Principles for Responsible Investment

CALL FOR EVIDENCE RESPONSE

WORK & PENSIONS COMMITTEE ON PENSION STEWARDSHIP AND COP26

June 2021

This response represents the view of the PRI Association and not necessarily the views of its individual members.

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THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $100 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to this call for evidence on how pension scheme stewardship can inform—and should be informed by—approaches taken internationally.

ABOUT THIS CALL FOR EVIDENCE

The Committee for Work and Pensions seeks evidence on how the UK Government's approach to pension scheme stewardship can inform, and should be informed by, approaches taken internationally, as well as the role of pension schemes in setting and achieving COP26 targets. This call for evidence also questions whether pension schemes have suitable information to assess climate risk, and how the UK can both lead and learn from international standards and best practice.

The PRI welcomes the opportunity to respond to this call for evidence.

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SUMMARY OF PRI'S RESPONSE

- **Pension schemes need a consistent TCFD-aligned framework for companies and across the investment chain.** The UK provides a roadmap for the much needed and welcomed plan towards mandatory climate-related disclosures for different parts of the investment chain.[1] We note that in their current form, the most recent proposal out for consultation on enhancing climate-related reporting requirements for Public Interest Entities (PIEs) and LLPs[2] from the Department for Business, Energy and Industrial Strategy (BEIS) will not provide the comprehensive and comparable disclosures for market participants, including pension funds, to adequately manage exposure to climate risk. In response, PRI urges BEIS to strengthen their proposals for greater consistency with other UK climate reporting regulation, such as that which has recently been introduced by the Department for Work and Pensions (DWP). This will be vital in providing asset owners and their appointed managers with the necessary level of transparency to conduct due diligence and align pension fund portfolios with COP26 climate goals.
- **Pension schemes that have made an emission reduction commitment should set near term targets and report on progress.** Action in the next five to ten years are critical to deliver mid-century net-zero targets, both for the prospects of future limiting temperature rise and for financial markets. We commend the DWP for incoming regulations on fund disclosure which will provide useful parameters for pension schemes to understand and disclose climate risk.[3] In addition, as a demonstration of leadership ahead of COP26, the Committee could consider means to encourage funds to set interim targets aligned with the UK's sixth carbon budget and ahead of 2050.
- **Pension schemes should participate in collaborative investor-company engagements.** Climate Action 100+[4] is backed by over 540 investors with $52 trillion in assets under management. It offers pension funds the opportunity to share resources with other investors on engaging companies to disclose net-zero transition plans. Collaboration as part of this and other similar initiatives enables pensions funds, through their stewardship activities, to promote companies' strategic alignment with the Paris Agreement objectives, including five, ten and 15 year targets GHG emission reduction targets (Scopes 1, 2 and most relevant scope 3 emissions), as well as capital expenditure plans and accounts aligned with these targets.
- **Pension schemes should participate in the 'Race to Zero' campaign.**[5] Race to Zero is an umbrella campaign that requires members to pledge to reach net zero GHG emissions as soon as possible by setting interim targets and publishing progress against targets. Race to Zero initiatives, such as the UN Asset Owners Alliance (UN AOA) and the Paris Aligned Investment Initiative (PAII) provide pension schemes with a platform for collaborative peer learning, to share

[1] A roadmap towards mandatory climate-related disclosures, HMT, November 2020

[2] Consultation on requiring mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs) BEIS, March 2021

[3] UK brings forward world-leading climate change legislation, DWP press release, 8 June 2021

[4] Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change

[5] Race to Zero is a global campaign to rally leadership and support from organisations and regions to move towards a decarbonised economy ahead of COP26.

tools and best practice that may help inform policymaking. Greater engagement from pension funds on all of these aspects will better enable them in turn to positively engage with and meet key requirements in line with COP26 targets.

RESPONSES TO SPECIFIC QUESTIONS

Q1. How should pension schemes contribute to setting COP26 targets and helping to achieve the targets once agreed?

Pension schemes can make a significant contribution to achieving COP26 targets and can be influential in shaping future targets and policies through engagement in key investor initiatives, such as the UN AOA, which currently includes 5 UK members who collectively represent over £600bn in assets. Thirty-three investors, with $5.1 trillion in assets, had joined the initiative as of the end of 2020. PRI supports the approach set out by the UN-convened Net Zero Asset Owner Alliance target setting protocol which recommends a -16% to -29% emission reduction by 2025 against base year 2019. Members who join the Alliance and issue targets after 2020 may reduce emissions by 5%-pts. per annum in their 2025 sub-portfolio targets. Near-term accountability is essential to realising climate targets within the timeframes required to adequately address these urgent challenges.[6] Action in the next five to ten years matters even more than mid-century net-zero targets, both for the prospects of future limiting temperature rise, and for financial markets. Near term accountability is also important for investors and companies' net-zero plans. The Committee for Work and Pensions should consider policies that provide pension schemes with coherent guidance on climate targets and stewardship duties within a time frame that enables them to effectively plan and implement climate targets in the near-future.

Q5. What regulatory changes or other government action has been most effective in delivering change in the UK; and what changes on the part of Governments elsewhere should the UK learn from?

National policies promoting sustainable finance have developed at an unprecedented rate. There are currently over 650 sustainable finance policies globally, of which 95% have been developed since the year 2000. The PRI identified 124 new or revised policy instruments in 2020,[7] the highest number so far and 32 more than the previous year. However, progress has been uneven among countries. Further international cooperation on best practice sustainable finance policies will be needed to support a rapid and just transition to carbon neutrality. Policies across governments, industrial strategy, businesses and investors need to be aligned and mutually reinforcing for change to be systemic and effective enough to achieve climate goals. As other governments also look to the UK for leadership on climate, it is important that UK government action and regulatory changes are robust

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[6] Policy Briefing: The Road to COP26 outlines the PRI's recommendation that policymakers support ambitious commitments and take decisive action at COP26 to deliver a net-zero economy by 2050

[7] The PRI Regulation Database documents existing and in progress sustainable finance policies around the world

and aligned with achieving COP26 targets. The PRI makes recommendations on aspects of UK policy below.

- **UK Sixth Carbon Budget.** The UK government has displayed notable leadership in being the first government to enshrine the net zero by 2050 target into law,[8] and subsequently in the sixth carbon budget, outlining a 78% reduction in emissions by 2035. This provides stakeholders with clear direction and foresight for planning and adoption. This leadership demonstrated by government on enshrining net zero into law and on the carbon budget can serve as an example for other jurisdictions, and can be further bolstered ahead of COP26, by considering means to encourage funds to set interim targets aligned with the UK's sixth carbon budget and ahead of 2050. This will improve near-term accountability to emissions targets and increase chances of targets being met within necessary timelines. Putting a price on carbon is essential to realising the net-zero transition. A carbon price will also need to be combined with robust policy and regulatory measures, such as Carbon Border Adjustment Mechanisms (CBAMs), to avoid a policy that disproportionally impacts those with lower incomes.[9]
- **Mandatory climate-related disclosures.** Regulations from DWP on mandatory climate disclosures for occupational pension schemes above £5 billion in assets in line with the TCFD framework[10] set detailed expectations for investor disclosures and enhance the availability and comparability of climate data. The TCFD recommendations provide a valuable framework to interpret and integrate on climate-related issues, test the resilience of the pension fund and structure corporate and asset manager engagement on these issues. The PRI welcomes the proposal from the DWP to extend the scope of mandatory climate-related disclosure to smaller pension funds in the coming years. This approach by government on mandatory climate-related disclosures should be encouraged internationally and can be further bolstered by ensuring consistency on climate reporting for companies and the investment chain.
- **The UK Stewardship Code (2020)**. The Code outlines that signatories, including pension funds, should consider environmental and social issues when applying the Code to ensure high-quality stewardship. Three principles specifically outline climate-related considerations to investment and stewardship engagement.[11] The new Code should prove useful in addressing historically poor disclosure on fund voting policies highlighted by the Association of Member Nominated Trustees (AMNT) 2019 report.[12] This report showed that out of all fund managers they surveyed that publicly disclose a voting policy, over half did not have climate change-related policies or guidelines. The leadership demonstrated by the UK on the 2020 Stewardship Code is influencing the development of Codes worldwide. We look forward to seeing the effectiveness of the Code and its impact on disclosures and Stewardship in due course.

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[8] Press release: UK enshrines new target in law to slash emissions by 78% by 2035, April 2021

[9] Policy Briefing: The Road to COP26 outlines the PRI's recommendation that policymakers support ambitious commitments and take decisive action at COP26 to deliver a net-zero economy by 2050

[10] Policy Paper: UK joint regulator and government TCFD Taskforce: Interim Report and Roadmap , November 2019

[11] The UK Stewardship Code 2020

[12] The Association of Member Nominated Trustees Article: AMNT identifies poor transparency in its review of fund manager voting policies and practices as part of complaint to FCA

- **The development of a UK Taxonomy.** The PRI welcomes announcements on the proposed development of a UK Taxonomy which will provide pension funds with a framework to classify and interpret the environmental sustainability of investments, including in relation to climate change, and in turn support pension funds and asset managers in making well-informed investment decisions that are better aligned with COP26 emissions reduction targets. In being the first country to mandate climate targets, the UK has unique strategic advantages as it comes to set its own Taxonomy. In order to harmonise global capital markets reporting standards, consideration of existing taxonomy developments in other jurisdictions may be helpful in delivering a well-aligned UK Taxonomy. The PRI outlines key considerations for developing a taxonomy framework in their policy toolkit guide.[13]

Q6. Do pension schemes have suitable information to assess climate risk, or do there need to be international reforms to financial reporting?

For climate-related risks and opportunities, the primary framework of reference should be the recommendations of the TCFD. The PRI welcomes a process initiated by the IFRS Foundation (IFRS)[14] to build on the TCFD framework and establish a new board for setting sustainability reporting standards that meet the needs of the capital markets.

The lack of high quality, relevant and comparable corporate sustainability data remains one of the central challenges faced by investors seeking to integrate sustainability risks into their processes, and increase their contribution to sustainability outcomes, such as alignment with net zero targets. Corporate sustainability reporting is critical to the ability of investors to take into consideration material environmental, social and governance (ESG) risks and opportunities, and increasingly important to understand corporate and investor activity in meeting sustainability goals. A global set of sustainability reporting standards, widely supported and endorsed by public and private stakeholders, would be a significant step towards achieving this.

The PRI supports the IFRS Foundation in expanding its standard-setting activities and playing a role in setting sustainability standards. The globally established status of the IFRS, its robust governance structure and extensive network could give a significant impulse to standardisation of sustainability reporting standards on a global level.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of the Work and Pensions Committee to increase focus on transparency and disclosure around climate-related targets in the UK. Any question or comments can be sent to policy@unpri.org.

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[13] The PRI's A toolkit for sustainable investment policy and regulation (part 1)

[14] More on the IFRS Foundation and their work.