



LPP

Local Pensions Partnership
Investments

**Responsible Investment
Policy – Annex on Defence
Investments**

1. Introduction

Definitions

Abbreviation (A-Z)	Definition
LPPI	Local Pensions Partnership Investments Ltd
The/this Policy	Responsible Investment Policy Annex on Defence Investments
UN	United Nations

Summary of revelation regulations and legislation

There is no relevant regulation or legislation expected to affect the Policy.

Purpose

- 1.1 This annex to the LPPI Responsible Investment Policy explains our approach to investing in the defence sector.
- 1.2 Defining and articulating a clear position on the sector is helpful to navigating the considerations which apply to investment in products and services which support national and international security (threat detection, deterrence, protection, and resistance to armed attack) but which can feasibly also facilitate undue surveillance, aggression, and broader harms.



2. Policy standards and criteria

Policy Scope

2.1 This Policy applies to LPPI's entire portfolio under management and relates to investments in publicly listed, private, and state-owned companies, whether these arise through direct investment by LPPI or under mandates delegated to third party investment managers.

Our Definition of the Defence Sector

2.2 In the absence of a readily adoptable universally agreed definition of the defence sector, we consider this to comprise industries and activities involved in the development, manufacture, production, trade and maintenance of equipment, technologies, and systems utilised by security agencies and the armed forces for defensive purposes.

2.3 We utilise the following sector classifications to help us identify actors and activities captured by our definition:

- GICS Sub-Industry 20101010 - Aerospace & Defence, for listed equity investments
- BCLASS Level 4 Aerospace & Defence for fixed income and credit investments

2.4 'Dual use' technologies frequently originate from outside the GICS classifications outlined in 2.3. 'Dual use' is a collective term for technologies developed for civilian purposes which also have defensive and military applications (for example Global Positioning System (GPS) technology, drones, cybersecurity tools, artificial intelligence, satellite communications, and advanced materials).

2.5 The number and type of dual use technologies is potentially vast, meaning they defy sectoral categorisation and treatment. Consequently, we consider them as part of the sectors they originate from when applying our responsible investment policies to them as part of the core investment processes described below.

Our Position on Investments in the Defence Sector

2.6 We consider the defence sector to be a legitimate area for investment. Our conviction in the legitimacy of investing in the defence sector reflects 2 key premises:

- Nations have an inherent right to self-defence referenced by Article 51 of the United Nations Charter.
- the capacity for self-defence is reliant upon:
 - nations having the right to develop, purchase and possess technology and arms for the purposes of defence; and
 - a supply of effective technology, equipment and services supportive of national and international security.

2.7 We recognise that the defence sector stimulates diverse views, and we acknowledge that products and services legitimately developed for deterrence, protection and resistance to threats can also facilitate harms. The investment risks associated with the defence sector are both financial and reputational in nature and require that we consider, assess, and address them as a responsible steward.

Our Approach to Defence Sector Risks

- 2.8 We assess financial risks systematically through our core investment processes and established approach to evaluating the long-term financial sustainability of business models based on drivers and detractors of value (explained in our separate RI Policy Annex on ESG integration).
- 2.9 The reputational risks posed by investment in the defence sector are more complex given the range of circumstances which can trigger adverse perceptions. We assess reputational risks to protect long term portfolio value and maintain our role as a responsible steward, ensuring that our decisions are informed and our responses are appropriate.
- 2.10 As a long-term investor, our navigation of considerations specific to the defence sector acknowledges that:
- there are persons who will consider any association with the defence sector reprehensible given the connection with developing and supplying weapons and surveillance;
 - public perceptions of the sector will vacillate in reaction to circumstances - supportive where an increased threat level or specific social or economic benefit is perceived, critical in reaction to infractions or blatant harms;
- the defence sector is core to national security and directly contributes to regional and global stability;
 - the defence sector's benefit to the UK economy is considerable. It supports thousands of jobs both directly and through diverse supply chains, is sometimes a regionally important employer and often a hub for innovation fostering technological advances, particularly in hi-tech applications; and
 - technology and innovation will evolve at pace and societal perceptions and formal controls (through law and governance) will also continue to adapt.
- 2.11 The dynamic nature of the defence sector recommends that we anchor our approach in governing law and fiduciary duty, which is consistent with our core Responsible Investment Policy belief that detailed analysis and due diligence are generally preferable to placing artificial restrictions on our investment universe which cannot take account of context and nuance.

Our Approach to Investment and Stewardship

- 2.12 Our conviction in the legitimacy of investing in the defence sector is subject to the checks and balances our policies and processes for making, monitoring and managing investments routinely incorporate.
- 2.13 We expect defence sector companies to be operating in accordance with applicable regulations and complying with applicable laws. Where we have evidence that this is not the case, we may seek to investigate the circumstances and take appropriate action.
- 2.14 Where issues relate to a company under consideration for direct investment, we will address matters as part of investment due diligence. Where they relate to an existing direct investment we will engage with the company. Where they relate to an investment held by an external manager, we will engage with the manager.
- 2.15 Further details on how our core investment processes provide for evaluating and managing the risks posed by investments in the defence sector are summarised below.

Key Processes for the Identification and Consideration of Defence-related Risks

- 2.16 Our Responsible Policy Annex on ESG Integration explains our approach and processes for the integration of ESG considerations within investment management as part of our capital deployment, portfolio oversight and asset management processes.

Capital Deployment

- 2.17 Capital deployment includes:
- due diligence performed in underwriting prospective companies for investment; and
 - due diligence performed in evaluating and appointing delegate asset managers.

Portfolio Oversight

- 2.18 Portfolio oversight includes:
- portfolio monitoring by investment teams (inhouse and external);
 - engagement with investee companies (direct investments); and
 - dialogue with delegate managers (externally managed investments).
- 2.19 For prospective investments in private markets, the likelihood of material exposure to the defence sector is assessed at stages one and two of our investment due diligence in accordance with [LPPi's ESG Integration Policy](#). For existing investments (direct investments, or where 'look-through' data on underlying holdings is available for indirect funds), we review sector and geographic exposures as part of our asset management approach. Potentially material ESG risks are addressed through our active ownership activities, principally via company or manager engagement noting the greater illiquidity of private asset classes.

2.20 By identifying material matters through monitoring (which routinely includes environmental, social and corporate governance considerations) our investment teams are assessing the resilience and profitability of investments over time and ensuring risks are being appropriately priced and managed.

Asset Management

2.21 Investment decision-making and stewardship are continually being informed by our due diligence and portfolio monitoring to determine an appropriate response in the context that applies. Depending on the circumstances, the management actions under consideration will include:

- enhanced due diligence;
- a decision not to invest/not to appoint pending required standards being met;
- an active “watching brief”;
- focussed engagement with target outcomes; and
- selective disinvestment.

Business Risk Monitoring

2.22 Our enterprise risk team survey emerging risks that could impact our business, ensuring they are recorded so that appropriate responses to threats can be developed. Emerging risks are identified from internal and external sources and include significant geopolitical and macroeconomic events.

2.23 Business risk oversight incorporates monitoring of escalating sources of risk for LPPI and will include potential harms arising from exposure to the defence sector where (for example) specific circumstances have heightened public concern, norms are evolving, or regulatory intervention is anticipated.

2.24 In addition to the processes outlined above, the following policies have bearing on LPPI’s stewardship of investments in the defence sector:

Policy Annex on Controversial Weapons	<u>Read here</u>
Approach	Implementation
Exclusions: LPPI does not invest in companies identified as in breach of applicable norms, conventions, and treaties.	We have placed a hard restriction on our investment universe by applying a norms-based screen reflective of international conventions and treaties ratified by the UK government. We maintain a list of excluded companies which may not be invested in by LPPI directly or on LPPI's behalf by delegate managers as a minimum.
Policy Annex on Human Rights	<u>Read here</u>
Approach	Implementation
Compliance with global norms: LPPI's Human Rights Policy acknowledges our responsibilities as an investor under the United Nations Global Principles on Business and Human Rights (UNGPs).	Human rights responsibilities are considered throughout the investment cycle (as part of decision-making on the deployment, management and oversight of capital).
Our responsibilities under the UNGPs are addressed through our core investment processes which help us recognise the presence of situations which trigger the requirement for additional measures. These situations include conflicts in which investee companies in the defence sector are potentially supplying equipment and services. LPPI has published a position statement on conflict-affected areas available here .	Human rights considerations are routinely surveyed and material matters identified as part of ongoing stewardship practice, enabling significant concerns to be managed appropriately.
Policy Annex on Climate Change	<u>Read here</u>
Approach	Implementation
The Aerospace & Defence sector are classified as a High Impact sector within our net zero framework. High impact companies are expected to meet higher standards of climate change management and progress towards decarbonisation as measured using the LPPI Net Zero Alignment Framework.	The alignment status of companies feeds into LPPI's Alignment and Engagement targets where they have been set. Companies which contribute materiality to portfolio emissions intensity or are deemed laggards against our alignment framework are subject to engagement. For Global Equities, this can lead to escalation action through our use of shareholder voting rights. More details of this process can be found in LPPI Shareholder Voting Guidelines , our dedicated Climate Change Annex and progress against targets in our annual TCFD reports.

Review of this Policy

- 2.25 This Policy is subject to annual review by LPPI's Stewardship Committee, and its implementation is supported by LPPI's Responsible Investment Team. Annual review supplements regular assessment of the changing geopolitical landscape and best practice stewardship standards.



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LPP
Local Pensions Partnership
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Company registration no: 09835244
Incorporated in England and Wales and trading as LPPI

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

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