Problems with GMPF's approach to investment

Fossil Free Greater Manchester analysed the Greater Manchester Pension Fund's (GMPF's) approach to investment and climate risk and identified four major problems.

1. Limited understanding of climate risk
2. Lack of alignment with current industry investment standards
3. Failed policy of 'engagement' with fossil-fuel companies
4. Mistaken rejection of a policy of divestment.

Our discussion of these problems is set out below. We rely on relevant documentation from the Fund, specifically: [1] GMPF Chair's response to Cllr Coggins dated 5 June 2023; [2] the GMPF Annual Report 2023; and [3] the GMPF document entitled How we're investing for the energy transition dated 2 November 2023.

1: GMPF does not adequately identify or measure the climate-related risks to its investments

The Taskforce for Climate-related Financial Disclosure (TCFD) guidance, which GMPF claims to follow [1], recommends that organisations 'Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term' [2, p42]. In the case of pension funds, it is commonly assumed that these are risks and opportunities affecting the value of their investments.

The economy-wide phasing out of fossil fuels over at least the medium and long term poses one such very large potential risk to the value of pension fund investments, so this risk needs to be measured over the short, medium and long term. Investments in companies that themselves invest in or are heavily dependent upon fossil fuels are therefore also at potential risk, which likewise needs to be measured.

GMPF, however, does not follow TCFD's recommendation. Its 2023 annual report does not describe any specific risk over any specific time period but just says: 'there is too much uncertainty around the timings to place timeframes around them. Therefore, GMPF remains cognisant of risks and opportunities over all time horizons' [2, p42]. GMPF appears to see only climate-related investment *opportunities* - in energy efficiency, choice of energy sources, products and services and new markets.

TCFD was disbanded on 12th October 2023, and its guidance is currently being updated in the form of the Transition Plan Taskforce Disclosure Framework (October 2023), which has links tomore specific sectoral guidance for Asset Owners and Asset Managers. The Framework recommends that all economic entities should have a plan that sets out their targets, actions or resources for responding to climate-related risks and opportunities (pp15, 17). GMPF, however, has no plan that complies with this guidance.

GMPF repeatedly [2, pp51 and 182] states that its decarbonisation goal will be ‘regularly evaluated in line with the latest science and climate risk assessment’. However, there is no record of any such evaluation having been carried out, and GMPF does not appear to have taken any account of recent assessments of climate risk - in particular the risks to the value of its portfolio arising from continuing to invest in fossil fuel production and combustion.

The latest research for the Institute for Energy Economics and Financial Analysis shows that fossil fuels have been a poor investment over the last ten years. It has also been known for years now that in the long term (of over ten years) fossil fuel investment portfolios do not achieve better returns than portfolios that exclude fossil fuel investment. This indicates that GMPF is already failing in its fiduciary duty to secure the best returns for its pension fundholders in the longer term.

An example of a more advanced approach to assessing climate risk is the one now followed by Sarasin and Partners (see also the Net Zero Asset Managers initiative).

2: GMPF does not have a credible Net Zero portfolio

GMPF is at risk of being increasingly out of step with the progress being made in the wider investment community.

For example, the European Responsible Investment Network Assessing Net Zero and Paris Alignment Claims states: ‘A credible Net Zero portfolio should invest in companies implementing Paris-compliant cuts, and include new investments in the infrastructure and technologies needed for the low-carbon economy. A portfolio on the way to Net Zero will have reduced exposure to the high-risk carbon-intensive sectors, particularly those at most risk of asset stranding (assets that suffer from an unanticipated or premature write-down, devaluation or conversion to a liability) such as fossil fuel production, industrialised livestock and aviation.’ (p5)

In comparison, GMPF is investing in renewable energy, but it has not reduced its exposure to high-risk fossil fuel production, and has *no clear plans to do so in the future*.

GMPF claims that it is Paris-aligned [2, p51] and that it is indeed a signatory to the Paris-aligned Investment Initiative’s Net Zero Asset Owner Commitment [2, p182]. The GMPF Chair’s response to Cllr Coggins also stated: ‘We have set our portfolio emissions targets in line with science-based pathways as laid out in the Net Zero Investment Framework and the Net Zero Asset Owners Alliance guidance’ [1].

This Alliance guidance has interim absolute emissions reduction targets from 2019 of 22-32% by 2025 and 40-60% by 2030. Similarly, the Institutional Investors Group on Climate Change (IIGCC) Net Zero Stewardship Toolkit aims for investors to halve their emissions by 2030, and its Toolkit is aligned with both Net Zero Asset Managers and Paris Aligned Asset Owners.

In contrast, GMPF, which is not a member of the Alliance, has an interim target only for reducing carbon intensity - by 50% by 2030. Whatever merit carbon intensity reduction targets might have, they cannot substitute for targets for absolute emissions reduction.

The latest Transition Plan Taskforce Disclosure Framework (p17) recommends that a transition plan should specify the actions to be taken in the short, medium and long term to reduce greenhouse gas emissions. But GMPF has no such plan.

In the very latest Net Zero Finance Report, the best performing banks, pension funds and asset managers are identified as those that are following the IEA's net zero emissions by 2050 scenario (IEA, 2023), which expects that investment into fossil fuel expansion should cease immediately. GMPF has not communicated such a demand to any of the companies in which it invests.

GMPF, therefore, is not following industry guidance or good practice on achieving net zero. In order to comply with that guidance, it urgently needs to provide a detailed plan showing not only how it will reduce the carbon intensity of its investments by 50% by 2030, but also how it will reduce the absolute emissions arising from its investments by at least 50% by 2030.

Additionally, if it wants to be among the leaders in the field of finance, It should immediately cease investing in companies that are expanding or planning to expand their extraction and selling of fossil fuels.

GMPF could also consider following the example of Wiltshire Pension Fund, who have decided to divest from all fossil fuel assets by 2030, and most recently West Yorkshire Pension Fund, who have decided to stop funding new fossil fuel developments and stop lending to the oil, gas and coal sector.

3: GMPF claims that 'engagement' with fossil-fuel companies is the best way forward to a low-carbon future but offers no convincing evidence to support this claim

In its most recent publication [3], GMPF declares: 'We expect that several of the "traditional" oil and gas majors will be key drivers behind this transformation' [3, p3]. Playing its part in this, GMPF continues to invest hundreds of millions of pounds each in Shell, bp, and TotalEnergies.

GMPF is to be applauded for its ambition in believing that, through 'engagement' with major fossil fuel companies, it can get them to transform themselves into green businesses. However, we can find no evidence in GMPF's documents that such engagement has made any difference to those companies' behaviour. We found just two examples of GMPF's external adviser UBS-AM's engagement - with bp and Equinor.

bp announced in 2020 a 40% reduction in oil and gas production by 2030. GMPF claims that its advisers were influential in bringing about this change in policy [3, p12] but there is no evidence to support this claim. Coincidentally, bp did achieve a 40% reduction in oil and gas production in 2022 due to relinquishing its share in Rosneft following Russia's invasion of Ukraine. However, this had nothing to do with GMPF's influence.

Later on in 2023 bp said it would phase out its own direct production more slowly [3, p12] (see also bp net zero ambition progress update, p2). This seems to be the opposite of what GMPF is aiming to achieve, namely to speed up the energy transition, so again it seems that GMPF's engagement with bp has been ineffective.

On Equinor, the key point is that it has committed to reducing its absolute emissions only in Norway, not in the world as a whole [3, p13], so GMPF's impact on the company again cannot be detected. As in other cases, GMPF appears to be proud of its voting record on oil and gas companies' AGMs, etc, but there is no example of GMPF actually winning any of these votes.

Arguably also, it hardly seems reasonable to expect 'traditional' oil and gas majors to drive the green transition rather than, say, an energy company such as Ørsted, which is already transforming itself. The Transition Plan Taskforce Disclosure Framework (p18) refers to some cases where divestment could be a false positive, that is where the divestee is one that can help the transition, e.g. a company that mines copper or lithium or is accelerating lower-carbon solutions in historically harder to abate sectors (concrete and steel come to mind). Fossil fuel companies, however, are not mentioned in this context, implying that divestment from fossil fuel companies is not considered to be capable of being a false positive.

Interestingly, the Framework also mentions false negatives, where an investee company reports low emissions but may support the continuation of a high-carbon economy, and cites companies providing services to the coal, oil and gas sector (p18). Arguably, this could include financial services that support fossil fuel companies such as banks and insurance companies.

In the absence of evidence that GMPF's engagement strategy has any impact in shifting oil and gas companies away from fossil fuels, its claim to be 'an activist investor, driving the climate transition' [3], would appear to be an empty one. Indeed, it can be argued that continued investment in such companies by pension funds serves only to act as cover for other investors who may be less concerned about the transition to renewable energy.

4: GMPF is not following the Net Zero Investment Framework approach to engagement

In the GMPF Chair's response to Cllr Coggins [1], he claimed that GMPF follows the Net Zero Investment Framework. This Framework, however, sets out an approach to engagement that is notably different from GMPF's. It recommends that pension funds should set an engagement strategy that has clear milestones (p16), with selective divestment based on climate financial risk, and escalating to exclusions based on a company's activity being inconsistent with a credible net zero pathway over time. A clear link can be seen here between engagement and divestment whereas in the case of GMPF no such link exists - indeed, GMPF seems to reject the option of divestment altogether [3].

The piece of text in GMPF's literature that seems to come nearest to suggesting that it might divest is in the Responsible Investment Policy 2021 [2, p197]: 'Where boards of investee businesses are resistant to dialogue or change, GMPF will escalate issues by voting against the re-election of the Chair of the board. Ultimately, in such cases, GMPF will consider adjusting its investments as appropriate to the risks.' However, we have been unable to find any record of GMPF making such an adjustment - except perhaps in the case of divestment from tobacco companies (back in 2014).

The message here is that: 'Engagement makes no sense without the threat of divestment: True engagement needs the pressure created by divestment' (https://gofossilfree.org/uk/why-not-engage). This has been the approach used by well-respected organisations such as the Church of England and the National Trust. Most recently, the Dutch pension fund PFZW, the 10th largest in the world, after a 2-year engagement process, sold all its shares in oil and gas companies, including Shell, BP and TotalEnergies, for 2.8 billion euros. This decision is explained here.

Conclusion

It is now generally accepted that the world as a whole must achieve net zero greenhouse gas emissions by 2050 if we are to avoid dangerous levels of global warming. To this end, fossil fuels must be phased out as quickly as possible. We now know that LAPS are capable of divesting completely from fossil fuels within periods of less than 5 years. Accordingly, the GMPF Management Panel needs to instruct its advisers to devise a plan that will result in a fossil-free Fund before 2030.

Such a plan should:

- show a credible pathway to net zero;
- fully identify and address the climate risks to GMPF investments;
- comply with the Net Zero Investment Framework approach to engagement.

To sum up:

- Climate research (IEA, 2023) shows that, if we are to avoid 1.5 degrees of global warming, there should be no investment in new oil and gas projects or coal mines or mine extensions or new unabated coal plants
- Consequently, GMPF needs immediately to divest from companies that are planning to embark on such projects - in particular, Shell and TotalEnergies
- The financial risk from stranded fossil fuels is growing and GMPF in particular is at risk of falling further and further behind the curve
- Trying to ‘encourage’ or influence fossil fuel companies appears to have had no effect on those companies’ behaviour
- Therefore, steps must be taken urgently to divest from fossil fuels NOW.

Fossil Free Greater Manchester, 14 April 2024.