Give Me an 'E', Give Me an 'S', Give Me a 'G'!

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Environmental, Social and Governance (ESG) is never out of the news for long. With manifestos from the Lib Dems and Labour containing pledges around pension funds being required to align with the Paris Agreement goals, and the Green Party's manifesto containing a pledge to require the removal of fossil fuel assets from investment portfolios, now seems like a good time to recap some of the latest ESG developments for pension trustees.

Firstly, what has The Pensions Regulator (TPR) been doing on the ESG front? It has recently completed its second review of TCFD reports and took a sample of 30 reports that had been prepared in the last year. These are the reports that trustees of pension schemes with assets of £1 billion or more, along with authorised master trusts and authorised collective defined contribution schemes, are required to produce once a year as part of their scheme accounts. These reports must be published within seven months of the end of the scheme year. There is more to the requirements, however, than just producing a report. Trustees that are caught by the requirements must establish and maintain, on an ongoing basis, suitable processes to enable them to identify, assess and manage climate-related risks and opportunities that are relevant to their scheme. Trustees must also have an appropriate level of knowledge and understanding to be able to do this. One of the ways in which TPR measures this, is by assessing whether the TCFD report is written in a way that pension scheme members are able to understand. Trustees that are subject to the TCFD requirements must undertake scenario analysis to understand the impact on, and resilience of, pension scheme assets where there is an increase in the global average temperature. TPR notes in its latest review that this can be problematic. When trustees addressed the "hot house" world scenario in their TCFD reports (i.e. where temperature rises are well over two degrees Celsius), TPR noted that there were significantly varying results. The trustees of one defined benefit (DB) scheme estimated this would result in a reduction of over 40% in projected funding levels, while four other sets of trustees found that there would be a positive impact under this scenario because liabilities would fall more than assets. TPR's review contains useful recommendations and suggestions for the preparation of future TCFD reports. It also notes that it would be good practice for all trustees to comply with the TCFD requirements so far as appropriate for their schemes.

Next, let's take a look at what the government has been doing on the ESG front. Last month, the government published an implementation update on sustainability disclosure requirements. This includes a timeline for the latest sustainability developments that the government has introduced, or plans to introduce (general election permitting!). The update notes that the Financial Conduct Authority's (FCA) anti-greenwashing rules came into force on 31 May 2024, along with its anti-greenwashing guidance. The government has said that it will consult on a UK Green Taxonomy (i.e. a framework to assess whether an investment is environmentally sustainable) during the course of 2024, and that it will consult on requirements for the UK's largest companies to disclose their climate change transition plans during Q2 of 2024. Whether these initiatives will now happen remains to be seen. Into next year, UK sustainability reporting standards are expected to be available, and the FCA will consult on sustainability reporting disclosure requirements for UK listed companies, during Q1 of 2025. The government has said that it will then decide during Q2 of 2025 on the extent to which sustainability reporting disclosure requirements will apply to companies not falling within the FCA's remit. All of these measures should assist pension trustees when assessing the sustainability of any particular investment. Of course, a new government might adopt a different approach and/or timeframe.

Another development from the government, which seems to have gone under the radar so far as the pensions press is concerned, is a statement relating to defence spending and ESG investing. Back in July 2022, the government published its response to a call for evidence in relation to consideration of social risks and opportunities by occupational pension schemes. It recognised that in considering the 'S' in ESG, investment in defence companies was normally shunned by pension trustees but noted that times are changing, and it went on to say that "*the government will be providing further guidance on defence industry matters in due course*". Fast forward to April 2024, and the government has published its policy paper on defending Britain, in which it said that it would boost UK spending on defence by 2030-31 to £87 billion, representing an increase of £23 billion on what the government expects to spend in 2024-25. It also went on to say:

"*We will also take action to boost private sector investment in defence suppliers by confirming that ESG (Environmental, Social, Governance) considerations are compatible with investment in our defence industry. A joint HM Government and ADS Taskforce has been set up to assess ESG and defence investment and support further work to ensure that our defence industry has the access to capital that it needs. ESG investment has a role to play, including in supporting the green transition, but must not reduce access to capital for our vital defence industry. The ability to defend our country is one of the most important social considerations investors should have in mind when they are allocating their capital*."

This was followed by a joint statement made by HM Treasury and the Investment Management Association:

"Investing in defence companies contributes to our national security, defends the civil liberties we all enjoy, while delivering long-term returns for pensions funds and retail investors.

That is why the UK's world leading investment management industry supports our defence sector, with the Investment Association's members having invested £35 billion in UK defence companies.

Investing in good, high-quality, well-run defence companies is compatible with ESG considerations as long-term sustainable investment is about helping all sectors and all companies in the economy succeed."

While the government has concluded that investing in defence companies is compatible with ESG considerations, trustees should make their own assessment as to what is, and is not, an appropriate investment for their pension fund in line with their own ESG policy. The general point made by the statement, however, is worthy of note – ESG considerations do not remain static from one year to the next. Trustees should therefore keep their ESG policy under regular review.

What other government initiatives are currently underway? Pensions Minister, Paul Maynard, has said that the government is holding roundtable sessions this month to help the government further clarify pension trustees' fiduciary duties (assuming a future government would take this forward). The roundtables were first announced in the Green Finance Strategy 2023, and they follow on neatly from a call for evidence that the government ran in the second half of 2023 in connection with trustees' skills and capabilities. The government's response to that call for evidence noted that "*the majority of respondents agreed that fiduciary duties are a well-established and well-understood concept by both professional and lay trustees, and that any policy intervention from government to change fiduciary duty would be undesirable*". However, it did go on to note that some respondents felt that there was a lack of clarity around how trustees' fiduciary duties interact with sustainability and climate-change considerations. Earlier this year, the Financial Markets Law Committee published a paper in relation to fiduciary duties in the context of sustainability and climate change. The paper is a useful resource for pension trustees, both in the context of sustainability and fiduciary duties generally.

We haven't even touched on the work and recommendations of the UK Transition Plan Taskforce, the Taskforce for Nature-related Financial Disclosures, the Taskforce for Social Factors and the soon to be Taskforce on Inequality and Social-related Financial Disclosures (TISFD)), or on stewardship issues. The latest guide from the SPP is a good starting point in relation to the latter. It takes a look at ESG obligations on asset managers, and sets out how pension trustees can engage effectively with their asset managers.

Finally, a reminder for trustees of schemes with 100 or more members – do not forget to ensure that your latest implementation statement has been published online in a manner that is accessible to all, not just on a private portal for pension scheme members. Diarise each year to check that your implementation statement has been published within seven months of your scheme year end. Schemes that have a 31 December year end will shortly need to publish a new implementation statement – by 31 July. TPR will no doubt continue to do spot checks to make sure that schemes have uploaded their latest implementation statement. TPR has the power to fine trustees between £2,500 and £5,000 for failure to upload the most recent statement. Remember, too, that this is a personal fine – it cannot be paid out of scheme funds. The DWP has said that it will also be undertaking a review of implementation statements to ensure that they comply with regulations and statutory guidance.

Trustees are facing a mountain of compliance requirements, not only in relation to ESG. For further resources, both ESG-related and pensions generally, please visit our pensions thought leadership library.

If you would like any assistance, please get in touch with your usual SPB contact. In the meantime, pension trustees, we will be cheering you on from the sidelines!