May 2018

Responsible investment update

In this edition, we look at regulatory and political developments around responsible investment, including consultations by the UK Parliament, the DWP and the European Commission. We also discuss the proposed updates to the UK's Corporate Governance Code and introduce our new climate change projection scenarios.

In this issue

MPs seek answers from pension funds on climate risk

The Environmental Audit Select Committee (EAC) has asked the trustees of the UK's 25 largest pension schemes to explain how they manage the risks that climate change poses to pension savings. The Department for Work and Pensions (DWP) has previously found that a large of number of trustees are not aware of their duty to consider environmental risks as part of their investment process. Additionally, the Bank of England has noted that trustees sometimes misinterpret their duty to act in the best interest of their beneficiaries as a need to maximise short-term returns, often at the expense of longer-term considerations.

We supported a number of the schemes on the list with their responses to the questions. Note that while, in this instance, only the largest schemes in the UK were asked, the letter forms part of the Committee's wider inquiry into this area, so your scheme may very well be asked to provide a response to questions in the future. **We would therefore encourage trustees to consider how they would answer the Committee's questions on a pro-active basis.**

The questions are:

1. Do the trustees accept the TCFD (Task Force on Climate-related Financial Disclosures) conclusion that pension funds are potentially exposed to financial risks through climate change?
2. Which climate-related financial risks are you most concerned about?
3. Has your pension scheme formally considered climate change risk at Board (or Investment Committee) level?
4. If you have considered climate change related risks, what actions have you taken in response to these risks? We are interested, for example, in the development of specific investment strategies on this issue, whether you have taken formal advice, any changes in your investment strategy made or planned, and the exercise of your ownership responsibilities on this issue (either directly, or through your investment managers).

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5. Are you planning to adopt the TCFD recommendations in your scheme's reporting? If so, please indicate your planned timing.
6. How would you suggest the Government and regulators implement the recommendations on climate risk reporting? Is a voluntary approach sufficient to ensure widespread adoption?
7. Would guidance from Government or regulators on climate risk reporting be helpful for pension funds?
8. Have you discussed climate change with your actuarial advisers, in regard to the Risk Alert that the IFoA issued to its members last year?
9. Please share with us any other information you think may be relevant as we develop our understanding of the approach UK pension funds are taking to climate change and, more generally, green finance.

DWP consultation on responsible investment

The DWP has revealed that it intends to launch a consultation on the way pension fund trustees incorporate climate change and corporate governance considerations into their decision-making process.

The DWP's consultation will, among other things, consider whether to make it compulsory for trustees to prepare a formal statement setting out their climate change and corporate governance policies.

The Department has stated that it is committed to "introducing regulations which are as effective as possible in delivering the right level of evaluation and consideration by trustees" rather than minor technical amendments.

The consultation is likely to be launched in May or June 2018.

Climate change scenarios

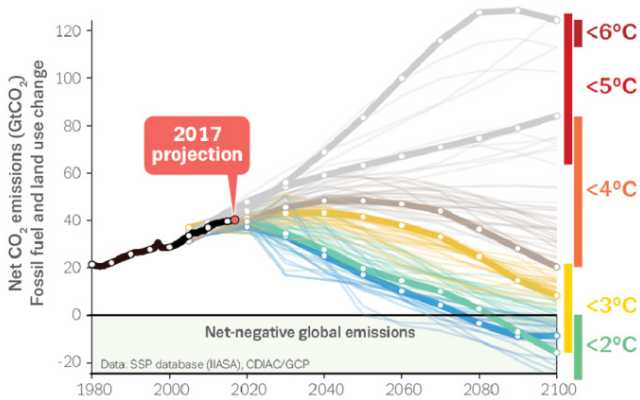
Man-made climate change is one of the defining scientific and political challenges of our time. The effects of climate change are already evident with more erratic weather patterns, more severe weather events and greater environmental degradation.

The systemic risks posed by climate change and the policies implemented to tackle them will fundamentally change economic, political and social systems and the global financial system. They will impact every asset class, sector, industry and market in varying ways and at different times, creating both risks and opportunities for investors.

It is a worthwhile exercise to consider how events might unfold and their possible implications. To help with long-term thinking, we have developed two climate change scenarios (at opposite ends of the policy spectrum). These are new mega-trend scenarios that look at how climate change may impact assets and liabilities over different time horizons: short, intermediate and to the end of the century.

The Climate Change Calamity scenario considers the potential impact of climate change if insufficient long-term sustainable policy action is undertaken to manage global temperatures effectively, and if the current trend continues which projects temperature rises above 4°C versus 1990 levels, as illustrated in the chart below.

The Green scenario explores how markets might evolve if rapid progress towards tackling global warming is made, as may be required to keep warming below the 2°C threshold. This leads to some short-term costs but society, economies and markets are generally better off long term.



Please contact a member of the Responsible Investment team if you would like more information about our climate change modelling capabilities.

The European Commission publishes its sustainable finance action plan

In December 2016, the European Commission established a High-Level Experts Group on Sustainable Finance (**HLEG**) to provide advice to the Commission on how to:

- steer the flow of public and private capital towards sustainable investments
- identify the steps that financial institutions and supervisors should take to protect the stability of the financial system from risks related to the environment
- deploy these policies on a pan-European scale

The HLEG published its final report earlier this year, which you can read here. The HLEG's recommendations form the basis of the Commission's action plan, which it published in early March. Its key action points include:

- establishing a clear and detailed EU classification system – or taxonomy – for sustainable activities. This will create a common language for all actors in the financial system
- establishing EU labels for green financial products. This will help investors to easily identify products that comply with green or low-carbon criteria
- introducing measures to clarify asset managers' and institutional investors' duties regarding sustainability
- strengthening the transparency of companies on their environmental, social and governance (ESG) policies. The Commission will evaluate the current reporting requirements for issuers to make sure they provide the right information to investors
- introducing a 'green supporting factor' in the EU prudential rules for banks and insurance companies. This means incorporating climate risks into banks' risk management policies and supporting financial institutions that contribute to fund sustainable projects

We support the Commission's action plan and look forward to working with the Commission as it works to implement its objectives.

Changes to the UK Corporate Governance Code

The Financial Reporting Council (**FRC**) announced its review of the UK's Corporate Governance Code in early 2017. Late last year, the FRC released its proposals (which you can access here) with the intention of publishing a final version of the new Code later this year.

The revised Code puts greater emphasis on companies' responsibilities to wider stakeholders (e.g., its workforce and local community), employee engagement, corporate culture, diversity and directors' remuneration. The FRC has opted to retain the "comply or explain" principle, whereby companies are required to disclose how they have implemented the Code's provisions or explain why they have not done so.

The public consultation on the draft Code ended on 28 February 2018 and the FRC intends to bring the revised Code into effect for accounting periods on or after January 2019.

The Task Force on Climate-related Financial Disclosures publishes its final report

The Task Force on Climate-related Financial Disclosures (**TCFD**) was established to develop a set of voluntary and consistent climate-related financial disclosures that would be useful to financial market participants in understanding material climate change-related risks. The TCFD's final report, which it published in June 2017 and can be found here, focuses on four themes:

- **Governance:** disclose the organisation's governance around climate-related risks and opportunities
- **Strategy:** disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material
- **Risk management:** disclose how the organisation identifies, assesses and manages climate-related risks
- **Metrics and targets:** disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

We welcome its recommendations, particularly its focus on disclosure and transparency.

Links to materials

Green Bonds

An Investor's Guide to Responsible Investment

For your diary

Date	Event
8-9 June	G7 meeting – climate change and key energy will be a key theme
14 June	Aon Investment Breakfast: Responsible investing: how much does it matter?
24-30 September	Climate Week NYC
12-14 October	World Bank and IMF annual meetings – deforestation and coal likely to discussed
30 November – 1 December	G20 summit – sustainable finance likely to feature prominently in discussions
3-14 December	UN Climate Change Conference

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