AVON PENSION FUND COMMITTEE INVESTMENT PANEL

Minutes of the Meeting held

Thursday, 5th September, 2024, 2.00 pm

Bath and North East Somerset Councillors: Paul Crossley

Co-opted Voting Members: Pauline Gordon and Jackie Peel (John Finch attended the Panel remotely and is therefore unable to vote)

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), Rebecca Whelan (Senior Investments Officer) and Jeff Wring (Director of One West & Avon Pension Fund)

14 EMERGENCY EVACUATION PROCEDURE

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

15 DECLARATIONS OF INTEREST

There were none.

16 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Councillor Shaun Stephenson-McGall and Councillor Chris Dando had given their apologies to the Panel.

John Finch (Independent Member) attended the Panel remotely.

17 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

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

There were none.

19 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

20 MINUTES: 5TH JUNE 2024 (PUBLIC & EXEMPT)

The Panel **RESOLVED** that the minutes of the meeting held on 5th June 2024 be confirmed as a correct record and signed by the Chair.

21 LONG LEASE PROPERTY REVIEW

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

- The overall strategic allocation to Secured Income is 9% and the portfolio is currently valued at £627m. LLP represents approximately 60%, or £376m, of this value, which itself is 6% of total fund assets.

- At its December-23 meeting the Panel discussed the challenges facing the LLP market. Notably, the investor base of a number of LLP funds had become concentrated due to redemptions from investors looking to shore up liquidity positions post the 2022 gilts crisis.

- At its meeting in December the Panel was minded to retain its allocation to the Secured Income portfolio in its existing make-up of 60% LLP / 40% Operational Infrastructure and requested Brunel present their views on the return outlook for LLP, taking account of current demand from new investors and how redemptions and asset disposals have been serviced to date.

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 report and the information contained in the Brunel Presentation in Exempt Appendix 1.

22 NET ZERO MONITORING UPDATE

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

The Fund has four decarbonisation and transition alignment targets that support the ambition to achieve Net Zero by 2045. Progress against each is summarised as follows:

1.
    - Listed equities - target 43% emissions reduction by 2025 and 69% by 2030 (versus 2020 baseline)
    - Ahead of 2025 target with 60% reduction, need another 22% reduction from here to reach 2030 target. Progress will rely more heavily on underlying company decarbonisation than asset allocation.

2.

- Corporate Bonds - target 60% emissions reduction by 2030 (versus 2020 baseline)
- Ahead of target pathway as achieved 47% reduction so far. Require a further 24% in carbon footprint to reach 2030 target reduction.

3.

- Ensure 70% of financed emissions in material sectors are subject to engagement and stewardship actions for all listed equities by end 2024 and 90% by June 2027
- On track - 87% of material sectors' financed emissions are aligned or subject to active engagement.

4.

- By 2030 we will divest from developed equity holdings in high impact sectors that are not achieving NZ or not aligning to achieve NZ by 2050
- No action taken to date. 88% of financed emissions within the listed equity portfolio are aligned or subject to active engagement (up from 76% last year). Companies not aligned will be captured under the Fund's 2030 divestment commitment.

Transition alignment of the underlying assets is also measured by Mercer shows the exposure to assets that are 'well aligned', those that have 'transition capacity' (not aligned as yet but can align) and those that are 'not well aligned' (and probably will find it difficult to align). The Fund has a low exposure to the 'not well aligned' category and a high allocation to the well aligned (particularly across the equity portfolios). The focus of engagement to achieve real world impact must be on our exposure to the most carbon intensive transition capacity assets.

Hill Gaston, Mercer addressed the Panel and highlighted the following points from within the Net Zero Monitoring 2023 Update.

<u>Progress to date</u>

- 2021 – Set targets: Total Fund 2050 net zero target
- Adopted listed equity portfolio carbon reduction targets of 43% by 2025 and 69% by 2030, versus 2020 baseline position

- 2022-23 - Revised target: Total Fund 2045 net zero target
- Monitor progress vs. 2025 and 2030 decarbonisation targets
- Investment Manager decisions - Helped inform decision to switch from Brunel Emerging Market Fund to Brunel Global High Alpha Equity and Global Sustainable Equity Funds
- Stewardship & Engagement - Identified most strategically important companies to engage with from a climate perspective.
  - Engagement and divestment targets adopted for listed equity.

- Today - Monitor Progress vs. 2025 and 2030 decarbonisation targets: On track

- Strengthening targets - Recommendation to:
    - Engage with Brunel on most intensive companies not already under engagement by CA100+ or Brunel.
    - Engage with Brunel on initial private market metrics and timeline for fuller disclosures. Explore adopting Brunel private market targets following this exercise.

- 2024 and beyond
- Listed Equity / Corporate Bonds - Evolve approach to engagement and alignment targets.
- Scope 3 - Introduce targets when data quality / availability allows
- Private markets - Continue monitoring and consider net zero targets (where feasible)
- New investments - Implement allocations to biodiversity / natural capital

Pauline Gordon asked if it could be explained what BlackRock does in its work with the Government in terms of the LDI assets, including gilts, as gilts are not always 'green' and it's necessary to engage with governments.

Hill Gaston replied that a lot of their investment is in Government bonds and feedback from investors is then supplied to the Debt Management Office. He added that the Government has also set its own net zero targets.

Pauline Gordon asked if he was aware of any schemes lobbying Government, for example, the PLSA (Pensions and Lifetime Savings Association).

Hill Gaston replied that there are a number of different working groups, some setup by the Government, that will push for the need to have transition plans. He added that he was also aware of the National Wealth Fund that could look at investing in climate opportunities within the UK.

<u>Three Elements of Net Zero</u>

- Portfolio constructed from companies / assets aligned with a low carbon transition
- Investment in climate solutions that support economy wide decarbonisation
- Front-loaded portfolio decarbonisation with a focus on managing transition risk

<u>Summary of progress</u>

- Listed equity carbon footprint has fallen 60.0% over 2020-2024 and is ahead of the targeted decarbonisation pathway
- Corporate Bonds carbon footprint has fallen by 47.7% over 2020-2024 and is ahead of the targeted decarbonisation pathway
- Low allocations to grey assets, concentrated primarily in the Brunel MAC and Global High Alpha mandates. Positive progress in the Brunel Developed Paris Aligned mandate, which has almost eliminated exposure to grey assets.
- Private markets: The Fund has made commitments to Schroders Greencoat, Brunel Renewable Infrastructure and Secured Income Funds. We note the

Octopus Affordable Housing Fund has a strong net zero focus and the Fund is exploring natural capital allocations.

Councillor Paul Crossley asked what analysis is undertaken when deciding which new companies to invest in.

Hill Gaston replied that a normal starting position would be to assess what sectors need to decarbonise. He added that the risk element then needs to be assessed before investing in mainly proven and reliable technologies. He said that new areas of investment involving hydrogen and nature based solutions were areas to consider.

The Group Manager for Funding, Investment & Risk said that it is difficult for Fund Managers to make decisions around new and emerging technologies as the rate of technology changes so rapidly and only some will become commercially successful.

Pauline Gordon asked if following the Fund's decision to withdraw from the Brunel Emerging Market Fund was there any indication that their climate metrics had improved as on withdrawal from Emerging Markets, Mercer took an action to monitor.

The Group Manager for Funding, Investment & Risk said that it was also the inability to engage as well as other financial factors that had led to this decision.

Hill Gaston said that they still obviously have a critical role to play, but are slightly behind where they need to be.

Steve Turner commented that China (30% of the index) have a net zero target of 2060 and India (15% of the index) have a net zero target of 2070.

Climate Solutions

- The Fund has allocations to climate solutions across its portfolio including:

    - Within the listed equity portfolio (e.g. Paris Aligned Equities, Sustainable Equity).
    - Exposure to renewable infrastructure, including the Schroders Greencoat Wessex Gardens commitment and the Brunel Renewable Infrastructure and Secured Income Funds. This exposure constitutes 9-10% of total Fund assets.
    - Octopus Affordable Housing Fund has a strong net zero focus.

- The Fund has also agreed to invest in Natural Capital, with work ongoing to determine the size and make-up of this allocation.

Summary

- Good progress to date; the Fund's listed equity and corporate bond portfolios are ahead of decarbonisation targets
- Good progress on alignment and climate solutions
- Too early to set net zero targets for private markets
- Look to agree approach to natural capital allocation and implementation plan

- Integrate nature risk assessment into approach

The Group Manager for Funding, Investment & Risk said that the Responsible Investment report would be debated by the Committee later in the month. She stated that it was important to have a good evidence base and that Brunel were also due to provide details of how they will engage with their top 10 emitters.

Jackie Peel referred to slide 17 of the appendix and asked if a reason could be given as to why the figures for Multi Asset Credit – Carbon Footprint had deteriorated.

Hill Gaston replied that there were no formal targets in place, in terms of Muli Asset Credit (MAC) and that he was not sure of reason behind these figures. He added that it was showing better figures under the WACI and said that often it could be a single holding that could be making the difference.

Pauline Gordon asked if consideration was being given to moving to the M&G Multi Asset Credit 'Sustainable version' as another of her schemes had switched.

The Group Manager for Funding, Investment & Risk replied that when Brunel appoint their managers they are always pushing from an ESG perspective. She added that further development is required across the credit markets.

Steve Turner added that privately owned businesses are not compelled to collect climate data.

Councillor Paul Crossley asked if any pressure could be applied from the LGPS regarding private companies.

Steve Turner replied that lobbying the Government could be one course of action to take. He added though that the majority of MAC is dominated by companies within the USA.

The Panel **RESOLVED** to note the Net Zero analysis and progress report.

23 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 30 JUNE 2024

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

- The Fund's assets were £5,858m on 30 June 2024 and delivered a net investment return of -0.3% over the quarter which lagged the 2.2% rise in the benchmark. The relatively flat nature of returns reflects some positive performances from some of the listed Brunel portfolios, however these were offset by negative returns elsewhere in the portfolio, such as private markets and the risk management strategies.

- The estimated funding level stood at 102% at 30 June (c. £120m surplus).

- Rebalancing: During the period, following the reduction in the equity protection hedge ratio, and to increase the amount of cash held in anticipation of future private markets calls, officers redeemed £50m from the Risk Management portfolio. Aggregate private markets call, excluding the final drawdown from the Secured Income portfolio, totalled £17 million. The Secured Income portfolio is now fully drawn.

- Local Impact Portfolio - £50m investment into Octopus Affordable Housing has now been completed. Octopus are now in the process of building out their pipeline.

Steve Turner, Mercer addressed the Panel and set out the points below from their report.

- The funding level is estimated to have increased over the quarter to c. 102% as the value of the assets fell by less than the estimated present value of the liabilities. The funding level is estimated to be c. 5% higher over the year to 30 June 2024.

- We believe the US economy is slowing which should lead to further labour market loosening. This should lead to lower inflation allowing the Fed to cut interest rates. We believe this creates an environment where risk assets should perform strongly. We continue to remain wary about equity valuations and corporate earnings forecasts, particularly given higher bond yields. However, we continue to believe further upside is likely and that favourable macroeconomic conditions balances stretched valuations.

- Underperformance relative to the strategic benchmark over the one year period was mainly due to the active equity funds underperforming, as well as negative returns from the Equity Protection strategy (as underlying equity returns were positive).

- Elsewhere underlying relative performance was mixed. The main drivers of underperformance over three years were the active equity, Equity Protection, Overseas Property and Secured Income mandates.

- Less concentration in technology stocks since July 2024.

- Apple performed above the index by 22% in Q2. Fund has zero exposure – is this a big risk position? Conversation to be had with Brunel at some point on this matter.

The Head of Pensions referred to slide 13 of appendix 1 and asked if further detail could be given in due course to describe the 3 year underperformance figure of 4.8% across LDI, active funds and Brunel.

He commented that a higher allocation to passive may well be prudent and that the main difference would be the associated costs.

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

24 RISK MANAGEMENT FRAMEWORK REVIEW FOR PERIODS ENDING 30 JUNE 2024

The Group Manager for Funding, Investment & Risk introduced the report to the Panel and highlighted these points from within it.

- The long-term strategic target is to achieve a 70% hedge ratio for interest rates and inflation (as a proportion of the Fund's assets). However, hedging has become more capital intensive since the gilts crisis as we are required to hold a larger collateral buffer to support the strategy in times of market stress. Therefore, the interim target is capped at c. 40%. Given the interest rate hedge is at 40% (and the inflation hedge is at c.22%) the trigger framework is currently suspended.

- In the June meeting the Panel reviewed the liquidity requirements for the Fund over the next few years. Given the increased commitment to private markets it was agreed that the hedge ratios could not increase without depleting the collateral headroom. However, Mercer have explored whether the inflation hedging could be increased in isolation towards 40% without impacting the collateral buffer.

- Mercer's assessment and proposal are set out in Exempt Appendix 2 (this paper was originally prepared for the FRMG). By changing the instruments that Blackrock can use to implement the hedge, a higher hedging ratio could be achieved, capped at 40% without impacting the collateral buffer.

- The existing inflation trigger levels will not be changed as they represent attractive levels to lock in inflation, therefore no immediate action is expected to take place upon reactivation of the inflation triggers.

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 reinstate the inflation triggers to up to a 40% hedge ratio without impacting the collateral buffer as set out in Exempt Appendix 2.
ii) Note the performance of each of the underlying RMF strategies and current collateral position.

25 FORWARD AGENDA

The Group Manager for Funding, Investment & Risk introduced the report to the Panel.

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

The meeting ended at 4.12 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services