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# Sixty second summary

## Climate considerations for actuarial valuations

- LGPS funds are under growing pressure from oversight bodies and lobbyists to explain how they are managing climate risks.
- Climate change is not just a risk for asset values, but could also affect liability values
- The 2019 valuation is the ideal time to consider how climate risks may affect your funding and investment strategies and discuss the actions your Fund could take

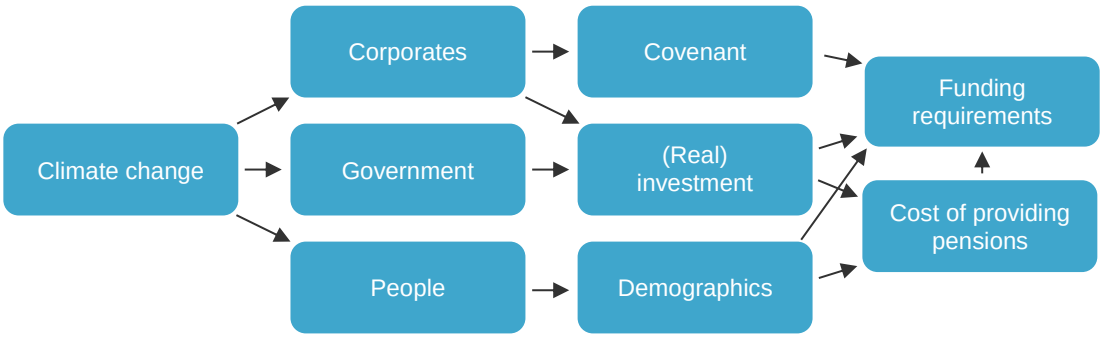
### A *hot* topic

As institutional investors with a combined capital base of £300bn, LGPS funds face increasing pressure to explain how they are responding to climate risk. Oversight bodies are taking more interest in what funds are up to: the forthcoming guidance on responsible investment is likely to require funds to explain how they are managing climate change risk. NGOs and divestment campaigners continue to subject funds to scrutiny whilst Fund actuaries must take account of professional guidance to consider climate risk in the development of advice on long-term funding strategies.

Most LGPS funds now have ESG policies in place. This has led to improvements in the understanding of climate change and other ESG risks and greater challenge of investment managers. Few, however, have considered the broader impact that climate change could have on funding and investment strategies and the actions that it could be sensible to take to reduce risk. With 2019 valuations in England and Wales in full swing, now is the time to begin asking and trying to answer some questions.

### How could climate change affect LGPS funds?

Questions of "what if" are generally addressed by modelling although the uncertainties of climate change pose some challenges. Investors must consider not just their assets, but the broader factors that will be directly affected by climate change. The following (simplified) diagram illustrates how the health of the economy and, ultimately, factors such as inflation and longevity that affect the cost of providing LGPS pensions can be linked back to climate change.



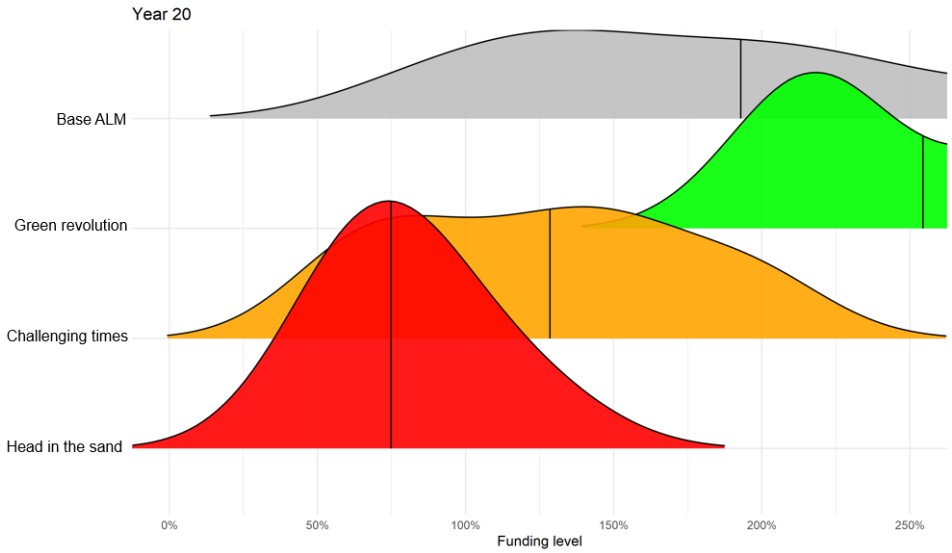

Some will approach modelling by starting with different climate pathways. However, in considering the impact on LGPS funds, we think it sensible to consider the actions of both companies and governments as these will largely drive climate outcomes. In both cases, the time horizon over which decisions are taken can be questioned; the so-called "Tragedy of the Horizon" highlighted by Mark Carney.

We can make broad assumptions about what may happen. Policies focused on adaptation in the short-term may give rise to more immediate costs although benefits may be realised in the longer term as there is a lower need for mitigation. Delayed action may increase the likelihood of more extreme climate outcomes and consequently financial loss from physical impacts.

There remains considerable uncertainty around the pace and scale of both the policy and market response to climate change and our approach to considering the impact on LGPS funds is to employ different climate related scenarios. Building on the Club Vita paper (Hot and Bothered?) we can position three scenarios into a framework which allows us to help funds explore the challenging questions. Briefly, these scenarios are:

- **Green Revolution**: Rapid policy response from government creates the absolute necessity for change which is matched by the deployment of green technologies and ongoing investment in adaptation;
- **Challenging times**: Challenging times reflects delayed policy action. Change is likely to be intermittent at first but is assumed to become more severe in response to growing environmental feedbacks;
- **Head in the Sand**: Policy responses do not prioritise environmental change with corporates largely continuing business as usual type approaches.

Although different methods can be employed, we have assumed that climate outcomes fall within the broad range of outcomes from our economic model. Taking the three scenarios outlined above, we have filtered out those funding level projections that fit the economic parameters for each climate scenario This allows us to illustrate the potential impact on funding level outcomes: the sample output below demonstrates how the distribution of funding level projections can be markedly different under each scenario compared to the 'baseline' distribution.




## What are the next steps for LGPS funds?

Modelling helps to both pose and answer questions and by undertaking analysis, we believe that funds can begin to have more meaningful conversations on climate risks.

Please request bespoke analysis from your fund actuary and/or investment consultant and use this as a basis for discussion on how climate risks are reflected in funding and investment strategies. Although climate change is a global challenge, there are a number of actions that funds can begin to take to mitigate the risks that climate change may bring.

## And finally

Date for the diary – we are re-running our recent PLSA 'learning zone' session as a webinar on 1 July. This will expand on our approach to thinking about climate risks set out above. Please look out for the invitation.