LGPS Central Limited

LGPS CENTRAL LIMITED

Responsible Investment & Engagement Framework

March 2023

Cheshire Pension Fund

Derbyshire Pension Fund

Leicestershire County Council Pension Fund

Nottinghamshire Pension Fund

Shropshire County Pension Fund

Staffordshire Pension Fund
Local Government Pension Scheme

West Midlands Pension Fund

Worcestershire Pension Fund

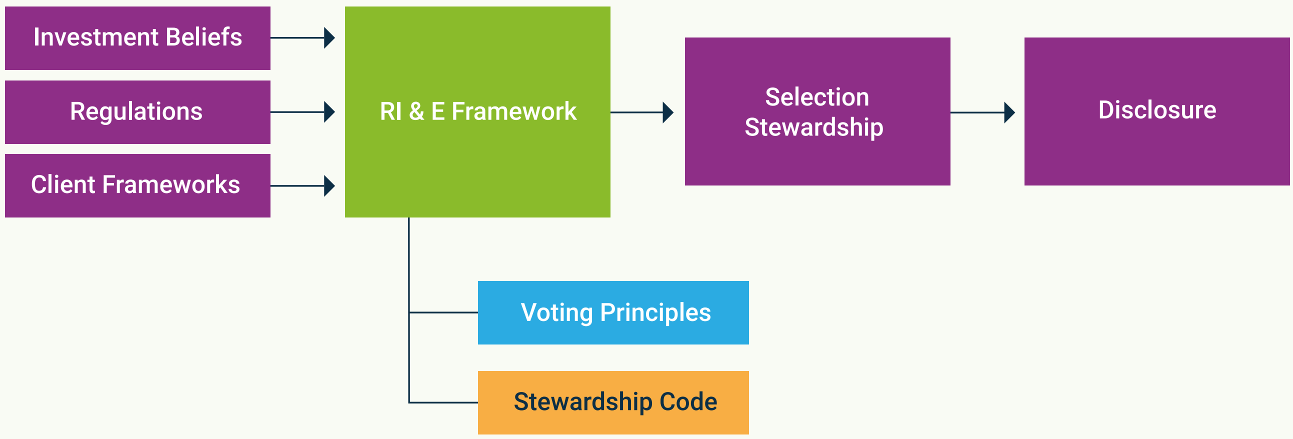
About this document

LGPS Central's Responsible Investment & Engagement Framework ("the Framework")describes LGPS Central Limited's ("the Company") approach to responsible investment ("RI"). The approach takes as its starting point the investment beliefs of the Company's eight local authority pension fund clients ("the clients") and delivers against the clients' RI and stewardship policies. The clients' investment beliefs and RI policies are developed in the context of relevant regulations, statutory guidance and the advice of the Law Commission. Whilst this document sets out the overarching framework for RI, specific disclosures on the Company's approach to voting and alignment with the UK Stewardship Code are provided in separate documents (see the Company's Voting Principles and Annual Stewardship Report.

This document is owned by the Company's Director of Responsible Investment & Engagement. Day-to-day management of the Framework is delegated to the Investment Team, with oversight from the Investment Committee (IC) and the Chief Investment Officer (CIO). The Director of Responsible Investment & Engagement (DRIE) is accountable to the IC for the implementation of the Framework. All products/portfolios are monitored using an internal Responsible Investment Integrated Status ("RIIS") classification.

The Framework is subject to annual review by the Company's Board. Board-level Key Performance Indicators are in place for RI and regular updates on progress are provided to the Board. RI is included as a regular item on the Board's agenda.

Figure 1: The Framework in context



What we mean by responsible investment

The term 'responsible investment' refers to the integration of financially material environmental, social and corporate governance ("ESG") factors into investment processes. It has relevance both before and after the investment decision and is a core part of our fiduciary duty. It is distinct from 'ethical investment', which is an approach in which the moral persuasions of an organisation take primacy over its investment considerations.

Responsible Investment Beliefs

Using the Investment Strategy Statements of the Company's clients, we arrive at the following beliefs about responsible investment:

- ***LONG TERMISM:***

  A long-term approach to investment will deliver better returns and the long-term nature of LGPS liabilities allows for a long-term investment horizon.

- ***RESPONSIBLE INVESTMENT:***

  Responsible investment is supportive of risk-adjusted returns over the long term, across all asset classes. Responsible investment should be integrated into the investment processes of the Company and its investment managers.

- ***DIVERSIFICATION, RISK MANAGEMENT AND STEWARDSHIP:***

  Diversification across investments with low correlation improves the risk return profile. A strategy of engagement, rather than exclusion, is more compatible with fiduciary duty and more supportive of responsible investment, because the opportunity to influence companies through stewardship is waived in a divestment approach.

  Even well-diversified portfolios face systematic risk. Systematic risk can be mitigated over the long-term through widespread stewardship and industry participation.

- ***CORPORATE GOVERNANCE AND DIVERSITY:***

  Investee companies and asset managers with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is clear evidence showing that decision-making and performance are improved when company boards and investment teams are composed of diverse individuals.

- ***FEES AND REMUNERATION:***

  The management fees of investment managers and the remuneration policies of investee companies are of significance for the Company's clients, particularly in a low-return environment. Fees and remuneration should be aligned with the long-term interests of our clients, and value for money is more important than the simple minimisation of costs. Contributing to national initiatives that promote fee transparency such as the LGPS Code of Transparency is supportive of this belief.

- ***RISK AND OPPORTUNITY:***

  Risk premia exist for certain investments; taking advantage of these can help to improve investment returns. There is risk but also opportunity in holding companies that are on an improving trajectory in respect of financially material ESG issues. Opportunities can be captured so long as they are aligned with the Company's objectives and strategy, and so long as there is a sufficient evidence base upon which to make an investment decision.

- ***SUSTAINABLE BUSINESS PRACTICE:***

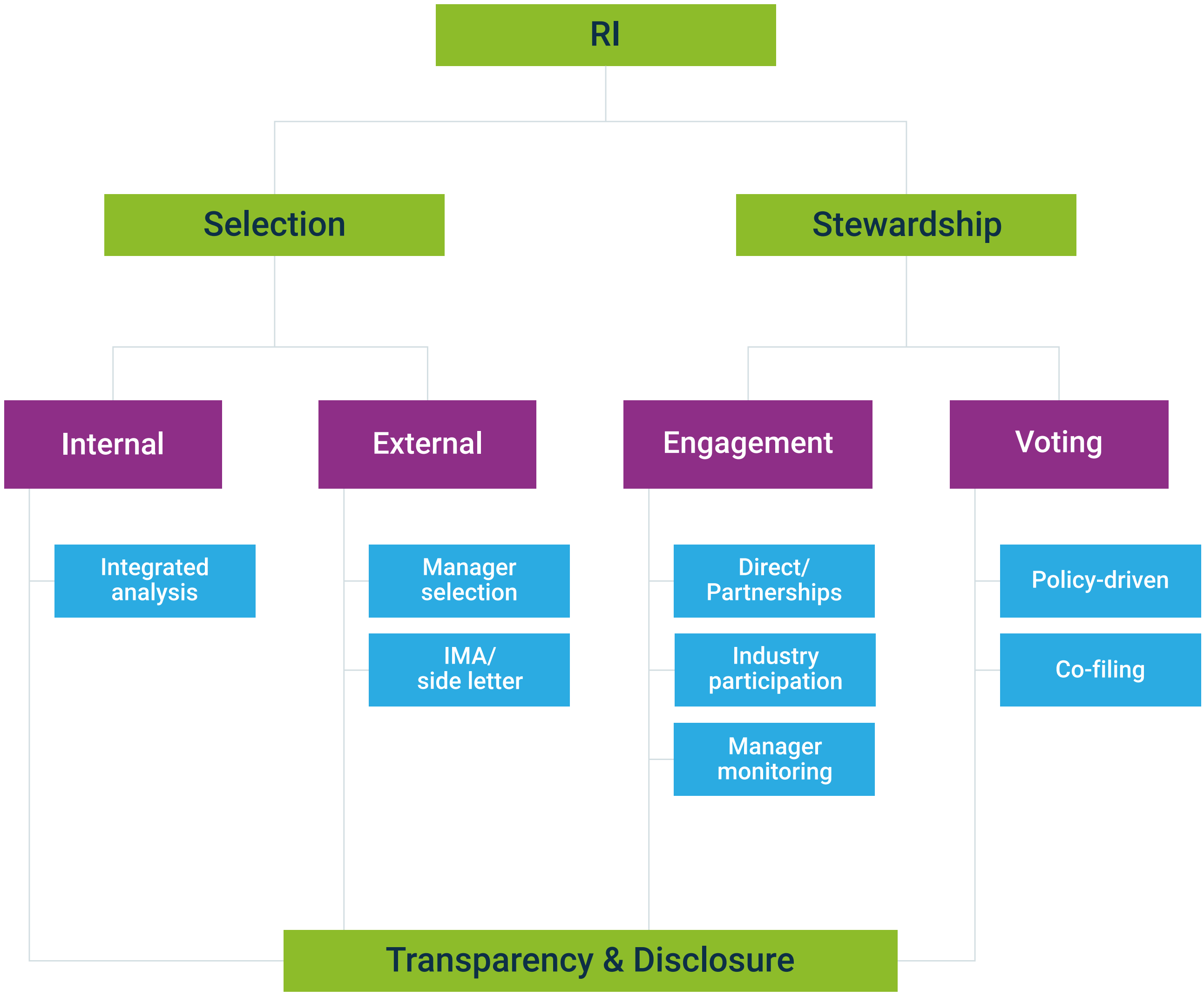
  We expect investee companies to consider relevant, material social and environmental risk factors in their long-term strategic business planning such as climate change related risks, including biodiversity loss, and human rights related risks. We believe these can have a significant effect on the value of a company's assets over time, and on its ability to generate long-term returns for shareholders.

Responsible Investment & Engagement Framework

Using our clients' investment beliefs, we have designed a Responsible Investment & Engagement Framework with two aims: (1) primarily, to support investment objectives; (2) secondarily, to be an exemplar for RI within the financial services industry, promote collaboration, and raise standards across the marketplace. We intend to realise these aims through actions taken both before the investment decision (which we refer to as the *selection* of investments) and after the investment decision (the *stewardship* of investments). Actions will be taken with reference to an evidence base, using the best available objective data sets. We aim to be transparent to all stakeholders and accountable to our clients through regular disclosure of RI activities, using best-practice frameworks where appropriate. These ambitions yield our three RI pillars: Selection, Stewardship and Transparency & Disclosure.

We have developed customised RI procedures which are bespoke to the asset class in question, and to whether the assets are managed internally or externally. The specific asset class processes are detailed in these documents and serve as a basis for a product to achieve Responsible Investment Integrated Status (RIIS). No single framework document can cover every investment eventuality, and this document's ambition is to serve as a guide. The framework is represented graphically in Figure 2 and explained below.

Figure 2: High-level overview of the Company's Responsible Investment & Engagement Framework



Selection

INVESTMENTS MANAGED INTERNALLY

RI factors are integrated into investment decision-making where those factors are financially material within the context of the investment mandate. Financial materiality is determined using an evidence base of objective data. RI factors include systemic factors considered in this document as well as other ESG factors. Our approach is to consider RI and other performance drivers at the same time, rather than have a ring-fenced or stand-alone RI function.

RI expectations are inserted into mandates and an RI strategy forms part of the investment process documentation.

In order to ensure consistency with the investment beliefs of the Company's clients, an exclusionary or divestment approach is not preferred.

As is the case throughout the Company, conflicts of interest are managed in accordance with the Company's Conflicts of Interest Policy, and a long-term approach is applied.

INVESTMENTS MANAGED EXTERNALLY

Each investment manager's approach to RI is assessed as part of the selection and due diligence process. External managers will not be appointed unless the Company is satisfied with the manager's approach to RI.

RI expectations will be inserted into the investment management agreement or side letter as appropriate, where applicable.

Stewardship

ENGAGEMENT WITH COMPANIES

The Company engages directly with investee companies on RI issues with the objective of improving investment outcomes over the long term. The Company also engages through partnerships, in order to maximise the scale and effectiveness of the Company's engagement programme.

The prioritisation of engagement themes or companies depends on economic significance, resourcing and likely significance for the majority of stakeholders. Further detail of the Company's approach to engagement is provided in its reporting against the UK Stewardship Code.

The Company expects UK companies to adhere to the UK Corporate Governance Code on a comply or explain basis and expects non-UK companies to adhere to international corporate governance principles, whilst recognising local application and development.

The Company's approach to engagement is focussed on outcomes, and as such the Company will seek to escalate an engagement where escalation is deemed to improve the chances of engagement success. A decision to escalate, and the form or sequence of subsequent escalation is particular to the engagement in question. The most effective means of escalation varies from one engagement to another (see further detail below).

The Company reports on its engagement activities on a quarterly basis.

SHAREHOLDER VOTING

The Company's Voting Policy is subject to annual review by the Board of the Company. The Voting Policy document is owned by the Company's Director of Responsible Investment & Engagement, and is implemented by the Investment Team, with ultimate responsibility resting with the Executive Committee.

The Company aims to vote all eligible shares in accordance with its agreed Voting Principles. This includes the voting shares of portfolios managed externally where those funds are held in segregated accounts.

Voting decisions will relate to engagements undertaken during the period in review and a vote might be used as an escalation step in an engagement process.

Voting decisions are executed by third-party provider(s); the provider(s) also offer analysis and advice.

Where the Company invests in externally managed pooled funds, the suitability of the manager's voting policy is assessed during due diligence, and ongoing disclosure is required.

The Company will seek to co-file shareholder resolutions where beneficial to clients' long-term interests.

The Company has a procedure to recall lent stock in order to vote on significant issues.

MONITORING EXTERNAL MANAGERS

External fund managers are monitored in order to ensure the ongoing application and efficacy of their approaches to RI and stewardship. Managers are expected to report to the Company on RI and engagement activities that support the objectives given in the investment mandate.

INDUSTRY PARTICIPATION AND COLLABORATION

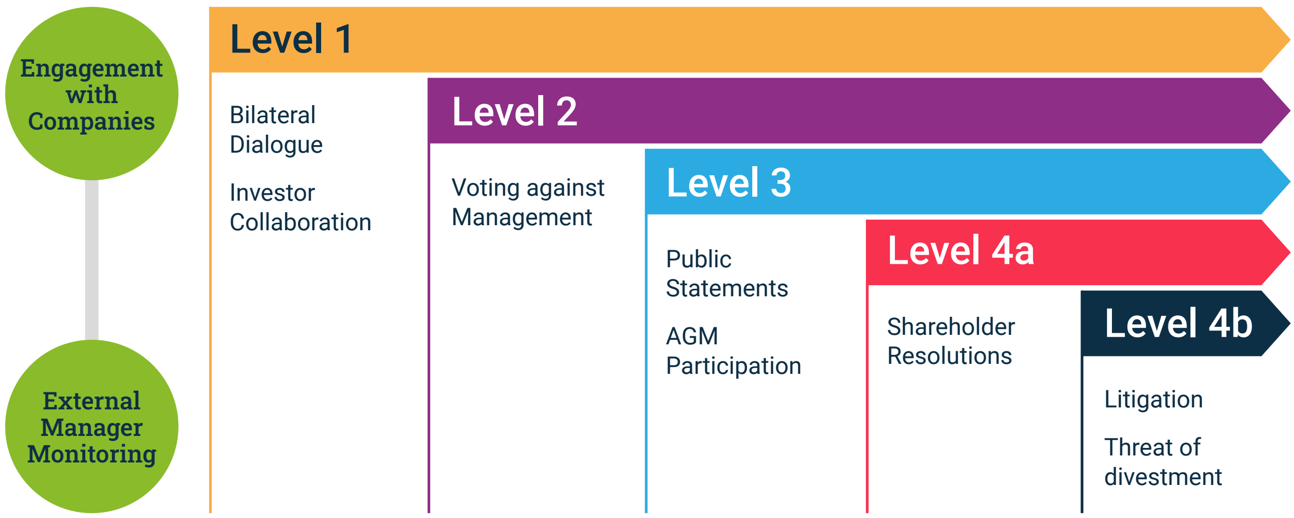
Joining working groups, responding to consultations, dialogue with regulators and presenting at conferences are important features of the Company's stewardship approach. Industry participation allows the Company to represent the interests of its clients to a broad audience and, through joint action, supports investment outcomes over the long term. The Company will seek participation including active contribution where this serves the long-term interests of the Company's clients.

ESCALATION PROCESS

Any decision to escalate will always be particular to the engagement in question, and the most effective means of escalation can vary significantly from one engagement to another. It is also important to consider that escalation is rarely a linear process, hence the use of one engagement method does not preclude the use of others.

All escalation techniques are reliant upon either direct engagement with the company or external manager monitoring. While the escalation process is rarely linear, the examples of escalation are ordered in terms of potential impact. Escalation techniques in the higher levels will normally not be considered until a significant proportion of the preceding techniques have already been exhausted.

Figure 3: Escalation process



Transparency and Disclosure

REGULAR REPORTING

The Company aims to report its RI activities in a manner deemed to be best practice. This includes regular disclosures that demonstrate to its stakeholders how this framework has been applied in practice.

The Company supports the statutory annual reporting requirements of its local authority pension fund clients.

The Company has been a signatory to the UK Stewardship Code since inception and will provide annual reporting in line with the revised Stewardship Code 2020. In addition to the annual stewardship report, the Company will disclose its stewardship activity at three intervals during the year.

As a signatory to the Principles for Responsible Investment, the Company discloses a Transparency Report on an annual basis.

The Company has signed up to the LGPS Code of Transparency.

The Company's voting service provider will support disclosure of voting activity on a vote-by-vote basis.

Where appropriate, RI factors are integrated into periodical product disclosures to the Company's clients.

Systemic Risks

CLIMATE CHANGE

The Company believes that financial markets are likely to be materially impacted by climate change and by the response of climate policymakers. As such, responsible investors should proactively manage this risk factor through integrated analysis and stewardship activities, using partnerships of like-minded investors where feasible.

OUR NET ZERO AMBITION

LGPS Central Ltd has formally committed to transitioning our investment portfolios to Net Zero greenhouse gas emissions (GHG). As part of the commitment, we have developed a strategy utilising Institutional Investor Group on Climate Change's ('IIGCC') Net Zero Investment Framework to achieve Net Zero emissions across our internally and externally managed portfolios by 2050 (or sooner).

IDENTIFYING AND MANAGING CLIMATE CHANGE RISKS AND OPPORTUNITIES

Depending on the asset class in question, risk identification is either a bottom-up or a top-down process. For index-tracking funds (other than climate-factor funds), a top-down process is employed to identify which sectors and constituents should be prioritised for engagement. For actively managed funds, including funds of funds, a bottom-up process is employed to understand the inherent risk and any mitigants in place at a stock or fund level.

The Company manages climate risk in different ways according to the nature, duration, magnitude and time horizon of the risk itself. External managers are required to have the people, processes and systems in place to integrate ESG risks, including climate change into the investment decision making process. Delivery against this requirement is monitored accordingly by the LGPS Central Investment Teams supported by the RI & Team.

ESG integration is accompanied by a comprehensive approach to investment stewardship delivered through engagement and voting. In order to encourage a broad transition towards a low-carbon economy, LGPS Central pursue a stewardship strategy including multiple strands of engagement; engagement with companies, sector-level engagement, industry standard setter and policy engagement.

CLIMATE CHANGE DISCLOSURE

The Company reports annually using the recommendations of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD). This complements the Company's broader support for the TCFD and its work to encourage other participants in the corporate and investment value chains to adopt the TCFD recommendations.

HUMAN RIGHTS

OUR APPROACH

The long-term legitimacy of sectors and markets depends, among other things, on operations and products that are ethically acceptable. We recognise the role that we as investors can play in advancing human rights globally. Just as for all businesses, institutional investors have a responsibility to respect human rights. This is reflected in The UN Guiding Principles on Business and Human Rights (UNGPS) and the OECD Guidelines for Multinational Enterprises.

Our investments are monitored and reviewed to detect ESG risks, including human rights risks. Concerns are managed in accordance with the Framework. In line with our RI beliefs, a strategy of engagement is preferred over exclusion. Stewardship activities on human rights risks are conducted across multiple engagement strands, including direct, collaborative and engagement with policymakers.

MODERN SLAVERY

Due to the nature of our business, we consider ourselves at low risk of being directly involved in facilitating modern human slavery. However, we recognise that we play a role in helping to eliminate modern human slavery, wherever possible through our operations and our investments.

Commercial organisations in the UK with an annual turnover of at least £36 million are required to publish a modern slavery statement as per Section 54 of the Modern Slavery Act 2015. While LGPSC is currently below this threshold, the Company has decided to voluntarily publish a Modern Slavery Statement where our approach to combatting modern slavery in our operations, investments and supply chain can be found.

DIVERSITY, EQUITY AND INCLUSION

Equal opportunity and no discrimination are key components of the UN Universal Declaration of Human Rights. The Company is committed to promoting equal opportunities in employment and discharging our obligations under the Equality Act 2010. Our Diversity and Inclusion Policy sets out our approach to equal opportunities and the avoidance of discrimination at work.

Investee companies and asset managers with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is clear evidence showing that decision-making and performance are improved when company boards and investment teams are composed of diverse individuals. We integrate diversity criteria in our Selection process and are involved with diversity-related Stewardship activities (including through engagement and voting) alongside industry peers.

BIODIVERSITY & DEFORESTATION

Biodiversity loss could reduce nature's ability to provide goods and services, including food, clean water and a stable climate. Tropical forests play an important role in tackling climate change, protecting biodiversity and ensuring ecosystem services. Forests alone absorb one-third of the $CO2$ released from burning fossil fuels every year. We are concerned about the financial impact that biodiversity loss, deforestation and the violation of the rights of indigenous peoples may have on our portfolio and investee companies, by potentially increasing reputational, operational and regulatory risks.

IDENTIFYING AND MANAGING BIODIVERSITY RELATED RISKS AND OPPORTUNITIES

The Company, through our investments, play an essential role in incentivising the protection and restoration of biodiversity, as well as mitigating and preventing the major drivers of nature loss. We encourage investee companies to develop and disclose a strategy to address biodiversity loss and commit to publish a report based on the Taskforce on Nature-Related Financial Disclosures (TNFD) once the new disclosure framework is launched in 2023.

During COP26[1] many governments pledged to halt deforestation by 2030. Financial institutions, including LGPSC, have committed to engage with a view to eliminating commodity-driven deforestation by 2025 through engagement at policy and corporate levels Through our Voting Principles we have set expectations on companies across sectors to protect nature and biodiversity as part of their ongoing climate transition efforts. This is in support of ongoing engagements with high-risk commodity sectors including palm oil, soy, beef, pulp and paper.

We view policy dialogue as an important engagement tool alongside corporate engagement. LGPS Central participates in policy engagement with the Brazilian government through the Investor Policy Dialogue on Deforestation (IPDD) initiative. The goal of IPDD is to coordinate a public policy dialogue on halting deforestation. Since 2020, the investor group has met with federal representatives, state representatives, congress members, and civil society in Brazil. IPDD also holds educational and knowledge sharing sessions, both in and outside of Brazil, and conducts outreach with investor coalitions, foreign representatives, and other relevant stakeholders.

[1] The COP26 (Conference of the Parties' 26th meeting) event is a global United Nations summit about climate change and how countries are planning to tackle it.

Glossary of terms

DIVESTMENT/ EXCLUSION/ NEGATIVE SCREENING:

The exclusion, usually on moral grounds, of particular types of investments, possibly affecting in a negative way the risk-return profile of a portfolio.

ENGAGEMENT:

Dialogue with a company concerning particular aspects of its strategy, governance, policies, practices, and so on. Engagement includes escalation activity where concerns are not addressed within a reasonable time frame.

ESG FACTORS:

Determinants of an investment's likely risk or return that relate to issues associated with the environment, society or corporate governance.

ETHICAL INVESTMENT:

An approach to investment where the moral persuasions of an organisation take primacy over investment considerations.

NON-FINANCIAL FACTORS:

Determinants of an investment's likely risk or return that cannot be, or cannot straightforwardly be, given a monetary value for insertion into an organisation's financial statements.

RESPONSIBLE INVESTMENT/ RI:

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

RESPONSIBLE INVESTMENT FACTOR/ RI FACTOR:

An aspect of an investment which relates to environmental, social or corporate governance issues.

SOCIAL INVESTING/ SOCIAL IMPACT INVESTING:

Investments that seek to achieve a positive social impact in addition to a financial return.

STEWARDSHIP:

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

VOTING:

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

LGPS Central Limited

About LGPS Central Limited

LGPS Central Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No: 10425159. Registered Office: 1st Floor i9, Wolverhampton Interchange, Wolverhampton, WV1 1LD.