SAB Item 5

Scottish LGPS Scheme Advisory Working Group **14 February 2022**

Responsible Investing – Climate Related Financial Disclosures

Working Group Members

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Purpose

At the last meeting of the Scottish Scheme Advisory Board (SSAB) on 24 November 2021, the SPPA presented its paper 'Climate Risk Reporting & ESG Standards – TCFD requirements', which indicated that Scottish Ministers would welcome the SSAB's recommendations on making TCFD reporting a regulatory requirement for the Local Government Pension Scheme funds in Scotland.

In response to the request, the SSAB set up a working group to inform the recommendations. It was tasked with reporting back to the SSAB in February 2022. This paper summarises the group's findings and provides its recommendations.

Meetings and Research

The working group has met twice since the SSAB meeting in November, on 15 December 2021 and on 25 January 2022.

Ahead of the December meeting, advisers drafted the paper in the Appendix for information and for discussion. It describes the Taskforce for Climate Related Financial Disclosures (TCFD) and the evolution of climate reporting. It notes that the UK is a world leader in this area and that recent DWP regulations for private sector pension schemes in the UK have provided the latest 'template'.

With a clear understanding of the current and evolving landscape in the UK, the working group agreed to clarify how Scottish LGPS funds were thinking about TCFD and what they were doing. It had been noted that some funds have reported in line with TCFD recommendations for 3-4 years without being mandated to do so, but it was recognised that more detailed reporting would necessitate additional resource.

The 11 funds were contacted, and findings summarised for the meeting on 25 January. The working group reviewed these findings as well as feedback from JS and SS, who had attended a meeting of the England & Wales SAB Responsible Investment Advisory Group in early January.

Climate-related Reporting - Scottish LGPS

The working group was pleased to note that all 10 funds that provided feedback showed good awareness of climate-related reporting and climate-related risks and opportunities. Indeed, 4 funds already report in line with TCFD recommendations, and a further 5 funds are preparing to do so over the next one or two years. Other findings of note include:

- 9 of the 10 funds that provided feedback support one or more climate change engagement or disclosure initiative, and at least 4 use engagement specialists to support officers.

- Half the funds already undertake climate change reporting to the Pensions Committee or in their annual report.
- Most funds incorporate climate change policy or strategy in their Statement of Investment Principles (SIP) or Statement of Responsible Investment Principles (SRIP), and one fund has a standalone climate change policy.
- Several funds are signatories to the UN-sponsored Principles for Responsible investment (PRI)and report on climate-related activities through the annual PRI survey.
- Several funds use an external voting service with a climate focus, and Local Authority Pension Fund Forum (LAPFF) members (including Falkirk, Lothian, North-East and Strathclyde) receive climate-focused voting recommendations.
- Carbon footprinting is the main approach to climate reporting currently, although one fund undertakes scenario analysis. Funds noted the inherent limitations of such footprinting and scenario analysis, which provide transparency, but are open to interpretation. The methodology for carbon footprinting is still in development for some asset classes.
- Examples of approaches by one or more of the funds:
  - Engagement with companies to align with the goals of the Paris Agreement, assess against the Transition Pathway Initiative (TPI), withhold primary capital (debt and equity) from non-aligned companies, and integrate specific Environmental, Social and Governance (ESG) considerations into decision-making
  - Invest in funds that target Paris-alignment or so-called Climate Transition Strategies
  - Development of minimum standards assessment of energy sector companies.
- For those not yet reporting and for additional reporting, funds see additional costs being incurred as extra resources will be required eg data and consultants.
- Funds also noted how resource intensive the new Financial Reporting Council (FRC) Stewardship Code (SC) is. This involves voluntary reporting on responsible investing activities, including climate-related stewardship. One fund is a signatory to the SC, two have submitted applications and await the outcome, and two are considering submissions for 2022 or 2023.

The findings from the working group investigation were highly encouraging – all funds are fully aware of the evolving landscape and the vast majority are already preparing to report in line with TCFD recommendations voluntarily.

Climate-related Reporting – UK Pension Funds

The working group also considered developments at the Department for Work & Pensions (DWP) and the Department for Levelling Up, Housing and Communities (DLUHC). The DWP regulations for climate reporting for private sector funds are now effective. Meantime, the DLUHC is due to consult on the climate risk and reporting framework that will apply to the LGPS in England and Wales, but this has, apparently, been delayed due to resourcing issues rather than any controversy.

The E&W SAB's RIAG noted at its meeting in January that "…the DWP expects the LGPS to follow in broad terms what applies to trustees". Given the nature of reporting, financial or climate or otherwise, anything less than a standardised approach would cause unnecessary, unhelpful, and costly frictions for suppliers and consumers of the necessary data.

Conclusions

The working group found that the funds are fully aware of DWP regulations for the private sector, keen to minimise related risk, and willing and ready to report along the same lines. Significant progress has been made over the last couple of years:

- Most funds undertake climate change reporting or are planning to implement this voluntarily.
- Most funds participate in the Scottish Asset Owners' Roundtable on Responsible Investment to keep abreast of changes.

Rather than recommend that reporting regulations are imposed now, the group proposes that the SAB continues to monitor DLUHC developments. In the interests of adopting a consistent approach across all pension funds in the UK, and particularly the LGPS funds, it suggests that the SSAB:

- Writes to all Scottish funds to keep them informed about UK-wide developments; to encourage them to understand the TCFD framework and start collecting relevant data given lead-in times required; to voluntarily report in line with TCFD requirements where possible; and to cooperate with each other to share knowledge
- Engages with the E&W SAB to monitor the LGPS direction of travel there
- Assesses the outcomes of the DLUHC consultation when it is complete
- Revisits the question of regulations and reporting requirements at future meetings

Although the consultation has yet to be initiated, the presumption is that the LGPS across the UK will ultimately adopt a similar, if not identical, approach to the DWP regulations for private sector funds. The rationale is:

- The UK may be a leader in setting standards, but TCFD reporting standards are intended to be global standards
- Creating unique reporting requirements would cause confusion
- Creating unique reporting requirements would add resource and financial burden to the SLGPS
- Most, if not all, funds are clearly on the path to good disclosure, and understand the risks of ignoring climate change