

Contact: Paul Cooper
Telephone: 03000269799
Email: paul.cooper3@durham.gov.uk
Your Ref:
Our Ref:



By email to LGPensions@levellingup.gov.uk

LGF Pensions Team
Department for Levelling Up, Housing and Communities
2nd Floor
Fry Building
2 Marsham Street
London
SW1P 4DF

24 November 2022

Dear Sir or Madam

Local Government Pension Scheme (LGPS) Consultation: Governance and reporting of climate change risks

Durham County Council welcomes the opportunity to comment on strengthening Fair Deal protection in the LGPS. This response is on behalf of the council, acting in its capacity as Administering Authority for the Durham County Council Pension Fund. The Fund has around 60,000 current, deferred and retired members from over 100 organisations.

Generally, the Fund welcomes the principle of clear and consistent reporting for the LGPS, to demonstrate how the Scheme is managing both the risks and investment opportunities of climate change.

The Fund would however, like to highlight concern about the potential unintended consequences of pushing too far and too quickly towards a whole of scheme reporting regime. The Fund believes that amalgamating metrics calculated on different methodologies and using different data sets may lead in the short-term to unreliable information that is hard to explain and not sufficiently robust or credible on which to make decisions. Given the level of scrutiny that such figures will likely receive, we would ask that consideration is given to the potential impact and calls for action that will likely follow. The Fund would therefore also echo comments from the Scheme Advisory Board (SAB) that further guidance and clarity on the fiduciary duty is required - in particular, on the extent to which the pursuit of carbon or temperature reduction targets may justify investment choices that entail some element of financial detriment.

The Fund also has concerns about the proposed timeframes for implementation. Given the challenge to lay and implement regulations following the conclusion of this consultation, The Fund would ask that the Department consider 2023-24 a pilot year, with the regulations enforced in the following year and the first reports published by

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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 set out below specific responses to the questions raised in the consultation:

Question 1: Do you agree with our proposed requirements in relation to governance? The Fund welcomes the intention for LGPS Funds to establish consistent oversight of climate risk and opportunities. The proposals require that LGPS Funds appoint properly qualified advisors – it may be consistent with the Investment Regulations to require that administering authorities to “take proper advice”. Alternatively, the relevant qualification expected should be outlined.

The Fund would welcome the implementation of the recommendations of the Good Governance Project led by the Scheme Advisory Board, which would be an opportunity to formalise the knowledge and skills requirements in relation to climate risk for both members and officers.

Question 2: Do you agree with our proposed requirements in relation to strategy? The Fund welcomes the focus on both risk and opportunity, having already committed £70m to a Climate Opportunities Fund managed by our pool operator, Border to Coast Pensions Partnership (BCPP).

Question 3: Do you agree with our suggested requirements in relation to scenario analysis? The Fund welcomes the recognition of the limitations of available data and hopes that the intended regulations reflect the challenges around the use of climate scenarios, assumptions, and methodologies; and that these limitations are made clear in how conclusions are presented.

The Fund also agrees with the intention to align the analysis to the LGPS valuation cycle. The proposed regulations should clarify whether scenario analysis is expected in 2023/24 given this is mid-valuation. The Fund would also welcome any measures that limit cost and duplicate effort, with particular reference to GAD’s existing expectation to quantify the risk of climate change in valuation reports.

Whilst allowing for a range of scenarios across the LGPS will support a more broad exploration of the implications of a low carbon transition and climate-related physical risks; a more prescriptive approach may better enable the LGPS Pools to effectively support their underlying LGPS funds.

Question 4: Do you agree with our proposed requirements in relation to risk management? The Fund agree with the broad principles set out around risk management and look forward to seeing the detail in the statutory guidance. However, the Fund supports the view that 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? The Fund agrees that considering more than one metric will provide a more balanced view of climate risk exposure. In respect of *Absolute Emissions* metric proposed, the Fund is concerned however, that whole of fund reporting that relies significantly on assumptions may lead to misleading comparisons between LGPS Funds and misinform investment decisions. Additionally, the Fund

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understands that some managers within the industry are already reporting on Scope 1 and 2 in aggregate and Scope 3 separately. As noted in the proposals, Scope 3 emissions are less widely reported and are often approximated – the Fund would welcome these limitations being reflected in the Statutory Guidance.

In respect of *Emissions Intensity*, the Fund understands that WACI is more readily available, particularly in fixed income due to limitations on the availability of Enterprise Value (including cash), which is required to calculate the Carbon Footprint but not WACI. As such, it may be preferable to utilise WACI as the measure of intensity. For either approach, the Fund would welcome clarity in the Statutory Guidance on the calculation and formula to achieve consistency.

Whilst the Fund recognises the rationale for the inclusion of the *Data Quality* metric in order to utilise the LGPS scale to drive improvements in data quality; the Fund understands that it will be difficult to report data as ‘verified’ as this is not currently standard with third-party data providers. As such, Funds would need to report on a best endeavours basis, and it would therefore be welcomed if this difficulty was recognised in the Statutory Guidance.

The Fund agrees that the binary *Paris Alignment* metric will be useful in providing a simple to understand metric for stakeholders. To mitigate the risk of greenwashing, the Fund would welcome the Statutory Guidance mandating 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.

Question 6: Do you agree with our proposed requirements in relation to targets? The Fund welcomes the intention to provide Statutory Guidance to support LGPS Funds and the reiteration that targets should not be set that would require them to divest or invest in a prescribed way. Significantly, the Fund would welcome clarification in the proposed Guidance that specifically addresses the issue of fiduciary duty and in particular how LGPS Funds can reconcile the primacy of return requirement with Net Zero (or other) targets.

Finally, it would be useful to make clear in the Guidance how soon a target must be set – the Fund would understand that this would be after giving due consideration to the first year’s analysis (ie. post-2023/24) and that the first year’s report will not therefore include any analysis against targets.

Question 7: Do you agree with our approach to reporting? The Fund is fully supportive of the public disclosure of the Climate Risk Report and agree that the report should be suitable for both specialist and non-specialist stakeholders including scheme members, members of the public and other parties. However, implementing these reporting requirements from April 2023 and the production of first reports by December 2024 will pose a significant challenge for LGPS Funds. It will also pose a challenge to procure the necessary expertise given the timescales of the consultation and the proposed implementation.

Question 8: Do you agree with our proposals on the Scheme Climate Risk Report? The Fund notes the intention to produce a whole of Scheme annual Climate Risk Report via the SAB, who will develop a template for the aggregation of data. The Fund would welcome the opportunity for stakeholders (in particular LGPS pools)

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to have an input on the development of the template.

Whilst the Fund recognises the potential usefulness of a Scheme-wide report for its members and stakeholders, the Fund would caution against any move towards 'league tables' given the given the different funding levels and investment strategies pursued by the respective LGPS Funds.

Additionally, given the lack of available data, the quality of data and the limitations of metrics, as well as use of modelling and estimation, all noted in the proposals the Fund has concerns over the interpretation of the aggregated data and potentially misinformed comparison between LGPS Funds. The variations and uncertainties may risk stakeholders drawing erroneous conclusions around the respective performance of LGPS Funds 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? The proposals reference the benefits of scale brought by the LGPS Pools and the development of significant capabilities in relation to climate risks and responsible investment more broadly. The Fund recognises these benefits and has to date pooled 80% of its assets; with a clear plan for the transition of the remaining 20% of assets (aside from cash, and a small local impact investment aligned to the LGPS Levelling Up proposals). Where desired strategies are not available through the pools however (now or in future), LGPS Funds should retain the flexibility to set and implement strategies outside of the pools.

As noted, in response to Question 3, allowing for a range of approaches across the LGPS will support a more broad exploration of the implications of a low carbon transition and climate-related physical risks; but a more prescriptive approach may better enable the LGPS Pools to effectively support their underlying LGPS funds. Finally, the Fund would welcome progression with the consultation on the future of the pooling framework as soon as practical in order to provide greater clarity on the overlapping challenges of pooling, climate risk and reporting, and governance.

Question 10: Do you agree with our proposed approach to guidance? The Fund welcomes the overall principles of the consultation but remains cautious about the about the timeline for implementation.

Question 11: Do you agree with our proposed approach to knowledge, skills and advice? The proposals set out in this consultation rare likely to increase the demand for external consultant support and it should be noted that the proposals are likely to drive up LGPS costs.

Additionally, the Fund would welcome progression of the SAB's Good Governance proposals which will assist in addressing issues around ensuring participants in LGPS Governance have the appropriate knowledge, skills and advice. It may also be useful to LGPS Funds for the SAB to consider setting a list of priority climate-related topics that it expects LGPS Funds to consider as part of their investment and funding strategies, which could inform respective training plans.

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? No.

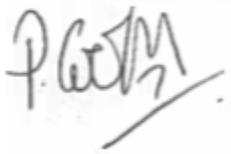
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Please do not hesitate to contact me if you wish to discuss this response.

Yours faithfully

A handwritten signature in black ink, appearing to read 'P. Cooper', with a long horizontal stroke extending to the right.

Paul Cooper
Head of Pensions

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