

Spotlight on Pensions



PRESENTS

Le Grand View

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Getting the right shade of green

Going green is a key theme in all aspects of life now. The movement is given a boost by each UN Conference of the Parties (COP). The latest, number 26, held in Glasgow has moved the issue on with ambitious new promises from most nations.

But despite that, the battle is far from won – in fact it has barely begun. Despite the obvious need for all to participate fully, some parties are still dragging their feet in order to gain an advantage at the expense of the majority by avoiding some or all of the disruption and transition costs from greening. Even those with the best intentions can have their efforts undermined through a lack of appropriate focus – an easy result given the complexity of the subject. This all makes life more difficult for those seeking to make a meaningful green impact.

Pension schemes' contributions

Pension schemes are already, quite rightly given their financial influence, involved in active pursuance of green policies. They are increasingly expected to lead by example. Most understand that failure to make the necessary changes not only harms the planet, but on an individual level increases the risks to investment security. Following pressure from government and members alike, the green agenda now forms a significant and growing part of the investment process of most schemes. Increasing legal obligations are weaponising schemes to influence businesses through investment strategies.

From October 2021 a new extensive set of obligations on schemes is being phased in (see [The Occupational Pension Schemes \(Climate Change Governance and Reporting\) Regulations 2021](#)), with more to come. The Pensions Regulator has also recently criticised what it regards as unduly slow progress being made by schemes overall, further increasing pressure to comply with the spirit as well as the letter of the law. For pension schemes there is no alternative but to get involved – and to support effective solutions.

Just "follow the science"?

The principles may be clear, but the details of how greening is to be implemented in everyday situations throw up immense challenges. The issue should rightly be driven by science, but the science is complex and sometimes conflicting. In many ways the issue is like pensions regulations, in that the multiple aspects of the subject result in various strands that are extensively intertwined. A positive amendment to one may well result in an unintended negative impact upon another. In extremis the negative may outweigh the positive.

As investors, pension schemes will want to ensure that the efforts they make to identify and back green solutions for the planet's climate woes are not only worth the effort, but also actually achieve the positive effects "on the ground" being sought. The issue of greenwashing and the need to avoid being misled is well understood, with for example increased scrutiny of the true green credentials of carbon credits. More widely, obtaining accurate data to avoid unintentionally making poor decisions is essential.

Accurate data is essential

The availability of accurate and transparent information across the board is not currently to the required standard. Nevertheless, even with the benefit of full information, the challenge facing investors in creating a portfolio which manages to be truly green in its impact, without imposing unnecessary disruption and cost upon businesses, individuals, or society generally, is immense. The complexity of the subject and - owing to the delayed response to the threat by mankind - the speed with which changes must be made if the planet is to escape catastrophic damage, makes identifying and implementing the most effective solutions a daunting task.

The siren call of the simple solution

Picking just one example, an issue currently receiving widespread attention – motor vehicles, and in particular private cars - illustrates the breadth of the challenges ahead. There is naturally a desire for an easily understood solution to address the problems of carbon and air pollution from motor vehicles. However, that can lead to a blinkered approach focused on just one superficial aspect of the problem – in this case the output from vehicle exhausts. This narrow focus fails to identify – or simply ignores - other related issues with their own negative impacts.

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An official statement from COP 26 identifies the need for “zero-emission vehicles”, noting that “some of the largest car manufacturers [are] working together to make all new car sales zero emission by 2040 and by 2035 in leading markets”. What that statement hides is that governments, followed by the media and the general public have largely interpreted the term “zero-emission vehicles” unduly narrowly to mean electric vehicles. However, there are other viable options which may provide more appropriate solutions but which could be overlooked in the dash for electric.

...but the simple solution can misdirect

But does this really matter, if a viable solution is being pursued? The answer is “Yes”. Every change generates a cost, financial and otherwise, with both direct and indirect implications for investors. Some of those costs are obvious, but in this example the narrow focus on electric vehicles as the sole solution diverts attention away from consideration of wider related issues. Examples include:

- Batteries use precious resources which are finite and will be rapidly exhausted if most vehicles across the globe become battery-powered. The situation will be exacerbated by the ever-growing demand for batteries to power other everyday items. Rechargeable batteries lose their effectiveness over time and need to be replaced regularly and there are significant pollution implications in their disposal. Although future technology may provide solutions to at least some of these problems, that will take time and a blinkered focus on battery power threatens significant damage in the meantime.
- In order to support the new national fleet of electric vehicles, a vast new infrastructure of charging facilities will be needed. The cost, in terms of carbon footprint as well as financial, of creating that new infrastructure is staggering.
- Currently the supply chains involved to bring together components to construct electric vehicles are particularly long. Plans to build a large number of new battery factories in proximity to car assembly plants will help, but they will generate their own new carbon footprint - and the necessary raw materials will still need to be delivered to them. They therefore will not be a green-only process.
- Switching the national car fleet to mainly electric will involve the complete replacement of most vehicles, as the technology involved cannot easily be retrofitted to existing vehicles. The resultant scrapping of most of the existing car fleet will have its own carbon and pollution implications.

Work is currently progressing on adapting existing internal combustion engines to run on alternative fuels such as hydrogen, also meeting the “zero-emission” objective. There are several possible technical options to achieving this. Some will allow existing engines to be adapted rather than replaced and require less new infrastructure than that required to support widespread electrification. Issues around the production of sufficient amounts of hydrogen without further contributing to global warming (a concern which previously threatened to undermine the viability of its widespread use) are also being addressed.

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Deeper thought required

Deciding whether or not this is a “better” option for the planet than electric vehicles involves detailed assessment. The answer may be that there are good reasons for following both paths to some extent. But whatever the conclusion, this one example illustrates the complexity inherent in the green agenda, and the ease with which investors and others may be misled into believing that a particular strategy will necessarily best deliver the desired outcomes.

Getting to grips with the green agenda is unlikely to be achieved through the pursuit of a few superficial solutions. One such enjoying popular support is tree planting to “offset” carbon emissions. Again, this is widely promoted as an undisputed green tool with minimal negative consequences. However, a simplistic approach of just planting millions of new saplings ignores important related issues including:

- the harmful impact on other aspects of the environment from planting unsuitable trees in unsuitable locations,
- the need to nurture them to avoid premature death and to manage them once established, and
- the fact that they will take many years to grow to a sufficient size to absorb significant amounts of carbon from the atmosphere.

Climate scientists have identified that wetlands are far more effective at carbon capture. But again, the understandable temptation to seek out a few simplistic solutions risks overlooking alternatives which may give better outcomes.

No easy task

The challenge for pension schemes will be to craft and implement a truly green investment strategy - not just following the letter of the law. This is expected from the leadership role that has been imposed upon them. Achieving this whilst also complying with mushrooming new regulations in other areas such as governance will be a tough ask.

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