PENSIONS AND LIFETIME SAVINGS ASSOCIATION

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Rt Hon Mel Stride MP
Chair, Treasury Select Committee
House of Commons
London
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Dear Mr Stride,

**PLSA response | Inquiry into the Decarbonisation of the UK Economy and Green Finance**

**About the PLSA**

The Pension and Lifetime Savings Association (PLSA) represents more than 1,300 workplace pension schemes serving 20 million savers and pensioners. Our members include defined benefit (DB) and defined contribution (DC) schemes, master trusts and local government pension funds, together controlling £1 trillion of investments in the UK and global economy. Our membership also includes 400 businesses – including asset managers, investment consultants and legal advisers – that provide essential services and advice to UK pension providers. Our mission is to ensure that everyone has a better income in retirement.

**Introduction**

We welcome the opportunity to feed into this timely and important inquiry. Although as a country we are all operating under extraordinary and challenging circumstances, the PLSA continues to believe that this year will remain a game changer for the UK financial system's approach to climate change.

We think that climate change is an important and systemic risk to nearly every business in every sector. We represent the full breadth of the institutional investment chain and believe that every segment of that chain must work in alignment to tackle the climate emergency and ensure the ongoing stability of the financial system.

We are committed to supporting schemes, including through practical guidance,[1] to act as good stewards of their assets, influencing positive change across the value chain. "Investing and Climate Change" is one of the PLSA's top policy priorities for 2020, with a programme of work designed to find workable solutions to the remaining barriers to green finance and provide practical support for actors across the investment chain. We will be undertaking further work – led by PLSA Chair Richard Butcher – on how to address the issues we have identified, to be outlined in a report in advance of COP26, and highlight below some specific activities either already or soon to be underway within this workstream.

We would be happy to further discuss our ongoing work or any of the issues we raise with the Committee in more detail or at an oral evidence session.

[1] This includes our 2019 ESG and Stewardship guidance for trustees and our 2017 *More Light, Less Heat* climate risk guidance.

## Pension scheme activity on responsible investment and green finance

Pension schemes are long-term investors and have often been at the forefront of responsible investment developments; examples include several schemes playing a prominent role in Climate Action 100+ (a collaborative investor initiative), the Church of England Pension Scheme working to launch the FTSE TPI Climate Transition Index or schemes such as NEST, the Environment Agency Pension Fund and HSBC Pension Fund being amongst the first investors to report using the Taskforce on Climate-Related Financial Disclosures (TCFD) recommendations.

Recent changes to the *Occupational Pension Scheme (Investment) Regulations 2005* (*Investment Regulations)* from the Department for Work and Pensions (DWP) requiring schemes to disclose how they have considered financially material ESG issues and their approach to stewardship have also provided a further catalyst for activity in this space.

## The role of policymakers on green finance

Although there had been growing industry momentum towards responsible investment approaches over recent years, DWP's 2018 and 2019 changes to the *Investment Regulations* demonstrate what can be achieved with well-targeted regulatory change. Just as no one part of the investment chain can solve an issue as complex as climate change on its own, so key government departments – such as HM Treasury – and regulators, including the Financial Conduct Authority (FCA), the Prudential Regulatory Authority (PRA), the Financial Reporting Council (FRC) and its successor body, must work in tandem. We are pleased to see evidence of this, including through the Climate Financial Risk Forum where regulators liaise to build capacity and share best practice on this issue, and a recent joint FRC, FCA, DWP, BEIS and TPR stakeholder workshop on stewardship.

## Areas for improvement and possible solutions

A significant amount of good work has been undertaken by both policymakers and the investment industry to achieve greater decarbonisation. However, we believe that there remains room for improvement across different segments of the UK investment chain, some of which are highlighted here (with possible solutions below):

- **Poor quality, conflicting and inconsistent provision of information**. Pension schemes need standardised and comparable information if they are to hold their service providers to account. Yet our members agree that the data and metrics they receive from their asset managers, custodians, consultants and other advisers is often inconsistent;

- **A proliferation of definitions and standards.** The investment industry agrees that it is hard to define what 'green' or 'responsible' or 'sustainable' looks like. This issue has been exacerbated by (well-intentioned) different policy and industry approaches to solve the issue and different assurance frameworks;

- **Lack of resource and expertise on green issues across the investment chain**. Although there are several individuals and some companies who have been leading on responsible investment for some time, there remain gaps in knowledge and understanding across parts of the investment consultant, legal adviser, asset management, corporate and pension scheme communities;

- **Lack of clarity from clients on their expectations.** Schemes need to ensure their expectations on stewardship and responsible investment are made clear to all the relevant service providers at every stage of the hiring, monitoring and review process, including through legal documents;

- **Challenges in exercising scheme stewardship influence outcomes in all investment arrangements**. This includes in pooled fund arrangements – where around 35% of pension scheme assets reside – where most asset managers do not split their voting by client preferences;

- **Lack of transparency by companies on climate assumptions**. Poor quality and inconsistent corporate reporting in this space is exacerbated by the failure of several accountants, auditors and actuaries to appropriately and accurately consider climate risk in their financial reporting and modelling;

- **The need to offer a compelling ESG narrative to beneficiaries**. We believe that highlighting what a scheme is doing on responsible investment can help make pension savings "real" to savers and build trust. Franklin Templeton's 2019 *Power of Emotions* research posited that an additional £1.2bn of employee contributions could be invested annually by younger savers if responsible investment was incorporated into their pension. NEST's 2018 *Building New Norms* paper also found that 50% of members surveyed would have an improved impression of NEST if they were given information about what NEST does as a responsible investor.

We believe that there are several practical steps which could be taken to solve many of the issues above. The PLSA is continuing to work with others in the sector to do so. The following list is not exhaustive, but specific projects include:

- Our **February 2020** **Stewardship and Voting Guidelines** for schemes which gives guidance on how to engage and exercise a vote to better hold investee companies to account on environmental, social and governance issues;

- Our forthcoming **template and definitions around reporting on shareholder engagement** activity and how schemes have implemented what they committed to do in their Statement of Investment Principles – with the support of a cross-industry group (to be published June 2020);

- A '**Recommendations for Action' report**, which will pull together data and information on how schemes of all types and size are considering and undertaking climate-aware investment and propose workable solutions (publication due Q3 2020);

- Our **work with the Investment Association (IA)** on the long-term relationship between asset owners and asset managers, to provide best practice guidance on how long-term incentives can be better incorporated into mandate design;

- A **joint project with the Investor Forum** on how to hold asset managers to account on stewardship and engagement (to be published shortly); and

- Our role as part of the ongoing **Pensions Climate Risk Industry Group (PCRIG)** on guidance for asset owners to using the TCFD recommendations to report on how they assess, consider and manage climate risk (ongoing). This will include educational webinars and other content to support our members in using TCFD.

- A **collection of essays from thought-leaders on climate change**, to draw out some of the key themes, opportunities and challenges facing the pension scheme community on climate change, particularly in the wake of Covid-19 (publication due Q3 2020).

In addition to industry initiatives, we also believe there is a role for well-targeted policy intervention across the investment chain. Pension schemes hold a privileged position in this chain, however UK schemes hold only 2.4% of the FTSE 100, compared to 4% held by insurers, 13% held by individuals and nearly 55% held by foreign owners. It is therefore important that any action is targeted at those who provide investment services to all these clients. Although our expertise lies particularly in the occupational pension scheme space, we believe that many of our suggestions below would also have relevance to other end clients and asset owners.

- **Require more consistent disclosure of green investment information by asset managers**. We note that the FCA is, for instance, currently considering whether to expand its proposals on TCFD reporting by listed issuers to all its regulated firms, including asset managers. Greater consistency of disclosure on how asset managers approach climate governance, strategy, use of scenarios and metrics would help asset owners to distinguish between who is undertaking meaningful and thoughtful action on responsible investment and the 'greenwash'.

- **Bring industry together to find a solution to voting in pooled funds**. We support the work of the Law Commission in its *Intermediated Securities* study – we note that there are legal but also technological barriers to the exercise of voting rights in pooled funds. The main tools for influence which schemes currently have over how and whether voting rights are used in such arrangements are either engagement (even when collaborating with other investors in the same fund, there are a number of barriers to doing so effectively) or removal of the manager (which is a blunt instrument). We believe that key actors in the industry, including policymakers where necessary, should be brought together to find ways to encourage investment and action in this space.

- **Incentivise upskilling on green finance by advisers**. We welcome the acknowledgement by the FCA in its papers on green finance that it will consider stewardship in designing a regulatory regime for investment consultants[2]. Although we recognise that HM Treasury is currently, and rightly, occupied with other urgent and necessary matters we hope that HM Treasury and the FCA will work as quickly as possible to give clarity to the industry around the shape of future regulation.

- **Further guidance and action on climate risk in financial accounts**. We welcomed the December 2019 paper by the International Accounting Standards Board (IASB) which provided further guidance on consideration of climate risk in impairment assessments and measurement of other items in the financial statements. We think that regulators should explore how they can enforce and uphold this guidance.

I hope that the above has been helpful. Should you have any queries or require any further clarification, please do not hesitate to get in touch.

Yours sincerely

Caroline Escott
PLSA Policy Lead: Investment and Stewardship

[2] This was one of the recommendations of the Competition and Markets Authority (CMA) after its study of the market for investment consultancy and fiduciary management services.