PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

LOCAL GOVERNMENT PENSION SCHEME (ENGLAND AND WALES): GOVERNANCE AND REPORTING OF CLIMATE CHANGE RISKS – PLSA RESPONSE

24 NOVEMBER 2022

CONTENTS

ABOUT US

The Pensions and Lifetime Savings Association is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

INTRODUCTION

The PLSA welcomes the publication of this consultation. We have long supported the TCFD framework being introduced throughout the investment chain[1], and our engagement with our LGPS members suggests they are keen to start reporting according to a standardised framework.

We recently asked our LGPS members their views on TCFD, and found that around two thirds (67%) had already started producing a TCFD report voluntarily. Though there is no underestimating the size of the task – particularly given the already squeezed resources within the LGPS – we believe most are preparing to report according to the timeframes set out in the paper.

Below we have set out some specific feedback in relation to each question, though broadly we believe that the proposals are sensible and we support the intention to introduce a largely similar framework to that already in place for most private sector schemes.

However, we have reservations about the plan to include smaller schemes – those under £1 billion – in the regulations, and subject to the same rules, from the outset. We have gone into further detail below, but we would highlight the general understanding that climate reporting is an evolving area, and that there remains significant challenges in relation to data and understanding. We are not in agreement that smaller LGPS funds – some managing funds of hundreds of millions rather, than billions – should be seen as the appropriate group to affect change in the rest of the investment chain. We have suggested that some more analysis of the impact of these requirements is undertaken.

As the paper correctly states, the understanding of climate risk to financial institutions is very much evolving, and data - though improving – remains challenging. We hope this will be taken into account in reviewing and monitoring compliance with the regulations. In our experience schemes are approaching this with an open mind, and keen to improve, and we believe that this approach should be encouraged.

The PLSA remains happy to discuss any of our answers if required.

[1] https://www.plsa.co.uk/Policy-and-Research/Document-library/A-changing-climate

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

Firstly, we welcome the publication of this consultation, and the Department's intention to introduce mandatory TCFD reporting within the LGPS. The PLSA has long supported pension schemes being required to report against this framework, and we have been working closely with our members in the private sector in relation to the DWP requirements. We acknowledge and welcome the drive to ensure consistency across all schemes, and look forward to working with the Department to ensure the regulations are workable and implemented smoothly.

We largely support the proposals set out in relation to Governance.

However, we would highlight a few issues, mainly because they are covered in this section, though are applicable to the entire consultation.

Firstly, we note Paragraph 10 states the role the LGPS plays as an investor, and states that *"these proposals seek to support that approach to addressing high carbon emissions and discourage any pursuit of lower emissions through withdrawing investment from energy companies"*.

We believe that the TCFD framework is necessary as a risk management framework in relation to the very clear climate emergency, but we do not agree that the implementation of it should be as a means to enforcing a particular investment strategy. We don't agree that the Government should be instructing schemes on these sorts of decisions. We are minded to agree that divestment is not necessarily the best means of meeting climate goals, but we also believe that Administering Authorities (AAs) should have the ability to do so where they have fully considered the matter and determined it to be in the best interests of scheme members – engagement may only be effective where there is an actual possibility of divestment. We appreciate this may have been a 'throwaway' comment, but we note it given that this is a consultation on future regulations – we do not believe this should form part of those.

Here we would also flag, as the consultation paper does, that these proposals will introduce reporting requirements for all LGPS AAs in one go – unlike the DWP regulations, which have been staggered. This means that 8 funds under £1 billion AUM will be required to report. On reviewing the size of the LGPS funds within the PLSA membership, we note that several are managing assets of several hundred million. Though much of the rest of our response acknowledges the challenges associated with reporting, but takes the view that it the right thing to do, we have reservations about the likelihood that those under £1 billion AUM will be in a position to report according to these requirements.

As well as the lack of infrastructure in place, we note the scale of the cost associated with producing these reports – evidence from our members already reporting suggest a six figure sum is typical. For smaller LGPS funds, this would post a significant portion of their already stretched resources. We are not convinced it is proportionate to their AUM. Though we are aware that many will have pooled some or all of their assets, and so will be in a position to obtain the necessary information from their pools, it remains the case that most are still using separate managers for some of the assets. Therefore, they will be required to obtain information from a number of sources and aggregate it. Of course, this is in addition to the risk management, strategy and knowledge and understanding requirements, all of which would continue to remain the responsibility of AAs even where they are significantly pooled.

Though we don't necessarily believe that there should be a complete exemption, we do feel that consideration should be given to how the regulations will be implemented in a manner that is proportionate to fund size. We would suggest that some further work is carried out to understand the impact on smaller funds. The feedback we have received suggests smaller funds are overwhelmed by the scale of the task.

Finally, we would note that we would prefer that there is a degree of continuity across the various requirements that apply across the investment chain. This is especially true in relation LGPS pools, which are subject to different FCA requirements, but will of course play an important role in assisting AAs in meeting their requirements.

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

We largely agree with these proposals.

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

We largely agree with these requirements. The consultation paper suggests that data is likely to remain a challenge, and this is very much in line with the feedback we receive from our members already reporting in line with the DWP requirements. We therefore would note the importance of the regulations capturing the 'as far as able' concept, as set out in the paper. The data is improving, and we will expect this to continue. However, we believe that it is paramount that the regulations capture the complexities of reporting on this matter.

We note that there is no mention of how scenario analysis should interact with the valuation cycle – at the moment the proposals would require that scenario analysis takes place in 2023/24, which would be mid-valuation. Given the expectation that, under normal circumstances, scenario analysis should only take place once during a valuation period, we would welcome some clarity on that point.

Finally, we would note that the consultation suggests that though both qualitative and quantitative scenario analysis are acceptable, it suggests that qualitative is preferable. We wouldn't necessarily agree that qualitative is always better, and hope that the rules will allow for AAs to make their own judgement. However, we would agree that the regulations should allow for both, and that further guidance on when each are appropriate is provided in the guidance, as is suggested.

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

They appear sensible.

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

We would largely agree. We note that the paper discusses the challenges of setting methodologies for the various metrics, and we would strongly urge that the regulations to not define this. As the paper acknowledges, this is very much an evolving area, and we believe that it is too early to set this out in legislation. We note recent debates around, for example, the likelihood of some metrics encouraging divestment over engagement. Given the agreement across Government, investors and other industry stakeholders that nuance is often required on such matters, we believe that the regulations ought to be neutral on the point of fixed methodologies.

We note the proposals include a data coverage metric, which will mean the LGPS will have more mandatory metrics to report than private sector schemes. Though we are not opposed to that per se, we would be interested in understanding the reasons for this. Given the challenges identified in our response to Q11 in relation to the resourcing problems the LGPS experiences relative to other schemes, we would generally be cautious about requiring a higher level of reporting than is required across the rest of the pensions industry.

Anecdotally, while data coverage has been cited as a metric choice taken up voluntarily by some of our members in the initial regulatory TCFD reports in the private sector (for schemes with AUM of over £5 billion), a recent survey of our LGPS members suggested that only around one in five are reporting this metric already.

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

We largely agree with this section. We would reiterate that targets are helpful in generating discussion, and focusing on what areas have been identified as important, though we do not agree that they should in any way be binding. As knowledge, understanding, and the flow of information improves over time, we would imagine that schemes might wish to alter which metric they monitor, to reflect changing circumstances or their evolving understanding.

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

We are supportive of the measures outlined in this section.

We note the proposals in relation to schemes reporting ‘as far as they are able’, and we strongly support this statement being included in the regulations – as the paper outlines, it is essential that the requirement take into account the challenging and evolving landscape in which schemes are managing these risks, as well as the lack of regulation requiring others in the investment chain to provide the information required to report. We believe that this is the appropriate manner in which to reflect this – to provide a framework that is flexible and open to change in future years, taking onboard best practice.

We note that the wording on the grid setting out the requirements of the Climate Risk Report requires them to 'report which metrics the AA has calculated, or why these were not possible’. This wording is most likely merging the overarching TCFD framework’s recommended reporting (where users could choose to opt of certain metrics), with the proposed mandatory requirements. Though we appreciate the regulations will be worded differently, we hope that communications around it will make clearer what the minimum requirements are in sections such as this.

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

We would agree that there is a role for the Scheme Advisory Board in providing a scheme wide report, which should provide a link to the individual reports, as well as offer some analysis of trends and progress. We note that the SAB already undertakes this role in relation to a number of other issues, and that it works well.

We would also support the minimum requirement that is suggested in the paper, of links to all individual AA reports being included in one location.

We have reservations about the proposals around the aggregation of metrics, as is set out here. Clearly the proposals give some level of flexibility to funds in terms of selecting the specific metric, and in selecting the method of calculation. This approach also reflects the private sector proposals and, more generally, an evolving debate on how some of these important metrics should be calculated, and the importance of ensuring that reporting requirements do not inadvertently encourage divestment. We would be unlikely to support proposals that would standardise metrics and methods of calculation, given the evolving landscape that we currently face.

We therefore question how meaningful aggregated metrics will be, and whether this might mislead scheme members and stakeholders who only review this one report. We hope that consideration would be given to introducing a scheme wide report that focuses on narrative analysis, and perhaps even provides a list of the metrics for each AA, but that stops short of aggregation.

Finally, this section doesn't appear to set out a different timeframe for the scheme wide report, which leaves us the impression that the first report would need to be published on the same date as the individual AA reports (1 December 2024). Assuming that some sections will publish immediately before or on the deadline, we would flag the impracticalities of this. We would therefore suggest that a different, delayed timeframe is implemented for the SAB report, to accommodate the appropriate sequencing of work and collaboration.

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

We recognise that it is likely that AAs will be heavily dependent on their pools in some of these new requirements, not least in terms of reporting specific metrics. Generally, we would prefer that there is some continuity across the investment chain on TCFD reporting, and the different requirements implanted by various departments is certainly a challenge. We note that the pools are already subject mandatory TCFD reporting, via the FCA requirements.

Our engagement with pools suggests that they are keen to be as supportive as possible in assisting clients meet the obligations. Though the PLSA takes the view that AAs should have some flexibility in what they choose to report – as the consultation paper sets out, and in order to reflect an evolving landscape – we recognise that this will result in challenges for pools, given differences in requested data and methodologies.

However, this is not dissimilar to the situation facing schemes and managers in the private sector. Alongside the Investment Association and the Association of British Insurers, we have produced a Carbon Emissions Template,[2] that is free to use, and which has helped standardise the flow of information between the various parties. The template continues to evolve – Phase 2 is already underway, with a view to including the most recently introduced DWP metrics – but has already become a widely used tool. We would certainly be keen to ensure that any LGPS specific metrics were included, depending on the outcome of this consultation.

Therefore, though we recognise the challenges faced by pools in assisting clients, we feel the existing governance infrastructure should greatly assist, and we would caution against mandating specific methodologies or metrics at a point when best practice is still emerging.

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

We agree with the proposals to provide statutory guidance – we believe this will provide a point of reference to help AAs produce consistent and meaningful reports that will make future collaboration on the evolving climate risk reporting process easier. We note that the department proposes asking the Scheme Advisory Board to take the lead in developing this guidance; we'd be happy to discuss whether we can assist with that development process, in order to share experiences from across our membership. From engagement with the SAB we are aware that has flagged the additional that may be required, and we would encourage making use of existing resources as far as possible. It will be important for SAB to work closely with other pensions stakeholders, such as TPR, to ensure that all guidance produced for the pensions industry is standard, to avoid inadvertently establishing different expectations across different parts of the sector.

In terms of a template, it's not clear from reading the consultation the purpose of requiring AAs to complete a template, and we have some reservations about how this would work in practice.

We don't believe that a template should be put in place in order to meet the minimum requirements – this is not in the spirit of the TCFD reporting framework and, as the paper correctly outlines, the narrative around the metrics are just as important in assisting readers' understanding of the full breadth of climate related risks associated with the scheme. We believe this is especially true of a 'non expert' audience. We therefore have reservations about any suggestion that TCFD reporting can be completed via a template. Given that a number of AAs are already reporting according to the framework – based on the taskforce's own non-binding guidance – we don't agree that this will reduce the burden on them. Rather, we are concerned this might add to the reporting requirements.

[2] https://www.plsa.co.uk/Policy-and-Research/Document-library/Carbon-Emissions-Template

If the template is proposed, as we suspect, to enable the SAB to produce a scheme wide report, again we have reservations. As set out in an answer above, though we can see the benefit of some sort of scheme wide report, we are concerned that there hasn't been consideration given to the strong likelihood that different AAs will choose to report different metrics. For those metrics that are mandatory, the flexibility to choose how they can be measured means that aggregation is likely to be both challenging, and potentially misleading to stakeholder audiences.

As set out above, we agree that there is a role for a scheme wide report, but do not agree that this can based on the same requirements as are proposed for individuals AAs. We recognise that SAB is likely to want to find some means of obtaining the information in a consistent manner. However, consideration as to what practically needs to happen in order to achieve this (and recognising that this may change over time). We do not agree that this should be achieved by introducing a new mandatory requirement for AAs complete a template.

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

We would largely agree with this section. However, we would draw attention to the challenges identified in the PLSA's report 'Today's Challenges, Tomorrow's Opportunities',[3] around staff retention and retaining the appropriate expertise in order to meet the volume of regulatory requirements facing the LGPS. These pressures are a live risk to both the short-term operational sustainability of funds and the long-term sustainability of the scheme overall.

Climate change is clearly an evolving area, and we know from our work with private sector schemes that accessing the necessary expertise and support is a challenge across the board – our research suggests that the reports produced by the first wave of schemes within the DWP requirements generally costs significantly more than the sum set out in the cost benefit analysis. In addition, LGPS AAs are likely to be working within tighter budgets than many other schemes.

Though we in no way believe that this undermines the need to report on climate risk, we hope that the department will be mindful of this in determining the support and guidance available to the scheme and, certainly in the initial years, to focus on providing feedback where reporting is falling short of expectations, rather than strict compliance with the regulations. The PLSA is of course happy to provide support and collaborative opportunities wherever we can, in order to assist AAs in meeting the standards.

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?

We have nothing further to add.

[3] https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/LGPS-Report-2022-Executive-Summary.pdf

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