

PENSIONS COMMITTEE

28 JUNE 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 strategy 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 March 2022 together with the following supporting information.

- Portfolio Evaluation overall Fund Performance Report up to the end of March 2022 (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 March 2022 being £931million and the amount that has been drawn, i.e., the capital invested being £592million (64%). 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 March 2022	%
Total Commitment Property Investments	332	212*	64%
Total Commitment Infrastructure Investments	599**	380	63%
Total	931	592	64%

* Note that Venn I and Walton St I is coming to an end and capital is currently being recalled. Also now includes 2 Forestry allocations of £50k and £75k respectively

** Includes recent BSIF II, Igneo (Was First Sentier) EDIF III & Stonepeak Fund IV commitment

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

5. As reported to the March Committee, 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 mandation beyond the requirement to have a plan. We are still awaiting further details to emerge and will update Committee appropriately.

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 100% as at the end of March 2022 and initial pension 2022 valuation discussions have begun with the actuary. The continuing rise in inflation will be a key issue and potentially have a major impact on the Funds liabilities. Also, the ongoing Ukrainian / Russian conflict together with the cost of living increases has brought further significant market 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. It was noted in the March report that the Fund had 0.1% (around £5M) 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. This has now been completed and holdings would have been written down to a nil value in most cases.

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	Mar 22
Assets £'M	1,952	2,795	2,612	**3,367	**3,540	**3,585
Liabilities £'M	2,606	3,090	*3,243	*3,404	*3,436	*3,585
Surplus (-) / Deficit	654	295	631	37	(116)	(0)
Estimated Funding Level	75%	90%	81%	99%	103%	100%

* 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 and have a more active strategy on the S&P500 (our US Passive equity Fund) and the FTSE100 (our UK Passive equity Fund) for a rolling 12 months and 18 months for the Eurostoxx50 (our European Passive equity Fund) by 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 (now taken over by Schroders) since September 2020.

12. The Eurostoxx50 was restructured at the date detailed in the table below. The Eurostoxx was restructured on the 5th April 2022, the FTSE on the 6th April 2022 and more recently, the S&P500 on the 16th May 2022 which benefited the Fund by \$19.1m. 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. The ongoing requirement for the EP strategy will be considered as part of the strategic asset allocation review during 2022.

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	16.05.22	4,019	4,622	3,216	12 Months
Europe – ESTOXX50	05.04.22	3,910	4,496	3,128	18 Months
UK – FTSE100	06.04.22	7,592	8,731	6,074	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 74.4% (76.5% as at December 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 passive equity portfolio, underweight on Fixed income and the increase in Property and Infrastructure investments target to 20% (currently 18.1%) which will take time to implement. The impact of inflation and the Ukraine / Russia conflict has also seen a lot of market volatility which has seen market valuations decrease recently compared to the existing Property and Infrastructure investments.

15. At the last Pensions Committee, the strategic asset allocation of 6% to Sustainable active equities was approved reducing the passive Market Capital Funds. £200m has been invested in Liontrust Asset Management PLC £121m and Baillie Gifford £80m and the transition was completed early May. Therefore, the table below does not reflect this.

Table 3 Strategic Asset Allocation targets

Actual Fund as at the 31 March 2022		Strategic Asset Allocation targets	
Asset Class	Portfolio Weight	Asset Class	Portfolio Weight
Actively Managed Equities	19.8%	Actively Managed Equities	20.0%
Far East Developed	10.6%	Far East Developed	10.0%
Emerging Markets	9.2%	Emerging Markets	10.0%
Passively Managed Equities – Market Capitalisation Indices	38.6	Passively Managed Equities – Market Capitalisation Indices	35.0%
United Kingdom	19.1%	United Kingdom	20.5%
North America	12.2%	North America	8.0%
Europe ex UK	7.3%	Europe ex UK	6.5%
Passively Managed Equities – Alternative Indices	16.0%	Passively Managed Equities – Alternative Indices	15.0%
Global	16.0%	Global	15.0%
Equity Protection (See note below)			
Total Equities	74.4%	Total Equities	70.0%
Fixed Interest	7.5%	Fixed Interest	10.0%
Actively Managed Bonds & Corporate Private Debt	5.9% 1.6%	Actively Managed Bonds & Corporate Private Debt	10.0%
Actively managed Alternative Assets	18.1%	Actively managed Alternative Assets	20.0%
Property	5.8%	Property & Infrastructure	20.0%
Infrastructure	12.3%		
TOTAL	100.0%	TOTAL	100%

Note Equity Protection is 6.4% 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

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

19. The attached quarterly engagement report (January to March 2022) Appendix 3 features LAPFF company engagements and their records of their collaborative engagements, community meetings, policy responses, and media coverage. There are also features on Ukraine, Human rights and Mining and an update on the engagement data.

20. The issues are set out in the Quarterly Engagement Report which is attached at Appendix 3 and is also available on LAPFF's website together with the previous quarterly engagement reports. [LAPFF quarterly engagement reports](#)

Stewardship in Investment Pooling

21. 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 January to March 2022 [Responsible Investment – LGPS Central](#). This will demonstrate progress on matters of investment stewardship.

22. 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

23. 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

24. 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).

25. 'Donut' charts for the engagement statistics (Appx 4) and Voting statistics (Appx 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 March 2022.

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 January to March 2022 (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.