1. Introduction

This report on Responsible Investment (RI) is a companion to the LPPI RI Dashboard (Appendix 1) and the Quarterly Active Ownership Report (Appendix 2 – available from the online Pensions Library).
It covers stewardship in the period 1 October to 31 December 2020 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:

- LPPI has signed investor letters to the Prime Minister and Secretary of State for Transport urging ambition in domestic climate policy in the lead up to the UK's Presidency of COP 26 [R] in Nov 2021.
- Investments in brown sectors (extraction, transportation, storage, supply, and generation of energy from fossil fuels) are 2.99% of the portfolio.
- Investments in green sectors (renewable energy generation, clean technology, and decarbonising activities) are 3.84% of the portfolio.
- The carbon intensity of the LPPI Global Equity Fund has continued to decline (per the annual snapshot exercise undertaken in December 2020).
- MHCLG [R] intends to consult during 2021 on a new requirement for TCFD [R] reporting by LGPS pensions schemes.

2. RI Dashboard – portfolio characteristics

This section of the report shares key takeaways from the RI Dashboard at Appendix 1.

Asset class metrics (*Dashboard pages 1 & 2*) offer insights on the composition of the portfolio and its general characteristics. There have been minimal changes compared with the position reported at Q3 2020.

<u>Listed equities (Dashboard p1)</u>

Sector Breakdown
Categorised by GICS[R] the largest sectoral exposures for the GEF are information technology (23%) and consumer staples (14%).

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.

The GEF is underweight energy (GEF 0.5% versus 3.0% for MSCI ACWI) indicating a much lower exposure to companies extracting, transporting, storing, and supplying fossil fuels.

Top 10 Positions
The top 10 companies (10 largest positions) make up 21% of the total LPPI GEF.
There has been no change in ranking since last quarter for the top 7 companies; Apple has moved to 8th Estee Lauder has entered the list at 9th, SPDR Gold Shares have moved to 10th and Alibaba Group has been displaced.

Portfolio ESG Score
The GEF's Portfolio ESG score has fallen from 5.4 (Q3) to 5.1 (Q4). In the same period the equivalent score for the benchmark fell from 5.2 (Q3) to 4.9 (Q4). Both shifts reflect a notified change in methodology introduced by the data provider rather than any worsening in relative standing (or higher ESG risk) compared with the position last quarter.

Transition Pathway Initiative (TPI)
Our monitoring of the portfolio using TPI [R] Management Quality ratings confirms the GEF has relatively low exposure to highly carbon intensive activities. By value, only 12.5% of the GEF is in companies under TPI assessment as global high emitters (unchanged from Q3).

Compared with Q3, the number of companies in TPI scope has decreased by 5 (Q3 41, Q4 36) through positions being sold.

Of the 36 companies in TPI scope:

- 95% (by value) are rated TPI 3 and above – demonstrably integrating climate change into their operational planning (TPI3) and into their strategic planning (TPI 4).
- all extractive fossil fuel companies are TPI 3 or above (100% compliance with LPPI's target for this sector).

The LPPI GEF is featured in the Real World Outcomes section of the dashboard this quarter. Dashboard pages 6-8 outline how 3 featured companies are making a positive contribution to targets under UN Sustainable Development Goal 6 - Clean Water and Sanitation [R] . These examples share insights into how companies are acting as responsible stewards of their water footprints and having positive social outcomes through a focus on sustainable operations.

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

Private Equity
Sector and geographical exposures are unchanged from Q3. The portfolio has a strong US presence (46%) and largest sector exposure is to Information Technology (32%).

Infrastructure
Sector and geographical exposures are largely unchanged from Q3. The portfolio is predominantly focussed within the UK/Europe (43% / 37%) and is 61% utilities (supply of power and water).

Real Estate
Sector and geographical exposures are unchanged from Q3.
The portfolio is 74% UK assets and has a 37% weighting to industrial uses (logistics).

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 green bonds within fixed income. Figures give an indication, rather than a precise measure, as an assistance to reviewing the overall position. Our methodology continues to develop, particularly as we work to improve look-through to underlying assets held by pooled vehicles and fund of funds.

Green activities are those directly contributing to real world decarbonisation, principally through renewable energy generation, but we 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. There have been minor changes in overall levels of Green and Brown exposure compared with Q3 2020.

Brown activities are 2.99% of the portfolio (Q3 3.07%). Rather than a reduction in the value of brown assets (which remained relatively stable), the change reflects an increase in the value of the wider portfolio the brown segment is being compared to.

Brown exposure is 89% infrastructure and is mainly indirect investments in **midstream and downstream** oil and gas through infrastructure pooled funds. Midstream and downstream activities are **collectively** 66% of total brown exposure.

Green activities are 3.84% of the portfolio (Q3 4.02%). The change is partly a result of the increased value of the total fund the green segment is being compared to, but also reflects a depressed valuation for an infrastructure asset which is exposed to merchant power prices (reduced revenues) and a smaller holding (compared to Q3) in green bonds (fixed income).

Green exposure is 98% infrastructure and reflects renewable energy generation from **wind, solar, hydro, and waste** which are collectively **82%** of total green exposure.

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 is publicly available from the LPP website within quarterly shareholder voting reports.

The period October to December 2020 encompassed 72 meetings and 586 proposals voted.

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)
- non-salary compensation (addressing inadequate disclosure of underlying performance criteria, use of discretion, and the quantum of proposed rewards).

Insights – Director related

At Oracle Corporation (USA: Systems Software), LPPI withheld support for all four incumbent members of the Governance Committee. This reflected concerns over the lack of risk oversight in relation to substantial pledging activity by the company founder and Chair Larry Ellison.

Pledging is the use of stock owned by an executive as collateral against indebtedness. Excessive pledging is not in the interests of shareholders since it can result in an executive being forced to sell considerable company stock quickly, which could negatively impact the share price and, in the case of a majority shareholder, affect their controlling interest in the company.

Oracle adopted a Pledging Policy in 2018 prohibiting the pledging of Oracle securities as collateral to secure or guarantee indebtedness, but restrictions put in place explicitly exclude the pledging of Oracle securities by the company's founder. Results: 17.0% - 23.4% against.

At Max Financial Services Limited (India: Life & Health Insurance), LPPI voted against one director due to attendance being below 75% without a satisfactory explanation. Result: 10.0% against.

Insights – Non-salary compensation

LPPI voted against management in 21 instances across 14 companies.

At Varian Medical Systems (USA: Health Care Equipment) 85.8% of shareholders, including LPPI, voted against the Advisory Vote on Golden Parachutes. Objections were based on a combination of accelerated vesting for all currently outstanding equity (regardless of the individual's employment status post-merger) and a modification to improve change in control agreements (which act to compensate executives in the event of the loss of their job due to merger or sale).

At Bid Corp (South Africa: Food Distributors) shareholders rejected resolutions to approve and to implement the remuneration policy, with votes against of 67.4% and 68.1% respectively. LPPI opposed management due to concerns with "in-flight" adjustments to the Long-Term Incentive Plan in response to Covid-19, which would ensure awards vested without reference to performance conditions.

At Cardinal Health (USA: Health Care Distributors), LPPI voted against the say on pay following discussion with the Robeco Active Ownership Team. Concern centred on the CEO being insulated against the company’s $5.6bn charge for an alleged role in facilitating opioid addiction in the US. One of the CEO’s proposed performance measures was adjusted operating income which excluded the charge. Result: 38.6% against.

b) Shareholder Proposals

11 shareholder proposals arose across the company meetings voted by LPPI in Q4, of which 8 were supported.

At the Proctor & Gamble Company (USA: Household Products), LPPI supported two shareholder proposals. One resolution requested reporting on efforts to eliminate deforestation in the supply chain and received 67.7% support.
The second resolution was a request to annually publish a report assessing diversity and inclusion efforts and received 37.1% support.

LPPI supported three shareholder resolutions requesting an independent Board Chair. Proposals received support of between 32.6% and 42.2%.

At Oracle Corporation (USA: Systems Software), LPPI supported a shareholder resolution seeking improved gender and ethnic pay gap reporting. The proposal received 46.2% support.

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 fourth full quarter of engagement activity. The RI Dashboard (page 4) presents engagement headlines for the quarter which confirm the Robeco Active Ownership Team undertook 72 activities in total, and the predominant focus (by topic) was corporate governance.

Page 5 of the Dashboard summarises the current status of each live engagement theme (as it stood at the end of Q4) within the table “Engagement Results per Theme”.

22 themes were live at the end of Q4. Of these, 4 themes (Sound Environmental Management, Sound Social Management, Good Governance, and Global Controversy Engagement) are evergreen, the remaining 18 are thematic and reflect priorities identified through a combination of Robeco research and client input. Each theme is scheduled to last approximately three years, with progress continually tracked against clear objectives.

The Active Ownership Report at Appendix 2 (a copy of which is available for Committee members to view in the online Pensions Library) provides 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.

Case study – Cybersecurity

Robeco commenced the cybersecurity engagement theme in 2018, reflecting that a recognition companies face clear and significant risks to their business models from lax cybersecurity practices has not translated into clarity on the steps taken by companies to mitigate these risks. As the number of successful cybersecurity breaches rises, so do the associated costs, necessitating urgent action from companies across sectors and markets

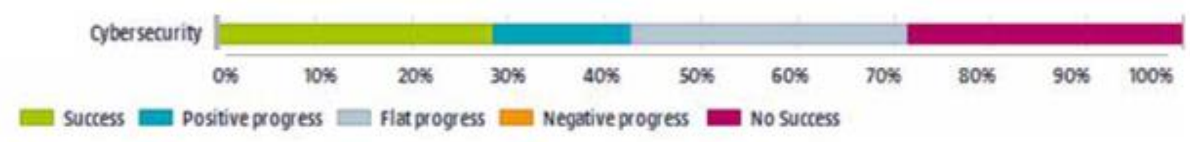
While cybersecurity is a universal concern, the engagement has focussed on consumer goods, payments, and telecommunications companies where cybersecurity risks have a deeper relevance to the business models of market players. Consumer goods companies often rely entirely on the internet to reach consumers, payments companies transmit an abundance of sensitive data, and telecommunications provide critical infrastructure to the economy.

The companies under engagement for LPPI are:
Altice NV – fixed income
Booking Holdings - listed equity & fixed income
Fidelity National Information Services – listed equity
Reckitt Benckiser – listed equity
Visa - listed equity
Vodafone - listed equity & fixed income

Robeco set five objectives for engagement with targeted firms, covering the key components of robust governance, controls, and policies:

- Governance and oversight: board-level responsibility with cyber KPIs linked to pay for the relevant member.
- Policy and procedure: a formal cybersecurity policy with a regularly tested response plan to a range of cyber risks.
- Risk management and controls: analysis of exposure to particular cyber risks, with regular testing of the sensitivity and integrity of data security controls.
- Transparency and disclosure: expectation that companies are transparent around the cost and effect of a cyber event, including the materiality threshold used for reporting. Communication to customers where data has been exposed should also be clear.
- Privacy by design: Companies should implement comprehensive policies that relate specifically to risks relevant for data privacy.

The engagement theme is due to run until September 2021 and progress thus far is mixed.



At Vodafone, Robeco have closed the engagement successfully, gaining confidence from the Board's involvement, significant growth in its cybersecurity team, and collaboration with competitors to share anonymised data to improve cybersecurity practices. At 2 companies, engagement has been closed without success, business sensitivities having limited the level of disclosure critical for determining the adequacy of arrangements. At the remaining 3 companies, dialogue is continuing, and the current status is either flat progress or positive progress for each of the objectives.

Following the annual process of consulting clients on priorities for future engagement themes (in which LPPI actively participated) Robeco has recently confirmed the new engagement themes that will commence in 2021.

Engagement Theme	Description	Start
Climate Transition of Financials	Global banks and insurance companies have an important role in financing the transition to a Paris aligned economy. • Currently they continue to have significant exposure to the fossil fuel industry. • Banks and insurers face climate change in form of physical, transition and liability risk. We believe that the impact will largely depend on financial institutions' exposure to high intensity GHG sectors and their assets' exposure to climate change stressed areas which can directly impact their book of business. With this engagement theme we call upon financial institutions to set climate targets and to adjust their lending and investment portfolios to be in line with the Paris Accord.	Q1
Labor Rights in a post-COVID World	The long-term viability of the companies in which we invest is inextricably tied to the welfare of their stakeholders, including their employees, suppliers and the communities in which they operate. The novel coronavirus (COVID-19) has shone a spotlight on the need to address the 'S' within ESG. Our engagement program aims to address risks related to labor practices in the retail, online food delivery and hospitality industries.	Q2
Acceleration to Paris Agreement	Climate change represents a significant threat to investors, and the global economy. To protect against this threat, investors should begin aligning their investment portfolios with the goals of the Paris Accord. We want to further shift gears in our engagement on the climate transition and want to focus on the worst-of-the-worst companies that are falling behind in the transition.	Q3
Enhanced Human Rights Due Diligence	Respect for human rights is strongly associated with value chain resilience and a stable business operating environment. Our engagement will focus on enhanced human rights due diligence for companies being directly linked to conflict-affected and high-risk environments. We will focus on companies in the technology, apparel and automotive sectors. Thereby we aim to heighten standards on human rights practices to counteract the increased risk that companies may become involved in or exacerbate ongoing grave human rights violations through their activities.	Q4
Social Impact of Gaming	Video games are acknowledged to have much positive potential. Some video games stimulate cognitive learning or training, and teach motivational resumption or optimism after failure. Yet, some concerns exist about the gaming industry, game content or gaming platforms, that has been exacerbated by the recent global lockdowns. In this theme, we will focus on mitigating the risks associated with game (development).	Q1

3. 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 2020 Q4.

Principles for Responsible Investment – Investor letters to UK Government

In Jan 2021 LPPI participated in an initiative co-ordinated by the Principles for Responsible Investment to draft and sign letters to the Prime Minister and the Secretary of State for Transport calling for strong policy ambition on climate change in the lead up to the UK's Presidency of COP 26 [R] (in Nov 2021) coupled with planning for a just transition for impacted workers and sectors.

Signing the letters publicly evidenced LPPI's advocacy for strong climate change policy from the UK Govt which will help to deliver against commitments made to be a climate leader and give investors greater clarity on the specifics of the economic transition required to deliver significant and lasting decarbonisation.

Workforce Disclosure Initiative (WDI) Engagement Outcome

As reported last quarter, as a supporter of WDI, LPPI directly engaged six target companies who have not previously disclosed to WDI, encouraging them to begin sharing prescribed information on their workforce policies and outcomes by responding to the annual WDI survey.

Of six companies engaged (all held by the Internal portfolio) three went on to complete the WDI survey for the first time in 2020 as follows:

Responded to the survey	Did not respond to the survey
Diageo	PepsiCo
Nike	The Estée Lauder Companies
London Stock Exchange Group	3M

LGPS Cross Pool RI Group

LPPI's Head of RI completed her term as the Chair of the LGPS Cross-Pool RI Group in January 2021 when a new Chair (from the Northern LGPS) took up the role which is held in rotation.

LGPS Scheme Advisory Board – Responsible Investment Advisory Group

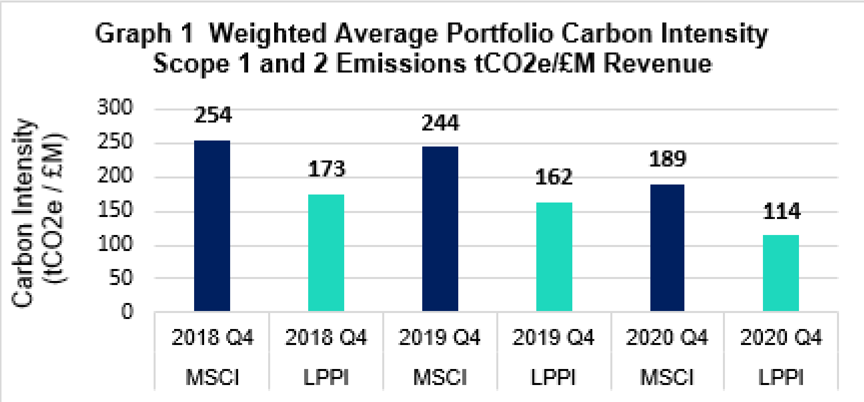
As reported in Q3, during 2020 the LGPS Scheme Advisory Board committed to appointing a Responsible Investment Advisory Group (RIAG) to advise on its work in this important area, with a clear specification for RIAG membership.

LPPI's Head of RI was nominated and has subsequently been appointed as one of two Pool representatives to the RIAG, which will meet for the first time in early March 2021.

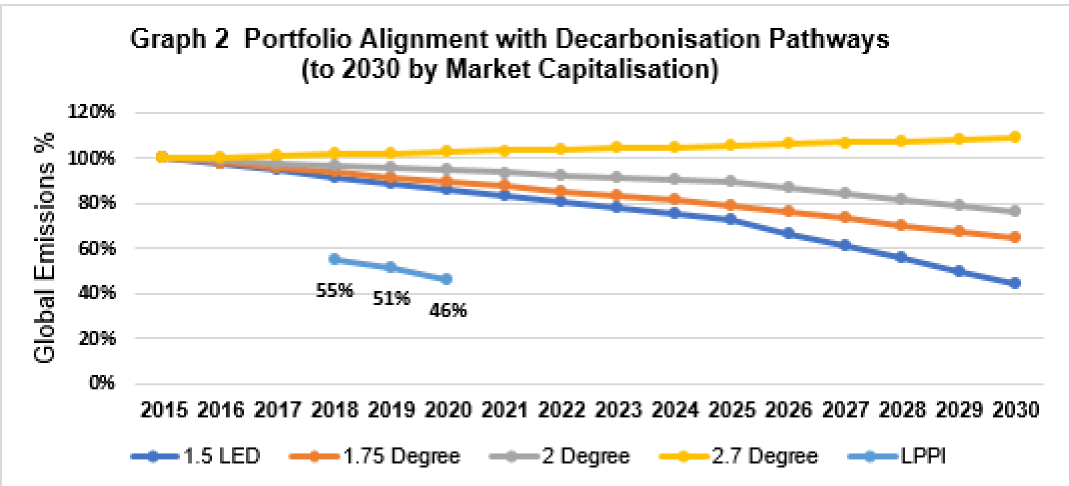
4. Other News and Insights

Carbon Intensity – LPPI Global Equity Fund

LPPI reviews the carbon intensity of the Global Equity Fund at 31 December each year. The annual snapshot exercise has confirmed a further reduction in the carbon intensity of the fund compared with the same point in 2019 and an intensity well below that of the fund's benchmark (MSCI ACWI [R]). Graph 1 below shows the position using a revenue measure (gross carbon emissions divided by total revenues for GEF companies) and includes scope 1 and 2 emissions. [R]



In prior years we have shared an additional metric (from our provider of carbon metrics - Urgentem) which plots the GEF's carbon intensity against decarbonisation pathways for different global temperature outcomes. Graph 2 shows the latest position for this metric using a market capitalisation measure (Portfolio gross carbon emissions divided by portfolio market value). It reflects scope 1, 2 and 3 emissions.[R]



The graph observes that portfolio carbon intensity continued to fall between 2019 and 2020 and indicates a current position beneath the trajectory for achieving the Paris Agreement goal of well below 2°c of temperature increase by 2050 (though the graph is to 2030 only).

As in prior years, we caution that this complicated metric involves numerous assumptions and has material limitations we fully acknowledge. As an early example of alignment measurement, it is a metric our data provider is due to retire this year, reflecting both the challenges and the evolution underway in this space.

In common with other investors, we await the development of robust market-standards for assessing portfolio alignment with the Paris Agreement, which are based on universally accepted, understandable, and decision-useful metrics. A recent paper (December 2020) by the Grantham Research Institute on Climate Change and the Environment and the Centre for Climate Change Economics and Policy notes that "the relatively undeveloped state of the work for assessing [the] Paris alignment of finance flows is becoming a key constraint to accelerating the transition and meeting the objectives of the Paris Agreement".

Clearer Signals regarding Mandatory TCFD Reporting

The Pensions Scheme Bill 2021 received royal ascent on 11th February 2021 and became the Pensions Scheme Act 2021. The Act does not directly apply to LPGS schemes but is of significance in providing a clearer indication of requirements likely to be translated to the LGPS in due course. The Act includes provisions for the effective governance of climate change which prepare the ground for regulations on how pension schemes will be required to adopt enhanced governance requirements and mandated to report in line with the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD) [R].

A consultation on the proposed new regulations for UK Pension schemes entitled Taking action on climate risk: improving governance and reporting by occupational pension schemes was launched in January 2021 and runs until 10th March 2021. The scope of the proposed regulations does not extend to LGPS schemes, but a consultation on regulations for the LGPS set to substantially mirror the requirements set out in this document are expected from MHCLG in 2021.[1]

In a pre-recorded speech to the Professional Pensions Investment conference on 27th January 2021, Minister for Pensions Guy Oppermann reflected on the proposals for new climate related regulations for UK pension schemes. The transcript of his speech offers useful insights into government thinking – which reiterates that the regulations are not seeking to direct pension fund trustees to divest from fossil fuels or mandating that schemes commit to specified emissions reductions. The new measures ultimately intend to ensure trustees are legally required to assess and report on the financial risks of climate change within their portfolios.

[1] Referenced at paragraph 2.10 of the roadmap towards mandatory climate-related disclosure here: FINAL_TCFD_REPORT.pdf (publishing.service.gov.uk)

For Reference

COP 26 – the 26th Conference of the Parties who signed the Paris Agreement (in 2015) which set targets for limiting global warming. COP 26 takes place in Glasgow in November 2021 under the presidency of the UK. https://ukcop26.org/uk-presidency/what-is-a-cop/

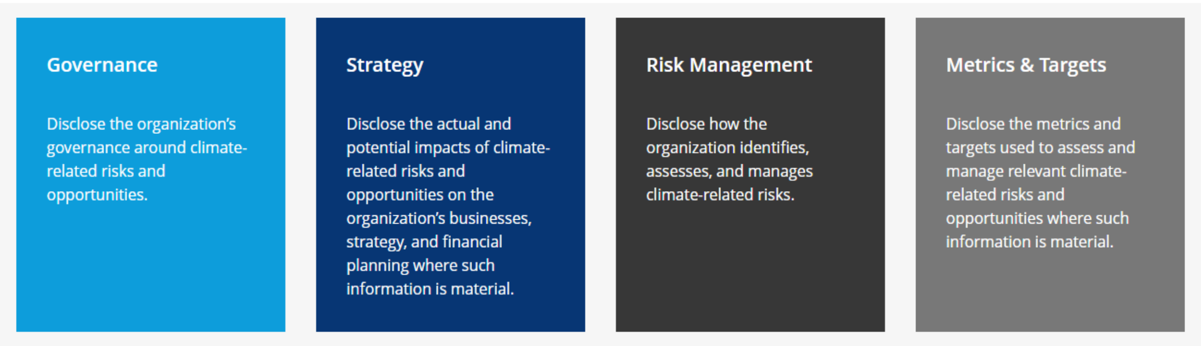
GICS - Global Industry Classification System
The most widely used approach to categorising activities into industry sectors. The main standard in use for public markets with growing use for other asset classes.
For more information on GICS and the activities that fall into each sector see:
https://www.spglobal.com/marketintelligence/en/documents/112727-gics-mapb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

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.

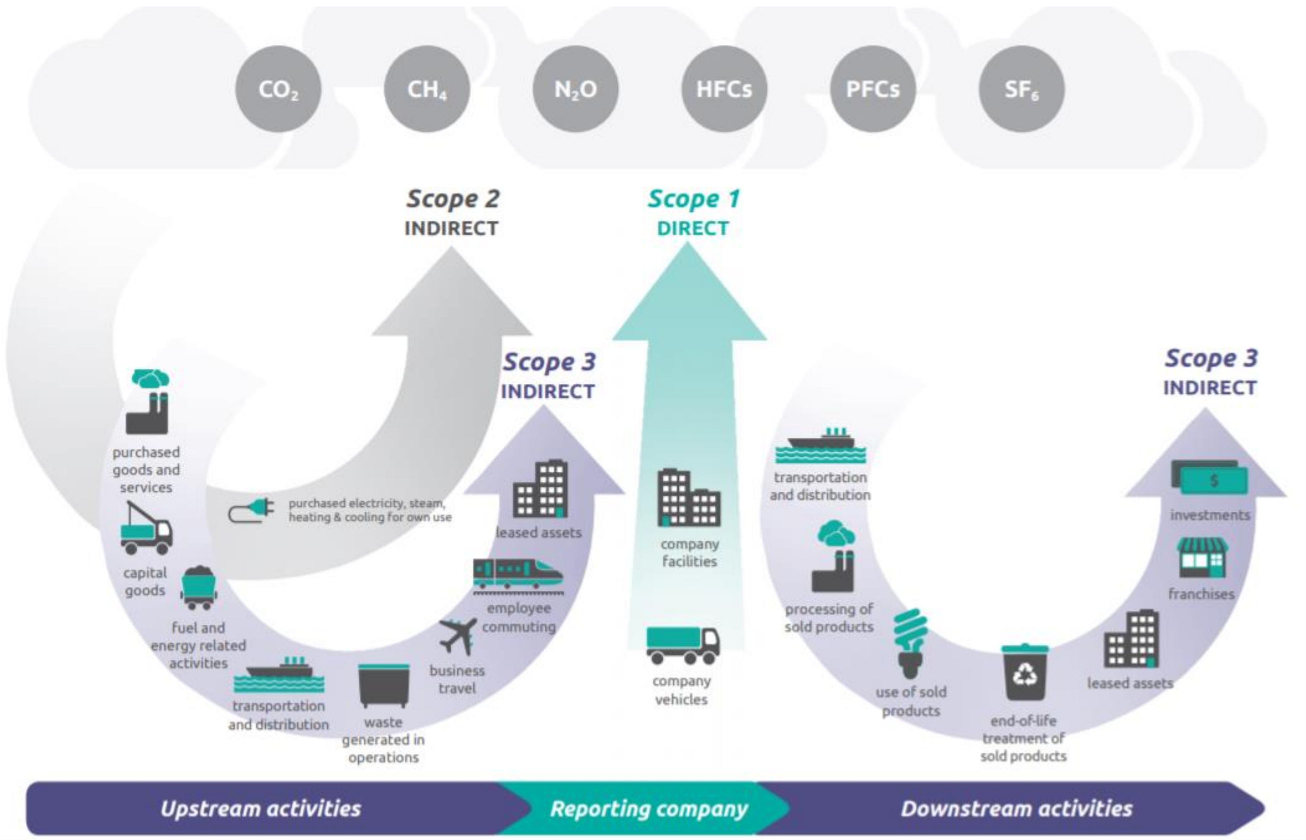
MHCLG - Ministry of Housing, Communities and Local Government

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:



Reference section continues below.

Scope 1, 2 & 3 Emissions



Source: [GGH Protocol]

Scope 1 covers direct **emissions** from owned or controlled sources.
Scope 2 covers indirect **emissions** from the generation of purchased electricity, steam, heating and cooling consumed by the reporting company.
Scope 3 includes all other indirect **emissions** that occur in a company's value chain.

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.