LGPS Central Joint Committee
20 November 2020
Item 6 - Public Questions and responses

Explanatory Note: Joint Committee procedure provides for questions to be asked by members of the public to be answered verbally in the meeting where time permits. A maximum of 15 minutes is set aside for this part of the Joint Committee. However, it was determined for this meeting that a longer period was given for the answering of questions on the basis that the June Joint Committee was cancelled, due to the Covid-19 pandemic and a written update was published, thereby not enabling public questions to be made.

In forthcoming Joint Committee meetings, the public questions item of the agenda will revert to the limit of 15 minutes for public questions to be answered in the meeting. Questions will be answered verbally received on a first come, first served basis. Any questions that cannot be answered in the time limit will receive a written response and all questions and answers will be published on the LGPS Central webpage.

Note: Questions posed are in black font with LGPS Central Ltd responses shown in red font

Question received 19.10.20
I was surprised and disturbed to find that the Central Climate Fund has investments in fossil fuel companies - BP, ROYAL DUTCH SHELL, CHEVRON, TOTAL and BHP BILLITON. How does this help to achieve a carbon neutral target as envisaged by the Paris Agreement?

The LGPS Central All World Climate Multi Factor Fund is a passive fund which looks to mirror the performance of the index that it is benchmarked against. This index takes into account a number of different factors in deciding which stocks are included and their weightings, some of which are climate-related, but it does not exclude specific companies. The Climate Multi Factor Fund holds these stocks because it is required to track the index.

A question on the operation of the Climate Factor Fund was also raised at the February Joint Committee and we will republish a copy of that response as it provides helpful information on the index management approach.

The LGPS Central All World Climate Multi Factor Fund tracks the FTSE All World Climate Balanced Comprehensive Factor Index. By contrast to the traditional FTSE All Share Index, FTSE Russell, the index provider, recalculates the market capitalisation of companies in the FTSE All Share Index in two stages, by reference to….

- Five performance related factors, which have been chosen as historic data suggests they are the main measurable characteristics of companies whose share price outperforms the main index, and…
- Further re-weighting companies with reference to three green factors: carbon emissions,
  fossil fuel reserves and green revenues.

The cumulative impact of these two stages results in a different index weighting for individual companies than that derived purely from their market capitalisation value. Over the past 8 years, when compared to the main FTSE All World Index, the FTSE All World Climate Balanced Comprehensive Factor Index has reduced an investee fund's carbon exposure in a number of ways:

- Reductions in carbon emissions (metric tons per $m revenue) of between 15% and 52% with an average reduction of 40%.
- Reductions in fossil fuel reserves (metric tons per $m revenue) of between 48% and 90% with an average reduction of 75%.
- In addition, the proportion of revenues earned by the companies in the fund versus those in the main index was higher by between 61% and 139% with an average of 97%.

Question received 24.10.20
I have looked at the latest list of 141 pages of investments (March 2020) by LGPS Central which total £8.5 billion. The new LGPS Central All World Climate Multi-Manager fund is just £1.8 billion of this – or about a quarter of the total. I read that originally my fund Cheshire and the West Midlands fund had invested in this. Are LGPS Central promoting this Climate Friendly fund so that all 8 of the LGPS funds in the pool

invest, and how will LGPS Central ensure it expands to support a genuine carbon free future.

The LGPS Central All World Climate Multi Factor Fund is available to all 8 Local Authority Pension Funds that make up the LGPS Central Pool. Pension Funds can invest it if it meets their strategic investment and climate strategy requirements. Partner Funds themselves are responsible for setting strategic asset allocation, so the decision about whether to invest in a fund or not is theirs. Further Partner Fund investment is planned in this particular fund, subject to local governance decisions.

Question received 31.10.20
What investments are held in sustainable energy sources, and what plans are there for increasing these?

The LGPS Central active equity funds (Global Equity and Emerging Market) are managed on a day-to-basis by external investment managers, whose remit is to outperform the benchmark index by a stated amount over a five-year period.

To do this the managers actively choose which stocks to hold and this decision will be based on their views of the risks and potential returns available from individual investments. Managers will consider many factors including the current share price relative to the expectations of future performance.

Whether the weighting to sustainable energy increases going forward will depend on how attractive the managers believe the companies are. At present the Global Equity sub-fund has a material overweight position in Alternative Energy (0.77% against the benchmark of 0.13%). The Emerging Market sub-fund has no holdings in Alternative Energy companies at this point reflecting the managers' views on the companies in the sector.

When appointing external managers, a significant part of the evaluation relates to assessing the integration of Responsible Investment and Engagement (R I & E) into the manager's investment process, and how they assess the risks and opportunities relating to climate change is a key element.

Question received 02.11.20
LGPS Central has been assisting member funds in carrying out climate risk analyses. Nottinghamshire Pension Fund recently received one such Climate Risk Report - which they have refused to publish "due to commercial confidentiality". LGPS Central provided a briefing session for members of the Nottinghamshire Pension Fund Committee and officers. No such briefing has been provided for members of the Pension Fund. However, Nottinghamshire's Service Director claimed, in a report to a public session of the Committee, that the analysis "demonstrates that a 2°C scenario is of benefit to the Pension Fund financially which means the Fund's financial interests are aligned with global environmental interests."

Can you please explain:

1) Given that the Paris Agreement of 2015 (UNFCCC COP21) included an aim of "pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels" why is LGPS Central claiming that a 2°C scenario is "aligned with global environmental interests" and why no account seems to have been made of the IPCC Special Report on Global Warming of 1.5°C (2018)?

2) Why do you think that Pension Fund members should not be allowed to question the methodology of your Climate Risk Reports?

LGPS Central uses an external service provider to conduct the Climate Scenario Analysis for the Climate Risk Reports. The service provider considers its 2˚C scenario to be aligned with the commitments of the Paris Agreement. It is likely that a 1.5˚C scenario will be developed by the service provider in due course as climate change integrated assessment models are updated to consider such a scenario. In future Climate Scenario Analysis, LGPS Central will consider including a 1.5˚C scenario if data quality and models permit.

The Pension Fund is prevented from releasing the Climate Risk Report (the Report) produced by LGPS Central as this would constitute a breach of confidentiality provisions. Such confidentiality provisions are necessary, amongst other reasons, because the Report refers to datasets, which themselves are the subject of confidentiality provisions stipulated by the organisations from whom they LGPS Central license the data and cannot be more widely disclosed. The Pension Fund does however publish the key findings of the analysis in its Climate-Related Disclosures Report (the TCFD Report). The TCFD report will disclose which methodologies and metrics were used in the Climate Risk Report, allowing pension fund members the opportunity to assess the methodologies.

Question received 03.11.20

In light of the widespread concerns on Climate Change, will LGPS Central attend the COP26 conference held in the UK in 2021 and follow the pressure for investments for Net Zero?

The UN Climate Change Conference (COP26) has three categories of permitted attendees: Parties to the Convention and Observer States, members of the press and media, and representatives of observer organisations. Only Non-Governmental Organisations can bid for tickets that may be available after these three categories have filled seats.

This means that we are unlikely to be able to participate in the main event. However, we will be represented through the Institutional Investors Group on Climate Change (IIGCC) which is an observer organisation to the negotiations. We may be able to attend events held in conjunction with COP26 outside of the negotiations.

IIGCC has more than 250 investor members across 16 countries with a combined €33tn assets under management and is recognised by governments and UN bodies as a key investor voice on climate. Through IIGCC we have directly supported policy engagements with UK and EU leaders this year, asking for a green recovery from COVID 19.

Similarly, we are asking of companies that they set a clear net-zero emissions ambition by 2050 and provide meaningful short/medium/long-term targets and plans for how to achieve that. It is clear that we need action from all sectors, not just the fossil fuel industry but the demand side (autos, aviation, steel, paper, shipping, utilities etc.). Leading up to COP26, we are taking part in discussions that address particular value chains (e.g. steel making and road freight). It is critical to get cross-sector input to these discussions, to uncover key hurdles for decarbonisation and to identify the most efficient solutions to address those hurdles. Just Transition (connecting climate action with an inclusive economy) is another discussion that we take active part in both through IIGCC and with other LGPS Pools and Funds leading up to and beyond COP26.

Question received 05.11.20

We note that the voting record of the LGPS Central Fund, mainly concerns company governance issues. I am concerned that other ESG issues, in particular Environmental, Social and Human Rights issues are not given the same level of priority in the voting records. Britain is signed up to the OECD Declaration on International Investment and the 2011 guidelines, which state in Chapter 4 entitled Human Rights, that 'enterprises should ...Respect human rights, which means they should avoid infringing on the human rights of others.'
With this in mind, we note that the LGPS Central Fund invests in arms companies including Boeing, Raytheon, General Electric, General Dynamics, and Rolls Royce all of which have been implicated in production and sale of weapons which have been used against civilians in Yemen, Libya, Gaza and others, involving human rights abuses on a horrific scale.
Our research in Derbyshire shows that the overwhelming majority of fund holders do not want these kinds of investments.
Is the fund planning to divest from arms companies and if the policy of the fund continues to be engagement rather than divestment, when will we see Environmental and Social concerns reflected in the voting records?

In close collaboration with our Partner Funds, LGPS Central has identified four core Stewardship Themes that will guide our engagement and voting efforts. These are climate change, plastic pollution, responsible tax behaviour and technology sector risks. The latter includes a combination of risks such as data protection, social media content control and broader human rights issues.

We maintain a view that engagement is a more powerful and impactful tool than divestment. We want to see not only individual companies, but whole sectors and industries move to better standards. That will have further reaching and longer lasting positive effects.

As far as possible, we aim to use voting to boost and fortify ongoing engagements, whether carried out directly through LGPS Central, through collaborative initiatives or through our external stewardship provider EOS at Federated Hermes. This means that we regularly raise issues concerning environmental sustainability, including climate change, and broader social issue like human rights risk oversight and management

through our voting. While it is a correct observation that many votes concern good governance (board composition, board oversight and skill sets, remuneration etc.) – these votes are often an expression of underlying concerns with lack of expertise and or/oversight at board level on issues like climate change or human rights. We also know that strong governance increases the likelihood of companies dealing well with environmental and social risks. During April – June 2020 (high voting season) many ESG-related shareholder proposals got very strong or even majority support. Specifically, on the issue of the Israeli-Palestinian conflict, we have partnered with organisations such as LAPFF (Local Authority Pension Fund Forum) who engage companies on this issue.
Question received 05.11.20 What is the total value of Central LGPS holdings in fossil fuel companies as of November this year, and what was the value of those holdings in November 2019? i.e. how much value has been lost due to the fall in fossil fuel stock value since last year? The total value of holdings across the LGPS equity sub-funds for the Energy sector was £268.3m at 16th November 2020, and this sector accounted for 2.77% of the assets within these sub-funds. Assessing impact of changing values between any given periods is not a straightforward calculation as the portfolios make regular purchases and sales and there are occasional flows of money into and out of the sub-funds. For the specific period referenced in the question, the passive funds managed by LGPS Central saw a change of value from Energy companies of 1.59% of their value as at November 2019. This change is impacted by the high weighting of Energy companies within the UK index. The two actively managed funds, in combination, saw changes in value of 0.43% over the same period. Pension Funds are long term investors and appointed managers will also lake a longer-term view of the outlook for sectors and individual companies. Recent movements in the price of Energy stocks may well prove to be a short-to-medium term anomaly. In the longer term, Energy had outperformed the broad global market by 0.6% p.a. over a 25 year period.

Question received 05.11.20

I am a pension holder with one of your eight partner funds. I am aware that you consider engagement with companies to be the way forward for responsible investment. I am also aware of the positive impact that engagement can have in some areas of a company's practice.

Having examined the available reports of your voting record I note that only the report from Q2 2018 shows the outcome of the vote as well as how you voted. Subsequent reports do not contain the voting results so it is not possible to gain an insight into the effectiveness of this aspect of your engagement. This does not provide transparency in your engagement operations.

Therefore my question is: will you agree to reinstate transparent reporting of your engagement (i.e. as provided in 2018), providing members with the outcome of the vote as well as a description of the motion with sufficient detail to understand the motion you voted on? Anything less than this contradicts claims to be fully transparent.

Transparency is an important pillar of our Responsible Investment and Engagement efforts. The report for Q2 2018 that you refer to was a report (1,500 pages) from a third-party provider posted on the website, however not as part of a Stewardship Report.

As you point out, we have since Q3 2018 published our own proprietary Quarterly Stewardship Updates (QSU), giving a holistic overview of engagement and voting activity as well as specific examples of engagement and voting action during the quarter. When providing voting examples we comment on the outcome of the vote and how that might affect future progress for engagement with a given company (see our latest QSU here: https://www.lgpscentral.co.uk/wp-content/uploads/2020/11/LGPSC-Quarterly-Stewardship-Update-Q2-2020-21-1.pdf

As far as possible, our voting will be engagement-led and used to enhance ongoing engagements. We provide voting statistics across regions and themes and a full vote-by-vote disclosure which is similar to the Q2 2018 report you refer to, in order to evidence how we have voted and the rationale for the vote across various ESG issues.

Question received 06.11.20

The science states to avoid 2C of warming we need to keep 80% of known fossil fuel reserves in the ground. Why are you willing to jeopardise my future and the future of my generation, by continuing to invest in fossil fuels?

Answer to this Question and to the Question received on 09.11.20:

We agree with you that the science is clear. Climate action failure is *the* stand-out, long-term risk the world faces in likelihood and impact according to the 2020 Global Risks Report from the World Economic Forum. If 'business as usual' continues, the world could heat up by about 5 degrees by 2100 which would cause profound societal damages and significant human harm. How companies manage climate-related transition and physical risks and opportunities is highly likely to affect long-term profits and company returns. Policy makers response equally so. How can investors best encourage a broader transition towards a low-carbon economy? We believe that the answer lies in a combination of company engagement, sector-level engagement, industry standard setter- and policy engagement. With our long-term investment horizon, we take a whole-of-market outlook. It is not sufficient to only talk to oil &gas companies. We actively engage both fossil fuel producers and all the companies on the demand side. We also engage the banks that provide finance and the accountants who check companies' accounts. To us, this is the most viable and most impactful way of using our voice. You could go so far as to say that we don't have time to divest. If we do that, we lose our seat at the table.

As an example, LGPS Central alongside 10 other investor institutions and led by ShareAction, filed a shareholder proposal at Barclays Bank asking the company to disclose targets to phase out the provision of finance to companies, starting with those in the energy and utility sectors, that are not aligned with the Paris climate change goals. Following multiple meetings with investors, Barclays – close to the AGM in May 2020 – announced an ambition to become a "net-zero bank" covering emissions across Barclays' own operations and those of its clients. We view this as a reflection of positive engagement pressure, and the bank's willingness to listen. We are keen to see evidence that all of Barclays' lending activities, including those that bear the most climate risk, will be addressed with Paris agreement urgency. The Company has signalled that further updates on its climate strategy will be published before the end of 2020. Although we at the time of filing held only a minority share of 0.05% of the company, that shareholding allowed us to take shareholder action.

Many companies seek out investors for their views on decarbonisation plans and strategies. There is positive momentum that we need to harness in this regard. LGPS Central is an active member of a collaborative engagement called ClimateAction 100+. CA100+ engages 161 companies across the globe that are responsible for 80% of industrial carbon emissions globally. The initiative builds on a simple but powerful logic: If you engage and influence the highest emitters, you influence whole sectors, markets and the global economy. CA100+ is currently being ramped up through a Benchmarking project. All companies are asked to set an explicit target of net-zero emissions by 2050 – and to provide verifiable evidence that this will be achieved in the short, medium and long term. This introduces an element of "no-where to hide" and investors will be able to assess companies progress relative to sector-peers and across the board.

Even in a 2C scenario, most projections assume that fossil fuels play a role in the energy mix – albeit a decreasing one – over the coming decades. Even where energy use plays a diminishing role in the end-use for fossil fuels, other end markets will likely still require fossil fuels, including chemicals, lubricants, iron & steel, aluminium, cement, and so on. At a broader level, investors need to recognise that decarbonisation needs to occur across all value chains, hence our holistic approach to engagement across sectors. The demanders of energy – not just the suppliers of it – need to recognise that their dependence on certain forms of energy, and the prices they pay for it, could be disruptive if the world achieves the Paris goals.

Recognising that most economic production currently depends on fossil fuels somewhere in the value chain, a portfolio that divested of fossil fuel producers would not in fact be free of fossil fuels. Indeed, if responsible investors sell their shares in oil & gas companies to investors that do not have the same stewardship credentials, it would be less likely that those companies will be held to account or would amend their business strategies. Should this happen, this would affect all investors, whether they hold oil & gas companies or not.

Generally speaking, and in line with Partner Fund beliefs as reflected in LGPS Central's RI&E Framework, engagement is seen as more conducive to both fiduciary objectives (i.e. not excluding parts of the investment universe that could be beneficial from a diversification perspective) and societal outcomes (i.e. engaging companies to improve corporate behaviour is more likely to be effective than selling shares on the secondary market) – whether the underlying issue is fossil fuels, tobacco, weapons or other areas that may be of ethical concern. The list of all our individual investments in our ACS Funds can be viewed by the public on our website. See also response to earlier question regarding engagement with companies

Question received 07.11.20
Given that divesting from fossil fuels has not resulted in lower returns over past years and the current climate emergency, why doesn't the LGPS divest from its fossil fuel assets?

Whilst the there has been an underperformance of returns in recent times from investing in fossil fuels, in the longer term, for example over the last 2 decades, investment in fossil fuels has provided positive returns.

Pension funds are long-term investors and as stated in the answer to earlier questions, we believe that the most efficient way to effect broader transition towards a low-carbon economy is to engage companies, industry standard setters and policy makers, not to divest.

Question received 09.11.20
I am a resident of South Derbyshire and would like you to confirm whether LGPS Central Ltd and the County Councils invest their pension funds ethically. In particular, I am concerned about investments in fossil fuels and the arms trade. Please can you inform me of the level of investments in each of these areas and what democratic processes are available to persuade you to divest.

Addressed in the response to the question received on 06.11.20

Question received 14.11.20
The Local Government Pension Scheme Central currently does not offer a portfolio that excludes companies for whom fossil fuels is their core business, and I understand that the development of any new product is driven by the needs of your partner funds.
My question is: how many partner funds would need to make a request for a 'fossil free' fund (not 'tilting away' or similar) for you to take action? Would it be just one, or if not, how many? Please be precise about the criteria needed.

LGPS Central limited develops funds in collaboration with its Pension Fund Partners. We maintain a view that engagement is a more powerful and impactful tool than divestment. We want to see not only individual companies, but whole sectors and industries move to better standards. That will have further reaching and longer lasting positive effects

The minimum total investment required is decided on a case-by-case basis and will vary dependent upon asset class. Typically, the minimum total investment is usually around £250m.

Question received 14.11.20

Does the LGPS consult with its members on whether they are happy to have their pension money invested into arms and tobacco?
And would LGPS give serious consideration to conducting a Citizens Assembly to find out exactly where members would like investments to be made on their behalf.

As part of the product development process, Responsible Investment is a key consideration for LGPS Central Limited and its Partner Funds. LGPS Central Limited is an FCA authorised Alternative Investment Management Company and therefore does not consult directly with Pension Scheme Members, but with its clients, who consist of the 8 Local Authority Pension Funds that make up the LGPS Central Pool.

Question received 14.11.20
In July 2019 the Shropshire County Pension Fund (SCPF), a member of LGPS Central, received requests to divest from fossil fuels from both Shropshire Council and Telford & Wrekin Council. Together these two councils make up 60% of employer contributions into SCPF. Since then several town and parish councils who pay into the scheme have also called on SCPF to divest.
However, SCPF has to date refused the divestment request, preferring to pursue a policy of "engagement" instead.

SCPF is a signatory to the UN-backed Principles for Responsible Investment through its investment managers. The PRI states that fiduciary duty concerns should not prevent investors from incorporating their clients' Environmental, Social and Corporate Governance (ESG) preferences.

1. Does LGPS believe that SCPF has a responsibility to carry out the wishes of a majority of its employers and provide a pension pot that excludes fossil fuel investments?

2. Does LGPS have the resources and investment vehicles available to assist SCPF in the divestment process if pursues this route?

We can only comment on the second point of the question…

LGPS Central Limited designs new investment funds by collaborating closely with the 8 local authority pension funds that make up the Pool to ensure that these funds meet their strategic needs. LGPS Central will launch an appropriate fund once it has been through a robust product development process and has been agreed by the Practitioner Advisory Forum (PAF). Currently, a Sustainable Equity Fund is being considered.

Question received 18.11.20

Cheshire Pension Fund's publicly available summary of their climate risk report (prepared by LGPS Central) concludes that the impact of 2°C, 3°C and 4°C global heating on investment returns would be minimal and describes 4°C as likely to present "*a slight drag*" on the fund.
Please provide references to climate science studies that support LGPS Central's core assumption that the world will be so unaffected by 3°C and 4°C of warming that financial processes will be able to function and continue with minimal loss of revenue.

The Climate Scenario Analysis was undertaken utilising the services of Mercer LLC. Mercer utilise a model to assess the impact of the Fund under a 2°C, 3°C and 4°C scenario. The model captures developments in the collective understanding of environmental science, and climate change-related political and technological developments, since 2015. This draws on Cambridge Econometrics global E3ME model, with comprehensive regional and sector data. E3ME is recognised globally as one of the leading models for comprehensive economic modelling of policy and technology scenarios. The three climate change scenarios were developed using existing climate change models and through an extensive literature review.

According to the analysis done by Mercer, the reason for the minimal impact on Cheshire Pension Fund's climate-related returns is due to the Fund's diversification, and in particular the Fund's high allocation to fixed income (UK Gilts and Multi-Asset Credit) which is relatively insensitive to the different climate scenarios.

Further information on the modelling approach and literature used to inform Mercer's Climate Scenario Analysis can be found in their publicly available report "Investing In a Time Of Climate Change – The Sequel".

The following questions were not read out at Joint Committee but were referred back to the local funds to respond as they were specific fund questions
Question 5 received 03.11.20 How much of our money is invested in Impact investment funds which support positive change like those involved in developing biodiversity, and social housing? And have you plans for increasing this? – **Question 7 received 04.11.20** How large is the current Derbyshire Pension Fund investment in tobacco? While researching the papers associated with our Derbyshire pensions ages ago, I was surprised to discover that our fund was involved with the tobacco industry. It would be helpful to be reassured that this is no longer true in 2020.