Future Proofing the Investment Strategy -
Should its Responsible Investment strategy be further strengthened and, if so, how?

DECEMBER 2018

Sustineri

MERSEYSIDE PENSION FUND

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CONTENTS

EXECUTIVE SUMMARY

- The recommendations in this report are built on a combination of "bottom-up" stakeholder input and "top-down" assessment of the major policy and market trends.

- Direction of travel on responsible investing (RI) and environmental, social and governance (ESG) issues in UK and Western Europe is clear: regulators are acting.

- Likewise, many institutional investors in the region – including other LGPS – are responding to the need for a pro-active approach on the RI agenda.

- MPF stakeholders are strongly supportive of the view that ESG factors are financially material and that their integration in investment strategy is consistent with fiduciary duty.

- Stakeholders would also like a stronger connection between MPF investments and the Merseyside region, including closer contact with Fund beneficiaries.

- There is stakeholder interest in the Fund doing more to invest in private markets, diversifying into more low-carbon and sustainable infrastructure opportunities.

- There is also interest in an investment framework related to the Sustainable Development Goals (SDGs) and support for the ongoing decarbonisation of the portfolio.

- These recommendations are backed up by a revised set of investment beliefs on RI (also incorporating the key element of active engagement), which build on the core framework of a strengthened MPF RI strategy and narrative. This in turn helps to future-proof MPF's overall investment strategy in the long-term.

MPF'S MOTIVATION IN REVIEWING ITS RI STRATEGY

In April 2018, Merseyside Pension Fund ("MPF" or the "Fund") commissioned Sustineri to consider its RI strategy and the case for strengthening it. This mandate took place against the wider backdrop of MPF's decision to review its overall investment strategy and to safeguard the future sustainability of the scheme. MPF therefore took the opportunity to revisit and deepen its investment beliefs on RI, climate change and sustainability issues; in order to:

- address both investment risk management and opportunities;
- form the basis of a coherent internal and external narrative around these topics; and
- establish a strong foundation on which to further develop and refine core areas in its investment strategy to more effectively manage risk, return and costs.

MPF's interest in examining its RI strategy at this time is motivated not only by the broader strategic exercise; it also comes **within the wider context of LGPS pooling**, which has been in train since 2015. MPF is part of the Northern Pool and it clearly makes sense to review the fund's RI policy alongside this major structural change going on in the pensions sector.

It's also worth highlighting at the outset that **high-level trends – policy, regulatory and the development of market standards – make this review timely**. As we detail in the section on the Policy and Markets Backdrop, the global transition to a low-carbon economy and a more sustainable future is well underway, and it would seem to be accelerating. As one of the larger pension schemes in the UK, MPF has consistently taken a progressive role in active stewardship and engagement on ESG issues. Therefore, as it considers its broader investment strategy, we suggest that it's incumbent on MPF to take account of these macro trends; and there would appear to be at an inflection point in the world of responsible investing because of the way that these trends are coming together.

MPF's Existing RI Strategy

Unlike many LGPS and pooled funds, MPF is confident and transparent about its RI strategy with a page that states **its "commitment" to a RI policy**. The Fund says furthermore that its policy is built on three pillars:

- the exercise of voting rights;
- engagement with companies on environmental, social and governance (ESG) issues; and
- collaboration with like-minded investors through investor advocacy groups.

However, the RI policy does not represent MPF's only public statements on this agenda. It also **gives substantial space on its website to the issue of climate risk**, reflecting a sense that, for the Fund, climate change would seem to be the most important of the issues that make up the RI agenda because of the material financial risks that it presents to assets in the portfolio. If we analyse the series of papers submitted to the Pensions Committee around 2015/2016, the Paris Climate Agreement was clearly a strong factor in persuading MPF: a) to undertake a strategic review of its exposure to climate-related financial risk; and b) to reach the conclusion in that review that options for a decarbonisation plan should be brought forward. It was agreed that the plan should concentrate on four elements:

- to use climate scenario analysis to further articulate its investment beliefs on climate and to shape these into investment strategy goals (e.g. the asset allocation level);
- an investment strategy that substantially reduces the Fund's exposure to high carbon intensity assets, incorporating partial but not the full divestment of fossil fuel companies;
- ongoing engagement through investor groups with fossil fuel companies – reading across to its corporate engagement on ESG;
- continuing to deploy capital at scale into renewable energy.

It is also important to read across the RI Strategy so that it is consistent with MPF's over-arching Investment Strategy Statement (ISS). The ISS makes clear that the Fund "*pursues a policy of Responsible Investment, arising from the belief that environmental, social and corporate governance (ESG) factors will materially affect investment performance over the long term*." The ISS adds that "*such an approach is consistent with MPF's view of its fiduciary duty to seek optimal investment outcomes that are in the best interests of all of its scheme participants…*"

Scope of the Project

When MPF commissioned Sustineri to undertake this review, we agreed on the following scope of work:

1. To identify and define MPF's investment beliefs relating to ESG/climate/sustainability, in order to support and strengthen the foundation of MPF's investment policy.
2. To develop a coherent and cohesive narrative around ESG, climate and sustainability that will in turn facilitate a deeper dive by MPF into assessing more effective asset allocation, manager selection and developing metrics that are a fit for the organisation.

3. To align the longer-term narrative and investment beliefs with the future needs of the organisation, for example how it can be translated into an investment framework based on the Paris Climate Agreement, the UN SDGs and the evolving macro trends such as policy and technology, and impact on assets such as infrastructure.

The review now by Sustineri of MPF's RI strategy must therefore build on the existing strategy: identifying through the process described below what is unique about MPF's principles as an LGPS, and serve to reinforce the next phase for MPF regarding its investment strategies and stewardship.

Review Process

Apart from building on what is ready there, this review draws on two other important components.

The first key element is the **stakeholder exercise** that we have undertaken. We agreed with MPF that, both as essential input but also to secure buy-in for the review, it would be important to talk to a cross-section of internal and external stakeholders of the Fund. The process therefore required an engagement with important decision-makers and other key stakeholders inside the organisation, in order to form a collective view on the issues and drivers that are most relevant to the investment strategy for the medium and longer term. This exercise has taken the form of one-to-one meetings with a variety of stakeholders. The list of interviewees is detailed in an appendix to this report. Essentially, it includes MPF portfolio members, Councillors, the Chair and other members of the Pensions Board, so it represents a broad representation of investment professionals (some with RI/ESG expertise), and also those with a deep knowledge of the Merseyside region and the challenges that it faces. The list of stakeholder interviewees is at Annex A.

The second key input is **desk-based research, underpinned by market knowledge and insights**. We agreed with the Fund that it would be particularly relevant to assess activity and practice by MPF peers, and to cover key policy and regulatory trends. We go into some detail in these areas in the next section of the report.

POLICY AND MARKETS BACKDROP

Policy and Regulatory Trends

Officers of the Fund are well acquainted with the **main policy drivers** of recent years: the Paris Climate Agreement; the UN Sustainable Development Goals (SDGs); and the establishment of the Taskforce on Climate-Related Financial Disclosures (TCFD) (whose overall impact on business and investment is probably still too early to assess, although there is clearly momentum behind it).

2018 is however seeing a significant acceleration, both at the UK and European level. To take the **UK** first, differing types of policymakers and regulators are taking a growing interest in the ESG and sustainable finance agenda, viz:

- BEIS (Dept. of Business) and Treasury, through their sponsorship of the **Green Finance Taskforce (GFT)**. In its report published in April 2018, one of the GFT's principal recommendations was that investors' roles and responsibilities should be clarified on this agenda. Specifically, relevant regulators should ensure that fiduciary duty clearly states the importance of ESG issues; and that the Government should require that pension fund Statements of Investment Principles (SIP) include language on the extent to which social, ethical and environmental issues (including climate change) are considered.
- The Government has still to respond to the GFT report, but the policy direction of travel was given a further steer in June 2018 when the **Department of Work and Pensions (DWP**) issued a consultation on clarifying and strengthening trustees' investment duties. The consultation, to some extent (although it's not clear if this was intentional, as the sponsoring Whitehall department is different) picking up on the GFT SIP recommendation, proposed that trustees should be required by 1 October 2019 to publish an SIP which should take account of financially material considerations, including ESG (singling out climate change here). In other words, a strong steer (in case there is any confusion on the behalf of trustees) that ESG issues are financially material and ought not to be placed in a special "other" category. The Government responded to this consultation on 11 September, confirming that (apart from some clarification on the appropriate time horizon for the scheme and its members) its proposal in respect of a required SIP taking account of financially material ESG criteria (singling out climate change owing to its systemic and cross-cutting nature), should stand.

- The key UK financial regulators are also starting to act. **The UK's Pensions Regulator** was somewhat ahead of the game when it updated and strengthened its guidance in 2016 to state to Trustees that where they think ESG factors (likewise singling out climate change as an example) are financially significant, they should take them into account.
- The **Financial Conduct Authority (FCA**) has been criticised for its comparative lack of activity on the ESG/climate risk agenda. But it is now coming under some pressure, e.g. from the bully pulpit of the Environmental Audit Committee (EAC). The EAC issued a report on greening finance and embedding sustainability in financial decision-making in June 2018, and flagged the "worrying disparity" between The Pensions Regulator's (TPR) and FCA's pension scheme guidance when it comes to considering environmental risk as a financial factor. Since then, the FCA has responded with its first ever consultation on climate change. The UK **Financial Reporting Council (FRC)** is perceived to be lagging behind the FCA in this field; but it should not detract from the message that UK policymakers and regulators are acting on ESG risks and their implications for UK pension funds, and that the overall issue is moving up their agenda in terms of its importance.

Likewise, at the European level, policymakers are acting. The Financial Services Directorate-General of the European Commission was initially a bit slow to react and take into account the implications of the Paris Climate Agreement – as Governor Carney did when he established the TCFD at Paris 2015 with his Financial Stability Board remit. However, recognising the significance of the TCFD once it got moving, the Commission then moved to appoint the High-Level Expert Group of Sustainable Finance (HLEG). The HLEG reported at the beginning of 2018, and their report was quickly followed up by a European Commission Action Plan, detailing envisaged policy and regulatory measures. The key areas where action is being taken forward (and on present scheduling due to be enacted by the end of 2019) are as follows:

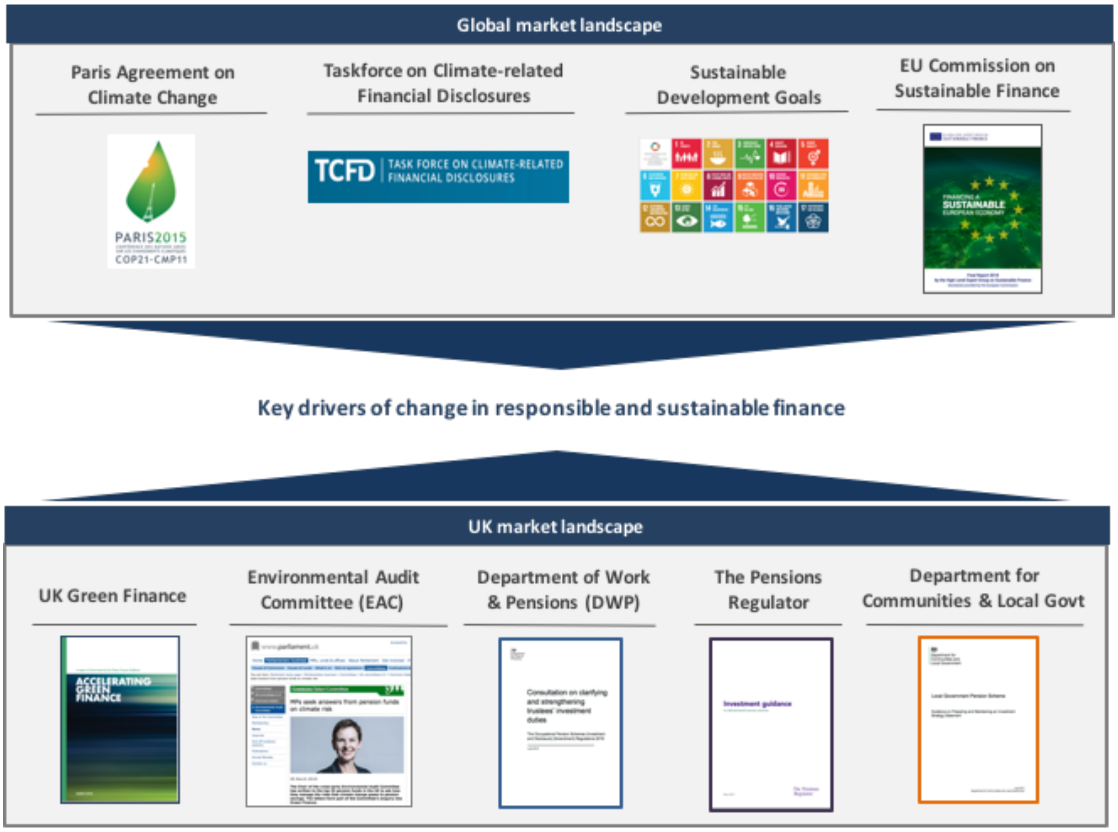
- as per the UK GFT report, the Commission has now introduced a discrete legislative proposal that will clarify the duties of institutional investors and asset managers and explicitly require them to integrate ESG matters into their decision-making;
- linked to this legislative proposal, the Commission will also require institutional investors and asset managers to disclose how they consider sustainability factors in their strategy and investment decision making process, in particular for their exposure to climate change-related risks;
- in addition, in a bold move, the Commission plan to scrutinise how credit ratings factor ESG into their decision-making processes.

We appreciate that some of the measures detailed above, notably the DWP consultation, are focused on the corporate pension funds sector, as opposed to LGPS, who come under the auspices of a different government department, the Department of Communities and Local Government (DCLG). That said, the regulatory thrust in both the UK and the wider EU is a clear signal of where the market is heading with respect to responsible investing and addressing sustainability/climate-related financial risks and opportunities.

It's also fair to say that actions in the corporate sector influence developments in the LGPS sector and vice versa. Moreover, on the key question of the regulatory backdrop, it's important to remind the Fund of the most recent (2017) DCLG guidance to LGPS on an investment strategy statement, where the Department clearly states that an LGPS Investment Strategy Statement (ISS) must include the authority's policy on how it takes into account ESG considerations. We understand also that DCLG is working to bring its guidance further into line with the new corporate pension fund guidance emanating from DWP. However, the point should be made here that, if anything, the guidance to corporate pensions funds is actually playing catch-up with guidance for the public sector. To underline this point, it is worth detailing here key relevant extracts from the 2017 DCLG guidance for LGPS, viz:

- a scheme ISS should consider any factors that are financially material, including ESG factors;
- that a scheme may take non-financial considerations into account provided that would not involve significant risk of financial detriment;
- also, even, that some part of the financial return may be foregone to generate the impact of social investments.

Figure 1: Key drivers of change in Responsible Investing and Sustainable Finance both globally and in the UK



Market Trends and Development

There is a self-evident dynamic between policy and regulation, and how the market is behaving. The case for a strengthened RI strategy for MPF therefore also needs to be considered in the light of market trends.

Broadly, **the institutional investor community in western Europe – and specifically asset owners - are responding to the pressure for a more pro-active and rigorous approach towards ESG issues**. To provide a example, Sustineri was recently commissioned by ClientEarth to analyse how a cross-section of asset owners in the OECD (bar the United States, who are regarded as a special case because of the prevailing federal climate politics) are addressing climate risk.

Our findings are set out in this report. A key passage in the executive summary sends a strong message:

"This review shows that climate risk management and disclosure is becoming increasingly mainstream for asset owners and that the existing market standard is growing in sophistication. The clear message to asset owners that are not currently taking the steps outlined in this report is that they must quickly ramp up their efforts and consider the impact of climate risk across their whole portfolio and multiple timeframes."

The detailed report lists why and how these asset owners are acting on climate risk. Factors, apart from the climate-specific TCFD, include financial materiality and regulation. There is also evidence – especially relevant for this report – that **LGPS recognise the reputational benefits** (and, conversely, how inaction can generate reputational risk) of acting on climate and ESG.

There are also specific examples of asset owners agreeing strong and quite detailed responsible investment strategies. In the local government community, it's premature to look at the new pooled funds as examples of best practice on RI. But some other individual local government pension funds, e.g. the West Midlands Pension Fund, are recognised as forward-leaning on RI, and therefore worth considering in terms of leading practice. Universities Superannuation Scheme (USS) is a progressive private sector pension fund and, in its statement of beliefs and principles, emphasises the importance of the long-term approach and of focusing on ESG.

However, a summary of how LGPS are treating this agenda, including in the new world of pooling, would be that it is a mixed bag and provides opportunity for those funds and pools who would like to be leaders or at least on the progressive end of the scale.

In Europe, the most progressive asset owners are located in Scandinavia (e.g. the AP funds in Sweden) and the Netherlands (e.g. ABP, PFZW), and they may provide pointers for more innovative measures. Certain themes are prominent: a concentration on the long-term horizon; a robust RI policy does pay off – sustainability factors in investment will be increasingly important in the future, and there is evidence that it leads to higher returns; a measured decarbonisation strategy supported by active engagement is a better stewardship policy than divesting from companies; and that the active steward role can be well supported through membership of organisations such as PRI and IIGCC.

Annex B provides some brief examples of innovative practices that UK, Swedish and Dutch asset owner funds are adopting in respect of decarbonizing the portfolio, reporting and disclosure on climate risk, and using an SDGs-related framework for investment. Internationally, as a tangible sign of how the investor community continues to mobilise on the low-carbon economy, the Investor Agenda – a coalition of regional investor groups representing $32 trillion in assets – issued a statement at the Global Climate Action Summit in San Francisco in September, highlighting the importance for investors to step up their work in addressing climate-related risks and opportunities, and to integrate these issues into their portfolio analysis and decision-making.

We note here the active role that MPF has played and continues to play an active role within the investor community on the agenda, viz on the Institutional Investors Group on Climate Change (IIGCC), UN Principles for Responsible Investment (UNPRI) and the UK Sustainable Investment Forum (UKSIF).

We should also make a point of singling out the prominence of MPF officers within local government forums, notably the Local Authority Pension Fund (LAPFF). MPF's presence in LAPFF circles is something that can potentially be leveraged more, both in the engagement context and as Northern Pool arrangements evolve.

Figure 2: Merseyside Pension Fund's role as an active steward in Responsible Investing and Climate Change

STAKEHOLDER EVIDENCE

As we highlighted early in our report, a key element of this policy review is the material we amassed from the number of internal and external stakeholders whom we interviewed in one-to-one meetings. We have now distilled this into principal stakeholder outputs, to provide support and evidence for the analysis and recommendations that conclude the report.

Stakeholder Input

The one-to-one interviews were conducted under three main headings: RI and wider ESG issues; Governance; Investment Strategy and Risk. This report presents the stakeholder evidence under the same headings.

1. RI and Wider ESG Issues

- A message coming through from some of the interviewees was the need to ground the revised strategy in the **relevant legislation**. This view emphasis the importance of the policy and regulatory backdrop (as set out above), and why it must be taken into major account in making changes.
- MPF is a public sector pension fund, and a number of the interviewees highlighted the **public sector ethos** of the Fund and how that fully aligns with the Fund's fiduciary duty responsibilities. More broadly, this theme of a public sector ethos seemed to represent a set of values and principles that people thought the Fund should bear in terms of how it conducts itself in the public arena and towards its members, a form of a "social contract".
- There was no questioning by any of the stakeholders, and a strong support for the view, that – although risk-adjusted returns remain the primary objective of those who manage a pension fund – ESG criteria are financially material and, therefore, the act of integrating them into decision-making is entirely consistent with **fiduciary duty**.
- Most interviewees regarded **climate change** as the most important issue on the ESG agenda, although there should be a proportionate balance between the attention given to climate and other ESG matters: "first among equals".
- There was some discussion about and support for whether the Fund should have a strategy that is more attuned and aligned with the **SDGs**. The broad conclusion was that any such development should support the need to fuse these global objectives with local priorities.

2. Governance

- Provided resourcing and cost constraints can be sensibly addressed, there was broad support among interviewees for MPF – building on the progressive position it has adopted within LGPS in recent years – to take a **leadership position on RI as part of the Northern Pool**, and to promote an ambitious approach.
- Stakeholders were near-unanimous that the Fund should make a **stronger connection between its investments and the Merseyside region and the North more generally**. A revised policy in this area would in addition enhance the local democratic accountability of MPF, demonstrating its ability to deal in "real world impacts": this could be labelled as a "partnership with the region".
- Some of the interviewees advocated – likewise within the context of local democratic ability – actions by the Fund to **engage more actively with its beneficiaries and members on responsible investing**. One idea mooted was for the Fund to undertake a survey of its members on its investment strategy; another view, expressed more simply, was for more regular communication and engagement with beneficiaries (which might also help to overturn the preconception that pensions are "dull"). It was noted that younger people attach particular importance to the environmental agenda, and that there is evidence that pension fund members engage more actively on tangible issues such as climate change and modern slavery.
- There was also unanimous support for MPF to continue to play an **active stewardship** role as part of its wider external engagement. Stakeholders welcomed the Fund's membership of organisations such as UNPRI and IIGCC, and wanted this to continue. Some noted that it would be useful to show how MPF influences through its active engagement. MPF's prominence in LAPFF circles was highlighted, with the suggestion that the Fund should capitalise on this.

3. Investment Strategy and Risk

- The widespread support among stakeholders for a strong local connection was also expressed within the context of a **more diversified investment strategy** – diluting risk and promoting opportunity.
- Some interviewees voiced the view that, given the present healthy (fully-funded) state of the Fund, MPF investment managers can afford to adopt a **more enterprising and innovative approach towards investing in opportunities in the low-carbon sector**.

- Related to this point was a view from a few stakeholders that MPF should **invest more in private markets.** This would position the Fund to take greater advantage, e.g. of infrastructure investment opportunities that should be more readily addressable through the scope provided by the scaling-up of pooling (and might also make a more SDGs-focused strategy, as mentioned above, feasible).
- There was in general terms (although not unanimous) a **lack of support for MPF to introduce more exclusion policies** dealing with certain asset classes, at least as far as the fossil fuels sector is concerned. As one stakeholder said, MPF is in fact steadily divesting from fossil fuels on account of its policy of decarbonising the portfolio. Tobacco was another subject discussed, with no definite conclusion on how tough the Fund should be on divestment. The key point made overall was that the Fund should have a robust and defensible narrative on divestment-type issues.

CONCLUSIONS

Against this background – combining this input "on the ground" from stakeholders with our summary of the major trends of policy and regulation, and how the market is responding to the accelerating agenda – our conclusions are as follows: -

Foundation Stones: MPF should be confident that its policies are aligned and consistent with the overall policy and markets backdrop. The Fund's interest in a more ambitious approach would be consistent with these trends. Its progressive approach towards integrating ESG matters into its investment strategy and decision-making likewise is in line with building a more resilient portfolio that can "future proof" for the long term; and its policies in respect of decarbonising the portfolio and robust external engagement are solidly grounded with its stakeholders.

Direction of Travel: there was strong support from stakeholders for MPF to promote leadership on the RI agenda, and the way in which this agenda is developing is continuing to pave the way for the Fund to take advantage of the progressive position and reputation it has already created, within LGPS and the Northern Pool. On its investment strategy, there would be support for the Fund to do more on climate-related themes and low-carbon sectors – as it is already doing, e.g. with steadily decarbonising the portfolio – in tune with the broader political, economic and business environment.

Innovative Measures: some innovative changes the Fund could make would also relate to the investment strategy. In particular, there would seem to be support for making more local and regional investments; and this could be combined (as part of a diversification strategy) with pushing more into private markets such as infrastructure, building on the sizeable Infrastructure Fund that MPF already has. Another major change would be to engage more actively and closely with MPF's members (which in itself could be wrapped up with the changes made to the investment strategy). Last, a strategy that utilises a framework more closely aligned with the SDGs would most certainly be innovative for an LPGS, although the evidence would suggest that this requires further exploration.

RECOMMENDATIONS FOR ACTION

By deciding to instigate a stakeholder exercise, MPF embarked on a **bottom-up process across key representative stakeholders within the Fund with an aim to develop a set of common and shared beliefs (principles) and narrative that would potentially support a strengthened approach towards what it does on RI**. Our recommendations are therefore derived empirically from the evidence and our resulting analysis. Furthermore, we believe that these recommendations are strengthened by having an authentic and authoritative stakeholder voice behind them.

When making the comparison with its existing strategy, we therefore recommend that the Fund should consider the following principal actions in order to strengthen its RI strategy:

1. Place its strategy within an **overall strengthened framework** that would support public positions and statements. This would enable a more robust and cohesive narrative, which would both bolster MPF's strong steward role and enable it to engage more widely with the spectrum of external stakeholders and the Fund's members. Resources permitting, this could enable MPF to do more on public engagement and extend its collaborations with specific organisations. This framework and narrative should be based on some key core beliefs and principles, viz:
    - A strong RI policy should be seen within the context of the long-term and future proofing the Fund.
    - ESG factors will materially affect investment performance over the long-term.
    - This approach is entirely consistent with a responsible asset owner's fiduciary duty.
    - A strengthened RI strategy chimes with MPF's core philosophy about the importance of active risk management.
    - Risk can be mitigated through diversification of the portfolio.
    - A divestment-led approach can weaken the Fund's ability to influence through active engagement. However, the promotion of ESG criteria in decision-making supports an active engagement approach.
    - MPF's approach towards active engagement, through its various channels and membership organisations, strengthens the Fund's ability to be a capable steward of capital, and also reflects its public sector ethos.
    - The exercise of voting rights is consistent with an asset owner's fiduciary duty.
    - Social impact investing is compatible with a strong RI policy, as supported by DCLG guidance for LGPS.

2. On t**hemes**, the Fund should be prepared to strengthen even further its public positions on climate change and the low-carbon sector, confident in its positioning on this agenda. In its March 2018 Annual Report, MPF published its first TCFD report. This was its first such report. This review should provide levers and material by which the 2019 TCFD report can be considerably expanded in line with the emerging best practice in the sector.

   MPF should also instigate a workstream on an SDGs-related investment framework, which could be linked to work investigating the feasibility of more local and social investments. Some detailed follow-up work might be necessary here; but one way to elaborate on this approach would be to consider each SDG in turn (following pioneering best practice from asset owners in the Netherlands) and assess how they relate to potential investments in the region. To take some possible examples:

   - Linking SDG 3 (Good Health) with a regional public health objective.
   - Linking SDG 7 (Affordable and Clean Energy) with investments in major local renewables projects.
   - Linking SDG 11 (Sustainable Cities) with Liverpool City's sustainable action planning.

3. On its **investment strategy**, MPF should look further to diversify its portfolio – in line with DCLG guidance on investing in a range of asset classes - so that there is a greater emphasis on **investing in private markets**. According to the 2018 Annual Report, MPF has 21% of its assets invested in these markets under the heading of "Alternatives". To take each of these discrete funds in turn:

   - The Infrastructure Fund (7% allocation) has major investments in bio energy and energy from waste, so already has a strong environmental tilt. According to the 2017 edition of the Bloomberg "New Energy Outlook", global investments in renewable energy will top $7 trillion by 2040, so the investment opportunity is clear.
   - The Private Equity Fund (5% allocation) might also provide opportunities in sustainable investment.
   - Separately, MPF's has 8% of its assets invested in Property, which can be examined from both the risk and opportunity perspectives as to whether it can be given a stronger sustainability theme.

MPF should, consistent with the more diversified approach, pursue its policy of **integrating ESG criteria into investment across all asset classes**.

The Fund has a **decarbonisation target** of switching one third of its passive equities into a low carbon benchmarking strategy. The recommendations in this review ought to support the achievement of this target, and should provide scope for further, more ambitious targets to be set.

4. On **governance**, we noted with interest the idea that the **Fund should engage more actively with beneficiaries on its approach towards responsible investing**. As we note in the main body of the report, there are various ways in which this active engagement could be pursued. There is a push from central government for pension funds (public and private sector) to have more meaningful communication with their members. We therefore recommend that a range of options be considered to take this idea forward.

In summary, the **implementation of a strengthened RI strategy along these lines would naturally put MPF in a stronger leadership position**, enabling it to push onwards within the Northern Pool and more broadly within the LGPS. There would then be a mutual reinforcement between this strengthened position and what it can do to influence behavior in the public sector pension fund marketplace, supported by the new policies that the Fund would like to introduce.

We believe that implementation of these recommendations – subject to some of the further work that might be needed, as we outline – should strengthen the resilience of MPF portfolio, help to future proof, and provide a revised set of shared investment beliefs that underpin the Fund's core objectives on behalf of its beneficiaries. The recommendations are consistent with and build on the actions that MPF has taken, in particular since 2015, and therefore represent a logical and evidence-driven strengthening of the Fund's RI strategy. Grouped collectively, we believe that they would enable MPF to make its mark as a leading LGPS – looking beyond the confines of the UK in asset owner terms – on an agenda based on what is important to them, aligned with their investment beliefs, and which is tailored to its local and regional objectives.

Next Steps

Merseyside Pension Fund will adopt, based on the findings of this report, a Statement of Responsible Investment Beliefs. This statement will form a cornerstone of the Fund's Strategic Investment Review process, culminating in a revised Investment Strategy.

MPF will also consider positioning this exercise into a case study which can be leveraged to promote the Fund's overall leadership position on RI.

ANNEX A: LIST OF STAKEHOLDER INTERVIEWEES

- Councillor Pat Cleary, Member of Pensions Committee
- Patrick Cleary, Co-opted Trade Union Representative on Pensions Committee
- Councillor Paul Doughty, Chair of Pensions Committee
- Shaer Halewood, CFO of Wirral Council (representing the sponsoring employers)
- John Raisin, Chair of Local Pensions Board
- Peter Wallach, Director of MPF Pensions

ANNEX B: PEER REVIEW EXAMPLES

Decarbonising the Portfolio

TPT, the UK pensions provider The Pensions Trust: TPT has for some years been progressive on decarbonising its portfolio and has an overall climate policy. In its latest (2017) report, the Fund sets out the work that it is doing: to reduce climate risk in equities; to quantify climate risk in alternatives/private markets; and to capture new opportunities in real assets.

AP4, the Fourth Swedish National Pension Fund: AP4 takes a strong stance on climate change in its public statements and positions. A feature of the Fund's policy on climate is the approach it is taking towards steadily decarbonising its portfolio: increasing investments in low-carbon strategies to 100% of the global listed (passive) equity portfolio by 2020; and measuring and disclosing carbon footprint in listed equity holdings.

Reporting in line with the TCFD

AP2, the Second Swedish National Pension Fund: AP2 has adopted the TCFD recommendations for its reporting on climate-related activities, citing it as a framework for trustees to assess the Fund's progress on climate-related goals. AP2 has used the TCFD's asset owner-specific guidance to produce, on an annual basis, a report covering the four TCFD climate-related disclosure pillars: Governance, Strategy, Risk Management, and Metrics & Targets. Furthermore, they hope to encourage investee companies to utilise the TCFD framework to increase transparency and risk-assessment capabilities for asset owners. This report is produced and published separately to other scheme disclosures.

An SDG Framework

ABP, the Dutch state pension fund: ABP has been working on a framework to assess how they are contributing towards meeting the SDGs. Apart from citing specific investment that support discrete SDGs, they now use the language of "Sustainable Development Investments" (SDIs) and declare how much of their total assets (12.2% at the end of 2017) contribute to SDG goals.