



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

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Item 8

8th September 2021

Investment Update

Purpose of Report:

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

- investment performance to 30th June 2021
- portfolios as at 31st July 2021
- the Investment Advisory Panel meeting of 12th August 2021 and
- responsible investment and climate change activity during Quarter 2 2021.

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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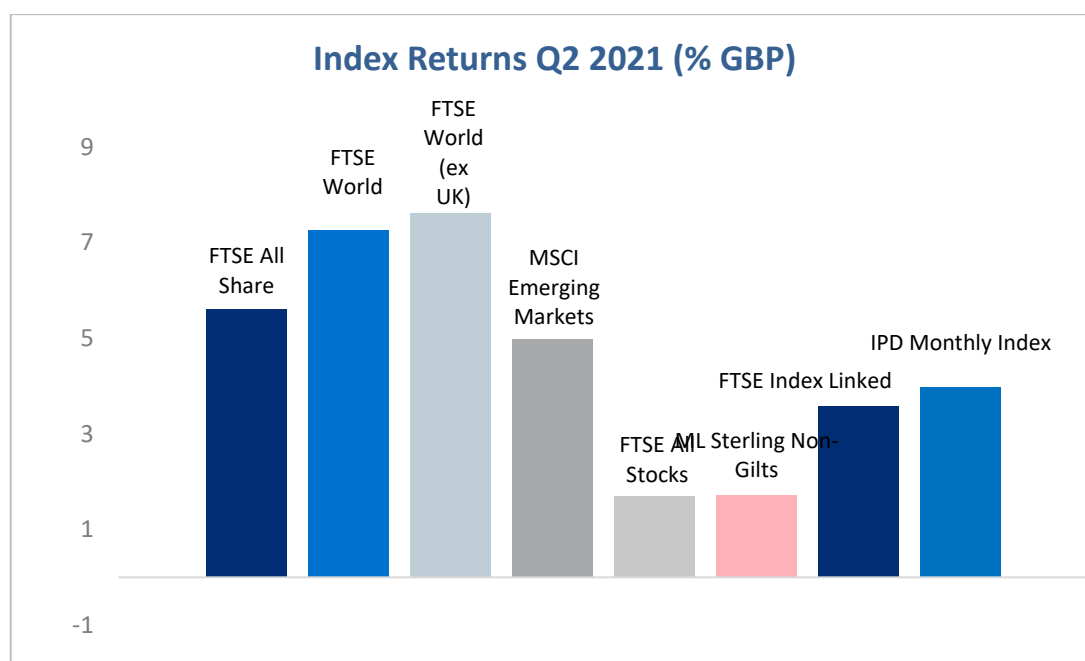
1 SPF Response to COVID-19

The SPF investment team commenced working from home in late March 2020 and is currently planning for the introduction of hybrid working between home and office.

The Fund's investment managers and other providers all switched to contingency arrangements in March 2020 but the majority are planning for, or have commenced, a phased return to office working on at least a part time basis. Investment activity continues without interruption.

2 Market Performance

COVID-19 remained a worry for investors in Q2 2021, in particular as rising cases emerged in many parts of the world, but the risk of inflation as a result of pandemic-driven stimulus became a particular focus of concern. World equity markets rose sharply however, as economic indicators suggested that the global economic recovery would continue despite the risk of inflation.

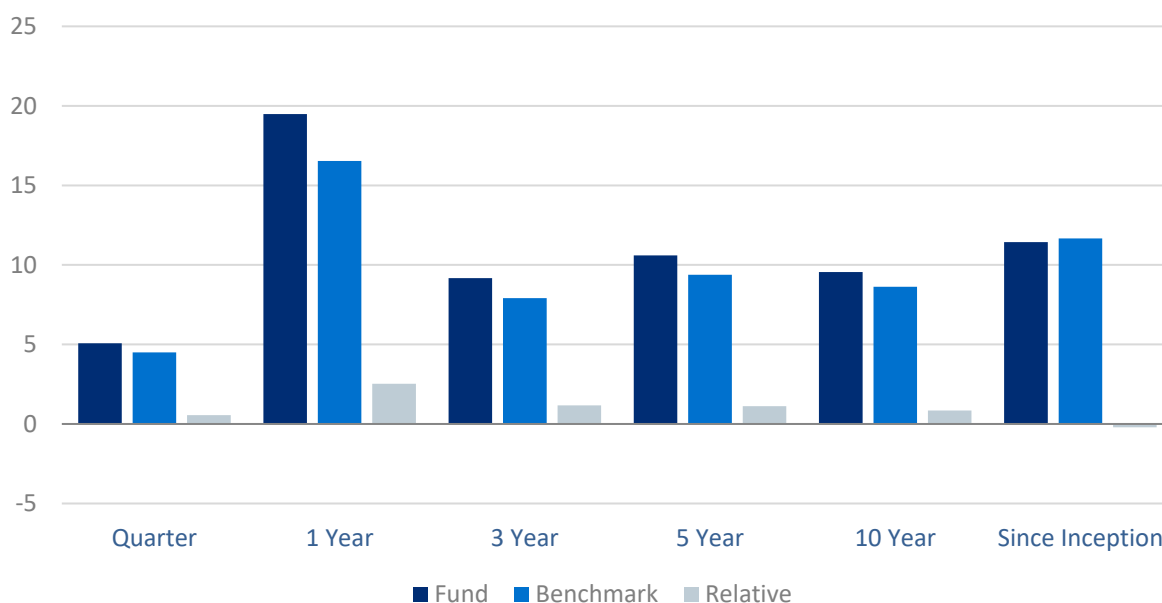


- The **FTSE All Share** Index returned **+5.6%**, the **FTSE World ex UK** index **+7.6%** and the **MSCI Emerging Markets** index **5.0%**, compared with Q1 2021 returns of +5.2%, +4.0% and +1.4% respectively.
- The **FTSE All Stock Index** returned **+1.7%** as investors weighed the effects of inflationary pressures and a new COVID 19 variant against the progress of vaccines and the economic recovery.
- Following the sell-off in the first quarter of 2021, **Credit Markets** stabilised and investment grade stocks generally outperformed high-yield bonds, with the ICE Bank of America Sterling Non-Gilts index returning **+1.7%**.
- **Sterling** finished the quarter up **+0.7%** against the dollar. In contrast, the pound fell by **-0.8%** against the Euro.
- The **IPD Monthly Index** returned **+4.0%**. While the Industrial Sector outperformed all other sectors, the retail, leisure and office sectors showed improved performance compared with the first quarter of 2021.

3 Total Fund Performance

The Fund's total return for Quarter 2 2021 was **+5.1%**, ahead of the benchmark return of **+4.5%**.

Fund and Benchmark Returns



The Fund's value at 30th June 2021 was **£27,501m**. (Fund value at 31st March was **£26,176m**).

4 Performance Analysis

Further performance analysis is set out in Appendix 1.

5 Investment Strategy Review

The following changes to the Fund's investment strategy, as agreed by the SPF Committee in March 2021, were implemented during the quarter:

- The Baillie Gifford portfolio transitioned to the firm's Global Alpha Strategy
- The Legal & General market cap portfolio was restructured
- The allocation to PIMCO was decreased by 1% and the allocation to Ruffer increased by 1%
- The small allocation to index linked gilts (Hedging and Insurance) was sold, with the proceeds being held in Legal and General cash funds.

The increased commitment of 1% of total Fund to the JP Morgan Infrastructure Investment Fund was also finalised, with drawdown of this investment anticipated within the next 6-9 months.

5 Portfolio Summary as at 31st July 2021

As at 31st July the Fund's value had decreased to **£27,471m**.

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

6 Investment Advisory Panel

The Fund’s Investment Advisory Panel met on 12th August 2021 via MS Teams.

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

7 Responsible Investment and Climate Change

Activity in respect of the Fund’s Responsible Investment policy and climate change strategy continued throughout the period. Highlights included:

- **Partners Group’s** 2020 Corporate Sustainability Report explains how the manager conducted 60 ESG engagements with its portfolio companies and assets, each consisting of several individual projects. These efforts delivered a reduction of over 1.5 million metric tons of CO2 emissions, recycled more than 29,000 tons of waste and reduced energy consumption by over 55 GWh across the Partners Group investment portfolio;
- **Legal & General** supported shareholder proposals at Exxon Mobil for alternative directors, and at Chevron and ConocoPhillips to set targets for emissions associated with the use of their products;
- The **Carbon Disclosure Project (CDP)**, which SPF supports, provided its new report, From Action to Impact: How Companies are Reducing Emissions at Scale with Science-Based Targets. This is the first study to look at how setting science-based targets correlates with corporate emissions reductions and the extent to which companies are delivering on those targets; and
- **SPF** submitted an annual Stewardship Report to the Financial Reporting Council (FRC) in line with the requirements of the new **UK Stewardship Code 2020**.

Further details of these and other activity are set out in Appendix 4.

8 Policy and Resource Implications

Resource Implications:

<i>Financial:</i>	None
<i>Legal:</i>	None
<i>Personnel:</i>	None
<i>Procurement:</i>	None

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

Equality and Socio Economic Impacts:

<i>Does the proposal support the Council’s Equality Outcomes 2017-22</i>	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
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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.

Climate Impacts:

Does the proposal support any Climate Plan actions? Please specify:

N/A.
Monitoring report.
Strathclyde Pension Fund's Climate Change strategy is being developed in line with Item 34 of the Council's Climate Action Plan.

What are the potential climate impacts as a result of this proposal?

N/A.

Will the proposal contribute to Glasgow's net zero carbon target?

N/A.

Privacy and Data Protection impacts:

None.

9 RECOMMENDATIONS

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

Appendices

Appendix 1 Performance Analysis

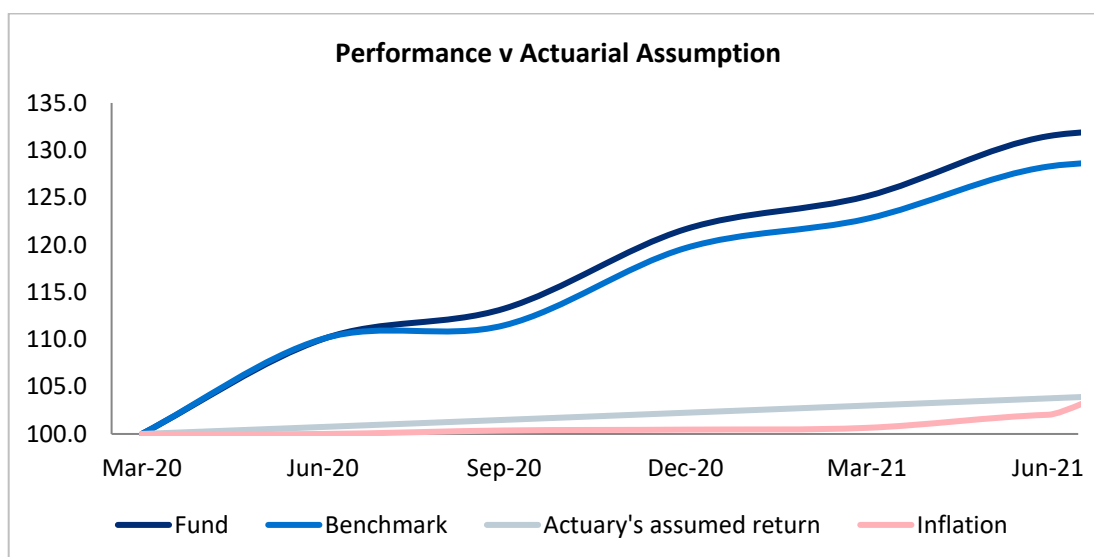
Appendix 2 Portfolio Summary as at 31st July 2021

Appendix 3 Note of Investment Advisory Panel meeting on 12th August 2021

Appendix 4 Summary of Responsible Investment Activity

Performance Analysis

1 Investment Performance vs Actuarial Assumption



As at the end of Quarter 2 2021, the Fund had achieved a return significantly greater than the actuarial assumed return of **+3.0%** per annum since the 31st March 2020 valuation.

2 Performance by Asset Category

Asset Class	Latest Quarter			1 Year		
	Fund %	Bench mark %	Relative %	Fund %	Bench mark %	Relative %
Equity	7.2	7.0	0.2	30.4	30.0	0.3
Hedging & insurance ¹	4.9	3.9	0.9	(3.6)	(4.4)	0.9
Credit	3.3	3.3	0.0	1.4	1.4	0.0
Short term enhanced yield	1.2	1.2	0.0	9.8	4.0	5.7
Long term enhanced yield	1.7	1.7	0.0	1.0	2.5	(1.4)

¹Portfolio divested June 2021. Performance for part quarter.

3 Performance by Investment Managers

Each of the Fund's investment managers has an individual portfolio benchmark. In Quarter 2:

- 12 managers outperformed their benchmark; and
- 9 managers underperformed.

Equity was the best performing asset class in Quarter 2, returning **+7.2%**, ahead of the benchmark of **+7.0%**. **Pantheon** and **Partners Group** private equity portfolios outperformed their benchmarks and the **JP Morgan** global small cap portfolio also outperformed. The most significant detractor from the Fund's equity performance was **Oldfield** as value stocks underperformed in the quarter.

Short term enhanced yield returned **+1.2%**, matching benchmark performance. **PIMCO** and **Ruffer** both underperformed, while the strongest performers were **Ashmore** and the **Barings Multi-Asset Credit** portfolio.

Long term enhanced yield returned **1.7%** over the quarter, in line with the benchmark. **DTZ** and **JP Morgan** outperformed, while the **Partners Group** global real estate portfolio underperformed.

4 **Direct Investment Portfolio (DIP)**

As at the end of June 2021, DIP comprised **51** investment commitments, totalling **£1,703m**. During Quarter 2 2021, **net drawdowns** to DIP amounted to **£53m**. These brought the **Net Asset Value** of DIP to **£988m** at the end of the quarter.

Portfolio performance to 30th June is as follows.

	Q4 2020 (%)	1 year (%)	3 years (% p.a.)	5 years (% p.a.)	Since Inception (% p.a.)
DIP	1.6	-0.1	2.8	4.8	7.1
DIP Benchmark*	1.2	3.9	3.8	2.5	1.6
SPF Total Fund	5.1	19.5	9.1	10.6	11.4

Source: Northern Trust

* CPI +3% pa from 2019; previously LIBOR

DIP's quarterly performance was positive following the effect of increased power prices on the renewable energy funds, plus the reversal of a number of precautionary provisions in the growth/debt capital funds put in place at the start of the COVID-19 pandemic. Longer term performance is ahead of benchmark, though some way behind SPF Total Fund performance which is driven mostly by equity returns.

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

- **44** investments are rated **green** (increase of 5)
- **3** are **amber** (decrease of 2) and
- **None red.**
- **4** are in legals

Portfolio Summary as at 31st July 2021

	Equity		Hedging & Insurance		Credit		Short Term Enhanced Yield		Long Term Enhanced Yield		Total		Target
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%	%
L&G	7,733	28.2%	0	0.0%	1,445	5.3%					9,179	33.4%	31.5%
Baillie Gifford	2,424	8.8%									2,424	8.8%	7.5%
Lazard	876	3.2%									876	3.2%	2.5%
Oldfield	755	2.7%									755	2.7%	2.5%
Veritas	844	3.1%									844	3.1%	2.5%
Lombard Odier	478	1.7%									478	1.7%	1.0%
JP Morgan	1,022	3.7%							568	2.1%	1,590	5.8%	5.5%
Genesis	510	1.9%									510	1.9%	1.5%
Pantheon	1,258	4.6%									1,258	4.6%	5.0%
Partners Group	896	3.3%					136	0.5%	372	1.4%	1,404	5.1%	6.0%
PIMCO							1,010	3.7%			1,010	3.7%	4.0%
Ruffer							527	1.9%			527	1.9%	2.0%
Barings (multi-credit)							735	2.7%			735	2.7%	2.8%
Oak Hill Advisors							487	1.8%			487	1.8%	1.8%
Barings (private debt)							485	1.8%			485	1.8%	1.3%
Alcentra							359	1.3%			359	1.3%	1.3%
ICG Longbow							161	0.6%			161	0.6%	1.0%
Ashmore							503	1.8%			503	1.8%	2.5%
DTZ									2,224	8.1%	2,224	8.1%	10.0%
DIP	72	0.3%					122	0.4%	830	3.0%	1,025	3.7%	7.0%
Cash							638	2.3%			638	2.3%	1.0%
Total	16,870	61.4%	0	0.0%	1,445	5.3%	5,162	18.8%	3,994	14.5%	27,471	100.0%	100.0%
Target		52.5%		1.5%		6.0%		20.0%		20.0%		100.0%	

Investment Advisory Panel Meeting 12th August 2021INVESTMENT ADVISORY PANEL
Held via MS TeamsMINUTES OF MEETING ON Thursday 12th August 2021

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

1. Minutes from Last Meeting & any Matters Arising

The minutes of the Panel meeting on 13th May 2021 were agreed to be an accurate record.

Officers of the Fund updated the Panel on the transition activity that had taken place during Quarter 2 2021 to implement the strategy changes agreed by Committee at its March meeting.

The Baillie Gifford and the L&G portfolios transitioned to their new benchmarks in late May/ early June. The overall costs of these changes were within the ranges estimated pre-transition. The Baillie Gifford transition came in under estimate at \$3.9m. L&G changes came in slightly above the central transition cost estimate at £8m due to a higher than expected cost of trading in Asia, although the requirement to implement futures trading the week before the transition, due to the scale of the positions needed, led to a gain of £5.3m.

The sale out of index-linked gilts and the 1% allocation switch between PIMCO and Ruffer were also completed over May and June 2021.

The Fund has formally increased its commitment to the JP Morgan Infrastructure Investments Fund. There is currently a commitment queue, and the expectation is that the additional commitment will be drawn down in 3-6 months' time.

2 Monitoring**2.1 Quarterly Investment Performance Review (Main Fund)**

The Fund's return for Q2 2021 was positive (+5.1%), and above benchmark (+4.5%). Performance for the year to 30th June 2021 was positive (+19.5%), and above benchmark (+16.5%). Both absolute and relative performance are

Investment Advisory Panel Meeting 12th August 2021

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 Investment Manager Annual Fee Review

The Panel reviewed a summary of investment manager fees and costs for the financial year 2020/21 together with 1 and 5 year manager performance data.

Total expenses for 2020/21 were £204m (2019/20: £119m) in line with the Fund's accounts. Expenses included all invoiced fees, together with estimates of pooled fees, performance fees, transaction costs and other expenses in accordance with CIPFA guidance. The total represented 0.81% of average investment value (2019/20: 0.55%). The allocation of the Fund's investments has shifted in recent years, in line with strategic objectives, to include greater exposure to asset classes with higher fees. Total costs had increased as a result of the increase in Fund value over the financial year (£26.2bn at 31/03/21 vs £20.9bn at 31/03/20) and also as a result of the performance fees payable on some mandates that had exceeded return targets over the period.

Overall, the Panel was comfortable that the fees and costs incurred in 2020/21 were largely as expected for a fund of Strathclyde's size and structure and reassured to see that there was some correlation between fees and performance - that is that higher fees were only paid for higher performance. There was one exception however, PIMCO, where the fee paid in 2020/21 seemed above the market norm for an absolute return bond strategy, and disproportionate to the manager's performance. The Panel asked Hymans Robertson to prepare an overview of alternative absolute return bond funds available in the market that may be suitable for the Fund together with a summary of the fees payable on such strategies.

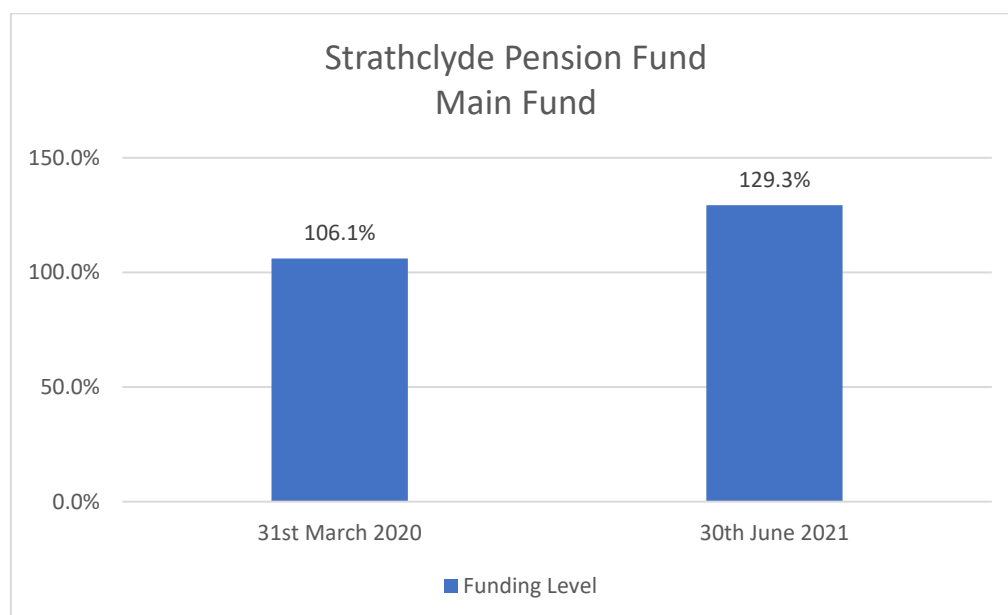
2.4 Direct Investment Portfolio Monitoring Report

The Panel reviewed the quarterly monitoring report for the Direct Investment Portfolio (DIP). Overall the portfolio and most of its investments are still progressing well. On a Red, Amber, Green (RAG) analysis:

- 44 investments were rated green
- 3 amber and
- None red.

2.5 Estimated Funding Levels

Hymans Robertson provided the following estimates of the funding levels as at 30th June 2021. The funding level had increased significantly since the 31st March 2020 actuarial valuation.

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3 Allocation

3.1 Private Market Allocations

The Panel reviewed a schedule of estimated cash flows for the Fund's private market investment programmes - private equity, global real estate, the Direct Investment Portfolio, and private debt commitments. Totals as at 30th June 2021 were as follows.

	2021 Estimate (£m)	2021 Actual YTD (£m)
Distributions	820	306
Calls	-1,162	-530
Net	-342	-224

The projected net cash flows to private markets programmes in 2021 is **(£342m)**. This projection has decreased from initial manager forecasts of **(£450m)**. The change is largely a result of revised distribution expectations for the Fund's two private equity portfolios following an increase in investment exits agreed or forecasted, including a £115m distribution (original investment £25m) anticipated from a single company investment made via co-mingled funds and SPF's specialist co-investment vehicle with Partners Group.

The Fund's private real estate, private debt and Direct Investment portfolios are still building their investment exposure and drawdowns to these investments are expected to exceed distributions from them.

The Fund's central cash balance at 30th June 2021 was **£642m**. This had increased by **£326m** since March 2020. During Quarter 2 2021, **£100m** was received from rebalancing activity. In order to implement the new investment

Investment Advisory Panel Meeting 12th August 2021

strategy agreed by Committee in March, the L&G emerging market future position was unwound and the Fund's holding in the L&G index-linked fund sold, with proceeds held in cash. **£180m** was divested from PIMCO to bring its portfolio weight in line with a revised target of 4% of total Fund and **£280m** invested in the Ruffer absolute return fund to increase the Fund's allocation to 2% of total Fund. The remaining outflows over the quarter were from net drawdowns to private market programmes.

3.2 Rebalancing Strategy

The Panel had a detailed and lengthy discussion on the re-balancing report as at 30th June 2021.

- Equity allocation is above target weight (61.1% vs 52.5%) but within the upper target range (42.0% to 63.0%).
- Short term enhanced yield (STEY) is under target weight (16.3% vs 20.0%) and under target range (17.5% to 22.5%). The STEY underweight is largely a result of the continued build-up of private debt portfolios and the strong performance of equity markets relative to short term enhanced yield mandates.

The Panel agreed that the LGIM market cap equity portfolio equity (21.4 vs 18.0%) should be trimmed by £100m and reallocated to Ashmore (1.9% vs 2.5%) in order to bring allocations for both mandates back within their target ranges.

- Genesis (2.0%) is also at the upper limit of the target range for its portfolio (1.0% to 2.0%). However, the board of the Genesis Emerging Markets Fund (GEMF) through which the Fund invests approximately 48% of the Genesis mandate, has just announced significant changes to the management of the Fund and so the Panel agreed to await additional information on the changes at GEMF before taking further action on the Genesis portfolio.
- Hedging and Insurance is underweight (0.0% vs 1.5%) following the recent sale of the LGIM index linked allocation for cash. The Panel agreed to revisit this asset allocation following the additional paper to Committee in September on the review of the rebalancing strategy, including the proposed implementation of a relative value framework for protection assets.
- Long term enhanced yield (LTEY) is underweight (14.2% vs 20.0%) and under target range (17.5% to 22.5%). Global infrastructure is underweight (2.1% vs 2.5%) but this position should be corrected when the additional £250m commitment agreed as part 2021 strategy review has been drawn down by the manager. UK and global property is also currently underweight (9.4% vs 12.5%). The UK property portfolio is under target (8.0% vs 10.0%) and the manager, DTZ, continues to re-invest rental income to increase the Fund's allocation. Partners Group is under target (1.3% vs 2.5%) but total commitments to the value of 1.4% of total Fund remain undrawn by the manager. The Panel will discuss LTEY rebalancing further in November when Partners Group are due to present to the Panel.

Investment Advisory Panel Meeting 12th August 2021**4 Governance****4.1 Strathclyde Pension Fund Committee**

The Panel noted the draft agenda for the next committee meeting on Wednesday 8th September 2021.

5 Investment Strategy and Structure**5.1 Emerging markets allocation****5.1.1 Genesis**

Genesis have managed a specialist emerging markets strategy for the Fund since 1995. The strategic target for this mandate is 1.5% of total Fund and exposure is made up of holdings in two underlying vehicles: the Genesis Emerging Markets Fund (GEMF) and the Genesis Emerging Markets Investment Company (GEMIC), split approximately 48% and 52% respectively.

On 1 July 2021, Genesis wrote to investors informing them of intended changes to the strategic approach underlying GEMF. The Board of GEMF has decided to expand the investment strategy to allow for investing in unlisted companies and to allow the use of tactical leverage (long/short positions through derivatives). This is not in keeping with the broader Genesis investment philosophy and hence the Board has decided to appoint another manager (Fidelity).

Investors in GEMF will vote on the change of manager and the new investment policy at an EGM scheduled to take place in the next few weeks. Shareholders will have the option to sell down all of their GEMF holding but this is subject to a cap of 25% of the GEMF fund as a whole, and at a 2% discount to Net Asset Value (NAV). Sales could therefore end up pro-rated between shareholders depending on demand and the Fund may only be able to sell 25% of its holding.

These changes only affect the GEMF fund and mean that, subject to the outcome of the vote, the Fund could be left with two different investment houses managing its active emerging market allocation.

The Panel:

- reviewed a paper from Hymans Robertson, outlining the developments at Genesis and the options available to the Fund and
- received a presentation from Genesis, where the performance of the Fund's mandate was reviewed in addition to the developments at GEMF.

The Panel were particularly concerned that the change of investment strategy proposed by the GEMF board represented a significant departure from the current approach, and that the Fund may end up with a manager it did not choose for this part of the emerging market allocation.

The Panel discussed at length the options that may be available to the Fund. They agreed that an exit from GEMF would be the Fund's preferred option and that officers should write to the board to request that they facilitate this. The

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Panel will review the options again at its meeting on 8th September 2021, when the Fund should have received a response to its request.

5.1.2 RAFI allocation

As part of the 2020/21 review of investment strategy, the Fund agreed to review alternative indices, including low carbon versions of the RAFI approach to passive investment managed by Legal and General (L&G).

The Committee agreed at its June meeting that the Fund should switch the current RAFI Global Allocation to the RAFI Fundamental Climate Transition Index when it becomes available. A paper from Hymans Roberson updated the Panel on the launch plans for this new strategy. L&G have confirmed that they are planning for the new CTI fund to launch in Q4 2021.

The focus of the Hymans paper was an update of options to achieve more meaningful decarbonisation in relation to the Fund's RAFI Emerging Markets Fund exposure. This currently makes up 11% of the RAFI mandate or 0.7% of total Fund. L&G have confirmed that a pooled fund version of the RAFI CTI approach for Emerging markets is not available. The Fund would therefore have to set up a bespoke vehicle for such a mandate, in which it would be the sole investor. This could be more expensive and the Fund will need to work further with L&G to fully understand the possible consequences of such an approach.

The Panel discussed two further options for the RAFI EM exposure, both of which could achieve a meaningful decarbonisation of the Fund's holding:

- Switch it into L&G's market cap passive emerging markets fund
- Switch it into the active emerging markets mandate with Genesis. The situation at GEMF would need to be resolved before the Fund could consider this a preferable alternative, however.

The Panel will discuss the options for the RAFI EM holding further at its November meeting, when the outcome of the GEMF EGM will be known. In the meantime, officers will discuss implementation considerations of the two potential passive options with L&G.

5.2 Investment strategy: review of rebalancing strategy, including relative value framework for protection assets

The current rebalancing strategy was approved by the Committee at its meeting in March 2017. Since then, the Fund has agreed and implemented a number investment strategy and structure changes. At the latest strategy review, the Fund also agreed to progress work on a relative value framework for medium term allocation across the Fund's hedging insurance and credit, together 'protection', assets.

Hymans Robertson presented a paper which reviewed the current rebalancing strategy and outlined a relative value framework for protection assets. The

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paper illustrated that in addition to ensuring that the Fund does not diverge too far from the long-term investment strategy and structure agreed by the Committee, rebalancing had the scope to add some value. The Panel agreed that the rebalancing framework should be maintained and that the minor changes suggested by Hymans to account for strategy changes should be adopted.

The Panel was also supportive of the introduction of the relative value framework presented in the Hymans paper as a means to minimise loss and to increase potential capital gain from the Fund's Hedging and Insurance and Credit allocations.

Details of the review of rebalancing strategy and the proposed relative value framework are presented in a separate paper to Committee for approval.

5.3 Climate Change Strategy: Initial Assessment of Energy Companies

The Panel noted the draft committee paper on initial findings of an assessment of energy sector companies in SPF portfolios.

5.4 DIP Review: Local Investment

The Panel noted the draft sounding board paper on Direct Investment Portfolio local investment.

6 Manager Reviews

In addition to Genesis, the following investment managers attended the Investment Advisory Panel:

- **Alcentra**
- **ICG-Longbow**

Performance of each of the managers was reviewed.

Alcentra

The Alcentra portfolio is currently valued at £359m, or 1.3% of total Fund, versus a target weight of 1.3%. Alcentra provided an update to the Panel on the Fund's existing investment in Alcentra European Direct Lending Funds II and III, and Strathclyde Private Debt SMA.

ICG-Longbow

The ICG Longbow private real estate debt mandate began investment in Quarter 4 2019. The mandate is currently valued at £154m, or 0.6% of total Fund, versus a target weight of 1.0%.

ICG-Longbow provided an update on the performance of new investments in its Senior Debt I LP fund and in Partnership Capital Fund V. Investment of the mandate is proceeding at the expected pace with 77% of the Fund's commitment drawn.

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The Fund's commitment of £200m to the 2 ICG Longbow funds was set when the Fund value was around £20bn. In order to attain the target weight of 1.0% of total Fund an increase to this commitment is required. Initial modelling from ICG Longbow showed that an additional commitment of £100m, split between the Partnership Capital VI fund and Senior Capital fund V, would increase exposure so that the Fund could achieve its target allocation of 1.0% in Q3 2022. The Panel agreed, however, that it was unlikely that this target exposure could be maintained much beyond Q3 2022 without a commitment greater than £100m, as distributions from investments were likely to soon reduce exposure again.

Officers will work with ICG Longbow to model total additional commitments of up to £150m with a view to agreeing the optimum amount for achieving and maintaining investment levels at the Fund's target allocation.

Responsible Investment Activity Q2 2021

Responsible Investment: Quarter 2 2021

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

In quarter 2 the Fund's private equity manager, **Partners Group**, provided its 2020 Corporate Sustainability Report. The report explains how Partners Group created positive impact from environmental, social and governance (ESG) factors throughout its investment portfolio in 2020 and provided updates on key corporate sustainability metrics. Partners Group conducted 60 ESG engagements with its portfolio companies and assets, each consisting of several individual projects. These efforts delivered a reduction of over 1.5 million metric tons of CO2 emissions, recycled more than 29,000 tons of waste and reduced energy consumption by over 55 GWh across the Partners Group investment portfolio.

Partners Group are committed to working towards net zero carbon emissions across their entire organization and managing the investment portfolio towards the goals of the Paris Agreement. Their group-wide Climate Change Strategy outlines the approach towards achieving these goals, highlighting how they manage climate risks and impacts across the firm and the investment portfolio. Partners Group have embedded this strategy into the key stages of their investment and ownership process from sourcing and due diligence through ownership to exit. The strategy also aligns with the Task Force on Climate-related Financial Disclosures' (TCFD) recommended disclosures.

The report also detailed Partners Group's efforts to support their stakeholders throughout the COVID-19 crisis. A CHF 10 million Portfolio Employee Support Fund was set up to support portfolio company employees, whose health, income, expenses and/or families were impacted by the COVID-19 pandemic. As of December 2020, the fund had supported over 12,000 portfolio company employees and addressed needs including increased childcare or remote learning costs, COVID-19 related medical expenses and shortfalls in household income.

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 June 2021 is summarised as follows.

Voting activity to 30th June 2021		
		(%)
Total meetings	3,814	
Votes for	41,617	81
Votes against	8,847	17
Abstentions	511	1
Not voted	445	1

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No. of Resolutions	51,420	100
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Voting activity in the quarter included:

- **Legal & General** supported shareholder proposals at **Exxon Mobil** for alternative directors, as the proposed candidates would make a positive contribution to board effectiveness and oversight as the company was falling behind global peers by failing to act on climate change. Legal & General also voted against the chair of the remuneration committee who was not reappointed to the board. Shareholder proposals to set targets for emissions associated with the use of their products were also supported at oil majors **Chevron** and **ConocoPhillips**. At the **General Electric** AGM, Legal & General voted for a shareholder resolution requesting that the company report on its progress towards achieving a target of net zero greenhouse gas emissions by 2050. 98% of investors supported the resolution. Also in the US, Legal & General supported a shareholder proposal at **McDonald's Corp** for a Report on Antibiotics and Public Health Costs. The proposed study will inform shareholders and other stakeholders of the negative ramifications of sustained use of antibiotics in the company's supply chain and signal the importance of this topic to the company's board of directors. And at **AT&T** Legal & General voted against remuneration for executive officers as the awards and payments made did not meet expectations of fair and balanced remuneration. In Japan, Legal & General supported shareholder proposals at **Sumitomo Corporation** and **Mitsubishi UFJ Financial Group** calling for the companies to adopt and disclose plans to align their businesses with the goals of the Paris Agreement. In the UK, Legal & General voted against approving the remuneration report at **Rio Tinto**, as further reductions in the exit package awarded to the outgoing CEO would have been appropriate given the destruction of the heritage site at Juukan Gorge. Also in the UK, Legal & General supported a resolution at **HSBC Holdings** to strengthen climate change policies and disclosure. The resolution commits HSBC to work towards a net-zero future and to set, disclose and implement short and medium-term targets and implement a phase-out policy for financing new fossil fuel projects.
- **Baillie Gifford** opposed two resolutions relating to remuneration at multinational food-products company **Danone** because they did not believe the performance conditions to be sufficient. At the French corporate service company, **Edenred**, Baillie Gifford opposed the remuneration policy due to low performance targets and the remuneration report which attempted to retrospectively amend targets without shareholder consultation. Baillie Gifford also opposed the remuneration reports at **Kingspan Group** and **Rio Tinto** due to concerns regarding the treatment of executive severance payments. In the US, Baillie Gifford supported a shareholder resolution requesting a climate transition report at US travel technology company **Booking Holdings Inc.** Baillie Gifford engaged with the company ahead of the AGM explaining to them the need to disclose emissions data and outline

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targets and a strategy to reduce its carbon footprint. The resolution passed with 56 per cent support.

- **Oldfield Partners** voted against remuneration for executive officers at **ENI** in response to inappropriate COVID-related changes to the 2020 performance objectives and termination payments. Oldfield supported shareholder proposals at **Mitsubishi UFJ Financial Group** calling for the company to adopt and disclose plans to align their business with the goals of the Paris Agreement.
- In the US, **Veritas** supported a shareholder proposal at **Facebook** to require an independent board chair. The recent data privacy incidents and subsequent controversies suggest that shareholders would benefit from the most robust form of independent board oversight, in the form of an independent board chair. Also in the US, Veritas voted against remuneration for executive officers at **Alphabet Inc.** as the stock plan cost is excessive and at healthcare provider **Illumina Inc.** as remuneration is not aligned with shareholders best interests.
- **J.P. Morgan** voted against approving the management incentive plan at UK retailer **Boohoo Plc.** due to the potential significant payout opportunity for management while its Agenda for Change Programme is still in its premature stage.
- **Lombard Odier** voted against executive remuneration at **Oxford Biomedica Plc.**, **PureTech Health Plc.** and **Medica Group Plc.** as their remuneration approaches and alignment with shareholder's interests is not sufficient.

2.2 Engagement

Engagement highlights during the quarter include the following.

- **Sustainalytics** provided a report on concluded engagement with the German multinational pharmaceutical company **Bayer AG** (Oldfield Partners). The engagement objective was to ensure that Bayer has suitable systems for identifying and communicating the side effects of its products to regulators, health professionals, and patients. Bayer has faced multiple litigations related to health impacts connected to three of its pharmaceutical products and to date has paid out over USD 2.04 bn in settlements. In response Bayer has increased its level of disclosure and made its clinical trial data available to healthcare professionals and the public, in addition to meeting regulatory requirements. Bayer also set up an independent Sustainability Advisory Council (SAC) of external experts to further develop the company's sustainability. The company also has a global pharmacovigilance department, which works with regulators around the world after a product is launched. Ongoing safety information is compiled using Post Authorisation Safety Studies (PASS), which is entered in the European Union's PASS Registry. Based upon

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these developments and the case settlements Sustainalytics consider the case to be resolved.

- **Baillie Gifford** continued ongoing dialogue with French beverage company **Pernod Ricard** regarding plans for executive remuneration and sustainability. The company is progressing with establishing a standalone sustainability committee at the board level. This group will be responsible for oversight and direction of Pernod's approach to environmental and social initiatives and will be led by a senior independent director. The company has also strengthened its emissions reduction targets. It now aims to be net-zero for scope one and two emissions by 2030, as well as cutting scope three intensity by 50 per cent over the same period. These targets demonstrate the company's intention to reduce emissions across its value chain, contributing positively to the objective of limiting global warming to 1.5-degrees above pre-industrial levels.
- **J.P. Morgan** engaged with UK retailer **Boohoo Plc** regarding its supply chain and working conditions. Boohoo has been under the spotlight to establish stringent policies and procedures on its supply chain and working conditions, since the allegations surfaced of labour issues and poor working practices at its factories. Subsequently, since an independent review, they have introduced an Agenda for Change Programme. Boohoo announced a series of changes towards their governance and supply chain management processes, where a list of T1 and T2 suppliers have been named and they have appointed a Sustainability professional to lead the projects of maintaining their supplier list and created a detailed audit process. J. P Morgan have had extensive engagement with the company and acknowledge that Boohoo have made some promising changes. However, at the recent shareholder AGM, JP Morgan voted against approving the management incentive plan, due to the potential significant pay out opportunity for the management board. Since the Agenda for Change programme is still in its premature stage such changes to compensation package are not appropriate.

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 Chinese multinational technology conglomerate company **Tencent Holdings** (Lazard) regarding allegations of surveillance and user content censorship. The Chinese government requires the monitoring, filtering, and censorship of Internet traffic by Internet service providers operating in the country. Tencent operates social media, messaging, gaming, music, and cloud services. Its multi-purpose messaging platform, WeChat, is considered a "super app" and dominates the Chinese market with approximately 1.2

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billion monthly active accounts. Tencent reportedly complies with the government's restrictions by censoring private chats, including those of users outside China. Purportedly, authorities have unrestricted access to user communications. While compliance is not unexpected, the absence of human rights due diligence presents a preparedness gap. Sustainalytics will initiate dialogue with the company to understand the steps it is taking to protect the relevant human rights of its users, especially privacy and freedom of expression.

- **Baillie Gifford** engaged with Irish building materials company **CRH Plc.** to get an update on the company's decarbonisation strategy. The company has continued to innovate, particularly with alternative fuels, which has enabled them to continue to reduce their carbon emissions. They have set a target to be carbon neutral by 2050. An industry roadmap is due to be published later in the year which is likely to provide greater clarity on the technological advancements that will be material for the cement industry achieving carbon neutrality. How CRH achieve their 2050 target is likely to become clearer after the roadmap is published. Baillie Gifford engaged with **Ryanair** to discuss the progress of the company's decarbonisation strategy. The company has submitted its carbon emissions data to the Carbon Disclosure Project (CDP) for external verification and has announced a sustainable aviation fuel target for 2030, as well as a partnership with Trinity University to research sustainable aviation fuel. Baillie Gifford also engaged with Canadian multinational e-commerce company **Shopify** to learn more about their approach to positive climate influence across the ecommerce value chain. Shopify reports its direct emissions and runs both its own and cloud-related activities on 100 per cent renewable power. Just as importantly, it is a direct investor in carbon reduction and removal innovators. Shopify is exploring ways to accelerate its offer of lower-carbon warehousing and distribution. The company also acknowledged that it may be able to deploy the deep dataset it is gathering on ecommerce purchases to further educate and empower consumers on product carbon footprints.

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 29 of the 31 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.
- Officers of the Fund completed the annual PRI reporting and assessment survey in quarter 2. This online questionnaire is compulsory for all asset

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owner and investment manager signatories and contains questions covering implementation of the Principles and responsible investment activities. An assessment report is expected in quarter 3. This report will demonstrate how a signatory has progressed in its implementation of the Principles year-on-year and relative to peers across asset classes.

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. Working with ShareAction and others, the Fund has carried out direct collaborative engagement across a range of initiatives. It is also a member of industry collaborative forums including the Local Authority Pension Fund Forum, the Institutional Investors Group on Climate Change and the Carbon Disclosure Project (CDP).

- **CDP** provided their new report, *From Action to Impact: How Companies are Reducing Emissions at Scale with Science-Based Targets*. This is the first study to look at how setting science-based targets correlates with corporate emissions reductions and the extent to which companies are delivering on those targets. The findings include:
 - The typical company with science-based targets has reduced its direct emissions by 6.4% per year from 2015-2019 since setting its target.
 - The rate of adoption of science-based targets doubled in 2020 versus the period 2015-2019.
 - Corporate ambition is rising, with 1.5C the new goal: 41% of all companies with science-based targets have 1.5°C-aligned scope 1 and 2 targets.

In 2020 the Fund joined with 137 other financial institutions to back the CDP 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 were targeted and combined they are the source of Scope 1 and 2 emissions equivalent to 25% of total global emissions. The Action to Impact Report is available at:

<https://sciencebasedtargets.org/resources/files/SBTiProgressReport2020.pdf>

- The **Local Authority Pension Fund Forum (LAPFF)** provided a Quarterly Engagement Report. The report highlights include:

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- Engagement with **Shell**, pushing for a clearer transition path towards net zero by 2050. In May a Dutch Court concluded that Shell's plans were inadequate on each of the points that LAPFF had highlighted.
- Continued engagement with **National Grid**, which has now set a Scope 3 target to reduce carbon emissions 37.5% below the 1990 baseline by 2034.
- 'Say on Climate' engagement, with a number of resolutions being put forward to company AGMs this year including **Shell, ArcelorMittal, Exxon Mobil** and **Mitsubishi UFJ Financial Group**
- Mining and Human Rights engagement and attendance at AGMs including **Rio Tinto, Anglo American, Glencore** and **BHP**. Community engagement around these issues has also continued, particularly with those affected by the Mariana and Brumadinho dam collapses in Brazil.
- Engagement with companies identified last year as operating in the Occupied Palestinian Territories.
- Continued engagement on diversity with LAPFF joining the City of London's Taskforce on Socio Economic Diversity.

The LAPFF Quarterly Engagement Report is available at:

<https://lapfforum.org/publications/category/quarterly-engagement-reports/>

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

- Legal & General, Lazard, Baillie Gifford, JP Morgan, Lombard Odier, 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 Fund co-signed The Investor Agenda **2021 Global Investor Statement to Governments**. This statement delivers the strongest-ever investor call for governments to raise their climate ambition and implement robust policies. This statement, coordinated by the seven founding partners of The Investor Agenda including the **Institutional Investors Group on Climate Change (IIGCC)**, was signed by 457 investors representing over USD \$41 trillion in assets. The joint statement to all world governments urges a global race-to-the-top on climate policy and warns that laggards will miss out on trillions of dollars in investment if they aim too low and move too slow. The statement also sets out five actions governments need to urgently undertake:
 - Strengthen Nationally Determined Contributions for 2030 in line with limiting warming to 1.5°C.
 - Commit to a mid-century net zero emissions target with clear sectoral decarbonisation roadmaps.

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- Ensure ambitious pre-2030 policy action including strengthened carbon pricing, phasing out fossil fuel subsidies and thermal coal-based power, avoiding new carbon-intensive infrastructure (no new coal power plants) and developing just transition plans.
- Ensure COVID-19 economic recovery plans support the transition to net zero emissions.
- Commit to implementing mandatory climate risk disclosure requirements.

The full statement and list of current signatories is available at: <https://www.iigcc.org/resource/2021-global-investor-statement-to-governments-on-the-climate-crisis>

- In quarter 2 the Fund submitted an annual Stewardship Report to the Financial Reporting Council (FRC) in line with the requirements of the new **UK Stewardship Code** (2020). 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. Organisations wanting to become signatories to the Code are 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.