As sustainable and responsible investing enters the spotlight, the UK is trying to harness the power of pensions to bring about positive change. Jack Gray assesses the regulatory changes designed to achieve a greener pensions system and their impact on trustees.

Net zero is a long-term challenge facing our country. By unleashing the productive power of our pensions and engaging with savers, we can get there,” UK Pensions Minister, Guy Opperman, stated in a recent essay series. His call for pension schemes to unleash their power is an example of the changing attitudes in the UK to utilise pensions to help fight climate change.

Several consultations and policy initiatives have been published and enacted in the past few months to help nudge trustees and providers to consider more environmentally-friendly investments and actions. In August, the Department for Work and Pensions launched a consultation proposing requirements for larger occupational pension schemes and authorised master trusts to publish climate risk disclosures and have effective climate-related governance, strategy, and risk management in place from October 2021.

It also proposes that large schemes report on climate risks in line with the Task Force on Climate-Related Disclosures’ (TCFD) recommendations by the end of 2022. These requirements would apply to schemes with more than £5 billion in assets and authorised master trusts, before extending to include schemes with £1 billion or more in assets from 2023 and consulting on extending them to all occupational schemes in 2024.

Additionally, from October 2020, trustees will need to publish an implementation statement alongside their scheme annual reports and accounts, describing whether certain climate-related policies in their statement of investment principles (SIP) have been followed and disclose the trustees’ voting behaviour. However, this will not apply to most trustees until their next SIP on 1 October 2021.

“These changes were designed to ensure that trustees identify all investment risks, they take action to mitigate them and they disclose their actions on a publicly-available website,” explains Aviva policy manager for workplace savings and retirement, Dale Critchley.

“The intention is to evidence trustee oversight to members, but also to enable easier enforcement activity by The Pensions Regulator (TPR). The challenge for many trustees has been in synthesising the necessary voting and engagement data from numerous fund managers.”

The Financial Conduct Authority
(FCA) has also recently confirmed plans to require asset managers and FCA-regulated pension schemes to report on the climate risks of their assets in accordance with recommendations from the TCFD, while measures on climate reporting have been included in the Pension Schemes Bill currently making its way through parliament.

Taking the initiative
The increased focus on greener pensions has been partially member-driven. Now Pensions director of policy, Adrian Boulding, explains: “Increasing numbers of members want to know that their pension is invested in areas where the money will do good things as well as earn a good return.

“Initiatives like Richard Curtis’ Make My Money Matter have made the issue more respectable and mainstream than the efforts of radicals like Extinction Rebellion. This is fine if a pension scheme offers a choice of funds, such as an ESG-titled version of the standard stock market index, but it presents a communication challenge to schemes that run a single default fund.”

Herbert Smith Freehills pension practice counsel, Michael Aherne, adds that public criticism over inadequate disclosures or a failure to properly consider ESG factors could force trustees to reconsider their investment strategy.

“ESG-related challenges against pension schemes in the UK have already been seen, so there is also a risk for the scheme’s sponsor of indirect reputational damage (particularly if the approach of the trustees is not in line with corporate values),” he continues. “Put together, this means careful consideration should be given to the form of disclosures to ensure they are meaningful, substantive and engaging.”

Adapting trustees
With so much change in attitudes and regulation, pension scheme trustees are having to adapt to the evolving environment. Critchley says the biggest challenge facing trustees is in measuring the progress within their investment strategy towards their goal, as there is a dependency on the availability and robustness of data, an area which is evolving.

“A further challenge for trustees will be monitoring the solutions they adopt within their investment strategy, along with their investment adviser, to ensure it’s consistent with their ESG beliefs,” Critchley explains. “It may be that trustees will need to alter their course as the market and the new economy develops, but that doesn’t mean they should delay setting off in the right direction.

“None of the proposals require trustees to follow a particular investment strategy, but in asking trustees to address more searching questions, the expectation is that the answers will become increasingly obvious. Changes will need to be made to focus on those investments with the brightest future in a world aligned to fulfilling the goals of the Paris Agreement.”

Aherne notes that, although trustees and schemes will face challenges, there are a range of possible mitigations. “To begin with is the basic issue of non-compliance with the new and upcoming requirements, particularly in respect of timing and form of disclosure,” he states. “Failure to comply can lead to fines from TPR, so trustees should make sure to obtain legal advice.”

Aherne adds that trustees will be expected to genuinely consider their scheme is potentially vulnerable to and affected by climate change as part of their disclosure process, rather than taking a ‘box-ticking’ approach.

Looking to the future
Despite the challenges, Dalriada Trustees head of technical, research and policy, John Wilson, says that most trustees do not need reminding of their changing duties as the amount of material published and months of explanations by the investment, legal, trustee and consultancy sectors mean that trustees are aware of their evolving roles.

“Trustees are aware of the changes and have responded; some by bringing forward the date of signing of their accounts to reduce the impact for this year; and many by taking a practical approach to reporting, bearing in mind that the investment reports in this year’s annual accounts will be based on a statement of investment principles in force during the last scheme year,” he explains.

“There are more requirements still to come in 2021 and we expect that, like chairs’ statements, implementation statements will evolve as ‘best practice’ is defined.”

However, Wilson ponders whether the increased information made available to members will be read and if there will be changes in the behaviour of asset owners.

“At very least, the implementation statement, like the chair’s statement, will focus the minds of trustees,” he summarises.

Looking forward, reporting obligations are only going to increase and become more burdensome for UK trustees, according to Aherne.

“The form of the reporting is still to be decided but whatever shape regulations take, affected trustees will need to reconsider their governance and decision making processes generally to accommodate the new disclosures requirement given that TCFD is not just a reporting obligation but a fully integrated approach to climate change risk management,” he concludes.