Pensions Committee

1.30pm, Tuesday, 5 December 2023

Stewardship

Item number 6.4

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the paper; and

1.2 approve the updated Statement of Responsible Investment Principles (SRIP).

Bruce Miller

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Stewardship

2. Executive Summary

2.1 The approach to stewardship of the fund's assets is described in the fund's Statement of Responsible Investments (SRIP), which the Committee reviews annually. An updated version of the SRIP is appended as Appendix 1 for approval.

2.2 There are some minor changes to the SRIP that are recommended by the fund officers, who are responsible for ensuring that investment activity adheres to the principles. The main change is a clarification of the fund's approach to climate change.

2.3 LPF incorporates Environmental, Social and Governance (ESG) issues into investment analysis and decision-making, votes all of its shares and pursues a policy of constructive engagement on such issues. This is consistent with best industry practice and its fiduciary duty to the members and employers in those funds. LPF's strategy of resourcing internal investment, operational and specialist legal expertise provides further substance and resilience to that process.

2.4 This paper expands on the fund's approach to engagement rather than indiscriminate divestment, an approach that has been reviewed regularly by the Pensions Committee and officers, who have always agreed that engagement is more responsible and potentially impactful.

2.5 Several times in the past, the Pensions Committee has considered the rationale for and against divestment / exclusion and always concluded that exclusion of a whole sector would constrain the fund and potentially be a breach of the fiduciary duty owed to the members and employers, who fund the scheme. When it comes to investing or not investing in shares, they have supported analysis of financial returns on a case-by-case basis.

2.6 The Pensions Committee is reminded that LPF's approach of engagement rather than divestment is validated by both the United Nations backed Principles for Responsible Investment (PRI) and the Financial Reporting Council's (FRC) Stewardship Code in the UK. Both encourage investors to use responsible investment approaches where these align with their fiduciary duties to enhance returns and better manage risks. This is as applicable to all investment risks, including climate change, other ESG, and market-specific risks. The rationale for our approach – one of ownership and engagement - is that a policy of divestment simply transfers ownership to another investor with no potential for positive outcomes from voting and engagement activity. By constraining the universe of potential investments, optimal outcomes are not achievable.

2.7 LPF encourage managers to incorporate an analysis of both physical and transition climate risk into their risk assessment of individual companies and their stocks. In addition, LPF actively engage with companies to align their business strategies with the targets of the Paris Agreement. While the policy is to not divest solely on the grounds of non-financial factors, where analysis of climate risk (or any other risk) points to poor financial outcomes, divestment is an option (on an investment-by-investment basis).

2.8 LPF has been a signatory to the PRI since 2008, and its six principles form the basis of our SRIP. The PRI introduced a new reporting framework for 2022/23 which no longer assesses asset owners' internal investment activities. While this has impacted the utility of the output for LPF as a benchmarking tool, we maintain our signatory status as an indicator of global best practice and LPF is working with the PRI to support reporting equivalency between the PRI and the UK Stewardship Code.

2.9 LPF participates in collaborative shareholder engagements through organisations including the Local Authority Pension Fund Forum (LAPFF), EOS at Federated Hermes (EOS) and Climate Action 100+. They act on behalf of asset owners with funds valued at over £350bn, US$1.6tn and US$68tn respectively. LPF continues to be represented on the LAPFF Executive Committee by John Anzani (Committee Member). Appendix 2 of this report provides his update on LAPFF's activities that are relevant to the fund.

2.10 LPF is committed to maintaining signatory status of the FRC's Stewardship Code. The LPF Stewardship Report for the period ending Mar 2023, which describes the stewardship of the fund's assets (including examples of voting and engagement activities) has been submitted to the FRC for assessment and is now available on the LPF website, having been noted by the Committee in September.

3. Background

3.1 The pension scheme is designed to fund members' pensions / manage costs for employers by investing assets to generate the cash flows that will fund the liability payments.

3.2 The SRIP (Appendix 1) is a voluntary statement that sets out how LPF operates as a responsible investor. The fund does this to provide greater insights into how it deals with real world complexity. The SRIP describes the fund's approach to responsible investment across all asset classes and provides further details regarding our approach to Climate Change using the guidelines of the Taskforce for Climate-related Financial Disclosures (TCFD).

3.3 LPF allocates meaningful resources to support implementation of its responsible investment policy. These include:

3.3.1 our Responsible Investment Group (RIG) was established in 2021 as a cross-functional team to oversee the development and enhance the execution of our responsible investment policies and their integration within LPF's investment approach, given expectations of significant changes in regulations;

3.3.2 a third-party provider of voting and engagement services, currently EOS at Federated Hermes (EOS), having been reappointed in 2021;

3.3.3 membership of the Local Authority Pension Forum (LAPFF);

3.3.4 a third-party provider of environmental, social and governance (ESG) research (currently MSCI ESG Research); and

3.3.5 external private fund monitoring and assessment (currently GRESB).

3.4 LPF pursues a policy of constructive engagement, which is consistent with fiduciary duties. The fiduciary duty responsibilities of the Scottish Local Government Pension Funds were clarified by the legal opinion sought and received by the Scheme Advisory Board of the Scottish Local Government Pension Scheme in June 2016[1]. The legal opinion reinforces the approach taken by LPF to date and is also accompanied by national guidance around pension funds integrating ESG practice into their investment process.

3.5 On 1 September 2022, the Department for Levelling Up, Housing and Communities launched a consultation seeking views on proposals to require Local Government Pension Scheme (LGPS) administering authorities in England and Wales to assess, manage and report on climate-related risks, in line with the TCFD recommendations. Feedback from this consultation is expected imminently with a target to introduce legislation by April 2024 to require this new reporting by Dec 2025 in England and Wales. Although this legislation has not yet formally been applied to the LGPS in Scotland, it is expected that it will be, and so LPF will be monitoring the consultation feedback and final proposals in preparation for future compliance.

4. Rationale for Revisions

4.5 Within Introduction:

4.5.1 On page 2/3, deletion of reference to academic research. The SRIP describes our approach to responsible investment. It is not designed to be a reference library. However, there are multiple pieces of academic research on the topics of engagement and divestment, which support our approach:

[1] https://lgpsab.scot/fiduciary-duty-guidance/

4.5.1.1 Divestment of shares in a company does not actually deprive a company of capital as an investor can only sell if someone else buys2.

4.5.1.2 Even where divestment campaigns have a short-term price impact on stock prices, they are unlikely to change the behaviour of executives, whose pay is typically linked to long-run prices, profitability, and stock returns3.

4.5.1.3 Most financing for fossil fuel projects comes from bank lending and bond issuance, not equity4.

4.5.1.4 A risk management strategy that prioritises divestment from fossil fuel assets – rather than early modification or retirement of assets – may have little impact on actual emissions with a limited contribution to achieving climate-related goals5.

4.5.1.5 'Brown' companies can take corrective actions that minimise the harm they create – for example, fossil fuel firms can develop renewable energy. The problem with blanket exclusion is that it provides no incentives for such companies to implement corrective actions[6].

4.6 Within Climate Change & the Taskforce for Climate-related Financial Disclosures (TCFD):

4.6.1 On page 7, rephrasing for improved clarity of paragraph detailing how we use data from the Transition Pathway Initiative (TPI) to engage alongside our collaborative partners, to encourage companies to adopt business models and strategies that are in line with the aims of the Paris agreement:

"*our ambition is that by 2025, all our holdings that are covered by TPI will have achieved the highest management quality assessment score, indicating strong governance of their greenhouse gas (GHG) emissions and the risks and opportunities arising from the low-carbon transition, and have a plan for alignment*"

4.6.1.1 This does not mean stocks that fail to meet this ambition will be immediately divested or excluded from our portfolio in 2025, but our managers will be expected to explicitly justify any such holdings.

4.6.1.2 Our Voting and Engagement provider, EOS, similarly uses TPI management quality assessments and the Climate Action 100+ Benchmark to identify laggards for engagement and provides recommendations to vote against the relevant directors or

[2] https://www.unpri.org/academic-blogs/the-effectiveness-of-divestment-strategies/11204.article
[3] https://econpapers.repec.org/article/eeejfinec/v_3a128_3ay_3a2018_3ai_3a3_3ap_3a558-575.htm
[4] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3376183
[5] https://www.i4ce.org/en/publication/framework-alignment-with-paris-agreement-why-what-and-how-for-financial-institutions/
[6] Socially Responsible Divestment by Alex Edmans, Doron Levit, Jan Schneemeier :: SSRN

resolutions at companies where it assesses a company's response to the risks and opportunities presented by climate change to be insufficient, or its activities and reporting to be materially misaligned with the goals of the Paris Agreement.

4.6.2 On page 7/8, including a paragraph on "deny debt, engage equity", which draws out the important distinction between directly funding fossil fuel capacity expansion as it relates to Paris Alignment and secondary investment in listed securities. The fund does not commit its capital to the former:

> "*While the trading of equities (shares) doesn't affect the capital position of a company, subscribing to new bonds and new equity does provide companies with funding. Within our equity portfolio we engage with our holdings, and that engagement includes using the tools and strategies we have at our disposal to influence companies to commit to align with the goals of the Paris Agreement. In our debt portfolios, we aim to deny funding to those non-aligned companies. We expect this approach to be a more effective means of achieving necessary change - a real reduction in greenhouse gas emissions - than divestment. Where material risks remain following engagement activity, we retain the ability to divest.*"

4.6.3 On page 8/9, rephrasing for improved clarity of the paragraph on carbon analysis:

> "*carbon-equivalent foot-printing produces a simple metric, which is backwards looking and can be misinterpreted. It can encourage selective divestment of the shares of high emission companies as some investors 'greenwash' their portfolios. Rather than divesting, we encourage our managers to incorporate an analysis of both physical and transition climate risk into their risk assessment of individual companies and their stocks. In addition, we actively engage with companies to align their business strategies with the targets of the Paris Agreement. Where analysis of climate risk (or any other risk) points to poor financial outcomes, we would expect to divest*.

4.6.4 Although a carbon footprint provides useful insights, it is important to recognise that reducing exposure to, or completely divesting from, carbon intensive stocks in no way reduces global carbon emissions. It does reduce a portfolio's carbon footprint, which might seem appealing, but it has no real-world impact. It simply transfers ownership of the emissions to another party. In terms of real-world outcomes, it is systemic decarbonisation that matters, not portfolio decarbonisation. Systemic decarbonisation can only be achieved by engaging with systemic emitters to change business practices and shift capital allocation towards green solutions, along with denying new debt financing to systemic emitters and supporting green projects with new capital (debt and primary equity capital).

5. Financial impact

5.1 The costs of LPF's stewardship activities are included in the pension fund's budget. Stewardship activities include participation in group / shareholder actions to hold companies to account for wrongdoing. US class actions are conducted on a "no win no fee" basis. Non-US actions are generally structured to avoid any exposure to costs for LPF. Recoveries over 2022/23 amounted to £1.3m.

6. Background reading/external references

6.1 LPF's Responsible Investment publications are available at:

https://www.lpf.org.uk/investments/responsible-investment/
Principles for Responsible Investment: http://www.unpri.org/
Local Authority Pension Fund Forum: http://www.lapfforum.org/

7. Appendices

Appendix 1 – Statement of Responsible Investment Principles (2023 update)
Appendix 2 – LAPFF Business Update

Appendix 1

Statement of

Responsible Investment Principles

Statement of Responsible Investment Principles

Introduction

At Lothian Pension Fund (**LPF**), we believe that Responsible Investment (**RI**) supports the purpose of the Local Government Pension Scheme (**LGPS**) – the provision of retirement income for individuals. We believe that it should reduce the risk associated with the invested assets that the Fund owns to pay pensions when they are due.

This Statement of Responsible Investment Principles (**SRIP**) complements LPF's Statement of Investment Principles (**SIP**), which is a statutory requirement codified in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010. The SRIP explains our (LPF's) approach to the oversight and monitoring of the Fund's investment activities from a Responsible Investment (**RI**) and Stewardship perspective.

RI is an approach to investing that aims to incorporate environmental, social and governance (**ESG**) factors into investment decisions, to better manage risk and to generate sustainable, long-term returns (according to Principles for Responsible Investment). Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society.

RI is not the same as Ethical Investment (**EI**). EI is an investment approach determined by an investor's specific views, usually based on a set of personal values. These values can take precedence over financial considerations. LPF should not be considered as either an "Ethical" or an "Unethical" investor, but as a responsible steward of capital. The management of ESG issues is a question of identifying and mitigating material financial risks, not a question of ethics.

At LPF, we are guided in our roles as quasi-trustees, executive officers and investment managers by the legal principle of fiduciary duty. Guidance on our fiduciary responsibilities is provided by the Scottish Local Government Pension Scheme Advisory Board, which took legal advice on this matter (https://lgpsab.scot/fiduciary-duty-guidance/). It advises the Scottish Government (the Responsible Authority for the Fund) and Scottish LGPS Funds themselves on policy issues. We review this guidance on an ongoing basis to assess it against any changes to the legal or regulatory framework, and still believe it to be relevant.

Our Pensions Committee (**the Committee**), comprising five elected councillors and two co-opted members representing employer and beneficiary interests, is responsible for fund oversight and policy setting. In carrying out its obligations, this group of quasi-trustees must take into consideration the views of its main stakeholders, members and employers.

The City of Edinburgh Council (CEC) is the administering authority for the Fund, but the Fund is neither owned nor controlled by CEC. Pension fund assets, which are earmarked for pension payments over the life of the fund, are ringfenced from 'Council Money'. There are more than 80 employers and 85,000 members, whose pension payments will be funded by these and further employer and member contributions.

At LPF, we are committed to acting as responsible investors by managing risk associated with ESG factors. ~~Academic research supports the belief that successful engagement adds value to the investment process; and that divestment has no effect on company finances in the long term and~~

~~can produce perverse incentives in the short term[1].~~ ~~Accordingly, we believe that~~As a responsible ~~owners~~ investor, ~~will~~ we engage with ~~their~~ our investee companies and appointed managers, either directly or via ~~their~~ collaborative partners. Where material risks remain following engagement activity, we retain the ability to divest.

~~[1] *University of Edinburgh Master's in Economics Dissertation, "In response to the recent Paris Agreement, how might pension funds contribute to helping reduce global climate change through investment policy?", Cooper, 2019*~~

Principles for Responsible Investment

LPF is a signatory to the Principles for Responsible Investment (PRI), an organisation which supports and enables asset owners and asset managers to work collaboratively towards RI best practice. As a signatory, LPF has committed to implement the six principles with the aspiration of contributing to the development of a more sustainable global financial system.

Principle 1

We'll incorporate ESG issues into investment analysis and decision-making processes.

The implementation of LPF's investment strategy is delegated by the Pensions Committee to officers, who employ internal and external investment managers to invest the Fund's assets. How ESG issues are incorporated into investment analysis and decision-making processes varies according to the asset category and whether the mandate is internally or externally managed as follows:

Internal Equity investment: our investment managers analyse ESG data as part of the stock selection process and, on an ongoing basis, monitor ESG developments at underlying investee companies. Data and rating changes from independent providers trigger stock reviews. We will not provide new financing to companies or projects that are incompatible with the aims of the Paris Agreement.

External Equity managers: during the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes. We monitor the managers' implementation of their approach on a quarterly basis alongside all other investment matters, and review the PRI transparency reports of external managers and their product-level Taskforce for Climate-related Financial Disclosures (TCFD) reports, where available. Managers are encouraged to join PRI as signatories where they are not already members. Our ambition is to appoint managers who will not provide new financing to companies or projects that are incompatible with the aims of the Paris Agreement.

Internal Sovereign Bond investment: our investment managers analyse ESG reports and respond to government and market consultations, either directly or with our collaborative partners.

External Corporate Debt managers: during the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes. We monitor the managers' implementation of the approach on a quarterly basis alongside all other investment matters, and review the PRI transparency reports of external managers and their product-level TCFD reports, where available. Our ambition is to appoint managers who will not provide new financing to companies or projects that are incompatible with the aims of the Paris Agreement.

Internal Direct Property investment: during the selection process, we assess the environmental efficiency and sustainability credentials of properties. In conjunction with the appointed property managing agent, we ensure that ESG opportunities and risks are considered at every stage of the ownership cycle. ESG improvement targets and performance, particularly Minimum Energy Efficiency Standards, will be incorporated into Fund strategy through asset management plans for owned assets and all new investment acquisition appraisals.

External Property managers: ESG management is considered explicitly during the manager appointment process. Management and monitoring of ESG matters by the manager is reviewed on a quarterly basis alongside all other investment issues. Where available, PRI Transparency and GRESB reports and product level TCFD reports are reviewed and, if they are not, managers are encouraged to articulate their approach to ESG and sustainability. Where appropriate, we seek improvement to both the management and implementation of that approach. Managers are encouraged to join PRI as signatories where they are not already members.

External Real Asset management (infrastructure, timber) managers: during the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes. We monitor the managers' implementation of the approach on a quarterly basis alongside all other investment matters, and review PRI transparency and GRESB reports and product level TCFD reports of external managers, where available. Managers are encouraged to join PRI as signatories where they are not already members.

Principle 2

We'll be active owners and incorporate ESG issues into our ownership policies and practices.

Voting: we aim to vote on all the resolutions at the Annual General Meetings (AGM) and Extraordinary General Meetings (EGM) of the Fund's equity holdings.

Shareholder resolutions: we also file or co-file shareholder resolutions on important issues at the Fund's investee companies in the interests of agitating for better governance.

Stock lending: LPF participates in stock lending, which generates revenue for the Fund and contributes to making investment markets more efficient. With the ambition to vote on 100% of equity holdings at all shareholder meetings, we recall stock on a systematic basis for voting.

Corporate engagement: we engage with our investee companies on material ESG issues. We use all methods at our disposal, including direct letters, open letters, company calls, company meetings, speaking at shareholder meetings, filing/co-filing of shareholder resolutions and proposing board members. We do this directly, through collaborative partners / service providers or alongside them.

Government engagement: we engage with government officials and regulators to ensure that markets run efficiently, and that rules and regulations proportionally protect the interests of the various market participants. This is done using all methods at our disposal, including direct letters, open letters, responding to consultations, working collaboratively with government departments and working collaboratively with regulators and quangos. We do this directly, through collaborative partners / service providers or alongside them.

Manager monitoring: we actively and regularly monitor the approach of our investment managers to ESG issues, and what portfolio activity has occurred as a result of managing ESG risks.

Conflicts of interest: we identify and manage conflicts of interests to put the interests of our members and employers first. It's incumbent on all our people to be alert to potential conflicts of interest and act accordingly.

Principle 3

We'll seek appropriate disclosure on ESG issues by the entities in which we invest.

Investee companies: we encourage the companies, whose shares the Fund owns, to report on relevant ESG metrics. These include the reporting of greenhouse gas emissions in line with the recommendations of the Taskforce for Climate-related Financial Disclosures (TCFD).

Investment Managers: we encourage the Fund's investment managers to provide transparency by reporting relevant and accessible ESG-related information. This includes their commitments to and alignment with the UK Stewardship Code 2020, the TCFD, the PRI and GRESB, where appropriate.

Principle 4

We'll promote acceptance and implementation of the Principles within the investment industry.

Commitment to PRI: we are transparent about being a signatory to the PRI and about how we implement the Principles. The Pensions Committee monitors the public assessment and transparency reports annually and these are published on the Fund's website to demonstrate implementation of the Principles and to promote them.

Investment Managers: we endorse the Principles to our managers and encourage them to become full signatories to PRI. Where this is not possible, we encourage our managers to use the six principles to guide their RI approach.

Partnership with PRI: we partner with PRI to promote the universal use of the principles, and work with PRI during any consultations to improve the effectiveness of the principles and further improve RI adherence across the industry.

Principle 5

We'll work together to enhance our effectiveness in implementing the Principles.

Collective Approach: we are committed to working collaboratively to increase the reach, efficiency and effectiveness of RI. We work with a host of like-minded partner funds, service providers and related organisations striving to attain best practice in the industry and to improve industry standards. A list of our collaborative partners and their roles are available within Our Stewardship Report on our website www.lpf.org.uk.

Principle 6

We'll each report on our activities and progress towards implementing the Principles.

PRI Assessment: we provide extensive details of our investment activities annually to the PRI for its independent assessment of our approach to RI.

PRI Reports: we publish our PRI transparency report annually on our website and we publish our PRI assessment results on our website and in our annual report.

TCFD: we are committed to report annually in accordance with Taskforce for Climate-related Financial Disclosures (TCFD) recommendations.

UK Stewardship Code: we report annually in accordance with the UK Stewardship Code requirements, and we are committed to adhering with the requirements of the UK Stewardship Code 2020.

Climate Change & the Taskforce for Climate-related Financial Disclosures (TCFD)

LPF recognises the importance of the Paris Agreement of the United Nations Framework Convention on Climate Change[2]. The central aim of the agreement is to strengthen the response to the global threat of climate change by:

- keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius;
- strengthening the ability of countries to deal with the impacts of climate change through appropriate financial flows, a new technology framework and an enhanced capacity building framework;
- enhancing transparency of action and support through a more robust transparency framework.

LPF understands that the Paris Agreement is creating change that represents both significant risks to - and opportunities for - the Fund. As such we make the following commitments to climate monitoring and action:

- To support the goal of transitioning the real economy to net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius by 2100
- To continue to measure and report annually on carbon-equivalent emissions throughout the equity and corporate bond portfolios
- To continue our work with Climate Action 100+
- To continue to research and support the deployment of new impact capital into projects set to benefit from the transition to a low carbon economy
- To assess and report on the carbon intensity of all assets (supported by external managers and using estimates if necessary) by the deadline for enhanced TCFD reporting for the Scottish LGPS
- Using data from the Transition Pathway Initiative (TPI), to engage alongside our collaborative partners to encourage companies to adopt business models and strategies that are in line with the aims of the Paris agreement. Our ambition is that by 2025, all our holdings that are covered by TPI will have achieved the highest management quality assessment score, indicating strong governance of their greenhouse gas (GHG) emissions and the risks and opportunities arising from the low-carbon transition, and have a plan for alignment ~~achieved a level 4 assessment and have a business plan whose carbon performance is in-line with the Paris agreement or better by 2025~~
- To assess, and monitor our external managers' assessment of, companies being provided primary capital in accordance with our ambition to avoid subscribing to new equity and fixed income issuance from companies whose business plans are not aligned with the aims of the Paris agreement

"Deny debt, engage equity"
While the trading of equities (shares) doesn't affect the capital position of a company, subscribing to new bonds and new equity does provide companies with funding. Within our equity portfolio we engage with our holdings, and that engagement includes using the tools and strategies we have at our disposal to influence companies to commit to align with the goals of the Paris Agreement. In our debt portfolios, we aim to deny funding to those non-aligned

[2] https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

companies. We expect this approach to be a more effective means of achieving necessary change - a real reduction in greenhouse gas emissions - than divestment. Where material risks remain following engagement activity, we retain the ability to divest.

Financial returns from current and future investments will affect LPF's ability to fund future pension payments, and so we have committed to implement processes that adhere to TCFD recommendations as follows:

Governance: The Pensions Committee monitors stewardship of the Fund's assets at least annually. This includes reporting on RI issues and specific climate-related risks and opportunities. In accordance with Scheme Regulations, the Pensions Committee and Pension Board are required to undertake a minimum of 21 hours training[3], which includes training on RI issues and climate change-related risks and opportunities. The Pensions Committee:

- Affirms the Fund's commitment to integrate environmental, social and governance (ESG) considerations, such as carbon efficiency trends into its decision-making
- Delegates scrutiny and engagement with investment managers to Fund officers with advice from the external advisers to the Joint Investment Forum ~~Joint Investment Strategy Panel~~ to ensure that they take ESG issues, including climate change and carbon risk, into account in their investment decision-making
- Affirms the Fund's policy of not divesting solely on the grounds of non-financial factors
- Notes that the Fund will monitor research on the link between ESG factors (including carbon-related factors) and financial performance to inform future investment strategy, such as stock selection criteria for quantitative strategies
- Agrees that the Fund will use its shareholdings in companies that perform poorly on carbon efficiency measures to influence engagement activity.

Strategy: we work individually and with our collaborative partners to drive for openness and transparency on climate related issues affecting our investments. Our Responsible Investment Group provides responsible investment advice to LPF officers and the Pensions Committee to develop and enhance the execution of our responsible investment policies and their integration within LPF's investment approach.

Risk Management: we subscribe to data services and analytical tools, including company and industry specific data, and scenario models, to help understand and manage the climate risk within the Fund. These are used by our internal managers and we monitor and assess the approaches taken by our external managers to risk management.

Monitoring: we use various monitoring tools with the aim of mitigating risk to Fund assets from trends towards net-zero carbon and more broadly from climate change. The Joint Investment Strategy Panel reviews and scrutinises RI issues and specific climate-related risks and opportunities at least annually. The internal investment management team uses data services and analytical tools to monitor climate risk at as granular a level as possible.

Carbon Analysis: we note that carbon-equivalent foot-printing produces a simple metric, which is backwards looking and can be misinterpreted. It can encourage~~s~~ selective divestment of the shares of high emission companies as some investors 'greenwash' their portfolios. Rather than divesting, we encourage our managers to incorporate an analysis of both physical and transition ~~carbon output~~climate risk into their risk assessment of individual companies and their stocks. In addition,

[3] https://www.lpf.org.uk/us/training-pension-committe-board/1

we actively engage with companies to align their business strategies with the targets of the Paris Agreement. Where analysis of ~~carbon~~ climate risk (or any other risk) points to poor financial outcomes, ~~share divestment is, of course, an option~~ we would expect to divest.

In conclusion

At LPF, our mission is to deliver a valued and sustainable retirement savings product for our existing and future members. We believe that as a provider of responsible capital, the Fund should be an agent for positive change, engaging with companies to help them maintain or adopt best business practices and sustainable business models. If you'd like more information on our ESG activities, please read ENGAGE, our ESG newsletter or visit our website www.lpf.org.uk.

Document Control

Approved by	Bruce Miller, Chief Investment Officer
Approval date	7 December 2022
Senior Responsibility	Bruce Miller, Chief Investment Officer
Owner	Gillian de Candole, Portfolio Manager
Review schedule	Reviewed annually, with approval by Chief Investment Officer
Next review	December 2023

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1.0	24/06/2020	DH	Press release re PC adopting	BM	24/06/2020
1.1	13/05/2021	DH	Reviewed along with the wording for the RI section of the Annual Report	BM	13/05/2021
2.0	22/11/2022	GdC	Updated the wording for PC approval (07/12/22)	BM	7/12/2022
3.0	09/11/2023	GdC	Updated the wording for PC approval (05/12/23)		

Report to the Pension Committee by John Anzani, Member Representative, concerning the Local Authority Pension Fund Forum (LAPFF) and his work as a member of the LAPFF Executive

Summary

- LPF supports the work of LAPFF in part through nomination of Cttee members to serve on the Executive Cttee. The current member of the Pension Cttee who was nominated to LAPFF Executive is John Anzani. He has served on the Executive since 2019,
- The involvement of John Anzani in company specific engagements is detailed.
- LAPFF plays a unique role in identifying and taking action on issues which are not necessarily tied to any specific holding, but which affect the operation of LGPS funds and/or specific industries in which funds are invested more generally.
- Specific examples of such initiatives that are being undertaken/suggested/developed are given.

Report

This brief report is intended to inform the Board and Committee of the activities of LAPFF and to place that within the context of the overall engagement work carried out by LPF. Whilst it does include information on John Anzani's involvement in specific engagements the main intention is to highlight the range and type of initiative which can best/only be undertaken by a collective body.

Individual contribution to engagement activity

LPF has supported the work of LAPFF through the nomination of candidates to serve on the Executive for decades. In chronological order Cllrs Child, Rose & Rankin have each been members of the Executive. John Anzani's initial nomination received the support of the Cttee in June 2019 and he was elected unopposed to the LAPFF Executive at the AGM in July 2019. The Cttee has agreed to renominate him for further terms since then. He was [re] elected unopposed on each occasion.

In the twelve months to 31/10/23 he has undertaken a number of engagements:

- ***Chipotle*** –this continued engagement was initially focused on Carbon reduction in food supply [Chipotle is the world's 6th largest purchaser of beef] it has now become more concerned with water usage and sustainability of supply. LAPFF had taken the lead on the latter topic and is now a lead investor in the Valuing Water Finance Initiative [VWFI] see below for further discussion.
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LAPFF established initial conversations with representatives from Renault, General Motors, Volvo, and Volkswagen across the year. Engagements have highlighted that supply chains for vehicle manufacturers are vast and complex, with limited transparency.

In these initial meetings, LAPFF has pushed for enhanced disclosures at every level of a company's human rights risk management, from the way audits are undertaken, to how corrective action plans and remediation are implemented if and when instances of contractual non-conformance or human rights abuses are found.

LAPFF has also continued to discuss company membership of the Initiative for Responsible Mining Assurance (IRMA) [see below]. LAPFF has continued a line of engagement that pushes for increased transparency and accountability, which is only possible through global collaboration.

LAPFF is set to continue its engagements on this issue, and John will be building on engagements he has already held with various motor manufacturers [see list below] in 2023. Whilst predominantly looking at the procurement of minerals, LAPFF has also been including questions on the refinement and processing of those minerals and will look to probe more on the full supply chain of minerals for vehicle manufacturers. This line of questioning becomes ever more important for companies and investors as new legislative instruments are enacted globally.

- ***Mercedes*** – Two engagements to date.
- ***BMW*** -.
- - ***Ford*** -.
- ***Renault*** - Two engagements to date
- ***Volvo*** - Two engagements to date. With Volvo we have also been discussing the non fossil fuel options for vehicles [especially trucks and buses] in Artic regions where grids to support EVs are not feasible.

Initiative for Responsible Mining Assurance [IRMA] – this organisation was mentioned during engagements by several companies and LAPFF wished to gain an understanding of its methods and capacity [could it really scale up activities to partner with all the companies that wished [or that we wished] to work with it.

To this end we had John had a zoom call with the Executive Director and the Director of Corporate Engagement. LAPFF were interested in their governance model which specifically allows for vetos by different "houses" [i.e. interest groups]. This can mean that progress is slow but when a decision is reached then it does enjoy the support of all stakeholders.

In order to gain further insight and to try and help IRMA generate more momentum John and a member of the research partner attended an IRMA presentation to the Finance sector in London.

Constellation – This continuing engagement is now under the rubric of the "Valuing Water Finance Initiative" and is focussed on getting the company to undertake a thorough water audit including its supply chain] and then to publish a time bound and science based plan to eliminate risks.

All of these are continuing areas of work and John will be continuing his involvement with each of them.

Attendance at AGMS
SSE
Obviously the lockdowns due to Covid 19 led to the suspension of in person Company AGMs. Slowly, companies are returning to holding such meetings.

John Anzani attended the AGM of Scottish & Southern Energy held in Perth [Scotland]. AGMs offer an opportunity not just for corporate investors but also individual shareholders to ask questions of the company board. There were two other questions from organisations but the vast majority were from individuals.

They covered a range of topics and notably some speakers opposed the Company's efforts towards decarbonisation. Whilst these comments attracted applause from the room which demonstrates that there is not yet any consensus re preventing climate change the Chair of the Company was very clear that the board had no intention of abandoning what they can demonstrate is a successful and profitable strategy.

Overarching Interventions
One key aspect of LAPFF is that it can identify and then take action on emerging issues and "systemic" aspects that affect the operation of the LGPS whether these are regulation, market failure or something like the risks and challenges due to Climate change. Very few, if any, individual funds have [or had] the resources to address these issues on their own. It is not clear what evidence there is that the move to pooling in England and Wales has altered that calculus.

An obvious example of this is the fact that LAPFF started discussing “environmental” risks and challenges in the 1990s and had issued guidance documents on related issues from early in the decade. It was represented at the launch of the Institutional Investor Group on Climate Change in 2001 and has played an active role in collaborative work on this topic to this date.

Valuing Water Finance Initiative [VWFI]
This is an international initiative that was launched by CERES a US based NGO with whom LAPFF has collaborated in the past. The reason for launching VWFI is the clear understanding of the financial materiality of water risk to most if not all companies.

Almost irrespective of Climate Change increasing scarcity of a substance that is almost always irreplaceable//cannot be substituted poses a threat to many companies. By focusing engagement on some of the biggest companies/those most affected it is hoped to generate leadership and momentum within Industries themselves.

LAPFF has undertaken to Co-Chair an international taskforce of investors and to take a lead in a number of engagements. John was allocated this responsibility by the LAPFF Executive and he has chaired/co-chaired several meetings of the Taskforce.

There was also a session concerning VWFI at the 2022 LAPFF Annual Conference with a speaker from CERES.

All Party Parliamentary Group on Pensions
LAPFF played an active and key role in the establishment of this body. Chaired by an MP [currently Clive Betts, Labour] it is able to hold hearings and issue reports. It offers a potential for pensions, and the concerns of pension schemes, to be discussed on a non-partisan [less partisan?] basis. The output of such bodies often carries great weight and will usually attract significant media coverage.

The APPG has maintained its focus on “Levelling Up” and the role that LGPS Funds can play in that process. Due to the lack of clear leadership and focus within Whitehall generally and DLUCH in particular progress has been limited.

During the period covered by this report the group hosted an event with the Minister focussed on LGPS consultation [for English & Welsh funds] alongside meetings on levelling up, affordable housing and illiquid assets.

LAPFF’s Role in Promoting Well-Functioning Markets
LAPFF

LAPFF has continued its efforts to ensure that the new body is not also subject to Industry Capture and is better placed to carry out the regulatory role that is required. Due to the instability of government in Whitehall not much progress has been made in the creation of Audit, Reporting and Governance Authority [ARGA] and the Forum continues to try and intervene in this area.

Reliable accounts
LAPFF’s work on International Financial Reporting Standards (IFRS) led a critique, post banking crisis, on issues of valuation. LAPFF has continued to engage with the UK Govt consultation regarding standards post Brexit. Again there has been little progress due to the instability of government in Whitehall.

Human Rights & the Mining Industry
Following on from the publication of the report written by Professor Robert McCorquodale and the 3 weeks study trip to Brazil to investigating the progress of reparations following tailings dam collapses and to meet with affected communities, the main focus was on producing a report and other materials covering the outcomes of the visit.

Despite pushback from a number of the companies the report was published and accompanied by a film. These have received a good response.

LAPFF has also continued to work with a Brazilian based investor group to maintian a process to increase the pace and quality of reparations following the tailings dam collapses

Due diligence and Human Rights

During engagements and other activities around forced labour and other violations of Human Rights LAPFF has started to encounter situations where it is increasingly difficult for any due diligence to be carried out.

Either this is because of fears for the safety of the individuals attempting the assessment[s] or because the laws and/or policies of the National/Local government is underpinning/encouraging/requiring the behaviours that are the subject of the complaint[s].

In such cases the “standard model” of engagement has severe limitations. It was in this context that the LAPFF Executive agreed to participate in a two day workshop on the situation of the Uyghur people within China and the abuses of Human Rights that they suffer.

This was held in London and John and a member of the research partner attended.