Leicestershire County Council

**LOCAL PENSION COMMITTEE – 27 JUNE 2025**

**REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

**RESPONSIBLE INVESTMENT UPDATE**

**Purpose of the Report**

1. The purpose of this report is to provide the Committee with updates on:
   a. Progress versus the responsible investment plan 2025 (Appendix A).
   b. The Fund's quarterly voting report (Appendix B) and stewardship activities.
   c. Considerations and the timeline for the Net Zero Climate Strategy review, and to agree next steps.

**Policy Framework and Previous Decisions**

2. Leicestershire County Council Pension Fund's (the Fund) Investment Strategy Statement (ISS) sets out that all prospective investment managers are required to take account of all financial, environmental, social and governance (ESG) factors as part of their decision-making processes before they can be considered for appointment. This is in-line with the Fund's fiduciary duty.

3. The Committee agreed the Fund's first Net Zero Climate Strategy (NZCS) on 3 March 2023, following extensive engagement with the Committee, scheme members, employers, and investment managers.

4. Climate change is one of many risks the Fund manages within the risk register. The NZCS recognises the systematic impact climate change could have on the Fund and sets out how the Fund would monitor and manage these risks and opportunities posed. Alongside other financially material factors, these considerations have fed into all decisions made since approval of the NZCS.

5. The Local Pension Committee approved the annual Responsible Investment (RI) Plan in January 2025. The Plan was developed following discussion with LGPS Central's (Central) in-house RI team. The Fund has a continual

focus on raising RI standards. Progress made to date on the 2025 RI Plan is set out in Appendix A.

**Background**

6. For the Fund, the term ‘responsible investment’ refers to the integration of financially material 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. The approach taken by the Fund, as set out in the ISS, is distinct from ‘ethical investment,’ which may look to exclude companies engaged in activities deemed ‘unethical’ by the investor, whereby the moral persuasions of an organisation or individual take primacy over financial factors.

7. Climate change is considered a systematic risk, given it is possible it will affect all investment asset classes, sectors and regions. For example, higher average and absolute global temperatures together with extreme weather events pose risks to physical assets, while the impact to markets from a transition towards a more decarbonised economy will have its own risks and opportunities with changes in consumer behaviour, and considerations around resilience and resource efficiency. The Fund considers this a key material risk within its risk register given the challenges across the short, medium, and long-term.

8. As set out in the NZCS, the Fund is targeting net zero by 2050, with an ambition for sooner. This ambition is one that considers the risks, and potential opportunities, such as investing in emerging technologies. It is also expected that government will align private pension scheme requirements to LGPS funds, which will require Fund’s to consider and disclose their climate-related financial risks and opportunities fully in line with recommendations by the Task Force on Climate-related Financial Disclosures.

9. Failure to consider these aspects, or exercise effective stewardship of the Fund’s assets risks inferior investment performance which would negatively impact contributing employers.

**Responsible Investment (RI) Plan 2025 Progress**

10. As set out above, progress made to date on the 2025 RI Plan is appended. This includes beginning work on the refresh of the NZCS. The current NZCS states it would be reviewed every three years and so is due in 2026. Further detail is set out below.

Net Zero Climate Strategy

11. In 2021, prudently in recognition of the potential risks posed by climate change to the Fund, the Committee began work on developing the Fund's first NZCS that looked to proactively manage climate risk, using a combination of nine targets and measures, as well as the approach to stewardship. This was based on metrics that were in line with the Net Zero Investment Framework developed by the Institutional Investors Group on Climate Change, a group with over 375 investor members with more than £45trillion in assets.

12. In 2022 climate scenario analysis was undertaken on behalf of the Fund by LGPS Central and Mercer LLC. While the limitations of the modelling as an emerging area is well documented, it set out that the Fund would perform best with a successful global transition in line with the Paris Agreement (a legally binding international treaty on climate change with an overarching goal to hold “the increase in global average temperature to well below 2°C above pre-industrial levels” and pursue efforts “to limit the temperature increase to 1.5°C above pre-industrial levels”).

13. The Committee agreed to undertake engagement on potential net zero targets from July to September 2022 and consulted on the draft Strategy from November 2022 to February 2023 which resulted in 1,700 responses from scheme members, employers and other stakeholders, a response rate which compared well against other council and LGPS fund consultations.

14. The outcome of the consultation saw the majority of respondents supporting proposed targets and ultimately the draft NZCS which was formally approved in March 2023.

15. The NZCS recognised existing limitations with regards to data availability and considerations across asset classes. However, it was recognised this should not be a block to managing risk and opportunities wherever possible. It was agreed that the Fund would review the Strategy at least every three years. This reflects the fact that good practice, methodologies, and data are evolving quickly and so may require flexibility to adapt.

Fund progress since NZCS approval

16. As reported to Committee in November 2024 the Fund has met its primary interim targets which have supported management of the climate risk within the Fund’s risk register, while also supporting investment returns, as shown below.

17. An example of portfolio performance of climate tilted funds and the standard type of index funds within the Fund's equity portfolio can be seen below as at 31 March 2025. It is worth noting that the Fund is a long-term investor and does not measure performance over short time frames. More detail on Fund performance is available in exempt papers elsewhere on the agenda.

| Fund name | Performance (%) | | | Commentary |
|---|---|---|---|---|
| | 1 Year | 3 years | Since inception | |
| LGPS Central All World Equity Climate Multi Factor | 3.9 | 7.5 | 9.6 (December 2020) | This fund tilts towards companies with green revenues. This is performing ahead of benchmark. |
| LGIM All World (No tilt) | 4.9 | n/a | 14.1 (November 2023) | This is a standard passive equity fund we expect to match the benchmark. This is performing in line with the benchmark. This is less than 18 months of investment. |
| LGIM Low Carbon Equity Fund | 5.4 | n/a | 14.3 (November 2023) | This fund tilts to increase exposure to 'greener' companies. This is performing in line with the benchmark. This is less than 18 months of investment. |
| LGIM UK Equity (No tilt) | 10.4 | 7.1 | 6.2 (December 2013) | This is a standard passive UK equity fund. |

18. Detail on the Fund's achievements since setting the NZCS are set out below.

- The Fund has achieved its first interim target of reducing the weighted average carbon intensity (WACI) by 50% by 2030. This is a measure of the Fund's underlying companies' total emissions per $1million of sales. The Fund's listed equity portfolio is now 52.8% less carbon intensive as at 31 March 2024. This means the companies the Fund is invested in are less exposed to carbon taxes and emissions trading programs for in-scope investments.

- The Fund has also achieved its second interim target of having reduced its total financed emissions (greenhouse gas emissions attributed to the Fund through its investments) by 40%, with an actual reduction of the total carbon emissions the Fund is responsible for by 40.4% as at 31 March 2024 from a baseline set in 2019, by 2030 across the listed equity portfolio. This is despite a corresponding increase in underlying assets under management. As above this means the Fund is less exposed to the potential monetary toll on underlying investments which can impact a company's share price.

- The Fund now has over £1.3billion (circa 20% of the total Fund) directly allocated to funds that are tilted away from carbon intensive companies and towards 'green' investments. These investments are across equity, debt, infrastructure, and forestry. These assets while part of an already diversified Fund are diverse in themselves, from managers choosing to invest in more carbon efficient investments (all else being equal), to forestry assets which act as a low-volatility investment while also contributing to carbon sequestration, to investments in critical grid stability mechanisms like synchronous condensers alongside renewable energy.

- 57.5% of the Fund's £6.3billion in assets are now covered by LGPS Central's Climate Risk Management Report. This is up from 47% in 2023 ahead of the scheduled timeline within the NZCS. The Fund will continue to work with LGPS Central to continue developing reporting mechanisms to give the Fund the best sight of potential risks.

19. The Fund meeting both interim targets requires careful consideration. From the start it was recognised that decarbonisation would not be linear. Furthermore, at this point it is clear the majority of the Fund's decarbonisation resulted from investment in tilted funds, rather than being only related to real-world decarbonisation of underlying companies.

20. Other progress has been made in the meantime in support of the NZCS, which will feed into considerations for the next NZCS.

  a. Following a motion to Committee in 2023, Hymans undertook an in-depth review of the fossil fuel divestment debate and considerations for the Fund. This was reported to Committee in January 2024 and set out that the Fund's approach to engagement, over a blanket exclusion or divestment policy remained appropriate, with recommendations that would strengthen the Fund's oversight of managers and engagement with companies.

  b. LGPS Central reviewed its Stewardship Strategy and presented to Committee in March 2024. Committee members requested more detail on an outcomes-based approach which will feed into future quarterly stewardship reports. Developments can be viewed within LGPS Central's 2024 Stewardship Report which provides more on their work to identify and respond to market-wide and systematic risks to promote a well-functioning financial system considered later in this report. Officers will continue to engage with Central on reporting their outcomes-based approach.

c. In November 2024 it was agreed by the Committee to change the measures for climate solutions and fossil fuel exposure to report these 'by revenue' rather than reporting any company with at least £1 in either metric, this allows for a fairer consideration of the Fund's potential risk exposure.

21. The original NZCS followed the Net Zero Investment Framework developed by the Institutional Investors Group for Climate Change. The Framework's purpose is to set a blueprint for guiding, supporting, and enabling investors to make significant progress this decade, and beyond by providing both the ambition and hugely practical guidance contained in the Framework. Alongside extensive consultation with scheme members, employers, and other stakeholders. Since the NZCS's approval the NZIF has issued an updated Framework extending to other asset classes. There are also other frameworks such as the Private Markets Decarbonisation Roadmap which have developed since.

22. As part of the 'Fit for the Future' consultation outcome Government has set out that pools are not expected to create bespoke arrangements for each Fund's ESG and RI requirements. Government expects each pool will facilitate discussions among their partner Administering Authorities to establish a common approach, though it is recognised this may not always be possible. In these cases, pools may need to consider alternative options such as offering more than one ESG standard. The appropriate solution may depend on the number of administering authorities within a pool and the degree of divergence between ESG and RI stances. The government does not intend to proscribe a single solution but does not expect to see bespoke arrangements for each Administering Authority.

23. The Fund will need to continue to engage with LGPS Central and partner funds on its own RI approach within the ISS and NZCS.

24. Hymans presented the Fund's Strategic Asset Allocation review in January 2025. As part of the review, it noted the Fund's good progress towards managing climate risk though they recommended officers wait for the outcome of, at the time ongoing consultation. The Fund will continue to work with LGPS Central and partner funds on the implications of the outcome.

Global Developments

25. According to research by the Global Carbon Project, there is still no sign that the world has reached peak emissions, and for the first time the world breached 1.5C for the calendar year. Current policies in place around the world are projected to result in about 2.7°C warming above pre-industrial levels.

26. The impact of increasingly extreme weather has also shown some areas are finding it increasingly difficult to obtain insurance because of rising wildfire and flood risks.

27. Energy demand continues to increase, partly driven by hotter weather and increased use of air conditioning and demand from digitalisation, data centres and artificial intelligence, this increasing demand was largely met through renewable energy and nuclear power that now provide 40.9% of the world's electricity generation. Passing the 40% mark for the first time since the 1940s.

28. Over the last year UK and European based banks and asset managers have largely been strengthening their approach to managing climate risks. However, political pressure has resulted in some US based banks, asset managers and the Federal Reserve exiting climate focused collaboration groups. A roll back of the US Securities and Exchange Commission's climate disclosure rule will mean reduced disclosure pressure on US-based companies, which may ultimately feed into how much detailed reporting the Fund can expect on underlying US assets.

Proposals for Review

29. This report seeks Committee's views on the following key strands and timeline for the review.

A. Managing climate risk and opportunities: It will be important to consider the results of the Fund's triennial valuation where it is a requirement for actuaries to assess and report on climate risk per the Government's Actuary Department as part of their report under Section 13 of the Public Service pensions Act 2013 (GAD Section 13 report).

B. Evolution not revolution: Recognising the Fund is a long-term investor in comparison to the market and government cycles. To consider whether anything has significantly changed since March 2023 to require substantial changes to the Fund's approach or interim targets. As well as the latest available data as at 31 March 2025 which will be presented to Committee in November 2025.

C. Stewardship for real-world impact: LGPS Central enhanced their stewardship strategy as was presented to Committee in March 2024. How have outcomes progressed and does this continue to meet the Fund's approach. As well as activities and alignment of external managers, LGPS Central and the Local Authority Pension Fund Forum. Managers are in the process of returning questionnaires on these matters.

D. Remaining Asset Classes: The Fund's targets currently focus on the Fund's equity portfolio. Whether possible targets and measures should be expanded to further asset classes, while noting limitations existing in certain asset classes, the levers the Fund can continue to hold and Fit for the Future considerations for alignment with LGPS Central and other partner funds.

30. A proposed timeline is set out below for approval and consultation, while noting these may need to be flexible depending on work also taking place around Fit for the Future.

| **Date** | **Comment** |
|---|---|
| July/August 2025 | As part of the Triennial Valuation Hymans will begin work on climate scenario analysis for the Fund which will set out plausible scenarios and the potential impact that has on the Fund's current assets as required by the GAD Section 13 report. |
| 26 September 2025 | Proposals for Committee to agree regarding engagement with scheme members and employers of the Fund on key themes for the strategy. |
| 5 December 2025 | Committee to review Climate Risk Report for data as at 31 March 2025. |
| February 2026 | Local Pension Board oversight of Climate Risk Report and Strategy considerations. |
| March/ June 2026 | Engagement outcome and redrafted strategy. |

## Voting and Engagement

31. Appendix B sets out the Fund's voting report from January to March 2025. This incorporates circa 41% of the Fund's assets (LGIM's Global, UK and Low Carbon Transition fund, LGPS Central's Climate Multi Factor fund and the Global Equity Active fund).

32. A brief breakdown is set out below:

- The Fund made voting recommendations at 917 meetings (9339) resolutions)
- At 557 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 355 meetings.
- The majority of votes where the Fund voted against management were related to board structure (47%). These votes include issues such as over boarding, diversity, and inadequate management of climate risk.

33. Some further highlights from engagement activity from partners and investment managers are set out below.

LGPS Central – January – March 2025, and 2024 Annual Report

34. Central is the pooling company of the Fund. It is a strong supporter of responsible investment through the Responsible Investment and Engagement Framework. Over the last quarter they have published their quarterly report and 2024 Annual Stewardship Report which sets out progress across the year covering:

- Global Leadership: Actively participated in over 20 international initiatives.
- Direct Regulator Engagement: Engaged in policy dialogues with regulatory bodies in Brazil and Australia.
- Governance Oversight: Conducted a full audit of EOS's (Central's stewardship provider) engagement data, confirming alignment with Central's responsible investment and stewardship expectations.
- Strategic Focus: Refreshed their stewardship strategy around four core themes: Climate Change, Natural Capital, Human Rights, and Sensitive/Topical Activities.
- Impact Delivery: Achieved 100% engagement with priority companies, with 73% evidencing tangible progress.

35. As an example:

| Company | Theme | Outcome |
|---|---|---|
| Volution Group (Designs and manufactures indoor air quality solutions) | Modern Slavery | LGPS Central are the lead investors engaging with Volution through the Find it Fix it, Prevent it collaborative engagement initiative that aims to engage with the construction sector on addressing Modern Slavery Risk.<br><br>After engaging with them to discuss their approach Central requested that the Company publicly disclose their supply chain map and to identify their most salient modern slavery risks.<br><br>Volution have confirmed that they will address Central's request, following which Central plan to meet with the company to discuss. |

Legal and General Investment Management – Q1 2025

36. Legal and General Investment Management (LGIM) manage the majority of the Fund's passive equity which accounts for 16.8% of the Fund. LGIM's latest ESG impact report highlights some key activity in the Investment Stewardship team.

37. The latest ESG impact report highlights key engagements across LGIM's global stewardship themes, with a focus on:

   a. Holding boards to account - To be successful, companies need to have people at the helm who are well-equipped to create resilient long-term growth. By voting and engaging directly with companies, we encourage management to control risks while seeking to benefit from emerging opportunities.
   b. Creating sustainable value - LGIM see responsible investing as the incorporation of financially material ESG considerations into investment decisions, alongside engagement with companies, regulators, and policymakers, to help drive long-term value creation and support real-world outcomes for our clients.
   c. Promoting market resilience - The decisions that companies make today will impact our collective future in the decades to come, and over our clients' long-term investment horizons. Through LGIM, their clients have exposure to a slice of the global market, and therefore to systemic risks and opportunities that can be financially material to our clients' investments. LGIM's 'universal ownership' approach to investment stewardship means that we believe in using corporate

engagement and policy dialogue to drive long-term value creation and shape the future by encouraging more sustainable, long-term practices from companies.

38. An example of their activities are as follows:

| Theme | Action | Outcome |
|---|---|---|
| Corporate Governance<br><br>Timing of annual disclosures in Japan which are largely published the day of, or a few days after the AGM. | LGIMs engagement has ranged from direct and collective efforts over the years. More recently this included meetings with the Japan Financial Services Agency, Tokyo Stock Exchange and Ministry of Economy Trade and Industry. | On 28 March, the Japan Financial Services Agency requested all 4000 listed companies in Japan publish their annual securities report "a day before or a few days before the AGM". This contains the fully audited financial statements and other important governance and sustainability related information which investors need to make informed voting decisions.<br><br>LGIM will continue to engage noting real governance and investor dialogue improvements will only be possible if these reports are published three to four weeks before the AGM, in line with global best practice. |

Local Authority Pension Fund Forum: January – March 2025

39. 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. Highlights from the latest quarterly report include engagements with energy suppliers, housebuilders, and water stewardship.

40. As an example:

| Topic | Action | Outcome |
|---|---|---|
| London Stock Exchange Group (LSEG) Standards | LAPFF has been concerned with the weakening of standards relating to new entrants to the London listed | LAPFF have convened a 'Capital Markets Working Group' to help address shareholder interests, including issues of investor protection. |

| | | |
|---|---|---|
| | companies' market, which has included Aston Martin Lagonda, NMC Health, Finablr and Quindell, the former of which has lost >90% of its value since listing, the other three being 100% losses. | LAPFF have met with the Senior Executive Director of the LSEG and are looking to meet with the Capital Markets Industry Taskforce chair and members. It is recognised that there is a shared understanding regarding the fundamental challenge facing the London Stock Exchange. |

Ruffer – Q1 2025

41. Forming a small proportion of the Fund's portfolio, Ruffer invest in a handful of equities on behalf of the Fund within the targeted return portfolio. Their approach to engagement includes looking at developing an understanding of whether specific issues were industry-wide issues or specific to a company, and continuing work to support the market infrastructure needed to help managers make more informed investment decisions.

42. One of their tools is their resource usage and productivity indicator (RUPI) a quantitative model which assesses companies on nine variables they believe are integral to fostering value creation that should deliver shareholder returns over the long term. This allows Ruffer to identify gaps in disclosure and then engage with the laggard companies. For example, this quarter they engaged with the following company, noting they have low absolute RUPI scores, lag their global peers, and have low scopes for the disclosure of extra financial data they track.

| **Topic** | **Action** | **Outcome** |
|---|---|---|
| Toll Brothers | Human capital disclosure, to go alongside qualitative disclosure. | Ruffer shared interest in seeing quantitative data – for example, employee turnover and return on investment from training spend which might help Ruffer assess Toll Brothers' ability to attract and engaged skilled workers to drive competitive advantage. Ruffer expect to see a range of metrics from the company later this year when the sustainability Report update is complete, Ruffer will update their RUPI scores and re-run their benchmarking analysis to track progress. |

## Fiduciary duty

43. The Local Pension Committee has a fiduciary duty to act in the best interests of employers and 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. Investment powers must be directed to achieving what is the best for the financial position of the Fund, to ensure the Fund is able to pay benefits.

44. With regard to ESG considerations, the guidance states that the Funds should consider any factor financially material to the performance of their investments, including ESG factors. Although pursuit of a financial return should be the predominant concern, Funds may take purely non-financial (i.e. ethical) considerations into account provided that doing so would not involve significant risk of financial detriment to the Fund and where they have good reason to think that scheme members would support their decision. To gauge scheme members support, or otherwise, Funds should explain the extent to which the views of the local pension committee and other interested parties (i.e. Fund employers and members) are taken into account when making an investment decision based on nonfinancial factors and explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments.

45. 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.

46. Therefore, based on the present law and guidance 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.

## Resource Implications

47. The strategy review is planned and scoped based on existing Pension Fund resource as set out in the Pension Fund Budget and Business plan approved in March 2025.

**Recommendations**

48. It is recommended that the Committee provide any comments on the contents of the report and agree the next steps set out within the paper.

**Background papers**

Net Zero Climate Strategy

https://leicsmss.pensiondetails.co.uk/documents/LCC-Pension-Fund-Net-Zero-Climate-Strategy.pdf?language_id=1

Overview of the Current Asset Strategy and Proposed 2025 Asset Strategy Local Pension Committee Friday 31 January 2025

https://democracy.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=7986&Ver=4

Responsible Investment Plan 2025 Local Pension Committee Friday 31 January 2025

https://democracy.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=7986&Ver=4

Overview of the Current Asset strategy and Proposed 2024 Asset Strategy – Local Pension Committee 26 January 2024

https://democracy.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=7538&Ver=4

**Equality Implications**

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**

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.

**Appendix**

Appendix A: RI Plan Update

Appendix B: The Fund's Quarterly Voting Report

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