LAPFF Response to Recommendations of the Task Force on Climate-Related Financial Disclosure
10 February 2017

Local Authority Pension Fund Forum

LAPFF Response to Recommendations of the Task Force on Climate-Related Financial Disclosure

The Local Authority Pension Fund Forum ('the Forum') was set up in 1991 and is a voluntary association of 72 local authority 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.

1 Summary

LAPFF welcomes the opportunity to respond to the FSB's Task Force on Climate Disclosure ('Task Force') report. The Forum supports this report and associated recommendations and considers all market participants should be encouraged to aim for full implementation.

In the response to the Phase I consultation, LAPFF encouraged a forward-looking focus on detailed quantitative and qualitative reporting 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. The proposed four core elements are in line with these proposals and presented in a simple and clear framework. This will succeed in providing better investment decision-making information if fully implemented. However, we note that reporting on public policy positions is not currently included in the recommendations and we encourage the inclusion of this. We would also request a increase of focus on the reporting of financing and development of the climate-related opportunities that are critical to the achievement of limiting temperature increase to 1.5 to 2 degrees, initially proposed under the 'research and development' element.

LAPFF supports organisations' use of scenarios to provide forward looking analysis in a market where most risk management measures are short term and backward looking. However we additionally support the inclusion of at least one publicly-available climate related scenario (such as IEA) by each organisation to achieve comparability, market consistency and ease of understanding by investors. We strongly advocate for a 1.5 degree Celsius scenario to become the standard in line with the ambitious goal set in the Paris Agreement. Equally we support the use of the term 'low carbon' rather than 'lower carbon'

Report Origination: PIRC Ltd
Report Author: Helene Winche

due to the understanding that globally there is a recognised need to achieve net zero carbon emissions by c.2050.

LAPFF promotes reporting on climate risk to be made mandatory. In the UK, the mechanism for this is already in place under The Companies Act requirements for companies to report financially material risks in the annual report. We are supportive of the statements in the report that the Task Force believe climate -related risk is a financially material risk and this further reinforces the requirement for climate risk reporting under the materiality clause. Indeed, reporting of social and environmental risks are a key focus of directors' duties under Section 172 of the Companies Act which determines disclosure in the strategic report. Guidance could go beyond promoting disclosure of a scenario that reflected a two-degree future to recommending that companies should be positioning themselves for the required low carbon future by disclosing a transition plan.

The Task Force's recommendations also include the requirement for Asset Owners to report and this has already begun with some investors (including one LAPFF member) reporting on some GHG emissions data relating to equity and debt investments. In the Supplemental Guidance for Asset Owners, the proposed normalisation factor is strategy/fund investment value (in USD or equivalent) which will lead to annual changes in GHG footprint driven by market valuations rather than companies underlying strategy. There are some concerns over all normalisation factors and we request the Task Force remain flexible on the methods that Asset Owners can use to report until a suitable and generally acceptable standard is found.

Investors should additionally report what percentage of AUM they can measure and barriers faced in asset classes where GHG emissions reporting is not available. The Task Force may need to encourage further research to close gaps in data collection and methodology to ensure full disclosure is possible.

For the Task Force to achieve full implementation of its recommendations, LAPFF encourages it to work with national stock exchanges, financial regulators and the International Organization of Securities Commissions to ensure rapid take up and promotion of consistent standards. Annual reporting from the Task Force on the adoption achieved would be helpful so that further support could be provided by investors. We would also suggest a regular review of methodologies and metrics.

2 Consultation responses

Questions 1-2 cover factual Respondent Information. Q2 classifies the Forum as both a user of climate risk reporting and as a preparer of climate risk reporting within LAPFF members' annual reports.

<u>All Sector Recommendation and Guidance</u>

Q3a How useful are the Task Force's recommendations and guidance for all sectors in preparing disclosures about the potential financial impacts of climate-related risks and opportunities?

RESPONSE
Very Useful

Q3b Please provide more detail on your response:

RESPONSE
The final report and recommendations clearly state that climate change is a material financial risk and as such it is critical that disclosure is included in mainstream financial reporting. This definition of climate change as a financial risk should provide UK Trustees and Directors with sufficient evidence that it is within their duty to consider climate change and report on actions. Further, Section 172 of the Companies Act determines directors' duties for disclosure of such risks in the strategic report. However, accurate climate risk assessment depends on sufficient knowledge and skill levels and we would welcome transparency by companies on the existence of these skills. We recognise the focus on risk in the recommendations but consider there is scope to also focus on reporting on R&D and financing opportunities critical to creating a low carbon economy.

The recommendations articulated across four thematic areas are clear and systematic and flow through an organisation from board recognition and statement of climate change as a material risk, to imbedding it in strategic decisions, to evaluating risk and finally measuring the financial impact and agreeing targets. The recommendations are in a simple structure and the Forum considers the Task Force has found a balance between being prescriptive and detailed and allowing for sufficient flexibility for development over time as market knowledge and analytical methods improve. The recommendations are also consistent and cumulative rather than conflicting with other reporting initiatives which is welcome.

We would like to see the Task-force encouraging further global standardisation of methodologies for measurement and reporting.

We would recommend use of the commonly accepted market term 'low carbon' rather than 'lower carbon'.

Supplemental Guidance

Q3c How useful is the Task Force's supplemental guidance for certain sectors in preparing disclosures about the potential financial impacts of climate-related risks and opportunities?

RESPONSE
Very Useful

Q3d please provide more detail on your response:

RESPONSE
The Supplemental Guidance is useful, providing details relevant to each subsector.In particular the additional guidance for the Energy Group is helpful in a sector that will be subject to a continuing focus on disclosure.

The detail on water risk disclosure is relevant and couched in appropriate terms related to water stress and climate related risks which will include flooding, drought and rising sea levels.

The Asset Owner guidance is useful. It might be presented in a different format, such as 'Applying the Recommendations as an Asset Owner' rather than as supplemental guidance.

The work on mappings to other initiatives and example metrics is relevant and will provide useful information to companies that already report via other initiatives.

As companies work to align reporting with this guidance, practical examples will help shape the development of this guidance.

Organizational Decision Making

Q4a If organizations disclose the recommended information (or information consistent with the Task Force's recommendations), how useful will that information be to your organization in making decisions (e.g. investment, lending and insurance underwriting decisions)?

RESPONSE
Very Useful

Q4b Please provide more detail on your response:

RESPONSE
LAPFF considers the Task Force's view - that the lack of disclosure on climate-related risks is leading to an inefficient allocation of capital with an excess of capital invested in fossil fuels and a shortage of capital invested in climate-related opportunities - is merited.

The Task Force's recommendations are in line with the disclosure requests that LAPFF funds have been publicly asking for in engagement with resource companies and in the strategic resilience shareholder resolutions co-filed at a number of the UK-based companies' AGMs as well as being in line with best practice indicators highlighted in the 2010 LAPFF guide 'Investing in a Changing Climate'[1]. As such, information provided in line with these recommendations will be very useful in contributing to investment analysis. Further, disclosure resulting from these structured yet simple recommendations will allow for comparability within and across sectors.

Climate-related financial disclosures enable long term investors like Forum member funds to determine whether a company has fully considered all implications of climate change in its business strategy. Required disclosures suitably cover the entire organisation from board oversight (governance) to management (strategy), include risk and financial metrics and will provide investors information on the materiality and management of these factors. The disclosures will also provide baseline information to drive engagement conversations between investors and companies around their detailed disclosure statements.

Q5 What other climate-related financial disclosures would you find useful that are not currently included in the Task Force's recommendations?

RESPONSE
As it is difficult to predict which indicators will be valued and develop over time, we encourage the Task Force to remain flexible to be able to adopt new indicators as they emerge through best practice.

Further to our consultation response to Phase I, we continue to request disclosure on 'low-carbon energy research and development of new technologies' where companies report on

[1] Page 21 of 'Investing in a Changing Climate',2010, at www.lapfforum.org/Publications/latestresearch/files/ClimatechangeGuideA4.pdf

how they see the opportunities and their investment to date in climate related opportunities such as new technology and renewable energy assets. However we realise this is one area where some information might be commercially sensitive, so we would accept discretion being taken in the amount of detail provided.

We also requested disclosure on ‘public policy positions’ including advocacy and lobbying which covers information on membership of industry organisations, detail of policy action and objectives with best practice reporting in line with the guidelines in the UNEP report ‘Guide for Responsible Corporate Engagement in Climate Policy’.[2]

As already mentioned, disclosure of internal skills and knowledge on climate risk assessment would be valuable.

Additionally we would recognise a self reporting (or third party) statement on compliance to the Task Force's recommendations by all reporting organisations as useful additional disclosure.

Scenario Analysis

Q6 The Task Force recommends organizations describe how their strategies are likely to perform under various climate-related scenarios, including a 2°C scenario (see page 16 of the TCFD report). How useful is a description of potential performance across a range of scenarios to understanding climate-related impacts on an organization’s businesses, strategy, and financial planning?

RESPONSE
Very Useful

Q7 Please elaborate on your response above.

RESPONSE
LAPFF supports organisations using scenarios to provide forward looking analysis in a market where most risk management measures are short term and backward looking. However, to be of maximum use for investors, companies need to include at least one market available climate-related scenario to provide investors with consistency, comparability and ease of understanding. We would like to see the guidance updated to include this requirement. Scenario analysis also needs to undertaken with a regular review (such as every three to five years) as additional information on the energy transitions pathways and technology advancement will occur. Additionally, we would like to see sensitivity analysis on the key assumptions used in this analysis.

Recognising that the International Energy Agency (IEA) and Intergovernmental Panel on Climate Change (IPCC) have yet to complete their work on a 1.5 degree scenarios, it is critical that the Task Force's recommendations include a strong preference for a 1.5 degree scenario in line with the target agree by the 192 United Nations Framework Convention on Climate Change (UNFCCC) member countries and the global ambition to reach net zero emissions by the middle of the century.

In addition to the scenarios listed in the Taskforce report, Bloomberg New Energy Finance’s New Energy Outlook (NEO) provides useful estimates and long term pathways on the energy

[2]www.unep.org/climatechange/Portals/5/documents/Guide-RespCorpEng.pdf

mix and it would be useful to have a commonly agreed, publicly available scenario that can be used by publicly listed companies and other organisations.

The two climate scenario based projects by Mercer[3], that a LAPFF member fund participated in, provide very useful frameworks for investors to measure their potential financial exposure via four detailed scenarios. The investors involved have used these to set their Strategic Asset Allocation and to identify financial risks and opportunities.

Q8 The Task Force recognizes that there are challenges around disclosing sufficient information to allow a better understanding of the robustness of an organization's strategy and financial plans under different plausible climate-related scenarios. Some challenges may arise from unfamiliarity with scenario methodologies and metrics, insufficient practice standards or cost. What do you view as effective measures to address potential challenges around conducting scenario analysis and disclosing the recommended information?

RESPONSE

Further work by industry trade groups and disclosure users on critical elements to be disclosed is needed to help overcome concerns that some information may be commercially sensitive	
Reduce the cost of conducting and disclosing scenario analysis	
Additional methodologies and tools should be developed for use by organizations to enable more effective scenario analysis	1st
Allow a year or two to phase-in scenario analysis and related disclosures	3rd
Establish better practice standards around conducting and disclosing scenario analyses so that there are clearer rules of the road	2nd
We do not anticipate any difficulties	

Q9 Please provide more detail on your first choice in the box below

RESPONSE

We believe scenario analysis is new and potentially complex for some organisations but many leading organisations are already undertaking this analysis and reporting on their findings and realising that the process and data is a valuable source of information to both management and investors. However, more practical research and 'learning by doing' needs to occur and we believe there should be sufficient methodologies and tools for all companies to undertake this analysis within a few years.

[3] www.mercer.com/our-thinking/investing-in-a-time-of-climate-change.html, www.mmc.com/content/dam/mmc-web/Files/Climate_Change_Scenarios_Implications_for_Strategic_Asset_Allocation.pdf

Metrics and Targets

Q10a The Task Force is recommending that organizations disclose the metrics they use to assess climate-related risks and opportunities in line with their strategy and risk management process. For certain sectors, the report provides some illustrative examples of metrics to help organizations consider the types of metrics they might want to consider. How useful are the illustrative examples of metrics and targets?

RESPONSE
Very Useful

Q10b Please provide more detail on your response

RESPONSE
The example metrics are all useful qualitative and quantitative indicators for investors. We consider this additional level of guidance valuable for companies to consider relevant aspects of their business to for strategic consideration and disclosure.

Energy (oil & gas)
LAPFF considers disclosure on the two metrics '*Cost of supply for current and committed future projects e.g. through a cost curve or indicative price range. This could be broken down by product, asset or geography'* and *'breakdown of reserves by type and an indication of associated emissions factors'* to be crucial for investors to assess the degree to which their investments are aligned with a two degree future.

For the 'cost of supply', useful information would include oil and gas planning assumptions, whether a downside scenario is included for prices, and an indication of where future projects sit on the cost curve and the sensitivity of the company to oil and gas prices.

For 'breakdown of reserves' LAPFF would therefore welcome required disclosure on the split of undeveloped projects between oil and gas, and disclosure of the proportion of new projects that are LNG and oil sands.

Energy (utilities)
An useful additional metric for investors would be an energy efficiency measure, for example the volume of electricity the company has helped customers save as a percent of total electricity sales

Transportation
An additional metric that would be valuable for investors would be disclosure on assumptions regarding the development of infrastructure for charging electric vehicles.

Carbon-related Assets in the Financial Sector

Q11 Part of the Task Force's remit is to develop climate-related disclosures that would enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector. Beyond the metrics included in the Task Force's guidance, and

supplemental guidance, what other metrics could be used to measure carbon-related assets in the financial sector?

RESPONSE

Improved scope 3 emission reporting (lending and investment) by banks and listed asset managers

Across all sectors absolute USD (or equivalent) value of holdings / market capitalisation in fossil fuel and high climate risk sectors.

Across Infrastructure assets, USD (or equivalent) invested/value in renewable energy generating assets by source and fossil fuel generating assets split by type of fuel. In debt based asset classes such as loans and bonds, reporting on the average and range of tenor (time to maturity) of the commitments

Input assumptions such as carbon price, oil price, energy mix assumptions over a time period aligned to the length of the liabilities

Further examples are included in 'Carbon Metrics Report' (www.eapf.org.uk/~/media/document-libraries/eapf2/investment-pages/q3-2016/eapf-carbon-metrics-report-public-report-2016.pdf).

Q12 The Task Force is recommending that organizations provide key metrics used to measure and manage climate-related risks and opportunities. For example, the Task Force recommends that asset owners (including insurance companies) and asset managers report normalized greenhouse gas emissions (GHG) associated with investments they hold (for each fund, product, and strategy) using available data(see Annex pages 35 and 41).Please describe your views on the feasibility of implementing the above recommendation

RESPONSE

The Forum feels the above is feasible with one of our members already publishing GHG emissions data relating to equity and debt investments and others having undertaken the exercise to obtain this data. Note, reliable emissions data is currently limited to these two asset classes due to a lack of disclosure outside listed companies. Where full reporting is not possible due to information gaps, investors should report what percentage of AUM they have been able to measure and reported on the barriers faced across asset classes where data is not available. The methodology of aggregation of GHG footprint across all asset classes remains unclear at this stage and we support the recommendation that reporting is done at fund, product or strategy level.

There is an emergence of research and guidance for investors undertaking 'carbon foot-printing' which could be referenced by the Task Force including the PRI's Montreal Pledge and by the Institutional Investor Group on Climate Change (IIGCC), but practices remain new and somewhat untested.

There have been many discussions around the various normalising factors and it is worth highlighting that normalising by size of investment brings in the price (or value) of the investment as a variable. Hence if an organisation's stock price rises, the normalised GHG will fall for that investment. Therefore some flexibility on reporting method is required by the Task Force.

Emerging evidence of those that are already reporting shows that organisations that measure emissions also achieve an emissions reduction.

It would be useful for the purposes of comparability if investors reported their carbon metrics on an agreed date, such as the fiscal year end for that investor. Otherwise market effects such as oil price can affect the data.

Last, we request that the Task Force request more research be undertaken in this area to ensure Asset Owner reporting is relevant and meaningful.

<u>Greenhouse Gas Emissions (GHG) Associated with Investments</u>

Q13a How useful would the disclosure of GHG emissions associated with investments be for economic decision-making purposes (e.g., investing decisions)?

RESPONSE
Quite Useful

Q13b Please provide more detail on your response

RESPONSE
First, GHG reporting by listed companies, and hence for investments, is not sufficiently accurate or complete to currently fully rely on company GHG emissions data with some data being estimated. Full and complete organisation reporting will assist in the usefulness of GHG emissions reporting.

Second, GHG emissions are a useful initial indicator to the climate-related risk of a organisation but cannot be used as a sole indicator for investment decisions for a number of reasons. It is a backward looking indicator, it ignores any emissions reduction plan or energy mix transformation plan that the organisation may have in place, it ignores any background information on the business itself (an organisation with a large GHG emissions may be a diversified energy organisation who also has a large and innovative renewable energy business). In the banking sector the lack of scope 3 reporting ensures that little information is available on financial exposure to fossil fuels.

Research undertaken on carbon foot-printing portfolios has also raised issues of double accounting of carbon footprints across an investors' large and diversified portfolio covering much of the supply chain within an industry(see the IIGCC's investor guide to foot-printing[4]).

It is worth noting that some of our member funds already utilise listed company GHG reporting in investment decisions, including funds which invest, or are benchmarked to, a climate change or low carbon equity index. Disclosure by investors on what they are doing with their footprint data would be useful.

[4]at www.iigcc.org/files/publication-files/Carbon_Compass_final.pdf

Remuneration

Q14 Which types of organizations should describe how performance and remuneration take climate-related issues into consideration?

	RESPONSE
The energy group as recommended by the Task Force	Yes
Other non financial sector organisations	Yes
Financial sector organisations	Yes

Adoption and Implementation

Q15 What do you view as the potential difficulties to implementing the disclosures?

	RESPONSE
The information requested could be commercially sensitive	
The time and cost of collecting the information	Yes
Climate-related disclosure is not part of our current regulatory requirements	Yes
Lack of experience with concepts and methodology	Yes
Multiple climate-related reporting frameworks currently exist	
We do not anticipate any difficulties related to implementing the disclosures	
Other (please specify)	Yes

Climate-related disclosure is part of some national regulatory requirements but not others, so the former can provide good examples for the latter.

Asset Owners will be dependent on Investment Managers and Investment Consultants to provide timely and accurate reporting on normalised GHG emissions data for their investment portfolios. This reporting requirement is currently outside of all but a few of LAPFF member's investment mandate agreements (IMAs). One example is provided in the LAPFF guide 'Investing in a Changing Climate'.[5]

Additional work on asset classes where the GHG emissions data is not currently reported and going forward will not be covered by the Task Force's recommendations due to the exemption because of a lack of public equity/debt, needs to occur. Asset classes such as private equity, private loans, property, infrastructure and governments bonds will all fall outside of the Task Force scope for disclosure.

[5] Page 14 of 'Investing in a Changing Climate',2010, at www.lapfforum.org/Publications/latest research/files/ClimatechangeGuideA4.pdf

Q16 What, drivers if any, do you think would encourage you to adopt the recommendations?

	RESPONSE
Requests from investors to disclose	
Requests from clients or beneficiaries	Yes
Reputational benefits and goodwill from adoption	
Inquiries or requests from debt or equity analysts	
Adoption by industry peers	Yes
Other (please specify)	Yes
None of the above	

Other - Requests and subsequent monitoring from the industry regulators, The Pension Regulator and the Financial Conduct Authority (FCA), would provide further encouragement for adoption of the recommendations.

Early adoption by listed organisations will encourage further review by Forum members.

Q17 What support or actions would be helpful to you in implementing the disclosures within the next two years?

RESPONSE

As already noted, research and guidance covering the asset classes that currently do not have GHG emissions data.

We would also like to see implementation of the Task Force recommendations by the organisations that provide services to our members across sectors such as Accountancy, Actuaries, Auditors, Lawyers and Investment Consultants.

Q18 The Task Force's recommendations are focused on disclosure in financial filings; within what timeframe would your organization be willing to implement the recommendations in financial filings?

	RESPONSE
We already report these disclosures in financial filings	
In the next one to two years	
In three to five years	
We do not intend to implement the recommendations	
Do not know (please explain)	YES

As an entity, LAPFF does not make any financial filings, but would encourage member funds to implement these disclosures in a timely fashion. We note that one of our members intends to adopt the recommendations this financial year.

Additional Feedback

Q19 What additional feedback you would like to provide the Task Force on the recommendations?

RESPONSE

We support the implementation of the recommendations throughout the entire investment chain. We have concerns around the Task Force's ambition of achieving full implementation as we consider climate risk reporting is already mandatory in the UK under the Companies Act, yet a minority of companies are providing relevant disclosure. There are ongoing issues with the guidance given to companies and the monitoring of compliance of company's reporting and a lack of follow-on actions where companies are not providing full disclosure.

Hence our strong preference is for these recommendations to be incorporated globally into listing regulations (consistent with the sustainable stock exchange initiative) and become mandatory for all companies to report fully across the four thematic areas as we believe all companies will have a financial impact directly or indirectly from climate change and the low carbon energy transition.

We maintain our concerns that companies are not currently reporting in sufficient detail to allow Forum members to fully consider climate risk in investment analysis. Therefore we support these proposals which will go a long way to help but there also needs to be support from regulators in holding companies to account. We encourage the Task Force to engage actively with all financial regulators to agree a joint implementation plan across regulation updates, messaging and guidance.

We look forward to the Task Force monitoring and subsequently reporting annually on the global adoption of the recommendations. We welcome that the Taskforce has greatly extended the scope of best practice on climate-related disclosure and is working to ensure it becomes embedded in company reporting.

LAPFF’s experience of engagement with a number of resources companies has shown that most seem to plan their businesses on the assumption that the action on climate change needed to deliver a two-degree scenario will not emerge in the foreseeable future. The Forum therefore considers that guidance could go beyond promoting disclosure of a scenario that reflected a two-degree future to recommending that companies should be positioning themselves for the required low carbon future by disclosing a transition plan.

A review of the recommendations one year after implementation and from then on a three to five year basis could strengthen the guidance in this and other areas as market practices further develop.