PRI RESPONSE

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

November 2022

PRI Association
Registered office: 25 Camperdown Street
London, UK, E1 8DZ Company no. 7207947
T: +44 (0) 20 3714 3220 W: www.unpri.org E:info@unpri.org

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

INTRODUCTION

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to consultation from the UK Government Department for Levelling Up, Housing and Communities (DLUHC) on 'Local Government Pension Scheme (England and Wales): Governance and reporting of climate change risks'.

ABOUT THIS CONSULTATION

This consultation from DLUHC seeks views on proposals to require Local Government Pension Scheme (LGPS) administering authorities (AAs) in England and Wales to assess, manage and report on climate-related risks, in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).

It is proposed that LGPS AAs would calculate the 'carbon footprint' of their assets and assess how the value of each fund's assets or liabilities would be affected by different temperature rise scenarios, including the ambition to limit the global average temperature rise to below 2 degrees set out in the Paris Agreement.

It is proposed that AAs should report on this annually, and that these reports will be summarised in an LGPS-wide report, including the overall carbon emissions of the scheme.

For more information, contact:

Freya Bannochie	Ed Baker
UK Policy Analyst	Head of Climate Policy
freya.bannochie@unpri.org	edward.baker@unpri.org

Principles for Responsible Investment

SUMMARY OF THE PRI'S RESPONSE

The PRI welcomes the proposal from DLUHC to require LGPS schemes to assess, manage and disclose climate-related risks in line with the recommendations of the TCFD. These proposals represent good alignment with the most recent implementation guidance from the TCFD.[1]

The PRI has previously responded to a number of consultations relating to the roll-out of TCFD-aligned disclosures across the UK economy, per the implementation roadmap published by HM Treasury.[2] Here we note our responses[3] to consultations from i) the DWP that proposed requirements for trustees of occupational pension schemes to disclose a Paris-aligned metric;[4] and ii) the Financial Conduct Authority (FCA) on proposals to introduce climate-related financial disclosure rules and guidance for actors in scope at both the product and entity-level.[5]

In particular we welcome proposals to align new requirements for LGPS AAs with existing requirements for occupational pension schemes, as set out by the DWP.[6] In our response[7] to the call for evidence on updated to the Green Finance Strategy[8] we called for a joined-up regulatory approach from policymakers and regulators, both domestically and internationally. This should entail clear messaging from Government regarding the delivery of the UK's sustainability goals, as well as consistent efforts to implement interoperable disclosure and reporting frameworks.

We would finally like to take this opportunity to present our recently published report "A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry".[9] We outline a high-level summary of recommendations most relevant to DLUHC in the annex to this response.

[1] Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures, October 2021

[2] HM Treasury: UK joint regulator and government TCFD Taskforce: Interim Report and Roadmap, November 2020

[3] Please see here for a summary of consultation responses provided by the PRI's global policy team

[4] PRI's response to consultation from DWP on climate-related risk disclose and stewardship implementation, January 2022

[5] PRI's response to a consultaiton from FCA on climate-related reporting at product and entity level, September 2021

[6] Statutory guidance from DWP on governance and reporting of climate risk, June 2022

[7] PRI's response to the call for evidence by BEIS on the update to the Green Finance Strategy, June 2022

[8] Call for evidence from BEIS on proposals to update the Green Finance Strategy, May 2022

[9] PRI's report "A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry", October 2022.

KEY RECOMMENDATIONS

The PRI's key recommendations are:

- **DLUHC should develop guidance to clarify that AAs can, and in some cases must, consider sustainability impacts in line with their existing duties**. We make further recommendations on how such a clarification can be implemented in our recently published report "A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry". Our three main recommendations concern two closely related aspects of investors duties; i) duties of loyalty, care and prudence; ii) purpose-related requirements.
- **DLUHC should consider publishing guidance for AAs on how stewardship should be implemented** to manage climate risks and pursue sustainability impact goals, as outlined in the remit and purpose of proposals in this consultation. We make recommendations on supporting the use of stewardship by investors in their pursuit of sustainability impact goals in our recent report. DLUHC could also consider requiring AAs to set and report on investment stewardship priorities in a similar approach to that taken by the DWP.[10]
- **AAs should be required to consider whether or not the path to this outcome is orderly or disorderly**, rather than conducting scenario analyses on a range of temperature outcomes only as proposed by DLUHC.

[10] See here for guidance from the DWP on reporting on stewardship, July 2021

DETAILED RESPONSE

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

No response

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

and

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

Yes. We welcome the proposal to require AAs to consider climate risks relevant to both their investment and funding strategies, as well as how physical and transition risks and opportunities may affect both strategies and over what time periods. We also welcome the proposal to explicitly require AAs to integrate climate-related processes into their existing risk management processes.

We also welcome the proposal for LGPS to **provide AAs with statutory and non-statutory guidance in relation to these proposals**. Analysis of from the 2021 Legal Framework for Impact[11] report**,** as well as our recently published UK-specific paper**,** outline that **many investors are already required to consider sustainability impacts, including climate-related impacts**. As outlined above, the UK-specific paper makes recommendations on how this can be communicated more clearly to AAs through the provision of coherent and comprehensive guidance. The report also recommends that policymakers **clarify that stewardship powers should be used to achieve sustainability impacts in line with investors existing duties.**

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

We welcome the proposal to require AAs to conduct scenario analysis as it reflects the most up to date recommendations laid out by the TCFD. We also welcome the proposal for DLUHC to provide statutory guidance to AAs on this matter.

We note the acknowledgement of the current limitations of scenario analysis relating to data quality and availability, as well as methodological variation and limitations for some asset classes. As such, it is important that flexibility is accounted for and that support in addressing these variables is provided through guidance.

The PRI also supports the use of the 1.5C-degree benchmark for Paris-aligned reporting. Referring to 1.5C degree Paris-alignment rather than the term “below 2.0” will provide AAs with a clearer and more ambitious framework to manage and disclose climate-related risks. As acknowledged by this consultation, these forward-looking portfolio-alignment metrics are essential in helping AAs in their investment strategy, goal adoption and risk management ambitions.

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[11] See [here]() for more about the Legal Framework for Impact 2021 report and our implementation project

Finally, what is material for financial markets is not only the temperature outcome of a particular climate scenario, but also whether the path to this outcome is orderly or disorderly. To address this, the PRI recommends DLUHC specifies the following families of climate scenarios, which are relevant to both companies and investors, as scenarios to be reported against where appropriate[12]:

- **a measured, orderly transition**, which takes place with climate policies being introduced early and becoming increasingly more stringent, in line with national and global emissions reduction targets;
- **a sudden, disorderly transition**, which takes place with climate policies and wider action on climate change not happening until late (for example, introduced around 2030) – this scenario gets towards, but does not achieve, the climate goals set out in the Paris Agreement and is characterized by a higher level of transition and physical risk than in an orderly transition; and
- **'no transition'**, which assumes only currently implemented policies are preserved, current commitments are not met, and emissions continue to rise (i.e., a 4°C or higher climate scenario) – this would mean climate goals are missed and physical risks are high, accompanying severe social and economic disruption.

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

Yes. We welcome the proposal to require AAs to measure and disclose four metrics and account for Scope 1, 2 and 3 emissions in this process.

We welcome the proposal for AAs to disclose both forward and backward-looking metrics. It is important to note that each category of metric has a different use case, and that guidance should be provided alongside this proposal to help AAs distinguish these.

Forward-looking as well as static disclosures, such as emissions data, are important since climate change is a risk that will grow over time. Therefore, sole reliance on historical data provides a partial and misleading view of an investor's position. Investors have a view of the future with respect to market trends, key risks, and growth opportunities. The function of climate-related scenario analysis is to provide means for incorporating climate change into existing views and assessing the resilience of the business strategy to a range of plausible future scenarios.[13]

Due to the challenges associated with measuring climate-related data, we welcome flexibility around disclosing Paris alignment as proposed by this consultation. This approach reflects well the recent guidance from the TCFD that suggests actors should use "whichever approach or metrics best suit their organisational context or capabilities".[14]

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[13] We outlined this recommendation to ISSB in our recent paper Draft Climate Disclosure Rules and Standards: A Comparative Analysis, October 2022

[14] Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures, page 41, October 2021

The PRI agree, as noted by this consultation, that accounting for Scope 3 emissions is complex and such a figure is likely to be underreported and mostly approximated due to challenges with data availability and methodologies. However, as noted in the consultation, as Scope 3 emissions may represent a significant percentage of a fund's total emissions, it should be accounted for when assessing and reporting on metrics.

Please also see our response to *Question 3* for our position on the use of the 1.5C-degree benchmark for Paris-aligned reporting.

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

Yes. We welcome the proposal to require AAs to set and report against targets. The PRI acknowledge that this will likely entail additional resourcing requirements for AAs. However, target setting is an essential mechanism to ensure that actors remain accountable to the UK's climate targets. We welcome the proposal to allow AAs to select one of the four metrics to set a target against, providing greater flexibility.

Near-term accountability is essential to realising climate targets within the timeframes required to meet the UK's net zero goals. **AAs should be encouraged to set and report on interim targets**. The PRI supports the approach set out by the UN-convened Net Zero Asset Owner Alliance target setting protocol which recommends a -16% to -29% emission reduction by 2025 against base year 2019. Members who join the Alliance and issue targets after 2020 may reduce emissions by 5%-pts. per annum in their 2025 sub-portfolio targets.

Please also see our response to *Question 3* for our position on the use of the 1.5C-degree benchmark for Paris-aligned reporting.

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

Yes. We welcome the proposed approach to reporting outlined in this consultation. In particular we welcome the proposal to require reporting that is transparent and widely accessible to both specialist and non-specialist stakeholders. Beneficiaries are becoming increasingly interested in how their pensions are invested, exemplified by the success of the Make My Money Matter campaign[15] and their Green Pensions Charters[16] for workplace pension schemes. Moving forward, as beneficiaries call for more information about their pensions, transparent and accessible reporting will be crucial.

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

No response

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[15] See here for more information on the Make My Money Matter campaign

[16] See here for more information about the Green Pensions Charter by the Make My Money Matter campaign

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

No response

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

The PRI welcomes the proposal by DLUHC to provide AAs with statutory and non-statutory guidance to accompany changes to regulations.

The report "A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry"[17], highlights that UK investors remain hesitant to change their established practices and pursue sustainability impact goals, even when this is required to achieve financial objectives. To address this issue, the report suggests a number of clarifications to existing guidance and regulations.

Our report calls for policymakers and regulators to **make clear that investors should consider sustainability impact goals as part of purpose related requirements**, sometimes described as a duty to act in clients'/beneficiaries' "best interests".

We also recommend that **DLUHC consider issuing guidance on reporting on investment stewardship practises**, similar to that published by the DWP this year.[18] This would further increase consistency with requirements for occupational pension schemes.

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

Yes. We welcome the proposal to promote knowledge regarding climate risk among AAs.

In our recently published report 'A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry' we make the following recommendation to DLUHC[19]:

Provide training to pension fund trustees (and other key investment decision-makers and professionals such as investment advisers, consultants and lawyers). This would ensure they are better equipped to take sustainability factors into account in their decision-making and to consider pursuing positive sustainability impacts where that is relevant to achieving the purpose and objectives of the scheme. Sustainability impacts should be adequately considered when selecting investment managers, drafting mandates and assessing performance.

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?

No response

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[17] PRI's report "A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry", October 2022. Please read it here

[18] See here for guidance from the DWP on reporting on stewardship, July 2021

[19] This recommendation was made to DLUHC as well as to the FCA, PRA, DWP and TPR.

APPENDIX

ABOUT THE LEGAL FRAMEWORK FOR IMPACT PROJECT

Our recently published report ‘A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry’[20] comes as part of a wider plan to implement the finding of the Legal Framework for Impact[21] report published in July 2021 authored by Freshfields Bruckhaus Deringer and commissioned by the PRI, the United Nations Environment Programme Finance Initiative (UNEP FI) and the Generation Foundation. This 2021 report explores extent to which legal frameworks in 11 jurisdictions enable investors to consider impact in their activities.

The report finds that in the 11 jurisdictions analysed, including the UK, investors are broadly permitted to consider pursing sustainability impact goals where this would contribute to their financial return objectives. Specifically, the extensive legal analysis concludes that:

- financial return is generally regarded as the primary purpose for investors;
- investors generally have a legal obligation to consider pursuing sustainability impact goals where that can help achieve their financial objectives;
- in some circumstances, investors can pursue sustainability impact goals for reasons other than
- achieving financial return goals (i.e., as an ultimate end); and
- investors are legally required to pursue improved sustainability impacts if the objective of the financial product commits them to doing so.

We would be happy to further engage on these recommendations and our Legal Framework for Impact project more broadly.

Along with the UK, regional reports with jurisdiction specific recommendations have been developed for the EU[22] and Australia[23]. Reports looking at policy options for Japan and Canada will be published in 2023.

[20] PRI’s report “A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry”, October 2022. Please read it here

[21] See here for more about the Legal Framework for Impact 2021 report and our implementation project

[22] PRI’s report “A Legal Framework for Impact EU: Empowering investors to pursue sustainability goals”, April 2022. Please read it here.

[23] PRI’s report “A Legal Framework for Impact Australia: Empowering investors to pursue sustainability goals”, September 2022. Please read it here.

ABOUT THE UK-SPECIFIC PAPER AND RECOMMENDATIONS

The 2021 Legal Framework for Impact report found that the way UK investors understand and discharge their duties in practice may be discouraging them from pursuing positive sustainability impacts or even considering doing so. Furthermore, the UK legal framework limits investors' ability to pursue sustainability impact objectives as an ultimate end, rather than in support of financial objectives. Similarly, our own analysis shows that many UK investors remain hesitant to change their established practices and pursue sustainability impact goals, even when this is required to achieve financial objectives.

Building on the Legal Framework for Impact report, this paper[24] explores how UK policy makers could mainstream responsible investment writ large, helping the country achieve its climate and other sustainability goals.

The UK's existing requirements on responsible investment are focused on disclosures of sustainability risks: investors must report how they manage environmental, social and governance, or ESG, risks to investments, rather than if and how they tackle the sustainability impacts of their investments.

In contrast, leading responsible investors are using a much bigger toolkit to achieve positive sustainability impacts through their investments, with asset allocation, increasingly ambitious stewardship, and engagement with policy makers all brought to bear.

This report examines relevant aspects of the UK legal and regulatory framework and identifies areas where guidance and policies are insufficiently clear, potentially limiting institutional investors' willingness or ability to pursue sustainability impact goals. It then recommends policy options that would empower investors both to consider sustainability factors and to pursue sustainability impact goals, in particular where these are relevant to financial returns.

Summary of UK-specific recommendations

The UK-specific report outlines three key recommendations to relevant regulators and government departments;

1. Clarify when sustainability impacts can or must be considered as part of duties of loyalty, care and prudence
2. Clarify that purpose-related requirements entail consideration of sustainability impacts
3. Use of stewardship to achieve sustainability impact goals

We also outline a number of 'other areas to explore' which include;

1. Sustainability disclosures and product labelling/classification
2. Competition Law
3. Options to enable consideration of specific sustainability impact goals and individual investors' views
4. Guidance for pension schemes on assessing the relevance of social and environmental goals

[24] PRI's report "A Legal Framework for Impact UK: Integrating sustainability goals across the investment industry", October 2022. Please read it here

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of LGPS further to ambition on managing and disclosing climate-risk by financial actors in the UK.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org