



## **LOCAL PENSION COMMITTEE – 25 MARCH 2022**

### **REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

#### **RESPONSIBLE INVESTING UPDATE**

##### **Purpose of the Report**

1. To update the Committee regarding the Fund's position with respect to direct Russian exposure.
2. To update on the Fund's response to Climate Action Leicester and Leicestershire requests regarding fossil fuels.
3. To update the quarterly voting report (Appendix A)
4. To update the Committee on progress versus the Responsible Investment (RI) Plan 2022 to improve management of the Leicestershire Pension Fund (the Fund).

##### **Background**

5. The Local Pension Committee approved the RI plan at the January 2022 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 31<sup>st</sup> 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.
10. At the November 2021 Local Pension Committee meeting members agreed to approve officers commence work on delivering the Fund's first Climate Strategy.
11. At the November 2021 Local Pension Committee the Fund's second Climate risk report was delivered which when compared to the associated benchmarks carbon metrics showed the Leicestershire Fund is circa 17% more carbon efficient at total equity level and circa 52% more carbon efficient at total active equities level.

### **The Fund's position with respect to Russian investments**

12. The Russian invasion of Ukraine has prompted the Fund to identify investments in Russian (and Belarus) companies. Officers have contacted the investment managers and have estimated the total value of holdings to be c£10m or 0.15% of the total Fund.
13. The majority of this holding is within a LGIM passive equity fund and LGPS Central's active emerging equity fund, equity fund, climate fund and multi asset credit fund. There are some legacy holdings within the private equity holdings that Adam Street Partners manage.
14. Many of the managers contacted confirmed they held no position in Russian companies.
15. As with many investing decisions the Fund needs to consider short and long term financial considerations, incorporating Environmental, Social and Governance factors, as well as the moral outrage felt by many.
16. The Fund's Russia exposure is largely as a result of Russia being a constituent of many index providers emerging markets (EM) index. However, as the conflict has continued most index providers have moved quickly to remove Russia from their indexes. As a result, Russia does not have a weighting in popular EM indexes, and it is not usual for a manager to invest outside developed and EM markets given Russian investments will fall outside many investable mandates and will be subject to wide ranging sanctions.
17. Looking through the ESG lens further highlights the unattractiveness with free press suppression, the heightened risks of owning local physical assets, uncertainty of economic performance, foreign exchange risk or currency in Russian banks subject to capital controls will not be appealing to many managers.
18. Consequently, the Fund has spoken to managers and asked when possible and appropriate the Fund would like positions to be sold. This is a similar message to

that sent from other LGPS funds within the Central pool. At this point where governance and access to Company boards has broken down the Fund see's little benefit from maintaining positions with responsible investing and financial considerations in mind, which in line with fiduciary duty.

19. Whilst there is a desire to exit positions as soon as possible the position is complicated by the fact any such sales and proceeds are currently blocked from leaving Russia. The Central Bank of Russia imposed a temporary suspension on Russian banks executing withdrawal transactions of funds in all currencies held by foreign clients (both legal entities and Individuals), and residents of the countries who issued sanctions against the Russian Federation, to the accounts opened in foreign countries. For holdings that are not listed (private equity for example) there could be an extended period of time before divestment could be achieved.
20. The Funds position is in line with the public statements of most other LGPS funds and in line with correspondence from the Secretary of State for Levelling Up, Housing and Communities to LGPS Committee Chairs. The letter reminded Chairs to decide, "how best to manage your investments in the best interests of your members and within your legal and fiduciary duties".
21. An update outlining the exposure has been sent to employers. An update has also been posted to the employee section of the Leicestershire LGPS website. Both Pension Committee and Board members received an email update from officers.
22. The speed of developments in Russia's economic position is without precedent. Even during the Cold War, Russian exports of oil and gas continued. Swift and co-ordinated action by global Governments as well as Russia's own actions made the decisions regarding Russian investment reasonably straight forward.
23. Future decisions for the Fund may not be as straight forward, where there is public concern, but a less coherent Government response (global). The Fund will need to consider the changing geopolitical landscape over the course of the year.

### **The Fund's response to Climate Action Leicester and Leicestershire (CALL)**

24. The Fund received a representation from CALL regarding divesting from fossil fuel investments "in light of the urgent need for the world to reduce its carbon emissions sufficiently by 2030 to prevent catastrophic climate change." They group have asked the following:
  - a. Cease to make any new investments in the top 200 publicly traded fossil fuel companies.
  - b. Divest from direct ownership and any commingled funds that include fossil fuel public equities and corporate bonds within 5 years.
  - c. Make a public statement to divest from fossil fuel companies, giving a date by which you commit to being fully divested, and calling for national and international regulation of the fossil fuel industry to ensure the world remains below 1.5oC of global heating.

25. These requests listed above are broadly an engage versus divest debate. This will be considered as part of drafting a Net Zero Climate Strategy (NZCS) which will come to Committee later in the year for approval.
26. There are many ways the Fund could reduce its carbon emissions and so focussing on a portion of the Fund (fossil fuel companies) is not the only solution to a wider problem. In fact, it can be argued that some industries have a higher carbon footprint and It is with this in mind that the IIGCC framework intends to address the achievement of net zero by an overall reduction across many asset classes over time.
27. The Fund's 2021 Climate Risk Report highlighted five companies that contribute the most to the total portfolio carbon footprint. The largest contributor to the Fund's carbon footprint is the world's largest power utility company which also is one of the largest wind and solar renewable energy generators. Other companies in the top five include three materials (which includes cement) manufacturing companies and a semiconductor manufacturing company.
28. As a reminder, the current view of the Fund is that it does not see divestment from carbon intensive companies such as fossil fuel companies as the best way to manage climate change risk. 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.
29. In addition, direction from UK Government, at a 2021 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.

### **Quarterly Voting Report**

30. Per the 2021/22 RI plan the Leicestershire Pension Fund voting report is included as Appendix A to this report.
31. The report covers voting over the period October to December 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 c46% of all fund assets. Around 23% of fund assets reside within commodity futures, currency forwards, derivative contracts, debt, property and cash and have no voting rights.
32. The Fund made voting recommendations at 810 company meetings, containing nearly 6,000 resolutions in the quarter. At 374 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.
33. At those 374 meetings the Fund voted against management or abstained on over 3,000 resolutions. The majority of these were board structure related at 42%. Remuneration resolutions were voted against on 22% of all resolutions, where

issues such as variable executive pay packages could lead to excessive compensation. A full breakdown is contained within the Appendix along with a geographical breakdown.

34. 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.

### **Responsible Investment Plan 2022/23**

A progress update to the Fund's 2022 RI plan is shown below.

<b>Financial Quarter</b>	<b>Title</b>	<b>Description</b>	<b>Quarterly update</b>
Q4 21/22	Communicate draft RI Plan to Pension Committee	Publication of the Fund's 2022 RI plan.	Complete
	Manager review	ESG approach alongside presentation to Committee	Complete IFM infrastructure
	Climate Change Strategy	Begin work on the production of a LCCPF Climate Change Strategy with a view to publication in late-2022.	Commenced, update in March 2022 to Members of the Committee
	Climate Strategy Workshop	Meeting of the Fund's Officers and Pension Fund Committee to discuss and plan the Fund's Climate Change Strategy.	Due March 2022
Q1 22/23	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	
	Manager review	ESG approach alongside presentation to Committee	TBC - LGPS Central equity / private markets
Q2 22/23	Climate Strategy Update	Pension Fund Committee meeting to discuss progress of Climate Change Strategy.	
	Manager review	ESG approach alongside presentation to Committee	TBC – Stafford Timberland
Q3 22/23	Receive Climate Risk Report (CRR)	CRR 2022 containing updated carbon risk metrics results measured against the baseline from the previous two reports.	
	Climate Risk Training	Further training of pension fund officers, Pension	

		Committee and possibly Pension Board on the risks and opportunities associated with climate change.	
	Climate Change Strategy Publication	Publish the Fund's draft Climate Change Strategy. This should be consistent with the TCFD Recommendations and be monitored regularly by the Pension Fund Committee.	
	Governance Review	Publish updated draft Funding Strategy Statement and Investment Strategy Statements for consultation in line with the Fund's new Climate Change Strategy. Final approval in Q4 22/23.	
	Manager review	ESG approach alongside presentation to Committee	TBC – LGIM passive equity
TBC	Review of company engagements and TCFD / CRR recommendations	<p>Schedule time at LPC for discussion of climate related risks and strategy.</p> <p>Schedule one training session on general RI matters and one climate specific training per year.</p> <p>Develop climate change strategy.</p> <p>Integrate comms on climate risk into communications strategy.</p> <p>Update governance policy statement to explain how climate risks are governed.</p> <p>Review as part of the FSS the extent to which climate risks could affect other risks noted in the FSS.</p> <p>Make clear the roles of key governance committees in the ISS</p>	<p>Ongoing, progress to date:</p> <p>20/21 Pension accounts included summary of climate risk report</p> <p>Stewardship code reporting pushed to 2023 to accommodate NZCS work</p> <p>NZCS work commenced</p>

### **Supplementary Information**

35. None

### **Recommendation**

36. That the Local Pension Committee note the report.

**Equality and Human Rights Implications**

37. None.

**Appendices**

Appendix A: Quarterly voting report Central

**Background Papers**

None

**Officers to Contact**

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