Bath and North East Somerset Council

AVON PENSION FUND COMMITTEE INVESTMENT PANEL

Minutes of the Meeting held

Friday, 25th February, 2022, 2.00 pm

Members: Councillor Shaun Stephenson-McGall (Chair), Councillor Chris Dando, John Finch, Pauline Gordon and Shirley Marsh-Hughes

Advisors: Steve Turner (Mercer), Nick Page (Mercer), Joshua Caughey (Mercer)

Also in attendance: Tony Bartlett (Service Director - Financial Control and Pensions), Liz Woodyard (Group Manager for Funding, Investment & Risk), Nathan Rollinson (Investments Manager) and Richard Fanshawe (Brunel)

36 WELCOME & INTRODUCTIONS

The Chairman welcomed everyone to the meeting.

37 DECLARATIONS OF INTEREST

There were none.

38 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Councillor Paul Crossley had sent his apologies to the Panel.

39 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

The Chairman addressed the Panel and made the following statement regarding the Fund in relation to the recent Russian invasion of Ukraine.

Now that we have terminated our dedicated Emerging Markets portfolio, we only invest in developed world benchmarked funds. Therefore, any exposure to Russia will be very small and only through active stock selection decisions of our managers. However, given our ESG focus, it would be very unlikely that our active equity managers would invest in Russian stocks. We do have a small exposure through our MAC portfolio. In line with their Responsible Investment policy Brunel will be monitoring their managers to ensure all companies comply with UN principles on Business Human Rights and will consider what engagement is needed with companies as a result of this situation.

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

Mel Clarke addressed the Panel, a copy of her statement is attached as an online appendix to these minutes, a summary is set out below.

Whilst I acknowledge the progress made by APF in reducing the climate intensity of the fund, I feel that the dire state of the climate emergency means that the fund's commitment “to become a carbon neutral pension fund by 2050 or earlier” (1) is not sufficient. According to research by the campaign group UK Divest at the end of 2020, the fund's total fossil fuel investments were over £100 Million (3).

Global emissions continue to rise and people in the global south are suffering. Pension funds have been engaging with the fossil fuel industry for three decades.

Shell is the fossil fuel company most heavily invested in by Local Government Pension funds. Shell has set a target of reaching net-zero by 2050, with an interim target of cutting the carbon intensity of its output by 20% by the end of the decade.

In May 2021, a Dutch court ruled that Shell must cut its net carbon emissions by 45% by 2030. The ruling noted that Shell's current target of a 20% reduction is not sufficient to prevent global temperatures rising more than 1.5°C, in line with the Paris Agreement. Shell has since confirmed that it will appealing the ruling. Surely any company truly committed to net-zero would not appeal against a legally binding, independent court ruling that says they must make their operations Paris-aligned?

The world's 60 largest banks financed nearly $4tn in fossil fuel projects between 2016 and 2020, according to a March report from a coalition of climate organisations including the Rainforest Action Network (RAN), Sierra Club, BankTrack and more (4). Much of this money is lent to banks by pension funds.

Whilst gas and oil prices have recently demonstrated a temporary rebound following the COVID pandemic, in the long term, greener funds have better prospects. A recent article on the FT adviser website stated that “Renewable energy infrastructure is tipped to be 2022 winner and could be the best performing asset class of 2022, according to a survey of investment company managers” (4).

I put it to you that the case for rapid divestment from Fossil Fuels is overwhelming so please do it now.

The Chairman thanked her for her statement on behalf of the Panel and said that a written response would be sent in due course. He added that the Fund has put in place challenging intermediate carbon reduction goals for its equity portfolio between now and 2030 which are kept under review.

41 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

42 MINUTES: 19TH NOVEMBER 2021 (PUBLIC & EXEMPT)

The Panel were minded to approve the minutes.

43 PRIVATE MARKET PORTFOLIOS

The Investments Manager introduced this report to the Panel. He explained that representatives from Brunel will provide an update on the Cycle 1 & 2 portfolios as well as a Cycle 3 forward-look in line with their presentation (Exempt Appendix 1).

He added that representatives from Mercer were also present and have provided assurance that the Cycle 3 private market portfolios still meet our strategic objectives (Exempt Appendix 2).

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 noted the capital being committed to Cycle 3 private market portfolios to reach the existing strategic allocations as outlined in Exempt Appendix 2.

44 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 31 DECEMBER 2021

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

- No concerns to flag with any of the Brunel portfolios this quarter.
- The Global Sustainable Equity portfolio again posted strong performance, achieving a 6.8% absolute return over the quarter, which was 0.5% ahead of its benchmark due to positive sector allocation.
- The High Alpha portfolio returned 6.3% in absolute terms, underperforming the index by 1.1% and the underperformance is understood.
- The quarter saw a number of portfolio changes in line with recommendations from the Equity Review. October saw a £575m sale from Brunel’s Low Carbon Passive portfolio into their new Paris Aligned Benchmark (PAB) Fund, while in December the Emerging Markets portfolio was sold (c£275m) with proceeds being fully re-invested in Global High Alpha.

Josh Caughey, Mercer addressed the Panel and highlighted points from within Appendix 2 – Performance Report.

Market background: The fourth quarter of 2021 came with a number of challenges. Global supply chains remained stretched and the new Covid-19 variant was discovered mid-quarter. Soaring inflation also forced some major central banks to accelerate their exit strategies from ultra-loose monetary policies.

In spite of these headwinds, risk assets fared reasonably well with a few exceptions. Inflation expectations increased and gilt yields generally declined slightly over the quarter.

Funding level and risk: The funding level is estimated to have improved over Q4 to c.102% as asset growth outweighed the rise in the value of the liabilities. It is estimated to have increased by 7% over the year to 31st December 2021.

The Value-at-Risk rose over the quarter to £1,233m, mainly due to the increased allocation to equities under the new strategic asset allocation. Risk as a proportion of liabilities is lower compared to last year thanks to the decision to move to the dynamic equity option strategy.

Performance: Most assets delivered positive returns over the quarter, particularly the global equity portfolios. Property and infrastructure also generally fared well.

Relative performance was mixed at the mandate level, though the Hedge Fund and Core Infrastructure mandates have continued to stand out in outperforming their benchmarks. The Secured Income mandate has also done well over the year.

Asset allocation and strategy: The Fund terminated its holdings in Emerging Markets Equity, for which the strategic allocation was distributed between the High Alpha and Sustainable Equity mandates (which still contain emerging markets exposure).

From a strategic perspective, the allocation to Diversified Returns was also reduced, and the global equity mandates correspondingly increased in order to maintain the overall expected return of the portfolio in light of the reduction in emerging markets equities.

Total Fund performance attribution: Equities continue to be the biggest driver of returns and contributed over 70% of returns in the fourth quarter. The only detracting asset from class absolute returns over the period was Equity Protection (due to the rising underlying markets).

Performance vs. expected strategic returns: Returns have been above expectations for all global equity mandates, given the strength of equity markets since 2019.

Shirley Marsh-Hughes asked if a potential war in Europe would have a significant impact on the Value-at-Risk levels in terms of a 1-in-20 downside event.

Joshua Caughey replied that Covid-19 would also be put in the same scenario and that this highlighted the need for a scenario of differing portfolios as some asset classes might not suffer as much. He added that he felt that the Fund was in a strong funding position to do what it needed to going forward.

Steve Turner added that the dynamic protection would evolve with market levels, but said that sanctions imposed on Russia could damage economic growth.

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.

Steve Turner highlighted points within Appendix 5 for the Panel.

We have seen increased global coordination in the fight against climate change, with the US, China, India, Australia and Saudi Arabia all now also committing to net zero targets; and significant degrees of innovation and resulting disruption across a number of sectors, most notably healthcare and finance.

To translate these and other developments into relevant themes for investors, we have identified three overarching themes which we believe will impact investment decisions in 2022 and beyond.

Changing of the guard: Understanding the effects of the changing fortunes of economic players and ways of thinking that have held sway for a long time, including the evolving responsibilities of monetary policies; the prospect of an "Asian century"; the dramatic re-morphing of how finance is provided.

Position for transition: How investors should plan for the changes required to put us on a most sustainable path; the role of impact investing; the management of resources to facilitate the green transition; and the power that can be exercised through engagement.

Modern diversification: How portfolios should be reinvented to hit target returns while maintaining protection; the use of dynamic allocation between strategies and themes; and how to gain access to emergent innovators.

Shirley Marsh-Hughes asked how in the reporting process can we capture more of the good work that we are doing with regard to climate change.

Steve Turner replied that the most likely way that they would be able to do this would be as part of the TCFD (Task Force on Climate-related Financial Disclosures) reporting process. He added data most readily available on equities and that they were working with Brunel to expand coverage where available and where the data is sensible.

He added that he felt it was unlikely that they would see quick progress in receiving accurate data in areas such as Private Markets. He said that there were developments and initiatives taking place within property and some multi-asset credit managers that could improve their data.

The Group Manager for Funding, Investment & Risk commented on the need for consistency in the data being received. She agreed that property and multi-asset credit were two likely areas to begin to receive accurate data. She added that this work would also require appropriate resourcing and conversations were being had with Brunel on this issue.

The Chairman asked if having currently withdrawn from emerging markets was presenting any particular difficulties given the prominence of Asian economies.

Steve Turner replied that not all themes and opportunities would be relevant to all clients. He said that there were reasons to be positive about China / Asia in the long term return perspective, but investors with net zero targets would find it challenging. He stated that they were trying to find the balance between achieving the expected returns whilst still achieving the net zero transition.

He said that having come out of emerging markets had allowed the Fund to invest further in sustainable equities. He added that should the position change significantly then there could be a case for re-engagement.

The Chairman asked what the advantages / disadvantages would be with regard to re-engagement with emerging markets, either as a whole or with the exclusion of China.

Steve Turner replied that if targeted exposure could be achieved and was easily implementable with Brunel, then we would have to judge whether it would be additive to returns, help to enhance returns, add genuine diversification and be consistent with your overall climate goals.

The Panel were minded to note the information as set out in the reports.

45 RISK MANAGEMENT FRAMEWORK REVIEW FOR PERIODS ENDING 31 DECEMBER 2022

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

- Following its last meeting the Panel asked FRMG to consider the quantitative impacts of rising inflation on the Fund's investment strategy, specifically in relation to the LDI hedge ratio. FRMG examined the impact of different inflation hedge ratios in terms of risk/return, collateral and in the context of the wider investment strategy, noting how the Fund's already well diversified portfolio is well positioned to mitigate a range of downside risks. FRMG concluded that the Fund should maintain the current inflation hedge ratio while continuing to monitor the inflationary environment.

- The EPS was restructured in December 2021 to take account of the changes to the underlying equity portfolio that were agreed as part of the wider equity allocation review in September i.e. the removal of the dedicated emerging market equity allocation and the subsequent increase to developed market equities. FRMG considered the post-trade report prepared by Mercer which showed transaction costs for exiting the emerging market exposure came in higher than expected (0.21% of exposure traded vs. 0.14% estimate) as a result of increased volatility at the time of trading.

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 were minded to:

i) Note the current funding level and LDI hedging position
ii) Note the impact and performance of the equity protection strategy
iii) Note the current collateral adequacy position
iv) Note the current FRMG workstreams as summarised in sections 5-7 of the report.

46 FORWARD AGENDA

The Investments Manager introduced this report to the Panel and explained that reports have been identified for their next four meetings.

The Panel were minded to note the forward agenda as printed.

The meeting ended at 4.00 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services