



LOCAL PENSION COMMITTEE – 26 NOVEMBER 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RESPONSIBLE INVESTING UPDATE

Purpose of the Report

1. To provide the Committee with background information on the Leicestershire Pension Funds (Fund) 2021 Climate Risk Report (CRR). A PowerPoint presentation will be delivered at the meeting by representatives from LGPS Central, a copy of the Leicestershire County Council Climate Risk Report is attached (Appendix A)
2. To provide an update on the Fund's current responsible investing (RI) policy including potential future changes to the policy.
3. To update the Committee on progress versus the Responsible Investment (RI) Plan 2021 to improve management of the Leicestershire Pension Fund (the Fund).
4. To update the quarterly voting report (Appendix B) and quarterly stewardship report (QSR) (Appendix C) written by LGPS Central.

Background

5. The Local Pension Committee approved the RI plan at the January 2021 meeting which was developed with LGPS Central's in-house RI team. The Fund has a continual focus on raising RI standards.
6. The term 'responsible investment' refers to the integration of financially material Environmental, Social and 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.
7. The Fund's approach, as stated within the Investment Strategy Statement (ISS) is to ensure RI through engagement of companies to forward responsible investing aims rather than divest our holdings, thus forgoing any influence. This policy is reviewed annually with any proposed changes consulted upon and approved by the Pension Committee.
8. The Fund's first report on climate related disclosures, in line with the recommendations from the Taskforce on Climate Financial Disclosures (TCFD), was completed earlier in 2021, with any references to portfolio holdings based on the Fund as at 31st December 2019 and presented to the Local Pension Committee.

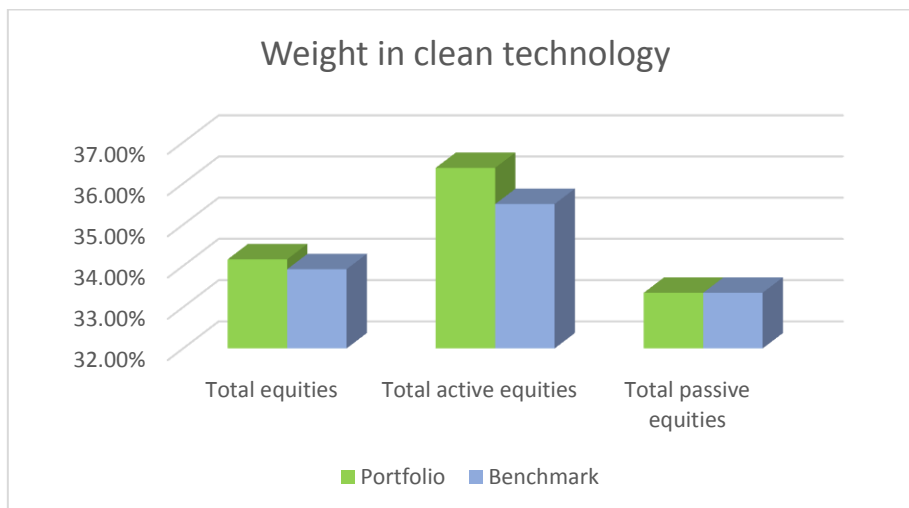
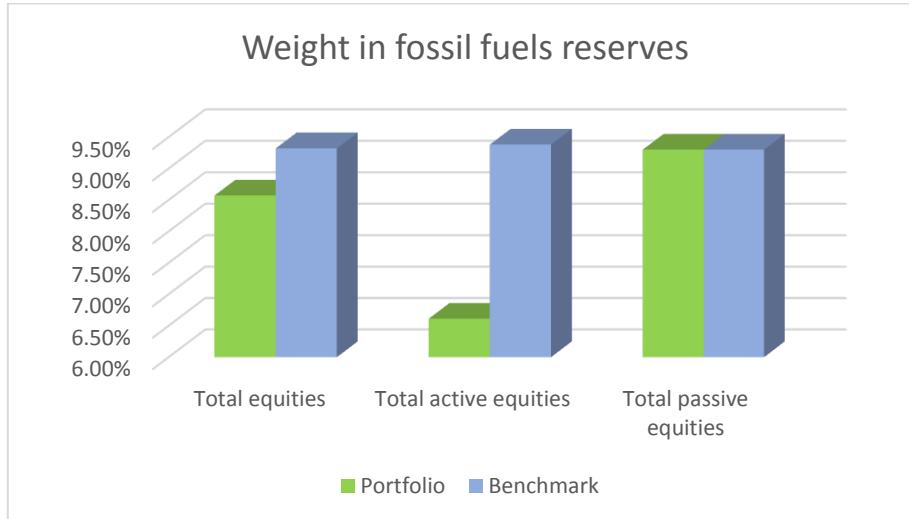
Summary information will be included in the Fund's Annual Report. The TCFD guidance aims to improve transparency by companies, asset managers, asset owners, banks, and insurance companies with respect to how climate-related risks and opportunities are being managed. Official supporters of the TCFD total 930 organisations representing a market capital of over \$11trillion.

9. A climate stewardship plan was delivered in 2021 and included a list of companies the Fund has exposure to. The nine companies included within the plan are those which face a high level of climate risk and are of particular significance to the Fund's portfolio. Eight of these companies are captured by the Climate Action 100+ (CA100+) engagement project, in which the Fund's pooling company LGPS Central is an active participant.

Climate Risk Report (CRR) 2021

10. A copy of Leicestershire Pension Fund's CRR is attached as Appendix A. Central will deliver a PowerPoint presentation to cover the key points in the report at the meeting, with a brief summary below.
11. The report includes updates on the twelve 2020 CRR governance recommendations and progress made to date, noting progress against 10 recommendations with 5 completed. The remaining recommendations will be included in the updated RI plan that will be presented to Committee in January 2022. The report makes a number of recommendations for the coming year, which are mainly based on carrying over those recommendations that are in progress and not yet complete. These are shown below with a comment from Fund officers where applicable.
 - a. Develop a Climate Strategy – proposed for 2022
 - b. Integrate communications on climate risk into communications strategy – The Fund will communicate intention and delivery when approved
 - c. Make clear the roles of key governance committees in the ISS
 - d. Update the governance policy statement to explain how climate risks are governed
 - e. Review as part of the FSS the extent to which climate risks could affect other risks noted in the FSS
 - f. Consider reporting against the Stewardship Code, should it be deemed feasible given the Fund's resources – The Fund will re prioritise this with the climate strategy taking priority
12. Carbon metrics with respect to the portfolio at 31st March 2021 are disclosed alongside the Fund's first CRR metrics which were calculated on the portfolio as at 31st December 2019. The 2021 analysis covers over 4500 companies within the portfolio. A summary is shown below:
 - Total Equities: 160.2 (tCO₂e/ \$m revenue)
 - Total Active Equities: 109.6 (tCO₂e/ \$m revenue)
 - Total Passive Equities: 178.8 (tCO₂e/ \$m revenue)
13. Overall, when compared to the benchmarks carbon metrics the Leicestershire Fund is circa 17% more carbon efficient at total equity level the portfolio and c52% more carbon efficient at total active equities level.

14. The CRR also measures the Funds weight to fossil fuel reserves and weight in clean technology versus the benchmarks for each of the mandates. The graphs below illustrate the positive performance versus both benchmarks.



15. It is the Fund's aim to include a greater proportion of the Fund's assets when calculating future climate metrics. At present investments such as infrastructure, property and credit assets do not have climate metrics. There is growing efforts to include more asset classes throughout the industry. Increasing the percentage of assets covered will be a significant step to fully understanding and managing climate risk.

The Fund's RI position with respect to Climate Change

16. Climate change and a transition to carbon neutrality present significant risk to the Funds investment performance. The primary approach to managing this risk is through a strategy of engagement with companies to improve their stewardship, rather than simply excluding them from the investment portfolio. The Fund has been appointing managers who share similar long term views, investing in better

run companies which should result in improved risk adjusted returns. Exerting increased shareholding power from the pooling process allowed for a step change in the impact of engagement.

17. Central lead on climate action and other ESG matters. They actively contribute to the following investor groups which include like minded investors:
 - a. Transition Pathway Initiative (TPI), their mission is to empower investors to understand and drive the low-carbon transition by providing independent, open-access data showing whether the world's largest high-emitting companies are adapting their strategies to align with international climate goals
 - b. Institutional Investors Group on Climate Change (IIGCC), to support and enable the investment community in driving significant and real progress by 2030 towards a net zero and resilient future
 - c. Climate Action 100+, leads initiatives against the worlds largest greenhouse gas emitters
 - d. 30% Club, promoting gender balance on boards and senior management

18. The Fund's own due diligence on investment proposals brought to Committees for approval include reviews of the proposed managers responsible investment policies.

19. The Fund's Investment Strategy Statement is updated annually which allows the opportunity to consult with employers, employees and stakeholders. The Fund will take into account views but must consider balancing any feedback with the financial consequences on employers within the scheme, many of which are providing social and environmental services such as district councils and schools.

20. The Fund acknowledges the views and representations of a number of lobby groups. Climate Action Leicester and Leicestershire have submitted representations to the Committee requesting fossil fuel divestment which the officers and Pension Committee members will consider in relation to any future strategy change the Fund makes. In addition, the representation made at the September 2021 Pension Committee regarding an engagement strategy will be considered as part of the Climate Strategy.

21. Direction from UK Government, at a recent Local Government Chronical Investment and Pensions conference, is to continue engagement with companies in an effort to influence their actions before any divestment decision is taken.

22. At the current time the Fund does not see divestment from carbon intensive companies as the best way to manage climate change risk. As mentioned earlier, divestment has no impact on world's carbon footprint and in some cases, divesting will remove 'green' investment exposure from the Fund. No company is insulated from the economic impact of extreme global warming. Engagement is therefore more compatible with our fiduciary duty and more supportive of RI, as it provides the opportunity to influence companies, something that is not possible if the investment is simply sold.

23. The Fund is currently engaged with Hymans Robertson, the Fund's Actuary, in relation to the 2022 Strategic Asset Allocation (SAA) refresh. Part of this refresh will allow the Fund to assess risks and opportunities in order to meet the Fund's long term objective of paying pension benefits, its primary goal. Hymans will propose an asset allocation that takes into account the Fund's exposure to climate change risk. The SAA is focused on medium to long term returns and avoids making short term asset allocation changes given the costs involved in trading in and out of sometimes illiquid positions and markets. The Fund has over the years achieved a balanced allocation over many asset classes in order to protect the Fund from a multitude of risks. Any changes proposed will allow the Fund in the future to make changes whilst balancing medium and longer term efforts regarding improving environmental, social and governance factors within the Fund.
24. The Task Force on Climate related Financial Disclosures (TCFD) has developed a set of recommendations that are changing the way organisations manage climate risks and opportunities. The Fund's first TCFD report was prepared in accordance with the guidance and aligned with the four 'pillars', governance, strategy, risk management and metrics and targets. One of the recommendations in order to improve alignment with the TCFD recommendations is to develop a climate strategy.
25. To meet this recommendation, the Fund is looking to publish its first climate strategy in 2022. It is assumed it will include targets for decarbonisation which are Paris aligned. At this stage there remains difficulties with setting targets given the number of moving parts and ability to measure all parts of the Fund, pace of change in the wider economy, taxes etc. As such a level of flexibility is to be assumed within any proposal and there is unlikely to be an obvious straight path to carbon neutrality.
26. With a significant holding within LGPS Central administered investments the Fund would like to align its ambitions with Central funds that first need to understand the ambitions of the eight partner funds, some of whom have published 2050 targets. With a single pool target aligning underlying managers that Central employ becomes easier with just one set of targets to hold underlying managers to account against for example. LGPS Central are currently conducting an exercise where they will gather the eight partner funds views before consulting with the partner funds on the right course of action.
27. The analysis and subsequent climate strategy options to be presented for approval in 2022 may need to include:
 - a. Long term and intermediate targets that are at least Paris aligned
 - b. Relevant and reliable metrics the Fund can routinely measure to gauge performance against the targets
 - c. Other measures that are deemed to be beneficial to a decarbonised future e.g. share of green revenues
 - d. Flexibility in the event of future changes in legislation, a change in required metrics, inclusion of new metrics etc
 - e. Development of reporting to cover more of the Fund's assets

28. The Funds Investment Strategy Statement has had a high level review and as a result of the proposal to commence work on a Climate Strategy a fuller review of the Investment Strategy Statement will take place once a Climate Strategy is approved.

Quarterly Voting Report

29. Per the 2020/21 RI plan the Leicestershire Pension Fund voting report is included as Appendix B to this report.
30. The report covers voting over the period July to September 2021 and the equity investments the Fund holds within LGIM's passive funds and LGPS Central's sub funds, namely the Climate Balanced fund, Global Emerging Markets fund and the Global Active Equity fund. This incorporates c45% of all fund assets. Around 24% of fund assets reside within commodity futures, currency forwards, derivative contracts, debt, property and cash and have no voting rights.
31. The Fund made voting recommendations at 852 company meetings, containing over 8,000 resolutions in the quarter. At 448 meetings, the Fund, via its managers recommended opposing one or more resolutions. The report further breaks down this percentage by geography given the global nature of the Fund's investments.
32. At those 448 meetings the Fund voted against management or abstained on over 4,000 resolutions. The majority of these were board structure related at 40%. Remuneration resolutions were voted against on 18% of all resolutions, where issues such as variable executive pay packages could lead to excessive compensation. A full breakdown is contained within Appendix B along with a geographical breakdown.
33. The appendix provides a measure of voting activity, showing how many meetings have been voted at and how many resolutions have been opposed. Insight into the themes the Fund is focusing on and specific examples are included within LGPS Central's Quarterly Stewardship Report.

Quarterly Stewardship Report

34. In line with the RI plan LGPS Central's Quarterly Stewardship Report (QSR) is included as Appendix C to this report. Historic QSRs can be found at LGPS Central's website, within the responsible investment section, <https://www.lgpscentral.co.uk/responsible-investment/>
35. The QSR covers the quarters (July to September 2021) engagement activity. There is a continued focus over the three year period of 2020-2023 on four stewardship themes which are, climate change, plastics, fair tax and tax transparency, and technology and disruptive industries. Statistics including the number of engagements and method of engagement (either direct, via a stewardship provider or via a partnership) are disclosed as well as details regarding certain engagements. The appended report allows readers to review the approaches taken regarding RI and ensure the Fund is taking acceptable actions in line with our stated strategy.

36. During this quarter Central's engagement set comprised of 353 meetings with engagement activity on 3,781 engagement issues and objectives. The majority of these engagements were carried out by Central's stewardship provider EOS.
37. The report highlights progress at SSE (a utility company) where Central voted for the company's Climate Change action plan. SSE's Board intends to provide shareholders with an annual vote on its climate strategy which aims to deliver a Paris aligned emissions reduction pathway over the short, medium and long term.
38. The report attached as Appendix C covers examples of engagement across the four themes.

Responsible Investment Plan 2021/22

An update to the Fund's 2021 RI plan is shown below.

| Timeline | Title | Description | Quarterly Update |
|-----------------|--|--|---|
| Q4 20/21 | Communicate draft RI Plan to Pension Committee | Publication of the Fund's 2021 RI plan. | Complete Jan 2021 |
| | Climate Stewardship Plan | Formulate a Climate Stewardship Plan of companies for prioritised engagement and monitoring. To be based on the companies identified in the Fund's 2020 Climate Risk Report. | Complete, next update delivered with Climate risk report in Q3 21/22 |
| Q1 21/22 | RI Training for Local Pensions Committee | Content TBC | Ongoing. Q1, Central's approach to RI within manager selection |
| | 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 | Complete Q1 21/22 |
| | Review of ext manager ESG approach | To be conducted via presentations from selected managers during each quarterly Pension Committee meeting. | Feb 21 – Aegon Jun 21 – LGPS Central Sep – 21 Pictet Nov – 21 LGPS Central Active equities |
| Q2-Q3 21/22 | Governance Review | Review of the Fund's Governance arrangements in conjunction with LGPS Central to identify areas | Ongoing, there is a recommendation in the CRR to carry into 2022. |

| | | | |
|----------|--|--|--|
| | | where the management of RI risks could be further embedded in the Fund's policies and reporting. Revised policies to be approved by the Committee. | |
| | Stewardship Code Review | Review of the Fund's compliance status with the UK Stewardship Code. To address any remaining gaps in preparation for reporting against the code in 2022. | Prioritising climate strategy ahead of stewardship code. |
| Q3 21/22 | Receive Climate Risk Report (CRR) | CRR 2021 containing updated carbon risk metrics results measured against the 2020 baseline. | Delivered Nov 2021 |
| | Climate Risk Training | Further training of pension fund officers, Pension Committee and possibly Pension Board on the risks and opportunities associated with climate change. | In planning |
| | Strategy review | Conduct a review of the Fund's current approach to managing climate risk, with a view to drafting a Climate Strategy in 2022. | Proposal for approval at Nov 2021 |
| | Annual Report | Revised report including new RI content (summary of annual voting activity; summary of Climate Risk Report in a manner consistent with the TCFD Recommendations), review by board before approval at Committee | Complete |
| Q4 21/22 | Investment Strategy Statement Review | Annual review | Delay into H2 2022 once Climate Strategy is approved. |
| TBC | Review of Good Governance Review findings & SAB guidance on RI | Review findings and recommendations into annual RI plan where appropriate | Update from independent consultant Jun 21 |

Supplementary Information

39. An exempt paper is included elsewhere on the agenda which includes information regarding the underlying mandates climate metrics which cannot be included for public consideration due to the contract between the data provider and LGPS Central.

Recommendation

40. That the Local Pension Committee approve the recommendations set out within the 2021 Climate Risk Report to:
- a. Develop a Climate Strategy
 - b. Integrate communications on climate risk into communications strategy
 - c. Make clear the roles of key governance committees in the ISS
 - d. Update the governance policy statement to explain how climate risks are governed
 - e. Review as part of the FSS the extent to which climate risks could affect other risks noted in the FSS
 - f. Consider reporting against the Stewardship Code, should it be deemed feasible given the Fund's resources

Equality and Human Rights Implications

41. None.

Appendices

Appendix A: Climate Risk Report 2021
Appendix B: Quarterly voting report Central
Appendix C: Quarterly stewardship report
Appendix D: LGPS Central Presentation

Background Papers

None

Officers to Contact

Mr C Tambini, Director of Corporate Resources
Tel: 0116 305 6199 Email: Chris.Tambini@leics.gov.uk

Mr D Keegan, Assistant Director Strategic Finance and Property
Tel: 0116 305 7668 Email: Declan.Keegan@leics.gov.uk

Mr B Kachra, Senior Finance Analyst - Investments
Tel: 0116 305 1449 Email: Bhulesh.Kachra@leics.gov.uk

This page is intentionally left blank