



LOCAL PENSION COMMITTEE – 1 DECEMBER 2023

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RESPONSIBLE INVESTING UPDATE

Purpose of the Report

1. The purpose of this report is to:
 - a. update the Committee on progress versus the Responsible Investment (RI) Plan 2023 (Appendix A);
 - b. update the Committee on the Fund's quarterly voting report (Appendix B) and stewardship activities;
 - c. set out a high-level overview of the Fund's investment managers net zero approach.

Policy Framework and Previous Decisions

2. Responsible investment factors have long been a consideration for the Leicestershire County Council Pension Fund having satisfied itself that potential investment managers take account of responsible investment (RI) as part of their decision-making processes before they are considered for appointment.
3. This is enshrined in the Fund's Investment Strategy Statement last approved by the Committee on 3 March 2023, as well as the approach to climate related risk and opportunities within the Net Zero Climate Strategy also approved 3 March 2023.
4. The Fund is supported by LGPS Central's Responsible Investment and Engagement Framework which sets out its approach to responsible investment on behalf of the eight pooled funds. The framework supports the Fund broadening its stewardship activities.

Background

5. 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 the Fund's 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.

6. Engaging companies on ESG issues can create value for those businesses and the Fund as an investor by encouraging better risk management and more sustainable practices, which therefore should generate sustainable investment returns.

Responsible Investment (RI) Plan 2023 Progress

7. The Local Pension Committee approved the RI Plan in January 2023. The Plan was developed following discussion with LGPS Central's in-house RI team. The Fund has a continual focus on raising RI standards. Progress made to date on the 2023 RI Plan is set out in Appendix A.
8. Highlights include continued discussions with investment managers, as outlined in more detail below, and continued work alongside LGPS Central on their approach to stewardship.
9. Officers will begin looking forward to a 2024 Responsible Investment plan to continue to enhance the Fund and the Committee's view of RI matters, in line with any relevant recommendations from the Climate Risk Management report produced by LGPS Central elsewhere on today's agenda and any best practice.

Net Zero Climate Strategy Implementation Progress

10. Alongside the Fund's Net Zero Climate Strategy (NZCS) an implementation plan was agreed which set out:
 - a. Strategic Actions
 - b. Actions linked to NZCS Targets, and approach to investment decisions
 - c. Actions related to Stewardship, Engagement and Divestment
11. Key to many of these actions is gaining a better understanding of existing managers' approach to monitoring climate risk, their own targets towards net zero if they have them, and the challenges they are facing. Managers have responded to our questions on these issues and this has proved helpful in understanding the differences in approach taken by each manager, different asset class issues and wider industry challenges.
12. Investment managers will have different views on potential risks and opportunities, and returns from individual assets, which supports the Fund's diverse portfolio in ensuring when one area of the portfolio does badly, it will be supported elsewhere.
13. The Fund has 19 investment managers outside of LGPS Central and as of 31 March 2023 this accounted for £3.3bn of Fund assets. There is evidence that investment managers are already taking these issues into account which is a positive step and is supportive of the Fund's long-term net zero ambition. A snapshot of just some managers commitments are set out below:

- 12 investment managers are members of the Net Zero Asset Manager Initiative, a group of asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050, or sooner, and to supporting investing aligned with net zero emissions by 2050 or sooner.
 - 10 investment managers have firm level operational net zero commitments. Two additional managers have already achieved carbon neutrality from their operations having utilised mitigation strategies and/or offset projects.
 - 10 investment managers have some form of long, or medium-term target (or both) which apply to the Fund's investments as at March 2023. In some cases, these targets may only apply to specific investments or asset classes they hold due to challenges they report from ownership structures, or their ability to influence underlying investments, or ability to set targets on certain asset classes.
 - Of the managers that have no current targets related to the Fund's investments, the Investment Sub-Committee (ISC) has already made a decision to disinvest from two due to other investment factors and the remainder fall under the following categories.
 - Looking to set out a climate plan during 2023/4;
 - Focusing on data collection before target setting, such as awaiting scope 3 data, or engaging third parties on how to measure their carbon footprint given the intangible nature of the investment.
 - Passively held investments.
14. The majority of these managers cover private markets and face significant data issues and does not mean they are not managing climate risk.
15. It is positive to see that many of the Fund's external managers have set net zero ambitions and have already begun measuring the impact of their portfolios, given these portfolios do not include climate factors as a mandate requirement. Officers will monitor data provided by managers and engage with them on progress made, even where these asset classes remain out of scope of the Fund's annual climate report produced by LGPS Central. This is supportive of the Fund's long-term net zero ambition.
16. For managers that have not set targets the Fund will need to monitor their progress in managing climate risk and encourage target setting. The Fund will also engage with managers that have set targets to ensure they are actively working towards these targets. This will be undertaken with future iterations of the annual manager questionnaire and follow up discussions.
17. Some managers have already begun reporting climate data to the Fund. While these asset classes may be out of scope for inclusion with the climate report currently, this can enable the Fund to monitor progress on a manager-by-manager basis. Speaking with managers it is clear reporting is still at a

relatively early level and there is significant variation in the style, metrics used and content of reporting produced by investment managers across asset classes. This is especially true within private markets which are lagging more generally across the industry. There is also a clear geographic divide of data provision with managers noting that the UK and Europe can be considered far more advanced with regards to requirements for company climate reporting than the US for example, which feeds into manager reporting.

18. Over time it is expected data provision will improve, particularly driven by regulatory requirements on investments and on underlying companies to report specific metrics.

19. In relation to managers' views on fossil fuel companies' active managers naturally take different views. The majority are not invested in fossil fuel companies, either due to them not being within their investable universe, or not part of their strategy. Where managers may invest, some have revenue thresholds which restrict assets too heavily reliant on certain fossil fuels. Others, while not implementing exclusionary policies instead ensure any 'controversial' areas include additional scrutiny on the investment cases. The Fund will continue to work with managers to understand their approaches and how it fits with the Fund's approach to climate risk, and how managers engage with these companies. The Fund continues to monitor its exposure to fossil fuel reserves where this can be accurately measured by the Fund's data provider as part of the annual climate report. The Fund looks to continue to manage this exposure down in line with the Fund's NZCS fossil fuel reserves target, while engaging with these companies.

20. LGPS Central hold the remainder of scheme assets through investment managers (circa £2.5billion) which the Fund will look to increase investment in, in line with pooling ambitions. LGPS Central published their net zero approach, currently focusing on targets relating to listed equity, corporate bonds, sovereign debt and private markets by 2050 setting out a five-stage implementation plan. Short term actions include:
 - For equities and corporate bonds: Central will be undertaking net zero analysis twice a year and cover assessments at all levels, both asset class and fund level. They will also send annual net zero questions to be discussed during biannual net zero meetings starting in 2024. Central will scrutinise their past carbon performance, expectations for future carbon performance, engagement outcomes and voting decisions.
 - Sovereign and Private Markets: Collecting data from private market managers, and collating net zero commitments.
 - LGPS Central are in the process of allocating net zero targets and a strategy for operational emissions, with a plan to publish in 2024.

21. A high-level snapshot of the Fund’s overall position in relation to net zero, and data provision as of March 2023 is set out below.
22. This is an officer view, and while we may consider a mandate currently aligning, or covered by an overarching manager net zero target, it will be vital for progress to be monitored on a manager-by-manager basis. As previously highlighted the vast majority of these investments have been held by the Fund for a significant time, and these mandates have not been built with net zero in mind. It is promising that despite these factors managers have set net zero targets where possible and have begun reporting metrics where possible. Where targets have not been set, this does not mean they are not considering climate issues and the Fund will continue to engage with them.
23. As set out in the NZCS the Fund will look where possible to review and develop investment mandates to increase alignment with the Fund’s net zero ambitions, where this is also in line with the Fund’s fiduciary duty.

Net Zero	Data Provision
Aligning to net zero.	Data included within CRR
Covered by manager/LGPS Central net zero ambition. Progress to be monitored on alignment to net zero.	Manager providing some data which the Fund can monitor.
Not target applicable. Further work needs to be undertaken.	Further work to be undertaken on engaging with manager on data

24. Each block within the snapshot generally represents a mandate across both LGPS Central and existing managers. The Fund holds a number of mandates with investment managers of which vintages remain very similar. These have been grouped where relevant.

Growth

Net Zero Alignment									
Data Provision									

Income

Net Zero Alignment												
Data Provision												

Protection

Net Zero Alignment		
Data Provision		

25. As highlighted previously the majority of mandates where further work needs to be undertaken relate to private markets investments due to issues prevalent across private markets relating to data scarcity and how they are able to consider net zero in the context of their portfolios.
26. While many assets remain out of scope for the Fund's annual climate reporting. It is not to say other areas of the portfolio are not integrating sustainability or climate related factors and supportive of the Fund's overall ambition to become net zero by 2050, with an ambition for sooner. Some highlights are set out below.
- LaSalle the Fund's property manager has estimated the portfolio will achieve net zero by 2043 based on underlying asset net zero commitments.
 - Partners, the Fund's private debt investment manager, introduced Sustainability Linked Loans. These are standard loan instruments which incentivize sustainability through a set of pre-agreed Key Performance Indicators (KPIs) related to environmental, social and governance factors. Given lenders often have far less impact than equity owners, it offers a key engagement channel to incentivise positive behaviour.
 - Stafford Capital, the Fund's timberland manager, provides a net negative emissions profile. As well as their comprehensive approach to ESG, Stafford place a high emphasis on forest certification, an independent third-party evaluation of the management of a particular forest against a certain standard. Stafford report that 97% of their portfolio is certified, with the remainder constituted of largely young timberland assets that are planned to be certified within the near future.

Voting and Engagement

27. Appendix B sets out the Fund's voting report from July to October 2023.
28. This incorporates circa 43% of the Fund's assets (LGIM passive funds, LGPS Central Climate balanced fund, global emerging markets fund and the global active equity fund). A brief breakdown is set out below:
- The Fund made voting recommendations at 826 meetings (8,052 resolutions)
 - At 471 meetings the Fund opposed one or more resolutions.
 - The Fund voted with management by exception at 4 meetings and supported management on all resolutions at the remaining 350 meetings.
 - The majority of votes where the Fund voted against management were related to board structure (40%). These votes include issues such as overboarding, diversity, and inadequate management of climate risk.

29. Some highlights from engagement activity from partners are set out below.

30. [LGPS Central Stewardship Report – April-June Stewardship Report](#)]
 LGPS Central is the pooling company of the Fund. It is a strong supporter of responsible investment through the Responsible Investment and Engagement Framework. Central's latest Stewardship Report sets out progress of ongoing and new engagements which relate to the four Stewardship Themes: climate change, plastic, fair tax payment and tax transparency, and human rights risk. This quarter the engagement set comprised 460 companies, with engagement activity on 1578 issues and objectives. Against 553 specific objectives there was achievement of some or all on 149 specific objectives.

Engagement	Action	Outcome
Marathon Oil Corp	Responsible Tax engagement. For the company to public a responsible taxation policy inline with the Global Reporting Initiative (GRI) Tax Fairness Standard, and disclose itemised payment to government the national. State and local levels.	The company suggested that it would publish a responsible policy in line with the GRI standard and disclose itemised payments.

Legal and General Investment Management – ESG Impact report Q3

31. Legal and General Investment Management (LGIM) manage the majority of the Fund's passive equity which accounts for 15.9% of the Fund. LGIM's latest ESG impact report highlights some key activity in the Investment Stewardship team.
32. The latest ESG impact report highlights continued engagement on LGIM's Climate Impact Pledge, the work addressing the issue of income inequality and poverty and engagement with stock exchanges in Asia. One highlight is set out below.

Company	Theme	Action	Outcome
Heidelberg Cement	Climate	Engagement with the management team to discuss progress and economic validity of the company's planned carbon capture and storage projects in relation to the economic and external viability factors and demand expectations for 'carbon free' cement.	To continue to engage with the company and other competitors in the cement industry on decarbonisation targets and trajectory. For the company the economics of carbon capture and storage will only become economical with either an increase in the carbon price, or if customers are willing to pay a premium for carbon free cement.

Local Authority Pension Fund Forum – July to September 2023

33. The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), which acts to promote the highest standards of corporate governance to

protect the long-term value of local authority pension fund assets. The latest report features an overview of engagement with global insurers on approaches to decarbonisation and natural resources, the 'Say on Climate' initiative, Mining and Human Rights and meetings with water companies.

34. LAPFF highlighted a number of engagements related to climate change and financial institutions, including writing to 13 global insurers on their approaches to decarbonisation and natural resources. LAPFF received responses from four companies so far, however flagged that US companies tend to be less willing to engage in a meaningful way than companies in many other markets, including the UK and Australia. LAPFF will continue to send letters and set up meetings over the course of the year.

Topic	Action	Outcome
Water Companies and Sewage Pollution	Chair of LAPFF met with the Chair of Severn Trent, and other water companies.	Severn Trent were ahead of targets on reducing overflows. Discussions over longer-term plans and targets and capital investment and how Severn Trent was addressing climate change, including through capturing emissions from the sewage treatment process. LAPFF continue to engage with companies on their progress and plans.

Other Developments

Taskforce for Nature Related Financial Disclosures

35. In September 2023 the Taskforce on Nature-related Financial Disclosures launched its final recommendations. This framework is intended to help companies disclose the risks, opportunities, dependencies and impacts of their activities on nature.
36. Like with climate risks, nature poses a financial and fiduciary risk if not managed well by underlying companies and investment managers, which can link into three risk areas similar to climate:
- Physical Risk
 - Systematic Risk
 - Transition Risk (including legal liability)
37. This area will also pose opportunities for investment like climate change, and the Fund already has investments which may provide favourable nature related benefits through its forestry portfolio.
38. Officers will continue work with LGPS Central's RI Team to ultimately provide data to the Fund through a Sustainability Report and look to integrate relevant questions with additions to the Fund's annual manager questionnaire.

Recommendation

39. It is recommended that the Local Pension Committee note the report.

Background papers

3 March 2023 [Local Pension Committee: Pension Fund Valuation - Consultation Results, Final Assumptions and Results](#)

3 March 2023 [Local Pension Committee: Outcome of Consultation on Net Zero Climate Strategy and Responsible Investing Update](#)

Equality Implications

40. There are no direct implications arising from the recommendations in this report. The Fund incorporates financially material Environmental, Social and Governance (“ESG”) factors into investment processes. This has relevance both before and after the investment decision and is a core part of the Fund’s fiduciary duty

Human Rights Implications

41. There are no direct implications arising from the recommendations in this report. The Fund incorporates financially material Environmental, Social and Governance (“ESG”) factors into investment processes. This has relevance both before and after the investment decision and is a core part of the Fund’s fiduciary duty

Appendices

Appendix A: RI Plan Update

Appendix B: Quarterly voting report

Officers to Contact

Declan Keegan, Director of Corporate Resources

Tel: 0116 305 7668

Email: Declan.Keegan@leics.gov.uk

Simone Hines, Assistant Director Finance, Strategic Property and Commissioning

Tel: 0116 305 7066

Email: Simone.Hines@leics.gov.uk

Bhulesh Kachra, Senior Finance Analyst - Investments

Tel: 0116 305 1449

Email: Bhulesh.Kachra@leics.gov.uk

Cat Tuohy, Responsible Investment Analyst

Tel: 0116 305 5483

Email: Cat.Tuohy@leics.gov.uk

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