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Pensions in a Warming World

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Introduction

Pension schemes sit at the intersection of long-term capital allocation and long-term societal change. Few forces will shape both as profoundly in the coming decades as climate change.

This paper does not rehearse the now well established case for why climate change is financially material, nor does it attempt to prescribe uniform actions across all schemes. Instead, it focuses on how climate risk is interpreted, governed and acted upon in practice, given real world constraints facing pension schemes today.

Different climate pathways imply materially different financial futures. The transition to a low-carbon economy will shape inflation, productivity, asset valuations and the stability of retirement incomes. Increasing physical impacts are already testing assumptions embedded in long-term strategies. For UK pension schemes, this raises questions about time horizons, resilience and intergenerational fairness, as well as governance capacity, data quality and the limits of current modelling.

This paper therefore sets out the impact on different scheme types, how these pathways may translate into investment outcomes and explores the implications for governance, regulation and policy. Rather than seeking to resolve the debate on its own, this paper clarifies the choices confronting policymakers, regulators, trustees and the wider industry supporting a more informed debate for the pensions industry to navigate a warming world and achieve "good outcomes" under uncertainty.

Economic Evidence: What Climate Pathways Mean for Returns

Climate change is not just an environmental concern; it is a governance issue with direct financial implications for UK pension schemes. The way economies respond to climate change will influence growth, inflation, public finances and asset valuations over time. For pension schemes, this ultimately affects funding positions, contribution requirements and the ability to deliver expected retirement outcomes.

There is no credible future in which climate change has no financial consequences. The more relevant question for decisionmakers is how different climate outcomes translate into risk, resilience and decision making challenges for long term investors, and how these risks are governed in practice.

How climate risk shows up in investment portfolios

From a trustee perspective, climate-related risks typically enter portfolios through two broad channels:

Transition risks
These arise from changes in policy, regulation, technology and behaviour as economies adjust. Such changes can alter cash flows, asset prices and credit quality, particularly where business models depend heavily on high emissions or carbon intensive activity.

Physical risks
These reflect the real world impacts of climate change, including extreme weather, heat stress and rising sea levels. Physical risks can damage assets directly, disrupt supply chains, affect labour productivity and place pressure on insurers, governments and infrastructure providers.

Neither category is confined to a small subset of "climate exposed" assets. Over time, they affect the overall functioning of the economy and financial system, which is why they are relevant at a strategic and governance level.

Where decisionmakers are operating today

Current global policies imply a level of warming that is widely regarded as inconsistent with long term climate stability. In the near term, this has not prevented certain sectors (particularly fossil fuel related activities) from remaining profitable. For pension schemes focused on near term funding or cash flows, this can create a sense that climate risks are distant or manageable.

However, this apparent stability can be misleading. Signs of strain are already visible in areas such as insurance availability, property markets and government finances in more vulnerable regions. Importantly, many economic and financial models still assume relatively smooth transitions and may understate the likelihood of disruptive adjustment, policy shocks or compounding physical impacts.

Decisionmakers are increasingly navigating climate decisions in a politicised environment, where long-term financial risk is often conflated with short-term political narratives. This creates governance risk in its own right, requiring clear decision-making records and disciplined framing of objectives.

For decisionmakers, the governance challenge lies not in choosing a "correct" model, but in recognising the limits of foresight and ensuring that decisions remain robust across a wide range of outcomes.

Climate pathways as governance lenses, not forecasts

Rather than precise predictions, it is useful to think about climate pathways as broad lenses for stress testing governance and strategy.

1. Earlier and more coordinated action

Under this pathway, governments act sooner and with greater alignment.

- In the near term, costs rise as companies and economies invest in new systems, leading to pressure on some business models and asset prices.
- Over time, the economy becomes less exposed to energy price shocks and policy uncertainty, and investment outcomes depend increasingly on capital allocation and company fundamentals rather than structural imbalances.

From a governance perspective, this pathway poses short term challenges but longer term benefits. Decisionmakers may need to manage near term volatility and distributional effects while maintaining focus on long term resilience.

2. Delayed and abrupt adjustment

Here, action is postponed and then introduced more suddenly.

- Markets may experience sharp repricing as policy and regulation catch up.
- Volatility increases across asset classes, and transition costs are higher because adjustments are less efficient.
- Physical climate risks continue to accumulate during the delay.

This is a particularly difficult environment for pension schemes. Sudden shocks can interact with funding levels, liquidity needs and covenant strength. Governance resilience, clear decision making, diversification and risk management, becomes critical.

Earlier action tends to involve near term costs but supports greater stability over time, while delay or inaction increases volatility and the risk of irreversible damage.

3. Limited action and rising physical stress

In this pathway, climate action remains weak and physical impacts intensify.

- In the earlier stages, returns may appear resilient as existing economic structures persist.
- Over time, physical damage, productivity losses and fiscal pressures weigh increasingly on growth and asset values.

Beyond a certain point, risks become systemic rather than diversifiable, affecting multiple asset classes at once. For decisionmakers, this raises fundamental questions about long term return expectations and the limits of traditional risk management tools.

What this means for decisionmakers

Several governance relevant conclusions emerge:

- Delaying climate risk considerations can increase exposure to more abrupt or disorderly outcomes.
- Climate risk is economy wide, not confined to a small group of assets or sectors.
- Periods of apparent market calm do not necessarily mean risks are understood or fully priced.
- Standard models and disclosures are helpful inputs but cannot remove judgement from trustee decision making.

Different climate pathways imply very different challenges for funding, liquidity and long term outcomes. Earlier action tends to involve near term costs but supports greater stability over time, while delay or inaction increases volatility and the risk of irreversible damage.

For pension schemes, the central task is therefore not to predict the future climate precisely, but to govern uncertainty effectively, embedding climate considerations into long term strategy in a way that is consistent with fiduciary duties and scheme objectives, and that supports financial security in retirement over decades rather than years.

Broader Implications of Climate Change for Pension Schemes

Climate change is not a discrete environmental issue sitting outside mainstream pension governance. It is a systemic economic and financial issue that affects the conditions in which pension promises are funded, invested and paid. For pension schemes, its relevance extends beyond investment performance alone. It can affect sponsor strength, inflation and interest rates, insurance markets, member outcomes, public finances, and the wider regulatory and political environment in which decisionmakers operate.

For long-term investors such as pension schemes, climate change matters because it can alter both the path of economic growth and the distribution of risks across the financial system. These effects may arise through physical disruption, policy and regulatory change, technological transition, litigation, shifts in consumer demand, and changing market perceptions of risk. Some consequences may emerge gradually; others may crystallise abruptly through repricing events, policy shocks or insurance withdrawal.

From a pensions perspective, climate change therefore has several broad implications.

Investment outcomes

Climate change can affect expected returns, volatility, inflation sensitivity and correlations across asset classes. Transition risks may affect sectors differently and reprice unevenly across listed and private markets. Physical risks may impair infrastructure, real estate, supply chains and productivity, with consequences that are not always captured well in conventional portfolio models. These effects are relevant not only to schemes pursuing growth, but also to those focused on matching, endgame or insurance transactions.

Funding and liabilities

For DB schemes, climate-related macroeconomic change can affect discount rates, inflation assumptions, asset values and the affordability of different journey-plan options. In principle, climate change may also influence mortality and life expectancy assumptions, although the direction and scale of those effects remain uncertain and may vary significantly across populations and time horizons.

For DC and CDC schemes, the issue is less about accounting liabilities and more about member outcomes: the value of accumulated savings, the resilience of drawdown or retirement income strategies, and the purchasing power of benefits in a changing economic environment.

Employer strength and covenant reliance

For schemes with employer support, climate change can affect the strength of the sponsor covenant through direct exposure to physical risks, transition pressures, litigation, supply-chain disruption or changing demand patterns. In some cases, climate-related disruption may weaken sponsor resilience before it is fully reflected in conventional financial metrics. This is particularly important where schemes are poorly funded, highly reliant on covenant over a long period, or returning surplus to the sponsor.

Insurance markets, superfunds and endgame planning

Climate risk is increasingly relevant to the affordability, availability and resilience of endgame solutions, including both insurance and superfund consolidation. Physical climate impacts, catastrophe exposure and the repricing of risk in insurance markets may affect bulk annuity pricing and, over time, the economics of buy-in and buy-out transactions. Similar considerations may also influence the pricing, investment strategy and risk appetite of superfunds and other consolidators operating over long time horizons. Decisionmakers do not need insurers or consolidators to eliminate climate risk entirely, but they do need confidence that climate-related risks are being understood and managed in a manner consistent with long-term obligations.

More broadly, endgame does not necessarily mean immediate transfer to insurance. Many schemes, particularly larger and better-funded schemes, are increasingly choosing to run on for longer, whether to improve member outcomes, retain flexibility, generate surplus or await more attractive market conditions. In those circumstances, climate risks become more material to the scheme itself over an extended period, including through investment exposures, funding volatility and the resilience of the employer covenant. The longer a scheme expects to remain exposed to market and sponsor risks, the more likely it is that climate-related factors will have a meaningful effect on outcomes.

Public finances

Climate change also has implications for sovereign balance sheets and public spending. Expenditure on adaptation, resilience and disaster response, alongside weaker growth or revenue volatility, can affect borrowing, inflation and the fiscal environment more broadly. For public sector schemes, and particularly for taxpayers supporting unfunded arrangements, this creates an additional dimension: climate change can influence not only asset values but also the political and fiscal capacity to sustain pension promises.

Governance and decision-making

Perhaps the most important implication is governance-related. Climate change introduces uncertainty that is often long-dated, difficult to quantify and poorly suited to simple optimisation. This places pressure on trustee decision-making frameworks. The central challenge is not to identify a single "correct" climate view, but to ensure that governance structures are robust enough in conditions of uncertainty, constraint and scrutiny.

Scheme Types and Their Specific Considerations

Private Sector Defined Benefit (DB) Schemes

Climate change can be financially material to private sector DB schemes through four main channels: investments, liabilities, employer covenant and the wider financial environment.

On the asset side, climate-related transition and physical risks can affect both the value of holdings and expected future returns. This is relevant across growth portfolios, matching assets and increasingly the private market assets used by many larger schemes. Some transition-related opportunities may arise, but the governance issue for decisionmakers is not simply whether such opportunities exist; it is whether they are relevant to the scheme's objectives, time horizon and risk budget.

On the liability side, climate change may influence assumptions such as inflation and, potentially, mortality, although the latter remains uncertain. In the UK context, one direct example of climate change on health is that milder winters could reduce cold-related deaths, but this may be offset by hotter summers, heat stress and other health effects. The practical implication is not that decisionmakers should rely heavily on speculative longevity adjustments, but that they should recognise climate change as one factor that may increase uncertainty around long-term assumptions.

Whilst much of the focus is, rightly, on considering the financial materiality of climate change in order to ensure the agreed pension payments are made, there is an additional aspect to consider and that is the potential for climate change to be highly inflationary. Where members typically have capped inflationary increases, the inflationary impacts of climate change would reduce the purchasing power of contractual pension payments, and the benefit that pensioners feel when receiving their pension. When considering the best interests of members (and potential expansion of this definition) this is an important element for decisionmakers to bear in mind.

For many DB schemes, however, the most distinctive climate-related issue is the employer covenant. Climate change can affect covenant strength directly through exposure to carbon-intensive business models, physical assets, vulnerable geographies, supply chains or changing regulation. It may also affect covenant resilience indirectly by weakening profitability, increasing capex needs, raising financing costs or increasing legal risk. Where covenant reliance is material and prolonged, these issues become increasingly relevant to integrated risk management.

Climate change may also affect the wider conditions in which DB strategies are implemented. Greater public borrowing related to transition, adaptation or disaster recovery could affect gilt yields, inflation dynamics and macroeconomic volatility. Insurance markets may reprice risk in ways that affect buy-in and buy-out affordability. Regulatory expectations around governance and reporting may also increase cost and complexity, particularly for smaller schemes.

For decisionmakers and sponsors, the practical response should be broad rather than formulaic. Climate change should be considered where relevant within the funding and investment strategy, integrated risk management, covenant assessment and endgame planning

The aim is not to create a parallel climate framework detached from core pension decisions, but to ensure that climate-related issues are incorporated into existing decision-making where financially material.

Covenant Perspective and Sectoral Risks

A defining feature of DB schemes is that members ultimately depend not only on scheme assets, but also on the strength of the sponsor where there is funding reliance. Climate change matters to covenant assessment because it can affect the employer's capacity to support the scheme over time.

The relevance of climate risk to covenant depends heavily on the scheme's reliance on covenant. A well-funded scheme expecting to transfer to an insurer in the near term may take a more proportionate view, although even here climate considerations may still be relevant in assessing insurer resilience and transaction timing. By contrast, a weakly funded scheme with prolonged covenant dependence, or a scheme running on while returning surplus to the employer, may face much greater regret risk if climate-related pressures undermine sponsor strength before benefits are fully secured.

No sponsor or sector is immune. Exposure will vary according to business model, geography, supply chain, customer base, physical asset footprint and regulatory environment. Carbon-intensive sectors may face more obvious transition pressures, while sectors with high physical exposure may be vulnerable to weather disruption, flooding, insurance withdrawal or resource stress. In many cases, the greater risk is not a single dramatic climate event but a gradual erosion of business resilience over time.

There is also a geopolitical dimension. Energy security, commodity shocks and political responses to transition pressures can change quickly and may materially affect sponsors operating in energy-intensive sectors or exposed global value chains.

For decisionmakers, the governance question is not whether covenant analysis should become a climate science exercise. It is whether climate-related stress factors are being considered in a way that is proportionate to the scheme's funding position, journey plan and degree of covenant reliance.

Public Sector DB Schemes and the LGPS

Public sector schemes are exposed to many of the same climate-related risks as other DB arrangements, but their context is shaped by government financing, taxpayer exposure, scale and political visibility.

In unfunded public service schemes, climate change can affect the broader fiscal environment through higher adaptation and disaster-related spending, weaker growth, revenue volatility and macroeconomic disruption. These pressures may intensify scrutiny of pension costs, especially where households are themselves facing the consequences of climate-related price increases or public service strain. This raises questions of affordability and intergenerational fairness, particularly when short-term climate costs and long-term pension promises compete for fiscal attention.

That said, public sector pensions also provide retirement security to workforces that are often directly involved in responding to climate-related pressures across health, emergency services, infrastructure and local government. The issue is therefore not whether such pensions are legitimate, but how climate-related fiscal stress reshapes the context in which they are debated and financed.

The funded LGPS sits somewhat differently. As a very large, open, cashflow-positive long-term investor, it is exposed to climate change both through its role as an asset owner and through its connection to local taxpayers and elected stakeholders. Climate risks affect investment performance through both physical and transition channels, while also creating opportunities in areas such as renewable energy, storage, energy efficiency, adaptation and resilience infrastructure.

Because of its scale, liquidity profile and long horizon, the LGPS is well placed in principle to allocate capital to long-duration climate-related investments. However, that same scale also makes it more visible to policymakers and more exposed to pressure around local investment, productive finance and broader public policy objectives. That creates governance tensions. The LGPS may be capable of supporting climate-related investment where opportunities are suitable, but it cannot be treated as a policy delivery vehicle detached from its core purpose of paying member benefits.

Climate reporting is also particularly significant in the LGPS because of the public nature of its governance. Done well, climate-related reporting can improve transparency around how funding and investment strategies are considering systemic risk. Done badly, it can become an exercise in producing visible narratives without improving decisions. The value of reporting depends on whether it provides meaningful insight into governance, risk management and strategy, rather than simply more disclosure.

Defined Contribution (DC) Schemes

For DC schemes, climate change is relevant primarily through its impact on member outcomes over time. Unlike DB, there is no sponsor standing behind a funding shortfall. The effect of climate-related risks therefore flows more directly through investment performance, retirement timing, sequencing, and the real-world purchasing power of retirement savings.

Physical risks can affect portfolio companies and assets through damage, disruption, resource stress and weaker productivity. Transition risks can affect valuations, sector performance and market structure as policy, technology and consumer preferences evolve. For DC members, these are financially material issues in the same way that inflation, interest rate or market risks are financially material.

2 IFCA, April 2013: https://www.fca.org.uk/publication/occasional-papers/occasional-paper-1.pdf

The long horizon of DC saving makes this especially relevant. Many DC members are invested for decades, and even members approaching retirement may still face long retirement periods in which drawdown strategies remain exposed to market conditions. Climate change is therefore not simply a distant issue for younger savers; it is a factor that may affect the environment into which all members retire.

From a governance standpoint, DC schemes face several particular challenges.

First, there is a tension between long-term systemic risk management and short-term benchmark or peer-relative assessments. Where value-for-money frameworks or commercial comparisons encourage herding, there may be less appetite for differentiated strategies, particularly where those strategies introduce tracking error or require higher governance budgets.

Second, the distribution of outcomes matters. Climate-aware positioning may not affect all cohorts equally at all times. A position that may appear prudent for younger members over decades could have different implications for members approaching retirement if climate repricing is slow or uneven. This does not mean climate risk should be ignored for older cohorts; rather, it means that scheme design, default structure and communications need to be sensitive to intergenerational trade-offs.

Third, fee sensitivity can constrain access to some climate-related opportunities, particularly in private markets where the most direct links to transition or resilience assets may sit. A narrow focus on headline fees can therefore crowd out potentially valuable long-term allocations, although this must be weighed carefully against value, liquidity and implementation constraints.

There is also a member engagement dimension. Climate change is one of the few investment topics that many members recognise and care about. Used carefully, this can help schemes communicate more effectively about long-term saving and investment. However, decisionmakers should be cautious about overstating what climate-related investment choices can achieve or implying that visible climate positioning is a substitute for sound retirement design.

Overall, the governance task for scheme decisionmakers is to integrate climate change as part of prudent long-term investment oversight, while remaining realistic about legal constraints, evidence limits, member heterogeneity and implementation costs.

Collective Defined Contribution (CDC) Schemes

CDC schemes occupy a middle ground between DB and DC, and climate change is therefore transmitted through a different governance and member-outcome mechanism.

As in other long-term arrangements, climate change can affect investment returns through both physical and transition risks. In CDC, however, the consequences of investment performance are reflected collectively in the scheme's ability to deliver target benefit increases. Because benefits are conditional rather than guaranteed, climate-related investment underperformance may translate more directly into lower indexation or benefit adjustments than in DB, while remaining more collectively managed than in DC.

Climate change may also affect demographic assumptions, including longevity, although the direction and scale of those effects remain uncertain. In a CDC structure, unexpected changes in longevity are pooled across the membership and reflected collectively in future outcomes. This makes climate-related uncertainty relevant not only to investment strategy but also to how the scheme communicates variability and risk-sharing to members.

There may also be indirect implications for participating employers, particularly in single-employer CDC designs. Climate-related disruption affecting recruitment, workforce composition or employer viability could alter contribution flows and the balance between active and retired members. These dynamics are less pronounced in broader multi-employer designs, but they still merit attention where employer concentration is material.

At the same time, CDC schemes may be relatively well placed to access long-term, illiquid investment opportunities, including some transition and resilience-related assets, because of their collective design and more stable cashflow characteristics. Compared with some DB schemes, they may also be less constrained by short-term mark-to-market funding volatility. That may support a longer investment horizon, but it does not remove the need for careful governance, member communication and proportionate climate oversight.

For CDC decisionmakers, the key issue is that climate-related risks and opportunities flow through the collective mechanism of the scheme. They are neither fully absorbed by a sponsor nor isolated at the individual member level. That makes governance, communication and stewardship especially important.

Cross-Cutting Challenges

Size, Scale and Resourcing

A major practical challenge across the pensions system is that many schemes remain lightly resourced. Outside the largest DB schemes, master trusts and regulated providers, most occupational pension schemes operate with limited in-house analytical capability and rely heavily on advisers, fiduciary managers and investment managers.

This creates a particular challenge for climate governance. Integrating climate considerations into investment decisions, risk management and reporting can be time-consuming and costly, especially where it relies on external providers. In smaller schemes, this can lead to formulaic or off-the-shelf approaches that satisfy process requirements without necessarily producing decision-useful insight.

Scale can help. Larger asset pools and consolidators may have greater capacity to engage managers, absorb fixed reporting costs, develop stewardship capability and access specialist expertise. Over time, scale may become one of the more practical enablers of more effective climate governance across the pensions sector.

The implication is not that every scheme must build a bespoke climate capability, but that regulatory expectations and industry practices should remain proportionate to governance budgets and real decision-making needs.

Regulatory Disclosures

Climate-related disclosure has become an increasingly important feature of pension governance, particularly for larger schemes subject to mandatory reporting expectations. In principle, better disclosure can support transparency and discipline. In practice, it also creates operational strain.

Schemes often depend on asset managers and pooled funds for data that may be inconsistent, incomplete or based on different methodologies. That makes it difficult to aggregate information and draw reliable conclusions at total-portfolio level. The risk is that decisionmakers devote significant resource to producing reports that are technically compliant but only modestly useful for decision-making.

There is also a broader issue of reporting fatigue. If governance effort is diverted disproportionately towards disclosure production, boards may spend more time documenting climate oversight than actually improving it. For smaller schemes, standardisation, pooled solutions and shared tools may help reduce this burden, but reporting expectations should still be calibrated carefully.

The value of climate-related disclosures should therefore be judged not only by their completeness, but by whether they improve risk understanding, manager oversight and strategic decisions.

Data, Transparency and Private Markets

Climate data presents a governance challenge not simply because it is incomplete, but because it is often inconsistent, estimated and difficult to interpret. These issues are especially acute in private markets.

Across many portfolios, climate metrics rely heavily on estimates, especially for Scope 3 emissions and forward-looking alignment measures. This weakens comparability and can create a false impression of precision. In private assets, the problems are often greater still. Mandatory reporting is limited, look-through is patchy, and data quality depends heavily on manager engagement with underlying assets and companies.

This matters because many pension schemes are increasing allocations to private equity, private debt, infrastructure and real estate. These assets may offer attractive long-term characteristics and access to parts of the transition or adaptation opportunity set, but they can also create blind spots for climate oversight where data and assumptions are opaque.

Decisionmakers therefore need to treat climate data as a governance input, not an answer. Better reported data may indicate deeper manager engagement and stronger stewardship, while reliance on broad proxies or high-level metrics may mask weak oversight. The absence of perfect data is not, in itself, a reason for inaction; but it is a reason for caution in how portfolio-level conclusions are drawn and communicated.

Public Scrutiny and Stakeholder Engagement

Climate change is now a visible public issue as well as an investment and governance issue. Pension schemes are increasingly scrutinised by members, unions, campaign groups, policymakers, regulators and the media. This can shape trustee behaviour in ways that are not always straightforward.

Public narratives often simplify climate action into visible choices such as divestment, headline emissions reduction or public commitments. Decisionmakers, by contrast, must often deal with less visible but more important questions: transition credibility, real-economy exposure, implementation constraints, stewardship effectiveness and long-term financial outcomes.

This can create tension between stakeholder expectations and trustee decision-making. Members and other stakeholders may have legitimate interests and views, but decisionmakers remain responsible for decisions grounded in scheme purpose and beneficiary interests. Engagement is therefore important, but so is clarity about the distinction between stakeholder voice and trustee decision rights.

Communication matters. Decisionmakers increasingly need to explain complex trade-offs to non-technical audiences, including the difference between engagement and divestment, between short-term optics and long-term outcomes, and between disclosure and actual risk reduction. This is not peripheral to climate governance; it is part of it.

As expectations evolve, schemes are likely to operate in an increasingly narrow corridor between ambition, credibility, fiduciary discipline and practical implementation. Managing that tension well will be one of the defining governance challenges for pension schemes in a warming world.

Fiduciary Duty and Investment Decision-Making

The legal basis of the principles applying to how UK occupational pension fund decisionmakers exercise their investment powers derive from fiduciary and trust law principles, the relevant pension fund's governing documentation and legislation.

Fiduciary duty does not mandate particular climate outcomes. It requires decisionmakers to evidence robust decision-making processes in the presence of financially material uncertainty. A key requirement is for decisionmakers to discharge their fiduciary duties to use the investment power prudently, for its proper purpose, acting in the interests of the beneficiaries of the trust. The proper purpose of the investment power in occupational pension schemes is to allow decisionmakers to allocate the fund's assets in order to achieve the overall purpose of the fund, broadly:

(a) in DB schemes: to deploy the scheme's assets in the manner that is most appropriate to provide the benefits to which beneficiaries are entitled, having regard to the funding needs of the scheme and the employer covenant (and managing the risks associated with these in an integrated way), and member contributions (if applicable); and

(b) in DC schemes: to deploy the scheme's assets so as to offer beneficiaries the most appropriate default investment option and range of other self-select investment options (as applicable) so that members can save and invest for benefits.[1]

(c) in CDC schemes: to deploy the scheme's assets in a manner that is consistent with the scheme design and rules, with a view to delivering target benefits over time for the collective membership as a whole, having regard to the scheme's long-term funding position, intergenerational fairness between different cohorts of members, the balance between investment risk and benefit stability, and the sustainability of the scheme over the relevant time horizon.

(d) Decisionmakers need to consider all relevant factors, and disregard irrelevant factors, when exercising their discretion. They therefore can, and should, take account of environmental, social and governance (ESG) factors, including climate change where this is consistent with their legal powers and purpose.

Yet it is also important to recognise that further regulatory guidance in this area has been promised by government[2]. Whilst this has been prompted by concerns around the mandation power now contained in the Pensions Act 2026, fiduciary duties could perhaps be clarified or potentially amended to better reflect long-term systemic risks such as climate change. Under the current legal position, trustees' primary obligation remains to act in the best financial interests of their own beneficiaries. Case law has consistently emphasised that trustees must not subordinate those interests to broader social or systemic objectives (for example, the principles articulated in cases such as Cowan v Scargill).

This creates an important practical constraint. While the UK pensions sector collectively controls very substantial assets, trustees of individual schemes are not generally positioned to pursue system-wide objectives for their own sake. In the absence of clearer statutory direction, there is therefore a risk that action on climate change remains incremental and process-driven, focusing on governance "compliance" rather than coordinated market-wide impact. A change to guidance here could, in theory, enable trustees to take a more consistent account of systemic risks where this aligns with long-term beneficiary interests, rather than requiring them to justify such considerations solely through scheme-specific financial materiality.

1 There may be greater scope for a scheme to offer ethical options (as part of a range of DC self-select funds), which take certain non-financial factors into account where this is supported by a sufficient evidence base, including member views but this can be challenging to achieve from both a practical and a legal perspective.

However, as it stands, climate change should be understood within the established framework of decisionmakers' legal duties rather than as an exception to them. Decisionmakers must act prudently, for proper purposes, and in the interests of beneficiaries. In practice, this means taking account of financially material considerations over the relevant time horizon and making decisions through appropriate governance processes.

Climate change can clearly be financially material. The more difficult questions often concern degree, timing and implementation. A scheme nearing insurance transaction may have a different climate lens from an open scheme with long-duration growth assets and decades of future cashflows. That does not mean one is taking climate risk "seriously" and the other is not. It means that the relevance of climate issues must be assessed in context.

> *Climate change is reshaping inflation, growth and interest rates through transition costs, disruption and price volatility.*

The governance discipline here is more important than trying to derive a universal answer. Decisionmakers should ensure they have sufficient information and advice to understand where climate-related issues may affect the scheme, ask questions where evidence is weak or assumptions are unclear, and weigh those factors alongside other relevant considerations.

In this sense, climate change is not best seen as a separate overlay on investment governance. It is one part of the broader task of identifying and managing financially material long-term risks under uncertainty.

Integrating climate change in scheme specific investment governance

Climate change is now a core concern for pension schemes. Focus is shifting from a policy-led net zero transition to increasing physical impacts and a more technology-driven transition. This complicates risk measurement but also creates new investment opportunities affecting Strategic Asset Allocation (SAA).

Decisionmakers must consider economy-wide systemic risks and mitigation actions. Climate is a material financial risk and opportunity affecting returns, funding and member outcomes. Integration into scheme-specific governance is essential, moving beyond generic policies to approaches tailored to objectives, risk tolerance and strategy.

From commitments to implementation

Many schemes have climate policies or net zero ambitions. The challenge is translating these into practical investment decisions. This requires embedding climate considerations into governance frameworks, including physical risks and transition support.

Decisionmakers must assess how climate risks interact with time horizon, maturity, cashflows and covenant. Impacts differ between open and mature schemes. Governance should clearly define decision-making, oversight and monitoring.

Strategic Asset Allocation and climate risk

SAA is one of the primary drivers of long-term outcomes and is directly affected by climate risk. Physical risks can reduce asset values and infrastructure performance, while transition risks affect returns, correlations and downside risk across asset classes.

Integration does not require divestment but involves stress testing portfolios under different pathways, assessing sector and regional exposures, and testing the resilience of return assumptions. Climate risk may also increase macroeconomic volatility, weakening traditional diversification.

Investment planning and macroeconomic change

Climate change is reshaping inflation, growth and interest rates through transition costs, disruption and price volatility. This affects liabilities, return targets and hedging strategies.

Governance frameworks should incorporate climate-related macro assumptions alongside traditional inputs. Investment planning should reflect greater uncertainty, with more emphasis on resilience and adaptability.

Effective integration

Climate integration must be proportionate and scheme-specific, with clear responsibilities, use of data and scenarios, and regular review of strategy alignment. Embedding climate into core governance improves resilience and long-term outcomes.

2 Column 1291, Hansard, March 2026: https://hansard.parliament.uk/Lords/2026-03-23/debates/C5ACBB70-23F0-4873-B200-C27FBE60E13B/PensionSchemesBill?utm_source=chatgpt.com

Linking climate to member outcomes

Climate governance ultimately affects member outcomes. Poor integration can reduce returns, increase volatility and raise costs, leading to higher contributions or reduced benefits. Strong integration supports stable long-term value.

- In DC schemes, members directly bear outcomes.
- In DB schemes, climate affects both assets and liabilities.
- In CDC schemes, climate affects the sustainability and stability of target benefits across the collective membership over time.

Clear links between climate risk, investment performance and funding ensure decisions remain financially grounded and focused on member outcomes.

Good practice investment governance in a warming world is characterised by:

- Clear ownership and accountability for climate related investment decisions
- Climate risk explicitly considered within SAA decisions, alongside funding, covenant and liquidity
- Use of climate scenarios and stress testing to assess portfolio resilience under different pathways
- Integration of climate considerations across all asset classes, not just equities or public market allocations, with regular monitoring and review
- Clear linkage to member outcomes, demonstrating how climate integration supports long term value

The business case for climate policy advocacy

The twenty-four years to the UK's net zero target in 2050 are an eternity compared to parliamentary and many business cycles. Business and political leaders are therefore structurally incentivised to focus more on short term costs than long term benefits, which can impact effective climate related policy.

The opposite is true of pension schemes. 2050 is well within the planning horizon of decisionmakers and other scheme managers and advisers. Savings being made today are intended to fund members' living expenses long into the second half of the century. Influencing policy to ensure a stable and beneficial transition to a sustainable economy is an effective way to protect long-term retirement security of beneficiaries.

The systemic risk of climate change poses an obvious threat to financial systems, particularly the long-term value of pension scheme portfolios. Funds are major investors and advocating for policy changes can have a compounding effect on other investors, companies, and stakeholders to align with climate goals.

Long-term investments and decisions will be less risky if there is confidence in stable and effective supporting government policy. Being involved in the political process can therefore help create that stability.

Pension schemes also have a role to play in educating members on long term risks to their finances and future lifestyles. Economies and cultures are inseparable from the natural environment, and unsustainable consumption will not continue indefinitely. By adding their voices to local, national and global conversations on sustainability, pension schemes can help to inform their members' choices as consumers and citizens.

Conclusion

Climate change is now a central factor in pension scheme outcomes. The challenge is not whether to act, but how effectively climate considerations are integrated into decision-making.

Different climate pathways will lead to materially different economic and financial outcomes. Early action supports stability and long-term returns, while delayed or insufficient action increases volatility and systemic risk.

Pension schemes face practical challenges, including data limitations, evolving regulation and governance constraints and more. However, they are not only exposed to climate risks but also play a role in shaping outcomes. There is no single solution to these challenges. Responses must be proportionate and scheme-specific. However, inaction carries clear financial consequences.

Embedding climate into investment governance, improving data and supporting a stable policy environment are key to managing risk and delivering sustainable retirement outcomes in a warming world.

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Further information

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