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Government pension's consultation on the reporting of climate change risks

The Department for Levelling Up, Housing and Communities (DLUHC) has published a consultation on proposals to require Local Government Pension Scheme (LGPS) administering authorities (AAs) in England and Wales to assess, manage and report on climate change risks.

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LGPS funds are increasingly coming under pressure to divest from fossil fuels and accelerate their progress to becoming carbon neutral. For example, in July, it was reported that the West of England Combined Authority Mayor failed in a bid to force an LGPS fund to divest entirely from fossil fuels and, in March, Climate Emergency UK published Council Climate Plan Scorecards for the climate action plans of 409 councils across the UK, showing that only a handful of LGPS funds have set net-zero target dates ahead of the government's 2050 target for the country.

Consultation proposals

The consultation is in line with recommendations made by the Task Force on Climate Related Financial Disclosure (TCFD) but was nearly derailed earlier this year by events in Cabinet.

The proposed measures are intended to ensure that the financial risks and opportunities arising specifically from climate change are properly understood and effectively managed by the 86 administering authorities that locally manage the LGPSs.

The proposals mirror similar measures introduced for private occupational pension schemes in regulations adopted in July 2021 that entered into force on 1October 2021. Implementation of the new requirements has been staged for private pension schemes, with private schemes with £5 billion or more in assets immediately in scope, while those with £1 billion or more will follow in October 2022, and schemes with less than £1 billion in assets not being covered.

In contrast, the proposed measures will apply to all LGPSs from 2023/24 regardless of fund size.

The proposals address four separate areas: governance, strategy, risk management, and metrics and targets, reflecting recommendations made in the TCFD's final report published in June 2017.

Governance

In relation to governance, the proposals place new duties on AAs to establish and maintain, on an ongoing basis, oversight of climate-related risks and opportunities and processes to ensure those who undertake climate-related governance activities do so effectively.

The proposals require AAs to identify short-, medium- and long-term climate-related risks and opportunities and assess their impact on the AAs' investment and funding strategy.

The TCFD recommends that organisations undertake scenario analysis in order to improve the quality of strategies. The consultation proposals require AAs to assess their assets, liabilities, investment strategy and funding strategy against climate risks and opportunities in at least two climate scenarios, which must include at least one scenario based on a global temperature rise of 2°C or lower on pre-industrial levels.

Risk Management

The proposals on risk management require AAs to establish and maintain processes to enable them to identify, assess and manage climate-related risks, and integrate climate-related risk management processes into their overall risk management.

Metrics

In relation to metrics, the proposals require AAs to measure and disclose four metrics: Total Carbon Emissions, Carbon Footprint, Data Quality and a Paris Alignment Metric.

The Paris Alignment Metric describes the extent to which an AA's activities are aligned with a well below 2°C scenario (i.e. with the goals of the Paris agreement), which is consistent with net-zero carbon emissions by 2050. This echoes a similar requirement on private occupational pension schemes to use a metric which gives the alignment of the scheme's assets with the climate change goal of limiting the increase in the global average temperature to 1.5°C above pre-industrial levels.

Targets

The TCFD recommends that organisations set targets based on the metrics they select, including a target date, baseline and performance indicators, in order to focus efforts on managing climate risk. The proposals require AAs to set a target for their funds in relation to one of the metrics which they have selected and annually measure, as far as they are able, the performance of their fund against the target they have set and, taking into account that performance, determine whether the target should be retained or replaced.

The consultation document also states: "*There is no expectation that AAs should set targets which require them to divest or invest in a given way, and the targets are not legally binding.*"

The consultation also proposes that AAs carry out scenario analysis, obtain data, calculate, and use metrics and measure performance against AA-set targets "*as far as they are able*". AAs are expected to take all reasonable and proportionate steps, given costs and time constraints.

The consultation notes that LGPS asset pools, which aim to secure the benefits of scale by bringing together several LGPS funds into one, can play a key role in supporting implementation, but does not propose any additional measures to support pooling.

Analysis

The proposals include the explicit and sobering acknowledgement that a temperature rise of up to 2°C is a sufficiently likely scenario that LGPSs and other pension funds should be planning for it.

The proposed changes should be read in the context of a new power introduced to the Public Service Pensions Act 2013 allowing the government to make regulations giving "*guidance or directions on investment decisions which it is not proper for the scheme manager to make in light of UK foreign and defence policy*".

The new power effectively overrides the Supreme Court's decision in the case of *R (on the application of Palestine Solidarity Campaign Ltd and another) (Appellants) v Secretary of State for Communities and Local Government (Respondent)*, decided in April 2020.

The case concerned amendments made to the investment regulations applying to LGPSs in 2016 by the then Department for Communities and Local Government (DCLG) to require AAs to publish an investment strategy — including their approach to pooling investments and how they take into account ESG factors. The reformed regulations required that the strategy must be in accordance with guidance issued by the Secretary of State.

The guidance initially issued under the regulations stated that schemes should consider any factor financially material to the performance of their investments, including ESG factors, but restricted the ability of schemes to pursue boycotts, divestments and sanctions, stating that they "*[s]hould not pursue policies that are contrary to UK foreign policy or UK defence policy*".

The appellants brought a claim for judicial review, alleging that the Secretary of State had overstepped their powers in seeking to prohibit the AAs from taking an investment decision that runs counter to the government's foreign and defence policies. The Supreme Court agreed and the Local government pension scheme: guidance on preparing and maintaining an investment strategy statement was amended.

Following the adoption of the new power incorporated into the Public Service Pensions Act 2013, the LGPS Scheme Advisory Board (SAB) has published a series of questions and answers, which confirm that there is no immediate duty on scheme managers to take immediate action, and that any guidance or directions issued under the power would be subject to a 12-week consultation period.

This suggests that the scope for AAs to take decisions on ethical investments is now subject to some political control or, at least, the inevitable delays that will result from waiting for guidance or directions on any boycott, divestment or sanction of such investments.

The Director of Treasury and Pensions at Westminster City Council has commented that a barrier to the pooling of LGPS assets is the creation of multiple sets of targets for climate action across England and Wales. The proposals in the current consultation do not establish a standard suite of targets across all LGPS funds, which might facilitate pooling, and the Climate Emergency UK Scorecard also suggests that there is wide variation in progress on plans to tackle climate change across LGPS funds, which would also impede pooling.

Any targets will not be legally binding and AAs are only required to measure performance against targets "*as far as they are able*".

The measures outlined in the consultation will more closely align the legislative framework with national and international climate change ambition, but it remains to be seen whether the proposals will accelerate progress by LGPS funds towards carbon neutrality.

The consultation will last for 12 weeks from 1 September 2022 to 24 November 2022.

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