

## SECTION 6: CLIMATE CHANGE AND SUSTAINABILITY

Though the cost-of-living crisis has grabbed the headlines in 2023, there is no evidence that investors are reducing their focus on climate change issues. Indeed, the PLSA has noted an increased focus among its members to hold their investment chains accountable to their Net Zero commitments, with a growing expectation of targets and transitions plans. According to a PLSA survey from Q4 2023, more than two-thirds of pension funds have a commitment to net zero alignment in place (68%), up from just over half (57%) in May 2022.<sup>41</sup>

The PLSA believes that climate change – or, rather, the climate emergency – is a systemic issue affecting nearly every industry and nearly every firm. Although the risks and opportunities arising as a result of climate change will impact some sectors more than others, most companies will need to assess the impact of climate change on their strategy and business model in the coming years if they are not already doing so.

The pension sector is now required to produce an annual TCFD report,<sup>42</sup> including all schemes with over a £1 billion AUM. LGPS funds will fall into the scope of new legislation to comply with TCFD reporting, after a consultation was published in 2022. However, at the time of publication of this document, the industry is still waiting to hear a final decision from the Department for Levelling Up, Housing and Communities (DLUHC). The PLSA therefore expects that companies reference the TCFD in their reports, in order to enable investors to fully assess the extent of their climate risk. We also expect to see evidence of credible transition plans, given the likelihood that this will soon be a mandatory requirement.

Companies should also disclose relevant material business issues and their strategic approach to addressing these, for instance their role in public policy and advocacy on related issues, as well as their membership within trade associations conducting similar activities.

While the issue of climate change is currently receiving significant focus, other sustainability issues – such as waste, deforestation, water usage/scarcity and biodiversity – are also high on many investors' agendas. Investors should be careful not to ignore non-climate sustainability issues and consider carefully which sustainability issues are most material to holdings in their portfolio, prioritising allocation of stewardship resources appropriately.

According to Minerva Analytics, in the 2023 proxy voting season, results for ESG-focused resolutions were mixed with more shareholder proposals but lower support, and regional variations. This reflected regional circumstances such as filing rules and anti-ESG sentiment.

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<sup>41</sup> Pensions and Lifetime Savings Association 'Number of Pension Funds with Net Zero commitment continues to rise', Pensions and Lifetime Savings Association (2023) <<https://www.plsa.co.uk/press-centre/news/article/number-of-pension-funds-with-net-zero-commitment-continues-to-rise>>.

<sup>42</sup> Taskforce for Climate-Related Financial Disclosures 'Final Report – Recommendations of the Task Force on Climate-related Financial Disclosures' Taskforce for Climate-Related Financial Disclosures (2017) <<https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf>>.

However, shareholders are considering a wider range of issues when voting on director elections and factoring in ESG oversight in voting decisions.<sup>43</sup>

Please note that smaller and medium sized companies should be allowed some discretion and flexibility regarding their choice of framework, approach and timescales. Nevertheless, their focus on climate reporting should remain the expectation.

## **BIODIVERSITY**

The World Wildlife Fund (WWF) defines biodiversity as the “...variety of animals, plants, fungi, and even microorganisms like bacteria that make up our natural world. Each of these species and organisms work together in ecosystems, like an intricate web, to maintain balance and support life.”<sup>44</sup>

The accelerating loss of global biodiversity is driven by several factors, including global warming from climate change, industrial activities (such as deforestation or water usage) and farming to fuel high consumption demands worldwide. These contribute to habitat destruction through the extensive transformations in how land and oceans are being used. Transport for trade and tourism are also drivers of the spread of invasive alien species which threaten ecosystems. International trade and habitat destruction have also been identified as factors in the spread of disease that threatens both humans and wildlife.<sup>45</sup>

These changes in the natural world have direct impact on financial markets, supply chains and corporate profitability, with knock-on impact on pension scheme investments tied to sectors linked to biodiversity loss. As a result, pension schemes will need to begin to treat biodiversity with the same prominence given to climate change. This can mean including biodiversity and natural capital impacts in assessments of a company’s transition plans. Schemes can also consider voting to support resolutions that seek to encourage companies to address direct or underlying drivers of biodiversity loss. Votes against directors can also be considered, where efforts to address drivers of biodiversity loss are deemed insufficient.<sup>46</sup>

Schemes can also encourage investee companies in at-risk sectors to engage with the Taskforce on Nature-related Financial Disclosures (TNFD) on approaches to better integrate impact on nature into decision-making, as well as on approaches to identify and access biodiversity data.<sup>47</sup> Working closely with asset managers will also be important to understand their biodiversity-related risk

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<sup>43</sup> Minerva Analytics ‘Minerva Briefing 2023 Proxy Season Review’. Minerva Analytics (2023).

<sup>44</sup> WWF ‘What is biodiversity? Why it’s under threat and why it matters’ WWF <<https://www.worldwildlife.org/pages/what-is-biodiversity>>.

<sup>45</sup> LSE, Grantham Research Institute on Climate Change and the Environment ‘What are the extent and causes of biodiversity loss?’ LSE, Grantham Research Institute on Climate Change and the Environment(2022) <<https://www.lse.ac.uk/granthaminstitute/explainers/what-are-the-extent-and-causes-of-biodiversity-loss/>>.

<sup>46</sup> Railpen ‘Global Voting Policy 2024’, Railpen (2023) <<https://cdn-suk-railpencom-live-001.azureedge.net/media/media/3dsbs2tm/voting-policy-2024.pdf>>.

<sup>47</sup> Ibid.

assessments, as well as their engagement strategies with invested companies, and capital allocation to nature-positive initiatives.<sup>48</sup>

## CLIMATE CHANGE RESOLUTIONS: WHAT SHOULD INVESTORS LOOK FOR?

The last few years have seen a growth in the number of climate-related resolutions being tabled at AGMs. We are also now seeing ‘Say on Climate’ and other shareholder initiatives resolutions tabled by companies, mainly seeking approval for the climate action plans.

Launched by the hedge fund activist investor Chris Hohn through the Children’s Investment Fund Foundation, ‘Say on Climate’<sup>49</sup> is a campaign promoting shareholder voting on climate transition action plans. The initiative was deemed the biggest shake-up of the annual meeting season since the US and UK gave shareholders a vote on executive pay<sup>50</sup>. However, the campaign has been more popular in Europe, Australia and Canada, while the US is yet to see its first ‘Say on Climate’ vote.<sup>51</sup>

If an investor judges that climate risk is particularly material to a holding in their portfolio, then they should strongly consider supporting resolutions tabled by others (or tabling a resolution themselves if they have sufficient resources) where this is in the broader shareholder interest.

Questions which investors should be asking when deciding whether to support a given resolution include:

- Does it conflict with other climate resolutions? If so, which one will be most effective in achieving aims in line with the impact on the portfolio?
- Has it been supported by management?
- Does it focus on disclosure of activities and action (i.e. taking a behavioural approach which is trying to nudge companies into certain behaviours) or on the substance?
- If the resolution covers issues applicable across a sector, have similar requests been made of other companies in the industry or is there a justifiable reason why the company has been singled out for attention?
- Does it clearly link to internationally agreed upon targets and other agreements such as the Paris Agreement?
- Is the resolution binding? If so, is the request proportionate? Is there a good understanding of its likely impact on all relevant stakeholders if passed? Would it impact the ability of the company to make strategic decisions without seeking further shareholder approval in the future? Or does it offer some flexibility?

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<sup>48</sup> Burgess Salmon ‘ESG: Biodiversity and nature risks for pension schemes’, Burgess Salmon (2023) ” <<https://blog.burgess-salmon.com/post/102iq7g/esg-biodiversity-and-nature-risks-for-pension-schemes>>.

<sup>49</sup> <https://sayonclimate.org/>

<sup>50</sup> Attracta Mooney, Billy Nauman “Say on Climate’ campaign faces first big test at investor meetings’, Financial Times (2021) <<https://www.ft.com/content/cc409667-e048-4246-808c-9cdf8e41ac77>>.

<sup>51</sup> BNP Paribas Asset Management ‘The Unpredictable Future Of Say-On-Climate Votes’, BNP Paribas Asset Management (2023) <<https://docfinder.bnpparibas-am.com/api/files/3C84684E-93F2-42B6-BE7A-42565C1EoEEE>>.

- If the resolution is non-binding (sometimes known as “precatory”), is the aspiration appropriate and consistent with the business’ long-term success? What actions would be appropriate for the company to take in response to the resolution? If those actions were not taken, how concerned would the investor be?
- Would voting against resolutions on political donations, re-election of the responsible Director or the Annual Report and Accounts better reflect specific concerns on a particular area (i.e. lobbying)?
- For Say on Climate and other shareholder voting resolutions, are the plans put forward for approval underpinned by credible targets? (Ideally plans should reflect an established industry frameworks and be in keeping with the UK TPT guidance<sup>52</sup>).

## EVIDENCE BASE

The PLSA believes that pension schemes should have access to as much information as possible – (including metrics and climate scenario testing) to enable them to invest well. It is mandatory for listed companies to measure and report on the greenhouse gas emissions that they are responsible for producing. However, although this information is vital, it is not sufficient in itself. This should therefore be accompanied by a clear narrative surrounding the approach that the company is taking to ensure it manages this risk through its governance, processes and internal control arrangements.

Investors may prefer that companies take a joined-up, industry wide approach to climate change and other sustainability issues, both environmental and social. Due to the interrelated nature of climate change impacts, system-wide approaches and discussions (rather than single-issue responses) may yield more insights.

Given the systemic nature of the risk the climate emergency poses to companies, there could also be implications for capital structure and allocation. Investors should also carefully scrutinise disclosures regarding any planned capital expenditure on climate change related research and development, or whether any relevant merger and acquisition activity has been planned.

## WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Climate change is discussed in terms of strategic, financial and operational factors. The potential impact of different scenarios, such as the reactions of policymakers and regulators on value creation in the long-term, should be clearly discussed. There should also be a clear link to risk management at the executive level and risk oversight at the board level. The impact of climate risk and opportunities of the firm’s strategy over the short-, medium- and long-term should be clearly outlined.

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<sup>52</sup> Transition Plan Taskforce ‘Consultation The Transition Plan Taskforce Implementation Guidance’, Transition Plan Taskforce (2022) <<https://transitiontaskforce.net/wp-content/uploads/2022/11/TPT-Implementation-Guidance-1.pdf>>.

- There are clear climate-related governance and oversight structures and processes. This includes climate change expertise at the board level, identification of which Director is accountable for climate issues and management's role in assessing and managing climate-related risks and opportunities. Every Director should demonstrate an understanding and awareness of the potential range of impacts which climate change may have on the company.
- A proactive approach both to identifying and managing climate risks and opportunities and sufficient disclosures on climate change. Companies should be referencing the TCFD framework in disclosures. There should be clear evidence that companies are considering the issue of climate change across the high-level TCFD areas of governance, risk management, strategy, metrics and targets and scenario analysis.
- The potential consequences of the expected physical impacts of climate change are actively considered and discussed in reporting. The resilience of assets and supply chains in the face of, for example, changing weather patterns and rising sea levels, should be considered as relevant.
- Companies also need to demonstrate their consideration of the potential impact of changes in public policy and regulation around the transition to a low carbon economy. The narrative reporting should reflect the level of financial disclosures provided.
- Clear reference to and use of credible industry climate reporting metrics in the Annual Report and Accounts. This should include reference to the TCFD, Sustainability Accounting Standards Board (SASB),<sup>53</sup> Climate Disclosures Standards Board (CDSB),<sup>54</sup> or other established third-party frameworks. Companies should provide explanations as to the rationale for their choice of framework and the extent to which, if at all, relevant metrics have been blended with others. Please note that smaller and medium sized companies should be allowed some discretion and flexibility regarding their choice of framework and timescales.
- Disclosures refer to the Paris Agreement and mention the UK's Net Zero goal. Companies should disclose whether they have assessed if their business model is compatible with commitments to mitigate global temperature increases (at either 2 or 1.5 degrees) and, where they do not feel this is currently the case, have outlined a process (complete with relevant timescales) under which they hope to achieve compatibility.
  - This should include a discussion of the metrics which the company has chosen to assess climate-related risks and opportunities in line with its strategy and risk management. These metrics should include Scope 1, 2 and (where relevant) Scope 3 greenhouse gas (GHG) emissions.<sup>55</sup>

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<sup>53</sup> Sustainability Accounting Standards Board 'SASB Standards', Sustainability Accounting Standards Board <[Download SASB Standards - SASB](#)>.

<sup>54</sup> Climate Disclosure Standards Board 'CDSB Framework for reporting environmental & social information', Climate Disclosure Standards Board (2022) <[cdsb-framework-2022.pdf \(ifrs.org\)](#)>.

<sup>55</sup> Greenhouse Gas Protocol <[Greenhouse Gas Protocol | ghgprotocol.org](#)>.

- Credible transition plans set out clear interim targets and milestones, material actions, activities and accountability mechanisms.
- Financial disclosures include transparency on the underlying assumptions used to calculate balance sheet valuations and earnings. Many key valuation and profit measures disclosed by companies depend on assumptions about future returns. Investors may wish to challenge the calculations and/or substitute alternative assumptions in their own financial analysis, should there be concern that these may be dependent on the Paris Agreement not being delivered in practice. In order to be open to such discussion, companies should be transparent on the assumptions underlying their calculations.
- A company's political donations and its trade associations membership are aligned with their stance on climate change. Investors have become increasingly concerned about corporate support for organisations and individuals whose lobbying activities and objectives are considered to frustrate climate change mitigation. Such support may take the form of political donations, trade association membership or the establishment of charitable or educational trusts that undertake lobbying against progressive climate legislation.
- The company has produced a summary of biodiversity impacts caused by its activities in its corporate scope of biodiversity influence, and has a list of goals and objectives that can be focused, and against which company biodiversity performance can be measured.
- The company has developed strategic and monitoring plans describing indicators to be used and mapping out how data will be collected, when, how, where and by whom.
- The company has, or plans to create, a database of relevant data on indicators, and a monitoring and reporting systems which ensure data is provided in a standardised format that can be displayed in appropriate data products, such as maps and dashboards, to meet decision-makers' needs at each level of the company.<sup>56</sup>

## HOW INVESTORS SHOULD CONSIDER VOTING

### **Investors should consider voting against the Annual Report and Accounts if:**

- There is insufficient disclosure on how a company intends to monitor and manage the risks and opportunities brought about by climate change.
- The business has operations which are highly carbon intensive and there has been no disclosure of the climate-related assumptions which underlie their financial calculations, or where those assumptions are not consistent with the Paris Agreement.

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<sup>56</sup> International Union for Conservation of Nature 'Guidelines for planning and monitoring corporate biodiversity performance', International Union for Conservation of Nature (2021) <<https://portals.iucn.org/library/sites/library/files/documents/2021-009-En.pdf>>.

- The business has operations which are highly carbon intensive and there is no commitment to disclose memberships and involvement in trade associations that engage on climate-related issues.

**Investors should consider voting against the remuneration policy if:**

- There are no plans to align senior Executive remuneration to performance against relevant sustainability metrics within a reasonable timeframe.
- The business has operations which are highly carbon intensive and has not included at least one climate-related metric in the calculation of executive incentives. The metrics also should not be contradictory.

**Investors should consider voting against the re-election of the Director or the re-election of the Chair if:**

- Shareholders have attempted to engage on the issue and companies have still failed to demonstrate effective board ownership, for example providing a detailed risk assessment and response to the effect of climate change on the business, or incorporating appropriate expertise on the board.
- The business is not already moving towards disclosures consistent with mandatory TCFD obligations or, where relevant CDSB, SASB or another established third party framework. For smaller businesses, they are not readying themselves at a pace proportional to the resources available and the TCFD roadmap.
- The business has operations which are highly carbon intensive and has not made sufficient progress in providing the market with investment relevant climate disclosures including committing to publish science-based targets.
- The company has not listened to investor concerns about any direct or indirect corporate lobbying activity whose objectives are considered to frustrate climate change mitigation.
- The company has not responded appropriately to the result of a climate change related resolution, whether binding or not, and whether it was passed or not.
- The company efforts to mitigate agricultural commodity-driven deforestation are considered insufficient.

**Investors should consider voting in favour of relevant climate-related or similar resolutions** – including Say on Climate resolutions – by making assessments on a case-by-case basis.