LPP
Local Pensions Partnership
Investments

Responsible Investment Policy Annex on Climate Change

Contents

1. Introduction

1.1 Definitions

Abbreviation (A-Z)	Definition
LPPI	Local Pensions Partnership Investments Ltd
ESG	Environmental, Social and Governance
TPI	Transition Pathway Initiative
GICS	Global Industry Classification Standard
TCFD	Task Force for Climate-Related Financial Disclosures
FSB	Financial Stability Board
the Policy	Climate Change Annex

1.2 Summary of relevant regulations and legislation

There is no relevant regulation or legislation expected to affect the Climate Change Annex (the Policy).

1.3 Purpose

This annex to our Responsible Investment Policy explains our climate change beliefs and describes our approach to understanding and managing the risks and opportunities climate change presents for the portfolios we manage on behalf of clients. Specifically, it addresses our management and monitoring of climate change as an investment issue. Climate change also exists as a business risk which could affect our employees, suppliers and internal systems, but the management and reporting of these fall outside the remit of this policy.

2. Policy standards and criteria

2.1 Our climate change beliefs

Climate change poses a long-term and material financial risk to client portfolios. It has the potential to impact value across all the asset classes we invest in globally, but the route scale and timing of this impact is both complex and uncertain.

Climate change is a systemic risk which arises from the physical effects of sustained changes in weather patterns due to global warming, and from human interventions to mitigate and manage these changes by adapting to new circumstances through regulation, technological innovation, or other cultural shifts otherwise termed transition risks.

Climate change will impact companies globally. It has the potential to destroy value where business risks are not being recognised and integrated into effective strategic planning but also presents opportunities for value creation where products and services can be developed which solve problems and meet societal needs.

The scope, dimensions, materiality and long-term significance of climate change as an investment issue merit specific attention as part of our responsible investment approach and the processes we develop to implement this in practice.

2.2 Our climate change beliefs translated into practice

LPPI's risk policy incorporates a climate change risk policy which recognises that the physical, transition and liability (litigation) risks posed by climate change are inherent and could aggravate LPPI's existing risks through an adverse impact on LPPI financially, reputationally, or through investment performance. The approach and actions outlined in this annex explain how, in addressing climate change as an investment issue, we seek to protect the long-term financial interests of our clients.

Our ultimate objective is to be able to identify, quantify, measure, act, monitor and report to clients on our management of climate change risk on their behalf. In doing so, our aim is to improve corporate climate risk management and resilience, encourage supportive, coherent and practical policy and frameworks, take advantage of climate-related opportunities in the market and ultimately contribute to real world emissions reduction.
This is a significant undertaking with numerous challenges. Whilst data, tools, methodologies, regulation and best practice in this area are still evolving, there are consistent avenues for applying our expanding knowledge of climate change to our stewardship and exerting influence to effect change in investee companies and the wider market, namely:

- Incorporation into the investment management products and services we provide to our clients
- Integration into our stewardship and asset management as part of our
    a. Direct dialogue with investee companies through our in-house investment teams
    b. Indirect dialogue with investee companies through the influence of our external investment managers and service providers
    c. Solo engagement through shareholder voting and board seats
    d. Collaborative engagement alongside like-minded investors through external initiatives, for example CA100+ and CDP

We provide insights into our use of these different channels below.

2.3 Our net zero commitment

We support the aims of the Paris Agreement to limit the rise in global temperature to 1.5°C above pre-industrial levels. We have set the goal of achieving net zero portfolio emissions by 2050 in partnership with our client pension funds and are aligning our stewardship with this objective in our role as asset manager. In November 2021, we signed the Institutional Investors Group on Climate Change (IIGCC) Net Zero Asset Manager Commitment (NZAM) which forms part of the IIGCC Net Zero (1.5°C) Investment Framework. We published our first set of targets covering our Global Equities Fund in 2022 in line with the expectation on signatories to publish short- and medium-term targets within a year of signing the NZAM commitment. We will progressively phase in additional asset classes as part of our ambition to bring 100% of assets under management within scope of net zero target setting over time.

Climate change has long been a factor considered as part of our efforts to integrate ESG across the investment lifecycle and understand the sustainability of current and prospective investments. However, the decision to make a net zero commitment was a conscious choice to develop our processes further in order to better understand and manage portfolio climate change risks and opportunities. As a lens focused on the global decarbonisation needed to halt planetary warming at 1.5°C, net zero provides a clear goal to aim towards in our management of climate risks and helps us set clear expectations of the path we expect our investee companies to follow.

Utilising and refining our influence through the channels listed above is the core focus of our efforts to achieve our net zero commitment. Our strategy involves the implementation of processes which embed this as part of asset selection, portfolio oversight and active stewardship. Further detail on our net zero targets and philosophy can be found in our **Roadmap to net zero** available from our website.

2.4 Investment selection and portfolio monitoring

Our approach to asset selection (for internally-managed assets) and to manager selection and monitoring (for assets managed by external managers) is built around detailed risk analysis and an up-to-date understanding of context as part of due diligence. This approach suits the complexity and multi-dimensional nature of climate change and the challenge it poses for strategy integration. Climate change is a core ESG factor considered as part of investment selection and decision making across our portfolio.

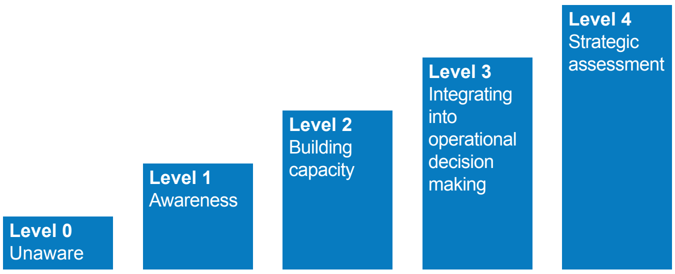
Our starting point is to ensure managers share our beliefs and have the capabilities to meet our requirements. In appointing third party managers we routinely assess their approach to responsible investment and the integration of environmental, social and corporate governance (ESG) factors. LPPI's External Manager Rating Framework incorporates a detailed Due Diligence Questionnaire which includes specific questions on assessing, monitoring and reporting on climate change. Questionnaire responses inform our detailed selection and appointment process. Further information on our approach to ESG integration and the tools and frameworks we have developed to embed this across our portfolio are covered in a dedicated **Annex on ESG**.

Identifying the risks client portfolios face from climate change requires quantitative measurement along with qualitative interpretation. We are continually seeking data and tools to help us to assess the position of individual companies and inform our ongoing dialogue with managers around their own evaluation of the climate change risks their portfolios encompass. Our main focus to date is listed equities where information is most readily available, but learning gained here is informing the more challenging (and ongoing) task of assessing the position of wider asset classes. We are using Transition Pathway Initiative (TPI) and Climate Action 100+ (CA100+) methodologies alongside data from CDP and our data and analytics provider MSCI as part of our application of the NZAM framework to aid our assessment.

For instance, the TPI toolkit is publicly available, refreshed annually and accessible to all managers without the need to subscribe to a proprietary data system. We are a long-term supporter and Strategic Asset Owner Partner to the TPI. Investee companies with a score below TPI 3 for management quality are subject to internal monitoring, requiring a clear rationale for their selection and enhanced evidence of the assessment, management and mitigation of their exposure to climate-related risks.

Transition Pathway Initiative (TPI) - Management Quality Stairway

Companies are assesed to one of five levels based on their position in relation to the recognition and management of transition risks. Standard questions are posed and are answered using publicly available data.



We recognise that climate change will present opportunities across different markets and asset classes and we already invest in a wide range of companies whose products and services offer climate solutions. Examples include renewable energy, battery storage technology and green bonds. We report to clients on their allocation to these activities as part of our quarterly reporting and work in partnership to accommodate their preferences in this area.

2.5 Exclusions

We recognise that whilst all companies may ultimately be impacted by climate change, some sectors face greater risks due to their emissions intensity or involvement in traditional energy production based on fossil fuels which will need to be significantly curtailed to meet global emissions reduction targets.

At a sectoral level, we have identified thermal coal extraction as a particular focus of risk. Coal is the most carbon intensive fossil fuel and the traditional energy source most likely to face declining demand in the face of rising renewable output at a reducing cost. As a consequence, we took the decision (in 2019) to cease investing in thermal coal extraction across our portfolio by progressively divesting existing holdings and placing an exclusion on further investments in this sector[1]. This approach is in line with protecting the long-term financial interests of all clients but presents challenges within private markets if pooled funds lack the facility to exclude sectors, reducing product choice.

Our objective is to avoid new (future) exposure to thermal coal via exclusion whilst monitoring and managing existing exposures out of the portfolio over time where this is achievable without significant financial detriment.

Our net zero commitment tightened our focus on the obligations of asset ownership and the importance of deploying stewardship resources for greatest influence, and prompted the decision to exclude extractive fossil fuel companies from our Global Equities Fund by the end of 2021[2].This step acknowledged that the sector is not a natural match for the fund's enduring quality bias and consumes stewardship resources disproportionate to the small exposure we might select to own long-term and the limited scope for shareholder influence this offers. Removing what has historically been a relatively small opportunity set for our Global Equities Fund has allowed attention to move to a broader range of sectors impacted by transition risk and required to decarbonise.

We will be considering our position on extractive fossil fuel companies within other asset classes as part of our net zero strategy development. Our approach will consider implementation routes for fulfilling our commitment to stewardship supportive of real-world decarbonisation which contributes to the acceleration of a market-wide transition aligned with the goals of the Paris Agreement.

Our side letters for new investments expressly communicate our net zero commitment and support for TCFD alongside any exclusions we have agreed. We also confirm reporting requirements for carbon intensive sectors and the expectation our investment partners will support us in monitoring and reporting on our climate change commitments.

[1] Companies within GICS 10102050 (Coal and Consumable Fuels)
[2] Companies within extractive fossil fuel industries are defined as those within:
- GICS 10101010 (Oil and Gas Drilling)
- GICS 10102010 (Integrated Oil and Gas)
- GICS 10102020 (Oil and Gas Exploration and Production)

2.6 Active ownership (voting and engagement)

Our commitment to encouraging good corporate governance through our ownership activities includes a specific focus on climate-related issues for investee companies. Our objective is to understand the preparedness of investee companies for the transition to a low carbon economy, support companies which are managing the risks and opportunities on behalf of shareholders and challenge those which are not.

Our shareholder voting approach explicitly identifies all upcoming resolutions on environmental themes. In appropriate circumstances we will support resolutions which encourage companies to recognise, evaluate, adapt to and report on climate-related business risks and opportunities, or which urge them to evolve their current approach where further development is warranted. This is in line with our Shareholder Voting Policy which recognises the responsibility of asset owners to monitor and engage with investee companies in order to protect value.

Our Shareholder Voting Guidelines provide further clarity on our decision making process and approach. The guidelines identify effective management of climate change as a priority engagement theme and provide further details on the steps we take if we believe minimum standards, such as a company's TPI management quality score or alignment of targets and trajectories with the Paris Agreement, are not being met.

We have developed an approach based on the NZAM initiative to assess the degree of alignment of companies with a 1.5°C trajectory, using the categories of Not Committed, Committed, Aligning, Aligned and Net Zero. We utilise data on greenhouse gas emissions, short- medium- and long-term targets, decarbonisation strategies and capital allocation plans to understand the position of different sectors and companies and evaluate the position of our Global Equities Fund relative to the goals of the Paris Agreement. Our net zero targets encapsulate ambition to see more of our portfolio companies progress along this continuum and become categorised as Aligned and Net Zero. Where not assessed as Aligned or Net Zero, they will be subject to direct or collective engagement and stewardship.

As part of our engagement approach, LPPI is networked with a range of organisations working on climate related agendas. These include the Principles for Responsible Investment, the Institutional Investor Group on Climate Change, the Transition Pathway Initiative and Climate Action 100+. Our interactions with these groups inform our thinking and provide opportunities to support collective initiatives which encourage companies to address climate change related business risks and report transparently on their efforts.

We support the recommendations of the FSB's Taskforce on Climate-Related Financial Disclosure which identified that inadequate corporate reporting creates significant information gaps which prevent investors from evaluating the quality of climate change governance by investee companies. We encourage investee companies to develop their reporting in line with the disclosures outlined by the TCFD.

We also recognise that TCFD recommendations on enhanced reporting extend to investors and asset managers. As part of the evolution of our approach to climate change we reported for the first time against the TCFD disclosure requirements in 2019 on a voluntary basis. We will continue to strengthen our alignment with the TCFD and related regulations and work towards providing enhanced reporting on our activities going forward.

To ensure the continuing effectiveness of our approach to addressing climate change as part of our commitment to responsible investment, our Stewardship Committee will review this annex to our responsible investment policy on an annual basis and will update it to reflect changes in approach and further progress.

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