Speech

Pension schemes and climate-related risks

A speech delivered by the Minister for Pensions to the 2021 Professional Pensions Investment Conference about climate-related risks.

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From:
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Good morning and welcome. My apologies I cannot be with you here today. But I am recording this in advance because I have the delights of the Work and Pensions Select Committee at exactly the same time as your conference.

And we decided to come outside to record this video because after all, this is a video, and a message, that relates to climate change, and the natural world, in which we all enjoy and want to enjoy for the future.

So, my first duty is to thank the Professional Pensions Conference for inviting me to speak.

We know that climate change is the defining challenge of our time. Our response will determine the future health and prosperity of the world.

Climate change is a major systemic financial risk and threat to the long-term sustainability of private pensions.

With £2 trillion in assets under management, all occupational pension schemes are exposed to climate-related risks.

You will all know that in late 2020, we consulted about: ‘Taking action on climate risk: improving governance and reporting by occupational pension schemes’.

Today, I am delighted to announce the publication of the Government’s response to that consultation.

Our proposals are world leading. The UK is set to become the first major economy to require climate risks to be specifically considered and then reported on by pension schemes.

The new measures will ensure trustees are legally required to assess and report on the financial risks of climate change within their portfolios.

I am extremely proud of these proposals, and my team, and we are now seeking views on the draft regulations and statutory guidance which will bring our policies into effect.

The government has also been working closely with The Pensions Climate Risk Industry Group to produce non-statutory guidance.

This will be a vital resource for all trustees when considering how to improve climate change governance and make disclosures in line with TCFD recommendations.

I am committed to ensuring that trustees do everything they can to limit this risk to their members’ future income.

I thank the industry for the significant engagement with our consultation – this played a key part in helping to shape the policy.

I recognise there are some legitimate and constructive concerns. We have sought to amend our policy according to these particular concerns.

The key issues we are changing are as follows.

Firstly, I have decided to simplify requirements on publication timings, to allow all schemes a full 7 calendar months from the scheme year end date in which to prepare and publish their TCFD report.

It is vitally important that these disclosures are as robust and set a positive benchmark for subsequent schemes that later come into scope.

Secondly, I have kept the scope of these requirements the same – authorised master trusts and schemes with £5bn or more in assets will be in scope from October 2021.

As a consequence of that, “buy-in contracts”, which involve a more or less irreversible surrender of decision making by trustees to an insurer, will not be counted towards that threshold.

We cannot afford delays to address the risk presented by the climate risk, therefore, I am bringing forward the commitment to conduct an interim review to 2023.

This will allow government to identify best practice and - subject to consultation – extend the measures to smaller schemes as soon as 2024.

The publication of the government's Green Finance Strategy was a clear signal to larger pension schemes that there would be an ambitious timescale for these regulations coming into force.

We have been true to our word and as such, smaller schemes should interpret the bringing forward of this review in the same way.

The consultation acknowledged that conducting scenario analysis is one of the most complex and costly sections of TCFD.

This is why I have reduced the frequency by which trustees are required to carry it out.

Instead of annually, scenario analysis must now be carried out in the first year that trustees are subject to the requirements and every three years thereafter.

This is not an invitation for trustees to do scenario analysis and forget about it. In the intervening years, trustees must do an annual review of their most recent scenario analysis and determine whether or not it is still "fit for purpose" or whether there are circumstances which make it appropriate for them to carry out fresh analysis.

As methodologies and data are evolving rapidly, we see a strong possibility that in practice, at least initially, trustees will need to do scenario analysis more frequently than every 3 years.

I have also sought to reduce the administrative and financial burden on trustees in relation to obtaining the data for calculating emissions-based metrics. This has been changed to an annual requirement.

Likewise, performance against targets is now to be monitored annually rather than quarterly. We have also provided for there to be an annual review of any targets, to determine whether they should be maintained or replaced.

Trustees must recognise that methodologies and data are evolving rapidly, and recognise the value in schemes regularly updating their calculations to ensure consistency and attention to risks and opportunities.

Indeed, government has recognised the evolution in this space in just the short few months since we consulted.

On metrics, we have made changes to our original proposals so that trustees will be required to select at least two emission-based metrics, one of which must be absolute and one which must be intensity-based – emissions per pound invested.

Data concerns and the TCFD Roadmap are absolutely crucial. And metrics leads on to concerns about the availability of data vital to carrying out effective and robust climate governance.

Some of the TCFD recommendations require an evaluation of assets which relies on the quality and flow of data from investee companies - through asset managers and investment consultants - to institutional investors.

However, we cannot let our work to tackle climate change falter, on the basis that the solution is too complex.

The government is resolute in its ambition to tackle this issue wholeheartedly.

It is therefore hugely significant that the government has recognised calls for regulatory alignment by publishing the TCFD Roadmap last November.

We intend to make TCFD-aligned disclosures mandatory across the economy by 2025, with a significant portion of mandatory requirements in place by 2023.

It would not be right, in my view, to place a requirement on trustees whilst the rest of the investment chain – on which they rely for data – is not held to the same regulatory standards.

Challenges to our proposals are significant, but the reality is that the government's roadmap will go a significant distance to address some of these challenges we are going to meet these requirements.

Some say that government is directing trustee decisions and increasing pressure for divestment of pension schemes from high carbon sectors.

However, I have repeatedly stated in Parliament, and I make the point again today, that ultimately decision-making on climate risk and opportunities are matters for trustees alone. I'm wholeheartedly opposed to divestment.

We are not mandating that schemes commit to specified emissions reductions, and we continue to believe that divestment would be the wrong approach.

We believe encouraging company engagement will reduce the climate risk to which that scheme is exposed.

That is why I've set up a working group, chaired by Simon Howard, the former Chief Executive of the UK Sustainable Investment and Finance Association, to look at how we can strengthen the trustee voice in engagement, and voting in particular.

If stewardship and voting are to be effective, we need to see improvement - the current system is not fit-for-purpose.

Trustees and asset managers need to work together to ensure scheme members' best interests are protected.

I intend to take steps to build trustee demand for better stewardship, which will drive failing firms to improve.

And as part of that, where trustees want to ask managers to follow their voting policy, I think they should be able to.

Investors should be clear that the transition to a low carbon economy is underway.

Our regulations will require trustees to act within their fiduciary duty by assessing their portfolio's susceptibility to this kind of transition risk.

It is then down to the trustees how they choose to act on that exposure to risk – I would encourage them to act quickly.

This transition also presents pension schemes with opportunities to invest in the real economy including the environmental infrastructure and businesses of the future that are emerging and are so needed.

These types of investments have the potential to offer pension schemes increased returns whilst driving the transition that we all want to 'net zero'.

That is why separate from our proposals on managing climate risk, the government is reviewing consultation responses on proposed changes to encourage greater allocation to these types of investments and other less liquid assets.

The most significant barrier that is holding the UK in that issue is the sheer number of members trapped in inadequate, poorly-performing schemes.

That is why I have been looking at a requirement for all occupational pension schemes with less than £100m in assets must either prove that they are offering that value or consolidate.

And consolidation will happen. It is not good enough that members are held back from accessing these types of investments because of historic choices made by their employers. Wholesale consolidation, I believe, is on its way, and is the right thing.

And on fees, last year, I also consulted on costs and changes to ensure that the fees that investors often pay for potential access to market-beating returns do not risk breaching the charge cap.

And we're smoothing the incurrence of performance fees over the course of five years which will provide many investors who are unsure about investing in such funds the confidence to make that leap.

I commend schemes that have already shown leadership by investing in infrastructure, property and private markets but we fall behind our global partners in our commitment to these asset classes and the economy as a whole suffers for it.

We have all been through an incredible journey this year, but there is an opportunity to contribute to a better financial future for ourselves and a future for our planet.

This challenge demands all of us to take action.

That is why I want every market participant to engage constructively with these proposals and these measures, to help us shape a policy that delivers the protection for members.

Together, we can build a better, safer and greener pensions system.

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