PENSIONS POLICY INSTITUTE

PPI

Executive Summary

Engaging with ESG: Climate Change

The Pensions Policy Institute (PPI)

We have been at the forefront of shaping evidence-based pensions policy for 20 years.

The PPI, established in 2001, is a not-for-profit educational research organisation, with no shareholders to satisfy– so our efforts are focussed on quality output rather than profit margins. **We are devoted to improving retirement outcomes**. We do this by being part of the policy debate and driving industry conversations through facts and evidence.

The retirement, pensions and later life landscapes are undergoing fast-paced changes brought about by legislation, technology, and the economy. Robust, independent analysis has never been more important to shape future policy decisions. The PPI gives you the power to influence the cutting-edge of policy making. Each research report combines experience with independence to deliver a robust and informative output, ultimately improving the retirement outcome for millions of savers.

Our **Independence** sets us apart – we do not lobby for any particular policy, cause or political party. We focus on the facts and evidence. Our work facilitates informed decision making by showing the likely outcomes of current policy and illuminating the trade-offs implicit in any new policy initiative.

Our Vision:

Better informed policies and decisions that improve later life outcomes

We believe that better information and understanding will help lead to a better policy framework and a better provision of retirement income for all.

Our Mission:

To promote informed, evidence-based policies and decisions for financial provision in later life through independent research and analysis

We aim to be the authoritative voice on policy on pensions and the financial and economic provision in later life.

By supporting the PPI you are aligning yourself with our vision to **drive better informed policies and decisions that improve later life outcomes** and strengthening your commitment to better outcomes for all.

As we look forward now to the next 20 years, we will continue to be the trusted source of information, analysis, and impartial feedback to those with an interest in later life issues. The scale and scope of policy change creates even more need for objective and evidence-based analysis. There is still much to do, and we look forward to meeting the challenge head on.

For further information on supporting the PPI please visit our website:

www.pensionspolicyinstitute.org.uk

or contact Danielle Baker, Head of Membership & External Engagement

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The future is ever changing,
but the PPI remains a constant
"Voice of Reason"
in the ongoing debate on the
future of retirement in the UK.

Pensions Policy Institute
PPI
EST. 2001

This report has been authored by:

Lauren Wilkinson, Senior Policy Researcher

Lauren Wilkinson joined the PPI in September 2016 as a Policy Researcher. During her time at the PPI Lauren has produced research on a range of topics, including Defined Benefit, consumer engagement, pension freedoms and Collective Defined Contribution.

Lauren was promoted to Senior Policy Researcher in January 2019.

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Sponsorship has been given to help fund the research, and does not necessarily imply agreement with, or support for, the analysis or findings from the project.

Sponsor's Foreword

Michael Eakins

One of the defining global issues of today is climate change. With weather patterns shifting, sea levels rising, carbon dioxide concentrations increasing and continual threats to food production, every industry has a role to play to create a tide of change. Without immediate action, the United Nations predicts more than 140 million people in Sub-Saharan Africa, Latin America and South Asia will be forced to migrate within their regions by 2050, causing major threats to international peace and security.

However, it is not too late to stem the tide. It will require major transformations in all aspects of our lives. From food production to energy and from logistics to land use, every sector will have to play their part.

As the UK's leading long-term savings and retirement business, Phoenix Group has a significant responsibility not only to its 14 million policyholders, as stewards of their savings but, to the industry as a whole. As a business we have committed to being net-zero in our operations by 2025 and in our investment portfolio by 2050. This will take our net zero target into account for all the unit linked fund solutions we design with our investment partners. We know this is important for our customers, clients, trustees and their advisers. This is why at the end of last year we launched a new ESG default fund solution for Standard Life's workplace pension clients, which screens out companies with sustainability risks.

In making this commitment, we have set targets that will contribute to the reduction of greenhouse gas emissions and accelerate our transition to a low carbon economy, which are core to the Group's sustainability agenda. Phoenix has also become a Business Ambition for 1.5ºC signatory.

With the United Nations Climate Change Conference (COP26) set to take place in Glasgow later this year, Phoenix Group stands ready to play its part.

This is why we were eager to be involved in the Pensions Policy Institute's (PPI) thought provoking research, which cuts through much of the confusion surrounding ESG and climate change. What is clear from this articulate and thorough report is that there is no easy or quick fix to the issues we face. Both industry and government must work hand in hand to establish a more consolidated strategy, with simpler, centralised data sources. This lack of a harmonised reporting process is proving to be a substantial barrier to improving the effectiveness of risk mitigation in schemes' investment strategies. With more than a quarter (28%) of respondents saying that too much information had been a challenge when designing their approach to ESG and 22% saying that conflicting information had also been a challenge, it is clear that this issue and others raised in this research paper, requires strong leadership and industry wide solutions.

Phoenix Group would like to thank the PPI for writing an outstanding report and to Lauren Wilkinson for all her efforts in putting this research together. The report also benefits from cross-industry support and expertise with it having been reviewed by colleagues from across the industry who are supporting the PPI with this important research series. It is research such as this that will enable us to combat and conquer climate and environmental change and we look forward to furthering the conversation and playing our part to make a difference, and urge the entire industry to collaborate together to ensure we find the right answers.

Michael Eakins, Chief Investment Officer, Phoenix Group

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Executive Summary

Recent changes in regulation require that pension schemes demonstrate they have at least considered Environment, Social and Governance (ESG) factors when formulating their investment strategy. As a result, understanding and awareness have grown, and there is an increasing focus on the financial risk-mitigation component of ESG investment. Climate change in particular has received increasing focus from policy-makers and social movements around the globe. However, there are concerns that some schemes are still not engaging with these considerations in a meaningful way. Following on from *Engaging with ESG: The story so far*[1], an introductory Briefing Note which provides an overview of historical and regulatory developments, this report delves deeper into the attitudes and behaviour affecting consideration of climate change in pension scheme investment. A second report will follow this one, exploring pension scheme investors' consideration of ESG as a whole. This series aims to identify areas where further support, guidance or intervention could help improve engagement and implementation of appropriate risk management.

This report explores the way in which pension scheme investment takes into account climate change within the current regulatory landscape, as well as future opportunities and challenges, and explores proposals for more effective support to encourage evolution and improved risk mitigation.

Relatively rapid regulatory changes mean that schemes will need to improve their knowledge and understanding, as well as their engagement with their external managers, to drive forward improvements in data and reporting in order to comply and appropriately protect members against climate risks.

1 https://www.pensionspolicyinstitute.org.uk/research/research-reports/2020/2020-12-02-briefing-note-number-124-engaging-with-esg-the-story-so-far/

While climate change has been the main area of focus of ESG strategies and some schemes (as well as pension providers and asset managers acting on their behalf) are doing a lot to mitigate these risks, there is still a lot of work to be done as physical and transition risks associated with climate change become more pressing. Schemes will need to take direct action, a more joined-up approach across the industry, from government, regulators, industry bodies and third parties such as consultants and asset managers, will be needed to drive forward progress.

This report uses data from PPI's Engaging with ESG survey 2020. Carried out in November 2020, the survey sought to gather insight on the approaches being used by schemes in order to take into account ESG risks, as well as the challenges they may have faced along the way. The survey was open to responses from both schemes and third-parties involved in the process, such as consultants and asset managers. There were 62 responses in total, including those covering 31 pension schemes, 48% of which were De ined Contribution (DC) and 52% De ined Bene it (DB). When drawing conclusions from the data it should be recognised that the responses cover a subset of the market, and those who responded are more likely to be more engaged on ESG in general.

This report has also been informed by qualitative interviews carried out with a broad range of stakeholders across the industry.

Relatively rapid regulatory changes mean schemes will need to improve their knowledge and understanding, as well as their engagement with their external managers, to drive forward improvements in data and reporting in order to comply and appropriately protect members against climate risks

- Policy and regulatory changes relating to climate change are occurring rapidly, which can be challenging for schemes that do not already have the necessary knowledge and expertise to catch up at pace.
- Although knowledge and understanding has grown across the industry, there is still a gap in some areas which may require more cohesive efforts from Government and industry to address.
- A lack of consistency and clarity in data and reporting is a fundamental barrier to improving the effectiveness of climate risk mitigation in schemes' investment strategies. Although the availability and quality of data is improving, schemes may need to take a more active role in encouraging evolution from external managers.
- Schemes that are heavily dependent on external asset managers will need to increase engagement with and monitoring of these managers in order to improve the effectiveness of their investment strategies and mitigation of climate risks. In some cases, schemes may need to directly demand more climate-aware products and strategies from their pension providers and external managers.
- Alternative asset classes may offer opportunities for climate risk mitigation but schemes may not have the expertise or familiarity to effectively integrate them into their portfolios.

Joined-up goals, strategies and data sources across Government and industry will improve scheme engagement with climate change:

- **Integrated goals:** Establishing a consensus across all stakeholders (Government, schemes, asset managers and platform providers) on goals, and the practical steps needed to achieve them, to ensure that climate change considerations are integrated across the investment landscape by a certain date.
- **Engagement and stewardship:** A greater focus on engagement and stewardship activities to ensure that companies across the board are making progress towards climate change goals.
- **Encouraging innovation from third parties:** Pressure from Government, regulators and industry bodies on those involved in schemes' approach to climate change (such as pension providers, external asset managers and consultants) to provide products and strategies that meet the needs of schemes in integrating these risks, as well as improving the data they provide schemes about their own activities relating to climate change.
- **Increasing knowledge and understanding:** Improving scheme decision-makers' knowledge and understanding of climate change across the industry, especially around the more practical aspects such as the implications of different investment approaches. This could be standardised and measured through a specific training module in The Pensions Regulator's Trustee Toolkit, for example.
- **Standardised data:** Producing a centralised data source which can provide a starting point for schemes that are unsure where to begin or are overwhelmed by the quantity of data available, particularly given inconsistency across different metrics. Feasibly, this would need to be a collaborative effort across the industry to agree upon standardised metrics and analytics tools, as well as standardised language to be used when talking about climate change.