

The Scottish Government
Public Bodies Climate Duties Consultation
Area 3-J, Victoria Quay
Edinburgh
EH6 6QQ

By email to climatechangedutiesconsultation@scotland.gsi.gov.uk

Tuesday 23 November 2010

To whom it may concern,

FairPensions welcomes this opportunity to respond to the Scottish Government's *'Public Bodies Climate Change Duties: Putting Them Into Practice - Consultation on Draft Guidance Required by Part 4 of the Climate Change (Scotland) Act 2009*. FairPensions is a registered charity established to promote Responsible Investment by UK pension schemes and fund managers. Responsible Investment is defined as the active management of those environmental, social and governance risks that have the potential to affect long-term financial returns. We advocate a strategy of active shareholder engagement with investee companies (i.e. the use of shareholder rights, including voting rights) to improve performance.

We are a member organisation, with a diverse membership including trade unions and others who represent pension fund beneficiaries, such as Unison, Unite and the National Federation of Occupational Pensioners; civil society groups, including environmental organisations (WWF & Greenpeace) as well as international development NGOs and human rights organisations with an interest in reducing the human impact of climate change (ActionAid, Amnesty International, CAFOD, Oxfam); and thousands of individual pension fund members.

We would like to offer a general response to the issues raised by the consultation; we do not comment individually on the specific questions posed in the consultation document.

Public sector pension funds and the draft guidance

We welcome the introduction of this guidance. However, we are concerned that no guidance is provided for public sector pension funds. FairPensions would like to recommend that guidance should be provided for public sector pension funds for the following reasons:

1. Public sector pension funds are classified as public bodies by the Freedom of Information (Scotland) Act, and therefore within the scope of the Climate Change (Scotland) Act's requirements.
2. Scottish public sector pension funds control huge amounts of assets (for example, the Strathclyde Pension Fund alone has assets of £9.1 billionⁱ), disproportionately

invested in the UK. These assets mean that public sector pensions funds are collectively (and in some cases individually) able to exercise considerable influence over the carbon reduction strategies of their investee companies (including Scottish companies and UK companies with substantial Scottish operations) through the exercise of shareholder rights. Nor is the power of investor action merely theoretical: for example, action by some investors has already affected companies' greenhouse gas emissions reporting through initiatives such as the Carbon Disclosure Project.ⁱⁱ

3. Pension funds (as well as the beneficiaries and taxpayers to whom they owe a fiduciary duty) have a financial interest in working with investee companies to help prepare them for the future risks and opportunities associated with climate change, given the increasing evidence that climate change will have a substantial impact on companies and their investors.ⁱⁱⁱ Given that the physical and environmental impacts of climate change will increase over time, long-term investors such as pension funds have an even greater interest in this issue.
4. Despite the potential power of pension funds to influence companies' greenhouse gas emissions and therefore to effect climate change; recent research shows that pension fund trustees have poor understanding of the risks climate change can pose to their investments, that pension funds often fail to integrate it into their investment strategies, and that they have a poor record of reporting on these issues:
 - A study by the Association of Chartered Certified Accountants (ACCA) found that *“climate change did not generally feature on the agenda of [UK pension fund] trustee meetings [...] Trustees interviewed were generally unaware of their fund managers' activities concerning climate change and displayed a low level of accountability to their members in relation to this subject [...] their understanding of how it could affect shareholder value and financial return was partial”*.^{iv}
 - Research by FairPensions, which questioned large public and private sector pension funds, found that of 20 respondents, only 7 require their fund managers to consider climate related risks and opportunities.^v
5. There is considerable evidence that the fund managers to whom pension funds delegate investment decisions, and of whose activities trustees are *“generally unaware”*, cannot be assumed to have taken action to manage the risks and opportunities of climate change:
 - A report by Mercer and Trucost for WWF found that *“Pension funds cannot assume that their fund managers are actively managing carbon risks in their investments. Indeed, interviews by Mercer found that fund managers are not yet doing so. Findings revealed that managers do not actively consider climate change factors such as greenhouse gas emissions as part of their investment processes”*.^{vi}
 - In a 2009 survey by FairPensions, although 89% of participating fund managers considered climate change an 'important' or 'very important' investment issue, only 29% actively integrated climate data into their analysis for all companies where it was available.^{vii}

6. Furthermore, there is evidence that lack of pension fund awareness is acting as a brake on progress towards the integration of climate risk by fund managers:
 - In the same survey, 56% of respondents cited “lack of demand from clients” as a key barrier to managing climate change risks and opportunities.^{viii} In this context the relevant ‘clients’ are institutional investors such as pension funds.

Perceived barriers to the provision of guidance to pension funds

We recognise that requiring pension funds to contribute to climate change goals through their selection of investments could pose legal difficulties, through being seen as an interference with trustees’ fiduciary duty to act in the best interests of their beneficiaries.

However, there are increasingly strong grounds to believe that the proper consideration of climate change constitutes good practice for trustees seeking to fulfil their legal obligations. Where funds are led by consideration of long-term investment returns, and incorporate climate considerations into investment and engagement decisions where they are financially material, then such decisions are not only compatible with fiduciary duty, but required by it.

A legal opinion obtained by the UN from Freshfields Bruckhaus Derringer, published in 2005, stated that *“It is not a breach of fiduciary duties per se to have regard to ESG [environmental, social and governance] considerations while pursuing the purposes of the trust. Rather, in our opinion, it may be a breach of fiduciary duties to fail to take account of ESG considerations that are relevant and to give them appropriate weight.”*^{ix}

Leading investment consultants, such as Towers Watson concur with this position, with statements such as *“Pension funds need more confidence that broader considerations such as ESG issues are consistent with their requirement to act in the best financial interests of members. Our analysis of research in this regard provides evidence to support this view.”*^x

This view is also supported by the practice of some investors - for example, the Environment Agency Pension Fund, which “seeks to manage its investments in a manner which is both financially robust and environmentally responsible” and *“selects investment managers that integrate environmental risk assessment into their investment decision-making and monitors both financial and environmental performance.”*^{xi}

However, as shown by the ACCA study referred to above, most pension fund trustees have a poor understanding and awareness both of the legal situation, and of the practical circumstances in which climate change might constitute a material financial risk. ACCA’s report identified an *“urgent need for a code of practice”*, concluding with the following recommendation:

“A code of best practice on climate change, produced with government backing as a mainstream policy document for trustees, is suggested as a means of forcing trustees to address the material issues of climate change seriously and urgently.”^{xii}

The publication of guidance under Part 4 of the Climate Change (Scotland) Act 2009 is a perfect opportunity for Scotland to take a lead in meeting this need. Below we make some more specific suggestions about what such guidance could entail.

Recommendations for further guidance

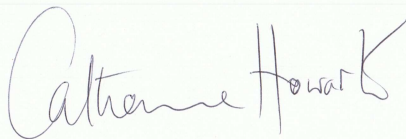
As well as clarifying trustees' legal position and the practical circumstances under which they should be considering climate risks, government guidance could make the following best practice recommendations:

- Funds should calculate their portfolio greenhouse gas exposure, and should report this to beneficiaries and, where possible, the public. Companies such as Trucost exist to carry out such exercises, which have been undertaken by several UK funds (including the London Pension Fund Authority^{xiii} and the Environment Agency Pension Fund.^{xiv}) as well as by overseas funds such as the Australian VicSuper.^{xv}
- Funds should report transparently on their policies for identifying and managing climate-related risks, and should report annually to their members on how these policies have been implemented.
- Funds should seek to integrate climate change into their criteria for selecting and monitoring fund managers & consultants.

FairPensions would be happy to assist further in developing such guidance

We remain at your disposal and would be pleased to meet with you to discuss any or all of the above.

Yours sincerely,



Catherine Howarth
Chief Executive, FairPensions

Notes

ⁱ *Pension Funds and Their Advisers 2010*, AP Information Services

ⁱⁱ <https://www.cdproject.net/en-US/Pages/HomePage.aspx>

ⁱⁱⁱ For example, see UN Environment Programme Finance Initiative: “*Universal Ownership: Why environmental externalities matter to institutional investors*” 2010.
(http://www.unpri.org/files/6728_ES_report_environmental_externalities.pdf)

^{iv} Professor Jill Solomon: *Pension Fund Trustees and Climate Change*, ACCA, 2009, page 7.
http://www.accaglobal.com/pubs/general/activities/research/research_archive/rr-106-001.pdf

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- v FairPensions: “*Responsible Pensions? UK Occupational Pension Schemes’ Responsible Investment Performance*” 2009
(http://www.fairpensions.org.uk/sites/default/files/uploaded_files/documents/ResponsiblePensions_2009.pdf)
- vi Mercer / Trucost / WWF: “*Carbon Risks in UK Equity Funds*” 2009, p5
(http://www.trucost.com/uploads/downloads/Carbon_Risks_in_UK_Equity_Funds.pdf)
- vii FairPensions: “*Preparing For the Storm? UK Fund Managers and the Risks and Opportunities of Climate Change*” 2009.
(http://www.fairpensions.org.uk/sites/default/files/uploaded_files/PreparingStorm2009.pdf)
- viii FairPensions: “*Preparing For the Storm? UK Fund Managers and the Risks and Opportunities of Climate Change*” 2009. p4.
(http://www.fairpensions.org.uk/sites/default/files/uploaded_files/PreparingStorm2009.pdf)
- ix Freshfields Bruckhaus Deringer: *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment*” 2005, UNEPFI.
(http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf)
- x <http://www.watsonwyatt.com/render.asp?catid=1&id=17339>
- xi http://www.environment-agency.gov.uk/static/documents/Utility/unepfidraft_1760566.pdf
- xii Professor Jill Solomon: *Pension Fund Trustees and Climate Change*, ACCA, 2009, page 7.
http://www.accaglobal.com/pubs/general/activities/research/research_archive/rr-106-001.pdf
- xiii
http://www.google.co.uk/url?sa=t&source=web&cd=2&sqj=2&ved=0CCgQFjAB&url=http%3A%2F%2Fwww.lpfa.org.uk%2Fdocs%2Fpowerpoint%2FFMF2010.ppt&rct=j&q=LPFA%20equity%20funds%20carbon%20footprint&ei=NiDtTPTMOMqIhQftvYzdDA&usq=AFQjCNH1AeBVmrkUbM0CIV_9OMbhlaGSg&sig2=fC0HfC9qbrIBUDgVtz0Pww&cad=rja see slide 20
- xiv http://www.environment-agency.gov.uk/static/documents/Utility/Responsible_Investment_Review.pdf
(see page 18)
- xv <http://www.vicsuper.com.au/www/html/2340-carbon-footprint-of-your-super.asp>