

PENSIONS COMMITTEE

22 MARCH 2023

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;**
 - f) The update on the LGPS Central report on the voting undertaken on the Funds behalf be noted (Appendices 4 to 6); and**
 - g) The update on Taskforce for Climate-related Financial Disclosures (TCFD) Consultation be noted.**

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 December 2022 together with the following supporting information.

- Portfolio Evaluation overall Fund Performance Report up to the end of December 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 December 2022 being £990million and the amount that has been drawn, i.e., the capital invested being £752million (76%). 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 2022 £m	%
Total Commitment Property Investments	391	311*	80%
Total Commitment Infrastructure Investments	599	441	74%
Total	990	752	76%

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

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

5. As reported previously to 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 mandate 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 recovered well from the previous significant volatility in the markets because of the Coronavirus which has since been found to be unprecedented. The Fund had a funding level of 100% as at the end of March 2022 and preliminary pension 2022 valuation discussions with employers took place on the 8 and 10 November with the actuary. Further details can be found within the Valuation report on this agenda.

Market turmoil

8. In the short term the current turmoil in financial markets, coupled with rising interest rates and inflation clearly continue to raise 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 10.1% (based on the 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	Jan-23
Assets £'M	1,952	2,795	2,612	3,367	3,585	**3,624
Liabilities £'M	2,606	3,090	*3,243	*3,404	3,585	*3,719
Surplus (-) / Deficit	654	295	631	37	(0)	95
Estimated Funding Level	75%	90%	81%	99%	100%	97%

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

** Note the Assets include cash of £35m which are excluded from the Portfolio Evaluation overall Fund Performance Report attached at Appendix 2.

Equity Protection (EP) update

12. The previous facility provided by Shroders (River & Mercantile), covered our passive equity market cap portfolio of approximately £1.1bn (including the Equity Protection valuation). It was 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. As discussed at the October Committee, the fund took the opportunity to exit the protection given the continued downward trend in market valuations at the time. This was fully exited from Schroders in early November and the £231m was then reinvested back into the passive equity market cap funds on the 10 November 2022.

14. Although the Fund has exited the Equity Protection, the Fund is looking to have this facility as part of the investment tools in its investment strategy. The Fund will need to reprocure Equity Protection strategy going forward.

Strategic Asset Allocation

15. Table 3 below shows the asset allocations as at 31 December 2022 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 **67.9%** (71.4% as at June 2022) (including the equity protection) compared to the revised strategic asset allocation target of 70%.

16. Property and Infrastructure investments represent **24.1%** of the portfolio and are therefore slightly overweight against the target of 20%. The Fixed Income portfolio is slightly underweight at **8.0%** compared to a 10% target. The impact of inflation and the Ukraine / Russia conflict continues to result in a degree of market volatility which has seen equity market valuations decrease recently compared to the existing Property and Infrastructure investments.

17. 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 31 December 2022		Strategic Asset Allocation targets	
Asset Class	Portfolio Weight	Asset Class	Portfolio Weight
Actively Managed Equities	24.3%	Actively Managed Equities	26.0%
Far East Developed	10.1%	Far East Developed	10.0%
Emerging Markets	8.8%	Emerging Markets	10.0%
LGPSC Global Sustainable	5.3%	LGPSC Global Sustainable	6.0%
Passively Managed Equities – Market Capitalisation Indices	28.2%	Passively Managed Equities – Market Capitalisation Indices	29.0%
United Kingdom	17.2%	United Kingdom	17.0%
North America	5.1%	North America	6.5%
Europe ex UK	5.9%	Europe ex UK	5.5%
Passively Managed Equities – Alternative Indices	15.5%	Passively Managed Equities – Alternative Indices	15.0%
Quality Factor	9.6%	Quality Factor	9.0%
LGPSC Climate Factor	5.9%	LGPSC Climate Factor	6.0%
Equity Protection			
Total Equities	67.9%	Total Equities	70.0%
Fixed Interest	8.0%	Fixed Interest	10.0%
Actively Managed Bonds & Corporate Private Debt	5.2%	Actively Managed Bonds & Corporate Private Debt	6.0%
	2.8%		4.0%
Actively managed Alternative Assets	24.1%	Actively managed Alternative Assets	20.0%
Property	8.6%	Property & Infrastructure	20.0%
Infrastructure	15.5%		
TOTAL	100.0%	TOTAL	100%

Responsible Investment (RI) Activities

18. 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.

19. 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)

20. 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.

21. The attached quarterly engagement report (October to December 2022) Appendix 3 features LAPFF company engagements and their records of their collaborative engagements, community meetings, policy responses, and media coverage. The key feature is the LAPFF Chair visits to the Tailings Dam affected communities in Brazil.

22. 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

23. 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 2022 [Responsible Investment – LGPS Central](#). This will demonstrate progress on matters of investment stewardship.

24. 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

25. 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

26. 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).

27. 'Donut' charts for the engagement statistics (Appendix 4), voting statistics (Appendix 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 2022.

Taskforce for Climate-related Financial Disclosures (TCFD) Consultation to be updated

28. As detailed at the last Pensions Committee in December, 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.

29. 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 skills** required.

30. The consultation opened on 1 September and had a closing date of 24 November 2022. The Fund has not submitted a response as it has similar views to those of LGPS Central and a number of Partner Funds in the Pool who have submitted returns. The Scheme Advisory Board have also submitted a response which can be found on the

following link [SAB DLUHCClimateRiskReportingresponse](#).

31. 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.

32. 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.

33. The Fund held an ESG Workshop on the 8 February 2023 which was to review progress against the Pension Committee ESG recommendations in March 2022 and ascertain what further changes may be required when looking ahead. The workshop was led by Karen Shackleton from Pensions for Purpose who has provided valuable support for the Fund in this area since January 2020, and supported by officers and the Funds independent Investment Advisor. The objectives of the review were as follows: -

- Refresh – the Fund's investment beliefs, priorities and how you can align to these.
- Review - strategic actions agreed at the last review and progress made.
- Review - Stewardship Code 2020 and TCFD reporting.
- Update on key outcomes of the Funds 3rd Climate risk report and 2nd Climate scenario analysis presented by LGPS Central.
- Consider – ESG progress in private markets (presentations from two Fund managers, Bridgepoint (Corporate Private Debt) and Stonepeak (Infrastructure).
- Explore - case studies of LGPS funds exhibiting best practice.
- Review - key insights from the ESG pensioner members questionnaire.
- Consider - net zero goals – mapping the journey to net zero.
- Discuss – priorities for the next 12 months.

34. The workshop finished with a consideration of the next steps to consider for the next 12 months with the issues below raised by Pensions for Purpose. General views expressed are shown by each issue:

- Enhance engagement activity? The fund was already doing a lot on engagement activity and the Fund would target its engagement activity in line with the stewardship plan within LGPSC Climate Risk report.
- **More action from investment managers/pool?** *To continue to monitor the Fund managers progress in this area and work with LGPSC to enhance reporting and information on the effectiveness of engagement outcomes over time.*
- More climate solutions/more de-risking? Agree a decarbonisation goal for the next five years with 2020 as the baseline (an action for the committee to consider).
- Commit to impact-driven investing? This may be a way to align to some of the other SDG priorities that the fund has agreed, subject to the opportunities delivering strong market-rate, risk-adjusted financial returns.
- Training on impact investing? This was felt to be a good suggestion.

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 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.