

Perspectives, policies and problems

Are pension funds preparing
for climate change?



Contents

Introduction	3
Climate change policy and actions	6
Responses to pension fund members	8
Barriers to action	9
Conclusion	11
Appendices	12

About ShareAction

ShareAction (Fairshare Educational Foundation) is a registered charity that promotes responsible investment practices by pension providers and fund managers. ShareAction champions greater transparency and accountability to the millions of people whose long-term savings are managed by institutional investors and other professional agents. ShareAction believes that responsible investment helps to safeguard investments as well as securing environmental and social benefits.

ShareAction is supported financially by a number of leading charitable foundations and counts amongst our member organisations a growing number of globally recognised NGOs and trade unions.

Author: Will Crowne

Introduction

The activities of human beings are warming our atmosphere and dangerously altering our climate. Whilst the early effects of the growing concentration of CO₂ are already with us, there is a time delay that defers the full destabilising consequences of today's carbon emissions. That delay makes it an enormous challenge to respond in a timely and prudent way to the threat posed by our own activities. One set of institutions whose primary task is to prepare for and improve our future well-being is pension funds. This should make them amongst the more engaged institutions in society with the challenges and threat of climate change. Yet, as the analysis in this report demonstrates, the UK's pension fund sector is still a long way from having figured out how to assess the scale of this risk or how to manage it effectively in the best interests of British pension savers.

This report provides a snapshot, in mid-2013, of pension sector thinking on climate change risks and opportunities. This was just prior to the launch of ShareAction's Green Light project in October 2013. Green Light is an ambitious campaign, supported by a wide range of civil society organisations including labour unions, international development charities and environmental groups, to transform UK pension funds into climate-conscious investors. Pension savers are at the forefront of Green Light, challenging their pension funds to provide them with convincing answers about how these new investment risks are being handled on their behalf. Positively, in early 2014, it is already clear that pension funds are more willing than in the past to acknowledge the implications of climate change for long-term investment success and for the future quality of life of those whose savings they manage. The crucial role and responsibility of institutional investors to address climate change is starting to get a far higher profile. In January 2014, the UN's top climate change official, Christiana Figueres, said this: *"Institutional investors who ignore climate risk face being seen as blatantly in breach of their fiduciary duty to their beneficial owners – men and women who have worked hard all their lives to put away something for their retirement and for their children"*.

ShareAction's task in the next few years is to rapidly accelerate the positive work to address climate change already underway at a small number of UK pension funds. With the second largest pension fund sector in the world, as measured by assets under management, the UK can and should take a clear leadership role internationally. We are determined it will.

Sample

This report incorporates two data sets from 2013: firstly, pension fund responses to ShareAction's 'carbon bubble' e-action which enabled pension fund members to email their fund about climate risks (launched in April); secondly, information gathered by a ShareAction questionnaire sent to the UK's 24 largest occupational pension funds (of which 18 were responsive) and four of the master trusts emerging as important players in the automatic enrolment sector.

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Attitudes towards climate change

The question of whether or not climate change is considered a 'material risk' to investments was addressed in both the questionnaire and the e-action

Questionnaire

Information from the questionnaire for large occupational pension schemes provides a significant amount of the data in this report. The questionnaire assessed responsible investment performance encompassing a wide range of topics, from how pension funds interact with investment managers, advisors and members, to their understanding of fiduciary duties. A section of the questionnaire covered how pension schemes are addressing the risks and opportunities presented by climate change: this report draws the majority its analysis from these answers. In this sample, there are 22 pension funds: 18 occupational schemes and four master trusts.

E-action responses

The e-action's template email contained information on a report by the Carbon Tracker initiative, Unburnable Carbon: Wasted Capital and Stranded Assets, and asked a series of questions in light of the report's conclusions. Specifically, pension funds were asked:

1. whether they considered climate change a material risk;
2. whether steps were being taken to mitigate the risk; and,
3. on what basis such risk had been assessed.

We have analysed pension fund responses to those questions which were forwarded to ShareAction by fund members. Whilst further information on the sample and methodology is included in the appendices, it is important to note that the sample includes only those replies forwarded to us by members. In total, there are 22 pension funds in this sample including occupational schemes, local authority schemes, and large insurance companies offering group personal pensions and retail pension products.

All pension funds' names have been redacted.

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All four of the master trusts that completed our questionnaire consider climate change a material risk

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E-action responses: is climate change a material risk?

15 out of 22 (or almost 70%) of the UK's largest occupational pension funds report that they consider climate change a material risk to their assets. This leaves seven remaining pension funds (over 30%) which state that they do not.

All four of the master trusts that completed our questionnaire consider climate change a material risk. Two offered insightful additional comments:

“Climate change will have far reaching impacts on economies and societies. Pension funds are heavily exposed to carbon intensive assets. If the carbon bubble scenario plays out or if policy is implemented to address climate change we need to have the portfolio positioned in such a way that might limit the impact on portfolio returns.”

“[Our fund] is investing on behalf of people who will retire as late as the 2070s, by which time many of the anticipated stresses of climate change on our society will be making themselves felt. Add to this the fact that [we] will continue to have a broad exposure to the different sectors of the economy and that [we are] required to offer low-risk products mean that the retirement incomes of [our] beneficiaries are strongly correlated to the fortunes of the economy itself.”

These new master trusts consider more complex, systemic interpretations of climate change, a process endorsed by a recent Law Commission consultation paper which asserts that pension funds are “universal owners” and “should consider, in general terms, whether they will take account of macroeconomic factors in their decision-making.” Some pension fund views of climate risks were simpler and less systemic in nature:

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“We do view climate change as a risk and include this topic in our meetings with investment managers but would not view this as more significant than any other environmental risk.”

“Environmental and social issues affect all companies differently. For some they present a constraint, whereas for others they represent an opportunity.”

The largest local authority funds responding to the questionnaire all acknowledged climate change’s materiality. However, the e-action responses suggest that smaller local authority funds do not have the same interpretation of climate risks.

Furthermore, it is intriguing to note that 3 out of the 4 banking sector pension funds do not consider climate change a material risk.

Those pension funds which do not view climate change as a risk offered little explanation. One such pension fund simply stated that *“the Trustee does not have a formal view on the matter”* whilst another said *“I don’t have an opinion”*.

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We certainly agree that climate change does pose risks and opportunities for long-term asset owners such as pension funds and we take a very deep interest in the financial and economic effects of climate change.

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Responses to fund members: is climate change a material risk?

Overall, 7 out of the 22 pension funds in this sample of e-action responses indicated that they do consider climate change a material risk. A particularly clear articulation of this is demonstrated here:

“We certainly agree that climate change does pose risks and opportunities for long-term asset owners such as pension funds and we take a very deep interest in the financial and economic effects of climate change.”

Out of the eight local authority pension funds for which we have seen responses, the two larger funds demonstrate a clearer understanding of climate risks than the six smaller funds. For example, one of the smaller funds explained that “[the fund] takes no view on climate change, as a risk or otherwise.”

Of the 22 fund responses, seven neglected to answer the opening question on material risk. Failing to address a member query in this way suggests a ‘missing link’ of accountability and communication between trustees and their beneficiaries.

We would argue that funds should respond proactively to concerns raised by the people whose money they manage.

Climate change policy and actions

Climate policy

Despite the fact that almost 70% of the 22 large occupational pension funds we surveyed consider climate change a material risk to investments, just one such fund was able to provide evidence of a climate change policy. In five other cases, pension funds stated that they do have such a policy; however, they did not provide solid evidence of it. These funds would point to their broader responsible investment policies which mention 'environmental issues' though not climate change explicitly.

Climate actions

The questionnaire prompted pension funds to disclose their current and future approaches to managing the risks and opportunities associated with climate change and those of their asset managers. Below is the information gathered from this section of the questionnaire.

Investor dialogue with companies

	Undertakes at present	Plans to undertake in the future	No plans to undertake	Total respondents
Engaging with fossil fuel companies on the issue of stranded assets	42.86% (9)	9.52% (2)	47.61% (10)	21
Engaging with other companies to reduce carbon intensity and/or increase energy efficiency	52.38% (11)	9.52% (2)	38.10% (8)	21

Overall, this information conveys a fairly even split between those pension funds that are actively engaging with companies on the issues of stranded assets and carbon emissions, and those with no plans to do so. Over half of the pension funds that are engaging, or plan to engage in the future, are either master trusts or large local authority pension funds. One local authority pension fund explains its reasoning in this regard:

"...a key area of manager and company engagement is on the topic of climate change. Climate change can introduce uncertainty and cost to business through direct impact on materials or trade and also through policy measures to tackle the change. Pension Fund investors are obliged to protect their members (sic) investments and we believe engaging with companies and encouraging climate change debate and if possible protective measures to make financial sense."

Reducing pension fund's exposure to holdings likely to be affected by climate change

Reducing exposure to holdings likely to be affected by climate change is not a popular option. Nevertheless, 7 out of 22 surveyed funds have either already reduced exposure to climate-sensitive assets or intend to do so.

	Undertakes at present	Plans to undertake in the future	No plans to undertake	Total respondents
Reducing pension fund's exposure to holdings likely to be affected by climate change	22.73% (5)	9.09% (2)	68.18% (15)	22

Other actions in response to climate change

	Undertakes at present	Plans to undertake in the future	No plans to undertake	Total respondents
Integrating climate risk into investment analysis and decisions	54.55% (12)	27.27% (6)	18.18% (4)	22
Supporting lobbying of policymakers by investors and investor groups on climate change	50% (10)	10% (2)	40% (8)	20
Increasing investment in renewable energy and low carbon alternatives	40.91% (9)	31.82% (7)	27.27% (6)	22

There are some positive findings in the rest of the data provided by the questionnaire. 18 out of 22 respondent pension funds integrate, or plan to integrate, climate risks into investment analysis and decisions.

12 support the lobbying of policymakers by investors on climate change. This suggests that the time is right for the National Association of Pension

Funds (NAPF) to dedicate resources to representing the interests of UK pension funds and their members in domestic and international climate talks and forums.

Encouragingly, 16 out of 22 respondent funds already undertake, or plan to increase, investment in renewable energy and low carbon alternatives.

Responses to pension fund members

None of the e-action respondents mentioned having a climate change policy. In just one case, the response states that a policy is under development; however, no date is given for its completion.

11 of the 22 pension funds whose responses to scheme members we have read cited membership of a collaborative initiative as evidence of commitment to addressing climate change. Initiatives named were the Institutional Investors' Group on Climate Change (IIGCC), the Local Authority Pension Fund Forum (LAPFF), and the Principles for Responsible Investment (PRI).

For smaller pension funds lacking the internal resource, it should be recognised that delegating responsibility to collaborative investor initiatives is an appropriate course of action for engaging with policymakers. However, pension funds have huge potential to take significant action on climate change not only by engaging with policymakers, but also by implementing internal action plans and policies.

Joining such initiatives is therefore no guarantee that portfolio climate risks are well managed. Where funds give this response as their only action, members should not be fully reassured.

Some pension funds did demonstrate additional positive steps taken to manage the risks and opportunities presented by climate change. Six pension funds, for instance, mentioned that they are investing in renewable energy and infrastructure. A major occupational pension fund explains that it is has adopted a *"diversified investment approach" which means it "invests in renewable infrastructure and has holdings in wind farms and solar plants"*.

Three funds also indicated that they have specific funds invested in renewable energy which members can opt in to.

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Three pension funds indicate how company engagement contributes to their climate change response. In one of these cases, a pension fund explained that it has appointed a service provider to *"help us do more in terms of engagements with companies on topics like managing climate change."* The other two funds explained that they have engaged with companies in the oil and gas sector about climate risks, and in one case, the fund gives specific information:

"a member of the RI team visited Royal Dutch Shell's oil sands facility in Alberta to observe how the company was managing its operations, particularly focusing on environmental concerns."

Three e-action responses mention conducting or participating in research, for example, highlighting jointly commissioned research with an academic institution on stranded assets.

The above examples demonstrate that, whilst some specific climate actions are being taken by funds and communicated to their members, these activities are very much in the minority.

Barriers to action

Our findings show that many pension funds are prepared to take climate change seriously, as demonstrated by 70% of our 22 questionnaire respondents reporting that climate change is considered a material risk. However, as only one pension fund respondent to both the questionnaire and the e-action reported a climate-specific policy, there is clearly more to be done. Two possible reasons for this disconnect between climate risk-awareness and climate action is explored below.

An unstable policy environment

A major occupational pension fund with one of the samples' most robust approaches to addressing climate risks explained that it is cautious in committing to low carbon investment because "there is currently significant concern regarding policy stability relating to renewable energy". It adds that the fund *"has a number of investments in clean technology and renewable infrastructure. There is potential for more of such investment if the policy environment improves."* This is echoed by another fund's response: *"we desperately need global agreement on climate change"*.

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12 out of 20 pension fund respondents to the questionnaire stated that they either undertake, or plan to undertake, lobbying of policymakers by investors and investor groups on climate change.

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The concern expressed above is understandable: policies at a national, European and global level will impact the relative competitiveness of high and low carbon assets, and therefore the risk/reward structure of the markets in which pension funds are invested. The lack of policy certainty in this regard, as reflected above, has often been cited as a major barrier to green investment. In this context, it is interesting to note that over a quarter of all respondents to the questionnaire state that they have 'no plans' to begin increasing investment in renewable energy and low carbon alternatives.

Whilst it is clear that a stable policy environment is fundamental for giving certainty to investors, ShareAction has argued that pension funds must not be bystanders in this process. On the contrary, pension funds can be active in shaping the policy environment in the best interests of their beneficiaries. Put simply, by engaging with policymakers on climate change, pension funds can help overcome this barrier of policy uncertainty.

12 out of 20 pension fund respondents to the questionnaire stated that they either undertake, or plan to undertake, lobbying of policymakers by investors and investor groups on climate change. This, however, leaves a significant 8 out of 20 respondents which have 'no plans to undertake' such policy-related actions.

The Institutional Investors Group on Climate Change (IIGCC) provides a means for investors to engage with policymakers on climate change and active membership of this initiative is recommended in ShareAction's recently launched report, *The Green Light Report: resilient portfolios in an uncertain world*. However, only a minority of 20% of respondents to the e-action and questionnaire reported membership of the IIGCC and at the time of writing, the total number signed up from all funds in both samples is fewer than 25%.

Whilst some pension fund respondents demonstrated a concerted effort to engage with policymakers, reporting *"meeting(s) with policy makers in Australia, the UK, and the European Commission,"* such a response was rare. This suggests a tendency for funds to adopt a 'sit and wait' approach to climate change policy, as described by a major occupational pension fund below:

"Clearly significant climate change could have a substantial impact on all aspects of life on earth and as such could affect your savings. It is hard to quantify risk levels and assign probabilities to various outcomes, let alone predict how governments, investment markets, scientists or indeed anyone else will react."

Confusion about fiduciary duties

Interpretations of fiduciary duties can act as an institutional barrier to action on climate change: a narrow interpretation might treat climate change as an ‘ethical’ or ‘extra-financial’ issue and assume that as such, it cannot be considered. This interpretation does not take account of the financial case for managing climate risks in the interests of beneficiaries. The level of uncertainty is illustrated by both the e-action and questionnaire responses. Around a quarter of the e-action responses invoke fiduciary duties; half as a reason for considering climate risks, and half as a reason for the opposite. The following quotation illustrates the latter interpretation:

“The primary aim of the Committee in setting the strategy, is to maximise the value of investments made for the benefit of the many stakeholders... Although the individuals involved in the management of Fund may have different personal views on ethical, sustainability, climate change or political grounds, these must be put to one side in the management of the Fund.”

This view of the law contrasts with the position recently set out by the Law Commission, which confirmed that trustees may consider the environmental impact of their decisions. The Commission stated that “ESG factors are clearly permissible” and that “trustees should consider, in general terms, whether their policy will be to take account of ESG factors in their decision-making”. The divergence between the Commission’s conclusions and some pension funds’ practical application of the law is evidence of significant confusion surrounding trustees’ fiduciary duties.

However, in line with the Law Commission’s position, some pension funds are beginning to consider fiduciary duties as a reason to factor in climate risks: *“In order to protect the assets under management...and in order to meet our fiduciary duty we have started to think about managing climate risks.”*

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We certainly agree that climate change does pose risks and opportunities for long-term asset owners such as pension funds and we take a very deep interest in the financial and economic effects of climate change.

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Conclusion

Clearly, the majority of the UK's largest occupational pension schemes and master trusts are aware of the significance of climate change. In some cases, respondents in our samples demonstrated a firm understanding of climate change as a systemic risk affecting pension fund investments across all asset classes. Whilst the type of funds that take climate change seriously varies, it is notable that the larger local authority fund respondents to our questionnaire, along with the newer master trusts, show particularly strong awareness of climate risks. There are some additional encouraging findings: 70% of respondents currently undertake, or plan to increase, investments in renewable energy and low carbon alternatives.

However, we are still far from an industry consensus on the relevance of climate change to long-term investment success and members' best interests. 30% of the UK's largest schemes have nothing to say or show on the subject. Despite the evident risks posed by climate change, just one pension fund respondent in our samples was able to provide evidence of a distinctive climate policy. It is therefore clear that awareness of climate risks is not yet translating into significant climate action. Furthermore, almost 70% of respondents report no plans to reduce exposure to holdings likely to be affected by climate change. Such lack of action may be due to the two barriers discussed in this report: an unstable policy environment and confusion about fiduciary duties.

Overall, our findings indicate that a more proactive approach to policy engagement and practical steps to embed climate risks into decision-making processes are needed to translate UK pension funds' climate awareness into climate action.

It is important to note that this report has provided a snapshot of the attitudes and relevant action at a particular point in time; mid-2013. Since this evidence was gathered, there have been some signs that pension funds are starting to focus more on climate risk and take more substantive actions. ShareAction launched its Green Light Report in October 2013 which gives insight into the possible, practical ways that pension funds might be able to create climate change-ready portfolios. Moving forward, ShareAction will be closely monitoring progress amongst funds of all sizes in the coming three years.

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Appendices

Appendix 1: sample questionnaire

In August 2013 a questionnaire was sent to the top 25 occupational pension schemes by assets under management as listed in Pension Funds and their Advisers (36th Edition, Wilmington). ShareAction sent it to four of the master trusts emerging as important players in the automatic enrolment sector. It was agreed that one pension fund's structure meant that it should not be included in our survey. We therefore reduced the scope of our survey from 25 to 24 occupational pension schemes. Involved in this report are the pension funds which responded to the questionnaire in full, making the total number in this sample is 22.

Individual funds

Aviva Staff Pension Scheme
BBC Pension Trust
BP Pension Fund
BT Pension Scheme
Greater Manchester Pension Fund
HBOS Final Salary Pension Scheme
HSBC Bank (UK) Pension Scheme
Lloyds TSB Pension Scheme (Number 1 and Number 2)
National Employment Savings Trust
National Grid UK Pension Scheme
New Airways Pension Scheme
NOW: Pensions
The People's Pension
Pension Protection Fund
Railways Pension Funds
The Royal Bank of Scotland Group Pension Fund
Shell Contributory Pension Fund
Smarter Pensions
Strathclyde Pension Fund
Universities Superannuation Scheme
West Yorkshire Pension Fund
West Midlands Pension Fund

E-action Responses

ShareAction knows from its records that the minimum number of emails sent from pension savers to their funds was 593 and that 179 different pension funds were contacted. In total, we received 58 separate replies from pension funds which were forwarded to ShareAction from pension savers. Constituting these 58 replies were 30 separate pension funds. In 8 cases (involving 8 separate pension funds) not enough information was given in the response, for example, the response was a generic acknowledgement of receipt, therefore it was excluded from further analysis.

The sample used in this analysis is therefore constituted of the responses of 22 different pension funds (whilst we received, for instance, 9 separate responses from one single pension fund and 5 from another, exact copies have been collated into one unit). In one case, a pension fund was removed due to it being a non-UK fund. This leaves the total number of pension fund responses involved in the sample at 22.

Individual funds

Aegon
Aviva plc
Aviva Staff Pension Scheme
Bath & North Somerset Council Avon Pension Fund
Dorset County Council Pension Fund
East Riding of Yorkshire Council Pension Fund
Hertfordshire County Council Pension Fund
HSBC staff pension scheme
Legal & General plc
Lilly UK (staff)
The London Borough of Harrow Pension Fund
London Pensions Fund Authority Pension Fund
Merseyside Pension Fund
The Pensions Trust
Prudential plc
Prudential plc Staff Pension scheme
Railways Pensions Trustee Company Pensions Scheme
St. James Place Wealth Management
Trades Union Congress Superannuation Society
Universities Superannuation Scheme
Virgin Money pension scheme
West Yorkshire Pension Fund

Appendix 2: relevant questions from questionnaire:

Q5. Is the pension fund a signatory to the UN Principles for Responsible Investment (UN PRI)?

Q6. Has the pension fund decided to comply with the UK Stewardship Code?

Q11. Does the pension use external managers?

Q12. If yes, in selecting and appointing external managers, does the pension fund:

- Require reporting by the manager on RI and stewardship issues
- Require compliance by the manager with the pension fund's RI position
- Require that the manager is a signatory of UN PRI
- Require compliance by the manager with the UK Stewardship Code

Q14. How does the pension fund monitor its investment

managers' performance on RI and stewardship?

Please tick all applicable.

- Requires to be kept up to date by managers on
- environmental, social and corporate governance
- (ESG) and stewardship issues, e.g. in analysis, research and reports
- Requires meetings with managers to address RI
- issues, e.g. tailored presentations on ESG and-stewardship issues
- Requires updates from managers on voting activities at companies
- Communicates explicit expectations to managers on engagement activity
- Requires managers to report on the effect of engagements on company behaviour

Q22. Does the pension fund think that climate change represents a material risk for its beneficiaries?

Please explain the reasoning behind your answer.

Q23. Does the pension fund have a policy or policies explicitly addressing climate change? If yes, please provide us with either (1) a link in the box below to the policy or (2) a copy of the policy by email...

Q24. If yes, why has the pension fund adopted this policy? Please indicate the importance of each of the possible factors set out below.

- Potential negative impact of climate change on
- quality of present and future members' lives
- Potential financial risks posed by the physical
- effects of climate change
- Potential financial risks posed by regulatory
- action being taken on climate change
- Potential financial opportunities presented by
- climate change

Q25. What is the pension fund's current and planned future approach for it and its service providers to manage the risks and opportunities associated with climate change? Please tick all applicable.

- Engaging with fossil fuel companies on the
- issue of stranded assets
- Engaging with other companies to reduce carbon intensity and / or increase energy efficiency
- Reducing pension fund's exposure to holdings
- likely to be affected by climate change
- Integrating climate risk into investment analysis
- and decisions
- Supporting lobbying of policy makers by investors and investor groups on climate change
- Increasing investment in renewable energy and low carbon alternatives

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