

## LAPFF Response to Task Force on Climate Disclosure Phase I Consultation

The **Local Authority Pension Fund Forum** was set up in 1991 and is a voluntary association of 70 public sector pension funds based in the UK with combined assets of approximately £175 billion. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest. The Forum has taken the opportunity below to provide our view on those issues which we consider relevant to our activities.

### SUMMARY

LAPFF welcomes the opportunity to respond to the Task Force on Climate Disclosure (the Task Force) Phase I Consultation. It appreciates the Task Force's commitments to develop an enduring reporting framework that promotes financial stability. The Forum encourages a forward-looking focus on detailed quantitative and qualitative reporting, supported by additional narrative where necessary, across five elements: operational emissions; strategic resilience; research and development; the governance of company policy implementation on climate change and key performance indicators; and public policy. Reporting against elements of this framework has already received support from oil, gas and integrated mining companies, and a wide spectrum of asset owners and asset managers. Within this framework, LAPFF strongly encourages scenario and sensitivity analysis, to rigorously test companies' assumptions, and to provide a comparable and consistent approach to disclosure. We encourage the Task Force to continue to consult widely as it progresses through Phase II, and ask it to consider, in particular, the relevance of its recommendations over the longer-term. We note that LAPFF is a member of the Investor Network on Climate Risk and supports its joint consultation response of 21 March.

### DETAILED RESPONSES

**1. Which types of non-financial firms should any disclosure recommendation cover? List in order of importance.**

LAPFF prioritises the below sectors as follows, with (1) being the highest priority:

- a. Consumer Discretionary (6)
- b. Consumer staples (7)

- c. Energy (1)
- d. Health Care (8)
- e. Industrials (4)
- f. Information Technology (9)
- g. Materials (3)
- h. Telecommunications (5)
- i. Utilities (2)

**RESPONSE:**

LAPFF's most active carbon risk engagement in the past two to three years has been with oil and gas, integrated mining and utilities companies, representing the larger corporate carbon emitters. As extractive companies are involved in exploring and/or producing and selling hydrocarbons, and utilities comprise some of the largest energy suppliers, they are thus arguably most exposed to the impacts of transitioning to a low-carbon economy. The emphasis here has been on understanding how these companies will be resilient to such a transition. LAPFF also believes that engaging with the transport sector should be a high priority.

LAPFF believes that disclosure is relevant across all sectors however, as climate change is a systemic issue and companies will be variously exposed, and contribute, to the low-carbon transition.

**2. What types of financial firms should any disclosure recommendations cover?**

- a. Banks
- b. Diversified Financials
- c. Insurance
- d. Real Estate
- e. Credit Rating Agencies
- f. Investment Consultants
- g. Pension Funds/Schemes
- h. Other

**RESPONSE:**

We consider that disclosure recommendations could be made to all of these categories.

### **3. Which users in the financial sector should be considered as the target audience?**

RESPONSE:

Investors should be seen as the primary audience for the disclosure requirements. As the providers of capital, investors require disclosure in order to make prudent investment decisions, from which financial stability flows.

However, LAPFF can also see that this disclosure would be of benefit to other users in the financial sectors, as part of the capital supply chain. Disclosure should thus be available to all, but designed primarily for investors.

### **Climate Risk Dimension**

#### **5. For users of climate risk and opportunity information, what are five specific points of information that you wish to secure?**

RESPONSE:

LAPFF believes that the five most essential aspects for disclosure, on a company-by-company basis are:

a) Ongoing operational emissions management

This aspect of disclosure focusses on the company's current carbon emissions. The UK Companies Act 2006 (Strategic Report and Directors Report) Regulations 2013 requires emissions reporting, but effective emissions management could also set out the scope of emissions to be reported, and whether reduction targets are set.

LAPFF agrees that disclosure of Scope III emissions is currently minimal, but would welcome increased disclosure in this area.

LAPFF has for several years promoted mandatory carbon emission reporting with related disclosure on the wider implications of the carbon transition on the business model and on strategy to be addressed in annual reports. It is recognised that the Task Force's aim is to provide a framework promoting alignment of existing laws and regulations focussing on financial risk. However, LAPFF considers that the Task Force could consider within its remit, to what degree it could promote core requirements that are already mandatory to report in certain jurisdictions, to recommend that other jurisdictions consider making them mandatory.

b) Business strategy resilience in the carbon transition

Oil, gas and integrated mining companies should here disclose their resilience against the International Energy Agency's (IEA) scenarios. These scenarios are forward-looking and enable investors to consider whether current capital expenditure will be profitable in the future, in the context of the low-carbon transition. For other companies, this disclosure would seek to ascertain whether the existing business strategy is well positioned for the transition; for example, a real estate company may need to reconsider its dependence on certain materials and suppliers in order to manage its direct and indirect operational emissions adequately. This factor, in particular, is important to investors to ensure prudence and capital protection.

[LAPFF supports the view](#) that companies are not adequately reporting under existing requirements to disclose future risks and uncertainties and that more could be done to ensure regulators are ensuring that existing reporting requirements are being properly implemented. The proposals put forward by the Task Force should help companies align their reporting under such existing legislation and should support regulators in holding companies to account.

c) Low-carbon energy research and development and investment strategies

Investors are keen to understand the extent to which companies are engaging in the development of new technologies, how this will position them in a low-carbon transition, and whether they are adequately focussing on the opportunities that such a transition presents.

d) Governance of policy implementation and relevant strategic key performance indicators

Accepting that the low-carbon transition is underway, disclosure of relevant strategic key performance indicators would provide a clear indication of how companies are monitoring this transition and incorporating this into the underlying business model.

e) Public policy positions relating to climate change

This aspect of disclosure acknowledges, in particular, the influence that companies have in shaping the direction of travel. It allows investors to understand the approach companies are taking and how influential they are intending to be in embracing the opportunities that the transition presents. For example, LAPFF considers companies could report on plans to encourage the take-up and effective implementation of carbon pricing mechanisms. Disclosure of industry association memberships would be useful here, and is already provided by some companies. Similarly, disclosure of funding for academic institutes carrying out research on climate change would be welcomed.

Originally devised in relation to oil, gas and integrated mining companies, this framework can be applied to companies, of varying sizes, across a range of sectors. LAPFF believes this reporting structure is sufficiently prescriptive to ensure a base level of disclosure that can be comparable across companies and sectors, whilst also retaining sufficient flexibility to allow for factors specific to each individual company to be adequately disclosed.

This structured approach is designed to extend disclosure, where possible, beyond 'high-level' narrative based reporting, to detailed, and quantitative, disclosure, supported by narrative where necessary.

**6. Are there any best-practice disclosures of climate risks by companies that you would like to bring to our attention? What specific climate elements of this disclosure would you like to highlight? (Please limit to two examples)**

RESPONSE:

LAPFF was heavily involved in co-filing shareholder resolutions to BP and Shell, in 2015, and Rio Tinto, Anglo American and Glencore, in 2016, asking for disclosure in annual reporting against the five-point framework listed in response to Question 5. All five resolutions were supported by the Boards, and by shareholders (having been voted in by between 96 and 99% of voting shareholders). Similar asks have been made, and accepted, by Total and Statoil, and are being considered by ENI. There has also been strong support for proposals to Chevron and Exxon on the 'Business strategy resilience in the carbon transition' element.

LAPFF sees the extent of shareholder support for these resolutions as being illustrative of investor demand for this form of carbon risk disclosure. Board support for these resolutions also shows the willingness of companies to improve disclosures, when given sufficient clarity and guidance on the basis on which to do so.

**7. "Transition Risk" in terms of climate is an evolving term. How would you define this risk? What specific disclosures would help measure it?**

RESPONSE:

LAPFF agrees that 'Transition Risk' is a broad and evolving term, used by different stakeholders to mean different things. To LAPFF, this term means the financial risk that a Company is exposed to through a transition to a 'low carbon economy'. The materialisation of Transition Risk destroys shareholder value.

Such risk can include, for example, assets that become substantially devalued owing to a substantial decline in demand (i.e. 'stranded assets'). Other factors that LAPFF may consider when assessing the level of Transition Risk are: whether a company applies a realistic internal carbon price; how it anticipates relevant legislative and policy changes; and what steps it takes to reduce its operational emissions. The five elements set out in response to Question 5 are intended to prompt disclosure that can inform an assessment of Transition Risk.

As a long-term investor, it is LAPFF's view that companies' preparation to avoid Transition Risk needs to be substantially underway, particularly given the length of potential life cycles for relevant assets. In the interests of financial stability, investors need to be able to understand now whether, for example, new capital expenditure is going to be profitable over the full life-cycle of an asset, and not just in the short-term. In making this assessment, investors need to see that a company has taken into account various permutations of a transition to a low carbon economy, and that the results of such consideration have been that the asset will still be profitable. This is

why LAPFF views scenario and sensitivity analysis as essential, and why quantitative analysis is necessary.

**8. Which three sectors do you think are most exposed to climate risks? For these sectors, how are physical, transition and liability risks best measured and reported?**

RESPONSE:

LAPFF does not think it is helpful to limit an assessment of the most exposed climate risk sectors to three. It sees energy, utilities, materials and industrials as all being substantially exposed to climate risks, along with a number of other sectors (albeit to a lesser extent).

LAPFF sees that there is overlap between physical, transition and liability risks. Whilst LAPFF sees these categories as helpful in prompting consideration of different types of risk, it does not necessarily see the need to encourage disclosure around each specific type of risk, if this does not sit easily within a broader disclosure framework, such as that suggested in response to Question 5.

For example, and applying that framework, physical risks could be reported as an element of 'portfolio resilience', whilst liability risks could be reported as an element of 'operational emissions' (if relevant), 'portfolio resilience', and 'key performance indicators'. Transition risks could be reported as an element of 'public policy' and 'key performance indicators'.

LAPFF would expect that, where possible, financial values should be attributed to quantify or demonstrate potential impacts. For example, a financial provision for litigation could be considered, and a hypothetical internal carbon price could be applied. Where this is not possible (for example, in relation to potential reputational damage), a qualitative description of the nature of the impact should be disclosed.

LAPFF considers that all reporting on carbon risk should be disclosed in companies' annual reports. This reflects the impact that carbon risk can have on the viability of a company and on capital protection. Disclosure is necessary on an annual basis given the rapidly changing policy environment, and the nascent development of measurement and reporting techniques.

**9. How should the task force consider the challenge of aggregate versus sector-specific climate-related financial risks and opportunities?**

RESPONSE:

A number of LAPFF funds have direct investments in specific companies. Therefore, the Forum has a strong need for company-specific financial risks and opportunities. Sector-specific data will also be relevant to LAPFF, in order to make comparisons between specific company performance as against their sector peers. Similarly, aggregate data is relevant in order to ascertain which companies, and sectors, are most exposed to carbon risk in the longer-term.

**10. Is there a role for scenario and sensitivity analysis – for the non-financial and/or financial sectors? Please provide three specific examples.**

RESPONSE:

LAPFF believes there is a strong need for scenario analysis and has been encouraging oil, gas and mining companies to disclose the scenarios that they apply to their asset portfolios. As a more advanced step, we also call on companies to show how they have stress-tested their portfolios against such scenarios.

Whilst some companies have developed their own internal scenarios, the IEA scenarios, in particular the 450 Scenario, provide a helpful and uniform basis upon which to compare companies' future resilience. This takes into account, for example, the potential for carbon pricing, shifting demand from oil and gas towards renewables, and population growth.

Sensitivity analysis is, to some extent, built into the range of IEA scenarios available. Companies should be encouraged to work in their own sensitivities when stress-testing against the scenarios.

**Asset Class Dimension**

**11. Which are the key asset classes that require initial attention? Are there any gaps that we should focus on? Within this, what are the top two priorities for action? (Limit 1000 characters).**

- a. Equities
- b. Fixed income
- c. Commodities
- d. Project and infrastructure finance
- e. Real estate
- f. Private equity
- g. Loans and other bank financing
- h. Other

RESPONSE:

LAPFF considers all of the above asset classes to be relevant for disclosure. LAPFF would prioritise attention on equities and commodities, closely followed by project and infrastructure finance, real estate and loans and other bank financing.

## Intermediary/User Scope

**12. Considering the breadth of services the capital supply chain provides, please provide up to three examples of leading work (research or other) from sell-side brokers' investment recommendations, listing rules of stock exchanges, portfolio management and stewardship examples by fund managers, fund-manager recommendations by consultants, or others we should consider.**

RESPONSE:

A number of useful resources have already been identified by the Task Force, including a report by the Carbon Tracker Initiative. The latest, commissioned by LAPFF 'Engaging for a Low Carbon Transition', sets out why a 2°C business model can be less risky than 'business-as-usual' for oil and gas companies.

**14. How can climate risk information be simply summarized for retail investors? What standards or mechanisms exist for assuring end investors that climate risks and opportunities have been considered in the way that their savings and investment and pension products have been managed?**

RESPONSE:

Whilst qualitative reporting is welcomed to clarify data outcomes, companies should be discouraged from extensive narrative, particularly in relation to assessing their portfolios' resilience. Investors need to understand the way in which a portfolio has been tested, and this cannot be achieved solely by reviewing a narrative report; as the Task Force has noted, granular detail is needed.

The Task Force has suggested that it will 'consider the appropriate level of discretion for management in determining relevance and materiality...consistent with the paradigm of 'through the eyes of management''. It is LAPFF's view that care should be taken with this paradigm when giving reporting guidance on carbon risk, given that it exposes disclosure to management bias. If this approach is to be taken, LAPFF would expect the Task Force to consult extensively on the safeguards that will be put in place to address such management bias.

Similarly, LAPFF opposes the suggestion that 'negative' disclosures (i.e. those that state there is 'no reason to believe that anything is wrong but never positively state that he or she believes things to be right') may be acceptable. Such disclosures are not helpful to investors as they do not evidence rigorous consideration of the issues upon which disclosure is sought. Transparency is a substantial aim of these disclosures, and negative disclosure does not achieve this.

These issues also raise the importance of recommending independent and adequate assurance of disclosures, which LAPFF supports.



## Macro Scope

**17. The United Nations Framework Convention on Climate Change (UNFCCC) five yearly "global stocktakes" seek to establish in part whether financial flows are consistent with the less-than-two-degree scenarios. Are there any climate-risk disclosure recommendations that would appropriately feed into such an effort?**

RESPONSE:

LAPFF considers that disclosure against the five points set out in response to Question 5 will assist in assessing whether financial flows are consistent with the less-than-two-degree scenario. In this regard, annual scenario and sensitivity analysis will be very relevant.

## Looking ahead

**18. How should the Task Force define "success"?**

RESPONSE:

The Task Force should continue to consult extensively, across a range of stakeholders, and should use the responses it receives to assess whether it has succeeded in achieving its aim of 'improving the consistency and effectiveness of climate risk financial disclosures for global capital markets'. If its recommendations are implemented by companies, and lead to improved disclosures for users, this will also indicate a short-term success. The Task Force should also consider that such success needs to have longevity, and so any recommendations should be revised or added to as necessary over time; the ability to do so will also define the Task Force's success.

**19. What are the key barriers that you believe the Task Force needs to overcome?**

RESPONSE:

The Task Force needs to remain focussed, despite operating in a broad area, in order to ensure that capital protection, stewardship and prudence are at the centre of its work on climate disclosure.

The Task Force is already aware of the varying interpretations of language used in this arena, (for example 'transition risk', 'materiality' and 'resilience') and should seek to clarify what it means when it uses these terms, so that there is certainty in its scope and its recommendations. The way in which it intends to apply these terms should be subject to consultation in Phase II.

As the Task Force has noted, an existing legislative framework exists in a number of G20 jurisdictions for climate reporting. Any recommendations that are made should, as far as possible, be relevant to such legislation and reference it, so as to strengthen and complement it, rather than to detract from it and cause confusion.

The Task Force should ensure that any recommendations issued in 2016 can be amended to remain relevant as the transition towards a low carbon economy unfolds. The Task Force's emphasis on developing an 'enduring framework' is welcomed in this regard.

**20. Is the Task Force focused on the appropriate set of topics for its Phase II work plan?**

RESPONSE:

The topics identified for Phase II are appropriate, although they are broad and thus difficult to appreciate in detail at this stage. LAPFF would strongly urge the Task Force to continue to consult on these topics during and after Phase II, and particularly before the publication of final recommendations.

**22. The Task Force plans to reach out to a broad sample of key stakeholders in the preparer, user and standard setting communities. Are there particular types of entities or organizations that you believe the Task Force should reach out to?**

RESPONSE:

The Task Force should ensure that it consults with a range of institutional investors, particularly those with long-term investment horizons.