Feature Article

From 'Not Sure' to 'Net Zero' in four steps

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For pension schemes, net zero typically means an investment strategy which targets nil net greenhouse gas (GHG) emissions from the portfolio by a certain point in time (often 2050). A net zero scheme can still hold GHG-emitting assets, but these need to be balanced with other assets that offset the emissions, for example through carbon capture.

Back in October I was honoured to take part in a panel about net zero at the PMI's inaugural Northern Conference in Leeds. It was a great discussion with a highly engaged audience from across the industry, and it got me thinking about what the key steps might be for a scheme's net zero journey. As a lawyer, I think there are four:

1. Duties

A net zero strategy must be consistent with legal duties for investing scheme assets, otherwise there will be a clear risk of successful legal challenge. I would suggest that net zero can be lawful where it is supported by careful judgment and reasoning. There needs to be a positive investment case that net zero supports the fundamental goal of investing to provide members' benefits over time. For schemes covered by climate governance (TCFD) regulations there is an even more direct legal imperative. Here, a target is expressly required, and Government comply-or-explain guidance says that net zero by 2050 is not enough on its own: these schemes will also need milestone targets along the way.

As I said at the conference, fundamentally this is about 'enlightened self-interest' on the part of each scheme. As the panel also discussed, it can be important to consider whether assets that contribute to net zero might have other negative knock-on effects or financial risks (such as those associated with environmental degradation or exploitation of labour arising from a 'green' business extracting precious metals for its products).

2. Data

Data is a prerequisite for understanding scheme assets' GHG emissions. There are known practical challenges here, and some assumptions may be needed at present. But, as we noted on the panel, industry practice and regulations will increasingly promote emissions data disclosures across the economy, and so reporting is expected to improve.

3. Disclosures

Net zero commitments are often publicly disclosable in legal policy statements or annual reports. It is therefore sensible for schemes to work on the basis that they will be strongly publicly accountable for what they say about net zero. It can help to be both clear and realistic about what a scheme intends to do, by when, and what level of commitment is being given.

4. Developments

Science and economics are still developing, and we are all learning in real time. The shifting sands of the current UK Government's net zero policies might be a new cause of concern for some but, I would suggest, seem unlikely to change the fundamental direction of travel in the global investment markets that pension schemes operate in. But it does make good sense for schemes to keep net zero policies under regular review, and to be clear about this with their stakeholders. That way, there should be nothing inherently wrong or reputationally damaging about evolving a scheme's net zero approach where new information comes to light.