APPENDIX C

By email: LGPensions@levellingup.gov.uk

Dear Sir/Madam

PROPOSED RESONSE TO LOCAL GOVERNMENT PENSION SCHEME (ENGLAND AND WALES): GOVERNANCE AND REPORTING OF CLIMATE CHANGE RISKS.

The Leicestershire County Council Pension Fund has always looked to adopt best practice in respect of its Responsible Investment practices and has already taken steps in line with the private reporting standards set by the DWP by reporting under TCFD for a number of years. We are strongly supportive of transparency in all reporting by Pensions Funds, however this would be aided by mandated companies' climate disclosures.

Please see our comments below in response to the questions raised in the consultation.

QUESTION	LEICESTERSHIRE COUNTY COUNCIL PENSION FUND (THE FUND) RESPONSE
QUESTION 1: DO YOU AGREE WITH OUR PROPOSED REQUIREMENTS IN RELATION TO GOVERNANCE?	AGREE: The Fund supports the governance proposals. The Local Pension Committee has responsibilities for all aspects of scheme governance, and this includes the financial risks and opportunities arising as a result of climate change. Governance arrangements should be recorded and communicated to scheme members and stakeholders. Roles and responsibilities should be clearly defined, and accountability established. Though not explicitly referenced it is worth highlighting the role of Investment Managers i.e. those tasked with making investment decisions on behalf of the Fund and integrating an assessment of

	climate risk into their investment processes. It is important that mandates agreed with managers and advisors accurately reflect expectations. Once the mandate has been established, discretion for selecting investments ultimately resides with the manager. It is important that pension fund’s are confident that managers are following their own processes and is committed to stewardship activities such as voting and engagement. With regard to ‘*establishing and maintaining processes by which the Fund can, on an ongoing basis satisfy themselves with those who undertake climate-related governance activities… are doing so effectively*”. Critiquing the work of externally appointed experts, who have been appointed for their specialist expertise and ability to fill knowledge and skills gaps is complex. This point references governance but we are also concerned with the oversight of the delivery of data, research, and analysis. In this regard pools should be better placed to provide this monitoring function.
QUESTION 2: DO YOU AGREE WITH OUR PROPOSED REQUIREMENTS IN RELATION TO STRATEGY?	AGREE: All pension funds should identify, assess and consider climate risks and opportunities in line with any other financial consideration. There is no market-wide approach to managing climate-related risks. Investment strategies will continue to evolve as data and analysis evolves over time. Given this it is important to recognise that climate risk at company and portfolio level is not entirely captured by emissions metrics data. The transition to a lower carbon economy and the associated changes in consumption patterns and regulations will result in physical and transition risks that go beyond risks indicated by a company’s carbon emissions. Carbon emissions related targets and metrics will not be enough to discharge the Fund’s climate risk management obligations, nor the obligations bestowed upon their appointed investment managers. Detailed stock, sector and regional analysis is required and should be delivered through robust ESG integration. The transition to a lower carbon economy and the emissions reductions required to achieve it will not be linear and shorter-term risks and opportunities will need to be considered along-side this longer-

	term trend to achieve attractive investment returns. Scenario Analysis needs to evolve as a discipline to provide further insights that direct asset allocation decisions. The Fund has applied climate scenario analysis to their investment portfolios. However, the application of climate scenario analysis to scheme funding and liability modelling is less developed. Carbon footprint analysis tends to be undertaken on a bottom-up basis, looking at the carbon emissions of different companies and assets in the portfolio. It is useful when attempting to understand exposures at portfolio level. Scenario analysis would appear to be a more useful tool for this liability side analysis.
QUESTION 3: DO YOU AGREE WITH OUR SUGGESTED REQUIREMENTS IN RELATION TO SCENARIO ANALYSIS?	AGREE: Climate considerations should be integrated into the normal SAA process. With actuarial consultants, investment advisors and Pool companies, working alongside the client to agree an SAA that delivers appropriate risk adjusted returns to meet scheme liabilities, and that also reduces climate risks. Climate scenario analysis should feed into the valuation cycle and be carried out at least every three years. We also agree that at least two climate scenarios are performed, one of which assesses the impact of Paris aligned outcome e.g. 1.5 degrees or well below 2 degrees and at least one that assesses higher levels of global warming e.g. a failed scenario. As investors it is important that we assess the implications of possible outcomes as well as desirable outcomes.
QUESTION 4: DO YOU AGREE WITH OUR PROPOSED REQUIREMENTS IN RELATION TO RISK MANAGEMENT?	AGREE: Climate risk should be considered as part of day-to-day risk management processes, as well as via specific climate scenario analysis. On the investment side the approach will vary depending on the asset class in question. Less liquid asset classes may require a heavier focus on initial due diligence. The first line of defence in respect

	of managing climate risk is the investment manager, whether they be internal or external.
QUESTION 5: DO YOU AGREE WITH OUR PROPOSED REQUIREMENTS IN RELATION TO METRICS?	**AGREE:** Given the advantages and disadvantages related to different metrics a dashboard of metrics is required to understand the trajectory of a portfolio in terms of climate risk. We agree that pension funds should be mandated to produce an annual climate risk report, which Leicestershire County Council Pension Fund has received for a number of years from LGPS Central. Comments in relation to proposed metrics are set out below: **Metric 1 Absolute Emissions Metric**: We agree with the requirement to analyse scope 1,2 and 3 emissions. We can see the logic of reporting emissions at an aggregated level across different assets classes to produce a fund level number. However, it is likely that significant reliance on estimated emissions data will be required, as real data becomes available the aggregated emissions numbers will fluctuate as real emissions data replaces estimated. Scope 3 emissions in particular are not widely reported and the estimation of scope 3 emissions can be complex leaving scope for inconsistent techniques across different data providers. Furthermore adding 1,2 and 3 emissions together may introduce a problem of double counting, e.g. one company's scope 1 and 2 emissions are another company's scope 3 emissions. Mechanisms will need to be developed to ensure this is accounted for correctly and consistently across pension funds. Absolute emissions will need to be apportioned and guidance will need to be provided to ensure this is done consistently. Different pension funds with different levels of maturity will have different attitudes toward risk, this will be reflected in their asset allocations and their carbon footprints. This will need to be considered when comparing different funds. **Metric 2 Emissions Intensity Metric:** Intensity metrics are important as they provide context for absolute emissions and portfolio/ asset class level metrics provide an explanation to fund level

changes. They should be considered together rather than in isolation.

Metric 3 data quality Metric: It is important to report data quality where possible. However, this metric must be caveated with difficulties faced by the funds in the absence of mandated company reporting. It is not something that pension funds have full control over beyond data vendor selection. This makes the setting of targets for this metric difficult.

Furthermore, the robustness of verification methodologies may vary from data vendor to data vendor, and finally the data quality metric is likely to be a product of asset class and regional exposure, for example disclosure in emerging markets, small cap and private markets tends to be lagging.

Metric 4 Paris Alignment Metric: Leicestershire County Council Pension Fund is looking to follow the IIGCC net zero investment framework which looks to set aligning/aligned metrics which requires analysis of the quality of the net zero commitment/ target of underlying portfolio companies. We consider this to be a more insightful indicator of risk and the future trajectory of the portfolio. We consider that not all Net Zero commitments/ targets are the same, some are more challenging and comprehensive than others. Consideration needs to be given to the detail of the commitment and the company's ability to deliver it. A binary metric could miss this important nuance. A net zero target quality score at portfolio/ fund level should also be considered. Similar to that provided by Net Zero Zeal.

We consider that all three options have some merit. Funds should be able to consider the options available and adopt the most insightful solution with the most robust methodology. The quality of data and robustness of analysis are critical in selecting a data provider. Pools can help to select and produce such analysis.

It is important that any guidance makes a distinction between metrics that are focused on measuring the impact of the portfolio and those metrics that are intended to provide insights into the risk exposure of the portfolio.

Implied temperature rise/ Paris aligned metrics are often a point in time analysis and do not

	necessarily give a strong indication of how a company or portfolio might look in 3 years' time for example. They do not necessarily give an indication of the direction of travel for a company or the portfolio in terms of carbon nor do they necessarily assess the potential for a company's product portfolio to contribute to the transition in a positive way. It is important to take a broad set of factors into consideration when making investment decisions looking at a company's strategy, R&D spend, Capex plans, the progress of technology innovation and the pipeline of regulation and legislation. It is important to be clear and transparent about the limitations of these metrics when presenting results.
QUESTION 6: DO YOU AGREE WITH OUR PROPOSED REQUIREMENTS IN RELATION TO TARGETS?	AGREE: Given the Fund is already on the trajectory to setting targets inline with metrics reported on, and agree these should be aligned with the Paris Agreement We know that the transition to Net Zero will not be linear in terms of the decarbonisation of the real economy events such COVID19 and the invasion of Ukraine can change international priorities in the short term which effect market views of sectors and sector performance. As a result, annual reporting will need to be caveated. The Fund does not agree with mandating an annual target if that could prove to be a distraction from the achievement of longer-term ambitions which we consider to be consistent with our fiduciary responsibilities. The achievement of an annual target may require investment mandate changes which might prove problematic in less liquid asset classes such as Private Markets. Any reporting against target should be accompanied by the data coverage of AUM. Implementation of a target across all asset classes is challenging, as in some cases data is not comprehensive, target setting in this regard will need to go hand in hand with increased data availability. A target that is specific to asset classes such as listed equity and corporate credit assets only may be more achievable.

QUESTION 7: DO YOU AGREE WITH OUR APPROACH TO REPORTING?	AGREE We consider the oversight and reporting of governance activities to be critically important and agree with these recommendations for reporting through Annual Climate Risk Reports in line with the Local Government Transparency Code 2015.
QUESTION 8: DO YOU AGREE WITH OUR PROPOSALS ON THE SCHEME CLIMATE RISK REPORT?	AGREE: However, must recognise the difficulties of doing this in practice. It would require consistent methodologies across funds and pools which would need to be mandated. Also as previously mentioned different funds with different levels of maturity will have different attitudes toward risk, this will be reflected in their asset allocations and their carbon footprints. This will need to be considered when comparing different funds This question also proposes "*each AA must report the proportion of its assets for which overall emissions data is: Verified, Reported, Estimated or Unavailable"*. We are in agreement with this requirement subject to data vendor classification methodologies.
QUESTION 9: DO YOU HAVE ANY COMMENTS ON THE ROLE OF THE LGPS ASSET POOLS IN DELIVERING THE REQUIREMENTS?	LGPS Central currently provides climate risk reporting and scenario analysis to the Fund, and other Partner Fund's that covers both assets managed within and outside of the pool, so it is clear they can play a key role in helping deliver the requirements.
QUESTION 10: DO YOU AGREE WITH OUR PROPOSED APPROACH TO GUIDANCE?	AGREE: Clear and comprehensive guidance is essential if there is an intention to make reporting comparable and consistent at scheme level, i.e across funds and pools As discussed above reporting Scope 1,2 and 3 emissions at fund level presents a number of practical questions that have significant implications for the resulting numbers. The absence of such guiding documents may compromise the consistency and comparability of reporting.
QUESTION 11: DO YOU AGREE WITH OUR PROPOSED APPROACH	AGREE: We agree in principle. However, in the absence of recognised climate related qualifications,

TO KNOWLEDGE, SKILLS AND ADVICE?	it is difficult to define base knowledge and climate related scenario analysis can be complex. LGPS Central currently provides information to the Fund on the management of climate risk and can assist with the appointment and management of external vendors and the assessment of scenario analysis results. Central also aids in respect of climate strategy development and climate governance. Pools like Central can provide assistance in respect of procurement and centralised contracts can help to keep costs down.
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 comment.