Report to:	**Pension Committee**
Date of meeting:	**1 March 2021**
By:	**Chief Finance Officer**
Title:	**Investment Report**
Purpose:	**This report provides Pension Committee with an update on the investment activities undertaken by the East Sussex Pension Fund.**

RECOMMENDATION

The Pension Committee is recommended to:

1. **note the Action Log and Investment Workplan (Appendix 1);**
2. **note the Quarterly Investment Report from the Investment Advisor, Isio (Appendix 2);**
3. **agree a strategic equity allocation approach for the equity mandate to replace the current passive market capitalisation investment as set out in Paragraph 2.10 and Appendix 3;**
4. **delegate implementation to the Chief Finance Officer of the preferred strategic allocation for the equity mandate;**
5. **note the Pension Minister update (Appendix 4); and**
6. **note the Local Authority Pension Fund Forum (LAPFF) quarterly engagement report (Appendix 5)**

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1. Background

1.1 Under the Local Government Pension Scheme (LGPS) Regulations, East Sussex County Council is required to maintain a pension fund, known as the East Sussex Pension Fund (ESPF or 'the Fund'), for its employees and other 'scheduled bodies' as defined in the Regulations. The Pension Committee, as the scheme manager, is required to maintain an Investment Strategy Statement (ISS) to govern the Funds' investments, and it receives a quarterly investment monitoring report from its investment consultant, Isio, to monitor its investments.

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

2. Supporting information

Action Log and Investment Workplan

2.1 Isio, the Fund's Investment Consultant, has taken over from the former adviser Hymans Robertson. Isio has provided a Workplan which will act as a reference point of all actions agreed at Pension Committee meetings. Unless otherwise stated, items in the Workplan are to be considered by the Committee or a comment provided explaining why the item is not to be covered at this time. This is included as **Appendix 1.**

2.2 Isio has included actions agreed at the November 2020 Committee meeting. The Investment Workplan details the areas of work that are anticipated over the next 12 months, with corresponding ownership and estimated timescale for completion.

Quarterly Performance Report

2.3 The Quarterly Performance Report is attached as **Appendix 2**. Since the last quarter, the valuation of the Fund increased from £3.847bn as at 30 September 2020 to £4.110bn as at 31 December 2020 (an increase of £0.263bn); The Fund's equity mandates performed strongly over the quarter as announcements over COVID 19 vaccines improved the outlook for global economies. M&G Alpha Opportunities, Newton and Ruffer all performed strongly over the quarter.

2.4 During the quarter, the Fund completely disinvested from both the UBS Fundamental Index Fund and the UBS Climate Aware Fund, with the proceeds being re invested with four new mandates; WHEB Sustainability Fund, ATLAS Global Infrastructure Equity Fund, Wellington Global Impact Fund and Storebrand ESG Plus Fund.

Fossil Fuel Exposure

2.5 The Fund's fossil fuel exposure at 31 December 2020 stood at £76.4m or 1.9% (compared with £134.6m or 3.5% as at 30 September 2020) of assets under management, Table 1 below refers. The top five contributions come from the Fund's holding in the Ruffer Absolute Return (24.3% of the funds exposure), M&G Corporate Bonds (18.6%), M&G Alpha Opportunities (11.5%), Passive UBS - UK (10.3%), and Passive UBS – North America (6.1%). This is a function of both the Fund's strategic allocation to these holdings and the higher fossil fuel exposure within these funds themselves.

Table 1 Fossil Fuel Exposure by Manager

Fund	Actual Fossil Fuel Exposure (%)	Actual Fossil Fuel Exposure (£m)	Benchmark Fossil Fuel Exposure (%)	Relative (%)	Management Style
UBS – Japan	4.7%	£1.5	4.7%	0.0%	Passive
UBS - Europe	5.3%	£4.4	5.3%	0.0%	Passive
UBS - UK	12.4%	£7.9	12.4%	0.0%	Passive
UBS – Pacific (ex Japan)	9.2%	£3.0	9.3%	0.0%	Passive
UBS – North America	4.3%	£6.1	4.2%	0.0%	Passive
UBS – Emerging Markets	9.0%	£5.5	9.1%	0.0%	Passive
Longview - Global Equity	0.0%	£0.0	-	-	Active
WHEB - Sustainability Fund	0.0%	£0.0	-	-	Active
ATLAS Global Infrastructure Equity Fund	3.5%	£2.8	15.0%	-11.5%	Active
Wellington – Global Impact Fund	0.0%	£0.0	-	-	Active
Storebrand – Global ESG Plus Fund	0.0%	£0.1	-	-	Passive – Smart Beta
Harbourvest – Private Equity[1]	1.4%	£1.6	-	-	Active
Adams Street – Private Equity[1]	1.5%	£1.9	-	-	Active
Newton – Absolute Return	0.0%	£0.0	-	-	Active
Schroders – Property	0.0%	£0.0	-	-	Active
Pantheon - Infrastructure	0.0%	£0.0	-	-	Active
M&G Infrastructure	0.0%	£0.0	-	-	Active
M&G -Private Debt	0.0%	£0.0	-	-	Active
M&G -UK Financing Fund	0.0%	£0.0	-	-	Active
M&G -Alpha Opportunities	3.2%	£8.8	9.5%	-6.4%	Active
Ruffer -Absolute Return	4.0%	£18.6	-	-	Active
M&G -Corporate Bonds	8.4%	£14.2	9.7%	-1.4%	Active
UBS -Over 5 Year IL Gilt Fund	0.0%	0.0%	-	-	Passive
Cash	0.0%	0.0%	-	-	Passive
Total Assets	**1.9%**	**£76.4m**	-	-	

Totals may not sum precisely due to rounding.

All asset valuations have been provided by Northern Trust.

Benchmark data where available has been provided by investment manager.

[1]. Data provided as at 30 September 2020.

Source: Investment Managers, Northern Trust, Link, Isio calculations.

Equity Review

2.6 Since the meeting of Committee in November 2020, the Fund has finalised the transition of its equity mandates to the new structure. The Committee requested that a review was taken to understand the implications that the changes have had on the strategic objectives. As part of this, Isio has been requested to review the remaining passive equity mandates with UBS. The results are attached as **Appendix 3**.

2.7 The main points Isio has identified are that the current equity portfolio is split equally between active and passive management (including the 'smart beta' exposure). This offers a good balance between overall management cost and diversification whilst enabling the Fund to implement a robust policy in relation to addressing wider Environmental, Social and Governance (ESG) risks and capturing opportunity from the anticipated transition in economies towards a lower carbon future.

2.8 The current structure provides good diversification by region, market capitalisation and manager style. The UBS portfolio is the most diversified in terms of underlying holdings.

2.9 Overall, Isio believes that the Fund should seek to retain a balance between active and passive management but believe that there are better alternatives to structure the passive allocation given the Fund's ESG objectives. Isio suggests that the active managed allocation sits in the range of 50% to 65% with the remainder invested in passive mandates that align with Funds objectives.

2.10 Isio has suggested three alternative equity allocations for consideration. Within all suggested options, Isio has suggested the retention of some aspect of the existing emerging market index exposure, as this is unlikely to be captured sufficiently elsewhere within the equity portfolio

- **Alternative 1** retains the 50:50 split between active and passive management by introducing exposure to a resource efficient index. The option would see the removal of the Developed markets index and replaced with 5% in a resource efficient index and a 2.5% increase in the Storebrand index.
- **Alternative 2** provides an increased exposure to active management through a new Core manager from the ACCESS pool of sub funds plus an allocation to a resource efficient index to provide increased diversification. Isio believes that this approach is appealing, particularly if Osmosis can be accessed via UBS cost effectively and as a result remain within the ACCESS pooled investments. The passive emerging market exposure has been moved towards market capitalisation and Isio would propose a small reduction in the Longview mandate to balance the active mandates.
- **Alternative 3** provides an approach where there is no new passive manager required, which may be simpler if the resource efficient mandate is not available via UBS and the ACCESS pool. This alternative increases the active management of the equity portfolio to 62.5% with the addition of a core equity manager from the ACCESS pool. Isio believe a 15% allocation to Storebrand is the maximum the Fund should consider given this remains a relatively new approach for the Fund.

2.11 It is recommended Pension Committee consider the alternative options above along with the retention of the existing strategy and delegate implementation to the Chief Finance Officer of the preferred strategic allocation for the equity mandate.

Private Equity commitments

2.12 Isio, the Fund's Investment Consultant, has undertaken a review of the Fund's private equity portfolio. As at 30 September 2020, the Fund was marginally overweight to private equity (6.3% vs 5.5% benchmark).

2.13 The Funds allocation to private equity is expected to decline over time, as the distribution of sale proceeds from the current investments progresses this is expected to exceed the drawdown of agreed commitments and any capital growth. To maintain exposure to private equity, the Committee is recommended to make additional commitments to their private equity managers. This should be implemented in order to achieve diversification over different vintages of funds through time. The Committee should then review this on an annual basis.

2.14 The recommendation for investment in private equity managers is set out in an exempt report later in the agenda.

ACCESS update

<u>Illiquid assets</u>

2.15 ACCESS appointed bfinance to conduct an initial review of existing illiquid (private market) assets, future requirements and to advise on the most appropriate implementation models going forward to meet the needs of the ACCESS pool members. This was known as 'Phase 1'.

2.16 This review included advice from Squire Patton Boggs on the legal structures required for the proposed solutions and their appropriateness within current pooling guidelines. This paper has also been reviewed by the legal advisor for consistency with their original advice.

2.17 The illiquid assets included in the scope of the review are:

- Private Equity;
- Private Debt;
- Infrastructure (potentially including other real assets e.g. timberland); and
- Real Estate (excluding direct property portfolios where administering authorities had stated it was their intention not to pool these allocations).

2.18 bfinance has now provided their advice on the appropriate solution(s) for each of the asset classes listed in paragraph 2.14. These continue to provide optionality to administering authorities where flexibility of approach was deemed appropriate based on the requirements communicated by each authority.

2.19 The proposed solutions do not require existing illiquid assets to be either re-housed or sold with proceeds then re-invested.

2.20 With the exception of real estate and potentially open ended infrastructure funds, the proposed solutions are geared primarily towards new strategic allocations that administering authorities may wish to make but will also enable new investments to maintain existing allocations where deemed appropriate in line with their own strategic allocation decisions and requirements.

2.21 The ACCESS Joint Committee agreed the proposed structures at its meeting on the 13 January 2021 and has agreed that ACCESS appoint an Investment Management Consultancy Service to support the implementation of the proposed illiquid asset pooling structures and manager/fund/allocator procurements as required.

<u>ESG Adviser procurement</u>

2.22 The appointment panel has concluded the procurement process for the ESG adviser and the ACCESS Joint Committee agreed the appointment of Minerva to provide external advice to support ACCESS's approach to ESG/Responsible Investment. The Officer Task & Finish Group has met with Minerva and are working with them to develop the project plan to deliver the revised guidelines for ACCESS.

ACCESS Joint Committee

2.23 The Joint Committee met on 13 January 2021. The agenda and public papers are on the Kent County Council website.

2.24 After the meeting, the Joint Committee received a presentation from Hymans Robertson on the current pooling solutions that have been implemented by LGPS Pools. To help the Joint Committee set criteria to evaluate these models when reviewing the future direction of ACCESS.

Sub Fund Progress

2.25 As reported previously to the Committee, Link, on behalf of ACCESS Authorities, is launching 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:

Tranche Asset class	T1	T2	T3	T3a	T4	T5a	T4a	T5b	T6	On hold	Total
Global equities	1	5	1	1		4	1		1		14
UK equities		2				1				1	4
EM Equities									1		1
Fixed income			1		1		1	3	1	1	8
Diversified growth					3						3
Total	1	7	2	1	4	5	2	3	3	2	30

2.26 Tranches 1 – 5a are live as ACCESS pooled funds with £20.4bn of assets within the live sub-funds. Tranche 5b is due to launch during June, the ESPF does not have any assets within the tranches currently transitioning.

Pension Minister speech to Professional Pensions Investment Conference

2.27 On the 27 January 2021, the Pensions Minister, Guy Opperman MP, delivered a speech to the Professional Pensions Investment Conference. On pension schemes and climate-related risks. A copy of the speech has been provided in **Appendix 4**.

2.28 Some of the main points from the speech are listed below:

- Triennial Scenario Testing of Climate Risks with annual interim reviews
- Adoption of absolute & intensity based Greenhouse Gas metrics
- Strong emphasis on improving engagement
- Clear opposition to blanket divestment from high carbon sectors

LAPFF quarterly engagement report

2.29 The Local Authority Pension Fund Forum (LAPFF) promotes the highest standards of corporate governance to protect the long-term value of local authority pension funds.

2.30 For LAPFF, corporate responsibility and long-term shareholder engagement is a fundamental to securing the value of pension fund assets. LAPFF issues a quarterly engagement report detailing the actions that it has undertaken during the quarter. The latest edition is attached as **Appendix 5.**

3. Conclusion and reasons for recommendation

3.1 Investments are regularly monitored to ensure that the Fund's strategic asset allocation set out in the Fund's Investment Strategy Statement 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.

3.2 It is recommended Pension Committee consider and agree an alternative strategic allocation option as set out in 2.10 for the equities mandate, along with the retention of the existing strategy, and delegate implementation to the Chief Finance Officer of the preferred strategic allocation for the equity mandate.

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