Michael Gove MP
Secretary of State
Department for Levelling Up, Housing and Communities
2 Marsham Street
London
SW1P 4DF

23 November 2022

Dear Secretary of State,

I am pleased to enclose our response to the consultation on the governance and reporting of climate change risks in the Local Government Pension Scheme (LGPS). Border to Coast Pensions Partnership is one of the largest pension pools in the UK. We work on behalf of our 11 LGPS Partner Funds who have c.£60bn of investments (as of 31 March 2022). Collectively, they are responsible for the pensions of more than one million LGPS members who work for around 2,700 employers, and are ultimately funded by local taxpayers.

We welcome this consultation on how the LGPS should be reporting on its response to climate change. We believe that clear and consistent reporting is important for the LGPS to demonstrate how it is managing the risks (and investment opportunities) of climate change. It will also help demonstrate how the LGPS is using its collective scale to effect change, both in the interests of transparency and to contribute to solving the continuing data reporting challenges in this area. We have sought to provide constructive comments to support the policy intent of the future reporting framework.

In so doing, we would like to highlight our concern about the potential unintended consequences of pushing too far and too quickly towards a whole of scheme reporting regime. Our own experience, having reported in line with TCFD since 2019 and supported some of our Partner Funds in their own reporting, is that there is a significant level of work required to understand, verify, and explain the analysis required. We believe that amalgamating metrics calculated on different methodologies and using different data sets will lead in the short-term to unreliable information that is hard to explain and certainly not sufficiently robust or credible on which to make decisions. Given the level of scrutiny that such figures will undoubtedly receive, we would ask the Department to give further thought to the potential impact and calls for action that will inevitably follow.

We recognise the Government's desire to see the LGPS punch its weight in this and other areas and therefore the attraction of reporting at scheme level. However, given the inconsistency in approach across Funds and the considerable data gaps we discuss in more detail in our response, this will be very difficult to deliver in a meaningful way in the short-term. We believe it further risks generating metrics that have the unintended consequence of increasing misinformed pressures to divest.

Secondly, we would note that the proposals appear to run contrary to the policy intent to create a more efficient and streamlined approach to managing the LGPS (for example through its pooling policy). The investment system already requires asset managers and those pools who are FCA regulated, including Border to Coast, to report under TCFD. The Government Actuaries Department has instructed LGPS actuarial advisors to provide climate scenario analysis as part of the triennial review. LGPS Funds are also required to consider climate risk as part of setting their investment strategy. This "triplication" of effort has the risk of creating an industry that not only uses up scarce resources and is expensive, but also leads to different data sets that are inconsistent with each other and do not enable effective decision-making. Even if pools are able to provide the underlying data for their LGPS funds, the reporting burden in this area is ever-increasing (including the FRC's Stewardship Code and Annual Report).

Ultimately each LGPS fund is accountable for the way in which climate change is reflected in its strategy setting and in overseeing the implementation of that strategy by its pooling company (and, during the transition phase, any mandates held outwith their pool's remit). One way to reduce the replication of effort and process would be to enable LGPS funds to focus on these specific elements of the TCFD framework, with reference to their pools' reporting where appropriate.

Our final point is the ambitious nature of the proposed timeframes. Given the challenge to lay and implement regulations following the conclusion of this consultation, we would strongly recommend Government consider 2023-24 a pilot year, with the regulations enforced in the following year and the first reports published by the end of 2025. As the proposals currently stand, it is likely that data will need to start to be collated before the regulations have been finalised (i.e. from 1 April 2023).

I would be pleased to discuss these proposals and their implementation in more details.

Yours sincerely

Rachel Elwell
Chief Executive Officer

Consultation Response

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

- Government should progress implementation of the recommendations of the Good Governance Project

The proposals set out in this consultation underline the need to take forward the recommendations of the Good Governance Project led by the Scheme Advisory Board, particularly in terms of ensuring both officers and members have the appropriate level of training and understanding, and that roles and responsibilities are clear.

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

- Administering Authorities should identify and assess climate-related risks and opportunities

Climate change is a systemic risk which poses significant investment risks, but also opportunities, with the potential to impact long-term shareholder value and investment returns. It is essential Administering Authorities identify and assess climate-related risks and opportunities that impact their investment strategies.

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

- Statutory guidance should mandate the scenario analysis to be carried out across all administering authorities
- Regulations should recognise that scenario analysis is only significantly developed for some asset classes
- Administering Authorities should have discretion over repeating scenario analysis within valuation cycle
- Clarity is needed on when first scenario analysis should be conducted

Conducting scenario analysis at the overall Fund level is relevant for Administering Authorities looking to assess the impacts over the medium and long-term on their assets, liabilities and strategies.

It is important regulations reflect the challenges around the use of climate scenarios, assumptions and methodologies acknowledged in the consultation and that these limitations are made clear in how conclusions are presented.

Given the wide range of scenarios based on a 2°C or lower temperature rise there is a risk of selection bias. Statutory guidance to mandate the scenario analysis to be undertaken for the common scenario analysis across all administering authorities would be more appropriate.

We consider alignment of scenario analysis with the valuation cycle is appropriate. The proposed regulations should clarify whether scenario analysis is expected in 2023/24 given this is mid-valuation. We agree that Administering Authorities should have the discretion over whether scenario analysis should be repeated within a valuation cycle and explain that approach.

It is important Government recognises the different approach to scenario analysis by participants in the LGPS ecosystem. While actuarial analysis is conducted according to Government Actuary's Department guidelines, investment consultants are conducting it to inform strategic asset allocation. As a pool we approach this at the portfolio level.

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

- Statutory guidance should set out best practice in this area

We agree with the broad principles set out around risk management and look forward to seeing the detail in the statutory guidance. However, there is the risk that Administering Authorities may not have sufficient resource leading to an over reliance on consultants. We believe the statutory guidance should set out what a best practice approach in this area could look like.

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

- Guidance must clarify methodology to calculate total financed carbon emissions metric
- Total financed carbon emissions should be reported at portfolio or asset class level
- All Administering Authorities should use the carbon footprint metric
- Proposals should be aligned with existing reporting template developed by industry
- Paris alignment should be determined according to Paris Aligned Investment Initiative (PAII) criteria
- Administering Authorities reporting fewer metrics may unfairly appear less committed to addressing climate change risks

Absolute emissions metric

We support the use of the absolute emissions (total financed carbon emissions) metric to measure overall carbon emissions attributable to the fund's invested assets but further clarity is needed on the calculation and formula for this proposed metric.

We do not agree with reporting Scope 1, 2 and 3 data separately as well as aggregated for each proposed metric. Whilst it is understood that Scope 3 should be disclosed, there are issues regarding data quality, with high levels of estimation required and the significant risks of double counting of emissions. In addition, there is an absence of sufficiently robust methodologies and issues with the data quality and availability.

Modelling or estimating emissions for assets not covered is problematic. Different methodologies could be used by data providers, Administering Authorities or their pooling companies, potentially leading to very different results and outcomes; for example, using the Listed Utilities sector as a proxy for renewables investments in Private Markets would result in a high carbon profile (under Scope 1/2) and perhaps result in unintended consequences impacting renewables investments.

Government should consider how proposals can align with the existing reporting template developed by a working group which included the PLSA, ABI and Investment Association to help pension schemes meet their obligations under the Climate Change Governance and Reporting Regulations, associated DWP Statutory Guidance and the FCA's ESG Sourcebook. This template requests managers to report Scope 1 and 2 emissions in aggregate and Scope 3 separately. Some managers will already be reporting data in this format.

We would question the usefulness of reporting total carbon emissions at a whole fund level. Such a figure would have the potential to be a highly misleading indicator where change from year to year is driven by complex underlying reasons which cannot be explained by a single number and may be misleading to stakeholders. We consider metrics to be most useful when calculated at the portfolio or asset class level.

Emissions intensity metric

We support the use of an emissions intensity metric, however further clarity is needed on the calculation and formula to ensure there is no ambiguity and that the calculation is aligned with current best practice.

An Administering Authority that can provide Weighted Carbon Intensity should be able to provide the Carbon Footprint data. Administering Authorities using different intensity metrics would make it harder to aggregate at Scheme level. As carbon emissions are the common input into all of the suggested metrics, it would be more appropriate for all Administering

Authorities to use the carbon footprint metric with the option to report a different intensity metric additionally.

Data quality metric

We agree the LGPS has a role to play in using its influence to encourage increased data reporting across asset classes.

Administering Authorities will find it difficult to report data as 'verified' as this is not currently standard with third-party data providers. This would need to be on a best endeavours basis, and to be improved and reported over time.

Reporting of data by third-party providers varies. Some do not report Scope 1 and 2 separately but as an aggregated figure. Requiring Administering Authorities to report all three scopes separately may add extra cost to extract the data. Reporting extra data and numbers also has the potential to make reporting more confusing for stakeholders with no perceivable benefits.

Paris alignment metric

We are supportive of aligning portfolios with the Paris goal. Reporting a Binary Target Measure based on the proportion of assets that have set a Paris-Aligned target is most appropriate and can be improved and added to over time. To ensure the credibility of these targets, guidance should mandate an approach to determining alignment such as the Paris Aligned Investment Initiative (PAII) criteria, as this is already enshrined in Net Zero guidance so easier to ensure mass adoption.

We agree with the reservations expressed about the use of implied temperature rise (ITR) models. Different models from different data providers can produce very different ITR results, which could lead to 'model shopping' to find the metric which produces the lower score. There are also data gaps, inconsistencies and lack of reliability across many asset classes which limits the value of the metrics. We are concerned that over reliance on ITR metrics, may drive investment decisions that improve alignment scores rather than actively manage underlying climate risks, such as reducing or divesting entirely from currently high emitting companies and sectors. Although DLUHC is not mandating the use of ITR models, it is encouraging their use. This, and the suggestion Administering Authorities could pursue other metrics, risks creating a perception that some LGPS funds are less committed in this area than others when the reality may be grounded in capacity and proportionality. If the use of ITR were to be progressed the methodology should be mandated otherwise there is no way to ensure comparability.

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

- Government should mandate the setting of a target against the carbon footprint metric

We have set targets to increase the proportion of portfolio companies aligned to Net Zero. Our portfolio target is broken down into asset class level targets which together aim for a more ambitious emission reduction trajectory than the IEANZE2050 pathway. Further details of our approach to targets can be found in our Net Zero implementation plan.

There is a fundamental tension in the approach set out in the consultation which prescribes the use of specific metrics, allows target setting against those or other metrics chosen by individual Administering Authorities and the intention to produce a Scheme-level climate risk report.

To promote a degree of consistency across the Scheme, one metric against which a target is set should be mandated. Carbon footprint would be the most appropriate metric against which the target should be set. Where targets are set, we believe that Administering Authorities should explain the rationale for their choice of metrics and targets and should disclose this in their TCFD report.

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

- LGPS should report in line with TCFD recommendations but the nature and timescale of these proposals across 89 funds will pose significant challenges

Given the urgent action required regarding climate change, there is a need for a consistent approach across the pensions industry with regard to reporting on climate-related risks and opportunities. We therefore support the principle of publishing reporting in line with the recommendations of the TCFD.

However, the proposals will place the same requirements on all Administering Authorities from April 2023, regardless of size, in contrast to the approach taken in regard to occupational pension schemes where a ratcheted approach was adopted initially focusing on compliance from the largest schemes. There would further appear to be a tension between the timelines for reporting set out in these proposals and the requirements of the FCA's TCFD regime which requires the first public disclosures to be made by June 2023.

Implementing these reporting requirements from April 2023 and the production of first reports by December 2024 will pose a significant and perhaps insurmountable challenge for many Administering Authorities, particularly those smaller in scale. It will be challenging for Administering Authorities to procure the necessary expertise given the timescale of this consultation and the proposed implementation. It is not clear there is sufficient supply of external advice to meet demand which will likely further drive costs upwards.

It is imperative that each LGPS fund is aware of and manages the risks around climate change and has a fundamental agreement with its Pool as to how this is managed. Requiring Administering Authorities to produce full TCFD reports risks a duplication of reporting and effort especially where assets are substantially pooled.

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

- Aggregating data at Scheme level risks producing unreliable headline figures which misinform stakeholders

We are unclear as to the purpose and usefulness of the proposed Scheme Climate Risk Report, beyond providing signposting to the reports produced by individual Administering Authorities.

The consultation acknowledges the lack of available data, the quality of data and the limitations of metrics as challenges facing Administering Authorities in terms of reporting and recommends the use of modelling and estimation to fill them. Until there is a standard industry approach to carbon footprinting, it would not make sense to aggregate the data for the four metrics from each Administering Authority's Climate Risk Report as the data would be neither comparable nor compatible. Aggregating these uncertainties and variations will increase the likelihood of significant shifts in the published headline data from one year to the next driven by the changing quality of the underlying data rather than material changes in the level of climate risk. While individual Administering Authorities and pools have the context in which to understand significant shifts in the data, these will be much harder to identify and explain at an aggregated level for the whole Scheme.

The variations and uncertainties would risk stakeholders drawing erroneous conclusions around the performance in addressing climate change risk, and could lead to misinformed pressures to divest.

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

- Pools have a role to play but have different operating models and levels of resource
- Encouraging consistency in approach across Funds will make it easier for pools to support
- Progressing consultation on future of pooling framework would help clarify roles and responsibilities across the LGPS

We see a positive role for LGPS asset pools in driving responsible investment, pursuing active engagement and encouraging the development of stronger data and transparency. We recently published our Net Zero Implementation Plan detailing how we intend to deliver on our commitment to reach Net Zero in the investments we manage for our Partner Funds by 2050. We also publish our annual TCFD report which sets out our approach to managing climate-related risks and opportunities.

Pools have different operating models and levels of resource to meet these and existing reporting requirements. We see supporting our Partner Funds in meeting reporting requirements as an important part of our function and are developing our role as a centre of expertise in this regard. However, it will take time to develop to meet the demand we might anticipate as a result of these proposals, particularly if there is an expectation to produce data in relation to metrics Partner Funds may choose to measure against over and above the four mandated in the consultation. A consistent approach across Partner Funds would create opportunities around joint procurement on scenario analysis, data and reporting that could be supported at a pool level.

We believe the role of LGPS pools in supporting Administering Authorities to meet reporting requirements, on climate change risks and other areas, should be addressed as part of a comprehensive approach to the future of pooling in the LGPS aligning roles, responsibilities and capacity. The Government should move forward with the consultation on the future of the pooling framework as soon as possible.

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

- A timetable is needed for publication of the guidelines and template

We agree with the principles set out in the consultation however we would welcome a clear timetable for the publication of the guidelines and template, both in order to provide feedback but also given the implementation timeline. We have already expressed reservations about the timeline for implementation and we would urge these to be reviewed if guidance is delayed.

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

- Proposals will pose significant challenges in terms of skills and capacity
- Guidance should recognise the range of ways Administering Authorities manage climate change risks
- Government should take forward the Good Governance Project proposals

The reporting and frameworks around climate change and carbon footprinting of investments remain comparatively immature. As such the talent pool in this area is underdeveloped. The proposals set out in this consultation require the production of annual reports from each of the 89 LGPS funds. Whether from within Administering Authorities, LGPS pools or via external advisors, it is highly unlikely there is sufficient talent and capacity within the sector to meet that requirement at this point. We are concerned the demand for external consultant support implied by the proposals will drive up costs.

Clear lines of responsibility and delineation of roles and duties is a key part of the TCFD's 'governance' pillar. While ultimate responsibility for managing climate change risks and opportunities lies with Administering Authorities, we would like to see the statutory guidance recognise that Administering Authorities vary greatly in their degree of reliance on and interaction with advisers: some rely entirely on internal pension teams and managers, whereas others delegate a great deal to external advisers and their pools. We would welcome some flexibility in the statutory guidance to allow Administering Authorities to establish and work within a governance framework that best meets their needs.

Taking forward the Good Governance Project proposals from the Scheme Advisory Board would be a welcome step in addressing issues around ensuring participants in LGPS Governance have the appropriate knowledge, skills and 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?

We have no comment to make.