Mary Creagh MP  
Chair of the Environmental Audit Committee  
14 Tothill Street  
London  
SW1P 3JA  

23 March 2018  

Dear Ms Creagh  

Re: Green finance inquiry – request for information  

Thank you for your letter dated 28 February 2018 in relation to the above. Please find below answers to your questions on behalf of Rolls-Royce UK Pension Fund Trustees Limited as Trustee of the Rolls-Royce UK Pension Fund (the “Fund”).  

Firstly, to provide some context, the Fund has assets of over £13bn currently and is well-funded on a prudent basis. The majority of the Fund’s investments are in UK government bonds, global non-government bonds and derivative instruments to hedge the potential impact of interest rate and inflation risks on the liabilities, in order to maintain and improve the current funding position.  

1. Do the Trustees accept the TCFD conclusion that pension funds are potentially exposed to financial risks through climate change?  

Yes, the Trustee accepts that pension funds are potentially exposed to financial risks through climate change. The Trustee has noted the importance of considering financially material Environmental, Social and Governance (“ESG”) issues, which includes climate change, within its investment processes. The Trustee’s approach to managing ESG issues is set out within the Statement of Investment Principles (SIP) and the related risks are monitored within the Trustee’s risk register. In particular the SIP notes that:  

“The Trustee believes that good stewardship is important. The Trustee has considered how environmental, ethical, social and corporate governance (“ESG”) issues should be taken into account in the investment process. The Trustee considers that it should in all circumstances act in the best interests of the beneficiaries within the Rules of the Fund. The Trustee has considered the guidance provided by the Law Commission, which states that trustees may take account of risks to a company’s long-term sustainability, such as ESG risks, if they are, or may be, financially material. In light of this guidance, the Trustee’s policy is that the investment managers should take account of ESG issues where they are believed to be (or are potentially) financially material.”  

2. Which climate-related financial risks are you most concerned about?  

The Trustee is mindful of the potential financial impact of ESG risks more broadly but has not identified particular climate-related financial risks that it views as being of greatest concern for its investments.  

3. Has your pension scheme formally considered climate change risk at Board (or Investment Committee) level?  

Yes, as noted above ESG issues are considered by the Trustee on a regular and ongoing basis through monitoring of identified risks on the Trustee’s risk register.
The Trustee’s risk register states that:

“Failure to consider ESG issues when implementing investment strategy could adversely impact funding and investment performance, reduce the security of member’s benefits and lead to reputational damage”.

The risk register is formally considered twice a year by both the Trustee and its Audit Committee. In addition, the Trustee’s appointed investment advisor, Mercer, monitors the extent to which the Fund’s appointed investment managers take into account ESG issues and reflect these in ESG ratings which are reported to the Trustee on a quarterly basis.

4. If you have considered climate change risks, what actions have you taken in response to these risks?

As noted in our introduction, the Fund’s investment strategy is now largely invested in liability-driven investments and other fixed interest assets.

We note that based on a report by our investment advisor Mercer, *Investing in a Time of Climate Change* (2015), the Fund has limited exposure to those asset classes that were found to be most sensitive to climate change. The Trustee has therefore not taken any further direct action, above and beyond general de-risking, in respect of the potential financial risks posed by climate change.

5. Are you planning to adopt the TCFD recommendations in your reporting? If so, what is the timeframe?

The Trustee may adopt the TCFD recommendations in its reporting in future but has not yet felt the need to change its current reporting. The Trustee already reports on its approach to managing ESG issues, which in our view is consistent with certain elements of the TCFD recommendations.

We note that climate change scenario analysis and carbon footprinting are likely to be less relevant given the Fund’s largely de-risked investment strategy, for example since carbon footprinting is at present predominantly an equity-based tool.

The Trustee will monitor the available forms of analysis and may consider taking further action when these are judged to be beneficial in view of the Fund’s investment strategy. We have not set a specific timeframe for this.

6. How would you suggest the Government and regulators implement the recommendations on climate-risk reporting? Is a voluntary approach sufficient to widespread adoption?

In our view, it is important that the recommendations are embedded in a consistent basis within existing regulatory frameworks, such as the UK Stewardship Code. The Fund supports the UK Stewardship Code and this is noted within the Fund’s Statement of Investment Principles as well as in reporting to members.

“The Trustee has delegated to the investment managers authority for exercising the voting rights attached to the Fund’s investments. The Trustee supports the UK Stewardship Code (“the Code”).”

Embedding the recommendations on climate-risk reporting into existing codes and guidance would facilitate more widespread adoption.

7. Would guidance from the Government or regulators on climate-risk reporting be helpful for pension funds?

Yes, in our view this would be helpful but as noted above in our response to Q6 we would encourage this through including such guidance within existing frameworks already used by pension funds, such as the UK Stewardship Code.
8. Have you discussed climate change with your actuarial advisors, having regard to the Risk Alert that the IFoA issued to its members last year?

The Trustee takes an integrated risk management approach to funding and climate change has been discussed with its investment advisor, Mercer. The Trustee will as a matter of routine discuss climate risk with its actuarial advisors as part of the next triennial actuarial valuation of the Fund.

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.

As noted in our response to Q1 and Q3, the Trustee considers ESG issues where they may be financially material and the Fund's investment managers are expected to take account of ESG issues where they are believed to be (or are potentially) financially material. We note that all of the Fund's appointed investment managers are signatories to the Principles of Responsible Investment (PRI) and, given the PRI annual reporting requirements have been updated to be consistent with the recommendations of the TCFD, we expect to be able to review our managers' progress in this area through this route. We feel this provides an example of the recommendations being embedded into existing frameworks used by pension funds.

Yours sincerely

Liz Airey
Chair, Rolls-Royce UK Pension Fund Trustees Limited