

PENSIONS COMMITTEE

23 MARCH 2022

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 be noted;**
 - e) The update on Responsible Investment activities, Local Authorities Pension Fund Forum (LAPFF) (Appendix 3) 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 4 to 6).**

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 2021 together with the following supporting information.

- Portfolio Evaluation overall Fund Performance Report up to the end of December 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 Dec 2021 being £856million and the amount that has been drawn, i.e., the capital invested being £572million (67%). 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 Sept 2021	%
Total Commitment Property Investments	257	210*	82%
Total Commitment Infrastructure Investments	599**	362	60%
Total	856	572	67%

* Note that Venn I and Walton St I is coming to an end and capital is currently being recalled. Also now includes Forestry allocation of £50k

** Includes recent BSIF II, First Sentier EDIF III & Stonepeak Fund IV commitment

2nd February 2022 Department of Levelling Up, Housing & Communities (DLUHC) publishes Levelling Up whitepaper

5. The government published the [Levelling Up whitepaper](#) which includes references to LGPS funds having plans for up to 5% of assets to be allocated to projects which support local areas. We understand that in this context local refers to UK rather than local to a particular fund and that there will be no mandate beyond the requirement to have a plan. Further details will emerge over the period up to an expected summer consultation which we understand will also include the outstanding climate risk and reporting regulations and the pooling guidance

Estimated Funding Levels

6. 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)

7. The last actuarial valuation was undertaken as at the 31 March 2019 showed the funding levels were 90% with a deficit of £295m. The Fund has recovered well from the previous significant volatility in the markets due to the effects of the Coronavirus which has since been found to be unprecedented. The Fund has an estimated funding level of 101% as at the end of January 2022 and initial pension 2022 valuation discussions have begun with the actuary. However, the ongoing Ukrainian / Russian conflict has brought further significant volatility and this together with the continuing increases in inflation are most likely to impact on the overall funding levels over the next 3 to 6 months at least.

8. At the time of writing this report the Fund had 0.1% of its Fund value in Russian holdings and investment Sub Committee on the 3rd March agreed to disinvest in Russian holdings when it was able to do so.

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	Sept-21	Jan - 22
Assets £'M	1,952	2,795	2,612	**3,367	**3,540	**3,566
Liabilities £'M	2,606	3,090	*3,243	*3,404	*3,436	*3,530
Surplus (-) / Deficit	654	295	631	37	(116)	(36)
Estimated Funding Level	75%	90%	81%	99%	103%	101%

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

** Note the Assets include cash of £39m which are excluded from the Portfolio Evaluation overall Fund Performance Report attached at Appendix 2.

Equity Protection (EP) update

9. 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.

10. 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.

11. 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.

12. The Eurostoxx50 was restructured at the date detailed in the table below. The FTSE was restructured more recently on the 16th of September 2021 and the S&P500 on the 29 December 2021. The table shows the triggers 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	29.12.21	4,787	5,505	3,829	12 Months
Europe – ESTOXX50	24.03.21	3,827	4,401	3,061	18 Months
UK – FTSE100	16.09.21	6,933	7,973	5,546	12 Months

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 76.5% (76.7% as at September 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 15.6%) 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 with the passive mandates with the aim of reducing our carbon metric whilst protecting or maintaining returns. Our initial focus has been on the “Factor” based portfolios, with a transition of the greatest carbon “sinner”, Low Volatility, into the LGPS Central Climate Multi Factor Fund circa £200m. The Value portfolio was consolidated into the Quality portfolio, which has a lower carbon footprint circa £120m. That remains with LGIM.

16. At the last Pensions Committee, the strategic asset allocation of 6% to Sustainable active equities was approved reducing the passive Market Capital Funds. Approximately £200m is to be invested in Liontrust Asset Management PLC and Baillie Gifford and the transition is in progress but is not anticipated to be fully complete until May 2022. Therefore, the table below does not reflect this change at the moment (to aid comparison) and will be reflected in the June 2022 Committee when the transition has occurred.

Table 3 Strategic Asset Allocation targets

Fund as at the 30 December 2021		Strategic Asset Allocation targets	
Asset Class	Portfolio Weight	Asset Class	Portfolio Weight
Actively Managed Equities	20.7%	Actively Managed Equities	20.0%
Far East Developed	10.8%	Far East Developed	10.0%
Emerging Markets	9.9%	Emerging Markets	10.0%
Passively Managed Equities – Market Capitalisation Indices	39.3%	Passively Managed Equities – Market Capitalisation Indices	35.0%
United Kingdom	18.9%	United Kingdom	20.5%
North America	12.4%	North America	8.0%
Europe ex UK	8.0%	Europe ex UK	6.5%
Passively Managed Equities – Alternative Indices	16.5%	Passively Managed Equities – Alternative Indices	15.0%
Global	16.5%	Global	15.0%
Equity Protection (See note below)			
Total Equities	76.5%	Total Equities	70.0%
Fixed Interest	7.9%	Fixed Interest	10.0%
Actively Managed Bonds & Corporate Private Debt	6.2%	Actively Managed Bonds & Corporate Private Debt	10.0%
	1.7%		
Actively managed Alternative Assets	15.6%	Actively managed Alternative Assets	20.0%
Property	4.4%	Property & Infrastructure	20.0%
Infrastructure	11.2%		
TOTAL	100.0%	TOTAL	100%

Note Equity Protection is 6.1% of the Market Cap Funds and has been pro-rated over the Market Cap Funds to aid comparison to the strategic target

Responsible Investment (RI) Activities

17. 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

18. 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)

19. 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 81 public sector pension funds and five pools in the UK with combined assets of over £300 billion.

20. The attached quarterly engagement report (October to December 2021) Appendix 4 features LAPFF company engagements, including with BHP and the conference held in December 2021. There are also records of their collaborative engagements, community meetings, policy responses, and media coverage. There are also features on Human rights and Mining and an update on the engagement data which after the COP 26 event was unsurprising that climate change dominated the agenda.

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 October to December 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. The continued agreed stewardship themes comprise 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 4 and 5) and a Table of vote-by-vote disclosure for full transparency is available at Appendix 6 for the quarter up to the end of December 2021.

Outcome and Recommendations of the Environmental Social & Governance (ESG) and Sustainable development Goals (SDG) mapping Audit report from Minerva & the Climate 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. The Fund had an ESG Review workshop with Committee members on the 2nd of February 2022 which was to review progress against the Pension Committee ESG recommendations in March 2021 and ascertain what further changes may be required when looking ahead. More detail and the outcome of the review is contained within the 'Investment Strategy Statement and Climate Risk Strategy update report contained in this agenda. Regular updates will continue to be provided to Committee on this area.

Contact Points

Specific Contact Points for this report

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Supporting Information

- Independent Financial Adviser summary report (Appendix 1)
- Portfolio Evaluation Overall Fund Performance Report (Appendix 2)
- LAPFF Quarterly Engagement Report October to December 2021 (Appendix 3)
- 'Donut' charts for how votes have been cast in different markets and regions (Appendices 4 and 5 and a Table of vote-by-vote disclosure (Appendix 6))

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.