



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

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Item 11

25th November 2020

Investment Update

Purpose of Report:

To provide the Committee with an investment update including a summary of:

- investment performance to 30th September 2020
- portfolios as at 31st October 2020
- the Investment Advisory Panel meeting of 5th November 2020 and
- responsible investment activity during Quarter 3 2020.

Recommendations:

The Committee is asked **TO NOTE** the contents of the report.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes No consulted: Yes No

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1 **SPF Response to COVID-19**

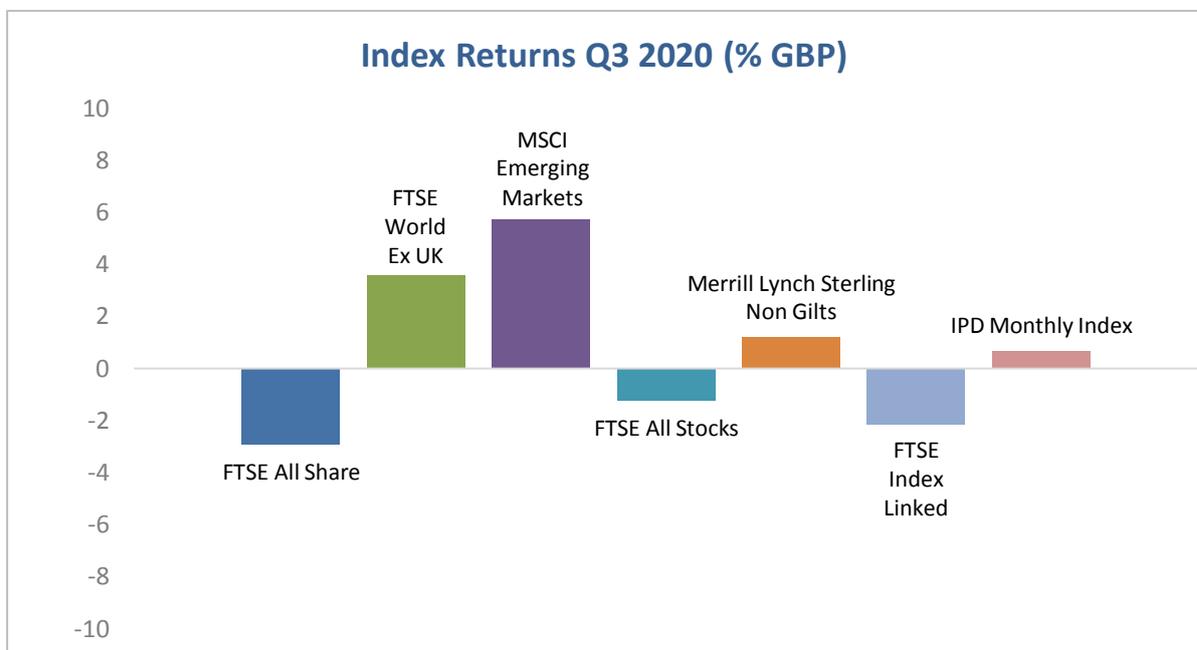
The SPF investment team commenced working from home in late March and will continue to do so for the foreseeable future.

The Fund's investment managers and other providers all switched to contingency arrangements in March. Investment activity has continued since then without interruption.

COVID-19 continues to impact investment markets, portfolios and performance. This remains a focus of management attention and SPF monitoring activity.

2 **Market Performance**

Following steep falls in Q1 2020, government actions to mitigate the impact of COVID-19 on the economy resulted in a sharp rebound in investment markets in Q2. Growth continued over Q3 in all markets except the UK, but at a slower rate as fears about a second wave in the COVID-19 pandemic and the potential impact on global economic growth weighed on markets.

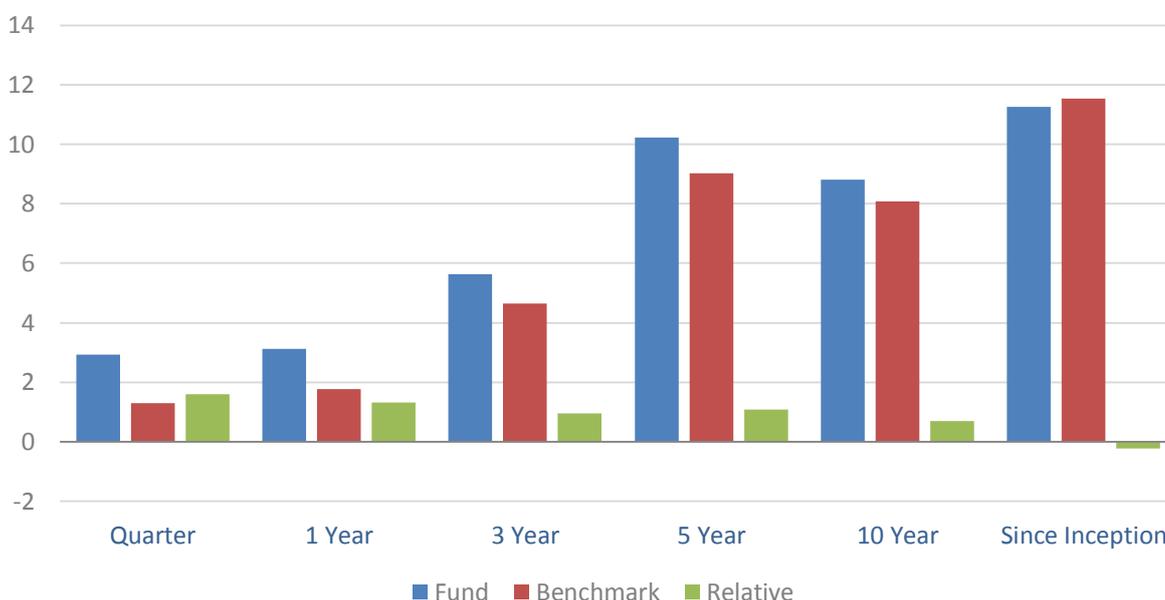


- The **FTSE All Share** Index returned **-2.9%**, the **FTSE World ex UK** index **3.6%** and MSCI Emerging Markets index **4.8%**, compared with Q2 2020 returns of 10.2%, 20.5% and 18.6% respectively.
- Government bond markets declined, the **FTSE All Stock Index** returning **-1.2%**, as comments from the Bank of England fueled speculation that policy makers may cut interest rates to below zero should economic growth fail to gain traction. **Credit markets** had a mixed quarter but generally outperformed government bonds.
- **Sterling** gained against the dollar at the start of the quarter, but declined against the Euro in September due to fears over the UK failing to reach a trade deal with the EU.
- Despite the resurgence of COVID 19 towards the end of the quarter, the UK property market returned **0.7%**. The best performance came from the industrial sector, while unsurprisingly the retail and leisure sectors declined.

3 Total Fund Performance

The Fund's total return for Quarter 3 2020 was **+2.9%**, ahead of the benchmark return of **+1.3%**.

Fund and Benchmark Returns



The Fund's value at 30th September 2020 was **£23,701m**. (Fund value at 30th June was **£23,026m**).

4 Performance Analysis

Further performance analysis is set out in Appendix 1.

5 Portfolio Summary as at 31st October 2020

As at 31st October the Fund's value had increased to **£23,441m**.

A summary of investment manager portfolios as at 31st October is set out in **Appendix 2**.

6 Investment Advisory Panel

The Fund's Investment Advisory Panel met on 5th November 2020 as scheduled via MS Teams.

A note of the Panel's meeting is set out in Appendix 3.

7 Responsible Investment

Activity in respect of the Fund's Responsible Investment policy continued throughout the period. Company AGMs and EGMs were held virtually and engagement activity was carried out remotely. A summary of activity is set out in Appendix 4.

8 Policy and Resource Implications

Resource Implications:

Financial: None

Legal: None

Personnel: None

Procurement: None

Council Strategic Plan: Strathclyde Pension Fund aligns with the theme of a well governed city.

Equality and Socio Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2017-22

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.

ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.

Sustainability Impacts:

Environmental:

ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.

Social, including opportunities under Article 20 of the European Public Procurement Directive:

ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.

Economic:

ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.

Privacy and Data Protection impacts:

None.

The Committee is asked to note the contents of this report.

Appendices

Appendix 1 Performance Analysis

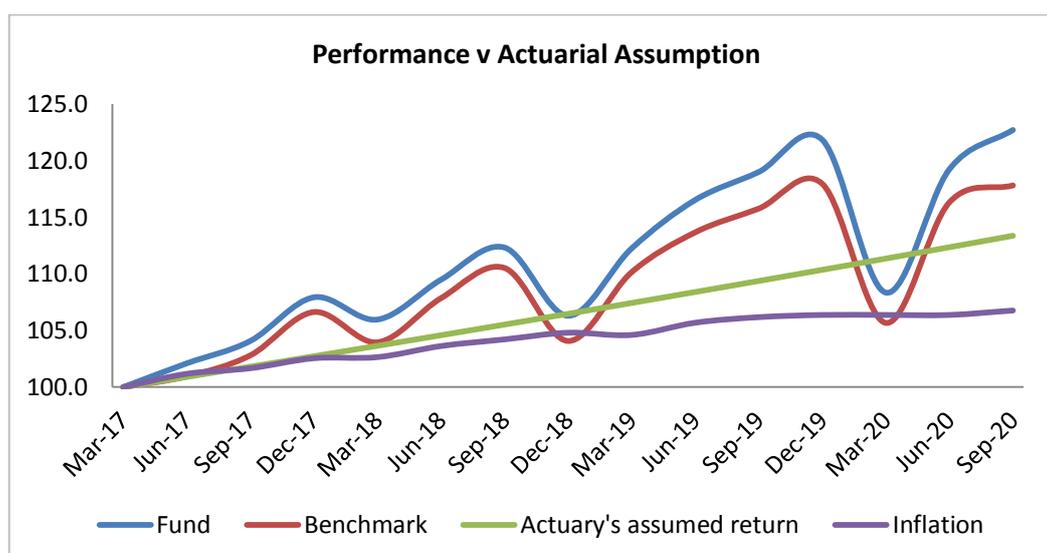
Appendix 2 Portfolio Summary as at 31st October 2020

Appendix 3 Note of Investment Advisory Panel meeting on 5th November

Appendix 4 Summary of Responsible Investment Activity

Performance Analysis

1 Investment Performance vs Actuarial Assumption



As at the end of Quarter 3 2020, the Fund had achieved a return greater than the actuarial assumed return of 3.5% per annum since the 31st March 2017 valuation. The Fund is in the process of completing its latest actuarial valuation as at 31st March 2020.

2 Performance by Asset Category

Asset	Latest Quarter			1 Year		
	Fund %	Bench mark %	Relative %	Fund %	Bench mark %	Relative %
Equity	4.4	2.3	2.1	4.3	(0.9)	5.3
Hedging & insurance	(2.5)	(2.5)	0.0	0.4	0.4	0.0
Credit	1.2	1.2	0.0	6.3	6.3	0.0
Short term enhanced yield	2.8	0.9	1.9	1.5	3.6	(2.1)
Long term enhanced yield	(1.0)	(0.6)	(0.4)	(0.5)	1.3	(1.7)

3 Performance by Investment Managers

Each of the Fund's investment managers has an individual portfolio benchmark. In Quarter 3:

- 15 managers outperformed their benchmark; and
- 6 managers underperformed.

Equity was the best performing asset class in Quarter 3, returning **+4.4%** and outperforming the benchmark of **+2.3%**. The Partners Group private equity portfolio performed particularly well, while Oldfield, Veritas and Lombard Odier underperformed.

Short term enhanced yield returned **+2.8%** over the quarter, outperforming its benchmark. Alcentra (private debt) performed particularly well (**+6.9%** relative to benchmark). While outperforming in Q3, the **Barings** and **Oak Hill** multi-

asset credit portfolios and Ashmore (emerging market debt) are behind benchmark over 1 year.

Long term enhanced yield performed least well on a relative basis over Quarter 3 (-0.4%) as a result of a fall in value of both UK (**DTZ**) and global (**Partners Group**) property portfolios.

4 **Direct Investment Portfolio (DIP)**

As at the end of September 2020, DIP comprised **42** investment commitments, totalling **£1,307m**. During Quarter 3 2020, **net distributions** from DIP amounted to **£14m**. These brought the **Net Asset Value** of DIP to **£866m** at the end of the quarter.

Portfolio performance to 30th September is as follows.

	Q3 2020 (%)	1 year (%)	3 years (% p.a.)	5 years (% p.a.)	Since Inception (% p.a.)
DIP	-1.4	1.2	4.7	5.8	7.5
DIP Benchmark*	0.9	4.1	2.9	2.0	1.4
SPF Total Fund	2.9	3.1	5.6	10.2	11.3

Source: Northern Trust

* CPI +3% pa from 2019; previously LIBOR

Overall, the portfolio has performed well as have a majority of its individual investments. On a RAG analysis:

- **36** investments are rated **green** (decrease of 3)
- **6** are **amber** (increase of 3) and
- **None red**.

The focus of all managers remains on the impact of Covid-19 and on protecting the value of their respective investments, although managers are also positioning their funds to take advantage of opportunities as they arise, in respect of both existing portfolio assets and new investments.

Portfolio Summary as at 31st October 2020

	Equity		Hedging & Insurance		Credit		Short Term Enhanced Yield		Long Term Enhanced Yield		Total		Target
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%	%
L&G	5,862	25.0%	359	1.5%	1,416	6.0%					7,637	32.6%	31.5%
Baillie Gifford	2,140	9.1%									2,140	9.1%	7.5%
Lazard	761	3.2%									761	3.2%	2.5%
Oldfield	585	2.5%									585	2.5%	2.5%
Veritas	698	3.0%									698	3.0%	2.5%
Lombard Odier	313	1.3%									313	1.3%	1.0%
JP Morgan	1,022	4.4%							536	2.3%	1,558	6.6%	5.5%
Genesis	464	2.0%									464	2.0%	1.5%
Pantheon	1,069	4.6%									1,069	4.6%	5.0%
Partners Group	776	3.3%					80	0.3%	397	1.7%	1,253	5.3%	6.0%
PIMCO							1,161	5.0%			1,161	5.0%	5.0%
Ruffer							220	0.9%			220	0.9%	1.0%
Barings (multi-credit)							653	2.8%			653	2.8%	2.8%
Oak Hill Advisors							449	1.9%			449	1.9%	1.8%
Barings (private debt)							260	1.1%			260	1.1%	1.3%
Alcentra							309	1.3%			309	1.3%	1.3%
ICG Longbow							73	0.3%			73	0.3%	1.0%
Ashmore							470	2.0%			470	2.0%	2.5%
DTZ									2,131	9.1%	2,131	9.1%	10.0%
DIP	42	0.2%					104	0.4%	742	3.2%	888	3.8%	7.0%
Cash							349	1.5%			349	1.5%	1.0%
Total	13,732	58.6%	359	1.5%	1,416	6.0%	4,129	17.6%	3,805	16.2%	23,441	100.0%	100.0%
Target		52.5%		1.5%		6.0%		20.0%		20.0%		100.0%	

Investment Advisory Panel

MINUTES OF MEETING ON Thursday 5th November 2020
Held via MS Teams

PRESENT:	Richard McIndoe	Director
	Prof. Geoffrey Wood	Investment Advisor
	Eric Lambert	Investment Advisor
	Iain Beattie	Investment Advisor
	David Walker	Hymans Robertson
	Nell McRae	Hymans Robertson
	Jacqueline Gillies	Chief Investment Officer
	Richard Keery	Investment Manager
	Ian Jamison	Investment Manager (part meeting only)
	Veronica Antonucci	Investment Assistant

1. Minutes from Last Meeting & any Matters Arising

Minutes of the previous meeting were agreed to be an accurate record.

Officers provided updates on the proposed deployment of the 2020/21 investment allocations to the Partners Group private equity and real estate programmes, and on the recent custody and responsible investment tenders. Officers advised that the switch of the Fund's passive segregated North America mandate to a pooled fund (Legal and General) was completed in October 2020.

2 Monitoring

2.1 Quarterly Investment Performance Review (Main Fund)

The Fund's return for Q3 2020 was positive (+2.9%), and above benchmark (+1.3%). Performance for the year to 30th September 2020 was positive (+3.1%), and above benchmark (+1.8%). Both absolute and relative performance had been positive over the three and five year periods.

2.2 Manager Ratings

Current officer assessments of the Fund's investment managers had been circulated, together with Hymans Robertson's manager update. On a Red, Amber, and Green (RAG) analysis:

- 19 of the Fund's managers were rated green
- 2 rated amber and
- None red.

2.3 Direct Investment Portfolio Monitoring Report

The Panel reviewed the quarterly monitoring report for the Direct Investment Portfolio (DIP). DIP investment managers had continued to provide detailed updates on the effect of coronavirus on their respective assets/ investee companies and reported portfolio impact assessments had been in line with expectations. Overall the portfolio and most of its investments are still progressing well. On a Red, Amber, Green (RAG) analysis:

- 36 investments were rated green
- 6 amber and
- None red.

3 Allocation

3.1 Private Market Allocations

The Panel reviewed a schedule of estimated cash flows for the Fund's private market investment programmes. Totals as at 30th September 2020 were as follows.

	2020 Estimate (£m)	2020 Actual YTD (£m)
Distributions	327	264
Calls	-820	-490
Net	-493	-226

The projected net cash flow to private markets programmes in 2020 is an outflow of **£493m**, of which **£226m** has already been drawn. The Fund's private debt and direct investment portfolios are still building their investment exposure, and drawdowns to these investments will make up the majority of remaining net cash outflow over the course of 2020.

The Fund's central cash balance at 30th September 2020 was **£304m**. This had increased by **£76m** since June 2020 due to funds received from private equity and private real estate. Cash balances are sufficient to cover drawdowns to private market programmes for the remainder of 2020.

3.2 Re-balancing strategy

The Panel reviewed a re-balancing report as at 30th September 2020.

The Fund's allocation to equity remains above target. The allocation to the Baillie Gifford portfolio was outside the upper limit of its target range at the end of quarter, however the Panel agreed that this would be addressed as part of the review of investment strategy and structure. Specialist equity mandates were also over target, and the JP Morgan small cap equity portfolio had exceeded its target allocation range. The Panel agreed that the JPM portfolio should be trimmed by 0.4% of total Fund in order to bring its allocation back within its target range. Proceeds of the sale will be held in cash.

Private debt was below target as individual manager portfolios continue to build up investment exposure. Global real estate was also under its target allocation but unfunded commitments should be sufficient to increase the mandate weight back to target. The Panel agreed that no action was required in respect of these two asset classes.

4 Investment Strategy and Structure: Review of Investment Strategy

A review of investment strategy in conjunction with the actuarial valuation of the Fund as at 31st March 2020 is one of the major items in the SPF 2020/21 business plan. The Panel considered the following as part of the ongoing review:

- Draft valuation results
- Oversea currency hedge
- Listed equity strategy and structure

- Hedging/ Insurance and credit allocations

4.1 Draft Initial Valuation and Asset Liability Modelling Results

Hymans Robertson presented a summary of the draft 2020 Fund valuation results. This indicated a funding level of 106% at 31st March 2020, an increase of 1% from the 31st March 2017 level of 105%. The 2020 valuation assumed a future investment return of 3.0%, a decrease of 0.5% from the previous 3.5%.

Full asset liability modelling based on the 2020 valuation, together with a review of the Fund's strategic allocation will be presented to the Panel at a meeting on 25th November 2020.

4.2 Overseas Currency Hedge

In September 2017, the Committee agreed that the Fund should hedge 33% of currency exposure arising from overseas listed equity by switching investments in Legal and General passive index funds to currency hedged alternatives.

The Panel reviewed a monitoring report that indicated the Fund's overseas hedge ratio at end September 2020 was 32.2% vs its target of 33%. The currency hedge had been beneficial in the 12 months to 30 September 2020, largely because of the appreciation in GBP vs USD in Q3. Since inception of the hedging strategy, it had marginally reduced total Fund returns as a result of the overall depreciation of Sterling vs US dollar, Euro and Yen.

Hymans Robertson presented a paper which considered whether the current hedging strategy remains appropriate. While currency risk will always be second order compared to other risks associated with the Fund's assets, analysis around currency hedging suggested that the current strategy

- maintains the aim of some reduction in equity return volatility, and places a greater focus on reducing volatility in times of market stress;
- takes account of currency hedging at the overall Fund level rather than just at the equity level;

The Panel had mixed views as to the long term benefits of currency hedging, but agreed to retain the current hedging exposure at or around its target weight of 33% of overseas listed equity.

4.3 Review of the Current Equity Structure

At its meeting in August, the Panel agreed that the following potential changes to the Fund's listed equity structure should be given further consideration:

- review of the Fund's regional allocation, including a reduction of the current overweight to UK equities
- a change in the Baillie Gifford mandate to include US Equity
- reduction of the Fund's allocation to RAFI in favour of a low carbon alternative.

Hymans Robertson presented a paper which reviewed each of these potential changes.

4.3.1 Listed Equity Regional Allocation

The Fund currently targets a regional equity split of:

- 20% UK
- 15% Europe ex UK
- 40% US and
- 25% Asia and Emerging Markets.

The principle of this approach is to maintain a broadly diversified regional allocation across geographical blocks. The strategy is implemented through a combination of passive regional allocations and active global equity mandates.

The bias to the UK and Europe relative to the weight of these regions in world equity markets has grown since the current target allocations were set in 2015. This is due to the substantial growth in the US market and the substantial valuation discount of UK equities.

The Panel discussed this bias and agreed that some adjustments should be made to the Fund's regional equity strategy in order to reduce the current bias to the UK and Europe. Hymans Robertson will consider implementation options and propose revised regional targets for the Fund's listed equity portfolio.

4.3.2. Baillie Gifford Mandate

The Panel had previously discussed switching the current Baillie Gifford mandate, which excludes the US, to a strategy that would include US equities. The US market is the most efficient, making it harder for active managers to show value in US equities, however investing on a global basis allows a manager to exploit the widest possible opportunity set. Baillie Gifford manage two global inc US strategies, both of which had been successful. One of these, Global Alpha, would meet the Fund's requirements.

The Panel discussed the Hymans analysis and agreed that a recommendation to switch the Baillie Gifford mandate to the Global Alpha strategy should be included in the final investment strategy review report, which will be presented to Committee in March 2020.

4.3.3 Legal and General RAFI mandate

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 and increased its exposure to the current level in 2015.

The value tilt of the RAFI allocation plays a key role in balancing overall style exposures across the Fund's equity allocation. Since the RAFI strategy was adopted the market has continued to evolve however and a number of alternative factor based investment strategies are now available. Given the increased interest in responsible investment initiatives, some strategies now also target Environmental, Social and Governance (ESG) related factors.

A paper from Hymans Robertson outlined ways that the Fund could integrate responsible investment or climate factors into a RAFI index-based solution with the current manager of this strategy, Legal and General. The Panel agreed that the Fund should retain the value tilt of the current RAFI strategy but that there would be merit in considering alternative factor investment strategies that included responsible investment factors.

In order to ensure that any alternative strategy met the Fund's long term investment objectives alongside its wider approach to responsible investment and equity investing, the Fund would need to decide if there were any specific climate related factors or objectives that it would seek to achieve.

4.4 Hedging/ Insurance and Credit Assets

The Panel reviewed a paper by Hymans Robertson which provided an outline of the Fund's allocation to hedging/insurance and credit assets. The current allocation comprises:

- 6% (of total Fund) in investment grade credit, split equally between sterling and US credit to provide some broad credit diversification and
- 1.5% in inflation linked gilts.

The credit exposure provides some yield advantage over gilts, together with some term and interest rate sensitivity. The index linked gilts provide some inflation linkage, albeit very little at 1.5%.

The Hymans paper considered an outline framework to vary the allocation between the different hedging/insurance and credit assets. In order to implement such a framework, the Fund would need to agree simple metrics that could act as triggers for switches between the various assets, as well as a practical process for monitoring these metrics.

The strategic allocation to hedging/ insurance and credit will be addressed as part of the asset liability modelling currently being prepared by Hymans. The Panel agreed that the Fund should give further consideration to a framework as part of this process.

5 Governance

5.1 Strathclyde Pension Fund Committee

The Panel noted the draft agenda for the next committee meeting on Wednesday 25th November 2020. Proposed dates for 2021 Committee meetings are 3rd March and 2nd June.

5.2 Investment Advisory Panel 2021 Dates

The Investment Advisory Panel will meet on the following dates in 2021:

- 11th February
- 13th May
- 12th August
- 4th November.

6 Manager Reviews

The following investment manager attended the Investment Advisory Panel.

- Pantheon

- Baillie Gifford

Performance of each of the managers was reviewed.

Pantheon

The Pantheon private equity portfolio is currently valued at £1,073m, 4.5% of total Fund, versus a target weight of 5.0%. Pantheon provided an update on the performance of the portfolio, demonstrating the significant value added since inception of the Fund's investment.

The portfolio is currently under its target allocation and this underweight position is likely to increase as distributions from the portfolio are forecast to continue to exceed drawdowns to fund new investments. In order to achieve and maintain the Fund's target allocation of 5% of total Fund, Pantheon proposed the following new investment allocations:

- £75m in Global Select 2019 (a primaries fund)
- £100m in Pantheon Global Co-investment Fund V ('PGCO V')
- £75m in Pantheon Global Secondary Fund VII ('PGSF VII')

The Panel supported the new investment allocations. Given the global nature of the Fund's investment portfolio with Pantheon, the Panel also agreed to amend the benchmark to MSCI AC World +3% instead of the current FTSE UK benchmark.

Baillie Gifford

The Baillie Gifford Global ex US equity portfolio is currently valued at £2,177m, or 9.2% of total Fund, versus a target weight of 7.5%. Baillie Gifford provided an update on the performance of the portfolio. Information on Global equity strategies, including US, was also presented to the Panel.

7 AOCB

None.

Responsible Investment Activity: Quarter 3 2020

A summary of activity against each of the six United Nations Principles for Responsible Investment is provided below.

1. We will incorporate Environmental, Social and Governance (ESG) issues into investment analysis and decision-making processes

The Fund's property manager, **DTZ Investors**, provided a report outlining the projected move to a net zero world and the potential impact on the property market. The World Green Building Council (WGBC) states that all buildings must be 'net zero carbon' by 2050 if the Paris Agreement is to be fulfilled. Following the UK government legislating its commitment to achieving net zero by 2050, DTZ Investors has commenced developing a pathway with the primary objective of reducing Strathclyde Pension Fund's operational carbon emissions to zero by 2030 and reduce the embodied carbon during developments and refurbishments.

So far in 2020 DTZ has put in place sustainability action plans for several assets in the Strathclyde portfolio with more due to be created in Q3 and Q4 2020. Sustainability action plans enable identification and tracking of environmental and social initiatives through collaboration with the property management teams, sustainability functions and asset managers. The purpose of the action plans is to capture and shortlist sustainability projects that are feasible for implementation over 2020—2021 and to support the portfolio in its approach to energy reduction for net zero. Their scope encompasses energy efficiency, waste, water, transport, health & wellbeing, stakeholder engagement, cleaning and landscaping & biodiversity.

DTZ is also currently in the process of implementing the Financial Stability Board's (FSB) Task Force on Climate related Financial Disclosures (TCFD) framework to identify what the climate related risks to the portfolio could be over the short to long term with the purpose of identifying the subsequent mitigating actions against any identified risk. DTZ is embedding a consistent and managed approach to the monitoring our exposure to climate risk and putting in place the required governance and reporting structures to report and disclose in 2021.

2. We will be active owners and incorporate ESG issues into our ownership policies and practices

2.1 Voting

Managers' voting activity during the quarter to 30th September 2020 is summarised as follows.

Voting activity to 30th September 2020		
		(%)
Total meetings	1,180	
Votes for	10,215	82
Votes against	1,908	16
Abstentions	152	1
Not voted	120	1
No. of Resolutions	12,395	100

Voting activity in the quarter included:

Responsible Investment Activity: Quarter 3 2020

- **Oldfield Partners** voted against the remuneration report and policy at **BT Group** due to inappropriate incentives.
- **J.P. Morgan** voted against 3 resolutions on executive remuneration in quarter 3. In India executive remuneration was opposed at **Endurance Technologies Ltd** due to lack of disclosure on compensation metrics and at **Dr. Lal PathLabs Ltd** due to the lack of disclosure on the performance linked incentives. In Hong Kong, the adoption of a share option scheme at **Country Garden Services Holdings Company Ltd.** was opposed due to dilution concerns.
- **Genesis** opposed the remuneration policy at **Naspers** as it included long-term incentives that are not performance related.

2.2 Engagement

Engagement highlights during the quarter include the following.

- **Sustainalytics**, provided reports on concluded engagements with seven companies including with the US agribusiness and food company **Bunge Ltd.**, (Legal & General) which was accused of deforestation in Brazil and Bolivia for the purpose of large-scale soybean cultivation. Bunge has now publicly committed to achieving a deforestation-free supply chain worldwide by 2025, to respect local and indigenous community rights and conserve biodiversity. In addition, Bunge has suspended cooperation with suppliers that illegally deforest the land. The company is also attempting to engage with those farmers who have a legal right to clear forests.
- **Baillie Gifford** engaged with consumer credit reporting company **Experian** on data security and privacy. Experian recently experienced a fraudulent capture of data in its South African division. The engagement with Experian management sought to better understand its data security resilience and where data security sits in the executive and board reporting framework. Baillie Gifford held a series of meetings with mining company **Rio Tinto** on the topics of effective governance, community stakeholder relations and mine safety. The destruction of a site of cultural significance in Western Australia in May 2020 prompted widespread criticism which led to the resignation of the CEO and two additional executive directors in August. The engagement with Rio Tinto set out expectations that the board is fully focused on delivering an effective corporate governance framework which respects all stakeholder rights.

2.3 We will seek appropriate disclosure on ESG issues by the entities in which we invest

Improved disclosure is a recurring theme of engagements with portfolio companies by investment managers and Sustainalytics.

- **Sustainalytics** reported efforts to engage with UK-based online fashion retailer **Boohoo Group Plc** (Baillie Gifford), after it was linked to labour rights violations in its supply chain. The NGO, Labour Behind the Label, reported that factories in Leicester, including those supplying Boohoo, required workers who had tested positive for COVID 19 to continuing working. Allegations were also made that a supplier making Boohoo

Responsible Investment Activity: Quarter 3 2020

garments was paying workers below the legal minimum wage. The National Crime Agency is currently investigating factory working conditions in Leicester and Boohoo has launched its own independent review into working conditions in its supply chain. Sustainalytics will outline investor expectations to Boohoo regarding ethical trade and decent working conditions and through engagement will aim to monitor measures taken by Boohoo to ensure a robust programme is adopted that eliminates abuse throughout the company's supply chains.

- Sustainalytics reported that it will engage with Russian diversified metals mining company, **MMC Norilsk Nickel PJSC** (Baillie Gifford), over an incident at its subsidiary, causing a diesel fuel spill which led to severe environmental and human rights impacts in the Russian Arctic region. Upwards of 21,000 tonnes of diesel fuel have contaminated an area of around 350 square kilometres, including the Ambarnaya river, located near the city of Norilsk in Russia's Arctic region. Russian authorities have issued a fine of USD 2.1billion and it is estimated that the clean-up will cost the company about USD 150 million. The engagement will ask Norilsk Nickel to take appropriate actions to contain the oil and prevent further damage to the environment. It should have remedial measures in place to address the impacts of the leak and the company should also ensure that it has maintenance and monitoring programmes to address the risks to its infrastructure, including from melting permafrost.
- **Baillie Gifford** engaged with Spanish multinational clothing company **Inditex** (parent company of Zara) to help understand how the company monitors its supply chain and minimises the risk of subcontracting. Inditex's processes is described as industry leading and is the most sustainable retailer according to the Dow Jones Sustainability Index. By 2025, 100% of the cotton, linen and polyester used by all eight of its brands will be organic, sustainable, or recycled and by 2023, all single-use plastics will have been eliminated for customers sales. Baillie Gifford were interested to learn what it has done and to build a picture of best practice. The call instilled confidence of a robust process which includes conducting regular audits that have evolved over time, and a company willing to build partnerships with various independent organisations that can provide on-the-ground monitoring. What came across as key is the presence of a continually evolving philosophy which emphasises the importance of managing supply chain risk as being crucial to the sustainability of revenues.
- **Oldfield Partners** continued engagement with electric utility **Korea Electric Power Corporation** (KEPCO). The focus of the engagement has been to dissuade KEPCO from proceeding with its development of coal-fired generation, which presents a clear risk considering the global transition towards a low-carbon economy. While the company has publicly committed to a transition towards renewables, the board is still approving international coal projects. Oldfield urged the company to cease approving any future coal projects and to adopt a more ambitious timeline to exit coal completely over the next decade to meet the Paris Agreement ambitions. As such change

Responsible Investment Activity: Quarter 3 2020

needs to be approved by government Oldfield will include the Ministry of Energy and Ministry of Trade and Industry in future engagement efforts.

2.4 We will promote acceptance and implementation of the Principles within the investment industry

- Currently all the Fund's investment managers are signatories to the principles and 20 of the 25 managers within the Direct Investment Portfolio are also signatories. The Fund strongly encourages managers to become signatories and to adhere to the principles. However, for some this will be less appropriate due to the specialised nature of their activities.

2.5 We will work together to enhance our effectiveness in implementing the Principles

The Fund seeks to improve the effectiveness of company engagement and voting by acting collectively with other institutional investors, charities, and interest groups. The Fund has been supportive of the work of **ShareAction** for several years and ShareAction has been successful in raising awareness of issues and in lobbying for change.

- In July, the Fund participated in a webinar to launch ShareAction's latest investor briefing 'Insecure Work in Insecure Times'. Whilst Covid-19 has thrown a spotlight on companies' treatment of low-paid workers the issues related to changes to work patterns and security of work have been building in all advanced economies in recent years. There is a danger that the use of insecure work practices continues to grow in the aftermath of the Covid-19 pandemic, as it did after the 2008 financial crisis. It is therefore becoming increasingly important for investors to be considering and engaging with companies on how their workforce policies and practices might be driving greater insecure work. This webinar discussed the issues experienced by workers on the ground; identified examples of good practice and explored how investors should engage on these issues.
- In quarter 3 the Fund joined with 137 other financial institutions to back a campaign for high-emitting companies to set greenhouse gas emission reduction targets following guidance from the **Science-Based Targets initiative (SBTi)**. SBTi, which is a collaboration between **CDP**, World Resources Institute, the WWF, and the UN Global Compact, aims to define and promote best practice in greenhouse gas emissions reduction target-setting. More than 1,800 companies are being targeted and combined they are the source of Scope 1 and 2 emissions equivalent to 25% of total global emissions. They also represent 40% of the MSCI ACWI index. SBTi allows corporates and financial institutions to have their targets validated as being aligned with the Paris Agreement's goals of keeping global warming to 1.5°C or well below 2°C above pre-industrial levels. To date, over 270 companies have set a science-based target with recent new joiners including Rolls-Royce, Velux, Diageo, H&M Group and Colgate Palmolive. These

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companies are committing to net-zero by 2050 alongside deep emissions cuts by setting interim science-based targets.

- In quarter 3 the Fund co-signed letters to Brazilian food producers as part of the **Investor Initiative for Sustainable Forests (IISF)**. The IISF, led by **PRI** and Ceres, aims to transform industry practices to eliminate deforestation from cattle and soy supply chains in the Amazon. The letters to **JBS**, **Marfrig** and **Minerva** regarding their management of deforestation and traceability within their cattle supply chains were supported by over 80 investors. JBS has yet to respond to the letter and a disappointing response from Minerva lacked a commitment regarding traceability and did not seem to acknowledge the important role they play in tackling the issue within the industry. In contrast, Marfrig made new commitments regarding deforestation. They committed to investing R\$ 500 million into sustainability by 2030, as well as to achieving full traceability in the Amazon by 2025 and the Cerrado by 2030, thus aiming to have a deforestation free supply chain by 2030.

2.6 We will report on our activities and progress towards implementing the Principles

- Lazard, Baillie Gifford, JP Morgan, Henderson, Veritas, and Oldfield Partners provided reports on ESG engagement during the quarter. Sustainalytics provided a full engagement report for the quarter and an engagement progress update on individual portfolio companies.
- The **Institutional Investors Group on Climate Change (IIGCC)** issued a policy report calling on the European Commission and EU member states to raise Europe's greenhouse gas emissions (GHG) target to ensure "at least" a 55% reduction in emissions by 2030. This is the minimum level of ambition required to achieve net zero emissions by 2050. The report also highlights that a high level of ambition for 2030 is needed to support a more orderly and cost-effective transition in achieving net zero emissions, between now and 2050. Especially as delayed action will be harder to achieve; clarity is required from policymakers on pathways to achieving net zero emissions across specific sectors of the economy. This is related to the importance of concrete, near-term, sector-specific market signals that can guide investors' decision-making; and the importance of further dialogue between investors and European Commission and member state policymakers, on further development and implementation of the EU's Green Deal policy agenda. The report is available at: <https://www.iigcc.org/download/iigcc-report-ambitious-eu-2030-action-essential-for-achieving-net-zero-emissions/?wpdmdl=3844&masterkey=5f58a06689ae3>
- The **Climate Action 100+** initiative outlined details of a new 'Climate Action 100+ Net Zero Benchmark,' which will help standardise what constitutes a 'net zero aligned' business strategy and how to measure company alignment with a 1.5°C transition pathway. The benchmark will provide comprehensive analysis on which companies are leading the transition to net zero

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emissions, alongside a range of 30 indicators in total, used by investors to inform investment and corporate engagement strategies. Given the significance of the benchmark, a letter was sent from the Climate Action 100+ Steering Committee to CEOs and Chairs of the Board at 161 global companies engaged through the initiative, to set out the benchmark and call on firms to commit to net zero business strategies. The letter also informs CEOs that companies will be assessed on progress in becoming net zero businesses. The first benchmark analysis will be published in early 2021

- The **Local Authority Pension Fund Forum (LAPFF)** provided a Q3 Quarterly Engagement Report. The report highlights include:
 - Engagement with the **Rio Tinto** board following the destruction of the historically significant caves at Juukan Gorge in Western Australia.
 - Net zero transition engagements including **Sainsbury** and **ArcelorMittal**. Engagement to date with ArcelorMittal has led to a 30% carbon emission reduction target for its European operations by 2030, and for carbon neutrality for 2050. Sainsbury provided detail of the company's net zero by 2040 target and progress towards the plastic reduction goal of 50% by 2025.
 - Engagement with the Brazilian government to stem deforestation in the Amazon.
 - Supply chain due diligence initiatives in response to the **Boohoo** scandal in Leicester.
 - Company engagements on varying issues including Cyber Security at **Clipper Logistics** and **BHPs** approach to environmental, social and governance issues in joint ventures.
- The Fund's engagement overlay provider, **Sustainalytics** announced two new three-year projects (themes) that aim to proactively improve companies' preparedness to mitigate risks and capitalize on opportunities connected to global ESG challenges.
 - **Modern Slavery** will target some of the sectors with the highest prevalence of the practice. Modern slavery breaches fundamental human rights and is a crime under international law, as well as in most national jurisdictions. This engagement will encourage companies to take a more ambitious and strategic approach to addressing modern slavery in both their direct operations and supply chain, including preventative measures, improved risk assessments, and enhanced disclosure.
 - **Feeding the Future** will focus on the need for the global food system to transition to more sustainable practices and business models. Agriculture is a major contributor to greenhouse gas emissions, deforestation, water stress, and biodiversity loss. Sustainalytics will engage companies on how to tackle the parallel pressures regarding sustainability and feeding the growing population, while adapting to changing consumer trends and ensuring that science-based contingency planning is in place.

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- **Lazard** provided their annual sustainable investment report. The Lazard investment process seeks to identify enterprises that financially prosper while protecting and preserving human and natural capital. The report illustrates that a wide variety of sustainability considerations are embedded in the investment and decision-making processes. The report is available at: https://www.lazardassetmanagement.com/docs/-m0-/106599/AnnualSustainableInvestmentReport2020_en.pdf
- The Fund's specialist Emerging Market equity manager **Genesis** provided their annual ESG report. In 2019, Genesis voted on 1,487 company resolutions and conducted more than 1,000 engagements. The report is available at: <https://www.giml.co.uk/files/policies/59-genesis-annual-esg-report-2019/file>
- The Fund's Infrastructure manager **JP Morgan** provided the annual Sustainability Report for the Infrastructure Investments Fund (IIF). The report discusses the importance of ESG implementation and provides an overview of how ESG is integrated at the fund level and throughout the portfolio and sets out specific examples of how IIF portfolio companies are contributing to ESG initiatives including in respect of climate, stakeholder and community engagement, diversity and inclusion and health and safety. Key takeaways from the report include:
 - Over USD 3 billion invested in renewable power generation.
 - 4.8 GW of renewable energy capacity - enough to power 3.7 million homes for a year.
 - 4 million tonnes of GHG emissions avoided in 2019.
 - Clean water and wastewater projects serving over 5 million people.
 - Over 10,000 volunteer hours from IIF portfolio companies and USD 500,000 in charitable donations and sponsorship.
 - GBP 1.7 million contributed to wind farms' local communities on behalf of Ventient Energy.
 - 16,000 trees planted through the Sonnedix One Tree partnership.
 - 'A' rated for direct infrastructure in the 2019 PRI survey.
 - GRESB benchmark ranked 5th from a peer group of 28 global, unlisted infrastructure funds. Sonnedix and Ventient received GRESB Sector Leader awards.
- The **Strathclyde Pension Fund** business plan for 2020/21 includes a review of the Financial Reporting Council (FRC) revised **UK Stewardship Code** and the publication of a revised Statement of Compliance.

The UK Stewardship Code 2020 is a substantial and ambitious revision to the 2012 edition of the Code and sets high stewardship standards for signatories. The new Code comprises a set of 12 Principles which require reporting and disclosure on an 'apply and explain' basis.

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Organisations wanting to become signatories to the Code will be required to produce an annual Stewardship Report explaining how they have applied the Code in the previous 12 months. The FRC will evaluate the Reports and those that meet the reporting expectations will be listed as signatories to the Code. The deadline for asset owner reporting to the FRC is 30 April 2021.

The Fund is in the process of reviewing its compliance with the requirements of the new UK Stewardship Code (2020) with a view to becoming a signatory of the new Code. However, it is not currently a requirement for LGPS Funds to be Stewardship Code signatories and early indications are that the FRC's expectations will be difficult to achieve, at least in the first reporting year.