BATH AND NORTH EAST SOMERSET

AVON PENSION FUND COMMITTEE

Friday, 15th December, 2023

Present:- Councillors Paul Crossley (Chair), Toby Simon, Chris Dando and Joanna Wright

Co-opted Voting Members: Councillor Robert Payne (North Somerset Council), Charles Gerrish (Academies), William Liew (HFE Employers), Wendy Weston (Trade Unions), Pauline Gordon (Independent Member), John Finch (Independent Member) and Jackie Peel (Independent Member)

Co-opted Non-voting Members: Councillor Kate Kelliher (Parish & Town Councils)

Advisors: Steve Turner (Mercer) and Hill Gaston (Mercer)

Also in attendance: Nick Dixon (Head of Pensions), Liz Woodyard (Group Manager for Funding, Investment & Risk), Nathan Rollinson (Investments Manager), Carolyn Morgan (Governance and Risk Advisor), Nicky Russell (Technical & Compliance Advisor), Jeff Wring (Director - One West) and Claire Newbery (Pensions Operations Manager)

32 EMERGENCY EVACUATION PROCEDURE

The Chair drew attention to the emergency evacuation procedure.

33 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Councillor Shaun Stephenson-McGall and Councillor Mike Drew had sent their apologies to the Committee.

34 DECLARATIONS OF INTEREST

There were none.

35 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

36 ITEMS FROM THE PUBLIC - TO RECEIVE STATEMENTS, PETITIONS OR QUESTIONS

Elaine Ashley addressed the Committee, her statement is set out below.

I am aware that you will be making the decision at this week's meeting on resetting the date for your net zero commitment for investments.

I would firstly like to acknowledge that this is a significant step. It demonstrates that you recognise the need to devote time to looking at the impact of the fund on the *climate and to monitor this on an ongoing basis. In addition, I acknowledge that you are ahead of most public sector pension funds in this area.*

However, I took part in some of the engagement activity both as a member and as a Unison Union rep and I was concerned that there was a strong presentation of the risks - as you see them - of bringing the net zero date further forward, but no representation to humanity of the risks of not doing this. It did not feel like a balanced debate and there was minimal opportunity for detailed discussions and presentation of alternative view points.

There is no easy answer to this situation and your arguments to as to why 2035 or 2030 is risky as well as the benefits of supporting companies who are on the path to divestment made sense. I just did not see a detailed benefits analysis comparing the other risks and weighing them up to come to a truly informed decision.

I hope that when you next review this date you will consider more honest engagement and debate and bring in some alternative viewpoints.

The Group Manager for Funding, Investment & Risk replied that they will look to build on the work carried out in the recent engagement sessions and use additional analysis in the future.

The Chair, on behalf of the Committee, thanked Elaine for her statement.

37 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

38 MINUTES: 22ND SEPTEMBER 2023 (PUBLIC & EXEMPT)

The Committee **RESOLVED** that the minutes of the meeting on 22nd September 2023 be confirmed as a correct record and signed by the Chair.

39 PENSION BOARD - DRAFT MINUTES - 7TH DECEMBER 2023

The Committee **RESOLVED** to note the minutes of the Board meeting held on 7th December 2023.

40 CLIMATE POLICY REVIEW

The Group Manager for Funding, Investment & Risk introduced the report to the Committee and highlighted the following areas.

- In March the Committee approved Phase 1 of the 2023 strategic investment review, which confirmed a diversified asset allocation with robust risk management to underpin more predictable employer contribution rates.
- Phase 2 of the review focuses on the Fund's net zero target, aligned with short and medium-term climate objectives.
- The review examines whether the Fund can raise its ambition by bringing forward the current 2050 net zero target date, recognising the urgent and material financial risk climate change poses. The aim is to set targets that will

drive real world change whilst achieving the appropriate risk/return required to meet our overriding investment objective.

- Extensive engagement has taken place with various stakeholders throughout this process including elected Councillors, employers, and
- trade unions, as well as a member survey.
- In addition, the Committee held a workshop in October to discuss the implications of the climate analysis undertaken by the Fund's investment consultant in terms of the impact on the investment strategy.
- There was a broad consensus across the workshop, engagement sessions, and member survey to bring forward the net zero target date and the proposals are set out for the Committee to consider and approve.

The Head of Pensions addressed the Committee and summarised the engagement sessions and member survey results.

Stakeholder engagement sessions

- 11 sessions
- 172 attendees
- 8 different stakeholder groups

Topics covered in the engagement sessions:

- our approach to responsible investment
- our climate policy
- carbon reduction progress to date
- how our Paris-aligned investments work
- our fossil fuel exposure
- our approach to engagement and divestment

The general consensus

- There is broad support for us to divest by 2030 from companies not aligning with net zero 2050.
- Many stakeholders favoured driving real-world impact and seek greater ambition on climate change.
- There is however broad concern about protecting the fund and sensibly managing investment risks.
- Broadly consensus in the engagement sessions converges on seeking to achieve net zero 2040-2045.

Member survey

- 5,210 members completed the survey (11% response rate)
- Majority of respondents aged between 55 – 74
- 3,876 people responded that it was 'very important' or 'important for the Avon Pension Fund to take account of climate change when making investment decisions.
- When asked about the level of investment risk we should take when considering net zero targets 39% responded that we should make a medium investment risk of net zero 2040-45

- 67% replied that it was important to both divest and engage with companies that are not aligning with net zero by 2050 or before.

Hill Gaston, Mercer addressed the Committee and highlighted the following sections from their report 'Avon Pension Fund - Net Zero Review'.

Net Zero Approach - Key considerations & levers

- Portfolio constructed from companies / assets aligned with a low carbon transition.
- Investment in climate solutions that support economy wide decarbonisation.
- Front-loaded portfolio decarbonisation with a focus on managing transition risk.

- It is challenging to maximise every net zero approach as there are trade-offs associated. When applied in isolation, they may lead to unintended outcomes from a financial and sustainability perspective.
- Based upon the Fund's objectives and commitments to stakeholders, it is important to establish priorities and strive for balance which minimises financial implication (risk, return, diversification) and supports real world impact.

Executive summary - Key areas of progress to date:

- Listed Equity decarbonisation is ahead of target.
- Good progress on total fund climate solutions versus target (to have 30% invested in sustainable/transition aligned investments by 2025).

Four strategic pillars

- Extending portfolio coverage of carbon analysis
- Accelerating targets
- Engagement
- Selective divestment

Building net zero portfolios - Summary of Analysis

We consider that the net zero 2045 or net zero 2050 portfolios achieve a sweet spot between balancing portfolio decarbonisation and meeting fiduciary duty of the Fund. This may change in the future should more companies adopt earlier net zero targets. Comparing 2050 to 2045 depends on the decarbonisation pathway, e.g. a 2045 target with a more gradual pathway may be preferable.

Fossil fuels – to divest or not to divest?

- Potential benefits of divestment / Trade-offs

    - Risk & decarbonisation: reduce portfolio exposure to 'stranded' assets and carbon intensity.

- Escalation tool when engagement fails and companies are too slow to transition.
- Signal to market about Fund's ambition and views.
- Increase cost of doing business if enough investors deny fossil fuel companies access to capital.

- Not sufficient for net zero as other sectors / companies are also carbon intensive.
- Engagement more effective when tackling systemic and non-diversifiable issues like climate change?
- Limits real world impact if no longer supporting high emitters to transition through engagement.
- Inconsistent with fiduciary duty if reduced opportunity set impacts returns?
- How to implement in a pooling context?

Divestment / exclusions approach should be reflected in Avon policy. Potential to engage other Partner Funds to form a collective approach for Brunel to implement.

The Chair asked if any of the outcomes from the recent COP 28 meeting had an impact on the work of the Fund.

Hill Gaston replied that he did not initially think so and that the main statement that came out of the meeting was that there is to be a phasing out of the use of fossil fuels. He added that he believed that the Fund already has a credible approach to fossil fuels in place.

Jackie Peel asked how a judgement will be made regarding divestment.

The Group Manager for Funding, Investment & Risk replied that Brunel were key to this decision and have the same ambition as the Fund. She said that there would be a mechanism put in place for an annual review to be held and that this would include third party analysis.

She added that the Fund could seek to set a forward criteria that sets out their expectations and consider divesting from companies that are not aligned to their views by 2030.

Hill Gaston suggested that Brunel be tasked with constructing some alignment definitions.

The Group Manager for Funding, Investment & Risk said that a further report on this subject would come to the Committee in 2026 following annual reviews that are carried out by Brunel and officers from the Fund.

Councillor Joanna Wright asked what impact the Fund has on decisions made within the pool.

The Group Manager for Funding, Investment & Risk replied that when the Brunel pool was originated the founding concept was responsible investing and that climate has been a focal point throughout the last seven years.

She added that there was not always a consensus from across the ten clients in the pool, but this was increasing and said that they were at the forefront of what they want to achieve. She stated that the introduction of the Sustainable Equities portfolio and the Paris Aligned portfolio was an important step on behalf of the Fund.

She explained that the Fund can hold Brunel to account and that they in turn can hold the managers to account.

Councillor Wright asked what the Fund were able to do if they are unhappy about a particular investment.

The Group Manager for Funding, Investment & Risk replied that the Investment Strategy will evolve over time and that their level of investment in low carbon assets is already quite high. She added that through the recent workshop Brunel had learnt of the current ambitions of the Fund.

The Head of Pensions reminded the Committee that Brunel have a broad number of arrangements in place and so, if necessary, there were choices available for the Fund, from standard index funds to those focused on carbon reduction.

Councillor Toby Simon commented that he was comfortable with the recommendations that were being proposed and stated that he would not want the Fund to be in a less focussed pool.

John Finch said that he believed that there were still advantages and that more can be achieved by being in a pool than working on our own. He said that by doing so it will enable us to influence other pool members and that we need to tell the Government how good this arrangement is.

Councillor Chris Dando commended the officers and Mercer for a good report and proposed the recommendations within it.

Councillor Toby Simon seconded the proposal.

Councillor Joanna Wright referred to section 8.2 of the report where it states that ‘each year the Fund will receive a climate analysis from Mercer’ and explained to the Committee that she would like a meeting to take place in which she and the Chair discuss climate issues further with Professor Steve Keen and Carbon Tracker as they have been recently critical of Mercer’s analysis reports.

The Chair replied that he would discuss with officers a timescale to setup an online meeting and then issue an invite to the rest of the Committee for others to attend if they so wish.

The Committee **RESOLVED** to agree:

The following climate targets for the Avon Pension Fund:

1a) Clear tangible targets for climate action in the years 2024-30:

- By 2030 the Fund will divest from all developed market equity holdings in high impact sectors that are not achieving net zero or aligning to achieve net zero by 2050.

- The Fund will reduce carbon intensity of its listed equity portfolios by 43% and 69% by 2025 and 2030 respectively (versus 2019 baseline).

- By 2030 the Fund will reduce the carbon intensity of its corporate bond portfolio by 60% (versus 2019 baseline).

- 70% of financed emissions in material sectors are covered by active engagement by the end of 2024 and 90% by 2027.

1b) To bring forward its overall net zero target to 2045 (from 2050) and review this formally again in 2026.

2) To endorse and support collaborative engagement and climate policy advocacy work through membership of various industry leading climate advocacy bodies.

3) That the Committee supports nature-based investments and asks the Investment Panel to explore investment opportunities in 2024/25 and bring a recommendation to Committee.

41 2023 ANNUAL RESPONSIBLE INVESTMENT REPORT

The Investment Manager introduced the report to the Panel. He explained that this was the eleventh annual report on responsible investment prepared by the Fund and that the aim is to bring together all the aspects of the Fund's policies and activities that contribute to its responsible investing objectives. The draft report was enclosed for the Committee to provide feedback and approve.

Councillor Toby Simon commented that within the listed priorities he would like to see 'g) Human rights and social issues' higher up the list and proposed this be placed at point b).

The Chair stated that he was keen for progress to be made over the coming year in terms of the Local Impact portfolio and wanted the Fund to stay ahead of the game as much as possible.

The Head of Pensions said that clear objectives would be set within that portfolio with a focus on social / local impact. He added that officers were in the process of assessing a number of proposals that had been submitted and were due to bring an initial report to the Investment Panel in 2024, prior to coming to the Committee.

The Committee **RESOLVED** to:

i) Approve the Draft 2023 Annual Responsible Investment Report for publication.
ii) Agree the 2024 RI priorities as set out in 4.4.

42 INVESTMENT STRATEGY (FOR PERIODS ENDING 30 SEPTEMBER 2023)

The Investment Manager introduced the report to the Committee and highlighted the following areas.

- The Investment Panel met on 1st December 2023 and their most substantive item discussed during the meeting was the modelling output of the dynamic equity protection strategy. There was unanimous support to reduce the hedge ratio to 50% from 100% of underlying equity exposure.

- Panel members considered the trade-offs between asset performance drag and risk reduction, and specifically the impact on the discount rate and employer contributions as part of their decision to recommend the strategic change to Committee.

- The Fund's assets were £5,268m on 30 September 2023 and delivered a net investment return of -2.9% over the quarter. The decline in the value of Fund assets over the quarter was driven mainly by the LDI portfolio and equity assets. Overseas property and secured income portfolios also detracted.

Councillor Joanna Wright asked for further explanation of section 5.2 of the report.

Steve Turner, Mercer replied that 40% of the Fund's assets are invested in equities and these account for around 70% of the overall risk. He stated that the Fund has a risk management approach and uses the hedge ratio as an insurance policy with regard to equities to act as a shock absorber.

He added that by reducing the ratio to 50% this would allow potential to capture any upside whilst retaining some degree of insurance.

He informed the Committee that there was no overall change in the funding position.

He said that historically the months of September and October are not great for investing, but added that the end of October saw a big reversal in some markets whilst a strong rally in equity took place during November.

Pauline Gordon commented that the Bank of England were less positive on rates than markets suggest.

Steve Turner confirmed that rates markets are not always a strong indicator of future rates.

He added that it would be interesting to see the end of year position.

Councillor Joanna Wright referred to section 6.1 (Quarterly Stewardship Summary) and asked for further information on this point.

The Investments Manager replied that the role of Hermes is to be a voting engagement provider for Brunel, having access to people at the highest corporate level and then advising Brunel on their voting policy.

The Chair commented that this issue had also been mentioned at the recent Pension Board meeting and suggested a future report on the approach to voting by Brunel and related service providers be received to give the Committee further information.

This proposal was seconded by Councillor Wright.

The Committee **RESOLVED** to:

i) Note the information set out in the report and appendices.
ii) Agrees the recommendation from the Investment Panel to reduce the dynamic equity protection hedge ratio to 50%.
iii) Agree that the implementation of ii) is delegated to the FRMG.
iv) Agree that the Committee receives a future report on Stewardship.

43 UPDATE ON LEGISLATION

The Technical & Compliance Advisor introduced the report to the Committee and gave an update on the following matters.

McCloud Judgment

The Fund have started processing McCloud cases from 1st October 2023 so adhering to the regulations, but guidance is still awaited from Government on the more complex cases. Remedy cases are to be looked at in 2024, and in the draft guidance, it has been proposed that certain cases are to be completed by 31 August 2025, which is the date the Annual Benefit Statements are to be issued with McCloud data.

Pensions Dashboard

The LGA have announced that the proposed date for Public Sector Schemes to be connected to the Pensions Dashboard is by 30th September 2025.

The Chair asked if as expected a General Election is held in 2024, would a change in government lead to a change in their philosophies towards pensions and what risk would this be to the Fund.

The Pensions Operations Manager replied that any ministerial change delays guidance and slows overall progress.

Steve Turner, Mercer commented that he believed that there was some degree of alignment between the Conservative and Labour parties over pooling.

The Committee **RESOLVED** to note the current position regarding the developments that could affect the administration of the Fund.

44 PENSION FUND ADMINISTRATION - OVERVIEW & SUMMARY PERFORMANCE REPORT

The Pensions Operations Manager introduced the report to the Committee and highlighted the following areas from Appendix 3 (Administration Service Improvement Plan update Q3 2023).

Current Service state

- Aggregate performance is broadly stable – but insufficient.
- Cases completed are starting to exceed new cases coming in.
- Reduction of outstanding cases is starting to come down and supports our focus on addressing backlog cases.

Five root causes affecting the Service

1. People & Capacity
    - Vacancy rate: 10% (13 recent appointments made)
    - Pay
    - Officer experience

Jackie Peel asked if the recent appointments were of experienced staff.

The Pensions Operations Manager replied that the staff appointed have a good range of general skills and have begun pension specific training.

Charles Gerrish asked when the post of Payroll Manager would be filled and is there enough expertise across the current teams.

The Pensions Operations Manager replied that a restructure programme has been undertaken and that following a revision of the job description the post was due to be advertised again soon. She added that she believed that the current teams have the expertise to deal with all aspects of their work.

Councillor Joanna Wright referred to sections 5.3 and 5.4 of the report and asked why two employers were due to be fined.

The Pensions Operations Manager replied that during the Year End exercise two employers had submitted information either where it was incorrect or missing. She added that they do try to be lenient and only issue fines when they are appropriate.

2. Processes
    - Duplication of process and checking
    - Volume of Leaver work
    - Payroll processes

3. Regulations
    - New McCloud regulations with effect from 1st October
        - Training received from Aon
        - Switched on in Live software system.

    - Disclosure regulations 60,000 letters / 20,000 emails to be sent by the end of the year to all affected members.
- New Fire Scheme Sergeant/McCloud regulations with effect from 1st October

The Chair asked why the Fund has taken the decision to switch on the McCloud regulations in the software from 1st October and other Funds have not.

The Pensions Operations Manager replied that for other Funds it could be due to either a resource or confidence issue. She added that some have done so since the start date occurred. She explained that they have encountered some quirks, but these have been reported and either resolved or a solution is being worked upon.

4. Work Spikes & Projects
    - Fire Scheme exit (31/1/24)
    - ABS (Annual Benefit Statement) spike in work
    - Pensions Increase errors

5. Increased demand
    - ABS spike in emails / calls
    - Increase in case workload
    - Increase in retirements / deaths
    - Backlogs

The Chair stated that if any enquiries are to be promoted as achievable through the website it will need to clear, easy to understand and secure.

The Pensions Operations Manager replied that this will be the intention when the new Member Website is launched. She added that they were currently at the testing stage, which will include accessibility and security checks.

Future road map

- Intention to attempt to meet KPI’s by Q4 2024

Jackie Peel suggested setting an interim target for the KPI’s.

The Director, One West replied that a review of the KPI’s generally was also due to take place.

The Chair thanked all officers involved for the work they continue to do and for the improvements made so far.

The Committee **RESOLVED** to note the service performance for Q3, the three months up to 30 September 2023.

45 GOVERNANCE UPDATE

The Governance & Risk Advisor introduced the report to the Committee and highlighted the following areas from it.

Hymans LGPS Online Learning Academy (LOLA)

Committee members have agreed to complete all training modules within twelve months of becoming a Committee member and repeat the completion of the modules every three years.

The schedule for completion of the modules is contained within the training programme (Appendix 3) for members who have not already completed the previous version. Module 7 should be completed by the end of December 2023.

Quarterly Review of Risk Register

Following the quarterly review of the risk register, one new risk has been identified and there are two changes to the current risk score.

NR18 - A new risk has been added to capture reputational risk to the Fund. Unforeseen events or service issues leads to reputational damage to the Fund amongst its stakeholders. This risk has been considered and mitigating actions are set out in the risk register.

NR04 – Governance of the Fund is not in accordance with APF policies and internal controls are not adequate. This risk has been increased from medium impact and unlikely (6) to high impact and likely (16) following the non-payment of pension increases to some members. The risk has been increased while the incident is fully investigated, and Internal Audit have been asked to review payroll procedures and internal controls for year-end processes.

NR08 - Employers unable to meet financial obligations to Fund. In the current economic climate the risk of employers being unable to meet financial obligations to Fund is elevated. There has been an increase in S114 notices issued by councils nationwide and Higher Education employers are particularly constrained as fees are fixed but costs have increased due to inflation. The Fund has no specific information about employers being unable to meet financial obligations and has strong covenant management and information gathering processes in place as a mitigation.

Internal Audit Findings

Internal Audit presented their findings to the Pension Board on 7th December along with the external auditor report.

The Fund’s Annual Report has also now been published.

Councillor Toby Simon asked how the Director, One West manages his role in terms of working for the Fund and Internal Audit.

The Director, One West replied that he was not the Head of the Audit Team and that his role was to accelerate issues when needed and assess risk on behalf of the Fund. He added that he keeps the role under regular review with other senior members of staff.

Charles Gerrish asked why the System Access Control – Internal Audit Report had not been shared with the Committee at an earlier meeting.

The Director, One West replied that if a ‘No Assurance’ (Level 1) rating had been assigned then the report would have been accelerated to an earlier meeting of the Committee. He added that the intention had always been to bring these reports during Q3.

Councillor Joanna Wright asked if other Councils were to issue Section 114 notices what impact, if any, would that have on the Fund.

The Director, One West replied that this is a risk that is accelerating across all Local Authorities. He added that if a Council declares that it is unable to meet its budget it will be placed into shortened, accelerated Improvement Plan and only be able to perform its statutory functions. He stated that actions involving pensions are protected by guarantee.

He said that lobbying in terms of funding to Local Authorities can be directed towards both the LGA and the Scheme Advisory Board. He added that a number of disconnects do exist between central and local government. He informed the Committee that an announcement regarding Local Government Funding was due within the next week.

Nick Weaver asked if an employer was to submit notification that their level of contributions needs to change would the Fund be in a position to handle this.

The Group Manager for Funding, Investment & Risk replied that it was and that contributions can be adjusted on the basis of affordability. She added that the level of contribution and over what period can be set and would be judged on a case-by-case basis. She said that the Fund was covered with a policy.

Councillor Toby Simon asked if the Committee receives a Covenant report.

The Group Manager for Funding, Investment & Risk replied that it does and that it was published as part of the agenda for the meeting that took place in June 2023.

The Committee **RESOLVED** to:

i) Note the Committee & Investment Panel workplans, training programme.
ii) Note the service plan.
iii) Note the risk register.
iv) Note the findings set out in the Internal Audit reports.

The meeting ended at 12.21 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services