Leicestershire County Council

LOCAL PENSION COMMITTEE – 6 SEPTEMBER 2024

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RESPONSIBLE INVESTMENT REPORT

Purpose of the Report

1. The purpose of this report is to present to the Local Pension Committee (LPC):

    a. The proposed metrics that will be presented as part of the Climate Risk Management Report for 2024; and

    b. An update on the Fund's quarterly voting and stewardship activities undertaken on its behalf via LGPS Central (Local Government Pension Scheme), LGIM (Legal and General Investment Managers) and the Local Authority Pension Fund Forum, as well as any current developments.

Policy Framework and Previous Decisions

2. Responsible investment (RI) factors have long been a consideration for the Leicestershire County Council Pension Fund, having satisfied itself that potential investment managers take account of 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, as well as the approach to climate related risk and opportunities within the Net Zero Climate Strategy, both approved by the LPC on 3 March 2023.

4. The Fund is supported by LGPS Central's RI 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. LGPS Central presented their revised Stewardship Strategy at the March 2024 Committee meeting.

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.

7. Since 2020 the Fund along with LGPS Central has produced Climate Risk reports which set out relevant climate metrics on measurable areas of the Fund's portfolio. In March 2023 the Committee agreed a Net Zero Climate Strategy which the Fund agreed to continue to report against.

RI Plan 2024

8. An update of progress against the Fund's RI Plan is set out in Appendix A attached to this report. All actions remain on track. Key updates are set out below.

Climate Risk Management Report 2024 Proposals

9. At the January 2024 Committee meeting it was agreed that the December 2023 Climate Risk Management Report be recirculated to enable Members to feedback on areas where they consider more information and data is needed to address concerns about the lack of clarity and transparency, specifically in relation to companies with fossil fuel reserves. Following feedback received officers will ensure improved narrative reporting, including outcomes in relation to engagements, and how the Fund can demonstrate any real-world emissions reductions.

10. Officers have held initial meetings with LGPS Central on how these considerations can be incorporated and have begun the data collection process. It must be noted that LGPS Central develop the report with a view of all partner funds requirements to streamline the processes.

11. Alongside previous developments, and narrative type input suggested by Members, LGPS Central will look to:

- Return areas related to engagement of Stewardship Plan Companies.
- Make the report more concise for ease of use.
- Expand metrics to further asset classes including sovereign holdings and private market holdings managed internally by LGPS Central.

12. The report will continue to report against the Fund's NZCS targets and additional forward and backward-looking metrics available alongside any narrative findings.

   a. Emissions: scope 1, 2 and 3. For sovereign assets this will include the production and consumption emissions of a country.

b. Carbon emissions metrics: financed emissions and weighted average carbon intensity.
c. Portfolio alignment and engagement metrics: companies climate management scores, implied temperature rise, science-based targets and Paris alignment, which can provide a forward look at the climate performance of the Fund.
d. Exposure metrics: Since 2019 the Fund has measured exposure to fossil fuel reserves, and climate solutions. These metrics have always been considered rudimentary due to the limitations of the metrics as neither consider the amount of revenue generated by fossil fuels or climate solutions.

   Instead, the metrics measure all companies which have any exposure regardless of how small. To overcome this the Fund and Central began measuring fossil fuel and climate solution metrics by revenue alongside the original metric. This newer metric instead identifies each portfolio company's maximum percentage of revenue derived from fossil fuels. However, this uses maximised estimates so may still overestimate the Fund's exposure. Further commentary on the pros and cons of these metrics and data available to the Fund will be presented in November.

13. Officers and LGPS Central will also undertake a review of Stewardship Plan companies and consider whether all remain appropriate key targets given current exposure within the Fund's portfolio and potential risks and opportunities.

Voting

14. 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 ESG investment factors.

15. 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.

16. This quarters report covers March to June which is a key period where many public companies' annual meetings occur.

17. Over the quarter there has been an increase in anti-ESG proposals. These mostly relate to social factors, though anti-environmental proposals have

doubled so far which mainly centre around financial risks associated with decarbonisation. Despite this increase support has declined each year since 2022, with support for the proposals remaining in the low single digits for anti-ESG proposals.

18. On the other hand, ESG proposals overall have seen better support, however this support has also declined. On climate-based proposals those that focused on scope 1 and 2 emissions received higher support than those including scope 3, or those from a company's supply chain.

19. This season sits within the context of a number of anti-ESG laws across the US which impact financial and pensions institutions. There is also an ongoing antitrust probe against groups such as Climate Action 100+ which may be impacting the approach of some investment managers based in the US. LGPS Central, LGIM and many other Fund Managers continue to be members of CA100+.

<u>LAPFF Voting Alerts and Stewardship Plan Companies</u>

20. LAPFF issued voting alerts covered 49 climate-related resolutions. Of the 42 resolutions voted upon at LAPFF's time of writing proposals received an average of 22% support, with over three quarters of proposals receiving more than 10% and well over half receiving 20% or more support. For alerts covering companies the Fund own shares of, Central and LGIM voted in line with LAPFF for more than 95% of these votes.

21. Below sets out key vote alignment from LGIM and LGPS Central in relation to Stewardship Plan Companies. A more detailed analysis of progress with Stewardship Plan Companies will be included in the Climate Risk Report in November.

Company	LAPFF Voting Alerts Issued	Commentary
CRH	No	No specific climate issues were on the AGM agenda. LGIM and Central aligned on all but one vote on the re-election of a Director.
BP	No	No specific climate issues were on the AGM agenda. As set out in the latest LAPFF report, BP has been regarded as at the better end of the sector in recognising climate change as an issue.
Holcim	No	Both LGIM and Central voted to approve Holcim's climate report (95%) with LGIM stating: "A *vote for the approval of Holcim's climate report is warranted. We are supportive of progress made this year and improvements made to the report, namely expanding the scope of the 2050 net zero target to include all categories of scope 3 emissions, and the upgrading of 2030 scope 1 and 2 targets"*
Shell	Yes	LAPFF issued 9 recommendations. Both Central and LGIM voted against Shell's Energy Transition which 22% of shareholders also opposed in line with LAPFF.

		In relation to the shareholder resolution asking that Shell include Scope 3 emissions within its medium-term emissions reduction target which LAPFF recommended a vote for, Central abstained and LGIM voted against. Both LGIM and Central provided reasoning for why they did not support the shareholder resolution. While both share the concerns on Shell's climate strategy the shareholder resolution did not address key concerns while also being legally binding. It was felt this could lead to unintended consequences of divestment of assets to less responsible operators, which would not be supportive of real-world emissions reductions.
Next Era	Yes	In line with a LAPFF recommendation both voted for shareholder resolutions that requested disclosures related to climate lobbying (32.5% support) and the Board's skills and diversity matrix (40.6% support) against managements recommendations.
Glencore	Yes	Alongside other recommendations LAPFF recommended investors vote against the 2024-2026 Climate Plan. LGIM voted against this Plan, and against re-election of some Directors and publicised it would sell Glencore in funds covered by their climate impact pledge as a result of the company not meeting LGIM's minimum standards with regard to climate risk management. LGIM further aligned with LAPFF on three other recommendations. LGPS Central voted against two directors due to concerns relating to climate change risk and abstained from voting on Glencore's Climate Action Plan. While Central were pleased to see the introduction of a new 2030 target covering all scopes absolute in nature, there remain significant concerns over adherence to any particular net zero scenario and the cap on coal production that was discontinued.
Taiwan Semi-Conductor	No	Central voted in-line with Taiwan Semiconductor on all recommendations. LGIM voted against recommendations in relation to renumeration, expecting it to be measured over a 3-year performance period as that is more aligned with long-term value creation.

22. Officers will continue to monitor key votes and alignment. As part of the preparation for the Climate Risk Report with LGPS Central the Fund will review these companies to understand if they should remain on the Climate Stewardship list, either given progress achieved or changes to the portfolio which mean other companies should be prioritised.

<u>Other Events</u>

23. Exxon Mobil brought a legal action against two activist investors that had filed a climate change-related shareholder resolution. A number of institutional investors raised significant concerns over this approach and the consequences this may have on shareholder rights more broadly. The case was ultimately dismissed by a US court.

24. At the AGM itself LAPFF issued one vote alert recommending investors vote for a shareholder resolution in support of clear and credible transition plans, which related to a request to the Board of Directors to report on the “social impact on workers and communities from closure or energy transition of the Company’s facilities and alternatives that can be developed to help mitigate the social impact of such closures or energy transitions”. This received 7.4% support from investors and was supported by both Central and LGIM, despite the company’s unprecedented legal action at the time.

25. Elsewhere on the AGM’s agenda Exxon also received an anti-ESG shareholder proposal which Exxon had also challenged as they considered it materially false, and. Exxon recommended that investors vote against this resolution which Central and LGIM aligned with alongside 98% of investors.

26. Elsewhere the most significant shareholder dissenting votes were at Quest Diagnostics (42% support), Markel Corporation (36% support) and Centene Corp (36% support). Woodside Energy saw a 58% opposition to its proposed climate plan, the strongest protest recorded against any listed company to date. These votes will serve as significant shareholder feedback that companies should take their concerns seriously.

27. Appendix B includes the Fund’s voting report covering the period March to June 2024. A brief breakdown is included below:

   i. The Fund made voting recommendations at 3623 company meetings (49,872) resolutions.
   ii. At 2616 of these company meetings, the Fund opposed one or more resolutions.
   iii. The Fund voted with management by exception at 68 meetings and supported management on all resolutions at the remaining 1002 meetings.
   iv. The majority of votes where the Fund voted against management, or abstained on resolutions (3126) were related to board structure (50%), audit and accounts (14%) and amend articles (9%) and renumeration (9%).

Engagement

28. Voting is just one of the tools available to the Fund to encourage better corporate behaviour on ESG factors, which often goes hand in hand with stewardship. The Fund’s approach to engagement takes a long-term perspective, a highlight of some of the latest actions and outcomes are set out below. The full reports are linked.

	Company	Theme	Action	Outcome/Next Steps
LAPFF	Canadian Banks	Climate	Reports indicated Canadian banks are increasing lending to oil and gas companies while other banks are stepping away. LAPFF met with the three largest Canadian Banks	Continue engagement with banks in the autumn to develop investor expectations from the Forum's point of view.
LGIM	Nippon Steel	Climate	Engagement with the largest steel making in Japan and one of the largest globally. Co-filed a shareholder proposal for better disclosure.	Achieved 27.98% support sending a strong message to the company's board that investors expect better transparency. This was one of the highest levels for support recorded for a climate-related shareholder resolution in Japan. LGIM will continue to engage and expect the company to address investor expectations and enhance accountability and transparency.
Ruffer	Newmont	Sustainability and Health and Safety	Newmont acquired a position in a gold and copper mining company. Given they consider Newmont a good performer on sustainability in terms of reporting and consideration of ESG factors, they asked for guidance on when the acquired assets would be integrated to reporting.	Newmont would work over the next 12 months to expand reporting and include acquired assets. Ruffer belief this to be an ongoing engagement and will continue to meet with their sustainability team.

LGPS Central	Telecommunications Company	United Nations guiding principles (UNGPs) on Business and Human Rights	Central have engaged since 2023 on the adoption of the UNGPs. Unlike its competitors it does not undertake human rights due diligence and its approach to human rights is not integrated into the terms of reference of any of its governance committees. Central met with the company to discuss its concerns.	Central were unable to secure a follow-up meeting. Central escalated concerns by voting against the Chair at the AGM due to inadequate engagement process and wrote to the company informing them of the rationale. Central will work with the external manager holding the stock to escalate concerns further.

Current Developments

Stewardship Code

29. As set out within the Fund's Responsible Investment Plan there has been consideration of applying to the Stewardship Code, given resource and extensive reporting required. The review offers a chance for the Fund to reconsider recognising the importance of promoting transparency and accountability of the Fund's stewardship activities and decisions. New changes will come into force on the 31 October 2024 which looks to streamline reporting and set clear expectations on what is considered an outcome for stewardship purposes.

30. The Financial Reporting Council will further review five themes looking at its purpose, principles, proxy advisors, process and positioning. If the Fund were to decide to apply to the Code this provides a clear template for the Fund to report on its best practice in stewardship activities both with companies and its investment managers.

LAPPF Recommendations for UK Climate Policy

31. LAPFF issued recommendations for UK Climate Policy recognising significant climate milestones have already been achieved, with coal use largely eliminated and renewable energy accounting for a third of electricity productions. However, it recognised the next stage of the energy transition will be more challenging.

32. The report makes the case for focusing on short-term actions and ensuring a just transition that creates new employment opportunities. It outlines specific actions by sector, including expansion of onshore wind and storage,

accelerating action on domestic heating (including through addressing skills shortages), and ensuring expansion of the EV rollout through a focus on affordability.

Recommendations

33. It is recommended that the Committee note the report.

Background Papers

None.

Equality Implications

The NZCS is a high-level strategic document and there are no direct Equality implications. The Fund takes into account issues around Equality as part of its whole approach to responsible investment and environmental, social and governance factors in all investment decisions. The Fund will not appoint any manager unless they can show evidence that responsible investment considerations are an integral part of their decision-making processes. This is further supported by the Fund's approach to stewardship and voting through voting, and its approach to engagement in support of a fair and just transition to net zero.

Human Rights

There are no human rights implications arising from this report.

Environmental Implications

The Net Zero Climate Strategy outlines the high-level approach the Fund is taking to its view on Climate Risk. This will align with the Fund's Responsible Investment approach as set out in the Principles for Responsible Investment. As set out above the Fund is committed to supporting a fair and just transition to net-zero.

Appendices

Appendix A: Responsible Investment Plan Update
Appendix B: Vote Report March to June 2024

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

Cat Tuohy, Responsible Investment Analyst
Tel: 0116 305 5483 Email: Cat.Tuohy@leics.gov.uk