Signing up for change

Jack Gray provides an update on the progress of ESG and sustainability initiatives from across the industry

The increased focus on environmental, social and governance (ESG) factors in pension investment has resulted in various initiatives springing up to support and encourage financial institutions to meet requirements and targets. While take up has been high, how have the initiatives progressed since they were introduced? And are financial institutions putting their money where their mouth is?

TCFD
Requirements for climate reporting in line with the Taskforce on Climate-related Financial Disclosures (TCFD) have seen a phased introduction since October 2021, starting with the largest pension schemes. Schemes in scope have since been submitting their TCFD reports in line with disclosure requirements. In its latest review, The Pensions Regulator (TPR) stated that it had seen many examples of good strategic decision making and trustee action on climate risk, including updates to DC default lifestyle strategies and increased allocations to low carbon tracker funds.

However, the regulator also highlighted several areas of concern and said future reports could be improved if trustees considered a qualitative analysis based on clear narratives while quantitative analysis is still developing in the market, and provide commentary on the challenges and limitations of the scenario analysis they have undertaken. "Climate change disclosures should be the product of good risk management," said TPR climate and sustainability lead, Mark Hill. "That's why we want schemes to know what 'good' looks like and improve their management of climate-related risks and opportunities."

Pension trustees have been urged to use TPR's feedback as an opportunity to improve their climate-related actions, with LCP senior investment consultant, Laasya Shekaran, saying that it should be useful in helping trustees focus their reports on being more meaningful, thereby driving forward positive real-world change.

TNFD
Following on from the introduction of TCFD, the Taskforce on Nature-related Financial Disclosures (TNFD) published its reporting recommendations in September 2023. The 14 recommended nature-based disclosures for companies and financial institutions build on those of the TCFD, with the TNFD saying they were a "key milestone" in the relationship between nature, business and financial capital; positioning nature risk alongside financial, operational and climate risk; and helping to shift cashflows to nature-positive outcomes. A total of 320 organisations across more than 46 counties have committed to making disclosures based on the recommendations, including 106 financial institutions with around £11 trillion of assets under management. These organisations have committed to begin adopting the TNFD recommendations and publishing TNFD-aligned disclosures as part of their annual corporate reporting for the 2023, 2024 and 2025 financial years.

However, concerns have been raised that it may be too early for most pension schemes to be reporting in line with the TNFD recommendations due to complexity and lack of data. Transition Pathway Initiative chair, David Russell, argued that adding TNFD commitments to TCFD reporting was too much for many schemes. While acknowledging that following the same process that was developed for TCFD as TNFD was "sensible" and would make it easier for those who wanted to report on nature-related risks, Russell warned that the challenge was that data is significantly worse for biodiversity than it is for climate change.

Taskforce on Social Factors
In February 2023, the Taskforce on Social Factors was launched with Department for Work and Pensions' (DWP) support following a consultation. Its aim is to support trustees and the wider

pensions industry with addressing the key challenges around managing social factors, including the identification of reliable data and metrics.

Later in the year, the taskforce issued guidance outlining more than 30 recommendations on how the industry can better incorporate social factors into investment decisions. The industry welcomed the guidance, praising its additional support to help the pensions sector understand social issues relevant to pension scheme stewardship and investment decisions, and for trustees and asset managers in meeting their existing disclosure obligations.

However, the Society of Pension Professionals suggested improvements could be made, including further development to better integrate the wider priorities and circumstances of UK pension schemes, such as covenant matters.

Final taskforce guidance and recommendations were published in March 2024, setting out the importance of embedding social factors within schemes' investment decisions and stewardship policies in four key areas: Social factors and pension funds, addressing social factors, materiality assessment frameworks, and social factor data.

UK Stewardship Code

The UK Stewardship Code is a voluntary initiative from the Financial Reporting Council (FRC) for asset owners and managers that targets high stewardship standards for those investing money on behalf of pension savers. The latest revision of the code came into effect in 2020 and requires signatory schemes to declare whether they have taken ESG factors into account when investing member funds, as well as disclosing their voting records and how they have protected and enhanced the value of their investments. Backing for the code has continued to grow, with a total of 273 organisations now signed up.

Earlier this year, the FRC began its review of the 2020 code and announced it expected to publish its revised code in early 2025. It is seeking views from stakeholders on whether the current format of the code is being used by asset managers and owners in a manner that drives better stewardship outcomes from engagement with issuers across all asset classes. The review also aims to assess whether the code creates reporting burdens on issuers and code signatories, and if it has led to any unintended consequences.

Sustainability Principles Charter

The Sustainability Principles Charter was launched earlier this year with the aim of promoting greater transparency, reporting and engagement around sustainability in the bulk annuity process. Developed by Accounting for Sustainability, the Church of England Pensions Board and Railpen, the charter had 20 signatories at launch, including the six largest UK pension insurers, alongside several pension schemes, advisers, and associations. It sets out four 'guiding principles' for the bulk annuity process: Transparency; decision making; reporting and engagement; and collaboration, with guidance also published around these key principles.

With the continued growth in activity in the DB risk transfer market and many DB schemes having made sustainability-related commitments to members, the charter looks to support transparency during the bulk annuity process on how insurers consider these commitments and ensure that scheme assets will continue to be resilient amid climate change and other sustainability challenges.

Climate Action 100+

Launched in December 2017, Climate Action 100+ is a worldwide, investor-led initiative that seeks to ensure the largest corporate greenhouse gas emitters are taking action on climate change. More than 700 investors are signed up to engage with companies on improving climate change governance, cutting emissions, and strengthening climate-related financial disclosures. Initially launched as a five-year initiative, it was announced in 2022 that it would run to 2030.

The initiative has recently been hit by the withdrawal of some major US asset managers. For instance, in February, J.P. Morgan Asset Management and State Street Global Advisors left Climate Action 100+, and BlackRock announced it had transferred its membership to BlackRock International, limiting its involvement. As reported by *Reuters*, State Street Global Advisors left the initiative as it felt that being asked to take stronger action, such as engaging with policymakers and publishing discussions with firms about setting net-zero 2050 targets, were not consistent with its approach, while J.P. Morgan Asset Management said it had not renewed its membership after developing its own investment stewardship capabilities.

Pension schemes have been urged to engage with their asset manager if they have left Climate Action 100+ and the scheme is unhappy about it, with Brunel Pension Partnership chief responsible investment officer, Faith Ward, saying: "These asset managers are managing our money. It is our money and if you are not happy about the decision, please let them know."

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