OPEN CONSULTATION

Local Government Pension Scheme (England and Wales): Governance and reporting of climate change risks

November 2022

Private and Confidential

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Redington Ltd is delighted to respond to the above consultation. We are broadly supportive of the proposals to require Local Government Pension Scheme ("LGPS") Administering Authorities ("AA") in England and Wales to assess, manage and report on climate-related risks, in line with the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD").

Redington is an independent investment consultancy based in London. We advise a range of long-term investors, including LGPS, DB, DC, private wealth, and insurance clients. Our mission is to help make 100 million people financially secure – for the benefit of people and planet.

We advise a number of Local Authority Pension Schemes which would be in scope of the proposed requirements. We also advise a number of corporate occupational pension schemes that are already subject to the Climate Change Governance and Reporting requirements set by the Department for Work and Pensions ("DWP") and so have substantial experience in supporting clients through the processes that LGPS Administering Authorities will need to follow. Many of our comments below reflect that experience.

We believe the requirements should be underpinned by the principles of simplicity, proportionality and, flexibility:

> **Simplicity**: Climate risk management is a complex area, and good practice is still nascent. There are large skills gaps across the industry, and so those AAs that have not made progress should be able to adopt the requirements in a simple, clear way.
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> **Proportionality:** The requirements will apply to all AAs; however, some are better resourced than others. The guidance should emphasise how to enhance monitoring and oversight, and how to get the best out of Pool companies, advisers, and asset managers.
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> **Flexibility:** Global policy and regulation is moving quickly and being implemented differently across sectors and geographies. UK asset owners are at the top of the investment value chain; however, they have been some of the first to have to publish regulatory climate disclosures. As more agents in the global economy fall under similar requirements, the regulations should be flexible to adapt to new standards and make use of new and improving disclosures.

We also believe the emphasis of the requirements and following guidance should be on action taken by AAs, principally through prudent risk management, investment strategy decisions, and effective stewardship through engagement with, and oversight of Pool companies, service providers, and invested companies/assets. The requirements should not create burdensome reporting obligations that distract attention from delivering this important action.

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

Yes, we agree with the proposal. However, we note from experience with private sector schemes that the lack of definition of what effective governance looked like caused confusion. In particular, there was uncertainty as to whether governing documents needed to be updated accordingly. The primary responsibilities of AAs include asset allocation, fund selection and effective oversight. The future guidance could clarify expected roles and responsibilities of the Pensions Committees/Panels, Fund officers, advisers, and Pool companies, and highlight channels/sources for AAs to use to enhance and maintain knowledge and understanding.

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

Yes, as this is broadly in line with the TCFD recommendations. However, to avoid confusion, it should be noted that scenario analysis is a primary method for the identification and potential quantification of long-term climate-related risks. Therefore, these sections of the proposals should not be unnecessarily split from the scenario analysis requirements. Guidance should also highlight the mechanisms other than scenario analysis through which this risk identification can be carried out, especially for resource and budget constrained AAs. There should be an explicit link between using the mandated metrics, and the setting of targets, as part of the Strategy element requirement.

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

We have some concerns with the proposed requirements on scenario analysis. The TCFD describes the Strategy element as "The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning". Scenario analysis is proposed as one of the key mechanisms to carry out this identification. However, our experience to date working with corporate schemes has shown scenario analysis providing only limited insight into risk identification at a strategic level. Rather, it has become a tick-box exercise for many. Therefore, requiring all AAs to undertake complex analysis with a limited track record of providing insight is potentially burdensome.

The modelling and scenarios broadly accepted by the market such as NGFS are nascent but will improve over time. We believe the requirements for AAs should be proportionate to available resources, and AAs should be guided to liaise with advisers and/or Pool companies to understand the scenario analysis they can provide. The proposal notes the expectation that AAs do the "best" scenario analysis they can. We believe this description may be unhelpful as it could be interpreted as most complex, or costly. We also believe the requirements should not be too prescriptive around the narrative of the underlying scenarios. The emphasis should be on identifying transition and physical risks associated with climate change.

We also suggest caution in requiring funding strategy scenario analysis, rather than just on investment portfolios. Stressing the funding strategy is consistent with DWP requirements, however from our experience, such analysis is dominated by actuarial assumptions concerning changes to UK mortality expectations under different scenarios, which are very uncertain at this stage. This skews the analysis and often shows material funding level improvements under the worst climate scenarios, weakening the perception of risks and the associated calls to action.

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

Yes, we agree with the proposed requirements.

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

We are broadly supportive of the proposed requirements. However, there are several elements within the proposals that could be simplified to deliver the intended outcomes with a lower burden:

- Aggregating emissions metrics across asset classes and only reporting the top-level figure may involve material double-counting and is not helpful for strategic decision-making. Emissions intensity does not tend to be homogenously distributed across investment portfolios or asset classes. Largest contributors need to be identified and prioritised.

- Guidance should cover how Scopes 1, 2 and 3 emissions figures should be aggregated and what appropriate de-duplication factor should be applied to Scope 3.

- It may not be possible to classify the underlying quality of data using the proposed classifications. This granularity is not provided across the board yet by asset managers, Pool companies, or data providers. The classifications could be indicated as best practice, with an expectation that they are adopted over time.

- We suggest the future guidance should require standardisation of metric methodologies and adherence to standards. The DWP specifies a preference for private sector schemes to calculate metrics in line with the standards set by the Partnership for Carbon Accounting Financials ("PCAF").

- Using the binary target measurement for portfolio alignment is a sensible, simple first step. However, it suffers materially from data coverage, often this can be as low as <20% of a portfolio. The primary risk is likely to lie within the assets that are not covered by the metric. Therefore, this metric should be first a trigger for engagement; it is a poor measure of risk.

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

We are broadly supportive of the proposed requirements. Given the restricted set of metrics available to AAs, the choice of target may be somewhat limiting, especially a target that can be influenced by AAs. Unlike the DWP requirements, a target setting an allocation to climate solutions would not be permissible. This seems a poor incentive mechanism given AAs long-term investment horizon and ability to deliver real-world change. On the other hand, emissions reduction targets could incentivise divestment from carbon intensive assets – a step which has no real-world impact.

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

From our experience with private sector schemes, the report-writing process can require significant resources and cost to complete. This should reduce over time; however for smaller AAs, it may be more appropriate to report on a less frequent basis (e.g., in line with the valuation cycle), or be able to refer to Pool company, asset manager, or adviser reports for substantive content.

The requirement to produce an annual report should not be made so significantly burdensome that it prevents key decision makers from taking effective action.

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

Yes, we agree with this proposal. The Scheme Climate Risk report could also include qualitative commentary, drawing out good practice, and case studies of effective action. This could act as a positive influence for smaller AAs to align with emerging standards.

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

Many Pool companies can act as a valuable additional resource for AAs given their scale and established expertise. Therefore, the requirements should be flexible such that they align with regulatory requirements of pool companies as they are set by the FCA. Hence, metrics and analysis provided by Pool companies should be explicitly compliant with the requirements.

We also highlight the potential constraints Pools have in providing full access for their clients to climate metrics and data. There may be contractual limitations with data providers that prevent this happening. We therefore propose caution when setting requirements on Pool companies as they may not be possible, low cost, or doable given that resources vary significantly across different Pool companies.

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

We believe the statutory guidance should be informed by the progress of other asset owner sectors, recognising what has been successful, and not be overly prescriptive. It should also not focus solely on the reporting, but the proportionate and effective actions AAs can take. Integrating climate risk into investment decision-making is a rapidly evolving space. The guidance should be flexible, principles-driven, and updated over time to reflect established good practice. We would welcome the opportunity to assist with the drafting of statutory guidance.

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

Yes, we agree with the need to take proper advice. The Climate Competency Framework developed by the Investment Consultant Sustainability Working Group was produced to help assess the effectiveness of Investment Consultants' advice. The guidance should specify additional means by which AAs can satisfy themselves the advice they receive is high quality and provided by appropriately qualified people.

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 no comments on this question.

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