

Leicestershire County Council Pension Fund Net Zero Climate Strategy (NZCS) Engagement

The Leicestershire County Council Pension Fund (“Fund”) has around 100,000 members, split between current employees, covering almost 200 organisations, deferred members (those who have built up benefits and left the scheme but not drawing a pension yet) and members in receipt of a pension or their dependants.

The LGPS is a defined benefit scheme, meaning that, when service has been earned and employees contribution made pension benefits are guaranteed, with employers having to ensure funding is available to pay the benefits as they become due.

Benefits are funded by a combination of employee’s contributions, which is a fixed amount set nationally depending upon salary, employer’s contributions that are based upon an estimate of the cost of future benefits earned and investment returns on cash held before pension payments are due. Employers have to make additional contributions if a difference arises between the expected cost of benefits and the funding available, for example due to greater longevity or below target investment returns.

When making investment decisions the Fund has to balance affordability of employers annual contributions against the level of risk being taken on in delivering investment returns.

Getting this balance right is particularly important in the LGPS where increased pension contributions would divert resources from the socially positive activity that employers undertake. Furthermore, if any employer becomes insolvent the other employers within the scheme have to pick up any deficits via increased employer contributions.

The scheme is administered by Leicestershire County Council on behalf of all participating employers. Leicestershire County Council delegated the responsibility for decisions relating to the Investment of the Fund’s assets to the Local Pension Committee. At its meeting on 27 November 2021 the Committee approved development of a Net Zero Climate Strategy to improve the management of climate change risk for the Fund.

Over 2022, the Strategy has started to be developed, utilising a best practice framework from the Institutional Investors Group on Climate Change (IIGCC). Other LGPS fund’s climate / net zero statements have also been referred to where publicly available.

This engagement is scheduled to run from July to the middle of September, to seek views from a range of stakeholders to inform the development of the Strategy before it is presented to the Local Pension Committee in late 2022.

Engagement

The engagement survey will be web based and administered by the County Council's in house team.

Questions which are proposed below have been selected in conjunction with the engagement and consultation team.

The following have been considered:

- The ability to separate and report on cohorts – employers, scheme members and other for each of the questions asked. Employers will be sent a link to the survey and will be asked to complete the survey from the employers perspective rather than the individual.
- The ability to gain a view on each question on a sliding scale where possible in order to understand general acceptance of the proposal. Where possible a scale of 1 to 5 will be used. 1 being strongly disagree with the proposal and 5 being strongly agree with the proposal
- Additional information will be provided in advance of each question where it is deemed appropriate to enable a better response from the responder.

Measures and Targets

A key part of managing the Fund's exposure to climate change is through a set of measures and targets that will be routinely monitored and updated periodically. The proposed measures for the Leicestershire NZCS include three primary measures and six secondary measures. The Fund believes that achievement of the three primary measures are the most important, with secondary measures being listed which will support delivery of the primary measures. Secondary measures inclusion reflects IIGCC guidance.

The proposed measures and targets are listed below, the majority of engagement questions will be based on the eight items below. Views will be sought for text in square brackets within the measures / targets column in particular.

i. Primary Measures

	Engagement Question	Rationale	Response type
1	Do you agree with the goal, "Net Zero by [2050, with an ambition for sooner]"	<p>Companies that commit to a net zero strategy will be operating under that particular countries legislation. Where a country has a stated net zero goal of 2050, for example, it will be difficult to enforce company earlier target date given the regulatory and policy environment in which they operate.</p> <p>For countries that set a net zero goal of 2050, it is believed that most companies, particularly those in high emitting sectors, will follow this pathway.</p> <p>It is important to note that not all countries will set 2050 targets with some beyond 2050 and some before, however it is expected that most of the developed world will assume 2050. Many industries that emit carbon are essential to the world such as agriculture and construction of essential of infrastructure. It is important to maintain a balanced investment portfolio so to not increase investment return risk by becoming more heavily invested in one sector such as tech whilst trying to reduce climate risk. An orderly transition that balances risk is favoured.</p>	1-5; 1 strongly disagree, 5 strongly agree
2	Do you agree with the goal, "Absolute net carbon emissions to be reduced by [40%] from 2019 reported levels by 2030."	<p>The proposed reduction applies to listed equity. The generally accepted metric WACI (weighted average carbon intensity) is measured using dollars of revenue as a denominator. As such the metric is subject to volatile changes based on revenue alone. The use of an absolute tonnes measure of carbon together with the WACI gives a more meaningful assessment over time. The use of a recent base position to measure reductions from is generally accepted to be better than older base.</p> <p>The absolute reduction in carbon is made more difficult to achieve as the Fund is</p>	1-5; 1 strongly disagree, 5 strongly agree

		<p>growing - i.e. the cash flow positive nature of the Fund as more money is added through employer and employee contributions, than pensions paid. Thus, aiming for 40% reduction seems sensible.</p> <p>This is a challenging target to achieve given increasing contributions into the Fund.</p>	
3	<p>Do you agree with the goal, "Reduce the Carbon intensity (WACI - weighted average carbon intensity) of the Fund by [50%] from the 31st December 2019 levels for the Equity portfolio by 2030. This target will extend to other asset classes as common methodology is agreed.</p>	<p>In line with the IIGCC guidance interim targets should be selected that are at least in line with the goal of achieving net zero by 2050 without back loading the achievement. The resulting carbon intensity is weighted so that a larger holding has a bigger weight within the WACI final metric.</p> <p>The metric is useful for comparing funds of different sizes and progress over time when funds are growing, such as the Leicestershire Fund, but can be sensitive to changes in the market value of a portfolio.</p> <p>Is currently based on measuring listed equities and will be expanded to include further asset classes as reliable measurements are available.</p>	<p>1-5; 1 strongly disagree, 5 strongly agree</p>

ii. Secondary Measures

Engagement Question		Rationale	Response type
4	<p>Do you agree with the goal "Reduce the proportion of the Fund with Fossil Fuel exposure within the equity portfolio (was 8.5% at 31st Dec 2019) by 31st March 2030"</p>	<p>A metric that the Fund should have an improving medium term view on as underlying companies publish more net zero strategies in line with legislation. The Fund can benefit from the measured improvements whilst holding the companies to account.</p> <p>The measure is currently very crude and does not take into account the level of fossil fuel exposure, just whether a company has some. As better information becomes available the measure will be refined.</p>	<p>1-5; 1 strongly disagree, 5 strongly agree</p>

		<p>By holding voting rights, the Fund, alongside lobby groups will be able to shape the pace and direction of the decarbonisation effort.</p> <p>Not having a specific target for this is not uncommon, within the LGPS Central pool just one LGPS fund has set a target. It is proposed that the Fund continually monitors (through the annual Climate Risk Report) the fossil fuel exposure within the Fund and limit it where new mandates are entered into. At the next review of targets the Fund should be better placed to understand if a specific target is more appropriate.</p>	
5	Do you agree with the goal “Increase the asset coverage to [90%] by 2030 (currently at 45% 2022 Est) to be analysed for WACI”	<p>This target will be dependent on the industry agreeing commonly accepted standards. The Fund expects corporate bonds (which the Fund has an allocation to) to be the next asset class to be included.</p> <p>This target is challenging but achievable, the Fund will aim to accelerate the goal in order to better support risk management.</p>	1-5; 1 strongly disagree, 5 strongly agree
6	Do you agree with the goal “Increase allocation to climate solutions (use EU taxonomy) as defined by weight in clean technology from the base 2019 weight of 34.1% by 2030.”	<p>The IIGCC suggests a target to renewables - this in the short term can be used as a proxy. This target will remain under review to ensure precision.</p> <p>Increasing the Fund's alignment to this metric will result in financing the activities the EU (inherited by the UK) have deemed to be in line with becoming carbon neutral by 2050.</p> <p>The European Union aims to be climate neutral by 2050. To help that process it has come up with a system to "facilitate sustainable investment". By adopting the EU standard, reporting will be made more reliable, as European companies are obliged to report their level of taxonomy-aligned undertakings. Any activity excluded from the list faces being cut out of sustainable finance products and will find itself at odds with long-term EU policy objectives.</p> <p>Any activity excluded from the list faces being cut out of sustainable finance products and will find itself at odds with long-term EU policy objectives.</p>	1-5; 1 strongly disagree, 5 strongly agree

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7	Do you agree with the goal, "Increase our percentage of portfolio underlying companies in material sectors with net zero targets, aligned to a net zero pathway or subject to direct or collective engagement to over [90%] by [2030] for listed equities, corporate bonds and sovereign bonds."	The IIGCC framework however does not state a target or by a specific date. A high target supportive of risk management is needed to ensure invested companies are managing the risk. Companies within material sectors are those where reductions in carbon will make meaningful impacts, these include agriculture, forestry and fishing, mining, electricity and gas supply, water and sewerage activities to name a few.	1-5; 1 strongly disagree, 5 strongly agree
8	Do you agree with the goal, "By [2030], [90%] of the Fund's financed emissions to be either net zero, aligned to a net zero pathway or subject to engagement programme to bring that about. Includes equities, corporate bonds and sovereign bonds at present."	As further asset classes come into scope with regard to agreed calculations for financed emissions then targets will be updated. This target is line with the IIGCC guidance.	1-5; 1 strongly disagree, 5 strongly agree
9	None	The County Council, as the Fund's Administering Authority, has a goal to be net zero for its own operations by 2030. LGPS Central (the pension pooling company) has a goal of 2030 for its own operations. Investment managers that the Fund invests with have various net zero target dates.	

iii. Additional Questions not related to the to the proposed metrics are noted below.

Additional Questions	Response type
<p>The philosophy of the Fund and its investment managers is to invest in well run companies who take into account a range of Environmental, Social and Governance (ESG) considerations with climate change being one of the considerations.</p> <p>The Fund via its Responsible Investment Policy (link: https://leicsmss.pensiondetails.co.uk/documents/Investment-Strategy-Statement.pdf?language_id=1) favours engagement with companies to improve their ESG risks rather than divestment.</p>	<p>1-5, 1 = strongly prefer divestment, 5 strongly prefer engagement</p>
<p>In line with most pension funds and the UK government the Fund’s approach is to encourage companies to improve on the ESG management of risks through engagement including actively voting at company meetings in collaboration with other like minded investors. Many traditional companies will be looking to becoming more carbon efficient and at present have poorer carbon metrics than other companies. There are companies who are engaged in renewable energy projects as well as traditional use of fossil fuels which could become tomorrows leaders as they transition away from fossil fuels. Divesting from these groups of companies would see the Fund miss potential opportunities.</p> <p>The benefit of any improvement in climate metrics from divestment is also not gained by the Fund after divestment, but by new owners. In addition, any new owners may not be as responsible an owner as a Local Authority Pension Fund is and therefore engagement with the company may cease.</p>	
<p>The Fund allows investment managers freedom to invest providing they can demonstrate management of ESG risks including climate change. There is no guarantee of success, and an alternative method could be to divest which could lead to quicker improvement in measured climate metrics for the Fund, but may introduce other risks to the Fund such as concentration in other asset classes which increases investment risk. For example, technology companies have lower carbon metrics than many other industry sectors but as history has shown can have times where they sell off at a higher rate than other sectors.</p>	

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Do you have a view on whether the Fund should employ carbon offsetting? What approach should the Fund adopt?	1 = No offsetting
Although strategies to avoid, reduce and substitute harmful greenhouse gases are more impactful than offsetting, it is not expected that globally all emissions can be stopped. In addition, it is likely that historic emissions will need to be removed from the atmosphere	2 = Only offsetting if removes carbon from atmosphere
So, as businesses transition, carbon offsetting is one way for them to neutralise any emissions generated from their activities, particularly where technology costs too much or is not currently in existence. Businesses can buy carbon credits generated by projects that are cleaning up the atmosphere or directly invest in schemes, to compensate for the emissions they haven't yet eliminated.	3= Only natural offsetting such as trees
	4= Offsetting acceptable if the economically best option
Do you understand what the fiduciary duty of the Fund is?	1-5, 1 = I don't know, 2 = I know a little, 3 = I know enough to explain to others, 4 = I have a good grasp of fiduciary duty with respect to defined benefit pensions, 5 = I have exact knowledge of fiduciary duty with respect to the LGPS
Can you describe the Fund's investment strategy?	No - I have little knowledge about where the fund invests, A little - I have read which investment classes the fund invests in and how they are agreed,

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	Yes = I know which policies include the investment strategy, how investments are selected and agreed and how often investment strategy is formally reviewed
Do you understand the impact of funding level changes on the pension contributions from employers and employees within the Leicestershire LGPS and who stands the risk of poor investment performance versus the expected performance when it comes to the ability to pay future pensions?	<p>1= I don't know the link between funding level and effect on pension contributions, or yes I do, it is:</p> <p>2 = employers</p> <p>3 = employees</p> <p>4 = employers and employees</p> <p>5 = neither</p>
What is your NI number	Mandatory - to check against membership of the Leicestershire LGPS, will be deleted in line with Council data retention policy
Are you an active member, deferred member, pensioner / dependant of the Leicestershire LGPS or not a member of the Leicestershire LGPS	Multi choice drop down selection, Active, deferred, pensioner/dependant, not a member

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