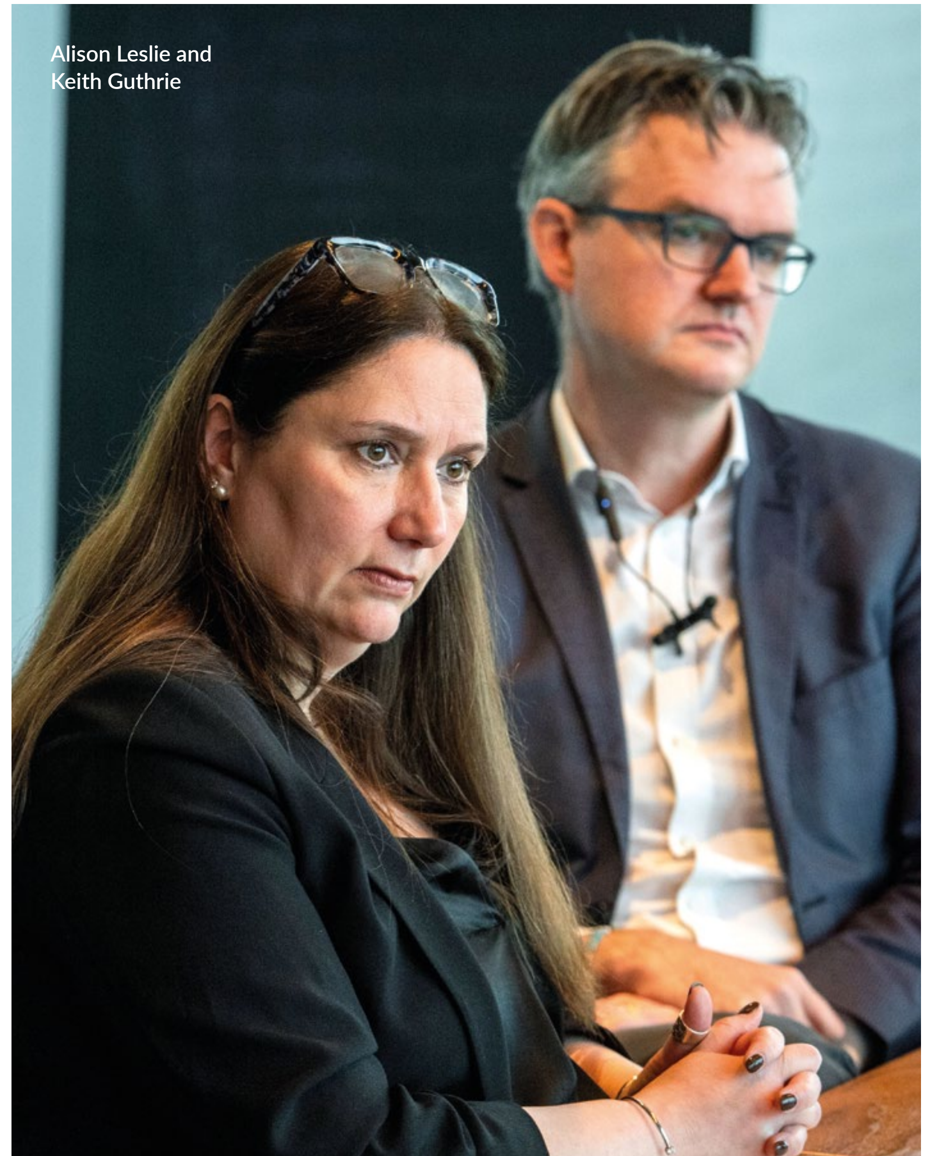
According to Hillis, a similar strategy could work in the UK, although she points out there are differences between the Australian and UK markets, with UK DC schemes being significantly smaller and less well funded than their Australian counterparts.

She says the Australian system is competitive, but this hasn't stopped people from working together. Hillis says she hopes that larger competitive UK companies – for example Aviva and Legal & General – should be able to do the work together on stewardship issues without major problems.

Asset managers

James brought attention to a possible barrier to collaboration in the UK pension system. He says that the use of third party asset managers in the UK DC ecosystems effectively puts another layer between voting and alignment with trustees' ESG and sustainability goals. This he said might make it more difficult for UK pension plans to work together effectively.

Julius Pursaill


Alison Leslie and Keith Guthrie

Guthrie mentioned how asset managers' interactions with clients are changing in the sector. Asset owners have been trying to persuade asset managers to act in a way that meets the expectations of their clients for years. He said that at first, some big asset managers responded by making changes, but political backlash, particularly in the US, has caused some to put business interests ahead of their commitment to change.

According to Guthrie, asset owners are faced with the option to either adopt the asset managers' present strategy or switch to a different manager. He said ensuring asset owners' beliefs align with their managers' actions is now more important than trying to influence asset managers and encourage them to adopt new voting tactics. He said: "I think we're at that point now where we've moved beyond the ability to influence asset managers I think we're much more in a situation where you have to change your asset manager because you're not going to get the engagement that you would otherwise want."

Hillis also added that asset owners rarely fire asset managers for acting against their interests, as fees and other factors often influence their decisions more than climate behaviour.

She said public accountability and market signals, such as dismissing underperforming managers, would, in her opinion, force change; nevertheless, a change in economic incentives, such as the removal of fossil fuel subsidies, would be crucial in getting asset managers to modify their voting patterns.

Hillis said: "I think if more asset owners dropped asset managers for those reasons and said that publicly, I think that would be an incredible market signal that would help push asset managers and drive change across the industry." ■

OPINION

MAKING A REAL-WORLD DIFFERENCE TO THE CARBON TRANSITION

» **Martyn James** director of investment, now:pensions

We're committed to making a real-world difference through the way we invest at now:pensions.

A 3°C warming scenario will be dire for member outcomes

According to our new narrative-based scenario analysis detailed in now:pensions 2024 TCFD report, the economic consequences of a 3°C or higher warming scenario are likely to be dire and bad for our members' investment portfolios. It is easy to paint a picture that a 3°C warmer world would impact global economic growth negatively and lead to higher inflation which consequently would be detrimental to the majority, if not all, of the asset classes we invest in today. We call this the systemic risk of climate change that cannot be diversified away as it affects all assets, in all regions and all sectors around the world.

A 1.5°C or 2°C scenario is likely to be much more favourable to members' investment portfolios. It is why our Trustee board has decided it should aim to deliver results focused on three Rs: Return, Risk and the Responsible Investment of our investments - all of which should be achieved in tandem.

Does this mean investors should decarbonise as quickly as possible?

In our portfolio, we are currently on track to achieve net zero by 2050, and a 50% reduction by 2030 based on 2019 levels, which is consistent with the Paris Climate Agreement to limit temperature increases to 1.5°C. We'd like to see the world decarbonise even more quickly than this, but the reality is that global greenhouse gas emissions have yet to peak, let alone decrease in-line with the pathway we've set out.

We do not believe investors can help achieve this goal by indiscriminately disinvesting carbon intensive industries and companies. It might present an artificially positive picture of our progress, but it will not help the world decarbonise any faster, as there are plenty of other opportunistic investors with different objectives willing to buy the shares of companies we would have sold.

Instead, we want the companies we invest in to reduce their greenhouse gas emissions as quickly as possible and set themselves targets to do so. To have a real-world impact on limiting global warming, we prefer to stay invested and engage with those 'high emitters' of today, whom we believe can develop credible plans to achieve net zero by 2050.

How do we manage our equity assets to make a real-world difference?

Our new equity portfolio implemented at the start of 2024 is managed with an aim to achieve a return in line with a global market cap index (including emerging markets). This could be considered aligned to a passive index management approach but with an enhanced element – the enhanced element being with reference to the ability of companies to contribute to the net-zero transition.

All our investee companies are categorised with reference to their contribution to net-zero carbon transition by 2050. We automatically exclude companies with exposure to thermal coal, and oil sands as these are completely incompatible with the transition. Companies that are not adapting quickly enough, and have not responded to our engagement, may also be excluded. Those companies which have credible plans to adapt to the transition – even if they are carbon intense today – remain as holdings in our portfolio. As a result, we have excluded a substantial number of oil and gas energy companies but continue to own shares and engage with others where we think there is more potential for the transition.

Once the exclusions are established, the portfolio is reweighted so the sector, country and factor exposures align with the global market cap index and returns will be broadly in-line with it. Through this process, companies that make a positive contribution to the transition or are adapting to it will have an overweight allocation.

Because the assets in the portfolio are managed directly by our in-house investment manager, Cardano, they are then stewarded in-line with the Trustee's key priorities which include climate change. We actively engage with companies about their plans to transition to net-zero in line with the Paris Agreement. As well as engaging with them, as share owners we of course vote on key resolutions relating to climate change. To increase the impact of engagement and voting, we collaborate with other investors with a similar mindset to drive change. If companies are not making sufficient progress, we may escalate our concerns by voting against management and directors or co-filing shareholder resolutions.

Conclusion

Investors have a massively important role to play in limiting the warming of the planet and therefore mitigating the impacts of climate change. In our view, exclusions should not be the first response – this presents a false picture of real-world progress. Investors should invest in a way that supports carbon intense companies' transition to net-zero. Alongside government policy, investor engagement and voting to influence corporate behaviour is vital to support the transition. Only if a company is unable or unwilling to adapt to the transition should they be excluded. ■

now:pensions

corporate adviser

ROUNDTABLE

IN ASSOCIATION WITH

now:pensions