worcestershire countycouncil

AGENDA ITEM 9

PENSIONS COMMITTEE
17 MARCH 2020

PENSION INVESTMENT UPDATE

Recommendation

1. **The Chief Financial Officer recommends that:**

   a) **The Independent Financial Adviser's fund performance summary and market background be noted (Appendices 1 and 2);**

   b) **The update on the Investment Managers placed 'on watch' by the Pension Investment Advisory Panel be noted;**

   c) **The update on the Pensions Investment Sub Committee's decision to invest £50m into the British Strategic Investment Fund (BSIF) which is a Fund with a mixture of Property and Infrastructure assets be noted;**

   d) **The update on the transition of the Active Corporate Bonds mandate into the LGPS 'Global active Investment Grade Corporate Bond Fund be noted;**

   e) **The funding position compared to the investment performance be noted;**

   f) **The update on the Equity Protection current static strategy be noted;**

   g) **The update on Responsible Investment activities (Appendix 4) and Stewardship investment pooling and the Stewardship code be noted;**

   h) **The update on the LGPS Central report on the voting undertaken on the Funds behalf be noted (Appendices 5 to 7);**

   i) **The update on the development of a Climate Risk Monitoring Platform be noted;**

   j) **The proposed Environment Social and Governance (ESG) Audit be agreed; and**

   k) **The update on the feedback on the 'spectrum of capital (Appendix 8) be noted**

Background

2. The Committee will receive regular updates on Fund performance. The Fund's Independent Financial Adviser has provided a Fund performance summary and a brief market background update at Appendix 1 up to the end of December 2019 together with the following supporting information.

- Portfolio Evaluation overall Fund Performance Report up to the end of December 2019 (Appendix 2)

The market background update is provided to add context to the relative performance and returns achieved by the Fund's investment managers.

3. The Committee will also receive regular updates regarding 'on watch' managers and will receive recommendations in relation to manager termination in the event of a loss of confidence in managers by the Pension Investment Sub Committee (Appendix 1).

JP Morgan Corporate Bond

4. The transition of this mandate to LGPS Central's appointed managers (Fidelity and Neuberger Berman) should have taken place by the time this Committee report is presented. JP Morgan has shown an underperformance of -0.05% (0.39% v 0.44%) in Q4 2019 against their benchmark. Their performance against benchmark over the last 12 months has improved to 1.1% outperformance (11.7% v 10.6%), in line with their target.

5. Relative to their performance target, they are behind by -0.5% over three years, and -0.4% over ten years, which is a slight improvement since the last report. They finish at breakeven since inception in April 2003.

Property and Infrastructure Commitments

6. Just to recap the Strategic Asset Allocation Report presented to the Pensions Committee on the 13 December 2019 agreed to increase the allocation to Infrastructure or a mix of Infrastructure and Real Estate by 5% from the current strategic allocation of up to 15% of the Fund to 20% and reduce the overall Equity strategic allocation exposure (proposal to reduce Market Cap indices element) by 5% (from 75% to 70%), with Fixed income remaining at 10%. This will help reduce portfolio risk and reduce portfolio concentration to large cap companies and therefore increase diversification across the number and size of companies in which the portfolio invests

7. The table below highlights the total commitments to the end of December 2019 being £591million and the amount that has been drawn, i.e. the capital invested being £434million (73%). These types of investments can take several years to be fully committed.

Table 1: Property and Infrastructure Commitments

Property & Infrastructure Commitments		Commitment £'m	Amount Drawn Dec 19	%
Total Commitment Property Investments		242	172	71%
Total Commitment Infrastructure Investments		349	262	75%
Total		**591**	**434**	**73%**

Venn Commercial Real Estate Fund II

8. Pensions Committee in March 2019 agreed a £30m investment for the Venn Commercial Real Estate Fund II after robust due diligence had been undertaken and reported. Negotiations have been continuing throughout the year and Venn's management team have recently been discussing some updated proposals which were discussed and agree at Investment Sub Committee on the 3 March 2020

9. The key changes are to include a larger proportion to the UK given the feeling is that there will be increased opportunities now that Brexit for instance has been agreed. Previously before the Fund was looking to concentrate on mainly European investments.

British Strategic Investment Fund (BSIF)

10. After due consideration of all due diligence and meetings that have been undertaken The Investment Sub Committee on the 3 March 2020 agreed to invest £50m into BSIF, a Fund with a mixture of Property and Infrastructure assets. The BSIF presentation provided at the investment Sub Committee is attached for information at Appendix 3. This will go towards the targeted agreed strategic asset allocation of 20% which currently as at the end of December is just under 15% in overall investments.

Transition of Corporate Bond assets to LGPS Central Global Active Investment Grade Corporate Bond Fund

11. LGPS Central appointed Inalytics to provide transition oversight to look to provide as smooth a transition as possible within the target implementation shortfall. LGPS Central then asked Inalytics to procure a transition manager and on 22 August appointed Blackrock as Transition Manager. A transition kick off meeting was undertaken again on the 18 November 2019 and funds should have transitioned by the time this report is presented.

Overall Management Fees

12. The Management fees are in the region of 8.3bps compared to the 17bps we pay now, so an estimated saving based on the existing Assets under management of approximately £0.1m per annum. However, the transitions costs will need to be considered before any real ongoing savings are achieved. An update will be presented to the next meeting.

Estimated Funding Levels

13. Table 2 shows the overall Funding level of the Fund. It should be noted that this is a weighted average across all the employers that are part of the Fund The range of funding levels across the employers is circa 20% to 144% (based on 2019 valuation)

14. The last actuarial valuation undertaken as at the 31 March 2016 showed that the fund was 75% funded with a £654m deficit at this point. The Actuary provided a preliminary valuation in September 2019 and further detail is provided in the 2019 Actuarial Valuation Funding Strategy Statement report on this agenda. This has been updated for discount rate assumptions, life expectancy trends, covenant, data quality etc. The estimated funding levels in March 2019 were 91% with a deficit of £265m. The Asset valuation as at the end of January 2020 was £2.933m. However there has been some recent significant volatility in the markets due mainly to the effects of the Coronavirus and it is likely that this will continue over the ensuing months which will impact on the overall funding levels.

Table 2: Estimated Pension Fund Funding levels based on a like for like comparison to the 2016 actuarial valuation.

	Mar-16	Mar-18	Oct-18	Dec-18	Mar-19
Assets £'M	1,952	2,701	2,708	2,650	2,795
Liabilities £'M	2,606	2,794	2,861	2,871	3,065*
Surplus (-) / Deficit	**654**	**93**	**153**	**221**	**265**
Estimated Funding Level	**75%**	**97%**	**95%**	**92%**	**91%**

** Note this is based on the Actuary preliminary valuation that the next triennial review is based on. The other Liability figures before this were based on a like for like comparison to the assumptions used in the 2016 valuation.*

15. Note the valuation takes on board the extension of the Equity protection.

Equity Protection update

16. Members will recall that a number of Equity Protection options / considerations were discussed and provided at the last Committee. A caveat to the discussions was that the Actuary believed that the Fund could benefit from using an equity protection strategy in terms of providing increased certainty and affordability of contributions if markets were to deteriorate. Note this only covers our passive portfolio of approximately £1.1bn (including the Equity Protection valuation).

17. Members agreed as *part of the Strategic Asset Allocation report to Committee on the 13 December 2019: -*

a) To use the Equity Protection strategy as a tool to manage and mitigate the risk of having still a relative high equity exposure but review regularly and update at Pensions Investment Sub Committee;

b) To agree trigger points were discussions should take place to discuss if any action such as restructuring or even exiting the Equity Protection strategy; and

c) That Fund officers with the support of the Fund's current Investment Advisor closely monitor the existing strategy and bring back more detailed information on how the strategy has performed at least on a quarterly basis to Pensions Investment Sub Committee

18. Following this recommendation 6 weekly reviews have been implemented with River & Mercantile (R&M) and discussions held on the 6 January 2020 and after due consideration no action was recommended. A further review took place on the 14 February 2020, 28 February and the 3 March 2020 due to the volatility of the markets, mainly to the Coronavirus.

19. R&M provided an update to the Pensions Investment Sub Committee on the 3 March 2020 and advised that no action at this point was necessary as the strategy was doing what it was set out to do. The Investment Sub Committee asked for a range of options / triggers based on different market scenarios that could be written into the existing Investment Management agreement so that action could be taken urgently if necessary. These are currently being progressed and discussed with R&M.

Strategic Asset Allocation

20. Table 3 below shows the asset allocations against the Strategic Asset Allocation targets (before the revised targets agreed by Committee in December 2019). This highlights that our overall investment in equities is still high being over 79.2% (80.0% as at Sept 2019) (including the equity protection) compared to the strategic asset allocation target at that time of 75%. This is mainly due to being overweight on the active equity portfolio and underweight on Fixed income. Although the actual Property and Infrastructure investments are at the previous 15% target levels, action is being taken to find suitable assets with the aim to increase this to the targeted 20% level

Table 3 Strategic Asset Allocation targets

Fund as at the 31st December 2019			**Strategic Asset Allocation targets**	
Asset Class	Portfolio Weight		Asset Class	Portfolio Weight
Actively Managed Equities	**25.0%**		**Actively Managed Equities**	**20.0%**
Far East Developed	13.2%		Far East Developed	10.0%
Emerging Markets	11.8%		Emerging Markets	10.0%
Passively Managed Equities – Market Capitalisation Indices	**31.3%**		**Passively Managed Equities – Market Capitalisation Indices**	**40.0%**
United Kingdom	13.2%		United Kingdom	23.5%
North America	11.6%		North America	9.0%
Europe ex UK	6.5%		Europe ex UK	7.5%
Passively Managed Equities – Alternative Indices	**15.6%**		**Passively Managed Equities – Alternative Indices**	**15.0%**
Global	15.6%		Global	15.0%
Equity Protection	**7.2%**			
Fixed Interest	**6.1%**		**Fixed Interest**	**10.0%**
Actively Managed Bonds & Corporate Private Debt	5.3% 0.8%		Actively Managed Bonds & Corporate Private Debt	10.0%
Actively managed Alternative Assets	**14.8%**		**Actively managed Alternative Assets**	**15.0%**
Property	5.8%		Property & Infrastructure	15.0%
Infrastructure	9.0%			
TOTAL	**100.0%**		**TOTAL**	**100%**

Responsible Investment (RI) Activities

21. The term' responsible investment' refers to the integration of financially material environmental, social and corporate governance ("ESG") factors into investment processes. It has relevance before and after the investment decision and it is a core part of our fiduciary duty. It is distinct from 'ethical investment' which is an approach in which moral persuasions of an organisation take primacy over its investment considerations

22. The Fund adopts a policy of risk monitoring and engagement with companies with sub-optimal governance of financially material Responsible Investment (RI) issues, to positively influence company behaviour and enhance shareholder value; influence that would be lost through a divestment approach. The Fund extends this principle of "engagement for positive change" to the due diligence, appointment and monitoring of external fund managers.

Local Authority Pension Fund Forum (LAPFF)

23. LAPFF exists to promote the long-term investment interests of member funds and beneficiaries, and to maximise their influence as shareholders whilst promoting the highest standards of corporate governance and corporate responsibility at investee companies. Formed in 1990, LAPFF brings together a diverse range of 79 public sector pension funds and five pools in the UK with combined assets of over £230 billion.

24. The quarterly engagement report (October to December 19) highlighted that: -

- Climate concerns remain centre stage at the close of the year. The wildfires in Australia (cover), floods in Indonesia and Saudi Arabia and other extreme weather-induced events in the last months of 2019 permeated public consciousness with the real and sometimes deadly impact of climate change. Shareowners engaging with companies continue to push, not only for companies' strategies to further the transition to net zero and their physical resilience, but also for alignment of corporate direct and indirect lobbying activities which can markedly affect national policy making.

- The report also highlights other areas relating to climate emergency, company engagement and the 2019 LAPFF annual conference

25. Through LAPFF, the Fund engaged with 35 companies during the quarter on issues ranging from human rights, climate change, environmental issues, governance and board composition. Most engagements concerned climate change and governance. Three engagements led to a substantial improvement and ten engagements led to a change in process /small improvement. Most engagements were conducted by meetings with specialist staff or the company Chair. The issues are set out in the Quarterly Engagement Report which is attached at Appendix 4 and is also available on LAPFF's website together with the previous quarterly engagement reports. : LAPFF quarterly-engagement-reports

Stewardship in Investment Pooling

26. As part of LGPS Central we are actively exploring opportunities to enhance our stewardship activities. More information is on the LGPS website LGPSCentral – Responsible Investment. One of the principal benefits, achieved through scale and resources arising from pooling are the improved implementation of responsible investment and stewardship. Through its *Responsible Investment & Engagement Framework* and its Statement of Compliance with the UK Stewardship Code, LGPS Central is able to help implement the Fund's own *Responsible Investment Framework*. LGPS Central Issues Quarterly Stewardship Reports to demonstrate progress on matters of investment stewardship and can be found on the above link for which the quarter ending the 31 December 2019 is currently available.

Stewardship Themes
27. Each of the partner funds were invited to take part in a short survey, to gauge interest in a list of potential stewardship themes. The outcome was an agreed shortlist of four (proposed at a recent Responsible Investment Working Group RIWG), which comprised of climate change, single-use plastic, technology & disruptive industries, and tax transparency. Further details of these 4 themes and the progress to date is provided in the quarterly stewardship report.

Voting Decisions
28. At the last meeting it was agreed that it would be beneficial for LGPS Central would compile and vote the shares for Worcestershire Pension Fund voting records (via LGPS Central contract with Hermes EOS and executed in line with LGPS Central's Voting Principles).

29. 'Donut' charts for how votes have been cast in different markets and regions (Appendices 5 and 6) and a Table of vote-by-vote disclosure for full transparency is available at Appendix 7.

Development of a Climate Risk Monitoring Platform
30. As highlighted in the June report, the partner fund Responsible Investment Working Group and LGPS Central are developing a Climate Risk Monitoring Service. This would provide four optional deliverables

- Assistance drawing up a climate change framework and strategy
- Per fund an annual climate change risk report tailored to individual funds requirements comprising
    - Climate scenario analysis, fund wide, all asset classes
    - Carbon metrics scorecard (carbon footprint, stranded asset analysis, etc.
    - Annual climate stewardship plan
- Per fund annual training of Pensions Committee
- Task Force for Climate-related Financial Disclosures (TCFD) report for public disclosure with our annual report

31. All partner funds have now agreed to take this forward. A procurement exercise has been completed for Climate Scenario Analysis and Carbon Risk Metrics and providers appointed. Work is now ongoing to look to provide initial reports for each individual partner fund and this should be available for the June Committee report.

Environment Social and Governance (ESG) Audit
32. Given the increase and focus on RI and particularly Climate change it is evident that the Fund needs to conduct an ESG audit to establish a baseline for the Fund for future action and consideration. This is also on the back of the presentation to members by Karen Shackleton from Pensions for Purpose on the 31 January 2020. on '**Responsible Investment, Sustainable/Ethical Investment and Impact Investment.**

33. A key aspect of the presentation was where as a Fund we would wish to be on the 'Spectrum of capital (Appendix 8) ranging from 1 being the traditional forms of investment through to 8 being Philanthropy. Members have been asked for their view and based on the feedback so far Members would like to see the Fund on 4 between a mix of sustainable and impact driven investments. The ESG audit will help the Fund

establish where we are and help formulate future strategic actions required for the Funds investment approach.

34. It is anticipated that this review will cost in the region of £20 to £30k and agreement is sought from Committee to look at procuring this ESG audit with a view to reporting back to the June Committee if possible. The Funding has been provided and highlighted within the Pensions Admin Budget for 2020/21 on the same agenda.

35. **Please note that Appendix 3 contain exempt information (on salmon pages) and should members wish to discuss the information included in these Appendices they would need to consider passing the appropriate resolution and moving into exempt session.**

Contact Points

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Supporting Information

- Independent Financial Adviser summary report (Appendix 1)
- Portfolio Evaluation Overall Fund Performance Report (Appendix 2)
- BSIF Presentation (Appendix 3) **exempt information (on salmon pages)**
- LAPFF Quarterly Engagement Report April to June 2019 (Appendix 4)
- 'Donut' charts for how votes have been cast in different markets and regions Appendices 5 and 6 and a Table of vote-by-vote disclosure (Appendix 7)
- Spectrum of Capital (Appendix 8)

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

- Agenda papers and Minute of the Pensions Committee meeting held on 13 December 2019