Referral to the Pensions Regulator

Local Government Pension Scheme and Climate Risk
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1 Introduction

1. This referral is submitted by NGOs ClientEarth\(^1\) and ShareAction\(^2\). It concerns the Local Government Pension Scheme (the “LGPS”). ClientEarth and ShareAction have serious concerns about the way in which many LGPS funds are approaching the financial risks associated with climate change (“climate risk”), putting scheme members’ savings at risk.

2. These concerns have arisen as the result of an extensive evidence-gathering exercise undertaken by ClientEarth and ShareAction over the last 15 months. This evidence-gathering exercise has included:

   a. Working with scheme members to write to their LGPS fund to ask questions about what the fund is doing to assess and manage climate risk (see Annex A - D for the full correspondence between scheme members and their LGPS fund);
   
   b. Reviewing publicly available information published by the funds; and
   
   c. Reviewing responses to Freedom of Information (“FOI”) requests sent to all the LGPS funds by the NGOs Community Reinvest\(^3\) and Friends of the Earth (see Annex E - X for the FOI responses referred to in this referral).

3. It has become apparent from reviewing this evidence that many administering authorities are operating under a number of misconceptions surrounding their duties and abilities to consider and address climate risk.

4. In particular, we have identified five fundamental misconceptions that need to be addressed by the Pensions Regulator (“TPR”):

   **Misconception 1:** Climate change does not pose financial risks and/or is only an ethical investment issue.

   **Misconception 2:** By delegating day-to-day investment decisions to external investment managers, the administering authority has discharged its legal duties to address climate risk.

   **Misconception 3:** By delegating stewardship engagement activities to the Local Authority Pension Fund Forum (“LAPFF”), the administering authority has discharged its legal duties to address climate risk.

   **Misconception 4:** Administering authorities do not need to think about climate risk anymore because this will now be dealt with at the pool level.

   **Misconception 5:** Scheme members should not concern themselves with this issue as any losses caused by poor management of climate risk will be met by the taxpayer.

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\(^1\) ClientEarth is a non-profit environmental law organisation working to create pragmatic solutions to key environmental challenges such as climate change. It is a company limited by guarantee, registered in England and Wales, company number 02863827, registered charity number 1053988, registered office 10 Queen Street Place, London EC4R 1BE. ClientEarth also has a registered branch in Belgium, N° d’entreprise 0894.251.512, and with a registered foundation in Poland, Fundacja ClientEarth Poland, KRS 0000364218.

\(^2\) ShareAction (t/a Fairshare Educational Foundation) is a charity that promotes Responsible Investment practices by pension providers and investment managers. [Fairshare Educational Foundation is a company limited by guarantee, registered in England and Wales, company number 5013662, registered charity number 1117244, registered office 16 Crucifix Lane, London, SE1 3JW.

\(^3\) For more details regarding Community Reinvest, please see their website: http://communityreinvest.org.uk/.
5. ClientEarth and ShareAction are concerned that, by operating under these misconceptions, the LGPS funds in question are failing to comply with their legal duties and/or putting scheme members' savings at risk. Accordingly, we urge TPR to take action to investigate and address them.

6. While the misconceptions identified in this referral are drawn from an evidence-gathering exercise in respect of LGPS funds, ClientEarth and ShareAction's experience indicates that these misconceptions are held more widely, that is, not just by administering authorities of LGPS funds but also trustees of private sector occupational pension schemes.

7. In Part 4 of this referral, we explain why climate risk needs to be considered by administering authorities at all stages in the investment process, and not just in discrete decisions.

8. In Part 5, we provide examples of LGPS funds that are already taking steps to address these risks.

9. In Part 6, we address each of the five key misconceptions identified above, setting out:
   a. The evidence we have gathered which indicates that a number of LGPS funds are operating under the misconception; and
   b. Why the misconception is wrong from a legal and/or financial risk-management perspective.

10. Finally, in Part 7, we set out our request for action from TPR and (where appropriate) the Department for Communities and Local Government ("DCLG"). There, we urge TPR to:
   a. Investigate the matters raised in this referral;
   b. Publish detailed guidance for pension funds (including the LGPS funds) dispelling these common misconceptions and setting out guidance on what pension funds can and should be doing to properly assess and manage climate risk;
   c. Engage with the Department for Environment, Farming, Resources and Agriculture ("Defra") with a view to preparing a report on the pensions industry under the Adaptation Reporting Power (pursuant to the Climate Change Act);
   d. Issue a public statement highlighting schemes that are demonstrating excellent practice in managing climate risk and schemes that are failing to meet the minimum expected standard; and
   e. Meet with us, as well as members of the East Riding Pension Fund, Hampshire Pension Fund, Leicestershire Pension Fund, London Pension Fund Authority, Surrey Pension Fund, West Yorkshire Pension Fund and the Wiltshire Pension Fund,\(^4\) to discuss the contents of this referral.

11. While some LGPS funds are showing excellent practice on the assessment and management of climate risk, others are failing. While the pooling process may make this a challenging time for LGPS funds, it is important not to miss the associated opportunities.

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\(^4\) Members of these LGPS funds have written to the Chief Executive of TPR separately to request a meeting.
2 Overview of the LGPS

12. The LGPS is a public service defined benefit ("DB") pension scheme established under sections 7 and 12 of the Superannuation Act 1972 (this Act has now been superseded by the Public Service Pensions Act 2013).

13. The LGPS is made up of locally managed funds, of which there are 89 in England and Wales (currently being rearranged into "pools"). Each fund is managed by a designated administering authority, with their powers and duties being derived from statute.

14. The investments of LGPS funds were, until recently, subject to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the "2009 Investment Regulations"). As of 1 November 2016, the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the "2016 Investment Regulations") apply to the LGPS.

3 What is climate risk?

15. With the relevant science confirmed,\(^5\) industry leaders have been warning of the significant - potentially unrivalled - economic and financial risks posed by climate change to investment returns.

16. Such risks not only stem from the physical impacts of climate change ("physical risks") but also from regulatory and technological responses ("transition risks") - both of which have the potential to scale into systemic risk.

17. **Physical risks:** These are the risks associated with the physical effects of climate change. Increasing temperatures, rising sea levels and an escalation in the frequency and severity of extreme weather events are among the changes already affecting the value of assets and causing knock-on effects on the availability and distribution of resources.

18. **Transition risks:** These are the risks from technological, policy and regulatory developments associated with the transition to a low-carbon economy, including those anticipated by the Paris Agreement.\(^6\) For example, explicit and implicit carbon-pricing mechanisms are already on the increase as governments follow through on their emissions-reduction commitments and the agreed phase-out of fossil fuel subsidies. Action to curtail emissions is happening in the context of rapidly falling renewable energy prices, policy support for deployment of zero-emissions energy and transport systems, and increased energy efficiency in key sectors. Current policies that subsidise economically inefficient, higher-carbon energy generation are likely to be revised to favour cleaner technologies. Such revisions can emerge quickly, surprising investors and the markets. Technological disruption driven by efforts to reduce carbon emissions is also already taking place across industries. Cheaper renewable power, electric vehicles and batteries all pose a significant threat to incumbent companies in the automotive, power utilities, and fossil fuel sectors.

19. **Systemic risk:** The financial impacts are likely to be systemic, being felt across all asset classes and industrial sectors. At higher levels of warming, the physical impacts of climate change will become increasingly widespread, posing a systemic risk through weaker growth and lower asset returns affecting entire portfolios. Consequently, climate risk arises across a portfolio, not just at the individual asset class or sector level.

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\(^6\) The Paris Agreement was negotiated by representatives of 195 countries at the 21st Conference of the Parties of the UNFCCC in Paris and adopted by consensus on 12 December 2015. The Parties agreed to limit the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels.
20. A selection of papers documenting these risks can be found at tabs 3 to 17. These include:

   a. Blackrock Investment Institute (2016) "Adapting Portfolios to Climate Change" [Folder 1/Tab 3].


   e. Carbon Tracker and Grantham Research Institute (2013) "Unburnable carbon 2013: Wasted capital and stranded assets” [Folder 1/Tab 7].

   f. Economist Intelligence Unit (2015) "The Cost of Inaction: Recognising the value at risk from climate change” [Folder 1/Tab 8].

   g. Goldman Sachs (2015) "The Low Carbon Economy” [Folder 2/Tab 9].


21. The relevance of these risks to asset owners like pension funds have also been documented in a series of papers over the last 11 years. These include the following key papers:


   c. Mercer (2015) "Investing in a time of climate change” (from page 73 onwards) [Folder 2/Tab 14].

   d. Mercer (2010) "Climate change scenarios - Implications for strategic asset allocation" [Folder 2/Tab 15].

   e. Mercer (2005) "A climate for change: A trustee's guide to understanding and addressing climate risk” [Folder 2/Tab 16].

4 Climate risk arises at all stages of the investment process

22. Climate risk arises at all stages of the investment decision-making process. This is made clear in many of the papers we refer to above, for example:

   a. The global investment managers BlackRock state in their September 2016 report "Adapting Portfolios to Climate Change": "We believe financial fiduciaries now can - and should - integrate relevant ESG factors in their investment processes or principles.”

   b. IIGCC's "Climate change investment solutions: A guide for asset owners" recommends that trustees ensure that the risk is accounted for in all stages of the investment process by taking the following steps:

      i. Evaluate the evidence;

      ii. Integrate climate change into their investment beliefs and investment policies;

      iii. Explore actions for measuring and managing the risks both within the existing asset allocation structure and through evolving the asset mix over time;

      iv. Reduce carbon intensity of existing assets and explore opportunities for investment in low-carbon assets; and

      v. Take action to reduce vulnerability of existing assets.

   c. In their 2016 report, investment consultants Mercer recommend "a thoughtful, integrated approach to addressing climate change ... establishing related investment beliefs that can inform updates to existing investment policy statements. In turn, these enhancements to investment program governance can form a solid foundation to support eventual evolutions in portfolio construction and manager/security selection ...”

   d. Similarly, in their “Climate Change Best Practice Methodology”, AODP also emphasises that:

      "... large asset owners in particular such as superannuation funds, pension funds, sovereign funds and insurance companies are faced with three key challenges:

      1. Integration of climate change risks and opportunities into investment strategies;

      2. Restructuring the processes within the investment chain to better account for high certainty, high impact, long-term risks; and

      3. Implementing systems to check that the processes in place are sufficient to manage climate change risks and opportunities on an ongoing basis.”

This is reinforced by AODP's statement in the same document that “Investment managers and asset consultants may be asked by asset owners to develop certain capabilities and become involved in using the Methodology. However, use of the Methodology should not be totally outsourced as it is critical that the structural changes be owned and managed by the asset owner themself. Additionally, the portfolio-level processes and investment adjustments need to be understood and made by asset owners.”
23. Consequently, in order to protect scheme members’ savings, administering authorities must consider climate risk at all stages of the investment process. This includes:

   a. When setting their overall investment strategy;
   b. When determining strategic asset allocation;
   c. When monitoring overall portfolio risk;
   d. When selecting, mandating and monitoring the activities of their investment managers; and
   e. When undertaking stewardship activities.

24. For trustees and administering authorities, the potential magnitude and systemic nature of climate risk, combined with its long-term nature, makes consideration at portfolio level a key part of any risk assessment. Climate risk could be a significant one for portfolios, with Paul Fisher, former deputy head of the Prudential Regulation Authority, commenting that a sudden repricing of assets as a result of climate change “could be the trigger for the next financial crisis.”

25. As will become apparent in the sections below, many LGPS administering authorities are failing to understand this basic principle. For example, many authorities believe that they are properly managing climate risk by simply checking that their investment managers have an environmental, social and governance (“ESG”) policy in place, or by asking the Local Authority Pension Fund Forum (“LAPFF”) to undertake stewardship activities on their behalf. This fundamentally misses the point that climate risk presents a risk to the portfolio as whole and therefore needs to be addressed across the portfolio and at all stages of the investment process.

5 Many LGPS funds are already addressing climate risk

26. Unlike the funds that we refer to in Part 6 below, there are examples of LGPS funds that understand this point and are already managing climate risk at the portfolio level. For example:

   a. Avon Pension Fund: The Fund "identified climate change to be a potential long-term financial risk" in its 2016 Responsible Investment Policy. It is also "reviewing the tools and solutions available to assess and manage carbon exposure and recognise the potential transition to a low carbon economy. These include:

      i. Review of annual carbon footprinting at the Fund and investment manager level.

      ii. Incorporate climate risk assessment as part of the Fund’s 2017 investment strategy review (considering the Fund’s investment strategy under a range of climate change scenarios, including a 2°C scenario).
iii. **Review of the Fund's benchmark for its passive equity exposure and the consideration.*

This is alongside the Fund's participation in LAPFF, through which it co-filed shareholder resolutions on climate change resilience at Rio Tinto in 2016, supported similar resolutions at BP and Shell in 2015 and, as part of the "Aiming for A" initiative, at Glencore and Anglo American in 2016. Also in conjunction with LAPFF, the Fund has identified Climate change resilience and strategic management of climate change risks at investee companies (e.g. disclosure and sustainability) as one of its strategic ESG engagement priorities for 2017/18.

b. **Environment Agency Pension Fund ("EAPF"):** The EAPF states in its policy to address the impact of climate change that "The Fund's fiduciary duty is to act in the best long-term interest of our members and to do so requires us to recognise that [ESG] issues can adversely impact on the Fund's financial performance and should be taken into account in the funding and investment strategies and throughout the funding and investment decision making process."

Among other things, the Fund has:

i. Adopted climate change investment beliefs and investment principles;

ii. Carried out carbon footprinting focussing on the greenhouse gas emissions from investee companies and commissioned analysis to provide information regarding the exposure of its active fund to carbon embedded within fossil fuel reserves held by globally listed companies (equity and debt);

iii. Set itself an objective of ensuring that its investment portfolio and processes are compatible with keeping the global average temperature increase to below 2°C relative, in-line with international government agreements; and

iv. Set itself goals including the following three targets for 2020:

1. "Invest 15 per cent of the fund in low carbon, energy efficient and other climate mitigation opportunities;

2. **Decarbonise the equity portfolio, reducing our exposure to "future emissions" by 90 per cent for coal and 50 per cent for oil and gas by 2020 compared to the exposure in our underlying benchmark as at 31 March 2015;** and

3. Supported progress towards an orderly transition to a low-carbon economy through actively working with asset owners, fund managers, companies, academia, policy makers and others in the investment industry.

c. **Merseyside Pension Fund:** The Fund has developed a climate risk options report, which states (among other things): "Merseyside Pension fund's present strategy has a high degree of climate awareness - as set out in its Responsible Investment policy, whereby climate as a leading ESG factor is being integrated throughout the Fund's investment process (as set out in the Fund's [SIP] and Investment Philosophies documents). It is identified as a theme guiding decision-making within the Alternatives and Property allocations (comprising 28% of the strategic benchmark) ... Ownership shapes the present approach to climate change mitigation and adaptation actions: to develop these approaches further, the Fund should

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10 Ibid.
11 Ibid.
13 Ibid.
commit to better understanding its ownership of climate risk and the alignment of its strategy to a '2 degree' scenario."\(^\text{14}\)

d. **South Yorkshire Pension Fund:** This Fund has implemented a climate change policy, recognising that "the risks and opportunities [associated with climate change] may have a material impact on the financial performance of the Fund. The interconnected nature of the problem is likely to reduce returns across all asset classes even on those investments not actually harmed by physical damage. Climate change will have a macroeconomic impact that will affect the entire portfolio."\(^\text{15}\) Accordingly, the Fund's climate change policy will aim, wherever possible, to:

i. "Establish its exposure to climate change and carbon risk through the commissioning of a carbon audit of the Fund's portfolios every two years. Results will be reviewed and used to focus engagement and strategy going forward";

ii. "Encourage companies to develop and implement strategies to deal with various scenarios in an energy transition (e.g. a 2°C policy outcome)" and use its voting rights accordingly";  

iii. "Co-file shareholder resolutions at AGMs to request deeper disclosure on climate risk issues"; and

iv. "Over time endeavour to manage a tilt within portfolios in favour of lower carbon assets in-line with the Paris Agreement, with a view towards progressively decreasing the Fund's carbon exposure."\(^\text{16}\)

e. **Strathclyde Pension Fund:** This Fund is also moving in a positive direction, with the Fund commissioning an assessment of carbon emissions and intensity and carbon footprinting of the Fund's listed equity portfolios in early 2016. In December 2016, the Pension Fund Committee agreed:

i. "To review the carbon footprint of the Fund's listed equity holdings every two years and investigate the inclusion of other asset classes in the Fund's carbon footprint;"

ii. To progress engagement with the largest contributors to the Fund's active equity carbon footprint;

iii. To join the IIGCC;

iv. To continue to monitor development of low carbon investment approaches ..."\(^\text{17}\)

According to its annual report, the Strathclyde Pension Fund is also increasing its investments in renewable energy through its direct investment portfolio.

f. **Teeside Pension Fund:** The Fund's SIP states: "... As a responsible investor, the Teesside Pension Fund wishes to promote corporate social responsibility, good practice and improved company performance amongst all companies in which it invests. The Fund will therefore monitor investee companies to ensure they meet standards of best practice in relation to their

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\(^{16}\) Ibid.

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key stakeholders. The Fund considers that the pursuit of such standards aligns the interests of Fund members and beneficiaries with those of society as a whole. In furtherance of this policy, the Fund will support standards of best practice on disclosure and management of corporate social responsibility issues by companies and will pursue constructive shareholder engagement with companies on these issues consistent with the Fund's fiduciary responsibilities ... The Fund will explicitly consider climate change risks and opportunities in the investment process and engage with companies in which we invest to ensure that they are minimising the risks and maximising the opportunities presented by climate change and climate policy.  

27. It is not just these LGPS funds that are taking climate risk into account as part of their investment strategies. In the UK, HSBC has recently chosen Legal & General Investment Management's Future World fund as the default equity option for its defined contribution pension scheme, while in Europe the Fourth Swedish National Pension Fund, Pension Denmark and ABP all offer examples of good practice.

6 The 5 Misconceptions

6.1 Misconception 1: Climate change does not pose financial risks

"Climate change does not pose material financial risks and/or is only an ethical investment issue."

6.1.1 Examples

28. As the papers in Part 3 demonstrate, it is now widely accepted that climate change poses potentially significant risks to the investment returns of pension fund portfolios if not properly assessed and managed. Yet, some funds still do not regard climate change as posing any financial risk to their funds.

29. For instance, in a snapshot survey carried out by Professional Pensions in August 2016, 53% of trustees and pension investment professionals said they did not see climate risk as a financially material risk to their or their clients' portfolios.

30. Others take a similar view by regarding climate change as an ethical issue. For example, the Kent Pension Fund recently responded to a Freedom of Information request which sought to understand whether the Fund would be reviewing its statement of investment principles ("SIP"), carbon risk management and investment mandates in advance of LGPS pooling. In its response, the Kent Pension Fund said: "The Superannuation Fund Committee takes the view that it has a fiduciary responsibility to the 600 fund employers who pay for staff pensions to maximize the investment return for a given level of risk. They do not believe that taking views on ethical investment issues is consistent with that objective. This will not change with pooling." The Kent Pension Fund's full response to the Freedom of Information request can be found at Annex E.

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19 https://www.ft.com/content/a5af8328-a4ef-11e6-8898-79a99e2a4de6.
6.1.2 Why is this approach wrong?

(a) The administering authority is legally required to turn their mind to the question of whether climate risk is financially material to the fund's investments

31. First, at the very least, administering authorities have a legal duty to turn their minds to the question of whether climate change poses a material financial risk to the fund's investments.

32. This is based on administering authorities’ legal duty to act in the best interests of scheme members. Although the "best interests" duty is not explicitly stated in the 2009 Investment Regulations, the general consensus was that administering authorities were, in any event, subject to the same duty as trustees of trust-based schemes.21 This duty has now effectively been put on a statutory footing by the 2016 Investment Regulations.22

33. Keith Bryant QC and James Rickards have recently considered this duty in the context of the consideration of climate risk by trustees of trust-based pension schemes in their Legal Opinion dated 25 November 2016. A copy of that Opinion is included in Folder 2/Tab 21. In that Opinion, they express the view that if the issue of climate risk is raised with trustees (in this case administering authorities), the trustees (administering authorities) are legally required to turn their minds to the issue (provided the issue raised is not "obviously fanciful" - which climate risk clearly is not) and consider whether it is financially material:

"The essential point would be that trustees are obliged to take into account financially material factors and they are therefore effectively obliged, when a matter is raised with them that is not obviously fanciful, to turn their minds to whether it is financially material. If they simply refuse to do so, whether because they consider that an ESG factor cannot ever be financially material or for some other reason, then that, we think, would not be a proper exercise of their powers and would be open to challenge." (At paragraph 60.)

34. Mr Bryant QC and Mr Rickards conclude that if trustees (in this case administering authorities) fail to do this, they may be susceptible to legal challenge.

35. It appears from the response in paragraph 30 above that the Kent Pension Fund has not even turned its mind to the question of whether climate change might present financially material risks to the Fund's investments.

36. This failure is a breach of an administering authority's most basic legal duty to act in the best interests of scheme members.

(b) If the administering authority did turn its mind to the issue, it should conclude that it is financially material

37. Secondly, we submit that if administering authorities did properly turn their minds to the issue (i.e. they have considered the available evidence), they would conclude (like many other LGPS funds already have - see below) that climate change does present a financially material risk to the fund's investments.

38. In light of all the publically available evidence (see the papers in Part 3 above for example), it is now extremely difficult for any asset owner - and particularly an asset owner with a long-term investment

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21 See for example: Law Commission (2014) Fiduciary duties of investment intermediaries, paragraphs 4.69-4.74 [Folder 2/Tab 18]; Nigel Giffin QC (March 2014) “Duties of administering authorities under local government pension scheme” [Folder 2/Tab 19]; Department of Communities and Local Government (November 2015) LGPS: Revoking and replacing the LGPS (Management and Investment of Funds) Regulations 2009, paragraph 2.21 [Folder 2/Tab 20].

22 To the extent that the 2016 Investment Regulations require compliance with the DCLG guidance.
horizon like an LGPS fund - to legitimately take the view that climate change does not constitute a material financial risk to the fund's investments.

39. As BlackRock recently said in its 2016 report: "Investors can no longer ignore climate change. Some may question the science, but all are faced with a swelling tide of climate-related regulations and technological disruption."23 LGPS funds are no different; it is essential that administering authorities urgently get to grips with this issue and stop mistaking it for non-financial and/or an ethical investment question.

(c) If the administering authority turns its mind to the issue and concludes (as it should) that climate risk is financially material, the fund MUST take the risk into account in that investment decision.

40. Thirdly, My Bryant QC and Mr Rickards also concluded (in line with the findings of the Law Commission in its 2015 report "Fiduciary Duties of Investment Intermediaries" (Law Com No 350)) that if, as a result of their consideration of the issue, trustees (administering authorities in this case) conclude that climate risk is financially material to the fund's investments, they must take that risk into account when making their investment decisions:

"If the risks associated with climate change are financially material to a particular investment decision then it is clear, we think, beyond reasonable argument that the law permits and requires the trustees to take those risks into account when making that investment decision." (At paragraph 55.)

6.2 Misconception 2: Delegation to investment managers is sufficient

"By delegating day-to-day investment decisions to external investment managers, the administering authority has discharged its legal duties to manage climate risk."

6.2.1 Examples

41. Several LGPS funds appear to be operating under this misconception.

42. A key example is the Leicestershire County Council Pension Fund (the "Leicestershire Fund"). The following extracts are taken from letters exchanged between a scheme member and the Leicestershire Fund (see Annex A for the full exchange):

"The Fund believes that our investment managers are better placed than us to form a view on this, and to avoid investment in certain companies/sectors if they do not think that the market consensus is correct (e.g. if they think stranded asset risk is not taken into account sufficiently)."

"... The major responsibility of the Local Pension Committee is setting and reviewing the Fund's strategic asset allocation ... as this accounts for over 90% of both the risk and return of the Fund. The selection of individual assets is considered to be the responsibility of the appointed investment managers, and is of a much lower level of importance to the Fund."

43. The following LGPS funds also appear to be operating under the same misconception. In response to Freedom of Information requests which asked what steps the Pension Fund Committee and Board have taken to address climate risk, the funds stated as follows:

a. Hampshire Pension Fund: "... specialist investment managers are best placed to build portfolios that will deliver the returns that the Fund requires while appropriately managing risk..."

23 Blackrock Investment Institute (2016) "Adapting Portfolios to Climate Change" [Folder 1/Tab 3].
... it is not possible to extend our Investment Managers’ company specific research and analysis to quantitatively evaluate the portfolio’s exposure to climate risks in a meaningful way”. For the Fund's full response, see Annex B.

b. Berkshire Pension Fund: "None - this is delegated to fund managers." For the Fund's full response, see Annex F.

c. London Borough of Bexley Pension Fund: “The London Borough of Bexley Pension Fund investments are all managed externally and the ESG decisions are delegated to Fund Managers who have been provided with a copy of the Fund's SRI policy.” For the full response, see Annex G.

d. Devon County Council Pension Fund: “Decisions on individual investments are the responsibility of the individual Fund Managers appointed by the Authority. Under the Fund's policies, Fund Managers are required to invest in the long-term interests of the scheme beneficiaries, monitoring the social, environmental and ethical issues which may impact on the long term performance of each company, and engaging with companies as appropriate. The Investment and Pension Fund Committee receive quarterly reports from each Fund Manager on their activity.” For the full response, see Annex H.

e. Dorset County Council Pension Fund: “Decisions on individual investments are the responsibility of the individual Investment Managers appointed by the Fund ... Under the Fund's policies, Investment Managers are required to invest in the long-term interests of scheme beneficiaries, monitoring the social, environmental and ethical issues which may impact on the long-term performance of each company, and engaging with companies as appropriate.” The Fund's full response can be found at Annex I.

f. Ealing Council Pension Fund: "The Pension Fund Panel, acting as trustee, has a duty of care to Fund beneficiaries when investment pension scheme assets. The Panel require the Fund's Investment Managers to have a formal policy on how they take social and environmental issues into account when investing on behalf of the Fund.” For the Fund's full response, see Annex J.

g. Essex County Council Pension Fund: This Fund produced an extract from its SIP, containing the following paragraph on ESG considerations: "The [Investment Steering Committee ("ISC")] does not place restrictions on investment managers in choosing investments in quoted companies except in limiting the size of single investments. The ISC expects investment managers to place their primary consideration on financial factors when selecting investments for inclusion in the portfolio … However, the ISC will allow investment managers to consider non-financial factors in selecting investments providing that such decisions are not expected to … be financially detrimental to the Fund … or represent significant opportunity cost if not held.” For the full response, see Annex K.

h. Royal Borough of Kensington and Chelsea Pension Fund: "This is delegated to the Fund Managers who are all UNPRI compliant.” For the Fund's full response, see Annex L.

i. Lincolnshire Pension Fund: "The investment decision making is with the external managers, who take account of all risks, including climate change, in the decision making process.” For the Fund's full response, see Annex M.

j. Oxfordshire County Council Pension Fund: “Decisions on individual investments are the responsibility of the individual Fund Managers appointed by the Authority.” For the Fund's full response, see Annex N.
k. **Somerset County Council Pension Fund:** "Decisions on individual investments are the responsibility of the individual Fund Managers appointed by the Authority. Under the Authority’s policies, Fund managers are required to invest in the long term interests of scheme beneficiaries, monitoring the social, environmental and ethical issues which may impact on the long term performance of each company, and engaging with companies as appropriate. The Pensions Committee receive quarterly reports from each Fund Manager on their activity." For the Fund’s full response, see Annex O.

l. **South Tyneside Council Pension Fund:** "The investment decision making is with the external managers, who take account of all risks, including climate change, in the decision making process." For the Fund’s full response, see Annex P.

### 6.2.2 Why is this approach wrong?

44. As we explain in Part 4 above, climate risk must be addressed: (a) at the portfolio level; and (b) at all stages of the investment process. As a result, wholly delegating management of climate risk to external investment managers does not discharge the legal duties of an administering authority to manage that risk.

45. Funds usually have multiple investment managers mandated to invest the fund’s money in certain sectors or asset classes. Each investment manager therefore only sees part of the overall portfolio picture. It is impossible for an investment manager to whom management of only part of the portfolio has been delegated to properly manage this risk - the risk needs to be assessed and managed across the whole portfolio.

46. Only part of the investment process is delegated to investment managers. Administering authorities still retain responsibility for many investment decisions, including setting the investment strategy, strategic asset allocation and managing overall portfolio risk. As the Leicestershire Pension Fund acknowledges in the above correspondence, "the Fund's strategic asset allocation ... accounts for over 90% of both the risk and return of the Fund" - strategic asset allocation is done by the administrating authority, not by investment managers.

**What is and is not delegated to investment managers?**

47. Investment decisions taken by administering authorities which are not delegated to investment managers include:

   a. Setting the SIP, investment policy and/or investment strategy statement;

   b. Strategic asset allocation;

   c. Selecting, mandating and monitoring investment managers; and

   d. Managing overall portfolio risk (which may include stewardship activities).

48. The investment powers of administering authorities were, until 1 November 2016, governed by the 2009 Investment Regulations. Since 1 November 2016, these have been replaced by the 2016 Investment Regulations.

49. Under Regulation 11 the 2009 Investment Regulations, administering authorities were required to formulate a policy for the investment of their fund money with a view to:

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24 See also note 6, supra.
a. The advisability of investing fund money in a wide variety of investments; and

b. The suitability of particular investments and types of investments.

50. An administering authority was also required, after consultation with such persons as it considered appropriate, to prepare, maintain and publish a SIP which would govern its decisions about the investment of fund money. The SIP was required to contain the administering authority's policy on (among other things) risk, including the ways in which risks are to be measured and managed.

51. This requirement has now been replaced by the 2016 Investment Regulations. Regulation 7(1) of the 2016 Investment Regulations requires an administering authority, after taking proper advice, to formulate an investment strategy which is in accordance with "Local Government Pension Scheme: Guidance on Preparing and Maintaining an Investment Strategy Statement" (the "guidance"), published by the DCLG.

52. The deadline for preparing and publishing the new investment strategy statements is 1 April 2017.

53. The investment strategy statement must include (among other things):

a. The authority's assessment of the suitability of particular investments and types of investments (Regulation 7(2)(b)). The guidance states:

i. "What constitutes suitability is clearly a matter for individual administering authorities to consider and decide in light of their own funding and investment strategies, but there is a clear expectation that the assessment [of the suitability of different investment classes] should be broadly consistent across all administering authorities. Administering authorities must therefore take and act on proper advice in assessing the suitability of their investment portfolio and give full details of that assessment in their Investment Strategy Statement."

ii. Administering authorities must periodically review the "suitability of their investment portfolio to ensure that returns, risk and volatility are all appropriately managed and are consistent with their overall investment strategy".

b. The authority's approach to risk, including the ways in which risks are to be measured and managed (Regulation 7(2)(c)). The guidance notes that some of the key risks that an administering authority needs to be aware of include financial and regulatory risks. In order to formulate a policy on their approach to risk, the guidance states administering authorities:

i. Must take proper advice;

ii. Should clearly state their appetite for risk;

iii. Should be aware of the risks that may impact on their overall funding and investment strategies;

25 Regulation 12(1), 2009 Investment Regulations.
26 Regulation 7(1). "Proper advice" is defined in the Regulations as "the advice of a person whom the authority reasonably believes to be qualified by their ability in and practical experience of financial matters". Regulation 7(5) reiterates the need for the administering authority to consult with such persons as it considers appropriate as to the contents of its investment strategy.
27 Regulation 12(2) states administering authorities must publish their new investment strategy statements by 1 April 2017. Regulation 12 of the 2009 Investment Regulations, which required administering authorities to formulate SIPs, will continue to have effect until such time as each administering authority publishes an investment strategy under Regulation 7(1) of the 2016 Investment Regulations.
28 The guidance notes that in identifying risks and counter-measures to mitigate against them, administering authorities must continue to act in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (the "2013 Regulations"). Regulation 58 of the 2013 Regulations requires administering authorities to have regard to the Chartered Institute of Public Finance and Accountancy's "Guidance on preparing and maintaining a funding strategy statement". This guide identifies a number of key risks for LGPS funds, including: investment markets fail to perform in line with expectations; market yields move at variance with assumptions; and asset reallocations in volatile markets lock in past losses etc.
iv. Should take measures to counter those risks;

v. Should periodically review the assumptions on which their investment strategy is based; and

vi. Should formulate contingency plans to limit the impact of risks that might materialise.

c. The authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments (Regulation 7(2)(e)): According to the guidance:

i. "[A]lthough administering authorities are not subject to trust law, those responsible for making investment decisions must comply with general legal principles governing the administration of scheme investments."

ii. In the context of the LGPS, "a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence" and administering authorities must also "act in accordance with ordinary public law principles, in particular, the ordinary public law [principle] of reasonableness. They risk challenge if a decision they make is so unreasonable that no person acting reasonably could have made it."

iii. The guidance further states: "The law is generally clear that schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors, and over the long-term, dependent on the time horizon over which liabilities arise."

d. The authority's policy on the exercise of the rights (including voting rights) attaching to investments (Regulation 7(2)(f)).

54. It is clear from the above that administering authorities must exercise reasonable care, skill and diligence when preparing the investment strategy statement and in managing overall portfolio risk. Importantly, this duty is not limited by subjective knowledge. Rather, the conduct of trustees (and administering authorities whose duties are akin to trustees) is judged by reference to facts and circumstances existing at the time when trustees (and administering authorities) were required to act, and which were known or ought to have been known to them at the time. This is a clearly established principle of law. The large body of evidence on climate risk (see paragraphs 15-21 above) should, by now, have put the reasonable administering authority on notice that such risks merit further inquiry at the portfolio level. If administering authorities fail to carry out such an inquiry, they may be susceptible to legal challenge.

55. Administering authorities must also act in the best interests of scheme members when making these decisions. The "best interests" of scheme members has been interpreted to predominantly mean their best financial interest (although non-financial factors may be taken into account in some circumstances). This is because ultimately, the purpose of the pension fund is to provide pensions to scheme members. As the evidence shows, ignoring climate risk at the portfolio level could have significant consequences (as well as opportunities) for investment returns. It could also expose administering authorities to legal challenge for failing to act in the best interest of scheme members.

29 This is also supported by the Pensions Ombudsman case of Brown (G00414), in which the Ombudsman found that while it was not necessary for trustees to pick the winning investment every time, they must nevertheless give investment matters due consideration. This requires investment performance to be monitored by trustees over time.

30 Re Hurst (1896) 67 LT 96 per Lindley LJ at 99. See also Duchess of Argyll v Beuselinck [1972] 2 Lloyd's Rep 172; and Nestle v National Westminster Bank plc (1996) 10(4) Trust Law International 112. In the case of Bartlett v Barclays Bank Trust Co Ltd [1980] 1 All ER 189, Brightman J at 442 said the duties of a trustee extended not just to contenting himself with the information he received, but to go further and "see that he has sufficient information to enable him to make a responsible decision from time to time either to let matters proceed as they were proceeding, or to intervene if he is dissatisfied".
Appropriate delegation to investment managers

56. Both the 2009 Investment Regulations and the 2016 Investment Regulations allow administering authorities to appoint one or more investment managers to invest fund money on their behalf.\(^{31}\)

57. When an administering authority delegates day-to-day investment decisions to an investment manager, there are strict legal requirements that must be followed. These include:

   a. Taking proper advice in relation to the appointment and the terms on which the appointment is made;\(^{32}\)
   
   b. Administering authorities must reasonably believe that the investment manager's ability in, and practical experience of, financial matters make that investment manager suitably qualified to make investment decisions for it;\(^{33}\)
   
   c. Investment managers are required to comply with all of the administering authority's instructions.\(^{34}\) Also, in exercising their investment functions, investment managers are required to take into account (and not contravene) the administering authority's SIP;\(^{35}\) and
   
   d. Under the 2009 Investment Regulations, investment managers were required to report to administering authorities at least once every three months on the various actions taken on behalf of the authorities.\(^{36}\) Administering authorities were then required to keep these actions, including the investment decisions of the managers, under review and periodically consider whether or not to retain them.\(^{37}\)

58. Consequently, in the context of climate risk, administering authorities should:

   a. Proactively request their advisors (often the investment consultant) to advise on the competencies of the investment manager to address climate risk;
   
   b. Consider the investment manager's qualifications to address climate risk;
   
   c. Monitor the investment manager on an ongoing basis to ensure the investment manager is taking into account (and not contravening) the administering authority's SIP/investment statement (both as it relates to climate risk and as a whole); and
   
   d. Ensure climate risk is reported adequately in the investment manager's quarterly reports.

6.3 Misconception 3: Delegation of stewardship to LAPFF is sufficient

"By delegating stewardship engagement activities to LAPFF, the administering authority has discharged its legal duties to manage climate risk."

6.3.1 Examples

59. Several LGPS funds hold the mistaken view that they are fully addressing climate risk by delegating stewardship responsibilities to LAPFF. LAPFF is a shareholder engagement group that seeks to

\(^{31}\) Regulation 8(1), 2009 Investment Regulations; Regulation 9(1), 2016 Investment Regulations.

\(^{32}\) Regulation 8(6), 2009 Investment Regulations; Regulation 9(4), 2016 Investment Regulations.

\(^{33}\) Regulation 8(3), 2009 Investment Regulations; Regulation 9(3), 2016 Investment Regulations.

\(^{34}\) Regulation 9(3), 2009 Investment Regulations.

\(^{35}\) Regulation 9(5)(c) and 9(7), 2009 Investment Regulations.

\(^{36}\) Regulation 9(3), 2009 Investment Regulations.

\(^{37}\) Regulation 10(1)-(3), 2009 Investment Regulations.
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protect the long-term investment interests of beneficiaries by promoting high standards of corporate governance and corporate responsibility among investee companies.

60. According to the East Riding Pension Fund (the "East Riding Fund"):

"... the administering authority considers that climate change is one of a large number of risks facing the Pension Fund...", the "Pension Fund does not explicitly take climate risk into account as part of the strategic asset allocation. However, the Fund does have a detailed environmental, social and corporate governance policy, of which climate risk forms a part, which is included in the [SIP]."

"In practice, the Fund's policy is to discharge its corporate governance responsibilities through engagement with investee companies, the utilisation of its voting rights, an interpretation of best practice guidelines, existing arrangements with its external investment manager, and through membership of the [LAPFF]. Further details of LAPFF's guidance on environmental, social, and governance issues can be found on www.lapfforum.org... the Fund will take into account the guidance issued by LAPFF, and any other appropriate guidance and information, in determining any relevant social, environmental, or governance considerations when selecting, retaining, and realising any of its investments. However, the overriding objective for the Pensions Committee will be to discharge its fiduciary duty in managing the Fund's investments in the best interests of the scheme's beneficiaries."

61. However, the existence of policies may be masking a lack of engagement on climate risk. When asked in September 2016 on how many occasions in the last 12 months climate risk has been discussed at the quarterly Pensions Committee meetings, the Fund replied: "Climate-related financial risk is discussed on a quarterly basis when reviewing the Committee reports relating to the work of the LAPFF." Asked to provide records of the discussion, the Fund responded that "The Pensions Committee agendas and minutes can be found online: http://www2.eastriding.gov.uk/council/committees/pensions-committee." There is, however, no reference to climate risk in any of the 2016 minutes, though LAPFF meetings are "noted". For the Fund's full response, see Annex C.

62. The LGPS funds identified below also appear to hold the same mistaken view. In response to Freedom of Information requests, which asked what steps the Pension Fund Committee and Board have taken to address climate risk, the funds stated as follows:

- **Cumbria County Council Pension Fund:** "The Fund does engage actively and productively with companies on the issue of climate change and investment in carbon stocks, through its participation in [LAPFF]." For the Fund's full response, see Annex Q.

- **Hertfordshire Pension Fund:** "The Hertfordshire Fund is a member of the [LAPFF] who engage on behalf of the [LGPS] with companies on ESG matters, and this can be matters of governance and climate change." For the Fund's full response, see Annex R.

- **Hounslow Borough Council Pension Fund:** "[The Fund] is a member of [LAPFF]. Our Chairman is a member of the Executive Board of [LAPFF]. This undertakes engagement on environmental, social and governance issues on behalf of its 70 local authority pension fund members." See Annex S for the Fund's full response.

- **Southwark Council Pension Fund:** "The Pensions Advisory Panel has supported the ongoing engagement work carried out by [LAPFF]." See Annex T.

- **Staffordshire Pension Fund:** "Staffordshire Pension Fund is a subscribed member of the [LAPFF] who carry out ESG work on the Fund's behalf." For the Fund's full response, see Annex U.
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6.3.2 Why is this approach wrong?

63. Climate risk is highly relevant to a fund's stewardship strategy and it is important that it is properly addressed in responsible investment and stewardship policies. LAPFF plays an important role in stewardship, including engaging with companies on climate risk.

64. Stewardship is a vital part of a fund's management of climate risk as it reduces the vulnerability of existing assets, and if done properly, can reduce the systemic economy-wide risk to portfolio returns as a whole. ClientEarth and ShareAction therefore commend the stewardship activities of the abovementioned funds through the LAPFF.

65. However, in the examples referred to above the funds appear to be stating that by delegating stewardship engagement activities to the LAPFF, the administering authority has discharged all of its legal duties to address climate risk. This misunderstands the nature of the financial risk that climate change presents to the portfolio and misses the point that climate risk needs to be addressed at all stages of the investment process and not just in stewardship decisions. Simply delegating engagement activities to LAPFF is not enough to discharge the rest of the administering authorities' legal duties to address climate risk. The authority must still take climate risk into account in the rest of its investment decisions.

66. As noted, this includes setting the investment strategy/policy/principles, strategic asset allocation, managing portfolio risk, and selecting and mandating investment managers - activities that are not part of LAPFF's remit. Such responsibilities also cannot be satisfied by simply delegating one particular group of activities (i.e. stewardship) to LAPFF.

6.4 Misconception 4: Climate risk will all be dealt with at pool level from now on

"Administering authorities do not need to think about climate risk anymore because this will now be dealt with at the pool level."

6.4.1 Examples

67. The LGPS is currently in the process of arranging itself into eight "pools". Each pool will work together to invest collectively and to pool stewardship activities. Each pool will operate on its own terms but in a broadly similar way.

68. The eight pools are:


c. Central (Cheshire, Leicestershire, Shropshire, Staffordshire, West Midlands, Derbyshire, Nottingham, Worcestershire and the West Midlands Integrated Transport Authority - £34bn AUM).


e. ACCESS (Northamptonshire, Cambridgeshire, East Sussex, Essex, Norfolk, Isle of Wight, Hampshire, Kent, Hertfordshire, West Sussex, and Suffolk - £34bn AUM).

f. Wales (Carmarthenshire, Cardiff, Flintshire, Gwynedd, Powys, Rhondda Cynon Taff, Swansea and Torfaen - £13bn AUM).

g. Border to Coast (Cumbria, East Riding, Surrey, Warwickshire, Lincolnshire, North Yorkshire, South Yorkshire, South Yorkshire Passenger Transport Pension Fund, Tyne & Wear, Durham, Bedfordshire, Northumberland and Teesside - £36bn AUM).

h. LPP (Lancashire, Berkshire and the London Pension Fund Authority - £13bn AUM).

69. Some funds appear to wrongly take the view that climate risk will be a matter exclusively for the pool once restructuring has taken place. For example:

a. Leicestershire Fund: “The Fund has no climate risk policy in place, and believes that climate risk is inexorably bound-up within the decision-making processes of the appointed investment managers. There are currently no intentions of introducing a policy in this area and, given the move towards the pooling of assets within the LGPS that will commence within the next two years, policies such as this will soon become the responsibility of the asset pool rather than individual funds (although individual funds will be able to influence the pool).” For Fund’s full response, see Annex A.

b. London Borough of Newham Pension Fund: “The Newham LGPS is a member of the London CIV and the assets will over time move across to them to manage and the responsibility for ESG decisions will rest at the CIV level.” See Annex X.

6.4.2 Why is this approach wrong?

70. Each of the eight pools has submitted a proposal document describing how their pool will operate. The proposals describe the decision-making processes at all stages of investment, including what decisions will be made by administering authorities, what decisions will be made at the pool level, and what decisions will be made by the pool supervisory bodies.

71. Generally:

a. Investment strategies, strategic asset allocation and a fund’s responsible investment policy will all be set by the administering authority;

b. The appointment of external investment managers, the implementation of investment strategies and FCA-regulated activities will be done at the pool level; and

c. Oversight and scrutiny of the pool and policy decisions on stewardship and voting at the pool level will be done by the supervisory bodies.

72. It is immediately apparent from this division of responsibilities that pooling is not an excuse for administering authorities to disregard consideration of climate risk. As we have explained in Part 4 above, climate risk is relevant at all stages of the investment process, including in setting investment strategies and strategic asset allocation.

73. It is the administering authorities that will retain responsibility for these strategic investment decisions. Accordingly, climate risk must still be taken into account by the administering authorities, as well as at the pool level.

6.5 Misconception 5: Taxpayers (not scheme members) bear the risk

"Scheme members should not concern themselves with this issue as any losses caused by poor management of the risk will be met by the taxpayer."

6.5.1 Examples

74. This view was expressed by the West Yorkshire Pension Fund (the "West Yorkshire Fund") in its correspondence with scheme members: "...your benefits from the scheme, as a member, are determined by government regulation, and are not in any way at risk." For the Fund's full response, see Annex D.

75. The Leicestershire Fund also took this position, stating: "investment returns have absolutely no impact onto the benefits that individuals receive … Given that the vast majority of these employing bodies are public bodies that receive a large majority of their income via either Central Government or the Local Taxpayer … It is the taxpayer, and not individual members of the LGPS, that take on the risks surrounding the investment policy of the Fund". For the Fund’s full response, see Annex A.

6.5.2 Why is this approach wrong?

76. This misconception has already been authoritatively dealt with by Nigel Giffin QC in his Legal Opinion “Duties of administering authorities under local government pension scheme”, dated March 2014.

77. In that opinion, Mr Giffin QC stated (at paragraph 7):

"Whilst a member’s statutory entitlement to his or her defined benefits subsists regardless of whether the fund is doing well or badly (and the contributions required of the member do not vary with that performance), it would be naïve to suggest that there is no scope for members to be affected by fund performance. If the fund is doing badly, and employer contributions rise as a result, it is easy to see that the various discretions for which the [Local Government Pension Scheme Regulations 2013] provide are less likely to be exercised in members’ favour. Further, as a practical proposition, if the fund is running into severe financial problems and employer contributions threaten to reach unsustainable levels, legislative measures are likely to be taken to curtail benefits or raise employee contributions well before the point of exhausting the fund is reached, regardless of what the position might be if such exhaustion actually occurred."

78. A full copy of the Legal Opinion can be found at Folder 2/Tab 19.

79. The new 2016 Investment Regulations also extend the best interests requirement out to taxpayers generally (i.e. it does not stop at scheme members). The guidance accompanying the 2016 Investment Regulations explicitly recognises the importance of safeguards for the “best long-term interests of scheme members and taxpayers”.

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39 Nigel Giffin QC (March 2014), “Duties of administering authorities under local government pension scheme” [Folder 2/Tab 19].
7 Request of TPR and DCLG

80. TPR is the UK regulator of work-based pension schemes. By section 17(1) and Schedule 4 of the Public Service Pensions Act 2013, TPR’s regulatory oversight was extended to public service pension schemes, including the LGPS.

81. One of TPR’s objectives is to protect the benefits of members of occupational pension schemes. According to TPR’s website:

“Our approach to regulating public service schemes is consistent with our overall operational approach to educate and enable and, where necessary enforce compliance. We will focus our activity on those involved in the governance and administration of public service schemes so that legal requirements are complied with, as well as increasing the likelihood that the standards and practices we expect are met.”

82. While the misconceptions identified in this referral are drawn from an evidence-gathering exercise in respect of LGPS funds, ClientEarth and ShareAction believe that these misconceptions are held more widely, that is, not just by administering authorities of LGPS funds but also trustees of private sector occupational pension schemes.

83. We therefore urge TPR to:

a. Investigate the matters raised in this referral;

b. Publish detailed guidance (in conjunction with the DCLG if necessary) for all pension funds (including LGPS funds) dispelling these common misconceptions and setting out guidance on what pension funds can and should be doing to properly assess and manage climate risk;

c. Engage with Defra with a view to preparing a report on the pensions industry under the Adaptation Reporting Power (pursuant to the Climate Change Act);

d. Issue a public statement highlighting schemes that are demonstrating excellent practice in managing climate risk and schemes that are failing to meet the minimum expected standard; and

e. Meet with us, as well as members of members of the East Riding Pension Fund, Hampshire Pension Fund, Leicestershire Pension Fund, London Pension Fund Authority, Surrey Pension Fund, West Yorkshire Pension Fund and the Wiltshire Pension Fund, to discuss the contents of this referral; and

f. Engage with DCLG to ensure that the pooling process leads to the highest standards in climate risk management being achieved.

84. Regulations 7 and 8 of the 2016 Investment Regulations require administering authorities to formulate an investment strategy in accordance with guidance issued by the Secretary of State for Communities and Local Government (the “Secretary of State”) and enable the Secretary of State to issue a direction to any authority which fails to act in accordance with that guidance.

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42 See also note 4, supra.
85. A copy of this reference, together with annexed documents, is therefore being sent to Marcus Jones MP, Parliamentary Under Secretary of State (Minister for Local Government) at DCLG. We will be following up separately to urge the DCLG to:

   a. Ensure that its further guidance dispels the misconceptions identified in this referral and sets out what pension funds can and should be doing to properly assess and manage climate risk; and

   b. Ensure that the pooling process leads to the highest standards in climate risk management.

86. These requests of TPR and DCLG are particularly important given the approaching 1 April 2017 deadline for LGPS funds to prepare their investment strategy statements. TPR and DCLG should indicate ahead of that deadline that climate risk is likely to be a financially material consideration for funds, and highlight best practice approaches. While this is a challenging time for the LGPS, it is important that pooling works in the best interests of members, and we are keen to offer assistance with the proposals outlined above.

7.1 Power to investigate

87. TPR has wide information-gathering powers under sections 71 and 72 of the Pensions Act 2004 (“PA 2004”):

   a. Section 71 provides that TPR may issue a notice to, *inter alia*, a member of the pension board of a public service pension scheme "requiring them or, as the case may be, him to provide [TPR] with a report on one or more specified matters which are relevant to the exercise of any of [TPR's] functions."

   b. Section 72 provides that TPR may require, *inter alia*, a member of the pension board of a public service pension scheme, "to produce any document, or provide any other information, which is (a) of a description specified in the notice, and (b) relevant to the exercise of [TPR's] functions."

88. We urge TPR to exercise these powers to investigate how LGPS funds are approaching the financial risks associated with climate change and, in particular, the misconceptions we have identified in this referral.

7.2 Power to issue guidance

89. TPR has the power to issue guidelines under section 90 of PA 2004. Section 90 states TPR may issue codes of practice:

   a. Containing practical guidance in relation to the exercise of functions under pensions legislation; and

   b. Regarding the standards of conduct and practice expected from those who exercise such functions.

90. In the circumstances, TPR should issue guidelines clearly setting out:

   a. Why the misconceptions identified above are incorrect;
b. The need for administering authorities and trustees to consider climate risk at all stages of their investment processes, particularly in setting their investment strategy and when determining strategic asset allocation;

c. Practical examples of how climate risk can affect portfolios with differing investment profiles and horizons; and

d. Practical examples of what steps administering authorities and trustees could take to properly assess and manage these risks.

### 7.3 Engage with Defra and prepare an Adaptation Report

91. The Climate Change Act 2008 gave the government an Adaptation Reporting Power ("ARP"), exercisable by Defra. The ARP enables the Secretary of State to invite public bodies to prepare reports into the impacts of climate change on their organisation/sector.

92. This was the mechanism under which the Prudential Regulation Authority’s report in September 2015 into the impact of climate change on the UK insurance sector (the "PRA report") was made, and we consider that it would provide TPR with an important opportunity to consider the risks to, and opportunities for, the pensions industry associated with climate change.

93. There has been considerable interest from governmental sources in expanding the APR to the financial sector:

a. The Government’s 2013 "Strategy for exercising the Adaptation Reporting Power" noted that "The ARP is relevant to regulators of the financial sector, to ensure that they are removing barriers to adaptation and taking account of climate change risks in their regulatory processes."

b. The Committee on Climate Change’s June 2015 "Progress in preparing for Climate Change" report to Parliament recommended that "The Bank of England should undertake research to better understand the potential systemic risks from climate change to the finance sector, building on [the PRA report]. The research should be completed in time to inform the next NAP, due in 2018. The third round of ARP reporting should be extended to cover all areas of the finance sector."

94. We urge TPR to engage proactively with Defra to express the view that it should be invited to prepare a report on the pensions industry in the next round of ARP reporting. This is with a view to preparing a report on the pensions industry under the Adaptation Reporting Power (pursuant to the Climate Change Act).

95. Further information on the ARP can be found at Folder 2/Tab 22.

### 7.4 TPR to release a statement

96. Issue a public statement highlighting schemes that are demonstrating excellent practice in managing climate risk and schemes that are failing to meet the minimum expected standard.

### 7.5 Request to meet with the Chief Executive of TPR

97. Finally, ClientEarth and ShareAction, along with the members of members of the East Riding Pension Fund, Hampshire Pension Fund, Leicestershire Pension Fund, London Pension Fund Authority,
Surrey Pension Fund, West Yorkshire Pension Fund and the Wiltshire Pension Fund, would welcome a meeting with the Chief Executive of TPR to discuss the contents of this referral.

98. Please do not hesitate to contact us if we can be of any further assistance. From ClientEarth, please contact Alice Garton (Company and Financial Project Lead) at agarton@clientearth.org and Natalie Smith (Company and Financial Lawyer) at nsmith@clientearth.org. From ShareAction, please contact Rachel Haworth (Policy Officer) at rachel.haworth@shareaction.org.

99. We kindly respect that TPR find the time to meet with us within two months to discuss the matters raised in the referral. Please provide us with some suggested times within a month so that we may be able to coordinate relevant diaries.