

PENSIONS COMMITTEE

8 OCTOBER 2021

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 Sub Committee be noted;**
 - c) The funding position compared to the investment performance be noted;**
 - d) The update on the Equity Protection current static strategy and the historical performance detailed in Appendix 3 be noted;**
 - e) The update on Responsible Investment activities, Local Authorities Pension Fund Forum (LAPFF) (Appendix 4) and Stewardship investment pooling be noted; and**
 - f) The update on the LGPS Central report on the voting undertaken on the Funds behalf be noted (Appendices 5 to 7).**

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 June 2021 together with the following supporting information.

- Portfolio Evaluation overall Fund Performance Report up to the end of June 2021 (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 also receives 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).

Property and Infrastructure Commitments

4. The table below highlights the total commitments to the end of June 2021 being £694million and the amount that has been drawn, i.e. the capital invested being £494million (71%). 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 June 2021 | % |
|---|-------------------|------------------------------|------------|
| Total Commitment Property Investments | 220 | 171* | 78% |
| Total Commitment Infrastructure Investments | 474** | 323 | 68% |
| Total | 694 | 494 | 71% |

* Note that Venn I is coming to an end and capital is currently being recalled.

** Includes recent BSIF II commitment

Estimated Funding Levels

5. 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)

6. The last actuarial valuation was undertaken as at the 31 March 2019 showed the funding levels were 90% with a deficit of £295m. At the last Committee it was highlighted that there had been some significant volatility in the markets due mainly to the effects of the Coronavirus which has since been found to be unprecedented. This had a significant impact on our March 2020 estimated funding levels, with a recovery by September 2020 and has continued to recover up to June 2021 as shown in the table below with an estimated funding level of 101%. However, it is most likely that the market volatility will continue which may impact on the overall funding levels.

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

| | Mar-16 | Mar-19 | Mar-20 | Mar-21 | June-21 |
|--------------------------------|------------|------------|------------|------------|-------------|
| Assets £'M | 1,952 | 2,795 | 2,612 | **3,367 | **3,496 |
| Liabilities £'M | 2,606 | 3,090 | *3,243 | *3,404 | *3,446 |
| Surplus (-) / Deficit | 654 | 295 | 631 | 37 | (50) |
| Estimated Funding Level | 75% | 90% | 81% | 99% | 101% |

* Estimated liabilities provided by the actuary and Assets include cash.

** Note the Assets include cash of £68m which are excluded from the Portfolio Evaluation overall Fund Performance Report attached at Appendix 2.

Equity Protection (EP) update

7. Just to recap this only covers our passive portfolio of approximately £1.1bn (including the Equity Protection valuation). It was also agreed as part of the 2019 strategic asset allocation review to use Equity Protection as a tool to manage risk within the portfolio and the Fund will have seen the benefits of having this in place since February 2018.

8. It was agreed to continue the Equity Protection for a further 12 months on the S&P500 (for our US Passive equity Fund) and the FTSE100 (for our UK Passive equity Fund) and 18 months for the Eurostoxx50 (for our European Passive equity Fund) and this was presented to the Pensions Investment Sub Committee on the 17 September 2020.

9. It was noted that the revised strategy is more fluid and is aimed at capturing as much market upside as possible as well as protecting from significant downside market movements. Increased active management is required for these strategies and fortnightly monitoring meetings have taken place with River and Mercantile since September 2020.

10. Both the Eurostoxx50 and the S&P500 have been restructured at the date detailed in the table below. The FTSE was restructured more recently on the 21st September 2021 after the 6 month trigger point and a verbal update will be provided at Committee. The table shows the triggers (FTSE to be updated) that have been implemented to consider restructuring the EP Strategy for both upward and downward market moves. The level of protection still remains at 20% for any Market downfall from the point at which the strategy is revised.

Revised Equity Protection levels implemented

| Mandate & Market | Date from | Initial Market Level | 15% restructure trigger consideration on upward market moves | 20% restructure trigger consideration on downward market moves | Duration |
|-------------------|-----------|----------------------|--|--|-----------|
| US - S&P500 | 20.04.21 | 4,128 | 4,747 | 3,302 | 12 Months |
| Europe – ESTOXX50 | 24.03.21 | 3,827 | 4,401 | 3,061 | 18 Months |
| UK – FTSE100 | 10.02.21 | 6,500 | 7,475 | 5,200 | 12 Months |

11. We asked River & Mercantile to provide the historical performance of the EP strategy since inception. The tables below demonstrate that the Funds structured equity has outperformed both the UK and Europe equity markets and underperformed against the US equity market which will largely be due to the sterling market performance over this period. However overall, the aggregated performance has been broadly neutral since inception.

12. This proves to date that the revised strategy has worked for the Fund particularly as this is a risk mitigation strategy and is aimed chiefly at protecting the Fund's assets from a significant downfall in valuation. Appendix 3 provides this detail in a series of charts and highlights the points at which the decisions were made to restructure the strategy.

Equity Protection Strategy performance since inception

| UK: Performance at end of July 21 | Equity | Structured Equity |
|-----------------------------------|--------|-------------------|
| since inception | 11.43% | 13.99% |
| over the last 12 months | 23.21% | 15.99% |
| over the last 3 months | 1.55% | 0.13% |

| Europe: Performance at end of July 21 | Equity | Structured Equity |
|---------------------------------------|--------|-------------------|
| since inception | 30.00% | 34.27% |
| over the last 12 months | 31.23% | 33.45% |
| over the last 3 months | 3.74% | 3.15% |

| US: Performance at end of July 21 | Equity | Structured Equity |
|--|---------------|--------------------------|
| since inception | 68.98% | 60.61% |
| over the last 12 months | 35.82% | 35.11% |
| over the last 3 months | 5.38% | 4.72% |

| Aggregated Performance at end of July 21 | Equity | Structured Equity |
|---|---------------|--------------------------|
| since inception | 35.68% | 35.42% |
| over the last 12 months | 30.10% | 27.45% |
| over the last 3 months | 3.61% | 2.68% |

Strategic Asset Allocation

13. Table 3 below shows the asset allocations against the Strategic Asset Allocation targets (over next 3 to 5 years) agreed by Committee in June 2020. This highlights that our overall investment in equities is still high being over 79.0% (78.5% as at March 2021) (including the equity protection) compared to the revised strategic asset allocation target of 70%.

14. This is mainly due to being overweight on the active equity portfolio, underweight on Fixed income and the increase in Property and Infrastructure investments target to 20% (currently 15.0%) will take time to implement. Also, the equity rally has seen the market valuations increase compared to the existing Property and Infrastructure investments which are likely to take longer to recover from the current market environment.

15. Since this report, the Fund has taken action to rebalance the developed Asia active equities mandate with Nomura to be nearer its target allocation of 10% and reinvested this into the actively managed bonds. Also rebalancing of the overweight on the passive US Market cap allocation has been undertaken by moving this to the underweight on the UK Market cap.

Table 3 Strategic Asset Allocation targets

| Fund as at the 30th June 2021 | | Strategic Asset Allocation targets | |
|---|-------------------------|---|-------------------------|
| Asset Class | Portfolio Weight | Asset Class | Portfolio Weight |
| Actively Managed Equities | 25.5% | Actively Managed Equities | 20.0% |
| Far East Developed | 13.4% | Far East Developed | 10.0% |
| Emerging Markets | 12.1% | Emerging Markets | 10.0% |
| Passively Managed Equities – Market Capitalisation Indices | 31.9% | Passively Managed Equities – Market Capitalisation Indices | 35.0% |
| United Kingdom | 12.3% | United Kingdom | 20.5% |
| North America | 13.0% | North America | 8.0% |
| Europe ex UK | 6.6% | Europe ex UK | 6.5% |
| Passively Managed Equities – Alternative Indices | 15.6% | Passively Managed Equities – Alternative Indices | 15.0% |
| Global | 15.6% | Global | 15.0% |
| Equity Protection | 6.0% | | |

| Fund as at the 30th June 2021 | | Strategic Asset Allocation targets | |
|---|---------------|---|--------------|
| Total Equities | 79.0% | Total Equities | 70.0% |
| Fixed Interest | 6.0% | Fixed Interest | 10.0% |
| Actively Managed Bonds & Corporate Private Debt | 4.7% 1.3% | Actively Managed Bonds & Corporate Private Debt | 10.0% |
| Actively managed Alternative Assets | 15.0% | Actively managed Alternative Assets | 20.0% |
| Property | 4.7% | Property & Infrastructure | 20.0% |
| Infrastructure | 10.3% | | |
| TOTAL | 100.0% | TOTAL | 100% |

Responsible Investment (RI) Activities

16. 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

17. 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)

18. 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.

19. The attached quarterly engagement report (April to June 2021) Appendix 4 detailed a number of headlines around Climate Emergency and Company engagements over the period,

20. Some of the highlights of the report include:

- LAPFF's engagement with Shell, pushing for a clearer transition path towards net zero by 2050.
- Continued engagement with National Grid, which has now set a Scope 3 target to reduce carbon emissions 37.5% below the 1990 baseline by 2034.
- 'Say on Climate' ramps up, with a number of resolutions being put forward to company AGMs this year.

- Mining and Human Rights engagement continues with LAPFF attending a number of notable AGMs to ask questions and holding a number of meetings with high level executives from Rio Tinto, Anglo American, Glencore and BHP.
- Community engagement around these issues has also continued, particularly where community members were affected by the Mariana and Brumadinho dam collapses.
- Engagement with companies identified last year as operating in the Occupied Palestinian Territories has been pursued.
- LAPFF's continued engagement on diversity with Cllr John Gray, LAPFF Vice Chair, joining the City of London's Taskforce on Socio Economic Diversity.

21. 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

22. As part of LGPS Central we are actively exploring opportunities to enhance our stewardship activities. More information is on the LGPS website [LGPS Central – 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 published their Quarterly Stewardship Report covering April to June 2021 [Responsible Investment – LGPS Central](#). This will demonstrate progress on matters of investment stewardship.

23. Also on this website details of LGPSC Task Force on Climate-Related Financial Disclosures (TCFD) can be found together with their successful stewardship code 2020 application.

Stewardship Themes

24. 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 against these themes are included in the quarterly Stewardship Report above.

Voting Decisions

25. LGPS Central 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).

26. '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 for the quarter up to the end of June 2021.

Outcome and Recommendations of the Environmental Social & Governance (ESG) and Sustainable development Goals (SDG) mapping Audit report from Minerva & the Climare Risk report by LGPS Central

27. The outcome and recommendations of these reports were provided to the last Pensions Committee in March as a separate report.

28. Progress to date against some of the recommendations are as follows:-

- a) Engagement with all the Infrastructure, Property and Private Debt Fund Managers has taken place to ask them a number of questions on their ESG processes and practices and their ability in the future to map / report against the United Nations sustainable Development Goals and in particular those SDGs we wish to target as a Fund. An update has been provided to the Pension Investment Sub Committee;
- b) 3 informal Investment Sub Committee meetings were held from August to early September 2021 to explore the potential investment in sustainable equities and Climate Factor Funds and presentations have been received from Fund managers currently on the West Midlands Frame work and from LGPSC on their Fund offerings;
- c) Due Diligence has now been undertaken for the LGPSC Sustainable active equity Fund managers and a decision should be made by the end of September and a verbal update provided to Committee; and
- d) Pension Investment Sub Committee agreed their commitment to future investment in suitable sustainable equities and Climate / ESG Funds with further options to be explored and brought back to the September meeting for a decision on future investment.

Contact Points

Specific Contact Points for this report

Rob Wilson

Pensions Investment, Treasury Management & Capital strategy manager

Tel: 01905 846908

Email: RWilson2@worcestershire.gov.uk

Supporting Information

- Independent Financial Adviser summary report (Appendix 1)
- Portfolio Evaluation Overall Fund Performance Report (Appendix 2)
- Equity Protection historical performance Appendix 3
- LAPFF Quarterly Engagement Report April to June 2021 (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))

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.