

# Scheme Advisory Board

## MEETING 10<sup>TH</sup> MAY 2021 ITEM 5 PAPER C

### CLIMATE CHANGE RISK AND REPORTING REGULATIONS

#### Issue

To note the response given by the Responsible Investment Advisory Group (RIAG) to MHCLG's request for comments on the presentation on TCFD reporting proposals given to the group on the 14<sup>th</sup> April

#### Background

Following DWP's consultation on proposals on climate change risk assessment and reporting, including mandating Task Force on Climate Related Financial Disclosures (TCFD) requirements on trustees MHCLG will follow suit later this year with their own proposals on how broadly similar reporting requirements should apply within the LGPS.

At the meeting of RIAG on the 14<sup>th</sup> April MHCLG set out its early thinking on how DWP's proposed reporting framework could be applied to the LGPS and, in particular, the areas where their proposals may differ from those of DWP. The four areas where MHCLG is minded to diverge from proposals made by DWP include:-

- applying the requirement to all funds by the year 2022/23, irrespective of the fund's size. DWP proposals include a staggered approach based on size of assets under management.
- proposing an LGPS-wide report summarising the constituent reports.
- not proposing to the same enforcement route through TPR which would include fines in the private sector.
- No requirements on individuals akin to the knowledge and understanding requirements made by DWP but instead to look at alternatives including a requirement to attain proper advice.

At the meeting MHCLG invited RIAG to respond to the proposals included in the presentation with particular focus on the above four areas of divergence from DWP's proposals.

#### Consideration

The response to MHCLG agreed by RIAG and the Investment, Governance and Engagement Committee is at Annex A.

The response supported the four specific proposals set out above although in the case of producing a consolidated annual report only qualified support was given on the basis that inconsistencies in data collection, measurement and reporting at fund level will vary unless centrally prescribed.

# Scheme Advisory Board

## Conclusion

**The Board is invited to note the above position and to task the Secretariat to continue to monitor developments and report back to the investment committee and SAB when appropriate.**

# Scheme Advisory Board

## Annex A

This paper sets out comments from the Responsible Investment Advisory Group (RIAG) on proposals for introducing TCFD reporting into the LGPS set out by MHCLG when the group met on the 14<sup>th</sup> April. The first part of the paper focusses on comments made in respect of the four areas where MHCLG is proposing to diverge from proposals recently consulted on by DWP for trust-based schemes. The second part covers more general comments in relation to the presentation given by MHCLG on the 14<sup>th</sup> April.

### Part 1

#### **“We are proposing to consult on the requirements applying to all funds by the year 2022/23, irrespective of the fund’s size”**

The group supports the proposal that the requirements should apply to all funds, regardless of size, by the year 2022/23. To do otherwise would result in a two-tier arrangement which we believe would be unhelpful. Historically, the LGPS has taken a lead on ESG and responsible investment issues and has always acted as a unified group. It is also the case that even the smallest LGPS funds are large by private sector standards

Although supportive of the proposal, the timetable proposed by MHCLG will be challenging for many fund authorities but we believe that concerns around resourcing and support, although valid, are more than outweighed by the advantages of a single arrangement applying equally to all fund authorities in the LGPS.

MHCLG also needs to be aware of the potential risk to the scheme if the quality of data and subsequent reporting output falls short of prescribed or acceptable standards. Guidance from both MHCLG and SAB will be key in this respect.

#### **“We are proposing an LGPS-wide report summarising the constituent reports”**

The group gives qualified support for this proposal. The proposal for a consolidated report appears sensible at the highest level but there are likely to be considerable difficulties and challenges in producing consolidated information given that different fund authorities and asset pools will be using different data providers, who in turn produce differing assessments of the same company.

More positively, we believe that a consolidated report of some form could be published provided that the content is sufficiently high-level rather than granular. Avoiding granular data would also mitigate against the risk of data being misrepresented in league tables by the media and special interest groups.

# Scheme Advisory Board

We recommend that any consolidated report should include the number of funds (and asset pools where appropriate) that have the relevant elements of the reporting framework in place, and key information such as the range of outcomes from the scenario analysis which is included in the fund/pool report.

**“We are not proposing to introduce fines and do not have the same enforcement route through TPR. We do not see strict enforcement as being necessary given the local accountability and transparency brought by a scheme wide report would be enough to foster good levels of compliance”**

The group supports this proposal. There is no clear evidence that LGPS funds ignore the various regulatory requirements imposed on it so an additional enforcement regime over and above existing requirements would seem to be inappropriate and unhelpful. We also believe that the monitoring arrangements that may flow from the good governance project should provide additional monitoring arrangements to ensure that reporting complies with prescribed standards.

**“We do not propose having requirements on individuals akin to knowledge and understanding requirements made by DWP.....We are proposing a requirement to attain proper advice.**

The group supports this proposal. SAB has already asked MHCLG under the auspices of the good governance project to make additional requirements around knowledge and understanding. The requirement for proper advice is entirely proper and reflects both general public law and existing requirements in the scheme’s 2016 Investment Regulations when investment decisions are being considered and agreed.

## Part 2

The following points have been made by individual RIAG members and do not necessarily reflect the views of the group as a whole. They are provided on the basis that they may help MHCLG to formulate their proposals for public consultation on the scheme’s TCFD reporting framework later in the year.

### Support from Asset Pools

- Where there is a pool company the Pool may be able to provide assistance and data in relation to assets which it manages. It may also be able to co-ordinate data provision for other assets but this may depend on the contracts in place for data provision (for example in our pool providing data on non-pooled assets requires a different licence agreement with MSCI (or another provider) for which a procurement will be required, meaning that it cannot be done this year). Equally while the pool companies do have considerably more RI resource than was present previously these resources are fully employed on other important work so freeing them to work on this is not cost free. Equally those pools who do not have an operating company (particularly those

# Scheme Advisory Board

renting an operator) will be drawing on the existing teams within the funds who again are fully committed.

- Once all assets are transferred from fund authorities the asset pools can play a major role but for now it is a step too far.

## Resources

- The supply of specialist suppliers and the ability to procure them easily is an issue that has been raised in the discussions around the new National LGPS Framework for Stewardship etc which is aiming to be operational from the end of March 2022. There will be cost implications arising from this. In the context of the scale of the financial risk being addressed and the scale of the scheme these are, in reality, minor. However, they do exist and it will be important to manage stakeholder expectations around this.
- Most funds will need to procure external help as many are under resourced already. This will incur additional costs which needs to be recognised.

## National v Local Prescription

- There is a significant (although possibly reducing) diversity of views amongst elected members on these issues and in particular the setting of targets which may generate a negative response to the idea of targets being “imposed” during a consultation process. I am sure there are ways of presenting things that can avoid this becoming an issue and the consultation being dragged down the rabbit hole of a debate over fiduciary duty, but I am conscious that the RIAG and those that CLG have talked to so far might be regarded as “the converted” so there is some risk when this goes out to a wider audience.

## Metrics, etc

- Consistent metrics and targets will facilitate comparability and also help to ensure that asset managers are able to provide their clients with the correct data in an efficient and cost effective way.
- Treat any data relating to fixed income with caution. The data quality is generally poor and disclosure level is very low. This can provide an inaccurate picture of climate risk.
- Scope 3 emissions are still not very reliable from a data perspective. A requirement around Scope 1 and 2 with an optional additional metric on Scope 3 may be more appropriate.
- Do not underestimate the amount of work involved in producing a TCFD report.
- Because all the data, information, scenarios and techniques are new fund authorities will need to be given a safe period to test and learn their reporting regime.

# Scheme Advisory Board