Hampshire Pension Fund consultation response – LGPS governance and reporting of climate risks

Hampshire Pension Fund believes that climate risk, and the issues which contribute to it, is a key risk to the Fund and of significant concern to all stakeholders. As a result the Pension Fund supports the objectives of the Paris Agreement.

Hampshire Pension Fund supports the aims and objectives of TCFD and has produced two annual TCFD reports, the latest of which is published on the Fund's website [TCFD-report.pdf (hants.gov.uk)]

In general terms Hampshire welcomes the adoption of TCFD reporting into the LGPS regulations, and the LGPS catching up with the requirements already in place for private sector pension funds. Hampshire welcomes DLUHC's consultation to work out how the LGPS should adopt the TCFD reporting requirements, however in several key areas we would caution that expectations need to be managed:

- There are significant gaps in both the coverage and quality of data. Scope 3 emissions are only starting to be reported for some listed equities and there is no emissions data at all for most unlisted investments.
- Given that there is an incomplete data set, it is unsurprising that the knowledge and understanding in this area is also evolving. Pension Funds cannot rely on a similar set of established standards that they typically would for general investment advice.
- This creates a challenge given the increased burden for knowledge and skills that Climate Risk Reporting places on all those charged with managing and governing LGPS funds, which will also take time to evolve to the levels that we would aim for.

Hampshire believes that LGPS funds will need to *learn by doing* in relation to Climate Risk reporting. This will inevitably lead to the need to acquire external support and Hampshire believes DLUHC needs to be more realistic about the extent of these costs. DLUHC have stated that they were expecting the estimated cost of compliance to be similar to that which DWP estimated at £14,000 for private sector schemes. Hampshire's experience to date and expectations are that this figure is significantly short of the mark, which is manageable for a fund the size of Hampshire and still provides value for members through the information that is produced but may be more of an issue for smaller funds.

Finally, and most importantly, the Hampshire Pension Fund calls on DLUHC and Government more generally to be clearer in its communication that the role of institutional investors like the LGPS is quite limited in comparison with the impact which national government policy can have. Whilst we as a pension fund are willing and committed to declaring our climate strategy and impact, there is a need for Government policy to be fully aligned on these questions – to highlight just one area of potential policy change - allowing landlords access to tenants utility usage data. Pension funds would find it much easier to make good environmental investment choices if the regulatory and tax policy incentives were also aligned with them.

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

Yes – it is reasonable that Pension should be (and are) managing climate risks/opportunities through their existing risk management frameworks, which should be clear and reportable. Similarly, Hampshire's Pension Fund Panel and Board will be equipped to scrutinise on an ongoing basis advice received in relation to climate risks, as they do with any other advice, albeit this is a significant and emerging area of new knowledge and skills for officers and committee members, which is discussed in more detail in answer to question 11. Given managing climate is an emerging discipline a definition of 'properly qualified' advisors in Guidance would be helpful.

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

Yes. Statutory Guidance with further clarity on the types of risks, opportunities, expected actions and time horizons is welcomed.

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

Yes, in particular the pragmatic approach of conducting scenario analysis every 3 years and that the responses can be both qualitative and quantitative. A small set of plausible scenarios should be agreed and defined in the Statutory Guidance. Given Government is acknowledging that *data quality and availability may also be a problem particularly for some asset classes,* there needs to be a degree of realism whether there can be any differentiation between two different scenarios.

Hampshire's experience from adopting TCFD reporting and conducting a scenario analysis of investments in 2021 based on the UN's *Inevitable Policy Response* was that it was not possible for investment managers in any asset class to consistently quantify an impact, but that it was a useful exercise in assessing the Fund's investment managers capabilities to engage with assessing climate risks and opportunities.

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

Yes – we agree with the proposed requirements on risk management but would welcome it being supplemented by Statutory Guidance.

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

Yes – to an extent. Hampshire is content that the consistent focus on 4 types of metrics is positive for the LGPS.

Whilst the Government acknowledges that gaps in data do exist, this feels like an understatement of the issue, and Government should acknowledge that full reporting of these issues is currently aspirational. Generally speaking only Scope 1 and 2 carbon data is available for public listed equities, which is about half of Hampshire's investment strategy, which we believe is fairly representative of LGPS funds. This leaves most asset classes other than equities unable to report on carbon data, with no reliable actual Scope 3 data available. We welcome the acknowledgement in the consultation to report on gaps in the data, but nonetheless feel that expectations need to be reset.

We do question the merits of reporting estimated data, which could encourage an industry in estimation and the associated cost, which while interesting carries the danger of taking focus and energy away from the actual change being targeted for a move to a lower carbon economy. Estimated data does not provide the evidence to support the necessary investment decisions and company engagement to encourage transition to a low carbon economy. It is therefore questionable whether including estimates is any better than just reporting gaps in the available data.

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

Hampshire Pension Fund has committed to the aim for its investments to have net-zero greenhouse gas emissions (which includes Scope 1, 2 and 3 emissions) by 2050 at the latest, and as such is comfortable with the proposal for target setting.

The Pension Fund welcomes the acknowledgement in the proposal that it is not legally binding and recognises the Fund's fiduciary duty that setting a target would not require a fund to divest from or invest in a particular investment. This is based on a reiteration of our opening remarks that while the Pension Fund acknowledges the part it has to play as an investor in achieving the transition to a lower carbon economy and its aim of having net-zero emissions from investments, it is reliant on national government policy and consequent company action leading this direction.

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

Yes – in line with its existing commitment to TCFD reporting, the Hampshire Pension Fund is supportive of annual reporting and consolidating Climate Risk Reporting requirements into the existing requirements and timescales for LGPS funds annual reporting.

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

No – we believe that it is premature to be considering aggregating reporting given the immaturity of climate data and believe that Administering Authorities should be given time to develop their approach to Climate Risk Reporting before thought is given to aggregated reporting. We note the SAB's response that *initially their report is likely to be limited to a commentary on the work undertaken at fund level*.

Hampshire believes that the aggregated reporting would be adding unnecessary further cost to climate reporting, and the Pension Fund would not be supportive of any addition to its contribution to the SAB for such a purpose as we do not believe that this would add any value to scheme members.

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

Hampshire welcomes the opportunity to work with its pool partners and the ACCESS pool in sharing expertise and benefiting from scale in implementing the TCFD requirements, and this has already begun with discussion of this consultation.

We believe that the pool will have an important role in establishing consistency in reporting across the investment managers it commissions and is well placed to jointly commission any additional analysis that may be required by all partners. However we would caution against this significantly diminishing the additional costs that the new requirements bring.

Furthermore we wish to highlight the unhelpful assertion that individual LGPS funds can mitigate the costs of TCFD reporting by further aligning their strategies and investments. This is very much the *tail wagging the dog*. It has been highlighted to Government on a number of occasions through consultation that individual Administrating Authorities have an individual democratic accountability and fiduciary duty for their pension fund and need to decide on the appropriate strategy for their own LGPS fund. The aim of minimising climate reporting costs should not be suggested as a determining factor in setting an Administering Authorities' investment strategy.

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

As stated in a number of places throughout this response, Hampshire welcomes further guidance on several key aspects of these proposals.

We would like to highlight that guidance is only useful if it is produced in a timely manner. Therefore we would ask that Government commits to both statutory and template guidance being published by 30 September 2023 if the Government wishes to implement the proposed timetable of reporting for the 2023/24 year.

As outlined in our answer to Question 8, we are not supportive at the current time of a Scheme Climate Risk Report and therefore believe that a standard template should be limited to providing Administering Authorities with a suggested approach for them to comply with the requirements as the basis for their own reporting.

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

We welcome the acknowledgement that Scheme Managers are not expected to be experts on Climate Risk and therefore Administering Authorities must take proper advice regarding assessing and managing climate risks and will need to satisfy themselves that the advice is high quality and provided by appropriately qualified people.

However, we would again reiterate the caution that this is a rapidly evolving field and there are limitations to the standardisation of qualifications and accreditation for providing advice. We therefore feel that an element of time is needed for this evaluation to take place before some of the more normal evidence and assurance for giving and receiving advice is available. In the interim we would expect to remain in dialogue with colleagues across the LGPS, our pool and industry providers on how best to acquire and share expertise.

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?

The Hampshire Pension Fund's Responsible Investment policy recognises the importance of an orderly transition to a low carbon economy being inclusive and not leaving anyone behind – referred to as a *just transition*. We would expect to be reference to this in our Climate Risk reporting.