



Leicestershire County Council Pension Fund

DRAFT Responsible Investment Plan

January 2020

About this report

The purpose of this report is to recommend a plan of action to enable the Leicestershire County Council Pension Fund (the Fund) to manage responsible investment (RI) risks. This report has been prepared by LGPS Central's Responsible Investment & Engagement Team.

Defining responsible investment and stewardship

The term 'responsible investment' refers to the integration of financially material environmental, social and corporate governance ("ESG") factors into investment processes. It has relevance both before and after the investment decision and is a core part of our fiduciary duty. It is distinct from 'ethical investment', which is an approach in which the moral persuasions of an organisation take primacy over its investment considerations.

The term stewardship is defined by the Financial Reporting Council's (FRC) Stewardship Code (2020 version): "Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society."

Applicable regulations

The regulations and statutory guidance relating to RI are:

- The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016¹
 - 7(2)(e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
 - 7(2)(f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.
- Relevant statutory guidance: "Local government pension scheme: guidance on preparing and maintaining an investment strategy statement"²
- UK Stewardship Code (referred to in the statutory guidance)³

In our view the Fund achieves compliance via its Investment Strategy Statement⁴ with the minimum regulatory standard. We note however the statutory guidance states:

- Funds should sign the Stewardship Code

¹ <https://www.lgpsregs.org/schemeregs/invregs2016/timeline.php#r7>, accessed January 2020

² <https://www.gov.uk/government/publications/local-government-pension-scheme-guidance-on-preparing-and-maintaining-an-investment-strategy-statement>, accessed January 2020

³ https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final.pdf, accessed January 2020

⁴ Investment Strategy Statement - consultation version November 2019



- Funds should issue an annual voting report

Both of these represent potential extensions to the Fund's current strategy.

In November 2019 the Scheme Advisory Board (SAB) published a consultation on draft Responsible Investment Guidance⁵. The draft explains the existing regulations and statutory guidance to administering authorities in order to make their current duties clear. "Part Two" of the guidance is expected to follow the SAB's meeting on 3rd February 2020. Whether the Ministry of Housing, Communities, and Local Government intends to review the regulations and statutory guidance is unclear. In light of the evolving regulatory picture, we recommend below that the Fund undertakes a mid-year review of its RI Strategy to capture any relevant developments.

Background

There is a considerable evidence base that long-term investors have scope to improve portfolio risk-return characteristics through the integration of financially material environmental, social and corporate governance (ESG) factors. This includes integration in asset selection, asset stewardship, and the management of material climate-related risks. Evidence includes academic papers, empirical evidence of ESG-managed portfolios achieving outperformance, and well-known case studies of companies failing to (or succeeding in) manage the risks (harnessing the opportunities) associated with ESG and climate change. The evidence base is supportive of the Fund's investment belief that:

"Responsible investment can enhance long term investment performance and investment managers will only be appointed if they integrate responsible investment into their decision-making processes."

A theme in the academic literature is that materiality matters. Focussing on what is relevant – rather than applying a tick box approach – is the avenue most likely to lead to benefits for the Fund. The Fund is recommended, in the suggestions that follow, to focus on certain core issues, rather than adopt a "do everything approach". For example, the adoption of focus stewardship themes, perhaps in collaboration with LGPS Central. This in turn circles back to the Fund's investment belief that "responsible investment can enhance long term investment performance".

Current policy framework at LCCPF

We have reviewed relevant (publicly available) Fund policies / disclosures. We comment further on possible extensions to the policy framework below.

Policy/ disclosure	RI content	Possible extensions
Investment Strategy Statement (<i>consultation version, November 2019</i>)	- LCCPF investment beliefs - LGPS Central RI beliefs - LCCPF current RI approach (Regulations 7(2)(e) and 7(2)(f))	- RI Strategy (as a standalone document)
Annual Report (2019)	-	- Voting report (Regulation 7(2)(f)) - RI annual activity summary - Summary climate-risk report aligned with the TCFD framework
Committee papers	- Public: LGPS Central Tactical Asset Allocation - Restricted: Fund manager reports	- LGPS Central Quarterly Stewardship Report (QSR) - Voting reports - Fund manager reports to include

⁵[https://www.lgpsboard.org/images/Consultations/RIGuidance/DRAFT Part 1 Responsible Investment Guidance Final pdf version.pdf](https://www.lgpsboard.org/images/Consultations/RIGuidance/DRAFT_Part_1_Responsible_Investment_Guidance_Final_pdf_version.pdf), accessed January 2020



		ESG information
Risk Register	Risk types which might be assumed to include RI or climate-risk: 10) Fund performance is below reasonable expectations 11) Failure to take account of ALL risks to future investment returns within asset allocation and manager selection	- Consider specific reference to responsible investment and/ or climate-related risks.
Training Policy	-	- Specific reference to responsible investment and/ or climate-related training.

Adherence to the UK Stewardship Code 2020

The 2020 Stewardship Code represents a significant increase in level of ambition compared to the 2012 version. Even current signatories will need to review their approach to stewardship, and reporting thereof, in light of the new code. The Fund is not currently a signatory. Were the Fund to decide to sign the Stewardship Code, reporting would not be required until 2021. The Fund currently undertakes a minority of the activities required for compliance with the 2020 code. This includes having a published policy and investment beliefs, and company engagement via LGPS Central. Many of the remaining compliance requirements (including communication of stewardship activities, integration of ESG and climate change investment factors, monitoring fund managers for ESG) form our recommendations below. A mid-year review of the Fund's compliance status is recommended.

Recommended focus areas:

We recommend a focus on four areas of responsible investment. These areas relate to the Fund's Investment Beliefs and align with the LGPS regulatory context.

1. RI integration into manager selection and monitoring
2. Focussed stewardship activities
3. Observation & management of climate-related risk
4. Working towards Stewardship Code compliance

We comment further on these areas below.



Recommended RI focus areas

In consideration of the applicable regulations, academic evidence, and current practice undertaken by the Fund, the follow action plan is recommended:

	1	2	3	4
<i>Focus area</i>	ESG integrated into manager selection & monitoring	Focused stewardship activities	Observation & management of climate-related risk	Work towards Stewardship Code compliance
<i>Rationale</i>	<ul style="list-style-type: none"> - Academic evidence on ESG and returns - LCCPF investment beliefs - Regulation 7(2)(e) 	<ul style="list-style-type: none"> - Academic evidence on ESG and returns - Stakeholder expectations of the Fund as a responsible investor 	<ul style="list-style-type: none"> - Financial materiality of climate-related risks over the long term - Stakeholder interest in climate-related risks 	<ul style="list-style-type: none"> - LGPS Statutory Guidance - Ideal reporting vehicle for RI and stewardship activities
<i>Actions</i>	<ul style="list-style-type: none"> - RI training for LPC - Include ESG assessment in processes for appointing fund managers - Include ESG in routine fund manager monitoring, reporting, and retention decisions 	<ul style="list-style-type: none"> - Contribute to and adopt LGPS Central's stewardship themes - Monitor the extent of engagement and voting by external fund managers 	<ul style="list-style-type: none"> - Procure Climate Risk Report for internal use - Publish Climate Strategy based on key findings in the Climate Risk Report - Climate risk training for LPF - Issue public-facing climate report aligned with TCFD - Consider case for include climate risk in the Fund's Risk Register 	<ul style="list-style-type: none"> - Align the Fund's RI strategy to the 2020 Stewardship Code's principles - Issue a Stewardship Code Report with a view to achieving signatory status from the FRC - Mid-year review to assess the remaining gap to full compliance
<i>Implementation vehicle</i>	<ul style="list-style-type: none"> - Selection: Fund advisors/ LGPS Central - Monitoring: Fund managers/ Fund advisors/ LGPS Central 	<ul style="list-style-type: none"> - LGPS Central RI Team - Hermes EOS (LGPS Central's stewardship provider) - LAPFF - Fund managers (voting) 	<ul style="list-style-type: none"> - LGPS Central - Climate Risk Report & Taskforce on Climate-related Financial Disclosures (TCFD) Report 	<ul style="list-style-type: none"> - LGPS Central - External fund managers
<i>Reporting</i>	<ul style="list-style-type: none"> - Local Pension Committee quarterly fund manager reports - Annual report (summary) - Stewardship Code Report 	<ul style="list-style-type: none"> - Include LGPS Central's Quarterly Stewardship Reports with Committee papers - Include Hermes EOS reports with Committee papers - Voting reports to Committee 	<ul style="list-style-type: none"> - Internal: Climate Risk Report - External: TCFD-aligned climate report (include in Annual Report and/ or on the website) 	<ul style="list-style-type: none"> - Stewardship Code Report (2021*)

*this timeline is given by the FRC



RI Timeline

In consultation with LCCPF officers we propose the following RI 2020 plan with the following timeline:

Timeline	Title	Description
Q1	Communicate RI Plan	- Publication of the Fund's RI plan via Pensions Committee / board papers.
Q2	Quarterly stewardship reporting	- Inclusion in Committee papers of LGPS Central's Quarterly Stewardship Report
	RI Training for Local Pension Committee	- Training of Pensions Committees, Fund Officers, or other, on responsible investment & the Fund's RI Strategy.
	Voting report inclusion in Committee papers	- Reporting explaining the execution of shareholder voting on the Fund's listed equity investments. To include funds managed by LGPS Central and LGIM initially.
Q2-Q3	Quarterly manager reporting on ESG	- The formal inclusion by external fund managers of ESG information in quarterly reporting in order to facilitate regular monitoring.
	New manager selections: integrate ESG where relevant	- Include an ESG assessment in processes for appointing fund managers.
	Receive Climate Risk Report	- Annual Report for your internal consumption comprising (i) Climate scenario analysis (ii) Carbon risk metrics (iii) Annual Climate Stewardship Plan.
Q3	Climate Strategy	- Publish a climate strategy based on the key findings of the Climate Risk Report. To be done ahead of Hymans Robertson's 2021 strategic asset allocation refresh so the Fund can embed their RI strategy in investment decision-making.
	Climate Risk Training	- Training of pension fund officers, Pensions Committees, or other, on the risks and opportunities associated with climate change, and the Fund's Climate Strategy.
	TCFD Report (Taskforce on Climate related Financial Disclosures)	- Public-facing report of the Fund's approach to climate risk, set out in alignment with the recommendations of the Taskforce on Climate-related Financial Disclosures
	Mid-year review	- Assess preparedness for UK Stewardship Code Review RI Strategy and capture any developments in the regulations, statutory guidance, or RI Guidance from the Scheme Advisory Board.

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