HYMANS ROBERTSON

Private & Confidential
All-Party Parliamentary Group for Local Authority Pensions
'Responsible investment for a Just Transition' Secretariat
c/o Steve Barwick (via email to steve.barwick@smith-institute.org.uk)

26 April 2021

Dear Mr Barwick

Call for evidence: Responsible investment for a Just Transition

Hymans Robertson LLP is pleased to provide written comments on the above inquiry. The Annex to this letter sets out our thoughts on the questions raised by the inquiry.

About Hymans Robertson LLP
Hymans Robertson has grown up with local authority pensions and the LGPS. The firm was founded to provide advice to the LGPS in 1921, just as the first funds were being created. Whilst our business has developed over the decades, working with local authority pensions remains at the heart of what we do. We employ over 60 people who provide exclusive funding and investment advice to over half of all LGPS funds.

Of course, tackling climate risk is also a challenge for private sector pension funds and other institutions. Advice across the markets that our firm serves covers over £300bn of assets under management.

Our climate pledge is to be carbon neutral this year, and halve our 2019 carbon footprint by the time we reach 2025. Climate risks will affect asset values and returns and advising clients on how to tackle them is an integral part of our research and services.

Yours sincerely

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Annex

What are the main barriers for investors and companies?

- Climate change is a global problem that requires a global effort, largely out with the control of local authorities. Progress may feel painfully slow to individuals as different economies, governments, companies and investors react to climate risk at different speeds. It takes a collective effort to effect change in this area, so it is important to avoid the feeling that the efforts of any one individual or entity are 'futile'.

- Whilst scenario modelling and other numerical analysis helps to shape both funding and investment decisions, there are also other factors at play. This analysis should not be the only focus. Careful thought is required to 'see through' decisions and to understand the factors that aren't modelled, such as value-chain impacts. For example, on the surface, a decision to withdraw an investment and close down a polluting factory that employs child labour is appealing. However, this may have adverse, unintended consequences, such as starvation due to lack of other job prospects or welfare support.

- The current fiduciary responsibility is to maximise financial returns subject to acceptable risk. This should be reconsidered with the climate change imperative to reallocate capital to low carbon businesses and companies facilitating the transition. However, it is important to remember that the LGPS is an open-ended scheme with a long-term investment horizon and climate change poses a significant threat to long-term returns and ongoing sources of capital.

- The perception from smaller pension schemes may be that they cannot make a material difference in supporting positive climate change outcomes due to their relative size. There is a clear opportunity for the LGPS pools to have a greater impact by harnessing the collective efforts of their members.

- There is currently a lack of positive incentives for companies to truly innovate as carbon taxes can influence behaviours in unintended ways (and can push problems elsewhere). Instead, tax incentives (for example, carbon capture technology for companies to reduce carbon emissions) could encourage further innovation.

How might government and those responsible investors signed up to a just transition raise awareness and stress the importance of a just shift to net zero, including throughout the investment community and across government?

- The key focus for the government will be education, particularly focusing on the positive aspects, such as lots of investment opportunities, economic growth and potential job prospects from renewable energy sourcesand other climate change solutions. The myth that climate friendly investment leads to lower growth opportunities or higher costs needs to be robustly dispelled.

- As part of the education process, case studies should be provided across different industries and geographies, highlighting both the positive and negative impacts on society and the measures that can be taken to maximise the former and alleviate the latter.

- It will be important for the government to acknowledge that change won't happen all at once. The targets set should be realistic and avoid knee jerk reactions as the end goal of net zero may require a series of small steps over a period (the pace of change won't be 'linear'). Well-intended but potentially meaningless declarations of net zero by 2050 should be avoided by producing clear, measurable, shorter-term targets to support the net-zero ambition. Initatives such as SBTi or Transition Pathway should be used to set verifiable goals and generate a clearly-defined path to reduce emissions in line with the Paris Agreement.

- Collaboration should be encouraged to help achieve the best outcomes. Climate science is a specialist area, and governments, investors, companies and scientists need to collaborate to achieve successful results. The government's key role will be to fund the basic economic and social research needed to highlight and quantify all of the crucial impacts of the transition.

- The public will expect government departments and other tax-backed bodies to be joined up and lead by example. The principles and beliefs behind a just shift to net zero need to be embedded consistently across all public bodies, and apply to suppliers where services are outsourced.

How can investors assess and report the level of risk of not considering a just transition? And what support and regulations are needed from government?

- The government will be required to produce a standard framework of measurements, metrics, analysis and disclosures that investors can use to assess and report on climate risk. Some of this analysis will be required to be qualitative (e.g. stewardship levels, advocacy) rather than quantitative (e.g. scenario modelling). The Task Force on Climate-Related Financial Disclosures (TCFD) framework could be used to build upon this analysis.

- The government should invoke statutory guidance that requires asset managers to produce regular reports that comply with the framework. Guidance, such as sample scorecards, should also be provided to investors to help them to assess the abilities, commitment and progress of investment managers.

- Climate risk should be added to the knowledge and skills required of professional investors. The complex nature of climate risk makes it hard to assess without having some prior knowledge or experience.

- Large institutional investors, for example, those investing over £1bn of assets, should be required by law to name a role or officer who has responsibility for managing climate risks. This could potentially be added to the draft Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021.

How can local authority pension funds, whilst exercising their fiduciary duties, invest in a just transition and the opportunities created? And what role is there for government to create and support new opportunities?

- Each local authority pension fund should adopt a policy statement outlining their individual principles and beliefs on tackling climate risk when making investment decisions.
- The government should engage with LGPS pools and partner funds to ensure that they also have their own policy statements as combining capital across LGPS pools can create large sums of money to invest in and support low carbon projects or infrastructure.
- Ensure mandates with underlying asset managers are reviewed regularly to remove obstacles to the flow of capital into the new opportunities created.
- The government should consider providing incentives for investing in a just transition. This could include tax breaks, education campaigns, allocation of grants/seed capital and research sponsorship.
- Plans to require LGPS Funds to report in line with the TCFD framework (as required for private schemes with greater than £5bn assets under management from October of this year) should be accelerated.

  As mentioned above in our response to the first question, we welcome reform to fiduciary duties for funds with a focus on the reallocation of capital to low carbon businesses and companies facilitating the transition. Given the open-ended and long-term investment horizon of the LGPS, climate change will be significant threat to fund returns and ongoing sources of capital.

How can investors best engage not only with investee companies but also with stakeholders locally, nationally and internationally about the risks and opportunities?

- Local authority pension funds face a lot of pressure from activists to divest from fossil fuel and other carbon heavy stocks. Funds need to clearly explain their rationale for maintaining such assets, for example outlining engagement and stewardship activities. They should be able to demonstrate strong engagement with high-emitting companies, participating, as appropriate, in collective shareholder activities with organisations such as ShareAction.
- Funds should be encouraged to use various networks and sign up to collaborative bodies in order to communicate effectively with a variety of stakeholders. For example, funds could be encouraged to sign up to Local Authority Pension Fund Forum (LAPFF), Pensions for Purpose and True Potential Investments (TPI).
- Funds should be encouraged to seek views from beneficiaries on climate risks and how their money should be invested. These views could be obtained via surveys and questionnaires.
- The government should encourage various stakeholders to team up across private and public sector and across industries. Climate risks affect us all and ideas can cross local, national and international boundaries.

What role is there for government to support a just transition (skills, active labour market policies, economic development, infrastructure investment, investment in communities) and how could investors be part of that process?

- The government has a key role to play in using legislative powers and guidance to steer companies and capital allocation towards a just transition.
- Investment capital may help to improve social value. For example, infrastructure investment in renewable energy sources in rural areas with higher levels of unemployment can create skilled job opportunities.
- The government could set up enterprise training with companies, such as apprentice programmes, to fill skills gaps.
- Consulting with colleges and universities to help identify appropriate courses that would provide the knowledge and skills needed by future workforces.
- Part of the COVID-recovery funding and/or green bonds could be used to fund education activities or targeted re-training to ensure that the labour force has adequate skills to be deployed as we transition to a lower-carbon economy.
- It should be considered how the tax system and other incentives (or penalties) could help society in the move towards a just transition.
- Ensure central government and councils with local knowledge work together and have a coordinated plan. This plan should focus on communities which are most in need, identification of possible skills gaps, planning permissions and identification of local concerns.
- The government will need to understand what barriers are hampering research, innovation and deployment of solutions that support the transition to a net-zero economy. They will also be required to take proactive steps to remove such barriers.

What lessons can be learnt (both successes and failures) from the UK and abroad about previous initiatives to support people and places as their economy has experienced industrial change? And what initiatives are already underway that can be drawn on?

This question draws on an area outside of our traditional range of expertise, however we do have some ideas that we believe merit consideration:

- Reskilling of employees is a key initiative. For example, UK miners in the 1980's felt 'left behind' after the closure of coalmines meant there were no appropriate jobs for their skillset.
- Employee skillsets matter more than their current roles. For example, engineers in fossil fuel industries are well placed to apply their skills to renewable forms of energy.
- Research and development should be encouraged, along with investment in technology and robust forward-looking plans to avoid stagnation and embrace change.

- It is important to create a business environment in which the industries critical to the transition can flourish. This includes key considerations in relation to regulation, tax incentives, grants and planning processes.
- The success of appreticeship schemes and Mittelstand in Germany could be a model for the government to consider.