



LOCAL PENSION COMMITTEE – 9 SEPTEMBER 2022

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RESPONSIBLE INVESTING UPDATE

Purpose of the Report

1. The purpose of this report is to provide the Local Pension Committee with
 - a. The legal view on the Committee's fiduciary responsibilities (Appendix A).
 - b. An update on the development of the Fund's Net Zero Strategy and the associated engagement exercise.
 - c. An update on the Fund's quarterly voting (Appendix B) and stewardship activities undertaken on its behalf via LGPS Central (Appendix C) and LGIM (Appendix D), and the Local Authority Pension Fund Forum.

Background

2. The Local Pension Committee approved the Responsible Investment (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.
3. 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.
4. The Fund's approach, as stated within its Investment Strategy Statement (ISS) that was agreed by the Committee on 26 February 2021 is to ensure RI through engagement of companies it invests in to forward responsible investing aims rather than divest the Fund's holdings, thus forgoing any influence.
5. At the November 2021 Local Pension Committee meeting the Committee agreed to commence work on producing the Fund's first Climate Strategy. At the June 2022 meeting it was agreed to engage on proposed metrics that were in line with the Net Zero Investment Framework developed by the Institutional Investors Group on Climate Change.

The Fund's Fiduciary Duty

6. In developing the Fund's Net Zero Climate Strategy the Fund has requested advice from Leicestershire County Council's Legal section regarding its fiduciary duty in the context of Pension Fund investment decisions. This is provided in full in Appendix A which indicates the legal and statutory guidance which the Local Pension Committee must follow.
7. In summary, fiduciary duty is a responsibility to act in the best interests of scheme members. Case law on fiduciary duty explains the duty as the exercise of discretionary power rationally and reasonably and for a proper purpose by reference to relevant legal considerations. This duty can be summarised as achieving what is the best for the financial position of the Fund.
8. The Fund must follow the law and statutory guidance for preparing and maintaining its Investment Strategy Statement, as well as take proper advice and act prudently when making investment decisions. Subject to this, the Fund should consider any factors that are financially material to the performance of its investments, including environmental, social and governance (ESG) factors. This includes considerations over the long term, dependent on the time horizon over which the Fund's liabilities arise.
9. Statutory guidance specifies that while pursuit of a financial return should be the predominant concern, the Fund may take purely non-financial (ie. ethical) considerations into account provided that doing so would not involve significant risk of financial detriment to the Fund and where it has good reason to think that scheme members would support their decision.
10. The legal advice concludes:

"The appetite of the Fund for taking risk when making investment decisions is ultimately for local consideration and determination by the Local Pensions Committee subject to the aim and purpose of the Fund. As a reminder this is to maximise the returns from investment returns within reasonable risk parameters. Therefore, the Local Pension Committee would not be acting lawfully with regard to approving investment decisions where Hymans Robertson or any successor external advisor believe a decision:

- *risks conflict with the fiduciary duty to the Fund*
- *risks lower investment returns"*

11. The Director of Corporate Resources advises that any decision that is consciously financially detrimental to the Fund would require employers to make resource allocation decisions, given contribution rates would increase as a result. It is not the role of the Fund to put its non-financial beliefs above those of the employers funding the pension scheme.

Net Zero Climate Strategy development update

12. Following approval by the Committee on 10 June 2022, the Fund is engaging on its draft Net Zero Climate Strategy (NZCS) metrics and targets. The engagement was

launched on 5 July through Leicestershire County Council's 'Snap Survey' tool and will run until 18 September.

13. The engagement has been advertised on the Pension Fund's Member Self Service Website, alongside Employer Bulletins to all Fund Employers. Emails have been sent to circa 40,000 scheme members who the Fund holds contact details for, along with a reminder within the Annual Benefit Statement notification.
14. It is intended that a draft of the NZCS, alongside the outcome of the engagement exercise, will be presented to the Committee on 18 November. Subject to approval, a period of consultation on the draft NZCS will be undertaken prior to the final NZCS Strategy being presented to the Committee for approval in March 2023.
15. As part of the development of the NZCS the Fund has commissioned work from its independent investment advisor Hymans Robertson on its views on the proposed NZCS targets and the view in regards to divestment and engagement, detail of which was presented to the Committee in June.

Quarterly Voting and Stewardship Update

16. The Fund has a longstanding policy of delegating voting and stewardship activities to its investment managers, with the view that well run companies protect and increase shareholder value by engaging on a range of financially material Environmental, Social and Governance (ESG) investment factors.
17. This is implemented through the Fund's equity managers LGPS Central (in contract with EOS at Federated Hermes) and Legal and General Investment Manager. As well as the Local Authority Pension Fund Forum (LAPFF) a group comprised of 85 funds and seven pools with combined assets of over £350billion, which is consequently able to exert significant influence over companies in which funds are invested. Some highlights are included below.

Quarterly Voting Report

18. Per the 2021/22 RI plan the Leicestershire Pension Fund voting report is included as Appendix B to this report.
19. The report covers voting over the period April to June 2022 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 c43% of all Fund assets. Around 22% of Fund assets reside within commodity futures, currency forwards, derivative contracts, debt, property, and cash and have no voting rights.
20. A record number of proposals were filed during a busy proxy season, where most large publicly traded companies hosted their annual meetings. The Fund made voting recommendations at 3,725 company meetings, containing around 52,064 resolutions in the quarter. At 2,733 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.
21. At those 3,725 the Fund voted against or abstained on 33,269 resolutions. The majority of these were board structure related at 51%. Remuneration resolutions

were voted against on 9% of all resolutions where issues such as variable executive pay packages could lead to excessive compensation, or where more needed to be done in linking delivery of climate targets with remuneration. The full breakdown is contained within the Appendix B along with a geographical breakdown.

22. The period saw around 30 companies adopt an annual shareholder vote on climate strategies, or an update on transition plans. The Fund's managers continue to take a robust approach to assessing these plans, with votes against management recommendations cast where plans were considered to be not fully aligned to a 1.5C scenario.
23. It is worth highlighting that Shell provided a progress update on the energy transition plan at their AGM, which was met by 20.1% opposition among shareholders including LGPS Central, and LGIM, due to gaps in reporting, and a clear operating plan and budget to meet its 2050 goals. The 20% threshold, according to the UK Corporate Governance Code's recommendations, 'should be considered as significant dissent, with boards required to report to shareholders any actions taken to address their concerns'. LGPS Central will continue to communicate expectations to the Company and continue engagement as part of Climate Action 100+.
24. More detail on the voting of the managers is set out within their respective stewardship reports, with highlights set out below.

Quarterly Stewardship report (QSR) update

25. Voting is just one of the tools available to the Fund to encourage better corporate behaviour on environmental, social and governance factors. Which often goes hand in hand with stewardship. Some examples from activities from LGPS Central, LGIM and LAPFF are set out below.
 - i. LGPS Central
26. The QSR covers the quarter's (April to June 2022) engagement activity 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/>
27. During this quarter Central's engagement set comprised of 558 companies. There was engagement activity on 1,673 engagement issues and objectives. Against 555 specific objectives, there was achievement of some or all on 135 occasions. Further 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 within the report.
28. Four stewardship themes which were collectively agreed by the Partner funds that make up the Central pool continue into 2022, these are, climate change, plastics, fair tax and tax transparency and human rights risks.
29. The report contains information on specific company engagements including the theme (one of the four listed above), the objective, the engagement details, and

outcomes. A brief description of two engagements that may be of interest to the Committee are set out below:

- NextEra Energy: LGPS Central co-signed a letter seeking a net zero target consistent with a 1.5C pathway. The company has since released its updated ambition on carbon emissions, dubbed 'real zero', calls for significant investments to eliminate all scope 1 and scope 2 carbon emissions across their operations no later than 2045. LGPS Central has welcomed this, but believes further work needs to be done for the company to be fully aligned with Paris goals, which needs to include greater disclosure and target setting on scope 3 emissions. The engagement continues alongside CA100+.
- Department for Environment, Food and Rural Affairs: LGPS Central co-signed a letter with First Sentier Investors and LGIM on behalf of 29 investors, to the ministers at the Department of Environment, Food and Rural Affairs (DEFRA). The letter emphasised investors support for the recommendations of the "All Party Parliamentary Group on Microplastics" issued in 2021, specifically to mandate the installation of microfibre filters in new washing machines by 2025. The letter also highlighted Alberto Costa MP's Microplastic Filters (Washing Machines) Bill that would allow the government to take this legislation forward appropriately. These measures would help combat microplastics pollution to the environment, a problem caused in large proportion by synthetic textiles which release microfibrils (a type of microplastic) when washed, which then can end up in the wastewater system where they are either caught, remain in sewage sludge or can be spread onto growing crops or released into river and marine environments.

30. Other companies included in this quarter's report include Shell (climate change), six packaging companies (plastic), Barrick Gold Corporation (tax), Experian (tax) and Booking.com (human rights). The report also contains background regarding voting decisions at Amazon, Barclays, JP Morgan and META (formally known as Facebook).

31. LGPS Central also published their Annual Stewardship Report for 2021 which is available here <https://www.lgpscentral.co.uk/wp-content/uploads/2022/05/LGPS-Central-Annual-Stewardship-Report-2021-FINAL.pdf>

ii. LGIM

32. LGIM also published its quarterly Environmental, Social and Governance Report, the latest covers April to June 2022 (Appendix D).

33. Of interest to the Committee may be the position taken in relation to votes for BP and Shell and their progress towards net zero. Both companies are considered as part of the Fund's Climate Stewardship Plan, which the Committee will be updated on in November. In determining which votes to support LGIM consider each shareholder resolution on a case by case basis, and like the Fund they are keen to support companies' transition to net zero

- BP – LGIM voted FOR management recommended 'Say on Climate' resolution. LGIM has held long-standing and intensive engagements both individually and collectively through the CA100+. Following which BP has

made substantial changes to its strategy and approach, including strengthening its ambition to reach net zero emissions by 2050 and to halve operational emissions by 2030, as well as extended its scope 3 targets, committed to a substantial decline in oil and gas production and announced an increase in capital expenditure to low-carbon growth sectors.

LGIM still holds some areas of concern and are continuing their constructive engagement with the company on its strategy and implementation of it, with a focus on both its downstream targets and approach to exploration. LGIM believe that *“achieving a perfect solution in an imperfect world is challenging, and on some occasions, the ‘carrot’ can drive better results than the ‘stick’.* *By supporting BP’s plan, we hope to see a similar level of upward trajectory across the industry, and we will keep using the tools at our disposal to encourage companies to meet our expectations.”*

- Shell - LGIM voted AGAINST management recommendation on the Energy Transition Progress Update. While identifying substantial progress had been made in strengthening Shell’s operational emissions reduction targets by 2030 as well as the additional clarity about the level of investments in low carbon products demonstrating a strong commitment towards a low carbon pathway. LGIM remained concerned about the disclosed plans for oil and gas production and ultimately voted against Shell’s Energy Transition Progress Update. The vote against will serve as an anchor for future discussions, given the relatively high 20.1% opposition as set out in paragraph 22.

iii. Local Authority Pension Fund Forum

34. The Local Authority Pension Fund Forum (LAPFF) was formed in 1990 to provide an opportunity for the UK’s local authority pension funds to discuss investment and shareholder engagement issues. LAPFF membership currently stands at 85 funds and seven pools with combined assets of over £350billion, including Leicestershire County Council Pension Fund. It is consequently able to exert significant influence over companies in which funds are invested.
35. LAPFF last met as a hybrid meeting on 13 July 10.30am. The business meeting agenda included, among other things, their engagement with the Principles for Responsible Investment Advance Human Rights Initiatives, Electric Vehicles charging infrastructure, and a presentation on long term investment for public health from Share Action.
36. LAPFF also set out their engagement work in the previous quarter. During the quarter LAPFF engaged with 90 companies. Most of this engagement was on climate change related issues, other key topics were human rights, environmental risk, supply chain management and board compensation.
37. Some highlighted areas are set out below, however the full report can be viewed at: <https://lapfforum.org/wp-content/uploads/2022/07/LAPFF-Q2-QER.pdf>
 - Engagement on Electric Vehicles – LAPFF engaged with various car manufacturers to discuss their approach to raw material sourcing and ensuring this is done in a responsible manner.

- Engagement with Water Utilities – Water utility companies have faced significant scrutiny for their environmental performance, specifically the release of raw sewage into rivers to safeguard against flooding. LAPFF is engaging on credible plans to minimise the release of raw sewage, as well as how they seek to reach net zero goals given the sector contributes 1% to the UK’s total emissions.
- LAPFF continues to engage with a number of companies included on the UN Human Rights Office database which details business enterprises involved in certain specified activities related to the Israeli settlements in the Occupied Palestinian Territory. Requesting that they undertake human rights impact assessments with regards to Occupied Palestinian Territories, and to publish them if they already do. Since publication of the Quarter 2 report Booking Holdings have published a human rights statement, recognising it has a way to go in developing its human rights strategy across all conflict zones but continuing to apply due diligence on its operations.

Other Developments

Aegon Short Dated Investment Grade Bond Fund

38. The Fund holds circa £83.1 million (as at 30 June 2022) via Aegon’s Short Dated Investment Grade Bond Fund. This holding is part of the Fund’s protection asset group, which provides lower volatility of the broader fixed income market.
39. While lower climate related risk and reduced carbon emissions, versus benchmark, have been a consideration of the fund since launch, on 15 July 2022 Aegon updated the investment strategy to formalise the environmental, social and governance characteristics of the fund. The fund is now categorised as falling within the scope of Article 8 of the Sustainable Financial Disclosure Regulations. An Article 8 fund is defined as “a fund which promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices.”
40. As a result, Aegon have changed the name of the fund to the ‘Aegon Global Short Dated Climate Transition Fund’. This does not change the risk profile or result in any material realignment of the portfolio.
41. Aegon will continue to use its dedicated and proprietary climate transition research to direct investments to companies that have robust and credible plans to transition towards a low carbon economy, which supports the Fund’s proposed net zero goals.

Responsible Investment Plan 2022/23

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

Financial Quarter	Title	Description	Quarterly update
Q4 21/22	Communicate draft RI Plan to the Pension	Publication of the Fund’s 2022 RI plan.	Complete

	Committee		
	Manager review	ESG approach alongside presentation to LPC	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, draft Strategy to be presented to November LPC
	Climate Strategy Workshop	Meeting of the Fund's Officers and LPC members to discuss and plan the Fund's Climate Change Strategy.	Workshop held in March 2022
Q1 22/23	TCFD Report (Taskforce on Climate related Financial Disclosures)	Report of the Fund's approach to climate risk presented to the LPC, set out in alignment with the recommendations of the Taskforce on Climate-related Financial Disclosures	Complete for June LPC
	Manager review	ESG approach alongside presentation to the LPC	LGPS private markets paper considered by the LPC in June
Q2 22/23	Climate Strategy Update	LPC meeting to discuss progress of Climate Change Strategy.	Draft targets and metrics presented to LPC June and agreement to engage with employers and scheme members agreed.
	Manager review	ESG approach alongside presentation to Committee	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, LPC 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 LPC.	
	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 LPC	TBC – LGIM passive equity
TBC	Review of company engagements and TCFD / Climate Risk Report 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 Net Zero Climate 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: 21.22 Pension accounts included summary of TCFD.</p> <p>Stewardship code reporting pushed to 2023 to accommodate NZCS work NZCS work commenced</p>

Recommendation

43. It is recommended that the Committee;

- a) Notes the legal view on the Committee's fiduciary responsibilities
- b) Note the latest position and next steps in the creation of the Net Zero Climate Strategy.
- c) Note the quarterly voting and stewardship reports.

Equality and Human Rights Implications

44. None.

Appendices

Appendix A: Legal View of the Fund's Fiduciary Duty

Appendix B: Fund Voting Report

Appendix C: LGPS Central Quarterly Stewardship Report

Appendix D: LGIM Quarterly Stewardship Report

Background Papers

Local Pension Committee – 21 January 2022 - Responsible Investment Plan 2022

<https://politics.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=6757&Ver=4>

Local Pension Committee – 10 June 2022 – Responsible Investing Update

<https://politics.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=6759&Ver=4>

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