Bath and North East Somerset Council

AVON PENSION FUND COMMITTEE INVESTMENT PANEL

Minutes of the Meeting held

Wednesday, 5th June, 2024, 2.00 pm

Members: Councillor Shaun Stephenson-McGall (Chair), Councillor Chris Dando,

Independent Members: Pauline Gordon and Jackie Peel

Advisors: Steve Turner (Mercer) and Nick Page (Mercer)

Also in attendance: Nick Dixon (Head of Pensions), Liz Woodyard (Group Manager for Funding, Investment & Risk), Nathan Rollinson (Investments Manager) and Rebecca Whelan (Senior Investment Officer)

1 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer drew attention to the Emergency Evacuation Procedure.

2 DECLARATIONS OF INTEREST

There were none.

3 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Councillor Paul Crossley and John Finch (Independent Member) had given their apologies to the Panel.

4 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

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

There were none.

6 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

7 MINUTES: 27TH FEBRUARY 2024 (PUBLIC & EXEMPT)

The Panel **RESOLVED** that the minutes of the meeting held on 27th February 2024 be confirmed as a correct record and signed by the Chair.

8 LOCAL IMPACT PORTFOLIO

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.

9 LIQUIDITY REVIEW

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

- Mercer have undertaken a liquidity review exploring current and potential sources of income and how best to use collateral that currently forms part of the Fund's risk management framework.

- On balance Mercer recommend using the excess collateral to reinforce the Fund's cash position. The remaining collateral in the QIF will be sufficient to back the existing interest rate and inflation hedges and significantly above the collateral buffer recommended by the regulator. No further hedging will take place until the trigger framework is reactivated.

- Income is the other source of liquidity and this will become more important as the cashflow matures over time. Income from the private market and property portfolios is already reinvested into those portfolios. Officers will discuss with Brunel whether there are other portfolios or underlying funds that could distribute income and how this could be achieved.

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.

The Panel **RESOLVED** to:

i) Agree to keep the LDI trigger framework on pause, noting the Fund's projected cash requirements over the next two years.
ii) Delegate how to invest excess collateral to officers in consultation with Mercer.
iii) Delegate the decision to select an appropriate funding source for a Natural Capital allocation to officers in consultation with Mercer.

10 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 31 MARCH 2024

The Senior Investment Officer introduced the report to the Panel and summarised the following areas.

- The Fund's assets were £5,818m on 31 March 2024 and delivered a net investment return of 2.3% over the quarter which was in line with the benchmark. The increase in the value of Fund assets over the quarter reflected strong equity markets, with Brunel's listed portfolios all positive on an absolute basis, although flat on a relative basis.

- The liabilities are estimated to have increased by c.0.6% over the quarter. Taken together with the asset return, the funding level stood at 98% at March-31 (c. £107m deficit).

- Risk assets began the year as they finished the last with global equities up close to 10% in sterling terms in the first quarter 2024. The US market was the clear leader, while emerging markets and the FTSE All-Share lagged. Gains across all asset classes could largely be attributed to a resilient US economy, rebounding oil prices, and continued positive sentiment around Artificial Intelligence. Expectations of interest rate cuts also boosted equity markets although the pace of cuts is likely to be slower than the market had hoped at the turn of the year as inflation has once again proved stickier than expected.

- In Brunel's listed market portfolios, absolute returns were positive reflecting the strength in global equity markets over the period. Global High Alpha returned 9.9%, just 0.1% below the benchmark (MSCI World). Sector attribution showed allocation and selection were neutral overall. The Global Sustainable Equity portfolio returned 9.2%, also 0.1% behind its benchmark (MSCI ACWI). Market sentiment for sustainable investing continued its positive trend that began in Q4 2023 however, over one year to end March 2024, the portfolio remains significantly behind the benchmark.

- The Diversifying Returns Fund (DRF) returned 4.3% over the quarter, ahead of the benchmark return of 2.0%. Increasing exposure to equities over the six months to quarter end enabled the portfolio to benefit from recent market performance. Multi Asset Credit (MAC) returned 2.2%, which was slightly behind the benchmark return. Credit spreads tightened over the quarter reflecting the improvement in the economic outlook and an increase in risk appetite.

- During the period £35m was drawn into the new local impact portfolio to finance the acquisition of an operational solar portfolio. A further £40m was drawn into the Fund's Secured Income portfolio. To facilitate these large capital calls the Fund used cash and liquidated some of its ETF holdings. Officers redeemed £50m from the Brunel Paris-aligned passive equity portfolio to increase cash at hand and reduce the aggregate overweight position to equities. Post period end the Fund received advance deficit payments totalling £30m.

- Voting and Engagement Activity: As a responsible investor, we actively endorse collaborative engagement and seek to use our power as a shareholder to encourage corporate change. Voting and engagement are delegated to the Brunel Pension Partnership for the actively managed equity portfolios and to Legal and General Investment Management (LGIM) for the passive portfolios. On significant issues, Brunel may request that their shares held by LGIM are split out and a different vote made.

Shell Plc Shareholder Resolution

- Shareholder Resolution – Resolution 23 – Filed by: Follow This

- Shareholders support the company, by advisory note, to align its medium-term emissions reduction targets covering the GHG emissions of the use of its energy products (Scope 3) with the goal of the Paris Climate Agreement.

- AGM date 21 May 2024.

- Brunel was one of 27 leading investors that backed this resolution alongside Follow This. The resolution was designed to give Shell a shareholder mandate to drive the energy transition.

- The co-filing demonstrates Brunel's commitment to tackling the climate crisis at its source.

- Outcome: the resolution received 18.6% support from shareholders which was not enough for it to be passed.

- Dialogue will continue with Brunel over next steps and we expect them to continue speaking with all underlying managers regarding this issue.

The Head of Pensions commented that, although an option, selling out was not always the right thing to do as the power to influence can be lost. He added that officers intend to work with Brunel and other investors to find a way forward.

Steve Turner, Mercer addressed the Panel and highlighted the following areas from their appendices to the report.

Market background

Despite rising bond yields, equity markets continued to rally driven by AI enthusiasm, strong corporate earnings and resilient earnings.
Headline inflation in the UK fell to 3.4% in February from 4% in December. Base effects played a significant part in inflation declining, however, food and energy costs are also declining sharply. The Bank of England maintained interest rates at 5.25%.

Mercer market views

Our medium-term outlook favours growth fixed income and nominal UK government bonds, with a slight overweight to equities (Emerging Market and Japanese equities).

A global economy landing softly, falling inflation and wage growth, resilient consumer and business balance sheets and the ongoing potential for artificial intelligence (AI) should support equity prices in the near term. However, we are conscious that equity valuations are rich and have rallied a lot in recent months.

He informed the Panel that assets were likely to become more expensive, especially in terms of credit spreads. The overall yield on the Multi Asset Credit portfolio was still attractive due to the underlying cash and nominal bond rates. He explained that the actual risk premium on top of this through credit spread is actually quite low.

The Group Manager for Funding, Investment & Risk asked regarding the credit portfolio, are defaults as expected or lower.

Steve Turner replied that the market always tends to over estimate in terms of defaults.

Funding level and risk

The Value-at-Risk increased over the quarter to £1,701m, and to 29% as a percentage of liabilities. Levels have gradually increased since 2020 due to market movements and changes in forward-looking assumptions. For Q1 2024 in particular, VaR has also increased due to the reduction in the coverage of the equity protection strategy (as expected).

Total Fund Performance Attribution – Quarter

The strong returns on Fund assets over the quarter were driven by the Equity portfolio. Multi-Asset portfolios also contributed, whilst the Alternatives did not have much impact.

The Equity Protection Strategy slightly detracted as expected given underlying positive returns from equity markets, although the impact was partly mitigated by the reduction of the coverage from 100% to 50% of the equity portfolio during the quarter.

Total Fund Performance Attribution – 1 Year

Equity was also the main driver of positive returns over the one year period, with Equity Protection slightly offsetting this as expected. Multi-Asset, Infrastructure and Private Debt were also positive, whilst Property and Secured Income were negative. The Currency Hedge contribution was positive due to the strengthening of Sterling.

The Panel **RESOLVED** to note the information as set out in the report and its appendices.

11 RISK MANAGEMENT FRAMEWORK REVIEW FOR PERIODS ENDING 31 MARCH 2024

The Investments Manager introduced the report to the Panel and highlighted the following points.

- The underlying equity benchmark rose over the quarter, with the equity protection strategy (EPS) performing in line with expectations, decreasing net equity performance by 0.9% as markets moved toward the protection levels. Since inception the dynamic EPS has detracted c. 2.7% from equity returns and reduced volatility by c. 25%.

- Following the reinstatement of the interest and inflation trigger framework in October 2023, several interest rate triggers have been hit leading BlackRock to trade up to the 39% cap on the aggregate interest rate hedge ratio. The inflation hedge ratio was around 22% at the same date. As it has hit the 40% hedge ratio, the trigger framework is currently suspended.

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.

The Panel **RESOLVED** to note the performance of each of the underlying RMF strategies and current collateral position.

12 LDI IMPLEMENTATION POLICY

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

- The policy has been drafted in line with the guidance from TPR, which addresses the issues that pension funds in general faced during the gilts crisis. It sets out the operational, governance and monitoring processes established by the Fund, as well as the responsibilities of each of the parties involved.

- The policy will be reviewed annually by the Funding & Risk Management Group, or more frequently should there be material changes to the investment strategy (which could, for example, affect how we source additional collateral) or market conditions.

Councillor Chris Dando referred to the Governance Model section of the policy and asked whether, as well as stating the role of the FRMG, it should include that matters are reported to the Investment Panel and the Avon Pension Fund Committee to give additional strength.

The Group Manager for Funding, Investment & Risk replied that any strategic risk management issues are reported to the Committee, but they have delegated the monitoring of risk management to the Panel.

The following amendment was proposed by Councillor Dando and seconded by Jackie Peel.

Strong level of governance within the FRMG, providing oversight and risk management-focused expertise that is relayed to the Investment Panel and scrutinised on a quarterly basis.

The Panel agreed and approved the amendment to the policy.

The Panel **RESOLVED** to note the LDI Implementation Policy, as amended.

13 FORWARD AGENDA

The Group Manager for Funding, Investment & Risk introduced the report to the Panel and drew their attention to the future meeting dates that have now been set through to the end of 2025.

Councillor Chris Dando referred to the meeting in September 2024 and asked whether the title 'Introduction to Nature Based Investing' was correct.

The Group Manager for Funding, Investment & Risk replied that it should be 'Introduction to Natural Capital Investing' and said that it was likely that this report would move to November 2024.

The Panel **RESOLVED** to note their forward agenda.

The meeting ended at 3.48 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services