

BATH AND NORTH EAST SOMERSET

AVON PENSION FUND COMMITTEE INVESTMENT PANEL

Friday, 25th November, 2022

Bath and North East Somerset Councillors: Shaun Stephenson-McGall (Chair), Paul Crossley and Chris Dando

Co-opted Voting 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 Jeff Wring (Director, One West)

24 EMERGENCY EVACUATION PROCEDURE

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

25 DECLARATIONS OF INTEREST

There were no declarations of interest.

26 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

There were none.

27 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

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

There were none.

29 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

30 MINUTES: 30TH SEPTEMBER 2022 (PUBLIC & EXEMPT)

The Panel **RESOLVED** that the minutes of the meeting on 30th September 2022 be confirmed as a correct record and signed by the Chair.

31 BRUNEL PRESENTATION - CLIMATE SOLUTIONS AND SUSTAINABLE INFRASTRUCTURE

The Group Manager for Funding, Investment & Risk introduced this report to the Panel. She explained that the Cycle 3 infrastructure portfolio will target a broad range of assets intended to aid decarbonisation, the energy transition and mitigation across sectors. She said that this is an appropriate approach and consistent with the Fund's strategic climate objectives given the lower forward-looking returns from traditional renewables i.e., wind/solar assets.

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 presentation from Brunel.

32 STRATEGIC INVESTMENT REVIEW

The Group Manager for Funding, Investment & Risk introduced this report to the Panel. She informed them that the objective of the review is to:

- Determine the optimal asset allocation to deliver the return required in the funding plan to maintain stable and affordable contributions.
- Ensure the Risk Management Strategies remain appropriate and add value to the overall strategy given the change in the market environment.
- Consider if new investment opportunities including Social/Local investing could be built into the strategy.
- Consider whether the net zero ambition can be accelerated, and the climate related targets brought forward, without detracting from the overriding return objective.

Steve Turner, Mercer addressed the Panel and highlighted areas from within Appendix 1.

Key areas of focus for the review:

Review of the Fund's core investment beliefs and principles: How this influences the design of the investment strategy and its implementation, taking into account key investment and ESG objectives and any potential constraints. We acknowledge that the Fund's investment beliefs may evolve as a result of the investment strategy review, which we would look to capture.

Overriding objective: The investment strategy needs to have a minimum expected return that supports achieving the discount rate of CPI +2.4% p.a. (margin above CPI is subject to change as part of the valuation), with a desired level of probability and acceptable level of downside risk.

Other principles and goals: Achieving the Fund's climate targets (e.g. net zero carbon emissions by 2050 and interim reduction targets) and broader Environmental Social and Governance (ESG) commitments/ambitions. We will consider the impact of asset allocation decisions on the ability to meet targets, and whether potentially strengthening climate targets (e.g. considering net zero by 2045) would constrain the asset allocation in any way.

Asset allocation: is the portfolio fit for purpose?

Review of underlying asset classes and their roles, and revisiting the rationale for their inclusion in the strategy in light of current markets and long term prospects.

Pauline Gordon asked if the allocation to Private Markets had gone up in terms of the proportion of assets within the scheme and should the illiquid Private Market assets be pulled down as a result of falls in most other asset classes.

Steve Turner replied that this had not been as much of a dramatic impact on the Fund because it is not as heavily exposed to hedging assets. He said that adding a Local Social Impact portfolio at around 1 – 2% initially was being considered and that if agreed small amounts would be allocated to it at a time.

The Head of Pensions commented that from a risk management perspective it would be interesting to include in the review whether asset allocation without LDI could achieve CPI +2.4% with similar risk.

Pauline Gordon commented that they would be assessing a different set of figures now, versus if the review had taken place 12 months ago.

Steve Turner replied that there had been a big shift in numbers over the past six months and had seen total returns on asset classes increased.

Jackie Peel commented that she liked the clean sheet approach being taken and said that the target -v- risk factors have to be balanced. She added that the decision needs to be clear as to why we include what we will do in the asset allocation and if possible she would welcome a guide to the Investment Strategy.

The Group Manager for Funding, Investment & Risk replied that they would discuss whether an appendix to the Investment Strategy statement could be produced.

The Director, One West acknowledged that the timescales involved in the review were quite tight with the Committee meeting expected to take place on 17th March 2023. He said that if the review was not complete by this date that it would be allowed to continue. He added that he wanted to enable all stakeholders to have an active voice in the review.

The Panel **RESOLVED** to note the report from Mercer and specifically sections 4.3 and 4.7 of the officer's report.

33 CASHFLOW AND LIQUIDITY ANALYSIS

The Group Manager for Funding, Investment & Risk introduced the report to the Panel. She said that each valuation a revised cashflow profile is generated for the Fund and that this profile shows the net cashflow of contributions paid in less benefits paid out. She added that it is determined by the benefits structure, membership data and actuarial assumptions.

She stated that Mercer have analysed the cashflow profile of the Fund using the 2022 valuation data and that this analysis will be used in the strategic investment review due in 1Q23.

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 implications of the Cashflow analysis for the Strategic Investment Review.

34 RISK MANAGEMENT FRAMEWORK: PARIS-ALIGNED EQUITY SOLUTION

This entire report and the supporting appendix had been classified as exempt.

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.

35 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 30 SEPTEMBER 2022

The Investments Manager introduced this report to the Panel. He informed them that the Fund's assets decreased by £91m in the quarter (-1.2% net investment return) ending September 2022 giving a value for the Fund of £5,365m. He added that the fall in the value of Fund assets over the quarter was driven mainly by the currency hedge as sterling weakened, although this was partially offset by positive returns from overseas exposure. He said over 1 year the Fund returned - 6.0% driven by negative returns from equities, LDI and currency hedging. He added that the Fund underperformed its strategic benchmark by 6.6% over this time horizon and the main detractors were the active equity portfolios, MAC and DRF.

Steve Turner, Mercer addressed the Panel. He said that it had been a very challenging period to invest and generate a positive return as very few asset classes are actually up over the year. He added for example that the Dollar was up over this period alongside Commodities, Energy and Property.

He stated that the total Fund level was down around 6% overall over the 12-month period. He felt that overall this was a modest reduction given the context of what had been happening on the whole and said that they were now seeing the genuine benefits of the diversification within the portfolio.

He explained that Brunel's style of climate aware investing had struggled because of their underweight to Commodities and Energy. He added that alternative investments and the Equity Protection Strategy had cushioned losses.

He stated that another positive feature of the strategy was the performance of illiquid assets such as Property, Secured Income, Infrastructure and Private Debt which have performed well, both in absolute terms and relative to their benchmarks.

Pauline Gordon asked if any comment could be given as to how the portfolio has performed under the Dynamic Equity Protection Strategy as opposed to the Static.

Nick Page replied that it was hard to say whether it was better or worse because we have recently seen some big market movements and the strategy has moved in line with that. He added that a key differentiator of the dynamic approach- that has worked to the Fund's advantage was the premium generated by selling upside in addition to the downside protection achieved.

Steve Turner referred to a chart on page 159 that illustrated the direct impact of the equity protection on the total Fund portfolio, by comparing the estimated total asset valuation with and without the strategy in place. He added it shows that the protection strategy has led to c. £68.7m of upside impact over the period since inception.

Jackie Peel asked what level on ongoing dialogue there was with Brunel in respect of portfolio performance and other issues.

The Group Manager for Funding, Investment & Risk replied that officers meet with them every quarter to talk about the portfolios in general and certain themes. She added that officers also meet with a senior manager to discuss matters in more detail.

Steve Turner commented that Brunel's performance is on par with other Funds that invest with a similar philosophy.

The Panel **RESOLVED** to:

- i) Note the information as set out in the reports.
- ii) Identify any issues to be notified to the Committee.

36 RISK MANAGEMENT FRAMEWORK REVIEW FOR PERIODS ENDING 30 SEPTEMBER 2022

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

He explained that the FRMG are reviewing the current collateral adequacy framework with the manager who has indicated a greater level of collateral may be required in future to ensure resilience against market shocks of the same magnitude as those seen in September.

He confirmed as previously mentioned that since the inception of the dynamic Equity Protection Strategy that it has added value (c. £64.2m in net gains at 30 Sept 2022).

He said that the LDI the trigger framework was currently suspended and reactivation of it would be considered as part of the forthcoming investment strategy review. He added the mandate had performed as expected over the quarter and the investment manager was within agreed guidelines.

Pauline Gordon noted that it was positive for risk levels that the inflation and interest rate hedge were aligned.

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:

- i) The performance of each of the underlying RMF strategies
- ii) That the FRMG are currently considering the appropriate time to reinstate the trigger framework following the pause it implemented in September
- iii) Whether the interest rate trigger framework should be adjusted higher to reflect current market conditions so that the Fund continues to hedge at attractive levels.

37 FORWARD AGENDA

The Group Manager for Funding, Investment & Risk introduced this report to the Panel. She explained that agenda items had only been listed for the March meeting as following the Local Elections in May there is the possibility of there being new Panel and Committee members.

She said that following the Investment Review they will have a clearer idea of the strategic items that need to come forward to be discussed.

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

The meeting ended at 3.52 pm

Chair(person)

Date Confirmed and Signed

Prepared by Democratic Services