

Report to: **Pension Committee**

Date: **22 June 2021**

By: **Chief Financial Officer**

Title of report: **Investment Report**

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

RECOMMENDATION

The Pension Committee are 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) receive Fixed Income training (appendix 3);**
 - 4) note the Fixed Income Review of Current Holdings (appendix 4);**
 - 5) note the ACCESS Pool update;**
 - 6) note the high level carbon foot printing and energy transition scores for the East Sussex Pension Fund's managers.**
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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 (ISS) to govern the Funds' investments and receives a quarterly investment monitoring report, from its investment consultant, Isio.

1.2 The ACCESS Joint Committee has been established as a result of the changes implemented in the 2016 LGPS Investment regulations to facilitate the arrangements relating to the collective investment vehicles, to allow the administering authorities to pool their respective investments. The ACCESS Joint Committee meets quarterly.

2. Action Log and Investment Workplan

2.1 Isio have 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 The workplan picks up actions agreed at the 1 March 2021 Committee meeting. The Investment Workplan details the areas of work that are anticipated over the next 12 months.

2.3 The main focus over the next 12 months is a review of the investment strategy which will be carried out in July 2021 and a number major projects in relation to Environmental,

Social and Governance (ESG) and climate reporting, including climate change scenario analysis modelling.

3. Quarterly Performance Report

3.1 The Quarterly Performance Report is attached as Appendix 2. Since the last quarter, the valuation of the Fund increased from £4.1bn as at 30 December 2020 to £4.2bn as at 31 March 2021 (an increase of £0.1bn). A positive absolute return of 3.0% over the quarter, outperforming its respective benchmark by 1.3%.

3.2 Over the period, both the Adams Street private equity mandate and the M&G Infrastructure mandate were the standout performers in both absolute and relative terms. The Adams Street mandate benefitting from the successful COVID 19 vaccine trials on expectations of future economic activity. The M&G infrastructure mandate benefitting from a strong material valuation uplift in one of its underlying assets as well as solid performance generally from the rest of its portfolio.

3.3 One of the main detractors to performance over the period in both absolute and relative terms was the ATLAS Global Infrastructure Fund, which suffered as a result of limited exposure to the stronger performing infrastructure sectors over the quarter.

3.4 During the quarter, we were notified of a number of the senior team within the M&G Real Estate Debt Fund leaving M&G, which includes the departure of 4 key individuals. This has resulted in Isio downgrading their rating for the fund from “meets criteria” to “partially meets criteria”. There is no recommendation to remove this holding from the portfolio at this time. A separate paper has been included within the exempt section of the Investment report to address the reasons for this change.

4. Fossil Fuel Exposure

4.1 The Fund’s fossil fuel exposure at 31 March 2021 stood at £82.2m or 1.9% (£76.4m or 1.9% as at 31 December 2020) of assets under management, Table 1 below refers. The top five contributions come from the Fund’s holding in the Ruffer Absolute Return £14.5m (17.6% of the funds exposure), M&G Corporate Bonds £13.2m (16.1%), Newton £12.8m(15.6%), Passive UBS - UK £8.9m (10.8%), and Passive UBS – North America £7.1m (8.6%). This is a function of both the Fund’s strategic allocation to these holdings and the higher fossil fuel exposure within these funds themselves.

4.2 The Fund’s fossil fuel exposure will reduce once the equity changes approved at the 1 March 2021 Committee have been fully implemented. Details on the progress for implementing those changes are reported in the exempt section of the Investment report.

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	9.5%	£2.9	9.6%	-0.1%	Passive
UBS – Europe	5.2%	£4.5	5.3%	-0.1%	Passive
UBS – UK	13.4%	£8.9	13.2%	0.1%	Passive
UBS – Pacific (ex Japan)	9.3%	£3.1	9.5%	-0.2%	Passive
UBS – North America	4.7%	£7.1	4.7%	0.0%	Passive
UBS – Emerging Markets	9.2%	£5.7	9.2%	0.0%	Passive
Longview - Global Equity	0.0%	£0.0	10.8%	-10.8%	Active
WHEB - Sustainability Fund	0.0%	£0.0	-	-	Active
ATLAS Global Infrastructure Equity Fund	0.0%	£0.0	-	-	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	1.1%	£1.2	-	-	Active
Adams Street – Private Equity ¹	1.7%	£2.6	-	-	Active
Newton – Absolute Return	2.6%	£12.8	-	-	Active
Schroders – Property ²	0.0%	£0.0	-	-	Active
Pantheon – Infrastructure ²	0.0%	£0.0	-	-	Active
M&G Infrastructure ²	0.0%	£0.0	-	-	Active
M&G -Private Debt ²	0.0%	£0.0	-	-	Active
M&G -UK Financing Fund ²	0.0%	£0.0	-	-	Active
M&G -Alpha Opportunities	2.0%	£5.6	8.4%	-6.4%	Active
Ruffer -Absolute Return	2.8%	£14.5	-	-	Active
M&G -Corporate Bonds	8.4%	£13.2	9.6%	-1.3%	Active
UBS -Over 5 Year IL Gilt Fund	0.0%	£0.0	-	-	Passive
Cash	0.0%	£0.0	-	-	Passive
Total Assets	1.9%	£82.2	-	-	

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 31 December 2021. 2. Manager unable to provide fossil fuel exposure information. Source: Investment Managers, Northern Trust, Link, Isio calculations.

5. Equity Review

5.1 Since the meeting of Committee on 1 March 2021, the Fund has been exploring the preferred option for the following strategic equity allocation approach for the equity mandate to replace the current passive market capitalisation investment with the allocation set out below:

- | | | |
|----|-----------------------------|-----|
| 1. | Storebrand Global ESG Plus | 10% |
| 2. | Osmosis Resource Efficiency | 5% |
| 3. | WHEB Sustainability | 5% |
| 4. | Wellington Global Impact | 5% |
| 5. | Longview Global Equity | 10% |
| 6. | 'Core' Active (ACCESS Pool) | 5% |

5.2 A separate paper in the exempt Investment report will discuss in detail the progress made with UBS and Osmosis and identify the 'Core' Active (ACCESS Pool) which best meets the Funds requirements.

6. Fixed Income

6.1 The Committee requested a review of the current investment strategy which is due to be discussed at the 12 July 2021 meeting. Ahead of this wider review, Isio have prepared some training on fixed income as an asset class and an overview of the current portfolio for Committee. The training material (appendix 3) has been provided alongside this review (appendix 4).

6.2 A further detailed report will be presented to the September 2021 meeting. Which will focus on the Fund's cashflow requirements and provide recommendations on evolving the fixed income portfolios.

6.3 The Fund's current strategy includes a 16.5% strategic allocation (15% currently invested) to fixed income investments (i.e. a range of different bond based strategies). These include inflation linked government bonds (index linked gilts), corporate bonds, commercial real estate debt ("CRED") and diversified credit ("DCF"). DCF invests in a wide range of different bond markets at the managers' discretion.

6.4 There are some areas for consideration in relation to the mandates within the portfolio. The Committee should consider the strategic direction of the fixed income portfolio and how this could be enhanced to meet the Fund's objectives. Initial observations by Isio are summarised below:

1. There is strong strategic rationale for the Fund's allocation to index linked gilts and real estate debt within the portfolio. There is scope to seek additional yield through assets that are directly linked to inflation but higher yielding than government bonds, and scope to increase the overall allocation to illiquid credit.
2. The Fund's allocation to diversified credit plays a useful role within the portfolio, providing diversification, stability and downside protection. However, due to M&G's bias towards European markets, Isio believe there could be merit in introducing a second provider within the diversified credit space.
3. There is limited strategic rationale for the Fund's allocation to corporate bonds and the Committee should considering deploying this capital elsewhere.

M&G Alpha Opportunities Fund fossil fuel exposure

6.5 At its last meeting the Committee requested to have a better understanding of the fossil fuel exposure within the M&G Alpha Opportunities Fund. As part of the Isio review of the current strategy they have conducted a review of the current holdings within this investment. A summary of the findings is set out below:

1. Over time M&G's exposure to fossil fuels has not meaningfully changed (currently 2.0% of the manager's portfolio) and remains materially lower than the comparative benchmark. M&G build their exposure (including fossil fuel exposure) from the bottom up and appear to have sound justification for holding the fossil fuel related names from an ESG point of view.
2. There is a sustainable version of the Alpha Opportunities Fund launching in Q3 2021, with a 'Net Zero by 2050' target amongst other sustainability driven exclusions and goals. This could be an opportunity for the Fund to maintain its diversified credit exposure with M&G in a more ESG conscious manner.

6.6 Discussion on Fixed Income within the Fund will be continued as part of the Strategic Asset Allocation review at the July Committee. Where these initial findings will be put in context to the wider portfolio discussions.

7. ACCESS update

Governance

7.1 The Governance technical leads were asked to review the Governance Manual following agreement by the Section 151 Officer Group.

7.2 Following an initial review of the manual and conversations with all participating Authorities, the technical leads have identified several themes both regarding the Governance Manual itself and wider governance of the Pool.

7.3 Work has been proposed which will focus on areas of highest risk to the delivery of the ACCESS objectives and the governance, policies and procedures needed to achieve them. The key time critical tasks within the ACCESS Business Plan are: implementation of approach to alternative / non-listed assets, the development and implementation of Environmental, Social and Governance (ESG) / Responsible Investment (RI) guidance, consideration of the future arrangements for Operator Services to the ACCESS Pool and determination of future sub-funds.

7.4 Once progress has been made in relation to the above, a third party is to be engaged to carry out an audit of ACCESS governance as recommended by the Governance Working Group.

Illiquid assets

7.5 The Joint Committee agreed the proposed structures for illiquid assets at its meeting in January 2021 and have agreed that ACCESS appoints an Investment Management Consultant to support the implementation of the illiquid asset pooling structures and manager/fund/allocator procurements as required.

7.6 The illiquid assets included in the scope are:

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

7.7 The Non Listed Sub Group has been preparing the specification and evaluation scoring matrix for the implementation advisor procurement. This is being undertaken through the LGPS National Framework with the aim of presenting the winning appointment to the September Joint Committee.

7.8 This will then start a rolling program of procurements and searches lead by the Implementation Advisor to complete the agreed illiquid programme structure. Based on the need of these investments from investing authorities.

Environmental, Social and Governance/Responsible Investment (ESG/RI) guidelines

7.9 Minerva, the appointed third party advisor to assist ACCESS with creating its ESG/RI guidelines, have undertaken a survey of each Authority's current position on ESG/RI matters and their aspirations in this space.

7.10 The results from this survey has helped Minerva create a skeleton set of guidelines covering:

1. Governance - ACCESS' approach to the responsible oversight and management of the Partner Funds' investments;
2. Process - ACCESS' approach to identifying RI factors and their potential impact on investments;
3. Implementation - the approach taken to implementing the Pool's RI objectives;
4. Stewardship - ACCESS' approach to voting, engaging with investee companies and assets, securities lending policy and working collaboratively with third parties; and
5. Monitoring & Reporting – the Pool's approach to assessing ongoing effectiveness and communicating findings to Partner Funds and stakeholders.

7.11 The Officer Task & Finish Group has met with Minerva and are working with them to develop the proposed guidelines for ACCESS. Alongside this Minerva will be having 1-2-1 meetings with all of the investing authorities to discuss their response to the survey to ensure these are interpreted correctly. The final ESG/RI Guidelines are set to be presented to the September Joint Committee for approval.

Joint Committee

7.12 The Joint Committee met on 8 March 2021. The agenda has been included in Appendix 5 and public papers can be located on Kent County Council website here [Agenda for ACCESS Joint Committee on Monday, 8th March, 2021, 10.00 am \(kent.gov.uk\)](https://www.kent.gov.uk/agenda-for-access-joint-committee-on-monday-8th-march-2021-10.00-am)

Sub Fund Progress

7.13 As reported previously to the Committee, Link on behalf of ACCESS Authorities, are 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:

Asset class	Tranche	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

7.14 Tranches 1 – 5a are live as ACCESS pooled funds with £20.7bn of assets within the live sub-funds. Tranche 5b has been delayed until October due to an ongoing insurance arrangement issue with Link.

7.15 One of the on hold sub-funds has progressed, M&G Alpha Opportunities, which East Sussex have an investment in. The investment into this sub-fund was agreed by the Committee at its November 2018 meeting. Due to technical issues around redemptions from the Authorised Contractual Scheme the launch of this fund was postponed until a solution to this could be made that was acceptable to all parties. Agreeable arrangements were finalised last quarter and the launch of the sub-fund has been reinstated and the current plan is for this to go live in July 2021.

8. Manager Carbon Footprint and Transition Scores

8.1 The Fund appointed Vigeo Eiris to conduct a carbon footprint measurement on its liquid investments in June 2020. The aim of these reports was to set a benchmark against which the Fund can monitor the progress of its investment decisions in relation to climate change. This also provides the Committee with information to assist them in their duties in ensuring the Fund’s managers are representing their beliefs in the investments they make.

8.2 The Fund has engaged Vigeo Eiris to run the carbon footprint measurement on its liquid investments for the second year running. As Carbon footprinting and carbon scoring is a relatively new science, there is limited consistency in the scoring between providers and can be quite subjective. The carbon footprint reports have been produced to help the Fund understand the direction that the Investment Managers are moving and where to focus engagement in discussions with the Fund Managers for the coming year.

8.3 The report looks at the Carbon Footprint of the underlying companies within each investment managers’ portfolio (based on scope 1 & 2 emissions). The score for the mandates range from Moderate, Significant, High and Intense based on the ranges in the table below. The emissions levels are based on the weighted average company carbon emissions within each Investment managers portfolio. In addition, the report looks at the energy transition of the investments, to determine how the companies are positioned to respond to a shift from a carbon based economic model to a green and sustainable one. The ranges are based on the ranges in the table below:

Carbon Footprinting

Scale	Emissions (t CO2 eq)	Categories
A	<100,000	Moderate
B	>=100,000 & <1,000,000	Significant
C	>=1,000,000 & <10,000,000	High
D	>=10,000,000	Intense

Carbon footprint is measured in equivalent tons of carbon dioxide (t CO2 eq.) emitted by issuers

Scale	Energy Transition Score	Categories
++	60-100	Advanced
+	50-59	Robust
-	30-49	Limited
--	0-29	Weak

8.4 This gives an overall portfolio score from A++ to D--. For Carbon footprint we have no D rated portfolios compared to three in 2020; one of the D rated portfolios was removed and two have dropped to C ratings. We have two B rated portfolios compared to one in 2020, which are active Longview and Wellington (new investment) mandates. The remaining managers are rated C.

8.5 On the Energy transition rating we have two portfolios graded as Robust or "+", the same as in 2020; these are the passive UBS Europe Ex UK and 1 Active M&G Corporate Bonds. All other portfolios are rated Limited or "-". The lack of movement at the rating level on the energy transition rating does not represent the improvement made by all except one manager on the underlying transition score basis. With all the managers achieving a score of above 30 with 6 scoring above 40. Not all companies will have an energy transition plan in place, with them being less likely in lower emitting sectors and industries, which the high level scoring does not identify.

8.6 Table below shows a summary of the headline scores and ratings for each mandate:

Manager	Mandate	Portfolio Rating (A to D, “++” to “- -”)	Carbon Intensity Rating (Mod; Sign; High; Int)	Movement	Energy Transition Rating (Weak; Ltd; Robust;Adv)	Energy Transition Score (/100)	Movement
WHEB	Impact	C-	High	N/A	Limited	31	N/A
Wellington	Impact	B-	Significant	N/A	Limited	38	N/A
UBS	UK Equity	C-	High	↑	Limited	47	↑
UBS	Rest of World	C-	High	↔	Limited	32	↑
UBS	North America	C-	High	↔	Limited	37	↑
UBS	Europe Ex-UK	C+	High	↔	Robust	53	↑
Storebrand	Climate Passive	C-	High	N/A	Limited	44	N/A
Ruffer	Absolute Return	C-	High	↑	Limited	44	↑
Newton	Absolute Return	C-	High	↔	Limited	44	↔
M&G	Corporate Bonds	C+	High	↔	Robust	53	↑
M&G	Absolute Return Bonds	C-	High	↔	Limited	45	↑
Atlas	Infrastructure	C-	High	N/A	Limited	41	N/A
Longview	Global Equity	B-	Significant	↔	Limited	39	↑

8.7 The individual reports for each of these managers has been included in the exempt section of the committee agenda under item 18. Vigeo Eiris will be present during the exempt item to discuss the detail of the reports.

9. Conclusion and reasons for recommendation

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

10.2 The Pension Committee are recommended to:

note the Action Log and Investment Workplan (appendix 1);

note the Quarterly Investment Report from the Investment Advisor, Isio (appendix 2);

receive Fixed Income training

note the Fixed Income Review of Current Holdings (appendix 4);

note the ACCESS Pool update;

note the high level carbon foot printing and energy transition scores for our managers.

IAN GUTSELL
Chief Finance Officer

Contact Officer: Sian Kunert, Head of Pensions
Tel. No. 01273 337177
Email: Sian.kunert@eastsussex.gov.uk