Report to:	**PENSION FUND MANAGEMENT PANEL**
Date:	23 March 2018
Reporting Office:	Sandra Stewart, Director of Pensions Tom Harrington, Assistant Director of Pensions (Investments)
Subject:	**INVESTMENT STRATEGY STATEMENT**
Report Summary:	The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1 November 2016. The Regulations required that the Fund publish an Investment Strategy Statement by 1 April 2017. An 'interim' Investment Strategy Statement was agreed and adopted following consideration by the Panel at their meeting of 10 March 2017. Following a detailed review, a draft Investment Strategy Statement was considered by the Working Group at their meetings on 13 October 2017 and 19 January 2018. At their meeting on 19 January 2018, the Working Group considered comments received on the draft Investment Strategy Statement following a public consultation period and subsequent changes proposed to the draft Investment Strategy Statement. The Working Group has endorsed the draft Investment Strategy Statement. A small number of additional minor amendments have subsequently been made to the draft Investment Strategy Statement to reflect recent changes in management arrangements. The draft Investment Strategy Statement is attached as **Appendix A**.
Recommendation(s):	That the Panel adopt the updated draft Investment Strategy Statement.
Financial Implications: **(Authorised by the Section 151 Officer)**	Maintaining a low, stable employer contribution rate is dependent upon good absolute and relative performance from the Fund's investments. The Investment Strategy Statement documents how GMPF addresses achieving this objective.
Legal Implications: **(Authorised by the Solicitor to the Fund)**	The Fund has a duty to review the Investment Strategy Statement when necessary and to consult as appropriate on the content thereof. This report assists in fulfilling that duty.
Risk Management:	The Investment Strategy Statement has at its heart an in-depth consideration of risk as faced by the Fund.

ACCESS TO INFORMATION:	**NON CONFIDENTIAL**
	This report does not contain information which warrants its consideration in the absence of the Press or members of the public.
Background Papers	The background papers to this report may be inspected by contacting: Abdul Bashir, Investments Manager, on 0161-301 7154 (email: abdul.bashir@gmpf.org.uk).

1. BACKGROUND – GMPF'S INVESTMENT STRATEGY STATEMENT

1.1 A report was submitted to the 10 March 2017 meeting of the Pension Fund Management Panel, which advised Members that an Investment Strategy Statement was required to reflect the 2016 Regulations, replacing the previous Statement of Investment Principles.

1.2 Given the short timeframe provided by Government, an interim Investment Strategy Statement was agreed and adopted following consideration by the Panel at their meeting of 10 March 2017. At that time, it was intended that a more detailed review of the Investment Strategy Statement would take place over the following 6 to 9 months.

1.3 A detailed review took place prior to the 13 October 2017 meeting of the Working Group. A number of changes were proposed to the Investment Strategy Statement, which are summarised below:

i. Minor changes to account for the appointment and recent funding of the new multi-asset credit manager, Stone Harbor.

ii. Additional wording was included in Section 9 of the draft Investment Strategy Statement to better reflect the policies of the Fund regarding climate change, in particular, the Fund's view on climate risk and the collaborative approach taken to mitigate it.

iii. Section 10 of the draft Investment Strategy Statement was amended to reflect the decision of the Management Panel at its meeting of 22 September 2017 to adopt PIRC's voting guidelines and to delegate execution of proxy voting rights to PIRC. This approach will be implemented over the coming months.

iv. The Appendix to the draft Investment Strategy Statement was updated. The previous limits on Fund investments by investment type have been replaced by prudent asset class limits. The new limits have been specifically designed to provide 'headroom' for the Fund's already approved investment programmes (e.g. alternative investments), and for 'drift' as a result of market movements.

1.4 The draft Investment Strategy Statement considered at the 13 October 2017 meeting was endorsed by the Working Group.

1.5 Following endorsement by this Working Group, a public consultation on the draft Investment Strategy Statement was held. The draft Investment Strategy Statement was placed on a newly created web page of the Fund's website with alerts and links placed on the 'News and Updates' section as well as the 'Investments' home page. An email alert was sent to all Employers and added to the Employer website. In addition, an alert was sent via the Fund's Twitter account.

1.6 Members of the public were able to submit any comments or feedback via a simple form placed on the newly created webpage for consultation of the Investment Strategy Statement. The consultation ran from 19 October 2017 to 19 November 2017 (inclusive).

1.7 During the consultation period, and following the publication of a report on LGPS holdings in fossil fuel companies by Friends of the Earth and other special interest groups, a number of Greater Manchester Councillors received template emails, calling on the Fund to disinvest from fossil fuel holdings. A copy of the Chair's response to these letters, which comprehensively sets out the context and the Fund's plans in relation to climate change, is attached as **Appendix B**.

1.8 The Fund held a Stakeholder Engagement event on 19 October 2017 at Gorton Monastery. The consultation on the draft Investment Strategy Statement coincided with this event where the public consultation was also publicised.

2. CONSULTATION RESPONSES AND FEEDBACK FROM THE STAKEHOLDER EVENT

2.1 The Fund was pleased to receive 30 distinct responses to the consultation. Of the 30 responses received, 29 related predominantly to climate change, and 1 related to poverty and the Living Wage.

2.2 Of the 29 responses relating to climate change, the main focus of the responses was that the Fund reduce or divest its holdings in fossil fuel companies. There was also a (lesser) focus on the Fund to invest more in green/renewable investments and the view that engagement on climate change has either been ineffective or is not working (thereby providing support for divestment of assets).

2.3 Of the 29 responses relating to climate change, one was submitted by Fossil Free Greater Manchester (FFGM). FFGM submitted a more detailed consultation response attached at **Appendix C**, where they suggest various amendments to the Investment Strategy Statement. In summary, "Fossil Free Greater Manchester continues to call for full divestment from fossil fuel holdings by means of a phased programme of responsible divestment and reinvestment in positive alternatives."

2.4 In October 2017, the Fund held what is believed to be the first LGPS stakeholder engagement and stewardship event with support from the Pensions & Investment Research Consultants Ltd (PIRC). PIRC are Europe's largest independent corporate governance and shareholder advisory consultancy whose objective is to facilitate and support responsible capital stewardship by long-term investors. PIRC's role is to assist the Fund effectively exercise its shareowner rights and to identify and mitigate governance risk in its portfolios and set 'Environmental, Social and Governance (ESG) Criteria'.

2.5 The event, which was open to all stakeholders, provided an opportunity to learn about the Fund's current approach to Responsible Investment and to have an input into shaping the evolution of the future approach. One input was by way of completing a survey. Almost 80% of survey respondents agreed with the Fund's general approach to engage with companies rather than divest from them. There was overwhelming support to the approach that the Fund is taking. The table below sets out the response in favour of the Fund's approach:

To what extent do you agree with the Fund's:	% in support
✓ policy statements represent a positive approach to ESG issues?	83%
✓ approach to its voting policy?	86%
✓ collaborative approach to engagement?	90%
✓ general approach to engage with companies rather than disinvest from them?	76%
✓ approach to measuring climate change risk?	85%
✓ approach to managing climate risk?	85%
✓ approach to holding the Fund Managers to account for their implementation of the Fund's ESG policies?	86%
✓ approach to being transparent on its ESG policies?	91%
✓ broad approach to investing locally with the twin aims of making a positive ESG impact and achieving a commercial rate of return?	92%
✓ approach to direct UK infrastructure investing?	93%
✓ ambition to develop housing in the local area?	90%

2.6 The debate around divestment of assets versus engagement is best addressed via means other than the Investment Strategy Statement (e.g. through membership of forums such as LAPFF) as the Investment Strategy Statement records Fund policy, it does not set Fund policy.

2.7 However, we provide a brief outline of some of the arguments supporting the Fund's policy of engagement rather than divestment of assets when considering climate change in Section 3 below.

3. ARGUMENTS IN SUPPORT OF ENGAGEMENT

3.1 The Fund believes that engagement is far preferable to divesting holdings and passing the problem to somebody else, who may not share our commitment to Responsible Investment. The Fund agrees that there is a place for disinvestment and has previously done this in relation to apartheid South Africa.

3.2 The Fund believes that divestment is a blunt tool and does not necessarily improve or change matters particularly in such a complex area as carbon where every one of us, who drive cars, use washing machines, purchase food which has not been grown locally etc. is responsible to some degree.

3.3 A major influence on investment strategy is the time taken to make the transition to sustainable sources. Historically energy transitions have taken around 50 to 100 years. We believe the urgency due to climate change is likely to accelerate this transition; however, it is still likely to take many years to transition to renewable energy and a sustainable energy mix. Vehicles continue to use petrol, albeit on a reducing basis as we move towards greater use of electric powered vehicles, with a need for that power to come from sustainable sources. So the divestment strategy has to be very different to the case of tobacco where there was no reason to continue direct equity investment.

3.4 In order to move to a sustainable, low carbon energy environment, all sources of renewable energy and financing will play a part. Many of the large fossil fuel producers are already funding leading renewables companies but there is massively more funding from all (governments, institutions, private and public companies) needed.

3.5 Careful consideration needs to be given to stranded assets, in particular, those of downstream industries. The following has been taken from the Fund's Climate Risk Pamphlet:

"In reality, the majority of the fossil fuel assets that will be stranded are uneconomic or barely economic coal reserves and/or tar in places like Canada and Venezuela that wouldn't have been developed until years in the future. Energy companies are valued for their close to production 1P (proven) and 2P (probable) reserves and the near term cash flows which they generate. Therefore the loss of these reserves in even the lowest emission scenarios contemplated by the IPCC and other environmental and planning bodies is unlikely to have a major impact on company valuations."

"If CO2 emissions are limited and this leads to limits in oil production then investors should be looking at the issue of fossil fuel limitation across the entire economy rather than focusing on energy producers.

For example, a large number of consumer and particularly tourism associated business models would be compromised by lower oil consumption, with some of the obvious examples being toll roads, airports, airlines, aircraft manufacturers, and cruise lines. A very large portion of society's infrastructure and capital stock is based on petroleum. These investments have longer lead times than oil investments and could all be left stranded if oil consumption must be curtailed to prevent global warming. To give an idea of the lead times *involved, roads and bridges can last 100 years or more, while airports, aircraft and ships are built with 50 year service lives in mind. These sectors comprise a bigger portion of global market capitalization than energy (currently 7% of global stock market capitalization) and should be a much bigger issue for investors."*

3.6 The Fund acknowledges that it is transitioning and that this needs to be an orderly process to avoid stranded costs and ensure that we continue to deliver affordable and sustainable pensions for employers and taxpayers alike. Active engagement is key in achieving this and ensuring new investments in renewables continues and grows sufficiently to address climate change.

4. UPDATED DRAFT INVESTMENT STRATEGY STATEMENT

4.1 Following the public consultation and feedback from the Stakeholder event, the following changes to the draft Investment Strategy Statement were made:-

- Amendment to paragraph 9.5 (and move the remainder of paragraph 9.5 into a new paragraph 9.7):

  Climate change is a key financially material environmental risk. The Panel believe that, over the expected lifetime of the Fund, climate-related risks and opportunities will be financially material to the performance of the investment portfolio. As such, the Panel will consider climate change issues across the Fund and specifically in areas such as Strategic Asset Allocation, Investment Strategy, Investment Manager Selection and Risk Management with the aim of minimising adverse financial impacts and maximising the opportunities for long-term economic returns on the Fund's assets.

- New paragraph 9.6:

  The Fund's long-term goal is for 100% of assets to be compatible with the net zero emissions ambition by c2050 in line with the Paris Agreement. The decarbonisation goal will be regularly evaluated in line with our objective of maintaining long term financial performance.

- Amendment to paragraph 9.11 (previously shown as paragraph 9.9):

  The Fund actively invests in low carbon and renewable energy technology and will seek to increase the scale of investment in this sector where suitable opportunities arise, in order to encourage a move toward a lower carbon economy. Within the strategic asset allocation to infrastructure, a key strategy is investments in low carbon and renewable energy opportunities.

4.2 Officers believe the above proposals buttress the previous changes made regarding climate change and in particular, provide further clarity of the Fund's policy in this regard.

4.3 More specifically, the amendment to paragraph 9.11 (previously shown as paragraph 9.9) incorporates some wording suggested by FFGM, whilst providing further detail on how the commitment to invest in low carbon and renewable energy technology may be achieved.

4.4 The wording in Section 9 of the Investment Strategy Statement already addresses broader ESG issues (e.g. labour rights and working conditions) without being overly prescriptive. No further changes have been proposed to explicitly address poverty or the Living Wage.

4.5 The draft Investment Strategy Statement was endorsed by the Working Group at their meeting on 19 January 2018.

4.6 A small number of additional minor amendments have subsequently been made to the draft Investment Strategy Statement to reflect recent changes in management arrangements.

4.7 The updated draft Investment Strategy Statement is attached as **Appendix A**.

5. RECOMMENDATION

5.1 That the Management Panel adopt the revised draft Investment Strategy Statement (as Appended to this Report).