Leicestershire County Council
Pension Fund

Net Zero Climate Strategy

Summary

Draft November 2022

About the fund

Leicestershire County Council's Pension Fund (the Fund) is a defined benefit pension scheme with assets under management in excess of £5.8billion (as at 30th September 2022) and invests across a wide range of asset classes to deliver returns to pay pensions and lump sum benefits.

The Fund has over 100,000 members (active pensioners, deferred members, and employees) and over 200 active employers.

Why climate change matters for the Fund

The Fund is made up of a portfolio of assets in which your pension contributions are invested, such as stocks and shares, bonds, infrastructure, and property. Almost all asset classes, sectors, and geographical regions that the Fund invests in are likely to be affected by the physical, policy or market-related consequences of climate change.

It is important that the Fund manages the financial risk this presents.

How it was developed

The following measures and targets have been set in alignment with the Net Zero Investment Framework developed by the Institutional Investors Group for Climate Change. The Framework sets a blueprint for guiding, supporting and enabling investors to make significant progress this decade and beyond. This has been supported by advice from our external investment advisor, and Fund member views.

At a glance

This Strategy looks to align the Fund to the Net Zero Investment Framework through the following pillars of the Fund's Net Zero Climate Strategy:

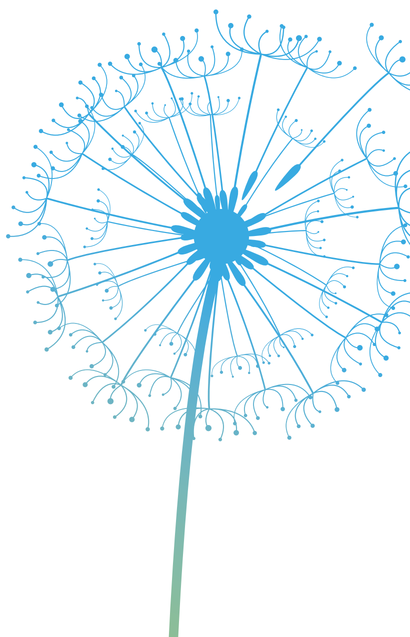
i. **Climate Change Risk and Opportunities:** The view on the risks and opportunities arising from climate change, and how the Fund will look to mitigate any impact to investment returns.

ii. **Targets and Measures:** The Fund's commitments to achieve Net Zero by 2050, with an ambition for sooner, and the underlying targets and measures that will be regularly monitored and used in the Fund's risk management processes.

iii. **Decision Making:** How the Fund will integrate risk management and our commitments to decarbonise the Fund's portfolio in the Strategic Asset Allocation and investment decisions.

iv. **Stewardship, Engagement and Divestment:** How the Fund will act as responsible asset owners. ensuring collaborative support to engage with the market via our investment managers to reach our targets.

The Fund is currently consulting on this draft Strategy. The outcome of this consultation will be presented to the Local Pension Committee on 3 March 2023. View the outcome of the previous engagement on the targets and measures within the Strategy here: 18 November 2022 Local Pension Committee meeting.



Primary Targets

NET ZERO

by 2050:

Net Zero by 2050, with an ambition for sooner

by 2030:

Reduce absolute carbon emissions of the equity portfolio by 40%.

Reduce carbon intensity of the equity portfolio by 50%.

Secondary Targets and Measures

90%

Coverage of assets measured by 2030.

90%

Assets under management in material sectors to be classified as Net Zero, aligned or aligning by 2030.

Increase allocation to climate solutions

90%

Of the Fund's financed emissions have Net Zero targets, alignment pathway or subject to engagement by 2030.

Reduce the proportion of the Fund with fossil fuel exposure.

Leicestershire County Council and LGPS Central: Operational Net Zero by 2030.

What investments does the Pension Fund make?

The Fund holds diversified investments to protect itself from volatility of certain assets and regions. However, diversification is not enough to protect the Fund from climate risk. This is because the actions, or inaction, of companies and society in relation to climate change can affect other companies and the overall economy.

A worldwide outlook

As a global investor the Pension Fund must be aware of international policy decisions and climate pledges. The United Nations brings together almost every country for global climate summits called 'Conference of the Parties' (COP).

The following insights underpin the Strategy:

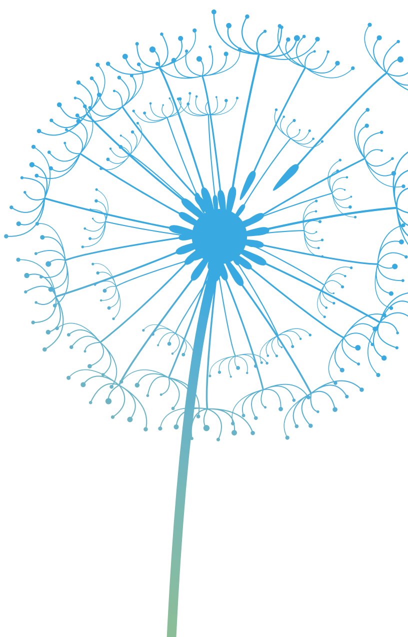
> The Paris Agreement (COP 21). For the first-time countries agreed to work together to limit global warming to well below 2°C. The aim was 1.5°C to adapt to the impacts of a changing climate in order to prevent loss of lives and livelihoods.
>
> The Glasgow Climate Pact (COP 26). Highlighted that progress to 2030 would be crucial in limiting global warming and keep the 1.5°C goal alive. Developing countries also recognised their responsibility to support 'just transitions.'
>
> Egypt's COP 27 (November 2022) looks to build and follow up on previous pledges to provide clarity on the world's progress and what more needs to be done to fight climate change.

Despite these agreements it is important to note that out of the top ten global greenhouse gas emitting countries only three have set legally binding Net Zero commitments. Where countries have not set appropriate Net Zero targets, we may struggle to engage with companies based there to set earlier dates.

How will Net Zero affect the Fund?

External climate scenario analysis of the Fund's investments had projected that the Fund's investment returns are best protected as part of an early and smooth transition to Net Zero. It performs worst under a 'failed' transition where the world fails to meet the Paris Agreement goals.

Recognising the importance of limiting global warming to 1.5°C, the Fund has produced a Net Zero Climate Strategy that will ensure it continues its role as a long-term responsible investor, while managing the risks and opportunities posed by climate change. Further information about the current consultation can be viewed on the Leicestershire County Council Pension Fund Member Self Service website.



Risks and opportunities

The Fund's actuarial valuation and climate scenario analysis will take place every three years to ensure capital assumptions are informed by a realistic assessment of climate risks and opportunities.

The Fund's 2022 Climate Risk Report shows that it is clear the Fund has already progressed from the 2019 benchmark, but that there is a long journey ahead.

The Fund will look for opportunities that arise from climate change such as climate solutions. Where financially viable, the Fund will continue to invest in them.

Science based goals

The Fund will use science based analysis and reviews of asset classes to prioritise risks to manage and mitigate based on the level of perceived threat to the Fund.

The Fund will work with LGPS Central to set alignment targets, which will be based on criteria by Climate Action 100+ Net Zero Company Benchmark and the Transition Pathway Initiative, in line with the Institution Investors Group Framework.

Alignment will be reviewed annually through the Fund's Climate Stewardship Report, including whether additional criteria can be incorporated where feasible and data is available, such as through the Science Based Targets Initiative.

Asset coverage

As of 2022 this data available only covers the Equity portfolio, circa 45% of the Fund's total assets. As set out within the targets above the Fund will develop key milestones to include further assets and ensure new investments are in line with the set view on climate risk. While the Fund cannot measure all assets reliably, by utilising the Fund's risk management processes and targets and measures set out in the Strategy, the Fund will ensure new investments are in line with the set view on climate risk.

Case Studies

Existing investment managers already manage the Fund's assets in balanced, diversified portfolios, these investments are expected to gradually decarbonise, subject to global action.

Some examples are detailed below:

CASE STUDY: Equity – LGPS Central Climate Multi Factor Fund

The Fund has already transitioned £775m to LGPS Central's All World Equity Climate Multi Factor fund which incorporates three key climate change considerations: carbon emissions, fossil fuel reserves and green revenues. The fund integrates responsible investment criteria by tilting towards companies that are taking a proactive approach to environmental factors.

Importantly the investment also presented as a financially attractive investment opportunity due to financial return expected, and its low cost as a passively managed fund.

To date the Climate Multi Factor fund has demonstrated a track record of generating better carbon metrics compared to the broad market indices. As of 30 June 2022, the weighted average carbon intensity of the fund is 62.5% lower than its corresponding broad market index.

CASE STUDY: In July 2022 the Fund invested £55million as part of the Fund's Infrastructure allocation to Quinbrook Infrastructure Partners Net Zero Infrastructure Power Fund. Quinbrook is an environmental, social and governance-focused investment manager that adds value by specialising in low carbon and renewable energy supply, storage and grid stability.

The Net Zero Power Fund focuses on decarbonisation and Net Zero emissions targets across the UK, US and Australia.

CASE STUDY:

The Fund has invested in timberland (forestry) since 2011. These investments extend across 12 countries and covers the equivalent of 17% (363 km^2) of Leicestershire's surface area. This sequesters more than 720,000 tonnes of carbon dioxide from the atmosphere each year[1]. This is equivalent to the annual emissions from 233,000 cars, or 62% of reported emissions within the city of Leicester in 2020[2].

In July 2022 the Investment Subcommittee agreed a further £55million investment in Stafford Capital Carbon Offset Opportunities Fund. This invests in 80% greenfield (65% afforestation and 15% reforestation) and 20% brownfield (improved forest management) and gives the Fund an opportunity to obtain or sell carbon offsets generated. While retaining these would improve the Fund's carbon metrics, ultimately it would not reduce transition risk of the Fund's other underlying assets. The Fund agreed to instead sell the offsets for positive financial return.

The price of carbon credits is expected to keep rising. The Carbon Offset Opportunity Fund provides the Fund with the option to financially benefit, thus reducing exposure of the financial risk elsewhere.

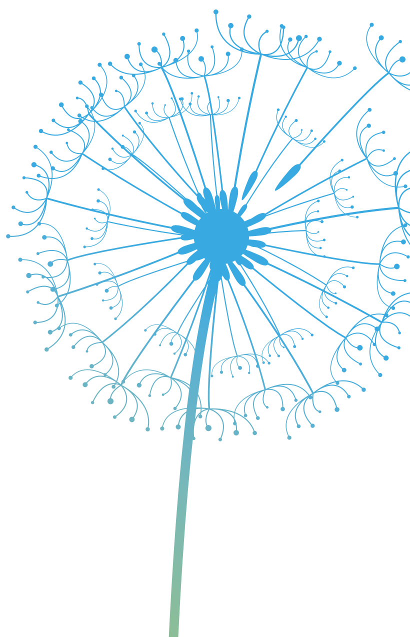
Stewardship, Engagement and Divestment

Stewardship is defined by the Financial Reporting Council as the "responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries

Depending on the asset class, there are various stewardship tools. Most important for the Fund at this stage is:

- Engaging directly with current or potential portfolio companies, across all asset classes
- Collaborative engagement
- Voting at shareholder meetings
- Filing shareholder resolutions/proposals
- Engagement with policy makers and standard setters
- Engagement with the media to promote stewardship goals.

The Fund views engagement and divestment as proven and necessary elements of an effective approach to stewardship; and they should not be seen as mutually exclusive



1 Based on above ground stemwood only.
2 As reported by BEIS www.gov.uk/government/collections/uk-local-authority-and-regional-greenhouse-gas-emissions-national-statistics

The 4-Step plan for conducting stewardship activities

Evaluation

To increase the financed emissions of the Fund that are Net Zero, aligned, or subject to an engagement, companies will be evaluated against the Climate Action 100+ Company (CA100+) Benchmark Indicators and the Transition Pathway Initiative. This analysis will be utilised to understand how companies manage their own climate risk, and the level to which it covers the Fund's investments.

Engagement

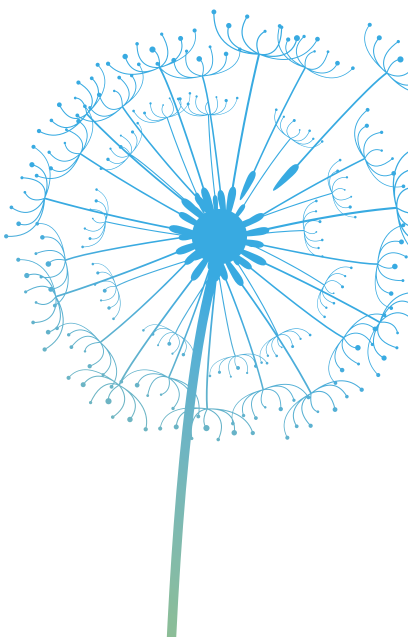
The Fund further supports the engagement objectives of the CA100+ initiative, that companies: adopt the appropriate governance structures to effectively manage climate risk; decarbonise in line with the Paris Agreement and disclose effectively using the TCFD recommendations. The Fund will continue to work with partners to engage with companies to set Net Zero 2050 emissions targets and provide verifiable evidence of how that will be achieved.

Voting

The Fund delegates responsibility for shareholder voting opportunities to LGPS Central and the Fund's investment managers. This includes the ability to file a resolution at a company meeting to allow shareholders to escalate engagement on specific issues.

LGPS Central's Voting Principles incorporate climate change, like seeking to influence companies by voting against the Chair and other relevant directors or resolutions (including remuneration) at companies where their response to the risks and opportunities presented by climate change are materially misaligned with the Paris Agreement.

For externally-managed Fund assets, votes are cast in line with industry best practice, as set out in the accepted governance codes. The results are reviewed quarterly.



Divestment

Divestment is the process of selling in part, or in full, an investment and can be achieved by the Fund in multiple ways, including:

- Reducing the strategic allocation to a specific asset class, for example high emissions.
- Reducing or eliminating allocations to specific investment managers
- Delegating decisions to divest individual portfolio companies to investment managers

Investment decisions alone will do little to support real-world decarbonisation directly. Due to this, the Fund does not support blanket divestment at this time, given this can overlook the fact that risks and opportunities might often lie in the same sectors. For example some utility companies with coal plants are also major developers of renewable energy.

Where engagements are unsuccessful, the Fund believes divestment should follow as a means of risk management, however this will be dependent on:

- Individual companies starting point.
- Some sectors will take longer to decarbonise than others
- Whether the company has adequate resources to achieve decarbonisation.
- Escalation of engagement to persuade decarbonisation.

Where a manager refuses to engage, does not provide credible evidence or reasoning to why they are failing financially on environment, social or governance factors the Fund has the power to replace an investment manager.

Glossary

1.5 degrees

The 1.5 °C target is the goal of the Paris Agreement, which calls for countries to take concerted climate action to reduce greenhouse gas emissions in order to limit global warming. Scientists believe limiting warming to 1.5 degrees would reduce the worst impacts of climate change.

Absolute carbon emissions

Also known as 'financed emissions', are absolute tons of CO2 for which the Fund is responsible from its underlying investments.

Asset Classes

An asset class is a grouping of investments that exhibit similar characteristics. The Fund invests in various asset classes such as:

- Equities – Refers to money invested in a company by purchasing shares of the company in the stock market.
- Bonds – Are issued by governments and corporations when they want to raise money. Investments in bonds are paid periodic interest payments.
- Infrastructure – Investments contain physical assets such as bridges, roads, highways and energy.
- Property – Investments in real estate. There are also less traditional asset classes such as Timberland which relates to investment in productive forestry and managed natural forests.CA100+

Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change.

Clean Technology

Companies whose products and services include clean technology. Products and services eligible for inclusion include Alternative Energy, Energy Efficiency, Green Building, Pollution Prevention, Sustainable Water.

Climate Solutions

Companies whose products and services that may include alternative energy, energy efficiency, green buildings, sustainable water and pollution prevention.

Decarbonisation

The process by which the Pension Fund will look to encourage countries, companies and other entities aim to achieve zero fossil carbon existence. Typically refers to a reduction of the carbon emissions associated with electricity, industry, and transport.

Carbon Intensity

A proxy for a portfolio's exposure to potential climate-related risks (especially the cost of carbon), often compared to a performance benchmark. It is calculated by working out the carbon intensity (Scope 1 and 2 Emissions / $M sales) for each portfolio company and calculating the weighted average by portfolio weight.

Investment Manager

An organisation to whom the responsibility for the day-to-day management of some of the schemes assets is delegated. The Investment Manager acts on the basis of the mandate, as agreed with them and their client (Leicestershire Pension Fund). The mandate may contain performance targets by reference to a benchmark.

Responsible Investment

The integration of financially material environmental, social and corporate governance ("ESG") factors into investment processes both before and after the investment decision.

Stewardship

The promotion of the long-term success of companies in such a way that the ultimate providers of capital also prosper, using techniques including engagement and voting.

Voting

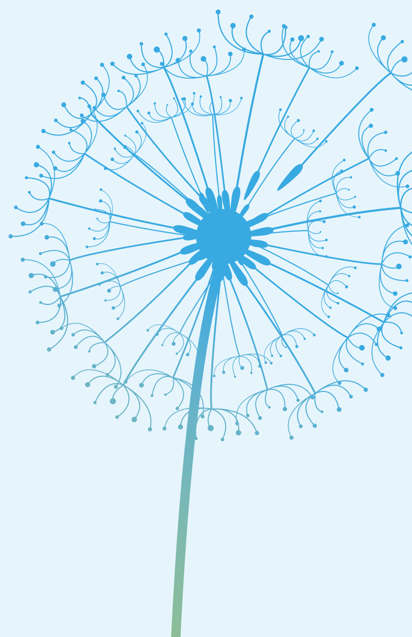
The act of casting the votes bestowed upon an investor, usually in virtue of the investor's ownership of ordinary shares in publicly listed companies.

What is climate change?

Climate change is the long-term shift in average weather patterns across the world. The release of carbon dioxide and other greenhouse gases have caused global temperatures to rise, resulting in long-term changes to our climate.

What is net zero?

The term net zero means achieving a balance between the carbon emitted into the atmosphere, and the carbon removed from it. This balance - or net zero - will happen when the amount of carbon we add to the atmosphere is no more than the amount removed.



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