



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

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Item 2

19th March 2024

Review of Investment Strategy and Structure

Purpose of Report:

To conclude a review of Strathclyde Pension Fund's Investment Strategy and Structure.

Recommendations:

The Committee is asked to **APPROVE**:

- the **strategic allocation** outlined in para 2.4
- the **Equity** mandate structure outline in para 3.2
- that the Fund switch the **passive market cap equity allocation to LGIM's lower carbon transition index series** as described in para 3.4.1 and **Appendix B**
- the **emerging market equity** allocation proposed in para 3.4.2
- the changes proposed to the **LTEY** mandate structure in para 4, including an increase from **3.5%** to **4.5%** in the allocation to **JP Morgan Infrastructure**
- the changes to the **STEY** mandate structure proposed in para 5, including the addition of a **0.75%** allocation to **private debt secondaries**
- the changes to the **Hedging and Insurance** and **Credit** mandate structures outlined in paras 6 and 7, including a review of Credit mandates to consider ESG tilted alternatives and the introduction of Buy and Maintain Credit allocation and
- the revised Statement of Investment Principles included at **Appendix G**.

The Committee is asked to **NOTE**:

The update on implementation of the SPF Climate Action Plan included at **para 9**.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes No

consulted: Yes No

1 Background

A review of investment strategy in conjunction with the actuarial valuation of the Fund as at 31st March 2023 is one of the business and development priorities in the SPF 2023/24 business plan. Some of the additional background to the review has already been reported and is summarised below.

1.1 Previous Reviews

As part of a previous review in 2014/15, the Committee agreed to adopt a risk return framework with 5 asset categories as a basis for modelling and developing investment strategy.



The strategy has developed as follows as a result of previous reviews.

Asset Category	2011 (%)	2014 (%)	2017 (%)
Equity	72.5	62.5	52.5
Hedging / Insurance	4.5	1.5	1.5
Credit	3.0	6.0	6.0
Short-term Enhanced Yield (STEY)	7.5	15.0	20.0
Long-term Enhanced Yield (LTEY)	12.5	15.0	20.0
Total	100	100	100

The 2017 strategy was maintained at the 2020/21 review subject to some minor amendments to individual manager mandates and asset allocation.

1.2 Priorities for 2023 Review

At its meeting in February 2023, the Investment Advisory Panel agreed the following priorities for the Fund's 2023/24 review of investment strategy:

- An ALM (Asset Liability Modelling exercise) should be carried out and provide a basis for the review and any decisions. This should include an analysis of extreme risks to different asset allocations as well as climate scenario modelling.
- High-level strategic allocation should be reviewed.

In addition, the Panel agreed that the following should be the subject of detailed review:

- Climate Action Plan outcomes, with review of tilted indices, green(er) fixed income, and allocation to climate solutions as likely priorities.
- Emerging Markets strategy and structure within Equity.
- Short term enhanced yield (STEY) structure and investment strategies and future fixed income positioning.

Results of the actuarial valuation and conclusions of the review of strategy and asset category structures are summarised below.

1.3 2023 Actuarial Valuation

The actuarial valuation of the Fund as at 31st March 2023 produced the following headline result.

Valuation Date	31 March 2020 (£m)	31 March 2023 (£m)
Past Service Liabilities	19,744	18,970
Market Value of Assets	20,941	27,872
Surplus	1,197	8,902
Funding Level	106%	147%

2 Review of Investment Strategy

2.1 Asset Liability Modelling (ALM)

The actuarial valuation process produces detailed cash flow data relating to the Fund's expected long term contributions income and pensions payments. Using this cash flow data together with projected investment returns under multiple economic scenarios, the Fund's actuaries and investment consultants, Hymans Robertson, have carried out extensive asset liability modelling. This tests the ability of the current and alternative investment strategies to achieve or maintain the funding target, i.e. the balance of risk across the main asset categories, and the potential to vary the size of allocations to each category.

The strength of the funding position over the last valuation cycle gives the Fund significant flexibility to consider changes to investment strategy. The Panel agreed that Hymans should carry out modelling to test:

- the potential to set more stringent measures of success and risk;
- a range of alternative (lower employer rate) contribution strategies;
- a range of alternative investment strategies;
- high-level cashflow requirements; and
- key risks – including stress testing of inflation, and climate change scenario modelling.

2.2 Metrics

The Panel agreed the following success and risk metrics to assess the effectiveness of the current and alternative investment strategies.

Primary Metrics

- A greater than **2/3** probability of being **100%** funded over the average future working lifetime of the active membership (the target funding period); and
- a less than **10%** probability of falling below **80%** funded over the next three years.

(Note that this is a minor change to the current objective of a less than **10%** probability of falling below **70%** funded).

Secondary Metrics

- probability of being over **125%** funded over the average future working lifetime of the active membership (the target funding period); and
- probability of the funding level falling by **25%** (from March 2023 level) over the next three years.

Additional

The modelling also looked at the median funding level outcome for each strategy considered to illustrate some of the potential trades off in addition to the above success and risk metrics.

2.3 ALM Conclusions

Current Strategy

Conclusions of the modelling were that, as expected, the Fund is in a very strong position:

- the current investment strategy maintains a high likelihood (>90%) of being over 125% funded in 2036;
- on the risk measures, there is a negligible chance of funding falling below 80% over the next valuation cycle but a 23% chance of the funding level falling by 25% over this period.

Alternative Strategies

Hymans modelled a range of alternative investment strategies. The modelling showed that there was not a huge differentiation between any of the alternatives from a quantitative perspective.

2.4 Revised Strategy

The Panel agreed, however, that a modest reduction in equity risk, in favour of protection assets, would be prudent when the funding level is so strong. A reduction in listed equity would fund an increased allocation to traditional fixed income assets, where yields have increased significantly since the last valuation, and an increased allocation to infrastructure assets, which play a key role in achieving the Fund's climate action plan.

It is therefore proposed that the Fund should adopt the following strategic allocation:

Revised Strategy

Asset	Proposed Allocation %
Equity	47.0
Hedging & insurance	10.0
Credit	5.0
Short term enhanced yield	17
Long term enhanced yield	21.0
	100
Return (% p.a.)	3.9

Implementation of the proposed new strategy will require changes to the underlying investment structure within each of the 5 asset classes.

Outline proposals for individual mandates and portfolios within each asset class are set out below.

Review of Investment Structure

3 Equity

The objective of the Equity allocation is to deliver growth over the long term.

The recommended investment strategy includes a reduction in **Equity** allocation from **52.5%** to **47%**.

3.1 Review

Hymans Robertson produced a series of reports reviewing the equity structure. The Investment Advisory Panel considered these at its meetings in August and November 2023 and in February 2024.

In addition to the overall balance between Equity mandates, and in accordance with the priorities agreed for the 2023/24 strategy review, the Panel conducted a detailed review of tilted passive investment strategies and the Fund's emerging market equity allocation.

3.2 Mandate Structure

The current Equity mandate structure combines passive, active and specialist portfolio benchmarks in order to implement the equity allocation in a diversified, efficient and cost-effective way.

The proposed mandate structure will maintain a combination of passive, active and specialist mandates but with a reduced allocation to passive mandates and a marginal increase in exposure to specialist mandates.

Portfolio	Current Target (Fund %)	Current Target (Equity %)	Proposed Target (Fund %)	Proposed Target (Equity)
L&G Market Cap	18.0	34.25	13.9	29.6
L&G RAFI	6.0	11.4	4.1	8.7
Baillie Gifford	7.5	14.3	7.5	16.0
Lazard	2.5	4.75	2.5	5.3
Oldfield	2.5	4.75	2.5	5.3
Veritas	2.5	4.75	2.5	5.3
Lombard Odier	1.0	1.9	1.0	2.1
JP Morgan	3.0	5.7	3.0	6.4
Active Emerging Markets	1.5	2.9	2.0	4.3
Pantheon (PE)	5.0	9.5	5.0	10.6
Partners (PE)	2.5	4.75	2.5	5.3
DIP	0.5	0.95	0.5	1.1
Total Equity	52.5	100	47.0	100
<i>Other Assets</i>	47.5	-	53.0	-
Total Fund	100.0	100	100	100

3.3 Regional Structure

It is proposed that the current allocation and approach to the Fund's regional equity structure is retained. This is described in **Appendix A**.

This will require changes to the regional allocation of the Fund's passive equity mandate managed by Legal & General to take account of the revised allocations to specialist and active mandates.

3.4.1 Mandate Changes

3.4.1 Legal & General (L&G)

Equity is the main driver of growth returns and the passive allocation achieves this at low cost by simply replicating an agreed market index.

L&G were appointed by SPF in 1998 when the Fund first decided to introduce a passive approach for some of its portfolio management. L&G have consistently delivered this efficiently and effectively, via a traditional market cap approach and an alternative RAFI strategy. The mandate has grown significantly over time. It has also changed frequently, having been used as the main channel through which SPF has implemented strategic and structural changes.

The proposed investment strategy changes would see a reduced allocation to the passive equity mandate managed by L&G from **24%** to **18.0%**.

It is proposed that the structure of the mandate should be:

- **13.9%** market cap Low Carbon Transition indices;
- and **4.1%** to RAFI.

A full analysis of this proposal is set out in **Appendix B**.

3.4.2 Emerging Market Equity

The Fund currently has exposure to emerging market ("EM") equities across 4 different dedicated mandates, due in part to changes to the make-up of the underlying active holding with Genesis over recent years. A review of emerging markets strategy and structure within Equity was a priority of the strategy review.

The Panel reviewed the investment case for continued allocation to emerging market equity via specialist mandates and agreed that a strategic allocation to emerging market equity remains attractive and should result in additional returns over the long term. They then looked at alternative ways of structuring the Fund's allocation and agreed that:

- Given the practical aspects of investing in this region, a passive allocation can help balance costs and governance alongside an active allocation.
- The Fund would benefit from consolidating its current exposure into two mandates, one active and one passive.

The following structure is proposed for the Fund's emerging market equity exposure. A short and long-term allocation is proposed to account for the

time required to select a new active emerging market equity fund and to completed the restructure between mandates.

Fund	<i>Current Target Allocation %</i>	Proposed Target Allocation (short term) %	Proposed Target Allocation (long term) %
EM passive market cap	2.2	2.2	2.4
EM RAFI	0.7	-	-
Genesis	1.5	-	-
Fidelity		0.75	-
New manger		1.5	2.0
Total	4.4	4.45	4.4

Selection of a new active mandate was further discussed at the Panel's February 2024 meeting, where Hymans presented a shortlist of 4 preferred emerging market equity funds.

It is proposed that 3 of these 4 funds should present to the Investment Advisory Panel Committee Sounding Board for review prior to the recommendation of a preferred fund to SPF Committee.

4 LTEY

The core objective of the LTEY allocation is to provide a long-term income stream above that expected on broad long dated investment grade corporate bonds, with a degree of inflation hedging.

The recommended changes to investment strategy include an increase in LTEY allocation from **20%** to **21%**.

4.1 Review

The LTEY structure and mandates were reviewed by the Panel in conjunction with results of the ALM at its meetings in November 2023 and February 2024.

The current and proposed LTEY mandate structure are summarised as follows:

Portfolio	Current Target (%)	Proposed Target (%)
UK Property - DTZ	10.0	9.0
Global Property – Partners Group	2.5	2.0
DIP	4.0	5.5
Global Infrastructure – JP Morgan	3.5	4.5
Total LTEY	20.0	21.0

4.2 Mandate Changes

Modest reductions in the allocations to UK and Global real estate are proposed in order to achieve a better overall balance in the LTEY structure between infrastructure, property and the Direct Impact Portfolio (DIP).

A review of DIP will be listed as a key priority in the Fund's 2024/25 business plan. The increased allocation to LTEY would support a further increase in DIP's capacity, but that is subject to the conclusions of the DIP review including further details of how this would be invested. A proposal will be brought to the Committee for approval later in 2024.

A **3.5%** allocation to the JP Morgan International Infrastructure Fund (IIF) was agreed as part of the 2020/21 investment strategy and the allocation has been fully funded since the start of 2022. JP Morgan presented to the February 2024 meeting of the Investment Advisory Panel. The Panel agreed that the IIF has performed well to date and its structure and management suggest it should continue to do so in the longer term.

An increased allocation of **3.5%** to **4.5%** to the JP Morgan Global Infrastructure Fund is proposed.

5 STEY

The core objective of the STEY allocation is to deliver an absolute return, meaningfully higher than can be achieved by investing in cash or in short-term high-quality bonds, but with reasonable degree of predictability.

The recommended changes to investment strategy include a reduction in STEY allocation from **20%** to **17%**.

5.1 Review

The majority of the STEY allocation has been built up by Fund since 2015, with the introduction of multi-asset credit, private corporate and real estate debt, emerging market debt and a second absolute return mandate since the allocation was first introduced. A review of the STEY structure and investment strategies was a priority of the current review and was discussed at the Panel's meetings in August and November 2023, and in February 2024.

The current and proposed STEY mandate structures are summarised as follows:

Portfolio	Current Target (%)	Proposed Target (%)
Absolute Return	6.0	6.0
PIMCO	5.0	5.0
Ruffer	1.0	1.0
Multi Asset Credit	4.5	4.0
Barings	2.75	2.25
Oak Hill	1.75	1.75
Private Corporate Debt	3.5	3.5
Barings	1.25	1.75
Alcentra	1.25	-
Partners Group	1.0	1.0
Pantheon	-	0.75
Private Real Estate Debt	1.0	1.0
ICG Longbow	1.0	1.0
EM Debt	2.5	-
Ashmore	2.5	-
DIP	1.5	1.5
Cash	1.0	1.0
Total STEY	20.0	17.0

5.2 Mandate changes

5.2.1 Multi-asset credit

The STEY review highlighted the complementary nature of the Fund's existing strategies with Barings and Oakhill. A small reduction to the strategic allocation to multi-asset credit from **4.5%** to **4.0%** is proposed and provides an opportunity to target a more balanced split between the two managers, with a small bias to Barings (**2.25%**) given the more diversified and global focus of this strategy versus Oakhill (**1.75%**), which is a more concentrated portfolio with a US focus.

5.2.2 Private debt

It is proposed that:

- a **4.5%** allocation to private debt is maintained, split **3.5%** to corporate debt and **1%** to private real estate.

While the strategic allocation to private corporate debt will be maintained at **3.5%**, the private debt market and manager allocations were reviewed in detail by the Panel. The following changes are proposed:

- Since 2016, the Fund has invested in 2 Alcentra European direct lending funds and in 2020 the manager was appointed to manage a separate account. The manager has experienced significant personnel and corporate change since their appointment. It is proposed that the strategic allocation of **1.25%** to Alcentra is removed.
- The Alcentra allocation should re-allocated in part to Barings, whose private debt portfolio has performed particularly well for the Fund. The allocation to Barings private debt will increase from **1.25%** to **1.75%**.
- The allocation of **1%** Partners Group private debt should be retained.
- The remaining **0.75%** of the private credit allocation should be allocated private credit secondaries, a market which has become increasingly significant over recent years. Pantheon, the Fund's longstanding private equity manager, are one of Hymans' preferred managers for this type of investment strategy. The Panel reviewed investment due diligence prepared by Hymans on Pantheon's latest private debt secondaries fund. It is proposed that the Fund invest the remaining **0.75%** of the credit allocation to Pantheon's latest private debt secondaries fund.

Note: the above allocations will be subject to further review as a result of personnel changes at Barings announced in March 2024.

5.2.3 Emerging Market Debt (EMD)

An allocation to EMD was agreed as part of the 2015 review of investment strategy. The manager, Ashmore, has not added value since inception of the mandate in 2017. The strong funding position means the Fund can afford to reduce risk.

It is proposed that the **2.5%** strategic allocation to Emerging Market Debt is removed.

6 Hedging & Insurance

The objective of the Hedging and Insurance allocation is to reduce funding level volatility to variation in interest rates and inflation pricing and to reduce reinvestment risk, as well to act as a source of liquidity and rebalancing capital in the event of adverse capital events.

The recommended changes to investment strategy include an increase in the **Hedging and Insurance** allocation from **1.5% to 10%**.

6.1 Review

In light of the Fund's strong funding position as well as developments in bond markets since the last investment strategy review, the Panel conducted a detailed review of fixed income implementation options at its November 2023 and February 2024 meetings.

The current and proposed Hedging and Insurance mandate structures are summarised as follows.

Portfolio	Current Target (%)	Proposed Target (%)
LGIM Index Linked Gilts	1.5	5.0
LGIM Gilts	-	5.0
Total Hedging & Insurance	1.5	10.0

Given the material change in the yield environment since the last strategy review, the Panel was supportive of an increased allocation to hedging and insurance assets.

It is proposed that the Fund increase the **Hedging and Insurance** allocation to **10.0%**, split equally between UK nominal gilts and UK index linked gilts.

7 Credit

The objective of the Credit allocation is to ensure additional yield, to provide income and to reduce funding volatility.

The recommended changes to investment strategy include a decrease in the **Credit** allocation from **6% to 5%**.

7.1 Review

The Panel reviewed the Credit allocation as part its detailed review of fixed income implementation options.

The current and proposed Credit mandate structure is summarised as follows.

Portfolio	Current Target (%)	Proposed Target (%)
L&G Corporate Bonds Buy and Maintain Credit	6.0	2.5
Total Credit	6.0	5.0

Some additional analysis of this proposal is set out in **Appendix C**.

7.2 Mandate Changes

Further work will be required in order to identify and agree appropriate options for this allocation. The Panel will review these at its meetings later in 2024.

8 Rebalancing and Relative Value Frameworks

8.1 Rebalancing Strategy

The current rebalancing strategy was approved by Committee in September 2021. The objective of the strategy is to ensure that the Fund does not diverge too far from the long-term investment strategy and structure agreed by the Committee. The methodology can be summarised as follows:

- A target allocation is set for each asset class / mandate type / portfolio.
- A range above and below that target is set.
- Actual positions are reviewed periodically (usually quarterly).
- Where, on review, an asset class / mandate type / portfolio is outside its range, action will be considered to bring it back towards its target allocation.

It is proposed that the existing methodology should be retained but that target ranges are adjusted at asset class, mandate type and portfolio level to account for the changes in investment strategy.

A revised framework showing the proposed allocations and proposed ranges at each of the levels is set out in **Appendix D**.

8.2 Relative Value Framework

A relative value framework was approved by the Committee in September 2021. The current framework is set out in **Appendix E**.

It is applied across the Hedging and Insurance and Credit allocations based on medium term asset class views, allowing the Fund to agree positions in credit, nominal and index-linked gilts relative to the 'neutral' strategic target. In some instances, this allows for the complete removal of an allocation versus a neutral target.

It is proposed that the relative value framework is retained but that, should the increased allocation to gilts, index-linked gilts and credit be agreed by Committee, the framework is adapted to operate within narrower or clearly defined ranges around the new target allocations. The appropriate degree of relative positioning will be reviewed and agreed by the Fund's Investment Advisory Panel.

9 Climate Action Plan

The Fund's Climate Action Plan included the following alignment priorities as the focus of the 2023 investment strategy review. An update on progress against each priority is provided below.

9.1 Investigate indices with a lower carbon tilt than the market capitalisation indices currently applied in the passive equity portfolio

Recommendations from the 2023 review of investment strategy include switching the Fund's passive market cap equity exposure to LGIM's lower carbon transition index series. The review also proposes removing the allocation to the L&G RAFI emerging markets fund. This fund has a high carbon footprint and there is no low carbon transition index equivalent.

9.2 Engage with active equity managers on the basis of their NZAM commitments

The Net Zero Asset Managers (NZAM) initiative is an international group of asset managers committed, consistent with their fiduciary duty to their clients and beneficiaries, to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with net zero emissions by 2050 or sooner.

All of SPF's active equity managers except Genesis have signed up to the framework and of the managers who have signed up, all but one has made initial disclosures on net zero targets and the assets under management covered by their commitment. L&G, the Fund's passive equity manager, has also signed up to NZAM.

SPF carried out its own alignment assessment in 2023 and this identified a list of priority companies for active engagement. The Fund has undertaken engagement with the managers concerned or through Carbon Disclosure Project (CDP) initiatives throughout the year. The Fund will update its alignment assessment in time for its next update to the Net Zero Investment Framework (NZIF), due in May 2024 and set engagement priorities for the coming year. These assessments will be completed on an annual basis. In addition, the Fund will continue to work with managers on their NZAM commitments.

9.3 Investigate green(er) fixed income solutions and alignment of fixed income portfolios

The Fund has carried out initial research into greener fixed income solutions as part of its review of fixed income implementation options. Greener fixed income solutions will be a key consideration in the selection of new credit mandates.

9.4 Engage further with DTZ and ICG Longbow on their Net Zero plans and alignment activity

UK Property manager DTZ has a well-developed and well-resourced net zero plan. The manager has set a target of net zero by 2040 across all client portfolios, including SPF's. Strong progress has been made in 2022/23 against interim targets set for the SPF portfolio. This is illustrated in the slide shown in **Appendix F**.

Property debt manager ICG has committed to net zero greenhouse gas emissions across its operations and relevant investments by 2040. This commitment is supported by two ambitious emissions reduction targets by 2030,

- Ensure 100% of relevant investments have SBTi-approved science-based targets by 2030, with an interim target of 50% by 2026
- Reduce ICG's direct (Scope 1 and 2) emissions by 80% by 2030 from a 2020 base year

The manager carries out climate risk assessments and possible opportunities for decarbonisation/ sustainability improvements on all assets and is currently implementing monitoring and reporting of climate metrics across strategies in line with TCFD.

The manager's green loan framework is also a firmly embedded in the investment process as a means of improving sustainability of existing and new commercial real estate.

9.5 Review SPF voting policy and practice to ensure alignment

Currently, all SPFs managers vote on the Fund's behalf at AGM/ EGMs. Sustainability have provided detailed analysis of proxy voting on climate change resolutions by SPF's active equity managers. The analysis indicated:

- All asset managers have climate change-specific proxy voting guidance. However, guidance varies in terms of coverage and detail. Three provide specific guidance for evaluating climate-related shareholder resolutions and approving climate transition plans.
- Four of the six asset managers also apply climate considerations to votes on management resolutions.
- Four follow in-house policies and two follow external policies.

The IIGC (Institutional Investment Group on Climate Change) published voting guidance in January 2024. The guidance highlights voting as a critical lever for investors to help support the decarbonisation of the real economy as part of their climate focused engagements and in line with fiduciary duties. The new guidance is designed to support asset owners and asset managers in the development of their own net zero voting policies and practices and aligns with the Net Zero Investment Framework and its recommendation for a voting policy consistent with assets in the portfolio achieving net zero emissions by 2050 or sooner.

The Fund is committed to the Net Zero Investment Framework and will review the guidance issued by IIGCC and use it as the basis on which to develop net zero voting policy and practice.

9.6 Consider explicit allocation to climate solutions mandate(s)

The Panel considered an allocation to timberland as part of the strategy review. Timberland did have some clear attractions as an investment asset and the potential for significant carbon sequestration was also noted. However, given its illiquidity, and the Fund's current focus on decarbonising existing investments rather than offsetting, timberland investment was not considered an immediate priority.

The Direct Impact portfolio (DIP) includes a significant allocation to climate solutions. DIP does not set quantitative targets for sector investment but had committed £585m, or 2% of total Fund, to renewable energy assets at 31st December 2024. The JP Morgan infrastructure portfolio (current allocation 3.5% of total Fund) also invests around 25% in renewable assets.

The move of passive equity and credit exposure to greener products recommended following the 2023 review of investment strategy will have a significant positive impact on portfolio carbon metrics.

Allocation to climate solutions within existing mandates is expected to increase in line with investment managers' Net Zero commitment.

A dedicated allocation to climate solutions is not proposed at this time but will be kept under review.

10 Statement of Investment Principles

A revised Statement of Investment Principles, updated to include the proposed changes to investment strategy and structure is included at **Appendix G**.

11 Policy and Resource Implications

Resource Implications:

Financial:

Transition costs for L&G to be confirmed but should be mitigated by amount of stock that can be transferred in specie between existing portfolio and LCT funds; Estimated additional fees for LCT funds £1-1.5m p.a., all other switches between existing mandates estimated as cost neutral; fee differentials for new mandates will be considered as part of the selection process.

Legal:

Amendments to the current investment agreement with L&G will be required in advance of the switch of passive funds into low carbon alternative. Advice will be sought from GCC legal as required.

Legal diligence of new emerging market equity, credit and private credit funds will be required. This will be carried out in by the Fund's external legal adviser, Pinsent Mason.

Personnel:

None at this time.

Procurement:

None at this time.

Council Strategic Plan:

SPF supports all Missions within the Grand Challenge of: ***Enable staff to deliver essential services in a sustainable, innovative and efficient way for our communities.***

The LGPS is one of the key benefits which enables the Council to recruit and retain staff.

Equality and Socio-Economic Impacts :

Does the proposal support the Council's Equality Outcomes 2022-25?

Equalities issues are addressed in the Fund's Responsible Investment strategy, in the scheme rules which are the responsibility of Scottish Government and in the Fund's Communications Policy which has been the subject of an Equalities Impact Assessment.

What are the potential equality impacts as a result of this report?

No specific equalities impacts.

Please highlight if the

policy/proposal will help address socio economic disadvantage. N/a.

Climate Impacts:

Does the proposal support any Climate Plan actions? Please specify: Yes.
Climate scenario modelling was carried out as part of the ALM process to inform the review of investment strategy and structure. Priorities in SPF's climate action plan were addressed as part of the investment strategy review.

What are the potential climate impacts as a result of this proposal? The switch to low carbon transition index funds is expected to have a positive impact on carbon metrics of SPF's investment portfolio.

Will the proposal contribute to Glasgow's net zero carbon target? N/a.

Privacy and Data

Protection Impacts:

Are there any potential data protection impacts as a result of this report
Y/N No.

If Yes, please confirm that a Data Protection Impact Assessment (DPIA) has been carried out N/a.

12 Recommendations

12.1 To Approve

The Committee is asked to **APPROVE**:

- the **strategic allocation** outlined in para 2.4
- the **Equity** mandate structure outline in para 3.2
- that the Fund switch the **passive market cap equity allocation** to **LGIM's lower carbon transition index series** as described in para 3.4.1 and **Appendix B**
- the **emerging market equity** allocation proposed in para 3.4.2
- the changes proposed to the **LTEY** mandate structure in para 4, including an increase from **3.5%** to **4.5%** in the allocation to **JP Morgan Infrastructure**
- the changes to the **STEY** mandate structure proposed in para 5, including the addition of a **0.75%** allocation to **private debt secondaries**
- the changes to the **Hedging and Insurance** and **Credit** mandate structures outlined in paras 6 and 7, including a review of Credit mandates

to consider ESG tilted alternatives and the introduction of Buy and Maintain Credit allocation and

- the revised Statement of Investment Principles included at **Appendix G**.

12.2 To Note

The Committee is asked **to NOTE**:

The update on implementation of the SPF Climate Action Plan included at **para 9..**

Regional Equity Structure

Regional Structure

The current regional listed equity structure is shown in the table below. The structure was agreed as part of the 2020/21 review of investment strategy and reflects the objective of pursuing a global investment strategy to maximise the opportunity set, whilst adjusting the benchmark allocation (in comparison to global market cap) to provide broader diversification across the 3 main market regions.

There is some bias to the UK and Emerging Markets to reflect the Fund's base currency and the future growth expected from developing economies.

Region		Market Cap 31 Dec 23 %	Current Benchmark Allocation %	
Europe	UK	3.6	10	25
	Europe ex UK	12.4	15	
N America	N America	65.4	48	48
Asia and Emerging Markets	Asia Pacific ex Japan	2.7	5	27
	Japan	5.4	8	
	Emerging Markets	10.5	14	
Total		100	100	

In practice, the regional allocation only applies to certain mandates. The Fund sets a regional benchmark for the passive portfolio based on this allocation adjusted to take account of the specialist mandates. For active portfolios the Fund sets global benchmarks where possible, and the regional allocation is a product of the manager's investment decisions.

Passive Equity Mandate

Alternative Investment Strategies

Alternative passive investment approaches to traditional market cap indices have been developed in which stocks are weighted not just on the basis of market capitalisation but also their exposure to other factors – ESG or carbon footprint. The starting point for most solutions is a market cap index, but the capital weights are tilted – i.e. those of stocks with positive characteristics (e.g. low GHG emissions, high exposure to decarbonisation opportunities) are increased and exposure to those with negative characteristics is decreased. Constraints are then applied to ensure that solutions achieve specific objectives (e.g. a minimum level of decarbonisation) and so that sector/regional exposures do not deviate too far from those of the market cap index.

L&G Market Cap

The current passive market cap equity portfolio will decarbonise (more or less) in line with the markets/economies in which the Fund invests. An alignment priority in the Fund's climate action plan is an investigation of indices with a lower carbon tilt than the market cap indices currently applied in the Fund's passive equity portfolio.

The review of passive equity focused on options for achieving alignment with the Fund's Climate Action Plan and concluded that tilted indices offer a relatively straightforward way of integrating climate change considerations into the investment process. The risk of significant under-performance vs traditional passive management is limited (to varying degrees depending on the choice of index).

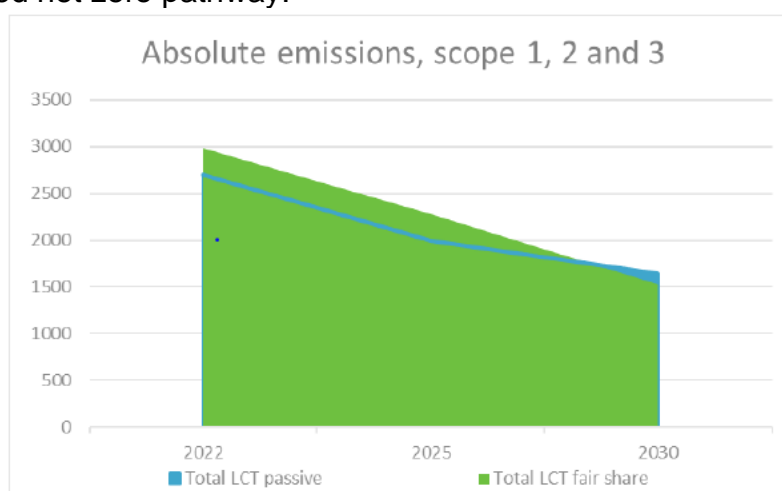
Of the investment options reviewed, the LGIM Low Carbon Transition index series was by some way the most aligned with the Fund's objectives. They also offered a potentially significant positive impact on portfolio carbon metrics:

As the chart below shows, projected carbon emissions of the net zero pathway for the Fund's listed equity portfolio are not aligned with a 2050 net zero target. Further analysis shows that this is because emissions from the underlying passive equity holdings, while starting in an aligned position, are not expected to decrease at a rate consistent with 1.5 degree scenario.



Passive Equity Mandate

When this analysis is updated to allow for a switch from passive market cap equity funds to the LGIM Low Carbon Transition index series, the position is significantly improved and the Fund's listed equity portfolio is estimated to be on track relative to the aggregated net zero pathway:



It is therefore proposed that the Fund's passive market cap equity exposure is moved onto the LGIM Low Carbon Transition equivalent indices.

L&G Regional Weightings: Lower Carbon Transition Portfolio

The table below shows the revised regional weights for the L&G portfolio, accounting for the proposed changes to the Equity mandate structure:

Region	Benchmark Allocation	
	Current %	Proposed %
UK	11.5	8.8
Europe ex UK	14.5	14.1
N America	49.5	51.2
Asia Pacific ex Japan	5.0	4.9
Japan	7.5	7.3
Emerging Markets	12.0	13.8
	100	100

Legal & General (L&G) RAFI

RAFI is an alternative approach to passive investment where allocation to stocks is based on value factors as opposed to market capitalisation. The Fund first invested in a RAFI strategy in 2013, with allocation split between global and emerging market funds.

The Fund moved the L&G RAFI Global portfolio to the Lower Carbon Transition index version of the RAFI strategy following the 2020/21 review of investment

Passive Equity Mandate

strategy. There is no equivalent low carbon alternative to the RAFI Emerging Market Strategy.

It is proposed that the passive Emerging Market RAFI allocation, which is relatively small but has a high carbon footprint, should be removed.

Currency Hedging

In September 2017, the Committee agreed that the Fund should hedge 33% of currency exposure arising from overseas listed equity by switching a proportion of investments in Legal and General passive index funds to currency hedged versions. In 2021, the Committee agreed to maintain the strategy, but with revised hedging and unhedged fund allocations in order to achieve a better balance across currencies. Current allocations to hedged and unhedged regional funds are shown below.

L&G Regional Weights: Hedged and Unhedged Funds

Region	L&G Benchmark Allocation		Hedging Ratio Achieved %
	Hedged %	Unhedged %	
UK			
Europe ex UK	82	18	43
N America	87	13	43
Asia Pacific ex Japan	86	14	43
Japan	88	12	43
Emerging Markets	0	100	0
Total			33

While currency risk will always be second order compared to other risks associated with the Fund's assets, the current strategy maintains the aim of some reduction in equity return volatility particularly in times of market stress.

It is proposed that the current hedging strategy with a target weight of around 33% of overseas listed equity is maintained.

Credit Allocation

L&G Corporate Bond Funds

All of the Fund's credit exposure is currently invested using a passive approach, split 50/50 between UK and US corporate bonds. The sterling corporate bond market is fairly well diversified relative to others and a passive exposure to US credit as well as to UK provides access to high quality securities, overseas diversification and increased liquidity relative to a sterling only portfolio. The L&G passive US fund excludes BBB rated credit however and BBBs currently make up half of the US market. This implies some loss of opportunity set.

More recently, a number of investment managers have overlaid these approaches with ESG tilted strategies, some of which have a particular focus on positive impact from a climate objective and emissions reduction perspective.

The Panel agreed that there was merit in proposing that the Fund consider moving the passive exposure to an ESG/ climate tilted corporate bond investment strategy, which also included coverage of BBB securities.

Buy and Maintain Credit

The Panel's review of fixed income implementation options included consideration of the 3 broad approaches to corporate bond investment:

- **Passive funds.** Passive, high quality credit funds provide low cost and low governance access to large, liquid credit markets. They have certain potential limitations, such as giving more weight to the most indebted companies, the potential for significant sector bias and limits on the investable universe.
- **Active funds.** An active approach to corporate bond management can add value through more diversified security and regional positioning. Active strategies have higher fees and turnover compared with a passive investment approach.
- **Semi-passive or 'Buy and Maintain' funds.** Here, a manager seeks to avoid the drawbacks of a true passive approach by limiting unwanted sector concentration risk and bias by actively selecting credits through research and not according to an index. These securities are then held until maturity, leading to low portfolio turnover and lower management fees compared with an actively managed fund.

The Panel agreed that there was merit in proposing that the Fund introduce a 'Buy and Maintain' mandate to sit alongside the passive allocation. This portfolio would be invested globally to ensure a more diversified exposure to the corporate bond market but at a lower cost than an active mandate.

It is proposed that the Credit allocation is split **2.5%** to a passive ESG tilted corporate bond investment strategy and **2.5%** to a Buy and Maintain investment strategy.

Passive Rebalancing

Level 1 – Asset Class

Asset Class	Target (%)	Range (%)
Equity	47	40-54
Hedging/Insurance	10	4-16
Credit	5	2-8
Short Term Enhanced Yield	17	15-19
Long Term Enhanced Yield	21	18-24
Total	100	

Level 2 – Mandate Type

Asset Class	Mandate Type	Target (%)	Range (%)
Equity	Passive	18	15-21
	Global	15	12.5-17.5
	Specialist	6	4-8
	Private Equity	7.5	5-10
	DIP Equity	0.5	0-2
	Total	47	40-54
Hedging/Insurance	Passive Index-Linked	5.0	4-6
	Passive Gilts	5.0	4-6
Credit	Passive Credit	5.0	4-6
Short Term Enhanced Yield	Absolute Return	6	5-7
	Multi Asset Credit	4.0	2.5-5.5
	Private Debt	4.5	3-6
	DIP STEY	1.5	0-2
	Cash	1.0	0-5
	Total	17.0	15-19
Long Term Enhanced Yield	Property	11.0	8-14
	DIP LTEY	5.5	2.5-7.5
	Global Infrastructure	4.5	3-6
	Total	21	18-24
Total	Total	100	

Passive Rebalancing

Level 3 – Portfolio

Asset Class	Mandate Type	Manager	Target (%)	Range (%)
Equity	Passive	L&G Global	13.9	11-17
		L&G RAFI	4.1	2-6
	Unconstrained Global	Baillie Gifford	7.5	6-9
		Lazard	2.5	1.5-3.5
		Veritas Oldfield	2.5 2.5	1.5-3.5 1.5-3.5
	Specialist	Lombard Odier	1	1-2
		JP Morgan <i>EM active tbc</i>	3 2.0	2-4 1-3
Private Equity	Pantheon/ Partners	7.5	5-10	
DIP Equity		0.5	0-2	
Total			47	40-54
Hedging/Insurance	Passive Index-Linked	L&G Index Linked	5.0	4-6
	Passive Gilts	L&G UK Gilts	5.0	4-6
Credit	Passive Credit Buy & Maintain	tbc	2.5	4-6
		tbc	2.5	4-6
Short Term Enhanced Yield	Absolute Return	PIMCO	4	3-5
		Ruffer	2	1.5-2.5
	Multi Asset Credit	Barings	2.25	1.5-3
		Oak Hill Advisors	1.75	1-2.5
	Private Debt	Barings	1.75	1-2.5
		Alcentra	-	-
		ICG Longbow	1	1-2
		Partners Group	1	1-2
	Pantheon	0.75	0-1.5	
DIP STEY		1.5	0-2	
Total			17	15-19
Long Term Enhanced Yield	Property	DTZ	9	7-11
		Partners Group	2.0	1.5-2.5
	DIP LTEY		5.5	2.5-7.5
Global Infrastructure	JP Morgan	4.5	3-6	
Total			21	18-24
Total			100	

Current Relative Value Framework

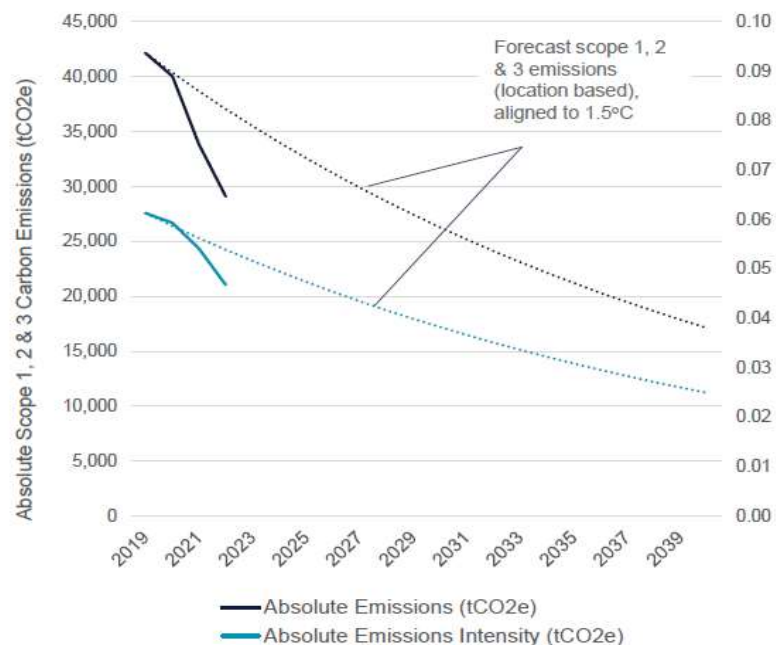
Asset category	Neutral Strategic Allocation	Key Alternative	Key Metric	Triggers for allocation changes:
Investment grade corporate bonds	6%	Nominal gilts	Sterling and US Benchmark index spreads over gilts/ treasuries vs historic levels	<p>Neutral allocation: <+/- between 25th and 75th percentiles of 20-year monthly history</p> <p>Increase: if spreads are above 75th percentile of 20 year history;</p> <p>Halve neutral allocation: if spreads are below 25th percentile;</p> <p>Remove allocation: if spreads are below the 10th percentile of the 20 year history</p>
Nominal gilts	-	Cash	<p>Forward yield vs expected path of cash rates to fair value yield;</p> <p>Difference between gilt yield and cash yield</p>	<p>Implied interest rates below expected path to fair value yield implies hold cash over gilts.</p> <p>Above or in line favours gilts over cash.</p> <p>Hold gilts when some modest premium for holding longer dated debt expected, reflecting growth and inflation risk.</p> <p>Hold cash in favour of nominal gilts if there is no premium.</p>
Index-linked gilts	1.5%	Nominal gilts	Implied Inflation	<p>Neutral allocation: pre 2030 RPI between 2.75% and 3.25% and post 2030 CPI between 2.0% and 2.5%, and nominal gilts acceptable.</p> <p>Prefer index-linked gilts to nominal gilts if implied (post 2030) CPI inflations is less than 2.0%.</p> <p>Hold less is implied (post 2030) CPI is more than 2.5%.</p>

Net Zero Progress DTZ UK Property Portfolio

PROGRESS AGAINST OBJECTIVES SET IN THE 2022/23 STRATEGY

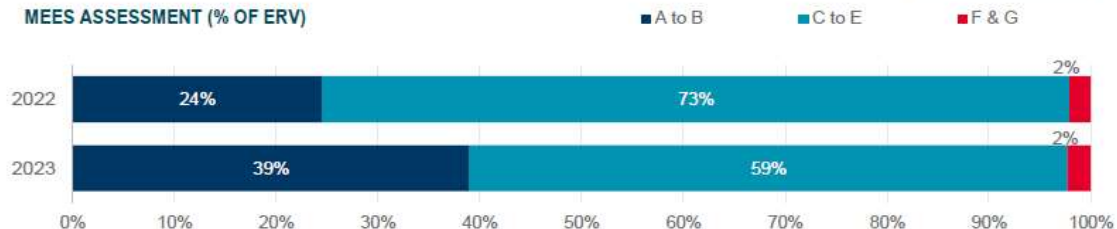
Strong progress has been made against the Fund's Responsible Investment targets with reduction in Carbon Emissions and an above Benchmark GRESB score.

PROGRESS AGAINST RESPONSIBLE INVESTMENT OBJECTIVES OVER 2023



Reporting Metric	Unit of Measure	Type	2022 Target	2021 Performance	2022 Performance
Scope 1 & 2 Emissions	tCO ₂ e	Absolute Change vs 2019 baseline	-12.6%	-13%	-33%
	tCO ₂ e/m ²	Intensity Change vs 2019 baseline	-12.6%	-28%	-40%
Scope 3 Emissions	tCO ₂ e	Absolute Change vs 2019 baseline	-12.6%	-20%	-31%
	tCO ₂ e/m ²	Intensity Change vs 2019 baseline	-12.6%	-12%	-23%
Tenant Data Collection	% coverage by floor area	Absolute	50%	36%	49%
GRESB Score	Total score Green stars		-	70 (vs BM 70) 2 stars	77 (vs BM 73) 3 stars

MEES ASSESSMENT (% OF ERV)



Statement of Investment Principles

Appendix G

A revised Statement of Investment Principles is attached.