Steady State Manchester: Commentary On GMPF Approach To Investment.

Paper for Manchester City Council, Finance Scrutiny Committee, 12 March, 2015.

Background

In September, 2013 Steady State Manchester wrote to the previous chair of Manchester City Council (MCC) Finance Scrutiny Committee to ask for an examination of investments with which the council is associated. We suggested that committee members would be interested to know whether council-related assets are involved in unethical practices (e.g. companies with poor labour practices, poor wage equality, or involvement in areas such as the arms trade, tobacco or the major oil companies), and also to what extent these assets are invested in options that positively create social benefit, for example by supporting local enterprise, sustainable businesses, and social goods such as affordable housing.

It is worth emphasising that, whilst 'ethical issues' is an acceptable shorthand for the concerns we brought to the attention of the committee, both climate change and risks in the financial sector are significant concerns in terms of both the returns and the security of investments. Our overriding concern is that these substantial investments are used to create social value for Manchester, that they are prudent, safe and support economic stability and local economic resilience.

The GMPF is the most significant of the assets concerned, so we are grateful for this opportunity for discussion on its approach.

We have examined the papers tabled with the agenda[1] and also other documentation on the Fund's website, and have the following comments.

Analysis

1) Investment for local benefit: could more be done?

We are encouraged by the Fund's investment in the Greater Manchester Property Venture Fund and especially its aim of making “an environmental impact through regeneration”. However, while we commend the scheme investing £25M, with MCC, to build 240 homes as well as some of the smaller schemes, we would question the extent to which environmental criteria (such as Manchester's goal of cutting carbon emissions) are being applied in the overall selection of projects. We appreciate the longish lead-in time for projects may mean that this may not be immediately apparent.

We suggest then, that the Fund should consider more direct investment in schemes that deliver local prosperity, through job creation while bringing measurable environmental benefits, for example in housing retrofit and renewable energy generation.

In particular the Committee may wish to recommend that the Fund supports the development of renewables in the Region.

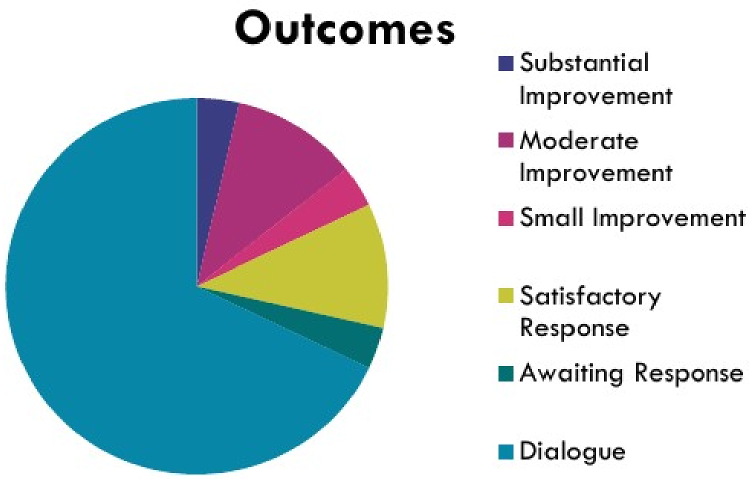
See **Appendix 1**. An alternative to fossil fuel investments: Community Renewables.

1 http://www.manchester.gov.uk/meetings/meeting/2219/finance_scrutiny_committee

2) Is Engagement on ESG issues effective? (Particularly in relation to Fossil Fuels)

While encouraged to know that the Fund is actively engaging with companies over ethical questions, we question the effectiveness of this strategy on its own. The Fund engages with companies (largely via the Local Authority Pension Fund Forum, which councillor Quinn also chairs) . A current focus is on Shell and BP.

We wonder how generally effective this engagement is, however, since the outcomes appear, in the main to be characterised as “dialogue”, as this chart, reproduced from the Forum's 2015 annual report shows.



The intervention with Shell and BP (which are the two largest investments of the Fund, together accounting for 2.25% of the its equity investments), in conjunction with other shareholders (including members of the Church Investors Group) is specifically addressed to the question of carbon emissions. However, it is our contention that this is too incremental an approach to the very real risks that continued exploitation of hydrocarbons will have for pensioners and other citizens.

We know that the larger part of hydrocarbon reserves are “unburnable” if global warming is to be averted[2], yet oil companies are based on their exploitation. Compare the wording of this motion to BP[3] with the **disinvestment** approach of a growing number of public sector and corporate investors[4]:

2 http://www.lse.ac.uk/GranthamInstitute/wp-content/uploads/2014/02/PB-unburnable-carbon-2013-wasted-capital-stranded-assets.pdf

3 From BP plc Papers for the 2015 AGM.

4 Including Bristol City Council, Oxford City Council, University of Glasgow, University of London SOAS, the Society of Friends, Church of England Oxford Diocese, Norway's public sector pension fund and Sovereign Wealth Fund among 180 Institutions worldwide http://www.theguardian.com/environment/2015/feb/13/fossil-fuel-divestment-campaign-grows-as-protesters-target-uk-banks

> "Special resolution – strategic resilience for 2035 and beyond
>
> That in order to address our interest in the longer term success of the Company, given the recognised risks and opportunities associated with climate change, we as shareholders of the Company direct that routine annual reporting from 2016 includes further information about: ongoing operational emissions management; asset portfolio resilience to the International Energy Agency's (IEA's) scenarios; low-carbon energy research and development (R&D) and investment strategies; relevant strategic key performance indicators (KPIs) and executive incentives; and public policy positions relating to climate change. This additional ongoing annual reporting could build on the disclosures already made to CDP (formerly the Carbon Disclosure Project) and/or those already made within the Company's Energy Outlook, Sustainability Review and Annual Report."

We therefore question whether tactics of persuasion are sufficient in protecting the interests of both Fund beneficiaries and of the wider population.

The Committee may wish to consider its position on the fossil fuel investments held by the GMPF. At the minimum it may wish to know what the fund managers' strategy is in relation to 'un-burnable carbon'. They may also wish to recommend full or partial disinvestment.

See **Appendix 2**: The Argument for Dis-investment from Fossil Fuel Related Equities

3) The GMPF approach to ethical investment: in need of an update?

Our reading of the GMPF approach to ethical investment, which dates from 2007 is that it is becoming outdated. It rests upon assumptions about the nature of fiduciary duty that have been challenged in recent years, not just by activist outsiders, but from within the financial services industry itself.

Recent thinking[5] identifies three main ways in which ethical considerations can determine investment strategy and decisions:

a) "If all other things were equal", for example when choosing between two investments, then it would be possible to use ethical criteria as a tie-breaker.

b) Non-financial considerations, i.e environmental, social and governance (ESG) issues, may have a bearing on the performance of an investment. In an influential report, commissioned by the UN Environment Programme, international lawyers Freshfields Bruckhaus Derringer (reviewing the question across several legal jurisdictions, including the UK) concluded that considering these factors is well within the scope of investors' fiduciary duties: , ***"it may be a breach of fiduciary duties to fail to take account of ESG considerations that are relevant and to give them appropriate weight"***[6].

c) There is also the question of the fund's wider responsibility to its beneficiaries. So local authority pensioners in Greater Manchester could be affected by things like climate change, risky hyper-leverage of financial institutions, or the health effects of smoking. So failure to take due consideration of these risks could leave trustees open to the charge of negligence.

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5 e.g. http://fairpensions.org.uk/sites/default/files/uploaded_files/press/ASHfinalbriefing.pdf and http://www.unpri.org/fiduciary-duty/

6 http://d2m27378y09r06.cloudfront.net/viewer/?file=wp-content/uploads/freshfields_legal_resp_200511231.pdf and http://d2m27378y09r06.cloudfront.net/viewer/?file=wp-content/uploads/fiduciaryII.pdf

As an example of a positive ethical approach the Environment Agency's Pension Fund applies what it calls an 'environmental overlay' to its investment decisions[7].

We do not think this is many miles away from the GMPF's developing approach:

> *Our trustees want to build the Great Britain of the future, yet must always make decisions within a fiduciary framework, assessing risks against returns, taking into account the new externalities like climate and carbon. …..*
>
> *In the 21st century, the local authority funds of the future need to be big enough to enjoy economies of scale, diverse enough to spread risk, collegiate in their thinking but remaining connected and committed to their beneficiaries in our regions and cities rather than the perspectives of Canary Wharf or the glass towers a few streets back from the Embankment.*[8]

4) Ethical concerns in the portfolio

In light of the above quoted aspiration, aspects of the portfolio should raise concerns. Just looking at the largest investments, there are multiple causes for concern. In addition to Shell and BP, there are three UK high street banks,[9] three mining companies and an armaments manufacturer. All the extractive companies[10] have been implicated in human rights abuses, some as recently as last year (see our annotated chart in **Appendix 3**). Smaller investments include **Nestlé** and **Hewlett Packard** (both the subject of boycotts), and **Canadian Tar Sands**, one of the most environmentally damaging enterprises on earth).

We understand the argument made about the lower returns of so called "ethical" funds. However, we argue that the approach of leaving most decisions to the discretion of Investment Fund managers is insufficient. It should be possible to both avoid investments in companies with damaging practices, and to positively favour those, like **3i** that are relatively benign or even positive in their impacts, without putting all the Fund's assets in one sector or type of investment vehicle.

Conclusion

In conclusion there are three distinct areas in which the committee may wish to make recommendations:

1) Whether more of the Fund should be directed towards investment for local economic benefit in the region.
2) Whether the Responsible Investment Framework is robust enough for the consideration of broad ESG issues in the holdings and management of the main fund.
3) Whether the Fund's engagement strategy in relation to climate risks should be revised and a degree of disinvestment pursued. (A proportion of the capital released

7 http://www.environment-agency.gov.uk/static/documents/Responsible_Investment_Policy.pdf
8 Cllr K Quinn, Investment Governance Reform is the Key to Infrastructure Funding, Nov. 2014 http://www.lapfforum.org/news/investment-governance-reform-is-the-key-to-infrastructure-funding
9 It is argued that holding equity in large UK banks reinforces the lack of diversity in the Banking sector, and entails new risks in the event of bank failure due to new 'bail in' rules. http://gallery.mailchimp.com/c9b157c9d89ca0bdb156c5128/files/MYM_ToolKit_Final.pdf
10 Extractive companies: those whose primary focus is mining, quarrying, or other mineral exploitation (e.g. oil and gas).

could be made available for support for community or commercial renewables in the region).

Accordingly, Committee is invited to consider the following specific recommendations, which could be pursued by MCC's representative on the GMPF's Advisory Panel.

1. The interpretation of fiduciary duty: to recommend that the Fund's ethical investment policy is revised in the light of contemporary thinking that widens the scope of fiduciary duty.

2. Divestment: To recommend that full or partial divestment from fossil fuels is pursued with a proportion of that investment redirected to renewables and energy demand reduction.

3. To recommend that the proportion of the fund devoted to local investments is increased by a specific amount and the strategy for selecting such investments is renewed to assess whether it is robust enough to support environmental and local economic benefit.

4. To recommend that the Fund should actively support community owned renewables development in GM, that a statement of intention is published and a contact process for projects seeking funding is established.

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Appendix 1: **An Alternative To Fossil Fuel Investments: Community Renewables**

We note that the Lancashire Pension Fund is investing £14M in a community solar energy plant, from which it expects a 10% return[11]. As well as, the £14.4bn Strathclyde Pension Fund's recent announcement of committing £10m to community power projects backed by the UK's Green Investment Back (GIB), with expected returns of 11-13%[12].

Supporting Community Renewables in the region could have a virtuous cycle of effects for the GMPF, its pension holders, GM Councils and residents. Such investment in the regional economy could creating jobs, contribute to business rates and ensuring locally held ownership of regional assets whose returns re-circulate locally (multiplier effects).

Community Owned Renewables create opportunities for civic involvement and can help bind communities together. They have been instrumental in getting public and local support for renewable energy projects and energy transition.

There is evidence that Pension Funds are well placed to play a supporting role and co-invest in community scale energy. As Chair of the Strathclyde Pension Fund's comments indicate, sometimes good local opportunities for developing renewable energy are otherwise unable to attract capital, 'it can be difficult for even the best-structured projects to access good long-term finance.'[13]

It is advocated as a positive alternative destination for funds divested from fossil fuels by many including Community Re:Invest, a community interest company specialising in this. They describe using pension funds to support community renewables as an opportunity to better use this significant financial resource to create a flourishing low carbon local economy, at a time when councils are struggling with austerity.

It is worth noting that Councils have more favourable financing options for developing renewable energy generation on council owned assets and buildings (through prudential borrowing).[14] The GMPF could however play a major role supporting projects on non-council owned land, allowing projects to be brought to optimal scale and replacing more expensive bank finance.

The Committee may therefore wish to recommend that the Fund Supports the development of renewables in the Region.

11 http://www3.lancashire.gov.uk/corporate/news/press_releases/y/m/release.asp?id=201302&r=PR13/0065
12 http://www.theade.co.uk/business-secretary-announces-60m-boost-for-uk-community-scale-renewable-energy-projects_2898.html
13 http://www.ipe.com/news/esg/strathclyde-joined-by-uk-green-bank-in-community-power-investment/10006714.article
14 CLASP Briefing 'Financing Large Scale Renewables' http://www.quantumst.co.uk/wp-content/uploads/2014/07/Financing-Large-Scale-Renewables-FINAL-July-2014.pdf

Appendix 2: **The Argument For Dis-Investment From Fossil Fuel Related Equities**

UK Councils manage pension funds totalling £180bn: typically funds have 2-5% of their holding in fossil fuel related equities. GMPF is typical in this regard.

Binding climate treaties enforce CO_2 limits on countries which limit global warming to 2 degrees Celsius – meaning at least 70% of known fossil fuels need to stay in the ground to achieve this target.[15]

Research by Carbon Tracker[16] suggests this implies that the world's listed fossil fuel companies, whose share prices are partly based on their proven reserves, are grossly overvalued. This is being taken seriously by mainstream financial institutions and rating agencies who have examined and developed it further, including HSBC, Citi, MSCI, and Standard & Poor's.[17]Evidence suggests Fossil Fuel divestment does not mean lower returns or higher risks. Studies examining how eliminating fossil fuels from portfolios would have impacted performance in recent years suggest investors could have substituted for clean energy stocks without any negative impact on performance and risk.[18]

A growing number of institutions, including the Rockefeller Brothers fund, numerous US Cities and Universities including Stanford University, Glasgow and Bedfordshire Universities in the UK, have signed up to a global divestment campaign urging investors to pull their money out of the fossil fuel industry. Committing to: Immediately freeze any new investment in fossil fuel companies and divest from direct ownership and any commingled funds that include fossil fuel public equities and corporate bonds within 5 years.[19]

Last week (February 12th 2015) the California senate called on two state pension funds to pull their combined GBP 325bn portfolio from fossil fuels.

Committee may wish to consider its position on the fossil fuel investments held by the GMPF. At the minimum they may wish to know what the fund managers strategy is in relation to 'unburnable carbon'.

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See this recent UCL study for example: http://www.bbc.co.uk/news/science-environment-30709211

16 http://www.carbontracker.org/

17 Impax Asset Management, *Beyond Fossil Fuels The Investment case for Fossil Fuel Divestment, p.3* http://communityreinvest.org.uk/wp-content/uploads/2014/12/Beyond-Fossil-Fuels-The-Investment-Case-for-Fossil-Fuel-Divestment.pdf

18 Ibid. p6

19 http://gofossilfree.org/commitments/

Appendix 3: **Ethical Alert – GMPF's Top 20 Holdings.**