Date: 5 October 2020

Response to the DWP's Consultation "Taking action on climate risk: improving governance and reporting by occupational pension schemes"

Background

- The Local Authority Pension Fund Forum was set up in 1991 and is a voluntary association of 81 local authority pension funds and six LGPS pool companies, based in the UK with combined assets of approximately £300 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. Although this consultation does not cover reforms which will affect LGPS funds, as pension regulation and legislation for our members' sector tends in the end to mirror those within the purview of DWP we wished to submit a response. In this section we outline our overall position before addressing the consultation questions in the following section.

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 strongly supports 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 the consultation document makes clear, practice differs even amongst the largest defined benefit schemes, and action is required to improve practice across the piece. Differences are sometimes due to the size of funds. This is our experience as a membership organization that represents pension funds of varying size. Those smaller funds sometimes have more limited resources available and may be less advanced in their approach to managing climate risk. The Forum therefore agrees with the staggered approach to implementation.

The Forum welcomes the compulsory nature of new regulations. As the survey findings in the consultation document make clear, a voluntary approach to adopting the widely accepted TCFD approach, has resulted in patchy take up. The potential scale of the value at risk and urgency of the climate emergency both demand a mandatory approach. However, it is surprising that while the proposed regulations are compulsory, with fines for non-compliance, the FCA's consultation for companies is only on a 'comply or explain' basis, which de facto makes the requirements voluntary. The Forum has suggested that if the FCA's rule is to be brought in on a 'comply or explain' basis, that at the same point the FCA announce its intention to make the rule mandatory after a set date (e.g. in three years' time). It would seem wise for government regulation to be aligned across the investment chain.

As outlined below, it would also seem wise to have alignment with government policy regarding scenarios. Achieving net zero by 2050, as enshrined in the UK Climate Act, implies a 1.5 degrees rise rather than 2 degrees and therefore requirements should focus on this figure.

As the proposals set out in the consultation refer specifically to occupational pensions regulated through the DWP, the Forum does not take a view on some elements. Nevertheless, we have made some responses to specific questions below.

Detailed response

Q2: Regarding phased timing of introduction

The Forum agrees with the approach of phasing in the introduction of the new requirements. Conversations with and surveys of our members have shown that integration of climate risk is often, but not always, more advanced amongst larger funds. Meeting these obligations will take more time for smaller funds/schemes. Alongside providing more time, the provision of advice and guidance from government will also be important.

Q3: Smaller schemes

The Forum's view is that climate risk affects all funds and their beneficiaries. Ensuring that climate risk is integrated into investment decisions also matters to help reduce climate risks that all investors, large and small, face. It would therefore be appropriate for DWP to consult on extending the obligations to smaller schemes.

Q6: We propose that regulations require trustees to assess the resilience of their assets, liabilities and investment strategy and, in the case of DB, funding strategy, as far as they are able, in at least two climate-related scenarios, one of which must be a 2°C or lower scenario and to disclose the results of this assessment.

The Forum supports requirements to assess climate resilience and welcomes its inclusion. However, the Forum would recommend that the one of the two climate related scenarios should be 1.5°C.

There is growing census around the need to achieve temperature rises of no more than 1.5 degrees, particularly following publication of the Intergovernmental Panel on Climate Change (IPPC) special report into the impacts of global warming of 1.5 degrees in 2019. The 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.

In addition, requiring one scenario to be a 1.5°C would bring the requirement into line with the government's commitment to net zero by 2050, enshrined in the 2019 Climate Change Act. The IPPC have stated that 'Limiting warming to 1.5°C implies reaching net zero CO_2 emissions globally around 2050 and concurrent deep reductions in emissions of non-CO_2 forcers, particularly methane (high confidence).' Using 2 degrees would therefore seem to undermine the ultimate objective of UK policy and would create transitional risks for asset owners if they are not considering the ultimate objective of UK policy (i.e. regulatory risks).

Q11: Penalties

The Forum welcomes the compulsory nature of the requirements, and therefore the need for penalties. The potential value at risk demands a mandatory approach. Furthermore, all market participants have a role to play to reduce emissions to lessen the negative economic (and wider) effects of climate change.

However, there is a need for greater alignment on the need for mandatory regulatory standards across the investment chain. The FCA's consultation for company reporting only requires companies to report on a 'comply or explain' basis. This effectively makes the requirement voluntary. As the survey on take up of TCFD by schemes presented in the consultation document makes clear, take up is patchy when voluntary. It is therefore important that a mandatory approach is adopted (sensitive to different sized investors and companies) across the piece and for DWP to make the case with other parts of government. This is particularly important as the failure of companies to report undermines the ability of pension funds to assess the climate risks they face and report accurately.

In the case of company reporting, the Forum has suggested that if the FCA's rule is to be brought in on a 'comply or explain' basis, that at the same point the FCA announce its intention to make the rule mandatory after a set date (e.g. in three years' time). It would seem wise (and an important principle of good regulation) for government regulation to be aligned across the investment chain.