LPP
Local Pensions Partnership Investments

Responsible Investment Policy – Annex on ESG Integration

Contents

1. Introduction

1.1 Definitions

Abbreviation (A-Z)	Definition
AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
FCA	Financial Conduct Authority
LPPI	Local Pensions Partnership Investments Ltd
the annex	LPPI Responsible Investment Policy – Annex on ESG Integration
ESG	Environmental, Social and Governance

1.2 Purpose

This annex to our Responsible Investment Policy outlines our ESG beliefs and explains our approach to the integration of ESG considerations within investment management. It describes the approach we apply to our assets under management which include direct investments, internally-managed mandates, and assets managed under delegation by external managers selected and overseen by LPPI.

2. Policy standards and criteria

2.1 Scope of the policy

LPPI's investment management activities centre on seven asset classes and on pooled investment vehicles (IPVs) comprising multiple fund mandates[1] (set out below).

Two of our pooled funds incorporate internal management where in-house investment staff select assets and engage with investee companies directly.

Asset Class	Externally Managed	Internally Managed
Listed Equity	Yes	Yes
Fixed Income	Yes	
Diversifying Strategies	Yes	
Infrastructure	Yes	Yes
Real Estate	Yes	
Private Equity	Yes	
Private Credit	Yes	

Our actively managed Global Equities Fund incorporates two mandates managed internally by our in-house listed equities team alongside a number of delegated externally-managed mandates.

Our Infrastructure Fund includes directly managed assets overseen by our in-house infrastructure team plus a number of externally-managed infrastructure funds under delegated external management.

Our IPVs are not ESG funds or impact funds. They do not directly address specific ESG characteristics or target identified sustainability outcomes in accordance with SFDR Schedule 8 or Schedule 9 labels[2] or UK Sustainability Disclosure Requirements (SDR) investment labels.

If LPPI opts to develop investment products with intentional sustainability outcomes, we will publish dedicated product level information disclosing the investment policy, strategy and metrics that apply.

Our consideration of material ESG factors occurs within the context of underwriting and portfolio monitoring as part of active stewardship and reflects our commitments as a signatory to the Principles for Responsible Investment.

The UK Stewardship Code defines stewardship as “the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society”. LPPI is a signatory to the code and our core investment processes incorporate the consideration of material ESG factors as part of an approach to building sustainable portfolios which meet the investment needs of our clients.

[1] LPPI is additionally the Alternative Investment Fund Manager for GLIL, an infrastructure collaboration in partnership with Northern LGPS, and the delegated Investment Manager for The London Fund, a place-based collaboration with London CIV. Both these initiatives have dedicated governance and investment management arrangements which are outside the scope of this policy annex.

[2] Sustainable Finance Disclosure Regulation. A European regulation introduced to improve transparency in the market for sustainable investment products. LPPI is not in the jurisdiction of the regulation.

3. Our approach

3.1 Our ESG beliefs

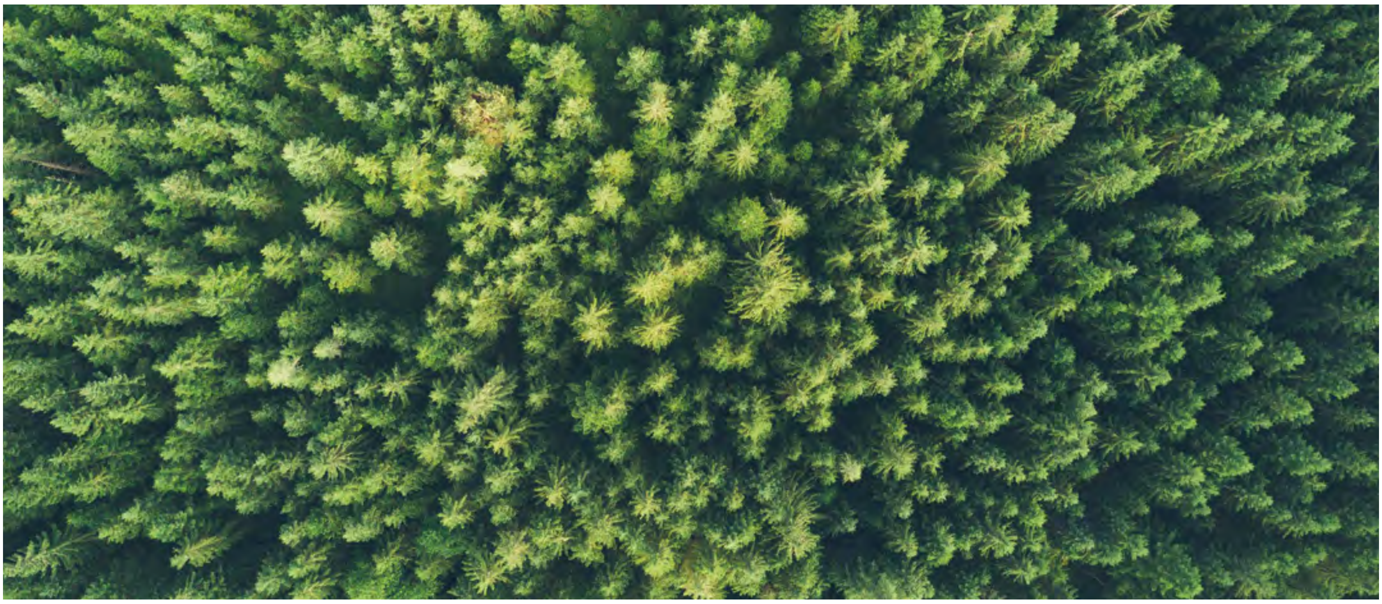
Environmental, social and governance (ESG) considerations encompass a broad range of factors related to how investee companies influence and are simultaneously influenced by the context in which they plan, resource, execute and manage their business activities. ESG considerations include how effectively companies are led and managed, how successfully they support and balance employee, supplier, consumer and broader stakeholder interests, and how the reach and lifecycle of a company's operations, products and services have an impact (positive and negative) on society and the natural environment.

Framed in this way, we understand that ESG factors have the potential for material financial influence in the short, medium and long term. We recognise that ESG factors can impact the value of investments we make on behalf of our client pension funds, and also have an influence on their ability to generate the investment returns necessary to pay pension liabilities as they fall due.

Our client pension funds are institutional investors with large, diversified portfolios invested across multiple asset classes. Their assets must fund liabilities which stretch many years into the future. This encourages a long-term view and strategy, rather than a focus on short-term market volatility.

ESG provides a valuable forward-looking lens for evaluating the sustainability of existing and prospective investments. It places a strong focus on context and on the interplay of value drivers and detractors with the potential to impact investment outcomes both positively and negatively.

As we outline in our Responsible Investment Policy, we believe the consideration of ESG factors is relevant at every stage in the investment cycle - within investment strategy, investment selection, and within the stewardship of assets in ownership. Reflecting this belief, ESG considerations feature in our key investment processes as part of asset and manager selection (underwriting), portfolio monitoring (investment oversight) and the stewardship of assets under management (active ownership).



3.2 Our ESG beliefs translated into practice

The diagram below illustrates the components of our core investment processes where ESG is integrated, which will be expanded upon in this annex.

Investment policies

Responsible Investment Policy and annexes
- Annex on ESG Integration
- Annex on Climate Change
- Annex on Controversial Weapons
- Annex on Human Rights

Practice standards
- UK Stewardship Code
- Principles for Responsible Investment

Investment procedures

Investment selection (direct assets and external managers)

Stage 1
- ODD and IDD
- CDG/IC approval

→

Stage 2
- ODD and IDD
- CDG/IC approval

→

Side letter
ESG requirements and commitments

Portfolio monitoring

- Manager monitoring calls
- Asset class review meetings (quarterly and yearly)
- ODD rating refresh

Active ownership

Investor collaborations
- Industry forum membership
- Collaborative engagement
- LP advisory committees
- Policy advocacy

Company engagement
- Shareholder Voting Policy
- Shareholder Voting Guidelines
- Board seats
- Direct dialogue
- External manager dialogue

Broader commitments
- Net zero
- TCFD

Our investment policies set the perimeter for our investment processes. Together with external practice standards, LPPI's Responsible Investment Policy (and supporting annexes) shape how our investment procedures implement ESG integration.

In selecting prospective investments we follow a detailed formal underwriting process which concludes with written proposals submitted for decision-making by the Chief Investment Officer, under delegation from LPPI's Investment Committee (IC). The Chief Investment Officer is supported by a Capital Deployment Group (CDG) convened to provide advice and insight. Whether we are selecting direct assets or investment products managed by external managers, ESG considerations feature within our operational and investment due diligence, within papers presented to the relevant CDG, and within side letters which confirm our investment and reporting requirements.

As part of portfolio oversight, ESG considerations feature within our monitoring dialogue with both companies and asset managers and within our evaluation of their performance and good standing.

As part of active ownership, we raise material ESG concerns directly with investee companies (using influence through board seats, investor panels, and shareholder voting) and asset managers. ESG considerations inform our selection of priority engagement themes, membership of key partnerships, interactions with other investors, and our objectives as participants in investor collaborations or signatories to broader commitments.

3.3 Operational due diligence

Operational due diligence (ODD) is a critical function within the LPPI investment process for both internally-managed and externally-managed assets and funds. It is configured to complement (and not repeat) the investment due diligence (IDD) performed by our investment and responsible investment staff.

ODD focuses on the investment management firm's own operational practices rather than their products, investment process or investment strategy (which are addressed as part of IDD).

The factors we systematically consider as part of ODD include, but are not limited to:

Policy and process	Diversity and inclusivity	Recruitment and retention
Firm policies, outside of the investment process	Cultural promotion within the business	Hires and departures
Resourcing of the firm's ESG function	Code of conduct	Removing unconscious bias
Seniority of ESG staff and position of ESG functions within the firm	Coaching and mentoring	Promotions
ESG within the firm's corporate governance		Employee engagement

As part of investment underwriting, our ODD team reviews policy documents to establish how well firm-specific ESG factors fit into the investment manager's corporate governance, culture and overall business practices. Our framework utilises a set of questions and metrics which focus on evaluating the actions and validity of firm level ESG processes and commitments. Responses are assessed and recorded in a central due diligence control document and rated based on a traffic light system (RAG score), which reflects the quality of the responses against our ODD requirements and best practice expectations.

Each individual data point receives a score within the due diligence control report. These are aggregated into section totals and a final rating assigned for the investment. The final rating appears in the ODD dashboard provided to the CDG as part of investment proposals (at stage 1 and stage 2).

A poor ODD assessment can result in an investment proposal being halted, precluding its consideration by the CDG. Where it is appropriate to do so, LPPI will work with an investment manager or investee company, explaining the issues identified and establishing a mitigation plan which can assist them to achieve the standards and controls required to allow the investment proposal to be considered.

4. Externally-managed assets and funds

LPPI has delegated responsibility for selecting assets and funds from external investment managers to fulfil client investment strategies. The process we follow routinely integrates ESG considerations.

4.1 Investment selection

We integrate ESG considerations into the identification and evaluation of prospective investments, through detailed processes of investment due diligence and decision-making. We use the frameworks and related requirements outlined in this policy to ensure a consistent application of our responsible investment policies and philosophy as part of investment selection.

Our manager selection process follows two key stages: Stage 1 and Stage 2. ESG frameworks inform our underwriting by setting consistent requirements for the incorporation of ESG considerations at Stage 1 and Stage 2, with conclusions recounted in papers to the CDG. Climate risks are always integrated within our analysis, even where they are not the primary ESG risk to the investment.

The diagram opposite represents the investment process workflow and the different ESG analysis carried out at each stage.

Investment due diligence overview

Stage 1 - Initial investment proposal

- Stage 1 paper to CDG
- Manager ESG status (initial)
- Material ESG risks and opportunities (indicative)
- Stage 1 ODD ESG assessment (preliminary)

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Stage 2 - Detailed investment proposal

- Stage 2 paper to CDG
- Manager ESG rating (detailed)
- Material ESG risks and opportunities (final)
- Climate change (if not a material ESG risk)
- Stage 2 ODD ESG assessment (detailed)
- Responsible investment business area approval

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Deployment decision

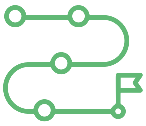
- Side letter ESG requirements
- Post-investment manager ESG action plan

4.2 Fund ESG due diligence process

The majority of LPPI's portfolio is invested through the selection and appointment of external managers. Our process for assessing externally managed funds considers both the fund's investment strategy and the manager's investment process.

Investment strategy

What ESG risks and opportunities is the investment strategy exposed to?



Investment processes

Are the manager's processes adequate to successfully execute the investment strategy?

4.2.1 Investment strategy - ESG risks and opportunities

Every investment strategy consists of inherent ESG risks and opportunities. To identify potentially material ESG factors, the investment team uses an internally-developed ESG factor checklist, the ESG SatNav. An ESG risk rating is assigned to the investment, and where relevant, ESG-related opportunities are also flagged.

Investment strategy - ESG Risk Rating

Where ESG risks are identified, we seek evidence of the adequacy of the manager's risk mitigation and management approach as part of their investment process. This may become a focus for ongoing engagement and monitoring with the manager. ESG risks range from low to high, helping to identify 'red flag' investments, which may warrant the decision not to invest.

LPPI ESG SatNav

LPPI has identified a range of ESG factors for investment teams to consider as part of their analysis of ESG risks. These factors have been formalised in an ESG tool, the ESG SatNav, based on guidance from the Sustainability Accounting Standards Board and the Task Force on Climate-Related Financial Disclosures.

The ESG SatNav is maintained and reviewed by the Responsible Investment team.

ESG factors routinely considered within investment due diligence and monitoring are categorised as follows:

- **Environmental** – factors relating to resource dependencies and environmental impacts
- **Social** – factors that reflect relationships with key stakeholders and the maintenance of a social license to operate
- **Governance** – factors that signify the responsible management of an asset or entity
- **Climate change** – a subset of factors specifically relating to the risks and opportunities posed by climate change

These include, but are not limited to:

Environmental

- Ecological impacts
- Energy management
- Waste and hazardous materials management
- Water and wastewater management
- Air quality and pollution

Climate change

- Greenhouse gas emissions
- Policy and legal
- Technology
- Market
- Reputational
- Physical risks – acute
- Physical risks – chronic

Social

- Customer health and safety
- Data security and privacy
- Access and affordability
- Product quality and safety
- Human rights
- Selling and product labelling
- Labour practices
- Employee health and safety
- Employee engagement, diversity and inclusion

Governance

- Policies, standards and codes of conduct
- Management and board structure
- Executive compensation
- Shareholder rights
- Board diversity
- Tax strategy
- Auditor and auditor selection
- Succession planning
- Critical incident risk management

4.2.2 Investment processes - ESG

Even for a given investment strategy, investment manager decisions can produce a variety of resulting portfolios. LPPI employs an extensive ESG due diligence process focused on evaluating an investment manager's ESG integration approach to ensure adequate management of potential ESG risks and opportunities.

During the underwriting process, managers are required to complete our Responsible Investment Due Diligence Questionnaire and provide ESG focused calls with investment teams. Manager ESG processes are evaluated against our manager ESG framework, which consists of four pillars with twelve underlying attributes, as shown below.

Performance against each attribute and pillar is given an ESG rating, ranging from inadequate (below minimum requirements) to outstanding. These are then aggregated to assign an overall ESG rating for the manager's ESG processes.

Managers are assessed against these qualities in each stage of the fund underwriting process. Where a manager is rated inadequate or not meeting minimum requirements overall, this is likely to contribute to them not being selected by our investment teams. However, where addressable weaknesses are identified, LPPI may elect to work proactively with a manager to remedy these, subject to adequate commitment from the manager and a clear plan for addressing concerns. Expectations of managers in relation to diversity and inclusion, reporting, and stewardship appear in side letters for new underwrites.

Governance

- Accountability and oversight
- Policy and standards
- ESG strategy

Active ownership

- Engagement
- Collaboration and initiatives

ESG integration

- Risks and opportunities
- Decision making
- Training and knowledge sharing
- Research, data and tools

Reporting

- Transparency
- ESG measures and metrics
- Material ESG incidents

4.3 Portfolio monitoring and active ownership

We oversee a large and diverse portfolio, and our approach is focused on identifying material concerns through a process which applies a status rating (red, amber, green) to external manager mandates which comprise our pooled funds.

Monitoring our appointed managers includes assessing stewardship and ESG integration in accordance with our manager ESG rating framework (Section 3.2.2) and LPPI's broader responsible investment policy on an ongoing basis. We expect fund managers to be assessing potential risks and engaging with investee companies on material ESG issues, as well as engaging on wider thematic issues we identify as important to our clients. Our requirements feature formally in investment management agreements.

Periodic fund reviews are conducted by asset class teams through monitoring calls. Within these manager calls, questions are asked around material ESG incidents, progress on ESG integration and examples of good stewardship.

ESG considerations feature within quarterly and yearly asset class reviews where the asset class head, Portfolio Manager, Chief Investment Officer, Risk Manager and Head of Responsible Investment are present. In each review, manager ESG ratings, engagement priorities and progress are presented and plans for high risk or underperforming assets are discussed.

5. Internally-managed portfolios

5.1 Direct public equity

This section outlines how LPPI's internal equity team assesses, monitors and integrates the responsible investment considerations which are bespoke to the internal public equity portfolio.

5.1.1 Investment selection

LPPI's internal equity team aims to fully integrate ESG into its investment process. The strategy's aim of investing in high quality and well managed businesses naturally lends itself to ESG integration, as a full assessment of business and management quality will include consideration of ESG risks and opportunities. It also aligns with the team's long-term, low turnover and active ownership approach.

Given investments are made at a company level, the team takes a bespoke ESG approach that emphasises the materiality of ESG factors, as defined by their potential impact on the long-term competitive advantages and durability of cash flows for both existing and prospective investments.

Company-level ESG analysis is guided by an ESG checklist, which aims to identify key ESG risks, mitigating factors and opportunities for engagement. The checklist is maintained and reviewed by the team's senior investment analyst (ESG).

Key areas of focus include, but are not limited to:

Governance

- Incentives
- Independent challenge
- Aligned interests
- Long-termism
- Treatment of minority shareholders
- Board diversity and structure

Social

- Customer satisfaction
- Capacity for innovation
- Product governance
- Employee engagement and retention
- Cyber security and data privacy

Environment

- Greenhouse gas emissions
- Energy management
- Net zero
- Environmental targets and incentives

5.1.2 Portfolio monitoring and active ownership

The team monitors key ESG issues through a structured framework that includes the following:

- Embedding ESG in the team's individual stock monitoring process, namely through incorporating information from operational results, investor presentations or capital markets days
- ESG alert systems that provide us with real-time insight into relevant company news flow or broader industry developments
- Formal portfolio reviews
- Direct engagements

The engagement process encompasses:

- Direct dialogue with underlying companies in response to an ad hoc update, ESG incident or upcoming vote requiring enhanced due diligence and/or escalation
- Shareholder voting - ESG factors are fully integrated into our exercise of shareholder voting rights, which are fully retained by LPPI. Our Shareholder Voting Policy and Shareholder Voting Guidelines detail the priority ESG factors considered, and methods used as part of this process
- Use of an external provider of engagement services which targets companies under a number of themes relating to environment, social and governance issues
- Collaborative investor engagements - examples of collaborative engagements include CDP's non-disclosure campaign and Climate Action 100+

The internally-managed equities mandate forms part of LPPI's Global Equities Fund which, in common with all other asset classes, is subject to oversight through quarterly and yearly review meetings where ESG considerations are incorporated (as described at 3.3). Changes introduced as part of the evolution of a more systematic approach will also apply to the internally-managed mandates.

5.2 Direct infrastructure

This section outlines how LPPI's direct infrastructure team assesses, monitors, and integrates the responsible investment considerations which are bespoke to the infrastructure portfolio.

5.2.1 Investment selection

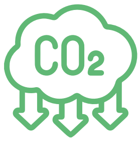
ESG considerations are embedded early in the investment appraisal process. The aim is to ensure capital is deployed at financial returns consistent with portfolio objectives and meets the broader LPPI responsible investment objectives.

Relevant ESG factors can vary significantly depending on the type of asset under consideration. A systematic appraisal is therefore carried out on a sector and asset specific basis to understand the relevant risks to consider. This may be on the grounds of financial materiality but also of reputation and corporate conduct. Every investment proposal submitted to a CDG integrates ESG analysis and outlines potential engagement opportunities, where appropriate.

Grounds for flagging the ESG positioning of potential investments at the earliest stage include, but are not limited to, the following considerations:

Environmental

- Hazardous materials
- Waste management
- Air pollution



Climate change

- Greenhouse gas emissions
- Physical climate risks
- Transition climate risks

Social

- Labour rights
- Unions
- Health and safety
- Human rights
- Child labour

Governance

- Supply chain
- Contractors
- Bribery and corruption
- Cyber security

A key part of the underwriting process is to ensure that potential investee companies understand our core responsible investment beliefs and have the capabilities to meet our responsible investment and stewardship requirements. In some cases, appropriate mitigations and risk management can be agreed relating to any inherent ESG risks or behaviours which are then actioned during the life of the investment. However, examples of potentially insurmountable ESG risks and performance include:

- Excessive climate transition risk that cannot be mitigated
- Persistent allegations of bribery and corruption
- Serious failings in corporate governance or health and safety

5.2.2 Portfolio monitoring and active ownership

A formal portfolio ESG review is integrated within quarterly and yearly asset class reviews where the asset class head, portfolio manager, Chief Investment Officer, risk manager and Head of Responsible Investment are present. In each review, engagement priorities and progress are presented and plans for high risk or underperforming assets are discussed.

Beginning with a thorough baseline appraisal, all incumbent direct assets are assessed with a view to identifying best practice objectives and implementing continuous improvement. Where relevant, any specific areas of concern or inadequacy will be identified for rectification and "best or reasonable" efforts will be required to improve performance.

Direct assets are also required to provide quarterly and annual reporting updates to LPPI. ESG data, analysis and supporting commentary must be included in their reporting, in line with the sector-specific requirements and with a scope appropriate to the investment. The scope and timetable for implementing these reporting requirements are agreed on a case-by-case basis at the outset. Requirements will take into account regulatory requirements pertaining to the asset, the extent of management control and influence, the investment horizon and the extent of reporting capabilities.

Governance oversight is primarily exercised through the investee company's board as the formal forum for raising ESG related issues. Engagement with our infrastructure assets is exercised through members of our investment team, who hold board positions on our directly held assets. Each of the boards has ESG related issues reported as a standard reporting item in the board packs, regular deep dive sessions conducted, and specific material incident reporting procedures. Executive management teams are regularly engaged with on the regulatory and sector context of ESG risks and opportunities, including understanding how these shape their judgements and progress on business activities.

6. Firm level stewardship

Active ownership includes engagement and advocacy with the wider market and often involves collaboration with other investors. Beyond our direct dialogue with investee companies and external managers on company specific and mandate specific ESG issues respectively, LPPI is committed to collaborating with other investors and stakeholders to maximise our influence on priority themes held in common.

Opportunities for collaboration arise in a variety of forms from a range of sources, perspectives and networks. Objectives in our stewardship activities can include drafting a common set of minimum standards for consistent adoption across our industry peers, articulating clear investor expectations of companies (or asset managers), and advocating for supportive policy, an assistive regulatory environment, and best practice standards from our service providers.

At the firm level, LPPI has committed to the following initiatives and standards which promote responsible investment practices and an active incorporation of material environmental, social and governance considerations:

- The UK Stewardship Code
- Principles for Responsible Investment (PRI)
- Taskforce on Climate-related Financial Disclosures (TCFD)
- Occupational Pensions Stewardship Council
- Asset Owner Diversity Charter
- IIGCC Net Zero Asset Manager initiative
- The 30% Club
- Workforce Disclosure Initiative (WDI)
- Climate Action 100+
- Transition Pathway Initiative (TPI)
- CDP (previously the Carbon Disclosure Project)
- Net Zero Engagement Initiative
- Nature Action 100
- PRI Advance

Significant collaborations require prioritisation based on relative importance, level of involvement, and likelihood of success. Proposals for LPPI’s involvement in significant collaborations and external commitments or initiatives are reviewed by the LPPI Stewardship Committee which meets under the chairmanship of LPPI’s Chief Investment Officer. The Stewardship Committee ensures our stewardship commitments have senior support and are considered from a corporate perspective. Members of the committee include the Chief Investment Officer, the Chief Risk Officer, the Chief Legal and Compliance Officer, and the Head of Responsible Investment.

Stewardship Committee members also contribute to the evolution of LPPI’s Responsible Investment Policy and its practical implementation under the aegis of their wider roles and responsibilities.

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Incorporated in England and Wales and trading as LPPI

Authorised and regulated by the Financial Conduct Authority
Reference number: 724653

December 2023