

## Bath & North East Somerset Council

MEETING:	<b>AVON PENSION FUND COMMITTEE</b>
MEETING DATE:	<b>23 SEPTEMBER 2022</b>
TITLE:	<b>INVESTMENT STRATEGY AND BRUNEL UPDATE (for periods ending 30 June 2022)</b>
WARD:	<b>ALL</b>
<b>AN OPEN PUBLIC ITEM</b>	
<b>List of attachments to this report:</b> Exempt Appendix 1 – Brunel Monitoring Dashboard Appendix 2 – Investment Strategy Dashboard Appendix 3 – Mercer Quarterly Investment Performance Report Exempt Appendix 4 – Brunel Oversight Board minutes	

### **1 THE ISSUE**

- 1.1 This paper reports on the investment performance of the Fund and seeks to update the Committee on routine strategic aspects of the Fund's investments and funding level, policy and operational aspects of the Fund.
- 1.2 Exempt Appendix 1 updates the Committee about Brunel and the wider pool covering delivery of service, performance, governance and risk management aspects of the pool.
- 1.3 Appendix 2 summarises progress in respect of the investment strategy (including the risk management framework), portfolio performance and responsible investment issues.
- 1.4 The Mercer Investment Performance Report at Appendix 3 contains performance statistics for periods ending 30 June 2022. Mercer will present their paper at the meeting.
- 1.5 Appendices to this report including Minutes of the Investment Panel and the LAPFF Quarterly Engagement Report are now available in the Modern Gov library.

### **2 RECOMMENDATIONS**

**The Avon Pension Fund Committee is asked to:**

- 2.1 **Note the information set out in the report and appendices.**

### **3 FINANCIAL IMPLICATIONS**

3.1 The returns achieved by the Fund from 1 April 2020 will affect the 2022 triennial valuation. Section 4 of this report discusses the trends in the Fund's liabilities and the funding level.

## **4 BRUNEL UPDATE**

4.1 The dashboard of key indicators covering strategic aspects of Brunel is set out in Exempt Appendix 1. It covers all aspects of service delivery, governance, finance and risk. It is updated quarterly to reflect current activity and developments and changes to ratings are highlighted in the commentary. A verbal update will be provided at the meeting.

### **4.2 Governance:**

- a) Since the last committee meeting, Brunel Oversight Board (BOB) have met once in September. The June meeting minutes are in Exempt Appendix 4. The next BOB meeting is in December.
- b) The Client Group (CG) meets monthly with mid-month update calls as required. Five sub-groups work with Brunel on specific aspects of the services to be delivered. Sub-group activity and output is discussed at each meeting/call.
- c) Quarterly performance and KPI reporting are reviewed by BOB consisting of
  - (i) RAG reporting on agreed metrics and commentary on action taken by Brunel if there is underperformance or areas of concern for each portfolio
  - (ii) Performance of each of the internal teams (Compliance & Risk, Investments, Operations) against their KPIs.

### **4.3 Investments:**

- a) Brunel now manages £4.6bn (at 30/06/22) of the Fund's assets (84%). This includes £669m in private market portfolios (invested capital).
- b) Brunel's quarterly investment performance and stewardship activity reports are included in the Investment Panel meeting agenda; Panel will highlight any issues or areas of concern via its normal investment reporting (covering all our managers) to Committee.
- c) The current focus of work is the 2022 Stocktake. This will review Brunel's climate policy and the approach the pool has taken given the evidence of progress/achievements over the last 2 years. The outcome (and Brunel's revised Climate Policy) will feed into our strategic investment review later in 2022.

### **4.4 Operational/Financial:**

- a) Brunel provides BOB with a business update at each meeting which includes high level monitoring of the budget and the transition plan. CG monitors the budget variances in detail on a quarterly basis, raising any issues with BOB.
- b) The project to improve investment reporting to clients is in full swing with a new provider appointed. New reports will be used from 3Q 2022.

4.5 The Brunel Working Group (BWG) met ahead of the September BOB meeting to discuss the meeting agenda. A verbal update will be provided at the meeting.

## **5 INVESTMENT STRATEGY**

## A – Funding Level and Investment Performance ('Amber' Ratings)

- 5.1 Based on financial markets, investment returns and net cashflows into the Fund, the deficit was estimated to have widened over the quarter to £490m. The Funding level is c.92%, which is 3% behind the existing recovery plan.
- 5.2 The Fund's assets decreased by £370m in the quarter (-7.1% net investment return) ending June 2022 giving a value for the Fund of £5,456m. Manager performance is monitored in detail by the Investment Panel. The Fund's investment return and performance relative to the benchmark is summarised below.

**Table 1: Fund Investment Returns** (Periods to 30 June 2022)

	3 Months	12 Months	3 Years (p.a)
Avon Pension Fund (incl. currency hedging)	-7.1%	-2.0%	3.0%
Avon Pension Fund (excl. currency hedging)	-5.9%	-0.1%	3.1%
Strategic benchmark (no currency hedging)	-6.0%	2.5%	6.0%
Currency hedge impact	-1.2%	-1.9%	-0.1%

- 1.1. **Returns versus the strategic assumptions:** Global Sustainable Equity returns are below expected returns due to portfolio biases. Multi Asset Credit is also behind due to negative returns from fixed income markets in 2022. The private markets mandates are either still in build-up phase or do not have a sufficient track record to properly compare against strategic return assumptions.

## B – Portfolio Performance

- 5.3 Brunel reports on the performance of the assets they manage on behalf of the Fund. The Brunel quarterly performance reports are available in the Modern Gov library.
- 5.4 Brunel listed market portfolios are currently rated amber due to the underperformance over the quarter and on a 1-year basis. Underperformance is largely attributed to the growth/quality and ESG bias in the portfolios. Towards the end of the quarter the quality factor began to outperform due to its defensive qualities in economic downturns and, as a result, the portfolios began to recover some of their losses. A small change to the underlying manager allocations in the high alpha equity portfolio took place during the quarter which served to moderate the bias to growth and marginally increase exposure to the value factor. The DRF and credit portfolios underperformed in part because their performance is measured against a cash benchmark. The MAC portfolio performed in line with comparable credit indices and the DRF performed as expected by participating to a lesser extent in the equity market sell off.
- 5.5 The currency hedge that forms part of the Fund's Risk Management Framework is rated 'amber'. As GBP has fallen the currency hedge has caused a drag on returns. GBP has fallen from 1.40 against the US Dollar in 2021 to c.1.15. The significant decline in the value of GBP has led to a -2.0% drag on returns over a 1-year period. Detailed performance attribution can be found on p14 of Appendix 3.
- 5.6 The 'amber' RI factors reflect current work in progress. Enhanced climate metrics and disclosures form part of the ongoing Brunel climate stocktake and a transition aligned equity fund that can double as collateral in the Risk

Management Framework will be explored further by Panel at its November meeting and implemented following the 2022/23 strategy review.

## **6 INVESTMENT PANEL ACTIVITY**

- 6.1 The Investment Panel is responsible for addressing investment issues including the investment management arrangements and the performance of the investment managers. The Panel has delegated responsibilities from the Committee and may also make recommendations to Committee.
- 6.2 The Panel's 9 September meeting has been rescheduled for 30 September. Issues arising from the Panel meeting will be raised with Committee as necessary and a copy of the draft minutes will be made available following the meeting in the Modern Gov library.

## **7 RESPONSIBLE INVESTMENT ACTIVITY**

- 7.1 **Voting and Engagement Summary:** Federated Hermes EOS provide voting and engagement services on behalf of the Fund. Summary reports available in the Modern Gov library disclose the number of companies and topics engaged on over the quarter.
- 7.2 The Fund is a member of LAPFF, a collaborative body that exists to serve the investment interests of local authority pension funds. In particular, LAPFF seeks to maximise the influence the funds have as shareholders through co-ordinating shareholder activism amongst the pension funds. LAPFF's activity in the quarter is summarised in their quarterly engagement report which is also available in the Modern Gov library.

## **8 RISK MANAGEMENT**

- 8.1 A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund's future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund and through the selection process followed before managers are appointed. This report monitors (i) the strategic policy and funding level in terms of whether the strategy is on course to fund the pension liabilities as required by the funding plan and (ii) the performance of the investment managers. An Investment Panel has been established to consider in greater detail investment performance and related matters and report back to the committee on a regular basis.

## **9 CLIMATE CHANGE**

- 9.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint. The Fund acknowledges the financial risk to its assets from climate change and addresses this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

## **10 OTHER OPTIONS CONSIDERED**

- 10.1 None.

## 11 CONSULTATION

11.1 The Council's Monitoring Officer and Section 151 Officer have had the opportunity to input to this report and have cleared it for publication.

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<b>Background papers</b>	Data supplied by Mercer & SSBT Performance Services Mercer ACT report 2022
<b>Please contact the report author if you need to access this report in an alternative format</b>	