worcestershire
countycouncil

PENSIONS COMMITTEE
13 OCTOBER 2022

PENSION INVESTMENT UPDATE

Recommendation

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

   a) **The Independent Investment 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 Investment Adviser has provided a Fund performance summary and a brief market background update at Appendix 1 up to the end of June 2022 together with the following supporting information.

- Portfolio Evaluation overall Fund Performance Report up to the end of June 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 June 2022 being £971million and the amount that has been drawn, i.e., the capital invested being £723million (75%). 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	371	300*	81%
Total Commitment Infrastructure Investments	599	423	71%
Total	**970**	**723**	**75%**

** 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*

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 a funding level of 100% as at the end of March 2022 and initial pension 2022 valuation discussions have begun with the actuary..

Market turmoil

8. In the short term the current turmoil in financial markets, coupled with rising interest rates and inflation clearly raises some concerns. LGPS pensioners have the benefit of index linked (CPI) increases to their pensions each year. This is in contrast to most private sector pension schemes, that tend to have a cap (or a limit) on the amount that pensions will increase each year, regardless of the rate of inflation.

9. In this respect Worcestershire Pension Fund is anticipating that the pension increase next year will be in the region of 10% (based on the yet to be published CPI increase for September). Certainly for pensioners this will provide some relief to the rapid increase in the cost of living, but it is acknowledged that with the large increases being seen in energy costs and for some food items times will still be challenging for many. This large increase in pension payments will be managed by the internal team at the Fund through appropriate cash flow planning.

10. Over the longer term the investment strategy of the Fund is designed to ensure that the ability to pay pensions in the short, medium and long term is fully maintained. The Fund invests in a diversified range of assets that over time is anticipated to increase in value and to provide a secure flow of income to pay those pensions.

11. The assumptions that are made in the management of the Fund are regularly reviewed to ensure that changes to economic forecasts, including the cost of living, are incorporated within the investment strategy. With the expectations that the rate of inflation and interest rates will increase further in the short term, but then fall back to lower levels (but higher than we have seen in recent years), the forthcoming asset allocation review will ensure that the investment strategy is adjusted accordingly to maintain the correct balance of assets between those that see a growth in value over time and those that generate a steady flow of income. One of the great strengths of the LGPS is the way in which it is designed to provide a secure income in retirement to our pensioners and to be able to absorb short term challenges due to the long term strength of the asset base

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	Mar-22	Aug-22
Assets £'M	1,952	2,795	2,612	3,367	3,585	**3,521
Liabilities £'M	2,606	3,090	*3,243	*3,404	3,585	*3,646
Surplus (-) / Deficit	**654**	**295**	**631**	**37**	**(0)**	**125**
Estimated Funding Level	**75%**	**90%**	**81%**	**99%**	**100%**	**96%**

* *Estimated liabilities provided by the actuary and Assets include cash.*
** *Note the Assets include cash of £64m which are excluded from the* Portfolio Evaluation overall Fund Performance Report attached at Appendix 2.

Equity Protection (EP) update

12. 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.

13. 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 Eurostox50 (our European Passive equity Fund) by the Pensions Investment Sub Committee on the 17 September 2020.

14. 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.

15. Due to the downward trend of the market we have taken the opportunity to exit the protection completely at near enough break even. We continue to monitor the situation and have the ability to put the equity protection back on if the opportunity arises. We are also reviewing the existing mandate as the River & Mercantile team that we were working closely with have now left Schroders.

16. 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	No Protection in place at the moment			
Europe – ESTOXX50	08.09.22	No Protection in place at the moment			
UK – FTSE100	06.04.22	No Protection in place at the moment			

Strategic Asset Allocation

17. Table 3 below shows the asset allocations against the Strategic Asset Allocation targets agreed by Committee in June 2020 and updated on the 8th December 2021 to take into account the investment in Global Sustainable equities. This highlights that our overall investment in equities is 71.4% (74.4% as at March 2022) (including the equity protection) compared to the revised strategic asset allocation target of 70%.

18. The Property and Infrastructure investments target of 20% is slightly overweight at 20.5% with the Fixed Income slightly underweight at 8.1% compared to a 10% target. The impact of inflation and the Ukraine / Russia conflict is continuing to see a lot of market volatility which has seen market valuations decrease recently compared to the existing Property and Infrastructure investments.

19. This table now reflects the strategic asset allocation of 6% to Sustainable active equities was approved in December 2021 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.

Table 3 Strategic Asset Allocation targets

Actual Fund as at the 30 June 2022		**Strategic Asset Allocation targets**	
Asset Class	Portfolio Weight	Asset Class	Portfolio Weight
Actively Managed Equities	**25.2%**	**Actively Managed Equities**	**26.0%**
Far East Developed	10.3%	Far East Developed	10.0%
Emerging Markets	9.6%	Emerging Markets	10.0%
LGPSC Global Sustainable	5.3%	LGPSC Global Sustainable	6.0%
Passively Managed Equities – Market Capitalisation Indices	**30.5%**	**Passively Managed Equities – Market Capitalisation Indices**	**29.0%**
United Kingdom	17.8%	United Kingdom	17.0%
North America	6.7%	North America	6.5%
Europe ex UK	6.0%	Europe ex UK	5.5%

Actual Fund as at the 30 June 2022		Strategic Asset Allocation targets	
Passively Managed Equities – Alternative Indices	**15.7%**	**Passively Managed Equities – Alternative Indices**	**15.0%**
Quality Factor	9.8%	Quality Factor	9.0%
LGPSC Climate Factor	5.9%	LGPSC Climate Factor	6.0%
Equity Protection (See note below)			
Total Equities	**71.4%**	**Total Equities**	**70.0%**
Fixed Interest	**8.1%**	**Fixed Interest**	**10.0%**
Actively Managed Bonds & Corporate Private Debt	5.7% 2.4%	Actively Managed Bonds & Corporate Private Debt	6.0% 4.0%
Actively managed Alternative Assets	**20.5%**	**Actively managed Alternative Assets**	**20.0%**
Property	6.4%	Property & Infrastructure	20.0%
Infrastructure	14.1%		
TOTAL	**100.0%**	**TOTAL**	**100%**

Note Equity Protection is 7.2% 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

20. 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

21. 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)

22. 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.

23. The attached quarterly engagement report (April to June 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.

24. 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

25. 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 published their Quarterly Stewardship Report covering April to June 2022 [Responsible Investment – LGPS Central](). This will demonstrate progress on matters of investment stewardship.

26. 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

27. 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

28. 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).

29. '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 June 2022.

Taskforce for Climate-related Financial Disclosures (TCFD) Consultation

30. The UK Government has launched their consultation on Governance and Reporting of climate risks. As widely expected, the consultation follows the Taskforce for Climate-related Financial Disclosures (TCFD) framework and will require Administering Authorities to consider and report against the four key areas of governance, strategy, risk management, and metrics and targets. The aim of this framework is to help the LGPS demonstrate how the consideration of climate change risks and opportunities are integrated into each Authority's entire decision-making process.

31. The proposals under the consultation are similar to the new requirements that came into force for private sector pension funds in October 2021 but include some key differences in order to reflect the needs of the LGPS, the desire to have consistency in data and reporting, and to try to positively impact the ability to accurately measure and report climate risk and emissions data.

Key requirements proposed in the consultation

- Establish and maintain a **Governance** approach for oversight of climate risks and opportunities.
- Assess the impact of climate-related risks and opportunities on funding and investment **strategies.**

- Carry out **scenario analysis** reflecting different temperature pathway alignments(one being Paris aligned).
- Establish and maintain processes for identifying and managing climate-related **risks and opportunities.**
- Report on a minimum of four prescribed **climate metrics** which need to be measured and disclosed annually.
- Set a (non-binding) **target** in relation to one metric, chosen by the Authority.
- As part of ongoing **disclosure requirements** Authorities will need to publish an **annual climate risk report** with the Scheme Advisory Board also preparing an annual report, linking to individual reports and aggregate figures for the prescribed metrics.

  Other requirements including taking **proper advice** and having the **knowledge and skill**s required

32. The consultation opened on 1 September and has a closing date of 24 November 2022. The relevant regulations are expected to be in force by April 2023 with Authorities' first report due by December 2024 covering the 2023/24 scheme year.

33. The Fund is already well placed to meet these key requirements as it has produced a Climate Risk Strategy and TCFD report for the past 2 years. The Fund will look to LGPS Centrals Responsible Investment Team and partner funds within the Pool to see how to address the key requirements and provide progress updates to Committee.

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)
- 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.