XPS Investment

Investment Briefing

November 2021

What happened at COP26 and what does it mean for pension scheme investments?

In brief

- World leaders met in Glasgow at COP26 and agreed a range of pledges which aim to limit global temperature rises.
- Ultimately, the pledges do not go far enough and more action is required to tackle climate change. However, material change is still expected given the increased attention and focus as a result of the conference.
- Schemes must consider the long-term viability of their investments and be proactive as new investment opportunities arise.

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COP26 drew to a close on Saturday 13th November, a day later than scheduled, as delegates from 197 countries pushed to finalise a deal which aims to limit global warming and accelerate the shift of the world's economies to a greener future. But what is in the deal, known as the 'Glasgow Climate Pact', and what does it mean for pension schemes?

What was COP26 and what happened?

The 2015 Paris Agreement set the goal of limiting the global temperature rise to 2 degrees above pre-industrial levels whilst pursuing efforts to limit the increase to 1.5 degrees. COP26 had the purpose of agreeing and outlining the pledges to ensure the global temperature rise aligns to the Paris Agreement, often phrased by delegates as 'keeping 1.5 degrees alive'. Below provides a brief overview of some of the key commitments and outcomes.

New commitments

India, the world's third biggest emitter, announced a target to reach net zero emissions by 2070, 20 years later than required. China disappointed by not unveiling new pledges – China had already announced emissions would peak prior to 2030 and reach net zero by 2060, whilst also stopping the funding of new coal plants outside of China, but many feel China must do more as the world's biggest emitter. However, they announced a deal to strengthen their dialogue on climate action with the US, a welcome sign of cooperation after a strained relationship recently.

Explicit reference to reducing coal

For the first time in a climate deal, reference to reducing the use of coal was included. The original wording stated coal should be "phased out" but India and China, who both rely heavily on coal, replaced this with "phased down". This caused outcry from several countries and a call from COP26 President Alok Sharma to "explain themselves".

Commitment to reduce methane

Over 100 countries committed to the Global Methane Pledge which aims to reduce global methane emissions by at least 30% from 2020 levels by 2030. Methane is less prevalent in our atmosphere than carbon dioxide but has a significantly higher global warming potential. It is estimated that the cut could lower temperatures by 0.2 degrees.

Ending deforestation

Over 100 countries, representing 85% of forest cover, committed to end deforestation and reverse land degradation by 2030. More than £14bn of government and private sector financing was committed. After agreeing to the deal, Indonesia's environmental minister criticised it, saying it was "inappropriate and unfair" given Indonesia's need to focus on their development.

Loss and damage

A notable omission was the lack of commitment to fund payments to countries most exposed to climate change to help them cope with the effects. Developing nations put the proposal forward but it was rejected as some developed nations pushed back.

It's estimated that global temperatures are already 1.1 degrees warmer than pre-industrial times. The commitments resulting from COP26 are estimated to lead to warming of 2.4 degrees. More action must follow.

The Glasgow Financial Alliance for Net Zero

The alliance, led by Mark Carney, consists of more than 450 financial firms across 45 countries with $130 trillion in assets under management. Members are required to transition their portfolios in line with the Paris Agreement and are being encouraged to align to 1.5 degrees.

Rules agreed on carbon credit trading

Governments agreed "Article 6" rules for how companies and countries can trade carbon-emissions credits creating increased scope for capital to flow towards carbon reduction programs. However, concerns remain on the quality of some eligible legacy carbon credits.

What comes next and what does it mean for pension schemes?

- Amid the frustration of the watered down wording surrounding coal, and the assertion that the pledges and commitments do not go far enough, the increased attention given to climate change as a result of COP26 is still expected to bring material change.
- There will be increased awareness, scrutiny and government intervention as a result of the Glasgow Climate Pact which will continue beyond COP26 – countries are committed to "revisit and strengthen" their 2030 targets by the end of 2022, for example.
- New investment opportunities will arise as countries and businesses get to grips with the action they need to take to achieve current (and future) commitments.
- Sponsor's will be impacted by climate change and the transition to a cleaner planet. Sponsors may also be affected by the Treasury's announcement prior to COP26 that UK-registered companies with more than 500 employees and turnover exceeding £500m will need to report against Taskforce for Climate Related Financial Disclosures (TCFD) from April 2022. As companies report on their activities they are likely to give greater consideration to how they can change their activities and their climate impact. This may result in greater engagement and scrutiny of their pension schemes' approach.
- Regulation affecting schemes will continue. TCFD is already here for very large schemes and coming in October 2022 for schemes over £1bn. Prior to COP26, the UK government unveiled its 'Roadmap to Sustainable Investing' including the Sustainability Disclosure Requirements (SDR) whilst the UK Green Taxonomy and TPR's new Single Code of Practice is coming soon.

It is therefore vital that pension schemes and investment managers are considering the long-term viability of their investments. Trustees have a fiduciary duty to act in the interests of members and tacking climate change is in members' interests. Trustees looking to take a lead on climate change can use the XPS Sustainable Designation to help choose funds which are aligned to a more sustainable approach in a variety of ways, including having a positive environmental impact.

Next steps for pension scheme trustees

Trustees need to be actively considering these issues as climate change is hot on their heels. The following approach is a good start:

1. Discuss and establish your scheme's **ESG beliefs and priorities** using our free beliefs survey.
2. Seek to fully understand ESG and climate risks and **how they relate to your scheme**. Undertake training to fill any gaps in understanding.
3. **Review your current investments** against your policy.
4. Engage with managers that are **underperforming** your ESG expectations.
5. Make changes to reflect **your objectives**.
6. **Consider the use of sustainable funds** which specifically seek to tilt towards sustainable strategies with high degrees of stewardship and engagement.

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Professional Pensions UK Pensions Awards 2019 – Winner – Third Party Administrator of the Year

Professional Pensions UK Pensions Awards 2019 – Winner – Actuarial/Pensions Consultancy of the Year

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