



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

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Item 5

26th June 2024

## Review of Investment Strategy - Implementation

### Purpose of Report:

To conclude selection exercises for investment allocations to

- Emerging market equity;
- Passive corporate bonds; and
- Buy and Maintain corporate bonds

### Recommendations:

The Committee is asked to **APPROVE** investments of

- (i) **2%** of total Fund in the RBC GAM Core Emerging Markets Equity fund;
- (ii) **2.5%** of total Fund in LGIM Low Carbon Transition credit index funds;
- (iii) **2.5%** of total Fund in the LGIM Future World Net Zero Buy and Maintain fund.

Ward No(s):

Citywide:

Local member(s) advised: Yes  No

consulted: Yes  No

### PLEASE NOTE THE FOLLOWING:

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## 1 Background

At its meeting on 19<sup>th</sup> March 2024, the Committee agreed that the investment strategy summarised below should be adopted as the strategic target model for the Fund.

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 a revised structure to deliver the strategy includes selection of new pooled funds for:

- the active emerging market equity allocation within the Equity asset class; and
- a passive and a buy and maintain corporate bond allocation within the Credit asset class.

This paper summarises selection exercises to identify suitable funds for these investment allocations.

## 2. Emerging Market Equity

### 2.1 Review

Under the new strategy, the Fund's Equity allocation is set to reduce from 52.5% to 47%. Within this, an alternative structure for the Fund's allocation to emerging market active equity was agreed by the Committee at its March 2024 meeting.

Fund	Current Target Allocation %	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 manager		1.5	2.0
Total	4.4	4.45	4.4

The Fund completed the sale out of the EM RAFI allocation in May 2024.

The revised structure includes an allocation to a new active emerging markets investment manager, as well as a short and long-term allocation to account for the time required to select the new active emerging markets equity fund and to complete the restructure between mandates.

**2.2 Selection Process**

The Fund’s investment consultants, Hymans Robertson, were asked to carry out a process to identify a suitable manager for the active emerging market allocation. Hymans presented their shortlist of 4 recommended active EM equity solutions at the February 2024 IAP meeting. Following discussion, 3 managers were selected to present to the IAP at its meeting in May 2024. Based on these presentations, the Panel concluded that either of the following 2 strategies could meet the Fund’s requirements:

- **Aikya Global Emerging Market Equity Fund**
- **RBC GAM Core Emerging Market Equity Fund.**

**2.3 Sounding Board**

The Sounding Board received presentations from **RBC GAM** and **Aikya** on 14<sup>th</sup> June 2024.

**2.4 Conclusion**

The Sounding Board concluded that RBC Global Asset Management (GAM) Core Emerging Markets Equity fund was more likely to achieve the Fund’s objectives. It is proposed that Strathclyde Pension invest 2% (c£600m) of Fund in the RBC GAM Core Emerging Markets Equity fund. A summary of the manager and the fund is provided in **Appendix A**.

**3 Credit**

**3.1 Review**

Under the new strategy, the Fund’s Credit allocation is set to reduce from 6% to 5%. All of the Fund’s Credit exposure is currently invested using a passive approach managed by Legal and General Investment Management (LGIM), and split 50/50 between UK and US corporate bonds.

The following revised structure for the Credit allocation was agreed by the Committee at its March 2024 meeting.

<b>Portfolio</b>	<b>Current Target (%)</b>	<b>Proposed Target (%)</b>
<b>L&amp;G Passive Corporate Bonds Buy and Maintain Credit</b>	<b>6.0</b>	<b>2.5</b>
	<b>-</b>	<b>2.5</b>
<b>Total Credit</b>	<b>6.0</b>	<b>5.0</b>

The Committee also agreed at its March meeting to move the remaining LGIM Passive Corporate Bond allocation to an ESG/ climate-tilted passive corporate bond investment strategy, which also included coverage of BBB securities.

**3.2 L&G Passive Corporate Bond Allocation**

At its May meeting, the Investment Advisory Panel reviewed two options from LGIM for the passive corporate bond fund allocation:

- The **LGIM Future World** corporate bond fund
- Passive **Low Carbon Transition (LCT)** UK and US corporate bond funds. These funds would be set up by **LGIM** with the Fund as the cornerstone investor, then also offered to other clients.

The Panel agreed that LGIM UK and US LCT credit index funds would meet the Fund’s requirements in accessing investment grade credit markets and would provide alignment with the Fund’s climate objectives.

### 3.3 Conclusion

It is proposed that Strathclyde Pension Fund invest 2.5% of total Fund (c£750m) in LGIM's Low Carbon Transition credit index funds.

### 3.3 Key Features

LGIM's Low Carbon Transition credit index funds are largely similar to the Carbon Transition equity index funds which were adopted by SPF during 2023 for SPF's passive equity allocation.

Key features include the following:

#### Overview

- Index provider: Solactive
- Universe: All investment grade
- Exclusions: Controversial weapons, Coal, [UN Global Compact](#) violators
- LGIM climate score to tilt issuer capital allocation within index.
- Constraints applied to sector, issuer (size), duration (maturity)
- LGIM Climate Impact Pledge applied to fund.

#### Methodology

1. Establish investment universe.
2. Create climate scores based on emissions intensity, reserves intensity and green revenues.
3. Tilt to decarbonise.
4. Active ownership including LGIM Climate Impact Pledge.

#### Current Status

- Simulated / model portfolios generated to ensure required carbon reduction objectives can be met.
- Product launch (post index creation): estimated 12 weeks for multi-investor pooled fund.

### 3.5 Buy and Maintain Corporate Bonds

An allocation of 2.5% of total Fund to a Buy and Maintain corporate bond strategy was approved by Committee at its March 2024 meeting.

### 3.6 Allocation

At its May 2024 meeting, the Panel reviewed three options from LGIM for the Buy and Maintain allocation:

- **LGIM Buy and Maintain fund.**
- **Future World Net Zero Buy and Maintain fund.**
- The creation of a **bespoke Buy and Maintain Low Carbon Transition fund.**

The Panel agreed that the **LGIM Future World Net Zero Buy and Maintain Fund** is a suitable solution, meeting the Fund's strategic aims as well as its climate objectives.

### 3.7 Conclusion

It is proposed that Strathclyde Pension Fund invest 2.5% of total Fund (c£750m) in **LGIM's Future World Net Zero Buy and Maintain fund.**

### 3.8 Key Features

Buy and Maintain provides a strategic core credit allocation with a focus on value preservation and capturing credit risk premium.

Key features of **LGIM's Future World Net Zero Buy and Maintain fund** include the following:

### **Overview**

- Benchmark agnostic
- Global Investment Grade credit universe
- Preference for sectors with high asset backing, high barriers to entry, low threat of disruption risk
- Investment time horizon to maturity
- Downgrades to high yield acceptable only for value preservation
- Currency and interest rate hedging
- Low turnover

### **Methodology**

1. Establish investment universe
2. Determine sector allocation
3. Fundamental credit analysis
4. Portfolio construction
5. Integrate ESG via:
  - Decarbonisation based on temperature alignment (1.5c by 2030)
  - Engagement based on UNSDG alignment and
  - LGIM Climate Impact Pledge

### **Current Status**

>£600m already invested in this fund.

## **3.9 LGIM Climate Impact Pledge**

A summary of the LGIM Climate Impact Pledge is provided in **Appendix B**.

## **4 Policy and Resource Implications**

### **Resource Implications:**

<i>Financial:</i>	c.£600m will be invested in the RBC GAM Core Emerging Markets Equity fund as soon as possible, though this is likely to be phased due to the time it might take to liquidate existing holdings. Fees for new strategy are lower than existing mandates. c.£1.5bn will be divested from the Fund's existing passive corporate bond holdings and transferred to the new passive and buy and maintain strategies. Fees are estimated to be an additional £1.25m per annum.
<i>Legal:</i>	The investments will be subject to the review and execution of appropriate legal documentation.
<i>Personnel:</i>	No issues.
<i>Procurement:</i>	None.

**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 2021-25? Please specify.* 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.  
Priorities in SPF's climate action plan were addressed as part of the investment strategy review. SPF's stewardship activity addresses all of the SDGs to some degree.

*What are the potential climate impacts as a result of this proposal?* The switch to the LGIM low carbon transition and future world corporate bond funds will have a positive impact on the carbon metrics of SPF's Investment portfolio. Both funds are covered by the LGIM Climate Impact Pledge. ESG / sustainability considerations are incorporated into the RBC GAM Core Emerging Markets Equity fund's investment process. The fund has a target of net zero by 2050.

*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.

### **5 Recommendation**

The Committee is asked to **APPROVE** investments of

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### **Appendices**

- A RBC GAM Core Emerging Market Equity Fund**
- B LGIM Climate Impact Pledge**

**RBC GAM Core Emerging Market Equity Fund**

RBC Global Asset Management (RBC GAM) is the asset management division of the Royal Bank of Canada (RBC). It comprises four investment teams focused on Emerging Market Equities, Global Equities, European Equities and Global and Emerging Market Debt. RBC's Emerging Market department in London was set up by Philippe Langham in 2009, who is lead manager on the Emerging Markets Equity Strategy. The RBC Emerging Markets Equity team includes 9 investment professionals with dual responsibilities as portfolio managers and regional analysts. They are supported by RBC's wider central research team including global sector analysts and the Asian equity team. The team manages USD14.3 billion for investors globally.

The investment process uses a blend of top-down and bottom-up analysis. The top-down research is driven by thematic research into long term secular trends, and the sectors and industries which can benefit from these. This research is derived from a variety of sources including meeting with experts and consultants, publications, and reports, attending conferences, and field trips to meet with company management. The bottom-up analysis is conducted with a quantitative screen which ranks the investment universe on quality, value, and momentum characteristics. Due diligence is then completed on the qualifying companies which align with a portfolio theme. The investment team will meet business stakeholders as part of their due diligence before investing in a stock.

Sustainability is central to the investment philosophy and the team uses a checklist approach and proprietary scoring system to assess ESG factors as part of the stock selection process. The checklist includes questions on franchise strength and sustainability, management quality and corporate governance. The team prefer using internally generated ESG scores as they have found that external data providers tend to have limited data on the companies which they consider for the portfolio. These scores are refreshed on a quarterly basis and weakening scores can lead to a reduction in the level of conviction in an investment. In addition to a net zero by 2050 target, the RBC Emerging Markets equity strategy is aiming for a 25% reduction in Scope 1 & 2 CHG emissions by 2030.



### LGIM Climate Impact Pledge

Since 2016, Legal & General Investment Management (LGIM) has encouraged companies to tackle climate change and transition to a low carbon economy through its Climate Impact Pledge.

While LGIM believes the window to achieve a 1.5°C outcome consistent with net-zero carbon emissions by 2050 is closing fast, it also believes that change is still possible if we all act now. The world has the means; it just requires the will. To help address this critical threat, LGIM's Climate Impact Pledge assesses approximately 5,000+ companies worldwide across 20 climate-critical sectors on their climate governance, strategies, policies, metrics and targets. LGIM has selected the companies that are responsible for the most global greenhouse gas emissions from listed companies and/or are vital to the transition to a low-carbon economy.

LGIM's Climate Impact Pledge uses a two-fold engagement approach:

- Quantitative: Assessment of 5,000+ companies across 20 climate-critical sectors.

LGIM's quantitative engagement, which consists of a data-driven assessment of climate commitments, and efforts to limit carbon emissions to net zero by 2050, is conducted across the 5,000+ companies. LGIM's assessment draws upon around 70 data points, including its own climate modelling tool, which involves robust measurement of the climate risk embedded in investments and their climate alignment as well as several third-party data providers.

Compliance with individual indicators within these five areas is assessed through a traffic light system. Companies are scored out of a 100 across five key areas:

1. Governance - How is the oversight of climate issues managed at the board level and communicated to investors?
2. Strategy - What policies do companies have in place, and what policies are they lobbying governments for?
3. Risks and opportunities - How much of companies' current earnings comes from 'green' activities and how much of potential future earnings is at risk in the low-carbon transition (shift from an economy that depends heavily on fossil fuels to a sustainable, low carbon economy)?
4. Scenario analysis - What level of global warming are companies' plans aligned to?
5. Metrics and targets - How ambitious are companies' emission targets, and how do they compare to past performance?

- Dial movers: In-depth priority engagements and exclusions.

In addition to a data-driven assessment of climate commitments and efforts of these 5,000+ companies to limit carbon emissions to net zero by 2050, LGIM engages directly with a subset of companies to influence and support them to reach this objective. This subset of 105 companies is referred to as 'dial movers', chosen for their size and potential to galvanise action in their sectors. Sector experts from across LGIM's stewardship and investment teams collaborate more closely with these companies to actively progress climate related strategies and processes.

Dial movers face further qualitative assessment and scrutiny versus LGIM's sector-specific frameworks. For example, LGIM assesses companies on whether they have a net-zero target in place, and whether they are evidencing a strategy to meet these targets. LGIM also considers to what extent companies

are collaborating across their supply chain, and if they are engaging proactively with policymakers on the net-zero transition.

Within LGIM's sector expectations, sector specific 'red-lines' or minimum requirements for investee companies have been identified. Where LGIM has proactively sought or undertaken direct engagement with a company, and the company continues not to meet these minimum 'red lines' after a certain period of time, they will be considered for potential sanction.

LGIM has set a 'red line' for all sectors on the disclosure of climate lobbying activities. This includes trade association memberships and explaining what actions a company will take if the lobbying activities of these associations are not aligned with a 1.5°C scenario.

In addition to using its voting rights, LGIM can ultimately make the decision to exclude investment in the dial mover companies across applicable funds. This is considered when companies, after a certain period of engagement, continue to not perform well against LGIM's qualitative climate assessment, are unresponsive to engagement recommendations, and/ or keep falling behind in meeting LGIM's red lines listed previously.

The Climate Impact Pledge engagement programme is reviewed on an annual basis by the LGIM Investment Stewardship team. The list of 'dial mover' companies subject to exclusion and/or voting sanctions is updated on an annual basis and published in June each year. Companies can be reinstated back into relevant funds if LGIM believes that they have made satisfactory improvements.