AVON PENSION FUND COMMITTEE INVESTMENT PANEL

Minutes of the Meeting held

Friday, 27th May, 2022, 2.00 pm

Members: Councillor Shaun Stephenson-McGall (Chair), Councillor Paul Crossley, Councillor Chris Dando, John Finch and Shirley Marsh-Hughes
Advisors:
Also in attendance:

1 WELCOME AND INTRODUCTIONS

The Chair welcomed everyone to the meeting.

2 DECLARATIONS OF INTEREST

There were no declarations of interest.

3 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies for absence were received from Pauline Gordon.

4 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was no urgent business.

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

Nick Aslett addressed the Panel asking that 2050 target for the removal of all funding to the fossil fuel industry be revised and money be divested from fossil fuel industries immediately.

The Chair confirmed that a written response would be sent to Mr Aslett and this, along with the statement, would be attached as an online appendix to these minutes.

6 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were no items from Councillors or co-opted Members.

7 MINUTES: 25TH FEBRUARY 2022

RESOLVED that the minutes of the meeting on 25 February 2022 be confirmed as a correct record and signed by the Chair.

8 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 31 MARCH 2022

The Investments Manager introduced the report and invited representatives from Brunel and Mercer to present their update.

Daniel Spencer and Luke O'Donnell (Brunel) gave an update as follows:

1. Credit update: US and UK Government Bond Yields were trending upwards.
2. Last year there was a supply shortage which caused prices to rise and inflation to increase and the Government Bond Yields adjusted accordingly.
3. Corporate borrowing costs had also increased due to the events of the last 3 months.
4. Managers and their portfolios: CQS had expertise in loans and asset class criteria, Neuberger Berman had a broad approach and Oaktree had specialist in asset class strength and distinctive asset allocation.
5. Asset types and return drives: 60%-80% of returns were of moderate risk. Higher risk assets were low in the portfolio (10%-20%).
6. Environmental, Social and Governance (ESG) progress of Managers to date were set out in the presentation slides, including key milestones to date in relation to climate issues. In the shorter term, there would be a full climate audit followed by target setting.
7. Responsible Investing: Q1 had been impacted by 2 events, the invasion of Ukraine by Russia and subsequent impact on commodities and the continuing lockdown policies of China which was causing bottlenecks in terms of supply. This had resulted in higher inflation causing central banks to react.
8. In Q1 ESG companies had done badly compared with carbon intensive ones so it had been difficult for sustainably focused investors to achieve progress this year due to global events. Sustainable themed investments were down by 5-6%.
9. Drivers of market in Q1: Growth and Quality stocks underperformed value and economic/commodity sensitive stocks
10. Current credit themes: Inflation; Covid; global growth uncertainty; rising credit volatility and central bank tightening.

In response to questions, Committee Members were advised:

1. In relation to responsible investment, the Portfolio Managers were of a high standard and the pipeline of investible opportunities was strong.
2. The target for net zero was 2050, but interim targets had been set for 2030 to monitor progress.
3. In terms of timescales for ESG progress, the long term would be 5-10 years and medium term 2-3 years. It was hoped that the short-term target of a climate audit would be completed this year.
4. Neuberger Berman was the leader in terms of RI and may be able to achieve ambitious medium term targets.
5. Consideration was being given to the impact of commodity production resulting from the Russia/Ukraine situation.
6. Even though sustainable themed investments were down, there would be no compromise on RI and Managers were looking at different scenarios in the event of the Russia/Ukraine conflict continuing for a long period.

7. The result of the Australian election would not impact on investments as this was a small part of the global equity universe.
8. Even though there were no direct investments in China in this portfolio, the zero covid policy and lockdowns in areas such as Shanghai did have an impact on inflation and market behaviour causing a domino effect.
9. In relation to the risks and opportunities of stagflation, work was being undertaken in terms of scenario planning and this would be reported back to Panel members.

The following questions from Panel Members would be raised with Portfolio Managers:

1. What were the knock-on risks and impact on poorer countries of commodity shortages resulting from the Russian/Ukraine conflict?
2. What analysis was taking place about the lessons learnt from the Covid pandemic in relation to investment risk?

Josh Caughey and Steve Turner (Mercer) gave an update as follows:

1. Market background: key issues were the Russian invasion of Ukraine and the increase in inflation. This had an impact on the Liability Driven Investment (LDI) portfolio.
2. Performance Summary: All global equity mandates were ahead of the assumed strategic returns with the exception of the Paris aligned fund, which has an insufficient track record to be able to draw any conclusions
3. Property, secured income and infrastructure were all ahead of returns.
4. Equity protection had been adding value, equity markets had come down and the funding level was protected by 1-2%.
5. The LDI portfolio made a large positive contribution to returns due to the protection it provided against inflation.

In considering whether any issues should be brought to the attention to the Pension Fund Committee, it was noted that the performance of responsible investment and the reasons for this would be highlighted to the committee in the officers' report. Officers also advised the Panel of the Government guidance due later in the year in relation to the levelling up agenda and the potential impact for the local government pension scheme.

RESOLVED that the information in the report be noted.

9 CLIMATE POLICY UPDATE

The Group Manager for Funding, Investment & Risk introduced the report and asked the Panel to note the outcome of the Analysis for Climate Transition (ACT) which would feed into the strategic review and also note the summary of the first Brunel 2022 climate stocktake workshop. She drew attention to the following:

1. It was important to manage expectations as it was only possible to divest from stocks that the fund owned.

2. There needed to be a way to demonstrate how the process worked for some high-profile stocks.
3. Communications were important especially the messaging in relation to selective divesting.

Panel members stressed the importance of communications and publicising information in a format that was easy to understand with basic facts about what the fund did not invest in; areas where the Council had some control; the reality of the size of investment and relatively small amount which was associated with fossil fuels and the progress already made towards achieving net zero alignment by 2050. It was agreed that the response to the public statement would be published on the website, and there could also be a press release to coincide with the publication of the responsible investment annual report in September.

The panel noted that consideration of the exempt appendices would need to be in exempt session due to the detail contained within, but that there would be a higher level presentation to the Committee which would be held in open session.

The Panel, having been satisfied that the public interest would be better served by not disclosing relevant information, **RESOLVED,** in accordance with the provisions of the Section 100(A)(4) of the Local Government Act 1972 that the public should be excluded from the meeting for this item of business, because of the likely disclosure of exempt information as defined in paragraph 3 of Part I of Schedule 12A of the Act as amended.

RESOLVED that the following be noted:
1. the outcomes of the ACT analysis as summarised in Exempt Appendix 1.
2. the proposals for additional climate targets that will be considered as part of the 2022/23 strategic review.
3. the summary of the first Brunel 2022 climate stocktake workshop.

10 RISK MANAGEMENT FRAMEWORK REVIEW FOR PERIODS ENDING 31 MARCH 2022

The Investments Manager fed back from the meeting of the Financial Risk Management Group (FRMG) which had considered financial and geopolitical assumptions and identified the main issue as the increase in inflation, how persistent it may be and whether this needed to be offset. He confirmed that Mercer had advised this was not necessary. Separately he drew the Panels attention to the recommendation for the collateral plan to be approved, and the implementation of the plan to be delegated to FRMG.

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RESOLVED
1. That the following be noted:

a. the current funding level and Liability Driven Investment (LDI) hedging position.
b. the impact and performance of the equity protection strategy
c. the current collateral adequacy position

2. That the proposed collateral plan as set out in Exempt Appendix 2 be approved and the implementation of the plan be delegated to Funding and Risk Management Group.

11 FORWARD AGENDA

The Panel were advised that officers would soon be arranging meeting dates for 2023.

RESOLVED that the forward agenda set out in the report be noted.

The meeting ended at 4.39 pm

Chair(person) .....

Date Confirmed and Signed .....

Prepared by Democratic Services

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My reason for speaking to you today is to ask that you revise your 2050 target for the removal of all funding support to the fossil fuel industry.

The summer picnic was always a cornerstone of the social calendar of this thriving community. From the babies born in the proceeding months to the diverse and rich mixture of elders, everyone enjoyed one another's company in the sunshine on the banks of the lake that was in the centre of the park. Tragically, in 2015, this idyllic happening was forever changed by the death of a child that drowned in the lake during the festivities.

In response to this tragedy the community banded together and committed to never letting this happen again. A committee was formed with the mission to ensure the lake was made safe. Lifesaving options were explored and a solution was proposed. The committee recommended a series of life lines and floating devices. There was just one issue; in the first instance, the preferred contractor could only guarantee that the lifesaving solution would cover "most" not all of the lake. They said that their technology was developing and that by 2050 they would guarantee full coverage of the lake and install the extra equipment free of charge.

The committee championed this solution saying that, whilst it was not perfect, it was cost efficient and represented a good compromise. The community was consulted and whilst concerns were raised that the proposed solution still put lives at risk, the committee went ahead with their plan. The equipment was installed and members of the committee sought coverage in the local media championing their efforts.

The annual picnics continued and memories of the events of 2015 slowly faded. Some 10 years later the picnic was, once again, in full swing. 2 children wandered off from the main group to explore the lake. It was a while before they were missed, following a brief search they were found playing at the far end of the lake. It became clear that they had strayed too far into the lake and were in trouble. The shout went out for the life lines a floats. Fatally for them, the 2 children had chosen to play in the part of the lake not reachable by the "compromise" lifesaving solution. They died

The efforts made by Avon Pension Fund (APF) to divest from fossil fuel (FF) funding are laudable as far as they go but greater courage is needed to fully divest from FF funding well before the current proposal of 2050.

In April this year the highest ever levels of CO2 were recorded in our atmosphere (421ppm, where no higher than 350 ppm is seen as healthy for humanity) and the trajectory is ever higher. Evidence grows every day of the determination of the fossil fuel industry to ensure a business as usual, growth focused model and the consequential destruction of our planet. The current investment plans of the top 12 FF companies is to spend $103m A DAY for the remainder of this decade on the expansion of oil, gas and coal extraction.

Through the UN Conference of the Parties (COP) mechanism, Nation States and Big Oil have consistently set targets without the slightest intention of ever meeting them. For them the approach is about procrastination and diversion, greenwash and greed. Carbon emissions continue to rise at frightening rates, drought, flood, fire and famine are becoming daily occurrences rather than rare events.

In my story the 2 children died not because the efforts of the committee weren't well intended but because those efforts fell short of what was actually needed. Humanity needs people with courage to make the hard decisions, to provide examples of what a positive future could be like. This Committee has the power to show that positive leadership. I implore you to recognise that, with every day that passes, money invested in the FF Industry is money that is accelerating this destruction of our planet. Be that positive example, have the courage, get our money out of FFs NOW.

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Avon Pension Fund
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Dear Nick,

Thank you for the statement delivered at the Pension Fund's Investment Panel meeting on the 27 May.

The Fund has long recognised the need for urgent action on climate change and has been taking tangible action to ensure we contribute to the solution while protecting our members interests, which remains our priority.

As at March 2022, the value of our holdings in the top 5 Oil & Gas companies was £4.1m, which equates to 0.2% of the Fund's listed equity portfolio and 0.07% of total assets. Using a broader definition of fossil fuel exposure[1], the Fund held around £86.6m in fossil fuels overall, representing just 3.4% of our listed equity portfolio and 1.4% of the total Pension Fund. Rather than operating a blanket divestment approach to fossil fuels, which we do not believe achieves any real-world impact in itself, we instead focus on portfolio decarbonisation, collective engagement, and investing to enable the climate-transition.

While our policy on climate change more broadly states we will become net zero by 2050 or earlier, we have important interim goals, targeting absolute emissions reductions of 43% by 2025 and 69% by 2030 (from a 2020 baseline), respectively.

In addition, we have made a number of strategic allocation decisions to align the portfolio with the transition to the low carbon economy. Recently we exited our investment in emerging markets where the ability to directly influence climate policy, at appropriate levels, is limited and this reduced our listed equity emissions by approximately 28% (from 86k tonnes to 62k tonnes of Co2).

In 2021 we invested over £500m in a new equity portfolio designed to divert capital away from the most carbon intensive sectors and companies and reward those that are investing in the transition and providing climate solutions. This portfolio does not invest in coal and tar sands companies as well as companies whose primary business function relates to the exploration, extraction or distribution of fossil fuels and will ultimately see us on a carbon reduction pathway consistent with achieving net zero by 2050, or earlier.

Decarbonisation represents one route to net zero, the other requires large capital investment in climate change mitigation technology. We are investing £380m in renewable infrastructure which includes traditional forms of renewable energy such as solar and wind as well as new technologies such as such as battery storage, bioenergy and sustainable agriculture.

These latest steps represent a continuation of the Fund's strategy on climate change, as it seeks to balance the need to generate an investment return required to fund our pension liabilities with setting ambitious – yet credible - climate change targets.

[1] Defined as companies that derive some proportion of revenues from either fossil fuel extraction, storage & transportation and/or power generated from fossil fuel consumption. This covers companies across Energy (Oil & Gas), Financials, Industrials, Materials & Mining and Utilities; a number of which are also known to own, operate and/or generate power from renewable energy sources. Fossil fuel figures as at December 2021.

Transformation at the speed and scale required to reach net zero will take a coordinated approach across the entire industry and ensuring the right policy frameworks are in place to unlock investment opportunities and scale up flows of low carbon finance is essential to addressing the issue. The Fund has engaged on finance and climate policy at the global, EU and national level which has helped inform and strengthen policy decisions made in support of a low carbon, climate resilient economy.

As a relatively small investor in global terms and, in order to maximise the contribution the Fund can make to reducing emissions in the real economy, it works collectively with industry groups and initiatives. As a signatory to ClimateAction100+, for instance, the Fund is represented at some of the most high-profile engagements with corporate greenhouse gas emitters. Last year we saw successes after engaging intensively with the banking sector on measures to limit the amount of financing the fossil fuel sector receives.

To ensure that we maintain our position as a market leader in responsible investment we are working with our investment manager, Brunel, on a review of their Climate Policy during 2022. This includes an assessment of the effectiveness of company engagement with a view to identifying those companies that we invest in that have not met our expectations and where selective divestment is an option. The Fund will report on the progress of this 'climate stocktake' in due course.

Details relating to our responsible investment policy as well as our approach to climate change can be found on our climate microsite here. The Fund's net zero target is consistent with the framework set-out by the Institutional Investors Group on Climate Change, further details of which can be found here. You may also find more information in our latest Responsible Investment Report here.

Yours sincerely,

Cllr Shaun Stephenson-McGall

Chair of the Avon Pension Fund Investment Panel

Investment Panel 27 May 2022 – Follow up answers from Brunel

1. **What were the knock-on risks and impact on poorer countries of commodity shortages resulting from the Russian/Ukraine conflict and how do your managers assess this when constructing their portfolios?**

Food prices as are their highest level since 1990. Ukraine and Russia, being major agriculture and fertilizer producers, the war in Ukraine further compounded the upward price spiral which began in mid-2020. For poorer countries surging food and fuel price inflation are a worrying prospect. Food represents a larger percentage of headline CPI baskets in EM (50% of India's CPI basket, 30% of Philippines and China vs 8% in the US) While high food and fuel inflation impacts all countries – lower income countries are hit harder as families spend more of discretionary income on basic goods and services. This has prompted export restrictions from governments with Indonesia and India banning palm oil and wheat exports recently. Continuation of the conflict is putting the planting season for wheat, barley, maize, rapeseed, sunflower at risk. It is unclear at this stage if food will be weaponised or will food exports from the region flow through. Some of the poorest countries in the developing world like, Sri Lanka and Ethiopia for example, have seen food inflation running at 25-40%. This crisis will no doubt set back the UN SDG to end world hunger by 2030, and worsen malnutrition in many low-income countries.

From a portfolio construction perspective - large agricultural and energy exporters like Brazil, and the middle east benefit from these elevated prices while large importers like Sri Lanka, Egypt and Vietnam have been adversely impacted. Using the Emerging Markets Equity portfolio as an example, some managers have approached this from a bottom-up perspective to identify company specific risks around food/agricultural input costs and revenue streams which could create a margin squeeze. For example, in consumer staples, one of our EM managers focused on which companies have the brand and pricing power to pass on price increases and where demand is relatively inelastic.

2. **What analysis was taking place about the lessons learnt from the Covid pandemic in relation to the investment risk and within wider markets?**

The main lesson learnt was the true value of diversification by investment style and also by sectors, themes and countries. Covid was first a short-lived demand shock as the world shut down but was then followed by a longer lasting supply shock. In the demand shock phase - the level of stimulus (low rates and anomalous QE that central banks unleashed) led to outperformance of a narrow group of growth stocks – led by digital companies that benefitted from pandemic lockdowns. However, in phase 2 - when demand recovered, it was clear that years of underinvestment in commodities meant the world cannot produce enough of these commodities at scale and the global economy saw persistent supply chain bottlenecks. This was the catalyst for the comeback of value as an outperforming style, led by sectors that were unloved and had underperformed for a decade. Rather than time style rotations, many managers learnt that an effective way to manage risk around these transitions is to prudently balance style exposures and monitor the earnings inflection these companies were going through.

COVID created one of the fastest stockmarket sell offs in history and a massive bull run in a year when economies saw the biggest contraction since WW2. Taking advantage of these dislocations and subsequent regime changes from QE to QT, disinflation to record inflation needed an adaptive process. It was important for managers to discriminate between intrinsically expensive companies and optically expensive companies - for example in the strongly performing technology – hardware,

software, semicon/internet sectors. As value rotation took hold, again the analysis focused on sifting value traps from sound business models that offered discounts to intrinsic value.

Finally, several managers cited the need to maintain a strong liquidity profile of their portfolios to manage risks at this time of multiple transitions.