HYMANS ROBERTSON

Leicestershire County Council Pension Fund

Review of the Fund’s Engagement and Divestment Policy

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For and on behalf of Hymans Robertson LLP

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1. Introduction

Addressee and purpose

This paper is addressed to the Local Pension Committee of Leicestershire County Council Pension Fund ("the Fund"). The purpose of this paper is to review the Fund's approach to engagement and divestment and sets out similarities and differences to the approach adopted by LGPS Central.

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Background and scope

The Fund has a long-standing commitment to responsible investment and recognises that stewardship — including active engagement, escalation and, where necessary, divestment — is central to managing financially material Environmental, Social and Governance (ESG) risks. Engagement and divestment both form part of the Fund's risk-management toolkit, but they serve different purposes.

Given the pooling requirements and the fact that stewardship is increasingly being delivered through LGPS Central, the Fund's expectations need to be clearly expressed and aligned with the pooling model.

This paper therefore considers:

- The Fund's current approach to engagement, escalation and divestment;
- The degree of alignment with LGPS Central's framework;
- The fiduciary and practical implications of exclusions or divestment, particularly within pooled vehicles;
- Areas where the Fund could further clarify expectations or strengthen alignment with the Pool.

Summary and recommendations

The review finds that the Fund already operates a clear engagement-first model, with escalation and, where needed, divestment used as complementary tools rather than mutually exclusive options. It is closely aligned with LGPS Central's philosophy and stewardship framework.

Differences between the two approaches relate mainly to timing and degree of escalation undertaken after unsuccessful engagement. In addition, there are slight differences relating to how the Fund could consider managing risk through divestment, and the breadth of stewardship themes beyond climate.

In our view, the Fund's immediate focus should be on:

- sharpening expectations around escalation and defining what constitutes "insufficient progress" against engagement objectives;
- improving visibility of how stewardship priorities are set; and
- confirming broader thematic expectations so LGPS Central's priorities reflect the Fund's own.

Together, these steps provide a practical way to strengthen alignment with LGPS Central, support more consistent stewardship outcomes, and ensure the Fund's approach remains grounded in fiduciary duty while keeping open the option of future policy development.

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For and on behalf of Hymans Robertson LLP,

December 2025

2. Current position

The Fund does not currently operate a standalone *Engagement and Divestment Policy*. Instead, the key principles are embedded across three core documents:

- the Investment Strategy Statement (ISS), which sets out the Fund's fiduciary framework and responsible investment beliefs;

- the Net Zero Climate Strategy (NZCS), which provides a detailed approach to climate stewardship and escalation; and

- the annual Responsible Investment (RI) Plan, monitored at each Committee meeting.

Together, these form the framework the Fund uses in practice to determine how it engages, when concerns should be escalated, and in what circumstances divestment or exclusion may be considered.

What guides the Fund's approach

The Fund's approach is based on its long-standing investment beliefs, which recognise that ESG and climate-related risks can affect long-term returns. These beliefs underpin the Fund's commitment to responsible investment and its support for the UN Principles for Responsible Investment (PRI).

The Fund has identified that ESG issues can affect the long-term sustainability of businesses. Therefore, thorough due diligence and targeted engagement is required to ensure that there is sufficient confidence that these risks are being managed, mitigated and monitored. Engagement topics should be focussed on issues that are financially material to long-term investment outcomes, and the Fund acknowledges that these topics and themes might vary by geography and sector and therefore engagement must be tailored as necessary.

The Fund believes that acting collaboratively with other investors will prove beneficial as this will amplify the Fund's voice and promote positive real-world change. Effective engagement is not about engaging with all companies on all topics at the same time but instead identifying relevant companies to engage with on specific topics to achieve stated ambitions in a clear, targeted and pragmatic manner. To maximise the impact of engagement it should also consider the size of exposures, assessment of risk and ability to influence real world change.

Climate risk is a central component of this framework. Through the NZCS, the Fund has committed to achieving net zero emissions by 2050 or sooner, supported by interim targets for reducing the carbon intensity and absolute emissions of the listed equity portfolio. The Fund has also set targets to expand climate-risk coverage across other asset classes over time. Managers are expected to assess, monitor and manage transition risks, engage with companies that are material to sectoral decarbonisation pathways, and improve the quality and coverage of climate-related data.

The Fund also endorses LGPS Central's responsible investment and stewardship beliefs, including the principle that engagement is generally more compatible with fiduciary duty than broad exclusion. Divestment is recognised as sometimes necessary but can reduce the investor's leverage and remove the ability to influence company behaviour through ongoing stewardship. This belief now sits in the background of how the Fund frames escalation and divestment decisions.

How stewardship is delivered

While the Fund sets the strategic direction, most day-to-day stewardship is delivered through LGPS Central, reflecting the degree of pooling across asset classes. Central's Responsible Investment & Engagement (RI&E) Framework provides the structure for:

- thematic and company-specific engagement programmes;
- voting guided by Central's Voting Principles, with voting outcomes linked to engagement where relevant;
- collaborative initiatives through the Local Authority Pension Fund Forum (LAPFF), EOS at Federated Hermes and other investor groups;
- regular reporting that enables the Fund to assess whether engagement is producing meaningful progress.

For climate specifically, the Fund also maintains a Climate Stewardship Plan which focuses engagement on a list of high-emitting, high-risk companies that are particularly significant to the Fund's portfolio. The Fund and LGPS Central continue to refine the classification and assessment of these companies, drawing on recognised frameworks and initiatives — including Climate Action 100+, the Transition Pathway Initiative, and other emerging best-practice approaches.

The annual RI Plan, approved by the Committee, then sets the wider stewardship and RI priorities for the year – for example, climate and net-zero engagement, governance topics, and expectations for manager reporting. Progress against the RI Plan and the Climate Stewardship Plan is reviewed routinely by the Local Pension Committee as part of quarterly RI and stewardship updates.

For non-pooled mandates, the Fund expects managers to integrate ESG and climate risks into their investment processes, to engage directly with companies on material issues, and to report on stewardship and voting in a way that allows officers and advisers to challenge them where needed.

Approach to exclusions

The Fund applies exclusions only in limited circumstances. In line with Government guidance and the ISS:

"The Fund does not exclude investments to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government."

Any exclusions that do arise therefore stem from legal or regulatory requirements, or from targeted escalation decisions (see below), rather than broad values-based screening.

Engagement, escalation and divestment in practice

The NZCS sets out a four-step approach which reflects how the Fund thinks about engagement and divestment in practice:

1. **Evaluation of concerns**
   The first step is to identify companies, sectors, managers or asset classes where climate or wider ESG risks appear material or insufficiently managed. This assessment draws on climate metrics, sector transition pathways, stewardship reports and challenge of investment managers. The purpose of this stage is to determine whether further engagement is required and where engagement should be targeted.

2. **Engagement**
   Where concerns are identified, the Fund's default response is engagement. This includes direct, thematic and collaborative engagement delivered mainly through LGPS Central, LAPFF and external managers. Engagement resources are focussed on the areas that are most relevant for the Fund. Goal-oriented engagement is targeted to ensure the desired outcomes are achieved and progress easily measured.

3. **Voting (escalation)**
   Voting is used to amplify the efforts of engagement and escalate action where engagement has not produced sufficient progress. This approach allows the Fund to hold directors accountable or signal concern about a company's management of material ESG issues. The Fund delegates responsibility for voting to LGPS Central and the Fund's directly appointed investment managers. For pooled mandates, LGPS Central exercises voting rights in line with its Voting Principles. For non-pooled mandates, the Fund expects managers to vote in line with industry best practices as set out in the accepted governance codes.

   Where relevant, the Fund will support escalation efforts with other investors through shareholder resolutions. This approach provides a formal platform to drive positive real-world change where private engagement has proven unsuccessful. Participating in shareholder resolutions enables the Fund to clearly articulate their expectations on specific topics to management. Utilising this option will require companies to publicly respond to specific questions and therefore increases accountability.

4. **Divestment**
   Divestment is considered only where financial risks remain unacceptable and engagement and voting have not been effective, or where risks cannot realistically be mitigated through stewardship. At the Fund level, this can involve reducing or removing allocations to particular managers, strategies or asset classes. At the stock level the Fund expects managers to sell or reduce positions where climate-related or wider ESG risks remain seriously misaligned with the Fund's objectives, taking account of factors such as the company's starting point, its sector, and the credibility of its transition plans.

Taken together, this framework reflects a clear engagement-and-escalation model: engagement is the starting point, voting and other measures provide escalation, and divestment (along with limited exclusions) sits within the same stewardship pathway rather than as a separate or mutually exclusive approach. This is the baseline position against which alignment with LGPS Central, can now be assessed.

3. Alignment with LGPS Central

As the Fund moves further into pooled arrangements, and with statutory pooling requirements due by 31 March 2026, LGPS Central ("the Pool") will take on an increasingly central role in delivering stewardship on the Fund's behalf. It is therefore important to understand how the Fund's current stance on engagement and divestment aligns with LGPS Central's wider stewardship approach – including, but not limited to, the Pool's Responsible Investment and Engagement (RI&E) Framework, Voting Principles and Net Zero Strategy for Financed Emissions.

This section sets out the areas of alignment and highlights where further clarification or dialogue with the Pool may be helpful.

Comparative alignment between the Fund and LGPS Central

Table 1: LCCPF vs LGPS Central

Topic	LCCPF position	LGPSC position	Assessment
Fiduciary basis for RI	RI used to enhance long-term risk-adjusted returns; engagement preferred over exclusion; climate risk treated as financially material.	RI&E Framework identified RI as supportive to achieving risk adjusted return objectives over the long term; focus on integrating ESG across asset classes with clear governance roles for Board, IC and RI&E team.	**Aligned** – same framing of RI as financially driven.
Primary stewardship tools	Four-step model in NZCS: identify concerns, engage, escalate (including voting), then divest where risks remain unacceptable. Engagement and divestment seen as complementary, not mutually exclusive.	RI&E describes a spectrum of tools: engagement (direct, collaborative, via EOS/LAPFF), voting sanctions, shareholder proposals, escalation with external managers and, where necessary, discussion of divestment at stock or mandate level.	**Aligned** – engagement first and view divestment as part of escalation, not a separate philosophy.
Engagement priorities	No specific stewardship priorities are set. However, for climate, the Fund's NZCS naturally focuses engagement on high emitters, key sectors in the transition, and companies that are most significant to the Fund's financed-emissions profile.	LGPSC has four stewardship themes (Climate Change, Natural Capital, Human Rights, Sensitive / Topical Issues) with an Engagement Priority List and Voting Watch List of companies. LGPSC has identified specific approaches to climate change, biodiversity and deforestation and human rights	**Broadly aligned** but LGPSC places greater emphasis on several thematic priorities, which the Fund can choose to lean into.

Use of exclusions	ISS states the Fund does not exclude investments to pursue boycotts, divestment and sanctions (BDS) against foreign nations or UK defence industries, except where required by formal sanctions or similar measures. The Fund's NZCS cautions against wide-ranging exclusions and emphasises reducing fossil fuel exposure mainly through manager selection and tilts, not blanket bans.	RI&E Framework generally favours integration over broad exclusions, though some mandates include standard screens (e.g. controversial weapons, tobacco) from the managers. The overall philosophy is that a wider investible universe plus stewardship is more compatible with fiduciary duty and achieving financial and responsible investment objectives.	**Aligned**, both avoid broad exclusions and focus on financially driven integration and stewardship.
Escalation and divestment	The Fund expects managers to escalate stewardship over time and that divestment should follow where engagement is unsuccessful, with reference to company starting point, sector pathway and ability to transition. The Fund can also replace managers at mandate level where ESG/climate concerns remain unresolved. The Fund has not issued any formal divestment instructions or replaced a manager purely on grounds of ESG /Climate concerns to date.	LGPSC uses a four-level Stewardship Effectiveness Framework to assess engagement outcomes. Companies that remain at Levels 1–2 are treated as showing insufficient progress, which triggers escalation measures such as stricter voting, public statements, collaborative engagement and — where appropriate — a formal challenge to external managers on whether stock-level divestment is warranted. LGPSC notes that it has not formally instructed divestment to date, though managers have sold holdings where ESG risks were judged unacceptable.	**Conceptually aligned**, though the Fund's wording is more explicit that divestment *should* follow in some cases. This is a nuance to be reconciled with LGPSC's case-by-case approach.
Climate & Net Zero frameworks	The Fund uses the Net Zero Investment Framework, sets portfolio-level decarbonisation and data targets, and commits to focused stewardship of high-impact companies.	LGPSC sets similar portfolio-level targets (e.g. 50% emissions reduction by 2030 for listed equities/corporate bonds) and embeds climate engagement thresholds and coverage targets for "material sectors".	**Aligned** – similar headline targets.
Reporting and oversight	The Fund uses LGPSC's Climate Risk Monitoring Service and TCFD-aligned reporting to track climate risk, and receives quarterly updates	LGPSC provides Partner Funds with a Climate Risk Monitoring Service (CRMS), annual climate reports, Stewardship Code reporting and quarterly	**Aligned** –Central supports Fund's reporting needs.

	on voting and engagement. NZCS and the RI Plan are monitored regularly by the Local Pension Committee.	stewardship updates, including engagement case studies and voting statistics.	

Interim conclusions on alignment

Pulling this together:

- **Beliefs and objectives** – The Fund and LGPSC are aligned on: responsible investment being financially material; climate change representing a material systemic risk; and importance of setting net zero target by 2050 (with interim milestones).

- **Operating model** – Both take an engagement-first approach, with escalation integrated and divestment used as part of the same process rather than a mutually exclusive option.

- **Exclusions** – Both the Fund and LGPSC are cautious about widespread exclusions and favour integration and stewardship.

- **Points of nuance** are mostly about degree and timing than to direction – for example:

    - how quickly escalation is triggered where companies or managers are not responding;

    - how firm the expectation is that divestment should follow if engagement is unsuccessful; and

    - how far the Fund wishes to shape stewardship priorities across themes (beyond climate), given LGPSC's broader thematic framework.

These points do not represent fundamental misalignment, but they do highlight areas where practical constraints and fiduciary considerations become more important as pooling progresses. This context frames the next section, which explores the implications of exclusions and divestment within a pooled environment.

4. Considerations for Policy Evolution

This section considers the factors the Fund must consider before introducing any additional expectations, and the risks of doing so without a clear decision-making framework.

Fiduciary duty as the foundation for any decision

Fiduciary duty is not simply a compliance requirement; it defines how the Fund must weigh evidence, risk, cost and member outcomes. This becomes particularly important in a pooled environment, where the implications of a decision extend beyond the Fund itself. In practice, this means the Fund needs to be confident that:

Any exclusion or divestment rests on demonstrable financial risk

Decisions must be grounded in material financial considerations — such as unmanaged transition risk, governance failures, litigation exposure or structural unviability under credible decarbonisation scenarios.

Divestment does not introduce greater risks elsewhere

A divestment must not undermine diversification, materially shift factor exposure, or inadvertently increase concentration risk elsewhere within the strategy. Where such impacts exist, the Fund must be able to demonstrate that the reduction in financial risk outweighs any negative portfolio effects.

The chosen implementation route is operationally realistic

Fiduciary duty extends to execution. Even where there is a strong financial case for divestment, the Fund must ensure the implementation is achievable within pooled structures, proportionate to the scale of the risk, and cost-effective relative to the expected benefit.

Practical constraints the Fund needs to consider

There are several practical constraints the Fund must work within when considering exclusions or divestment. Some stem directly from the requirements of pooling, while others reflect the realities of managing a large, diversified pension portfolio. The key considerations are as follows:

Pooling

Once an asset sits within an LGPSC pooled vehicle, the Fund cannot directly instruct the Pool to sell a particular company or apply a bespoke exclusion. Doing so would impact all Partner Funds and undermine the objectives that pooling is designed to deliver. As a result, Fund-specific exclusions generally cannot be implemented within existing pooled funds.

While alternative structures — such as bespoke pooled vehicles — may be possible, they typically involve higher costs, reduced pooling benefits and additional governance demands. Any exclusion that would require LGPSC to adjust a pooled strategy also depends on wider agreement from Partner Funds, introducing timing and dependency risks. We would also note that the draft Fit for the Future guidance from Government also seeks to limit direct engagement by the Fund on specific Ri and ESG issues.

Passive exposures

The constraints are particularly pronounced for passive mandates. Although exclusions can technically be applied, doing so carries significant practical and financial implications. Screened indices must be created or sourced, often at additional cost and additional tracking error. LGPSC may also not be able to offer the specific screened index required. For these reasons, exclusions or divestment expectations in passive strategies should only be introduced where the financial rationale is strong and the Fund is comfortable with the operational consequences.

Active strategies

While active managers can, in principle, apply exclusions or divest specific holdings more readily than passive mandates, the Fund's managers remain constrained in practice because most mandates are not run on a segregated basis and must reflect the approach defined by the prospectus approved by the FCA. Even where exclusions are technically feasible, they narrow the investable universe, restrict the manager's discretion, and may conflict with the underlying investment thesis. They also increase the risk of performance dispersion relative to benchmarks or targets, potentially affecting risk-adjusted returns.

Transition costs and market impact

Any exclusion or divestment requires a portfolio transition. This introduces direct trading costs, bid-offer spreads, market-timing risk and, in less liquid markets, the risk of adverse price movement.

Precedent-setting and expectations

Applying a targeted exclusion or high-profile divestment can create expectations for further action, both from stakeholders and the wider public. This raises the risk of pressure to extend exclusions into areas where the financial case may be weaker or less clear. Any further decisions would only add complexity and financial risk.

What this means for the Fund now

Under the current direction of LGPS reform proposals, it seems unlikely that the Fund would be able to apply Fund-specific exclusions within pooled vehicles at all. Even if a degree of flexibility were allowed, the practical constraints outlined above highlight why exclusions and divestments are challenging to deliver in practice.

Given these considerations, we do not recommend introducing Fund-specific exclusions at this stage. In our view, the more constructive route is to tighten expectations, clarify escalation pathways, and work with LGPS Central to define what constitutes credible versus insufficient progress against engagement objectives.

This approach keeps future options open while ensuring the Fund's immediate focus remains on actions that are practical and compatible with pooling constraints.

5. Areas for Future Development

With the constraints and implications now clear, the next step is to identify the areas where the Fund can most productively influence the Pool, and where additional clarity could improve the consistency and transparency of engagement outcomes.

Clarifying escalation expectations

One of the key points identified in Section 2 is timing: how quickly escalation is triggered where companies or asset managers are not responding.

LGPS Central applies a structured Stewardship Effectiveness Framework, but it does not set explicit time-bound triggers. The Fund, by contrast, takes a somewhat firmer view that escalation should follow where progress remains insufficient. We see value in the Fund working with LGPSC to:

- agree a shared definition of "insufficient progress" across different themes (especially climate, where expectations are more advanced); and
- understand how long companies typically remain at Levels 1–2 in LGPSC's framework before escalation is triggered

This does not mean imposing strict timelines — which may not be realistic across all sectors and regions — but rather agreeing with LGPSC a set of principles that link clear financial-risk signals to when engagement should shift toward stronger measures such as voting sanctions, public statements or further escalation.

Ensuring thematic alignment beyond climate

In our previous 2022 review, we noted that climate should be the most important stewardship theme for both the Fund and LGPS Central. At the time, this was appropriate: climate frameworks were more advanced than those in other areas, and climate risk was the most clearly understood from a financial perspective.

Since then, however, the climate framework has continued to mature, and the broader stewardship landscape has developed significantly. Issues such as nature, biodiversity, human rights and supply-chain practices are now receiving far greater attention and are increasingly recognised as financially material.

At present, the Fund does not set specific stewardship theme priorities. By contrast, LGPS Central already works across four themes — Climate Change, Natural Capital, Human Rights and Sensitive/Topical Issues.

We see four opportunities here:

- Considering the response to the Fund's Responsible Investment Survey to identify which issues scheme members and employers view as most important.
- Clarifying where the Fund has preferences across the wider themes. We consider LGPS Central's four themes to be a sensible and comprehensive starting point, and the Fund could formally adopt the same themes.
- Increasing visibility over how LGPSC proposes priorities within its four themes.

- Monitoring emerging frameworks such as the Taskforce on Nature-related Financial Disclosures (TNFD) and developments in nature-related reporting, as their relevance for stewardship is expected to grow.

Our suggestion is that these points are either built into the annual RI Plan or captured in a short addendum that sets out the Fund's expectations from a priority theme perspective.

Summary

Overall, these areas give the Fund a practical way to strengthen alignment with LGPS Central. By clarifying expectations, improving transparency, and setting a small number of future priorities, the Fund can support more effective stewardship while working within the realities of pooling.

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