Report to:	**Pension Committee**
Date:	**16 November 2023**
By:	**Chief Finance 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 note the investment report

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. Investment Workplan

2.1 **Appendix 1** shows a workplan which will act as a reference point of all actions agreed at Pension Committee meetings and the forward investment plan.

2.2 The main focus over the next 12 months is:

- Implement the strategic changes in relation to fixed income
- Implement the strategic changes in relation to passive equity
- Implement the strategic changes in relation to income distribution
- Implement the strategic changes in relation to private debt
- Monitoring of index link triggers for investment
- Work to define case on increasing exposure to index linked gilts
- Work with ACCESS to develop the governance and investment opportunities on the pool platform
- Engagement with investment managers on the engagement priorities defined in the Statement of Responsible Investment Principles
- Carry out Carbon Foot printing as at 31 March 2024
- Consider the creation of a standalone climate policy and biodiversity policy

3. Quarterly Performance Report

3.1 Due to the timing of the November meeting the usual Quarterly Performance Report for Q3 2023 is not ready. Isio have provided a summarised version of the report for Pension Committee attached as **Appendix 2**. Since the last reported position, the valuation of the Fund has decreased from £4.537bn as at 30 June 2023 to £4.501bn as at 30 September 2023 (an decrease of £0.036bn). This performance reflects a negative absolute return of -0.7% in the quarter to September the Fund also underperformed its benchmark in the period by -1.3%.

3.2 Although performance across the Fund was negative for the quarter for both absolute and relative terms the longer-term performance for 3 and 5 years is positive in absolute terms, however negative in relative terms.

3.3 The public equity managers all posted negative absolute and relative returns as equity markets were volatile and began to price in "higher for longer" interest rates leading to "growth" stocks struggling.

3.4 The Fund's illiquid holdings in private equity, which have posted negative performance in recent quarters experienced an improvement in performance in Q3 2023.

3.5 The various credit mandates posted mixed results in both absolute and relative terms as UK Gilt yields rose and spreads widened by varying degrees across credit sectors. The Absolute Return managers continued to disappoint relative to their "cash plus" targets, Ruffer particularly so.

3.6 Since the 19 September 2023 Committee meeting officers have had specific meetings with 2 managers (Wellington and Ruffer) to discuss their current performance. With 1-year numbers of -3.0% absolute and -13.5% relative and -7.5% absolute and -14.4% relative respectively, Officers felt discussions were required. The topics covered included reasons performance has been disappointing and what action they are taking or had taken in reaction to this. Officers were reassured that the managers have not amended their overall approach to selecting investments and were not drifting away from the mandate that they were appointed to. Officers will continue to monitor the performance of these managers to ensure that what we have been informed by the managers is taking place.

4. ACCESS Update

4.1 Since December 2016 the East Sussex Pension Fund has been working with 10 other administering authorities through the investment pooling arrangement called ACCESS. On the 30 June 2023 there was £24.8bn invested in the authorised contractual scheme (ACS) managed by the pool operator, with a further £10.7bn invested in the UBS passive ACCESS governance arrangements.

4.2 As at 30 September 2023 East Sussex had a total of £2.3bn (51%) in ACCESS governed investments, £1.89bn across 6 ACS sub-funds and a further £0.4bn through the UBS passive arrangement.

5. Stewardship Report

5.1 The Financial Reporting Council (FRC) revised its UK Stewardship code in 2020 this version requires the Fund to produce a report which demonstrates how the Fund meets the 12 principles within the code over a 12-month period. The principles are divided into four categories;

- purpose and governance,
- investment approach,
- engagement, and
- exercising rights and responsibilities.

5.2 The FRC requires the Fund to both describe how it implements these principles but also demonstrating the outcomes from these. The Fund has been working to provide its stewardship report for the year to December 2022 which was submitted to the FRC by the 31 October 2023 for assessment.

5.3 The FRC will be assessing all the submissions provided by the 31 October 2023 deadline; the FRC will read in full all reports and consider the responses against the reporting expectations proportional to each organisations size and type. Both successful and unsuccessful applicants will receive feedback where their reporting against the Code could be improved. The Fund anticipate a response from the FRC in February about our submission.

6. Carbon footprinting

6.1 The Fund appointed Minerva analytics to conduct a carbon footprint measurement on its liquid investments as at 31 March 2023 (appendix 3). This had previously been provided by Moody's however they have changed their model and no longer provide the service we previously undertook. The results from this forth year is not directly comparable to the previous three years as there is a different methodology behind the calculations.

6.2 The rationale for this analysis allows the Fund to 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.

6.3 Carbon footprinting and transition scoring are still 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 to focus engagement during discussions with the Investments Managers for the coming year.

6.4 Whilst the Department for Levelling Up, Housing and Communities ('DLUHC') considers the responses it received to the consultation on Governance and Reporting of Climate Change Risks undertaken in late 2022, the Fund decided to move forward with Minerva and follow up its previous work on assessing Greenhouse Gas ('GHG') emissions associated with the Fund's investments by commissioning some more up-to-date analysis based on the consultation.

6.5 Working with Minerva, Officers of the Fund agreed that the primary results of the analysis should be the 4 key climate ‘Metrics’ that were set out in the DLUHC consultation that Administering Authorities (‘AAs’) should use, with the rationale being that these Metrics are likely to feature in any final guidance or regulations. These four metrics were defined by DLUHC as follows:

- Absolute Emissions Metric - Under this metric, AAs must, as far as able, report Scope 1, 2 and 3 greenhouse gas (GHG) emissions;
- Emissions Intensity Metric - AAs should report the Carbon Footprint of their assets as far as they are able to;
- Data Quality Metric - AAs will report the proportion of the value of its assets for which its total reported emissions were Verified, Reported, Estimated or Unavailable; and
- Paris Alignment Metric - Under the Paris Alignment Metric, AAs will report the percentage of the value of their assets for which there is a public net zero commitment by 2050 or sooner.

Carbon Footprinting Analysis Results - Summary

6.6 The high level results of the carbon footprinting exercise are shown below:

Metric	Analysis Results	Comments
1. Absolute Emissions	Scope 1 & 2 = 1,708 Million tonnes CO_2e	This is the combined absolute emissions of the Fund’s investee companies that disclosed either Scope 1 emissions, Scope 2 emissions or both, taking account of any disclosed Emissions Offsetting.
	Scope 1, 2 & 3 = 17,026 Million tonnes CO_2e	This is the combined absolute emissions of the Fund’s investee companies that disclosed Scope 1, Scope 2 and Scope 3 emissions, taking account of any disclosed Emissions Offsetting.
2.Emissions Intensity	72,027 Tonnes of CO_2 e	The Fund’s share of Scope 1 & 2 GHG emissions from its investee companies equates to 72,027 tonnes of CO2 equivalent.
3. Data Quality	48% Verified	For this exercise, we sought to capture available GHG disclosures for the Fund’s investee companies. Importantly, we also noted instances where there were no Scope 1, 2 or 3 disclosures – since this ‘lack of data’ is valuable data in itself, as it can be used to identify prioritised targets for stewardship activity such as voting and engagement.
	26% Reported	
	4% Estimated	
	22% Unavailable	
4. Paris Alignment	22% Excellent	47% of the Fund’s investee companies have:
	25% Good	- made an ‘Excellent’ public net zero commitment by 2050 or sooner relating to all scope 1, 2 & 3 emissions, covering all company activities
	11% Moderate	- made a ‘Good’ public net zero commitment by 2050 or sooner relating to all scope 1, 2 & 3 emissions, but only covering some company activities / relating to all scope 1 & 2 emissions only (covering either all or some company activities)
	15% Poor	
	27% No Disclosure	However, 42% of the Fund’s investee companies have either Poor Net Zero plans or have not made any disclosure regarding their intentions.

6.7 The key takeaways are that:

- Where disclosures were made, the Fund’s investee companies emitted 1,708 Million tCO2e
- The Fund’s share of the GHG emissions made by its investee companies is just over 72,000 tonnes of CO2 equivalents;
- Almost 50% of the Fund’s investee companies had their GHG emissions disclosures externally verified; and

- 47% of the Fund's investee companies have publicly disclosed a decarbonization plan that is aligned with the Paris Agreement (achieving Net Zero by 2050 or sooner)

Metric 1: Absolute Emissions

6.8 The figures shown in the report reflect the actual disclosures made by the Fund's investee companies that Minerva were able to identify and collect. The table reflects the actual GHG emissions disclosure position as far as they could determine, and the total amount of GHG emissions is clearly connected to the size of the portfolio, in terms of the number of companies held. This explains why the figures for, say, Osmosis are larger than the figures for Wheb – since the Osmosis portfolio holds 549 individual assets, versus the 40 assets in the Wheb portfolio.

Metric 2: Emissions Intensity

6.9 The Fund's current carbon footprint - i.e., its 'share' of the emissions made by its investee companies - equates to c. 72,027 tonnes of CO_2e emissions. Again, the figures shown are clearly connected to the size of the individual portfolio, and also the size of investment held in each investee company.

6.10 The 'previous' calculations in this exercise simply use the disclosed GHG emissions for each existing investee company from the previous year. They do not reflect the actual investments held by the Fund at 31/03/22, since Minerva had not undertaken this exercise before, and the previous carbon footprinting reporting undertaken by Moody's did not display the results in this manner. This information is merely shown to allow for a very high level indication of the state of disclosures made by companies between previous and current years

6.11 The decrease of 8% from the 'previous' year's Scope 1 & 2 carbon footprint could be attributed to a number of things including:

- Companies actually reducing their GHG emissions between the years;
- Changes in the total market value of individual companies; and
- Exchange rate effects in currency conversions.

6.12 As a result, caution should be exercised against drawing too many conclusions from the data as presented.

Metric 3: Data Quality

6.13 In undertaking this assessment, Minerva used the following criteria, which are taken from the DLUHC consultation on climate change risk reporting:

Categorization	Description
Verified	Reported GHG emissions calculated in line with the GHG Protocol and verified by a third-party
Reported	Reported GHG emissions calculated in line with the GHG Protocol without verification by a third-party
Estimated	Reported GHG emissions where the company has explicitly stated that they are 'estimated'
Unavailable	Used when the company has not disclosed any GHG emissions on any basis

6.14 The results show that almost 50% of the Fund's investee companies are disclosing GHG emissions that have been verified by a third party in line with the GHG Protocol. This is an encouraging result for the first time that this metric has been measured, since all investee companies need to disclose their GHG emissions on an annual basis to allow investors such as the Fund to monitor the absolute levels of emission, and also track progress in reducing emissions towards achieving Net Zero. However, we also recognize that our investment managers need to engage with the 25% of our investee companies that either use 'estimated' data or do not disclose any GHG emissions.

Metric 4: Paris Alignment

6.15 In undertaking this assessment, Minerva used their own assessment criteria as shown in the following table:

Categorization	Description
Excellent	Issuer has made a public Net Zero commitment by 2050 or sooner relating to all scope 1, 2 & 3 emissions, covering all company activities
Good	Issuer has made a public Net Zero commitment by 2050 or sooner relating to: all scope 1, 2 & 3 emissions, but only covering some company activities; or all scope 1 & 2 emissions only (all company activities); or all scope 1 & 2 emissions only (some company activities)
Moderate	Issuer has made a public Net Zero commitment by 2050 or sooner relating to carbon (CO_2) emissions only (any extent of company activities)
Poor	Issuer has made some public disclosure relating to its efforts towards Net Zero but specifics are unclear/'coming soon'/don't otherwise meet criteria of options above
No Disclosure	Issuer has made no disclosure or reference to achieving Net Zero by 2050 or sooner

6.16 The findings are encouraging, in that almost 50% of the Fund's investee companies have been assessed as either 'Excellent' or 'Good' – which means that they have disclosed their plans to achieve Net Zero by 2050 or sooner, covering at least Scope 1 and 2 emissions on some of their company activities. However, there is again a material number of companies that have either 'Poor' or no disclosed decarbonisation plans, and so we would expect our investment managers to engage with the companies on this metric to close the disclosure gap.

6.17 The Fund continues to work with Minerva to provide individual manager reports and analysis of the fixed income mandates.

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 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.

7.2 The Pension Committee are recommended to note the Investment Report.

IAN GUTSELL
Chief Finance Officer

Contact Officer: Russell Wood, Pensions Manager Investments and Accounting

Email: Russell.Wood@eastsussex.gov.uk