



Response to DLUHC's Consultation "Local Government Pension Scheme (England and Wales): Governance and reporting of climate change risks"

Background

- The Local Authority Pension Fund Forum was set up in 1991 and is a voluntary association of 86 local authority pension funds and six LGPS pool companies, based in the UK with combined assets of approximately £350 billion. It exists to promote the investment interests of the funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest.

Response

The Local Authority Pension Fund Forum (hereafter LAPFF or the Forum) welcomes the opportunity to respond to this important consultation given its impact on our members.

LAPFF has long recognised the imperative to address climate change as a systemic and long-term investment concern for our members. It poses material financial risks across all asset classes with the potential for loss of shareholder value.

Achieving a just transition to a net zero economy cannot be achieved by companies or investors alone. It also requires government action to raise standards across the piece. With the provision of a clearly identified legislative framework on carbon reductions, companies and investors will be able to make the necessary decisions and financial commitments to provide the short and long-term solutions to decarbonisation of the economy that are needed.

The Forum therefore has been a strong and consistent supporter of the introduction of mandatory carbon emissions and risk reporting. The Forum has long promoted mandatory climate risk reporting for companies and that such reporting is required throughout the investment chain. LAPFF supports the recommendations of the Financial Stability Board's Task Force on Climate-

related Financial Disclosures (TCFD) report and considers all market participants should be encouraged to aim for the fullest relevant implementation. The Forum itself produced a climate change investment policy framework in 2017, based on TCFD, to help members integrate climate into investment decisions and reporting.

As LAPFF noted when responding to the [DWP consultation on TCFD](#), action is needed across the board. However, smaller funds have more limited resources and may be less advanced in their approach. The Forum agrees that all funds should report against TCFD. However, LAPFF would recommend that proposed guidance includes specific sections for smaller funds, especially with regard to metrics and scenario analysis. LAPFF would also suggest that smaller funds (below £0.5bn threshold) regulated by DWP are required to report against TCFD rather than LGPS being treated differently. The impact of greenhouse emissions is the same whether assets are owned by a private fund or one part of the LGPS.

There also seems to be misalignment between government objectives and regulation regarding scenario analysis. Clearly it would be unfair and inconsistent to have different obligations for LGPS funds than to issuers or occupational pension funds regulated by the DWP. It would, however, appear sensible to have alignment with government policy regarding scenarios. Achieving net zero by 2050, as enshrined in the UK Climate Act, implies a 1.5 degree rise rather than 2 degrees and therefore requirements should focus on this figure. As such, LAPFF would encourage government, its departments and its agencies, to adopt 1.5 degrees as the required benchmark for all issuers, asset managers and asset owners. Not doing so creates financial and investment risks associated with government policy pushing for 1.5 degree reduction but disclosures judged against a 2 degrees standard.

Finally, while LAPFF supports TCFD reporting, an area of concern is the oversight of the social implications of the transition within the TCFD framework. Failing to consider the impact of the transition on workers, communities, supply chains and consumers carries financial risks. These include opposition to climate action which will slow the pace of the transition (economy-wide and for individual companies). There are also specific issues around skills, employment standards and human rights, which create legal and operational risks as well as reputational ones. Alongside the risks there is considerable opportunities to improve social outcomes which can help support economic and financial stability. LAPFF would recommend that issues around the just transition are included within the government's approach to TCFD regulation.

The rest of this response is focused on the specific questions outlined in the consultation document.

Detailed response

Question 1: Do you agree with our proposed requirements in relation to governance?

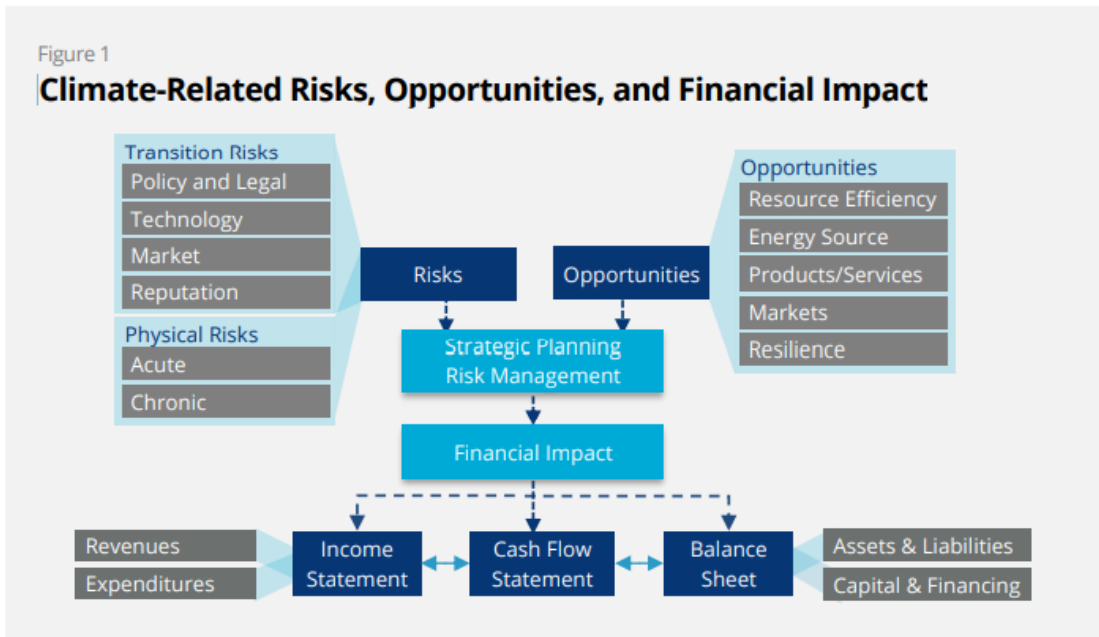
The Forum agrees that ultimate governance responsibility lies with administering authorities. As legislation clearly states scheme managers of administering authorities are responsible for managing and administering the scheme. This includes accountability for policies, strategies and risk management of the fund. In most cases, the scheme manager role is delegated to a pensions committee. As such, LAPFF would agree that the scheme manager has ultimate responsibility for climate change risk as it does for other financially material environmental, social, and governance factors. In addition, for the purposes of TCFD reporting, LAPFF would agree that the scheme managers (i.e. largely pension committees) have the same accountability function as the board of a private occupational pension or company. Therefore, it follows that scheme managers should have overall responsibility for oversight of climate risks.

As would be expected, and as highlighted in the consultation document, work will be undertaken by officers and external consultants. As part of the oversight function of the scheme manager, it would be expected that fund staff and external consultants' activities are scrutinised. LAPFF therefore agrees that processes should be established to ensure that those undertaking climate-related governance activities on their behalf are doing so effectively.

This approach is in line with LAPFF's framework for its members. LAPFF's suggested/template wording on climate-related governance, which was produced with TCFD recommendations in mind, is:

"The pension committee has responsibility for the direction of policy and the committee will have access to expert advice and have members with appropriate skills and knowledge. Responsibility for the implementation of this policy lies with the Fund's head of pensions and is adequately resourced. Regular monitoring of reports and impact assessments of policy implementation will be presented to the Committee and to the Local Pension Board."

Although LAPFF broadly agrees with the TCFD approach, a significant oversight of the framework are social risks associated with the transition. Looking at the below risks and opportunities diagram within the TCFD 2017 report, it is apparent that there is a glaring omission: people.



Source: TCFD, Recommendations of the Task Force on Climate-related Financial Disclosures, 2017

LAPFF would therefore strongly recommend that the government's TCFD requirements for companies and investors include consideration of the social risks and opportunities of the transition. The failure to consider the impact on workers, communities, supply chains and consumers risks creating hostility to climate action and therefore slowing the pace of the transition. This includes issues around skills required for the transition, human rights in the supply chain (not least sourcing of transition minerals), employment and health and safety standards in new industries and the impact of the transition on communities. This all creates legal and operational risks as well as reputational ones. LAPFF would recommend that this oversight is addressed and that components of a just transition are included within the risks and opportunities framework (and throughout the other pillars) of TCFD reporting. This is not only the view of LAPFF, but other investors are expecting companies to consider these issues. This includes the 'Financing a Just Transition Alliance' and also Climate Action 100+ (CA100+) whose benchmark has a just transition element.

Question 2: Do you agree with our proposed requirements in relation to strategy?

The Forum agrees with the approach to strategy outlined in the consultation. Specifically, that short, medium and long-term risks and opportunities are identified; and that administering authorities assess the impact of the risks and opportunities. LAPFF also agrees that this assessment is considered at the same time as other strategies.

LAPFF's climate framework states that 'climate change will impact all asset classes over the lifetime of the fund. As a result, many assets will be re-priced.' It also suggests in respect of timing that 'appropriate responses to the investment challenge of climate change are evolving rapidly' suggests that funds considering committing to reviewing their strategy and policy 'every three years or otherwise as in line with the investment review cycle.'

It is welcome that statutory guidance may be provided to aid funds. LAPFF's policy framework suggests a number of ways that climate change considerations can be integrated into fund's investment strategies (this includes areas covered in the consultation and under the different TCFD strands), such as:

- Asset allocation: considering alternative investment strategies to manage the risk and opportunities of climate change
- Investment management oversight
- Use of scenario analysis: to assess the relative performance under different scenarios
- Climate-related investment opportunities: cognisant of the fact these are often different in nature and are often found in private markets creating asset allocation implications due to the illiquidity and complexity of some of these classes
- Risk management: including integrating climate change into risk management processes and monitoring metrics
- Company engagement: using shareholder rights to engage directly, through third parties and collaboratively and using voting activity to change company behaviour and manage climate risks
- Public policy engagement: engaging with policymakers to address policy failures and provide the right policy framework for the transition to net zero.

Question 3: Do you agree with our suggested requirements in relation to scenario analysis?

Scenario analysis is an important part of managing climate risks.

However, LAPFF does have concerns regarding the benchmark scenario that government has set for occupational pensions regulated by DWP and the FCA rules for issuers, and now under the current DLUHC proposals. Clearly it would be unfair and inconsistent to have different obligations for LGPS funds. However, LAPFF would like to use this opportunity to recommend a

government-wide approach of one analysis having to be undertaken for a 1.5 degrees scenario.

There is now a broad consensus around the need to achieve temperature rises of no more than 1.5 degrees, particularly following publication of the Intergovernmental Panel on Climate Change (IPCC) special [report](#) into the impacts of [global warming of 1.5 degrees](#) in 2019, and subsequent reports in 2021 and 2022. The 2019 report outlined the significant climate change impacts to ecosystems with serious implications for society. These impacts could be substantially reduced by limiting global warming to 1.5 degrees rather than 2 degrees.

Requiring one scenario to be for 1.5°C warming limit would bring the requirement closer to the UK government's commitment to reduce greenhouse gas emissions by at least 100% by 2050, enshrined in the 2019 Climate Change Act. This includes legally-binding '[carbon budgets](#) over five-year periods. the [IPCC](#) stated that 'Limiting warming to 1.5°C implies reaching net zero CO2 emissions globally' around 2050 and concurrent deep reductions in emissions of non-CO2 forcers, particularly methane (high confidence).' The objective of limiting warming to 1.5 degrees was also the clear message from the [UK government after COP26 in Glasgow](#). Using 2 degrees would therefore seem to undermine the ultimate objective of UK policy and would create transition risks for asset owners if they are not considering the ultimate objective of UK policy (i.e. regulatory risks). Subsequent IPCC reports are clearer on the required limits in terms of the overall carbon budget. The IPCC's sixth assessment report¹ (2021) showed that for an 83% chance of limiting warming to 1.5°C² the world can only add another 300 GT of carbon in total to the atmosphere from the beginning of 2020. Global carbon emissions in 2020 and 2021 were 32 GT and 36.3 GT respectively³. Therefore, at the current emissions rate, the global carbon budget could well be used up by 2030. The most recent IPCC working group report (2022)⁴ indicates that limiting warming to around 1.5°C requires global greenhouse gas emissions to peak before 2025 at the latest.

As outlined in the consultation document, data quality and missing information creates considerable challenges. Statutory guidance on scenario analysis would therefore be welcome. As would greater compulsion of companies to disclose emissions data and their own scenario analyses.

Question 4: Do you agree with our proposed requirements in relation to risk management?

¹ [Sixth Assessment Report \(ipcc.ch\) \(2021\)](#)

² [Summary for Policymakers \(ipcc.ch\)](#) (see page 29) (2021)

³ <https://iea.blob.core.windows.net/assets/c3086240-732b-4f6a-89d7-db01be018f5e/GlobalEnergyReviewCO2Emissionsin2021.pdf>

⁴ [IPCC_AR6_WGIII_SPM.pdf](#)

The Forum agrees with the proposed requirements on risk management. LAPFF's framework suggests that funds consider integrating climate change into overall risk management processes. The framework suggested that funds:

- include climate related financial risk on its risk register;
- monitor the scheme's carbon intensity;
- monitor policy dialogues for early indicators of change; and
- increase internal awareness of publicly available climate change scenarios and other risk analysis tools.

Question 5: Do you agree with our proposed requirements in relation to metrics?

LAPFF supports the reporting of scope 1, 2, and 3 emissions for the fund's assets. This is a central expectation that LAPFF makes of companies when disclosing greenhouse gas emissions. The Forum also expects companies to disclose emissions data by total emissions and emissions intensity.

Where LAPFF would raise concerns is regarding the 'comply or explain' regulations for issuers. Failing to make it mandatory for companies is likely to place undue and unnecessary costs on funds. As companies will have more granular detail of their operations, it also runs the risk of inaccurate information or funds obtaining data 'as far as they are able' with gaps in information. This will ultimately undermine regulation which is seeking to address systemic market risks associated with climate change and the transition to a decarbonised economy. As the FCA review has highlighted, a significant minority of *premium* listed companies are failing to provide details on metrics (and targets).⁵ LAPFF experience of engaging companies is that information on Scope 3 emissions is frequently omitted. Therefore, LAPFF would recommend greater compulsion for issuers.

Leaving aside FCA regulation, as the consultation notes, gaining emissions data will not be straightforward (this is likely to be particularly challenging in private markets and overseas markets with few requirements to report emissions). This may cause specific challenges to smaller funds with more limited resources. As LAPFF's response to a [2020 DWP TCFD consultation](#) noted the DWP's proposed staggered approach to implementing TCFD requirements was appropriate. LAPFF would recommend that while TCFD duties are introduced that the future guidance referred to in the consultation document provides specific guidance for smaller funds with fewer resources.

LAPFF agrees with the inclusion of the Paris Alignment Metric. LAPFF seeks to ensure companies are Paris aligned and it is an important indicator of transition

⁵ FCA, Review of TCFD-aligned disclosures by premium listed commercial companies (2022)

risk. However, LAPFF would recommend that the wording on metric 4 is revisited and would suggest that getting the guidance right will be particularly important for this metric. On the wording, Paris aligned and net zero by 2050 can be two different metrics, the first implies seeking to be aligned with a 1.5 degree scenario with interim reductions of emissions being met. The second implies being net zero *at or by* 2050. This could be Paris aligned but equally it could be achieved with significant delays to emissions reductions which results in temperatures exceeding 1.5 degrees. LAPFF would therefore recommend greater clarity about what is meant by these terms to avoid any confusion or misreporting. Effective guidance will undoubtedly help in this regard. However, it will be important that this guidance ensures that there is transparency about inputs used for alignment measures and consistent methodologies.

Question 6: Do you agree with our proposed requirements in relation to targets?

LAPFF agrees that funds should set targets and measure progress against these targets. This is in line with LAPFF's climate investment policy framework. LAPFF's framework recommends that funds report progress in their annual report and accounts and these are aligned to TCFD metrics where possible. LAPFF also recommends that engagement work with investee companies is also noted as part of meeting targets. LAPFF's policy remains that divestment does not make a problem disappear (including emissions) and that engagement is a valuable tool in reducing investment risk. LAPFF's policy framework also suggests measurable targets are reported including: 'climate related training, analysis of climate risk across the portfolio, addressing climate risk with asset managers and on asset allocation, including climate-related investment opportunities across asset classes.'

Question 7: Do you agree with our approach to reporting?

LAPFF agrees with the reporting approach, including having an annual Climate Risk Report.

Question 8: Do you agree with our proposals on the Scheme Climate Risk Report?

LAPFF supports the *principle* of having a Scheme Climate Risk report. The value of the report will be in its accuracy. Great care will be needed regarding metrics and data, something alluded to in the consultation document. This includes the risk of unfair or inaccurate comparisons between funds and the scheme report because of different methodologies.

Question 9: Do you have any comments on the role of the LGPS asset pools in delivering the requirements?

As noted in Question 1, administering authorities are ultimately responsible for a fund's strategy, policies and assets. This role cannot be outsourced to external consultants, asset managers or pools. However, LAPFF agrees that the pools will play an incredibly important role. Pools will be critical in supporting funds in meeting their climate targets and managing climate risks. They will also be a major source of information and advice to enable administering authorities to meet their TCFD requirements. As noted in the consultation document, pools are already providing climate information and as they are required to report under FCA regulations this can evidently help prevent duplicate work.

Where LAPFF would be more cautious is regarding the wording in paragraph 144. The pooling process should happen in the best interest of administering authorities whose fiduciary duty is to beneficiaries rather than driven by crude cost savings on TCFD reporting.

Question 10: Do you agree with our proposed approach to guidance?

LAPFF agrees that there should be statutory guidance to accompany the regulations. Guidance is needed to support administering authorities and ensure consistency in approaches. There is no reference to consultation on proposed guidance. LAPFF would not support the approach to guidance if it was imposed without consultation.

Question 11: Do you agree with our proposed approach to knowledge, skills and advice?

LAPFF agrees with the proposed approach to knowledge, skills and advice. As LAPFF's climate investment policy framework recommended, scheme managers (in most cases pension committees) should have members with the appropriate skills and knowledge, should set expectations on training and ensure committees have access to expert advice.

Question 12: Do you have any comments on the impact of our proposals on protected groups and on how any negative impacts may be mitigated?

As noted, the transition to a decarbonised economy carries with it social risks. This includes risks to workers, communities, supply chains and consumers. Some protected groups are likely to be disproportionately affected, especially regarding employment impacts and as consumers. These impacts are widely accepted, including within the HM Treasury's Net Zero Review: Analysis exploring the key issues (2021). While the impact of TCFD requirements for LGPS funds alone is unlikely to have a significant impact, the objective of the



cross departmental push towards TCFD requirements is intended to support the decarbonisation of the economy. As such, TCFD requirements if effective may have some negative impacts on protected groups. To address the negative impacts, LAPFF would recommend that TCFD requirements include social considerations within the framework and more broadly that governments, investors and companies are committed to a just transition.