

**Report to:** Pension Committee

**Date of meeting:** 16 March 2020

**By:** Chief Finance Officer

**Title:** Investment Report

**Purpose:** This report provides Members with an update on the investment activities undertaken by the East Sussex Pension Fund.

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**RECOMMENDATION – The Committee is recommended to:**

- 1) approve the Pension Fund Action Log and Workplan (Appendix 1);**
  - 2) note the Investment Strategy Review Initial Modelling for East Sussex Pension Fund (Appendix 2);**
  - 3) note the Quarterly Investment Report from the Investment Advisor, Hymans Robertson (Appendix 3);**
  - 4) note the ACCESS update (Appendix 4);**
  - 5) agree the recommendations in the report from the Investment Advisor, Hymans Robertson on Responsible Investment Collaboration as set out in paragraph 6.4.**
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## **1. Background**

1.1 Under the Local Government Pension Scheme (LGPS) Regulations, the Council is required to maintain a Pension Fund for its employees and other ‘scheduled bodies’ as defined in the Regulations. The Pension Committee is required to maintain an investment strategy statement to govern the East Sussex Pension Funds’ (‘the Fund’) investments and receives a quarterly investment monitoring report, from its investment consultant, Hymans Robertson to monitor its investments.

1.2 The ACCESS Joint Committee has been established to conduct fiduciary oversight on arrangements relating to the collective investment vehicles to allow the administering authorities to pool their respective investments and meets quarterly.

## **2. Action Log and Investment Workplan**

2.1 The Fund’s Investment Consultant has been asked to provide an Action Log and Investment Workplan which will act as a reference point of all actions agreed at Pension Committee meetings. Unless otherwise stated, items in the action log are to be considered at the upcoming Committee meeting, or a comment provided explaining why the item is not to be covered at this time. This is included as Appendix 1.

2.2 For this first iteration, Hymans Robertson has included actions agreed at the November 2019 Committee meeting. Going forward, we will add agreed actions and remove actions once the Committee is in agreement that they have been completed. The Investment Workplan details the areas of work that are anticipated over the next 12 months, with corresponding ownership and estimated timescale for completion.

2.3 The below table provides ratings from Hymans Robertson of their prospects for markets over a period of around three years. Hymans Robertson will be providing these views on a quarterly basis, although they are not intended as tactical calls.

| Asset Class                        | Current Quarter View | Previous Quarter View |
|------------------------------------|----------------------|-----------------------|
| Equities                           | Neutral to Cautious  | Neutral to Cautious   |
| Sterling Investment Grade Credit   | Cautious             | Cautious              |
| Liquid Sub-Investment Grade Credit | Cautious to Negative | Cautious to Negative  |
| Private Lending                    | Neutral to Cautious  | Neutral to Cautious   |
| UK Property                        | Cautious             | Cautious              |
| Long Lease Property                | Neutral to Cautious  | Neutral to Cautious   |
| Gilts                              | Cautious to Negative | Cautious to Negative  |
| Index-Linked Gilts                 | Cautious to Negative | Cautious to Negative  |

Overall ratings: Negative, Cautious, Neutral, Attractive, Positive

### 3. Investment Strategy Statement

3.1 Regulation 7(1) requires an administering authority to formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State. Under Regulation 7(6) and (7), the statements must be published by 1st April 2017 and then kept under review and revised from time to time and at least every three years.

2.2 The current Investment Strategy Statement (ISS) has not been updated by the Fund's advisors at the date of this report to Committee. However, given that the asset liability modelling may amend the current strategic asset allocation, and more specifically the Fund's approach to active and passive investment management, it may be practicable to defer the approval of the ISS until after the completion of the asset liability modelling and confirmation of the Strategic Asset Allocation. Other considerations that will impact the ISS and which have not been agreed by Committee include articulating the Fund's policy on how social, environmental or corporate governance considerations are taken into account in respect of the selection, non-selection, retention and realisation of investments; and its policy on the exercise of rights (including voting rights) attaching to investments. The Environmental, Social and Governance (ESG) considerations, action log and workplan will be discussed later in this report in Section 6 Responsible Investment Collaboration. The outcomes of the action log and workplan will serve to update the ISS for approval by Committee in June 2020.

3.2 Notwithstanding, the Fund's Triennial Valuation concludes at the end of this month, and results of which demonstrate the Fund has improved its funding level to 108% (92%: 2016 Triennial Valuation). This improved funding level brings cashflow risks arising from reduced employer contribution rates. The recently commissioned asset liability modelling exercise will confirm the strategic asset allocation over the next triennium and support the determination of the optimal investment strategy for the Fund which takes into account the need for working capital and income. Hymans Robertson include within these reports a slide pack to explain the investment strategy view process and initial results based on the outcome of the 2019 valuation results. This process is illustrated in Appendix 2.

#### **4. Quarterly Performance Report**

4.1 The Quarterly Performance Report is attached as Appendix 3. As Table 1 shows since the last quarter, the valuation of the Fund increased from £3.878bn to £3.909bn (an increase of £0.031bn) in the main due to a strong performance in equities. The total return of the Fund was slightly behind the benchmark over the quarter to 31 December 2019, noting that the benchmark performance of each mandate reflects the updated benchmarks agreed at by the Pension Committee in September 2018.

4.2 Following quarter-end, equity markets have been extremely volatile, driven mostly by concerns over the economic impact of coronavirus fears. Given already subdued levels of global growth, the virus could be a potential source of disruption in the first half of 2020. China represents c16% of World GDP and contributes c35% of global economic growth. Central banks have sought to stabilise economies; the US Federal Reserve in particular has reduced interest rates by 0.5%, the largest cut for a decade. This however had the initial impact of spooking equity markets, which fell further on the news. Whilst the equity falls this year may prove to be a short-term market correction, the upcoming US election and Brexit outcome point to 2020 being more volatile a year than 2019.

4.3 As Table 1 illustrates in the quarter ending 31 December 2019, (Q4, 2019) the top contributors to relative performance were M&G Absolute Return Credit and Longview. Conversely, the main detractors to relative performance were Adams Street, Harbourvest (Private Equity Managers) and UBS Infrastructure. The remaining UBS investments performed broadly in line with its respective benchmarks.

4.4 In relation to Growth, Income and Protection asset allocations, the Fund allocation to Income is underweight at the end of Q4, 2019, however this will be address as part of the strategic asset allocation modelling later this year. Further drawdowns into infrastructure and real estate debt will address this over time. M&G Alpha Opportunities was also underweight at an underlying fund level however no action is proposed at the current time. The Fund's Protection allocation is overweight, following a further fall in gilt yields and also as a result of holding cash (0.9)% of asset allocation.

4.5 Since the end of the last quarter there have been developments around the potential for a Coronavirus (COVID 19) epidemic. The Fund has spoken to its advisors around the implications of this and the current stock market volatility.

4.6 Further to this it is important to remember that in contrast to the wider pensions market the LGPS is a very long term holder of assets. Whilst the news surrounding coronavirus can be alarming, the Fund has a diverse investment strategy designed to withstand market volatility over the long term and Hymans Robertson is not proposing any short term strategic changes in response to coronavirus at this stage.

4.7 Below is a table showing market returns for year to date and the past 12 months. The 12 month column demonstrates that recent equity falls should be considered in the context of a very strong year for equities in 2019:

| Index                             | Year-to-date | 12 months |
|-----------------------------------|--------------|-----------|
| FTSE All Share                    | -11.1        | -1.1      |
| FTSE North America                | 0.0          | 16.7      |
| FTSE Europe (ex UK)               | -5.5         | 7.9       |
| FTSE Japan                        | -6.7         | 5.0       |
| FTSE Pacific (ex Jap)             | -3.5         | 4.5       |
| FTSE Emerging Markets             | -5.0         | 5.1       |
| FTSE RAFI                         | -6.3         | 4.1       |
| FTSE Index-Linked Gilts (Over 5Y) | 6.9          | 13.7      |
| iBoxx Corporate Bonds (Over 10Y)  | 3.5          | 16.2      |

The above equity returns are in Sterling terms. In local currency terms, overseas regional equity returns are lower; a fall in Sterling during 2020 has helped to partially offset losses for (unhedged) UK investors.

## 5. ACCESS updates

### Operator Performance

5.1 The Ruffer Absolute Return sub-fund was launched on 4 December with two ACCESS authorities, Kent and East Sussex, migrating their pre-existing Ruffer mandates in-specie into the Ruffer Absolute Return Fund, from one Northern Trust custody account to another.

5.2 The Ruffer Multi Strategies Fund (RMSF) was part of this in-specie transfer. During the transfer, Ruffer discovered that RMSF was an ineligible asset for the new structure. The transfer of RMSF was therefore reversed and the asset returned to East Sussex's segregated account at NT, ensuring that the economic exposure for East Sussex, as a whole, remained the same. The RMSF was subsequently sold and ACCESS will simultaneously gain exposure to the same strategy through the purchase of the Ruffer Illiquid Multi Strategies Fund (RIMSF); a vehicle that is eligible for the new structure and already held in the ACCESS portfolio.

5.3 East Sussex's economic exposure to this strategy has therefore remained (and will continue to remain) the same as if the in-specie transfer of RMSF had been completed. The difference is that instead of close to 100% of East Sussex's exposure being held through ACCESS, for a short period of time its Ruffer portfolio was held around 95% through ACCESS and the balance through its segregated portfolio. The issue appears to have been caused by a failure to include the Ruffer Multi-Strategy Fund within the original portfolio listing signed-off by Ruffer and provided to Link. East Sussex was notified of the matter by Ruffer on the 17 December and received an email from Link a day later. The matter was discussed at the Officer Working Group (OWG) on 19 December and the meeting highlighted the requirement for a report on this matter. This report was published to East Sussex on 31 January 8 weeks after the transfer took place.

5.4 The eligibility of potential assets migrating into the ACS needs to be established prior to any transition. The absence of the Ruffer Multi-Strategy Fund from the original portfolio listing promoted an inaccurate understanding of the actual situation. Going forward, to mitigate a recurrence of this issue Link's onboarding procedures have now been updated to ensure asset eligibility and to track portfolio changes. A dry-run process, including depositary sign-off prior to launch, has also been added.

### Sub-Fund Launches

5.5 As reported previously to the Committee, it was intended that Link, on behalf of ACCESS Authorities, would launch a series of sub-funds representing those mandates which met criteria set by the Joint Committee relating to scale, commitment and value for money. The table below shows the progress made:

| Asset Class            | 1          | 2          | 3          | 3a         | 4a         | 4b         | 5a         | 5b         | Sub Total   | TBC        | Total       |
|------------------------|------------|------------|------------|------------|------------|------------|------------|------------|-------------|------------|-------------|
| Global equities        | 1          | 5          | 1          | 1          |            |            | 4          |            | 12          |            | 12          |
| UK equities            |            | 2          |            |            |            | 1          | 1          |            | 4           |            | 4           |
| EM equities            |            |            |            |            |            |            |            |            |             | 1          | 1           |
| Fixed income           |            |            | 1          |            |            | 1          |            | 3          | 5           | 3          | 8           |
| Balanced               |            |            |            |            |            |            |            |            |             | 4          | 4           |
| Diversified growth     |            |            |            |            | 3          |            |            |            | 3           |            | 3           |
| <b>Total Sub Funds</b> | <b>1</b>   | <b>7</b>   | <b>2</b>   | <b>1</b>   | <b>3</b>   | <b>2</b>   | <b>5</b>   | <b>3</b>   | <b>24</b>   | <b>8</b>   | <b>32</b>   |
| <b>Total £bn</b>       | <b>1.7</b> | <b>7.3</b> | <b>1.6</b> | <b>0.5</b> | <b>1.3</b> | <b>0.4</b> | <b>1.9</b> | <b>0.9</b> | <b>15.6</b> | <b>6.2</b> | <b>21.8</b> |

5.6 Since the last Committee meeting in November East Sussex has transferred the Fund's Ruffer, Newton (absolute return managers) and M&G (investment grade fixed income) mandates within tranche 4A and tranche 4B. This puts the East Sussex total investment with ACCESS Authorised Contractual Scheme (ACS) at £1.3bn with £1.6bn sitting with the ACCESS passive manager. East Sussex currently has 1 mandate the M&G Alpha Opportunities Fund awaiting to be transferred into the ACS this has not been assigned a tranche as there are some technical difficulties to be resolved.

### ACCESS Investor Day

5.7 The Second ACCESS investor day will take place at the Royal Horseguards Hotel, Westminster on 2 April, the same venue as that used for the previous event. The results of the survey conducted after the inaugural event have been considered and, where appropriate, incorporated in the design for this occasion. A formal programme is being developed with Link.

5.8 As in 2019, six Investment Managers will be presenting on the day which will be split into two distinct themes. In the morning, there will be presentations from Baillie Gifford, Newton and Ruffer. The afternoon session will be attributed to Equities and will feature BlackRock, JO Hambro and Schroders. Both sittings will end with a panel discussion. It is likely that Royal London and M&G will be invited to present at the next event in October.

### Joint Committee

5.9 The Joint Committee met on 9 March 2019. The full agenda has been included in Appendix 4.

## **6. Responsible Investment Collaboration**

### **UK Stewardship Code 2020**

6.1 In October 2019, the Financial Reporting Council launched its updated UK Stewardship Code. This follows the publication of a draft Code and a consultation on the proposed changes earlier in 2019. The new Code aims to improve stewardship practices and sets a substantially higher standard, reflecting the changing expectations of investors since the Code was last revised in 2012.

6.2 The revised Code seeks to raise standards for asset owners and managers, extending to establishing clear stewardship objectives, integration of stewardship in investment strategies, and adhering to clearer and more elaborate reporting requirements.

6.3 The Code comprises a set of 12 'apply and explain' principles for asset managers and asset owners, and six principles for service providers, including investment consultants. This sets high stewardship standards for asset owners and asset managers, and for service providers that support them.

6.4 The Fund signed up to the UK Stewardship code in June 2019. The revised Code came into effect on 1 January 2020 and the Fund would need to submit a Stewardship report that meets the Financial Reporting Council's ("FRC") reporting expectations by 31 March 2021 for the Fund to remain listed as a signatory to the Code. The report attached as Appendix 5 discusses in more detail the future expectations and requirements on the Fund of being a signatory to the Code. The report recommends that the Committee:

1. invite a representative from the UN Principles of Responsible Investment (UNPRI) to present at a Committee meeting so that the Committee can hear directly from the UNPRI of the main benefits and demands of signing up; and
2. agree that Hymans Robertson produces a draft Stewardship Report by the second half of 2020 to allow time for the Committee to consider the Report in detail and make amendments as necessary.

### **United Nations Principles of Responsible Investment (UNPRI)**

6.5 The UNPRI is the world's leading proponent of responsible investment. It works to understand the investment implications of ESG factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. The UNPRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

6.6 The UNPRI encourages investors to use responsible investment to enhance returns and better manage risks but does not operate for its own profit; it engages with global policymakers but is not associated with any government; it is supported by, but not part of, the United Nations. The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice.

6.7 The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. They have attracted a global signatory base representing a majority of the world's professionally managed investments.

6.8 The paper attached as Appendix 5 discusses in more detail the future expectations and requirements on the Fund of being a signatory to the UNPRI.

## **7. Conclusion and reasons for recommendation**

7.1 Investments are regularly monitored to ensure that the Fund's strategic asset allocation set out in the Fund's ISS is being complied with and to keep the Committee informed of any significant concerns with the investment managers, retained to implement the Fund's strategic asset allocation.

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