This report has been prepared by LPPI for Lancashire County Pension Fund as a professional client.

1. Introduction

This report on Responsible Investment (RI) is a companion to the LPPI RI Dashboard (Appendix B) and the Quarterly Active Ownership Report (available from the online Pensions Library).

It covers stewardship in the period 1 April to 30 June 2021 plus insights on current and emerging issues for client pension funds.

[R] This symbol indicates a term explained in the reference section at the end of this report.

Key takeaways for the period:

- In Q2 2021 (voting season) LPPI voted on 3232 company and shareholder proposals, supporting 90% and 81% respectively.
- Investments in brown sectors (extraction, transportation, storage, supply, and generation of energy from fossil fuels) are 2.66% of the portfolio.
- Investments in green sectors (renewable energy generation, clean technology, and decarbonising activities) are 3.22% of the portfolio.
- LPPI is an inaugural signatory to the Asset Owner Diversity Charter, reflecting our support for improved diversity across financial services firms.
- LPPI has provided input to a Department for Work and Pensions (DWP) call for evidence on the consideration of social risks and opportunities by occupational pension schemes.
- LPPI has signed the 2021 Global Investor Statement to Governments on the Climate Crisis.

2. RI Dashboard – Portfolio Characteristics

This section of the report shares key takeaways from the RI Dashboard at Appendix B.

Asset class metrics (*Dashboard pages 1 & 2*) offer insights on the composition of the portfolio and its general characteristics. See the summary for Q2 outlined below.

Listed equities (Dashboard p1)

Sector Breakdown

Categorised by GICS[R] the largest sectoral exposures for the GEF are Information Technology (23%), Consumer Staples (13%), and Industrials (13%).

Comparing the GEF with its benchmark (MSCI ACWI)[R] gives insight into how sector exposures for the fund differ from a global market index. The length of each horizontal bar indicates by how much exposures differ in total (+ or –) compared with the benchmark, which is the outcome of active managers making stock selection decisions rather than passively buying an index. For Utilities and Real Estate, the GEF weightings are equal to the MSCI Benchmark and so the variance is equal to 0% (meaning no bar is displayed here).

Top 10 Positions

The top 10 companies (10 largest positions) make up 24% of the total LPPI GEF.

In Q2 2021 Visa has risen to become the second largest holding in the GEF, overtaking Nestle. There have also been changes in the bottom 3 positions. Estee Lauder, AutoZone, and SPDR Gold Shares (8th, 9th, and 10th in Q1) have been replaced by Alphabet, Nike, and Waters Corporation respectively.

Portfolio ESG Score

The GEF's Portfolio ESG score has remains unchanged from Q1 2021 at 5.2. In the same period, the equivalent score for the MSCI ACWI benchmark has increased from 5.0 (Q1 2021) to 5.1.

Transition Pathway Initiative (TPI)

Monitoring against TPI[R] Management Quality ratings confirms the GEF continues its relatively low exposure to highly carbon intensive activities with minimal changes in ratings since Q1. By value, only 12% of the GEF is in the globally high emitting companies under TPI assessment (a decrease from 13% in Q1 2021).

The number of GEF companies in scope of TPI scoring has not changed since Q1 2021, remaining at 24.

Of the 24 companies in TPI scope:

- 90% (by value) are rated TPI 3 and above – demonstrably integrating climate change into their operational planning (TPI3) and into their strategic planning (TPI 4). This is down from 91% in Q1 2021, which reflects mark to market changes for different companies within each of these rankings.
- 7 companies are scored below TPI 3 and under monitoring.

<u>Other asset classes (Dashboard p2)</u>

Private Equity

Sector and geographical exposures have not changed materially from Q1 2021. The portfolio continues to have a strong presence in the United States (46%) and the largest sector exposure remains Information Technology (32%).

Infrastructure

Geographical exposures remain the same as they were in Q1 2021. The portfolio is predominantly focussed within United Kingdom (43%). Regarding sectoral exposures, the Infrastructure team has introduced a revised categorisation which is reflected for the first time this quarter. Under it, the portfolio's largest exposure (36%) is to Traditional Energy, Renewable Energy, Waste.

Real Estate

Sector and geographical exposures also remain relatively constant from Q1 2021 in Real Estate. The portfolio remains 74% invested in UK assets and has a 38% weighting to Industrial assets.

The Real-World Outcomes section of the dashboard features examples of socially positive investments and this quarter the focus is on Real Estate. Pages 6-7 share information on a selection of investments within the Lancashire Fund portfolio which are providing homes, workplaces, and specialist accommodation which is also contributing to the supply of sustainable building stock both in the North West of England, broader UK and further afield.

Green & Brown Exposures

Calculation of the Fund's exposure to Green and Brown activities focusses specifically on equity assets (listed equity, private equity, and infrastructure) plus corporate bonds within fixed income. Figures give an indication, rather than a precise measure, as an assistance to reviewing the overall position.

Green activities are those directly contributing to real world decarbonisation, principally through renewable energy generation, but include other activities supporting lower emissions including district heating, and waste management. Brown activities are those directly involved with extracting, transporting, storing, and otherwise supplying fossil fuels, or using them to generate energy.

The dashboard presents information on the trend in green and brown exposures (commencing in Q4 2019). Quarterly changes in Green and Brown exposure reflect multiple factors at play including funds reaching maturity, assets being revalued, and investments being made and sold. The total value of the Lancashire County Pension Fund portfolio (as the denominator) also affects brown and green % shares quarterly.

Compared with Q1 2021, both green and brown exposures have decreased slightly.

Brown activities are 2.66% of the portfolio (Q1 2021 2.85%). The change reflects a net reduction in the total value of brown infrastructure assets (including the sale of a natural gas asset) which was partly offset by the inclusion (for the first time) of fixed income investments within the "brown" calculation. Incorporating the value of corporate bonds where underlying companies are identifiable as having fossil fuel related activities reflects ongoing efforts to enhance coverage and improve insights as data availability allows across asset classes. Whilst the value of brown assets fell slightly, the biggest influence on the proportion of brown was growth in the value of Lancashire Fund (as the denominator) between Q1 and Q2.

Green activities are 3.22% of the portfolio at Q2 (Q1 2021 3.40%). There was only a minor change in the overall value of assets identified as green (a small net reduction in infrastructure asset valuations was more than offset by a larger holding in green bonds) but in total green assets are a smaller proportion of the total Fund in Q2 due to the increase in the value of the Lancashire Fund (as the denominator) between Q1 and Q2.

Investments in renewable energy generation from wind, solar, hydro, and waste make up 78% of total green exposure. Lancashire County Pension Fund's green exposure is 98% via Infrastructure investments.

3. Core Stewardship

This section of the report gives an overview of stewardship activities in the last quarter. Client pension funds delegate day to day implementation of the Partnership's approach to RI to Local Pensions Partnership Investments Ltd (LPPI). Ongoing stewardship activities by LPPI include portfolio and manager monitoring and the exercise of ownership responsibilities via shareholder voting, and engagement.

Shareholder Voting - LPPI Global Equity Fund (GEF) *(Dashboard page 3)*

Shareholder voting is overseen centrally by LPPI rather than by individual asset managers. LPPI receives analysis and recommendations from an external provider of proxy voting and governance research. We follow Sustainability Voting Guidelines focussed on material ESG considerations and liaise with providers and asset managers as needed to reach final voting decisions.

Full details of all shareholder voting by LPPI are publicly available from the LPP website within quarterly shareholder voting reports.

The period 1 April to 30 June 2021 encompassed 252 meetings and 3232 proposals voted. LPPI voted at 98% meetings where GEF shares entitled participation. Of the 4 (2%) meetings that were not voted, in Q2 21, 3 were a result of share blocking [R], and the final 1 was due to Hungarian Covid-19 legislation, under which AGM decisions may be passed by the managing directors or board of directors instead of shareholders, unless certain characteristics apply.

a) Company Proposals

LPPI supported 90% of company proposals in the period.

Opposition voting concentrated on:

- the election of directors (addressing individual director issues, overall board independence, and over-boarding), 37% of votes against company proposals.

- non-salary compensation (addressing inadequate disclosure of underlying performance criteria, use of discretion, and the quantum of proposed rewards), 17% of votes against company proposals.

Case study – Directors related

LPPI voted against 133 out of 1869 of directors related resolutions across the quarter (7%).

At Netflix (USA: Movies & Entertainment), LPPI withheld support for all four directors on the ballot. This was because the board failed to respond to a majority-supported shareholder proposal requesting the board adopt a simple majority vote standard and failed to address the issues that led to majority withhold votes against a director nominee (notably persistent unresponsiveness to majority supported shareholder resolutions). Results: 43.4% - 72.8% against.

At Motorola Solutions (USA: Communications Equipment), LPPI voted against one director due to overboarding (result: 43.5% against). LPPI also voted against a director considered non-independent who sits on three major Board Committees (result: 29.5% against).

LPPI cast 10 votes against directors across seven companies due to the lack of gender diversity on the Board. Results where disclosed: 3.7% to 38.1% against.

Case study – Non-salary compensation

LPPI voted against 51 out of 321 (16%) of management remuneration votes across 166 companies.

At Befesa SA (Germany: Environmental & Facilities Services) and Amadeus IT Group (Spain: Data Processing & Outsourced Services), a majority of shareholders opposed management, with votes against of 70.1% and 61.8% respectively. The vote at Befesa was driven by poor disclosure, especially around discretionary stock awards, and poor engagement following large prior dissent levels. At Amadeus, LPPI's reservations around the inclusion of a 'special recognition payment' alongside the choice of Long-Term Incentive Plan (LTIP)[R] metrics (e.g. emphasis on relative Total Shareholder Return (TSR)[R]) drove the vote against.

Over voting season, LPPI also incorporated insights from an engagement theme underway by a delegate manager on remuneration. This focused on the excessive use of stock options in management pay and informed LPPI's decision in to vote against management at McDonald's (USA: Restaurants) when our voting provider ISS recommended supporting management (result: 6.8% against).

Shareholder proposals

LPPI voted on 103 shareholder resolutions over Q2 and supported 83 (81%).

LPPI supported six climate-related resolutions at five companies. Two resolutions were on the ballot at Booking Holdings (USA: Hotels, Resorts & Cruise Lines). One requested that the Board issue a climate transition report, detailing the scale and pace of its responsive measures associated with climate change. This vote passed with majority support (56.1%). The second vote requested Booking introduce an annual advisory vote on its climate change policies and strategies (also known as a 'say on climate vote'). This vote did not pass but received significant support (34.1%). One reason for the discrepancy may be the fact the value of the say on climate is still a live debate within the responsible investment community. Some investors believe the introduction of a specific climate item would take the pressure off directors who may otherwise face large dissenting votes. The remaining four climate votes LPPI supported received For votes of 14.0% to 31.6%.

LPPI supported seven shareholder resolutions relating to diversity across six companies. Five of the seven sought greater reporting transparency around efforts relating to diversity and inclusion. Of these, three votes passed with majority support. Two took place at Union Pacific Corporation (USA: Railroads) and one at American Express Company (USA: Consumer Finance). An emerging trend is shareholder resolutions seeking race audits, representing two of the seven diversity votes. These are more comprehensive asks compared to disclosure requests and require companies to review the racial impact of their policies and practices. Requests for race audits were filed at Johnson & Johnson (USA: Pharmaceuticals) and Wells Fargo (USA: Diversified Banks). These votes received support of 33.9% and 14.5% respectively.

Shareholder Engagement

Company and manager engagements are underway on an ongoing basis, directly through board seats and Limited Partner Advisory Committees (LPAC) for private market assets, and more conventionally through shareholder engagement with listed companies.

LPPI's engagement partner Robeco has completed a fifth full quarter of engagement activity. The RI Dashboard (page 4) presents engagement headlines for the quarter which confirm the Robeco Active Ownership Team undertook 57 activities in total, and the predominant focus topics were Corporate Governance and Human Rights with 12 engagements each.

Page 5 of the Dashboard summarises the status of each live engagement theme (as it stood at the end of Q2).

During Q2, Robeco introduced a new theme: Labour Practices in a Post Covid-19 World. This theme was supported by LPPI at the 2020 Client Panel (our primary route to influence future themes). Robeco believe that there is a greater focus on workers' rights because of the pandemic, as the precarious employment status of certain workers exposed a widespread lack of adequate safeguards necessary to protect workers and enforce their rights. The inadequate management of labour and human rights may expose businesses to legal, operational, and reputational risks. Robeco will seek to ensure minimum standards are met in labour intensive industries such as e-commerce, with a focus on occupational health and safety, the right to freedom of association and collective bargaining, and wages and benefits.

LPPI's exposure to the theme captures two positions in the equities fund and one in fixed income. Robeco are currently scoping out 12 additional companies for the theme. At the recent Q2 meeting, LPPI highlighted the need for increased assets (portfolio holdings) to be under engagement and we hope to see our exposure to this theme increase going forwards.

The Active Ownership Report at Appendix 2 (a copy of which is available for Committee members to view in the online Pensions Library) provides detailed narrative on thematic engagements underway with listed companies (representing shares held by the Global Equities Fund, or corporate bonds held by the LPPI Fixed Income Fund).

Each quarter, we provide further insights into one of the live themes underway by the Robeco Active Ownership Team.

Robeco Active Ownership case study – Lifecycle Management of Mining

Robeco introduced the Lifecycle Management of Mining theme in March 2020. At theme launch, Robeco viewed mining as both the source of problems and solutions for many environmental and social issues. The low-carbon transition requires many minerals and metals; however, mining practices can cause irreparable damage to nature and communities. Further, the complicated global operations of mining companies bring challenges around consistent quality standards. Global principles and standards exist, but their effectiveness depends on how they are implemented at the asset level.

Maintaining a social license to operate is a critical risk for mining companies. The broad impacts of mining on communities means this license is dependent on many factors. For example, financial risks in relation to water management are a systemic part of the mining business. This is illustrated by CDP's [R] water survey which found that the percentage of firms affected financially due to water related risks is much higher than other sectors. Waste management is also critical to the license to operate, as highlighted by the recent accidents relating to tailings dam failure. These dam disasters are not only incredibly harmful to the local communities and the environment, they also have a huge financial impact on the mining companies involved. Recent disasters in Brazil have resulted in fines running into the billions of dollars for mine owners, protracted lawsuits that may cost billions further still, rating downgrades, and a stricter regulatory environment.

These factors inform Robeco's engagement priorities: water risk, tailings dam safety, and retirement planning of mines. Each pillar has its own specific objectives:

- **Water risk:**
  - Water risk management: group wide water stewardship policy and risk management system covering the full hydrological cycle and future water users.
  - Enhanced monitoring and disclosure of water consumption and impacts on water quality.
  - Targets to reduce water use and improve water quality.

- **Tailings safety management:**
  - Implementation of Global Standards developed by the Independent Global Tailings Review.
  - Public reporting to the Global Tailings Database.
  - Phase out of high-risk tailings dams and investing in technology to reduce mining waste.

- **Asset Retirement Planning:**
  - Financial assurances to cover the cost of reclamation and remediation with periodic review throughout operations.
  - Financial surety must be liquid and accessible

Robeco selected targets through a combination of factors, including exposure to client and Robeco portfolios, geographic location of miner, mining sub-industry, and performance across areas of engagement.

Progress so far for LPPI's companies under engagement has been neutral to positive. A Canadian gold mining company's effort in relation to water management and their disclosures of tailings dams has been an example of good practice in the group. Similar practices have been established at an Australian based mining company, who faced additional scrutiny following a partial failure of a dam wall. Following successful initial outreach, engagement with a Mexican mining group has slowed and Robeco are escalating their approach through collaborative engagement. At a Russian gold mining company, communication has been open, but limited resources to dedicate to matters outside a current focus on a climate strategy are an issue currently. With approximately 18 months remaining for engagement, we hope to see progress continue.

4. Collaborations and Partnerships

LPPI participates in a range of investor groups and partnerships which provide opportunities for shared learning and a platform for collective action. The following are headlines for 2021 Q2.

Climate Crisis Statement

LPPI has signed the 2021 Global Investor Statement to Governments on the Climate Crisis. This global investor statement was coordinated by the seven founding partners of The Investor Agenda [R] and is signed by 457 investors representing over USD $41 trillion in assets.

The statement urges all world governments to commence a global race-to-the-top on climate policy and warns that laggards will miss out on trillions of dollars in investment if they set their ambition too low or do not begin making clear progress soon. The overwhelming investor support represents the largest collective AUM to sign on to a global investor statement to governments on climate change since the first statement in 2009.

Feedback to the Department for Work and Pensions (DWP)

LPPI welcomed the opportunity to provide input to the Department for Work and Pensions (DWP) call for evidence on the consideration of social risks and opportunities by occupational pension schemes.

Our response expanded on the following observations:

- Pension Funds lack a frame of reference equivalent to that provided by the TCFD[R] for climate related issues, as a universal set of standards and agreed approach for considering social issues.
- Social issues are multidimensional and context specific, tending to be complex, and interconnected. They are harder to exemplify within headline policies than concepts of value destruction due to physical peril or asset stranding through the transition from fossil fuels to renewables.
- When a practical, useful, accepted approach and standard for social factors is available, articulation, disclosure, measurement, and reporting will improve in response.

- Experience and insights from Covid-19 include a strong spotlight on existing social inequalities and imbalances, the vulnerability of the social care sector, new concepts of social value, emphasis on the importance of relatively poorly paid "key workers", and the power of community cohesion.
- The Government's most productive role and actions going forward would be as:
    - a facilitator using influence to encourage the investment sector to convene and develop standards that will solve perceived issues in a resource efficient way
    - an advocate for the good practice being called for
    - an exemplar of the processes and outcomes being urged on pension fund trustees by incorporating due consideration for material social factors within Covid recovery planning, and by directly supporting the ability of investors to hold companies to account and set high standards for corporate governance via routes including listing rules.

Full details are available here.

Asset Owner Diversity Charter

LPPI has become an inaugural signatory to the Asset Owner Diversity Charter which addresses a lack of diversity across the investment management industry. The Diversity Charter offers a toolkit to review how asset managers are performing on diversity and inclusion – and where they can improve.

By signing up to the Charter, signatories are committing to take account of the diversity and inclusion records of fund managers when choosing new partners. Including diversity questions as part of the overall assessment will encourage prospective fund managers to disclose more information and to describe practical actions being taken to improve diversity and inclusion within their workforce.

Signatories also commit to including diversity as part of ongoing manager monitoring, through a questionnaire provided to managers annually for completion. A key aim is to create standardisation and improve disclosure by the industry as a whole. The charter questionnaire has been developed to be progressive and will encourage reporting on ongoing progress. It goes beyond asking about the strategic approach, to identify how managers look at diversity and inclusion across five key areas:

1. Industry perception
2. Recruitment
3. Culture
4. Promotion
5. Leadership

For more information on this initiative, visit the Diversity Project".

Call for Consistency on 'Corporate Net-Zero Alignment Plans'

LPPI has joined 52 other institutional investors in a call for consistency on ‘corporate net zero alignment plans’ and director accountability on climate targets. The aim is to establish new corporate governance measures which assist shareholders to hold companies to account in achieving ‘net zero emissions’ commitments.

Whilst at least a fifth of the world’s 2,000 largest public companies have committed to net zero targets, a lack of standardisation in the commitments made to date poses a challenge for investors, who are increasingly looking to align their overall portfolios with net zero objectives, through initiatives such as Net Zero Asset Managers and the Paris Aligned Investment Initiative.

In order to monitor status and progress at portfolio level, investors need information disclosed and targets set by investee companies to be robust, comparable, and properly implemented, giving them the means to identify and urge remedial action where this is needed.

The Investor Pension Statement can be found here and IIGCC[R] coverage of the initiative can be found here.

5. Other News and Insights

GLIL Focus on Sustainability

GLIL has continued to enhance strong capabilities in renewable energy investing, bolstering credentials through the appointment of an infrastructure and renewable investment specialist (GLIL Appointment). GLIL has also announced a £150m investment in Flexion Energy, the specialist utility and energy storage infrastructure company. The deal is a joint venture with ‘ion Ventures’ to scale UK energy storage infrastructure and directly supports the UK’s transition to net zero (Flexion).

Real Estate Fund Support for Electric Vehicle (EV) Charging

The LPPI Real Estate Fund has entered a joint venture with Harworth’s Multiply Logistics North to build a 400-space van park for Amazon. The site straddles the boroughs of Bolton and Salford and is next to Amazon’s 149,000 square ft last mile distribution hub.

The van park will include EV charging infrastructure for all 400 van storage bays, a significant installation to support Amazon’s ambition of powering all its operations through renewable energy by 2030. For more information, see the press release here.

For Reference

CDP (formerly Carbon Disclosure Project) – A not-for-profit charity that runs the global disclosure system for investors, companies, cities, states, and regions to manage their environmental impacts. The world's economy looks to CDP as the gold standard of environmental reporting with the richest and most comprehensive dataset on corporate and city action.

GICS - Global Industry Classification System
The most widely used approach to categorising activities into industry sectors. The main standard in use for public markets with growing use for other asset classes.
For more information on GICS and the activities that fall into each sector see:
https://www.spglobal.com/marketintelligence/en/documents/112727-gics-mapbook_2018_v3_letter_digitalspreads.pdf

GRESB – Global Real Estate Sustainability Benchmark. GRESB Assessments capture information on ESG performance and sustainability best practices for real estate and infrastructure funds, companies, and assets worldwide, based on detailed information submitted by organisations applying to be assessed.

IIGCC – Institutional Investor Group on Climate Change. LPPI is a member.

INVESTOR AGENDA – The Investor Agenda is a common leadership agenda on the climate crisis that is unifying, comprehensive, and focused on accelerating investor action for a net-zero emissions economy. It draws expertise from across the investor landscape to clearly set out joint expectations. The founding partners are seven major groups working with investors: Asia Investor Group on Climate Change, CDP, Ceres, Investor Group on Climate Change, Institutional Investors Group on Climate Change, Principles for Responsible Investment and UNEP Finance Initiative. https://theinvestoragenda.org/

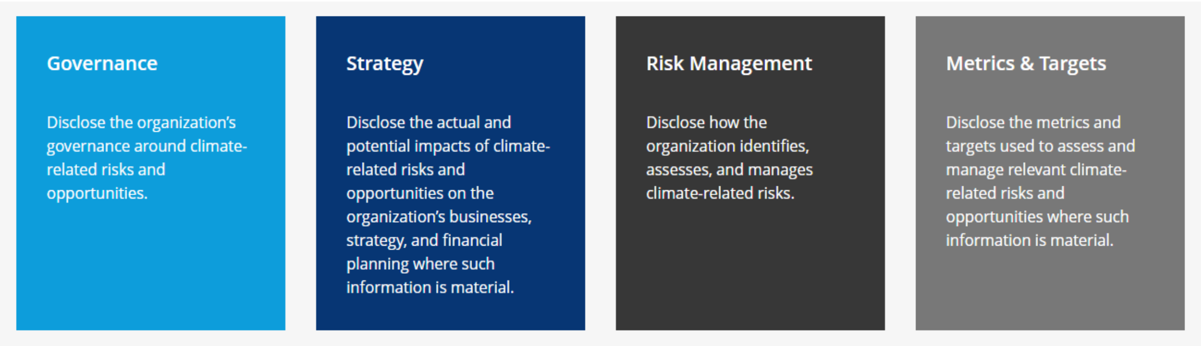
LONG-TERM INVENTIVE PLAN (LTIP) – A company policy that rewards employees for reaching specific goals that lead to increased shareholder value.

MSCI ACWI - MSCI All Country World Index
A stock index designed to track broad global equity-market performance.
The LPPI Global Equity Fund's benchmark.

MSCI - **Morgan Stanley Capital International** A global index provider.

SHARE BLOCKING – The share-blocking system requires investors who intend to vote at a company meeting to surrender the right to dispose of their shares for a period in advance of the meeting. LPPI submit a DNV (Do Not Vote) where share-blocking is in place, to maintain control, flexibility, and liquidity.

TCFD - Taskforce on Climate Related Financial Disclosure
The Financial Stability Board created the Task Force on Climate-related Financial Disclosure (TCFD) to improve and increase reporting of climate-related financial information by companies and investors.
Recommendations include annual disclosure under 4 pillars:



TOTAL SHAREHOLDER RETURN (TSR) – (or simply total return) is a measure of the performance of a company's stocks and shares over time.

TPI - **Transition Pathway Initiative** https://www.transitionpathwayinitiative.org/
The TPI assesses highest emitting companies globally on their preparedness for transition to a low carbon economy.
368 companies are rated TPI 0-4* for Management Quality based on 19 separate datapoints. TPI Management Quality scores provide an objective external measure of corporate transition readiness.