

Report to: Pension Committee

Date: 27 February 2025

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 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 Fund's investments and receives a quarterly investment monitoring report from its investment consultant.

1.2 The ACCESS Joint Committee was established as the result of 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 focus over the next 12 months is:

- Implement the strategic changes in relation to private debt via the ACCESS offer;
- Consider the Private Equity offer from ACCESS;
- Work with ACCESS to develop and implement the new pooling structures;
- Work with ACCESS to develop sustainable investment opportunities on the pool platform;
- Engage with investment managers on the engagement priorities defined in the Statement of Responsible Investment Principles.
- Add income considerations report

3. Quarterly Performance Report

3.1 Our new investment consultant Hymans Robertson's contract started on the 1 February 2025. As a result of the compressed timeframe to produce the report for this meeting the performance report is shorter, specifically around the manager update pages. The Investment Working Group will work with Hymans Robertson to develop the report going

forward so that it provides the most useful information to the Committee. A copy of the Q4 2024 report is attached as Appendix 2.

3.2 Isio, the previous investment managers, provided an executive summary of the quarterly performance report for Q3 2024 to the last committee meeting and the full report is attached at Appendix 3 for information.

3.3 Since the last reported position, the valuation of the Fund has increased from £4.917bn as at 30 September 2024 to £5.070bn as at 31 December 2024 (an increase of £0.095bn). This performance reflects a positive absolute return of 2.0% in the quarter to December. The Fund, however, underperformed the benchmark in the period by -1.6%. Performance of Fund assets is similarly behind the benchmark over longer time periods. Over the past 12 months and 3 years, the Fund has had relative returns of -4.3% and -3.1% p.a. respectively.

3.4 The asset allocation maintains its overweight position to Growth and Protection of +4.5% and +2.2% respectively with Income being underweight by -8.0% and Cash being +1.3% overweight. This is mostly driven by the unfulfilled private debt allocation and trigger points for the index linked investments being made in December.

3.5 On a relative basis, the stand-out detractors were:

- WHEB Active Impact Equity which underperformed its MSCI World benchmark by 7.8% over the quarter. Unfortunately, this trend continues longer-term, with the strategy underperforming its benchmark by 10.6% p.a. since inception.
- Atlas Infrastructure has underperformed its FTSE Developed Core 50/50 Infra benchmark by 8.3%, returning -6.6% over the quarter. In contrast, one of the Fund's other infrastructure mandates, Pantheon Infrastructure, returned c.9.7% over Q4. In fact, the Pantheon strategy had the highest relative returns over the quarter, of 8.0%.

3.6 The worst performing fund on an absolute basis was the UBS Index-Linked Gilts mandate, returning -7.4% over the quarter. Gilt yields rose considerably over the quarter due to expectations that UK interest rates will stay higher for longer. This consequently caused gilt prices to fall dramatically over Q4. Although this contributed negatively to overall performance, the fund performed broadly in-line with its index-linked gilt benchmark.

3.7 On a positive note, both the Fund's private equity managers posted strong returns over the quarter. Harbour Vest and Adams Street returned 8.9% and 11.2% respectively, both significantly outperforming the MSCI AC World benchmark of 6.3% over the quarter.

3.8 3 and 12 month performance figures compare favourably to the Fund's actuarial discount rate of 4.6% p.a. However, over the 3 year period the Fund has underperformed this by 2.2% p.a.

3.9 In addition to the manager business updates provided by Hymans, IFM have informed the Fund that IFM Investors, and the UK's largest profit-to-member pension provider, Nest, have entered a binding agreement that will see Nest take a 10% ultimate

ownership stake in IFM and provide foundation investments to help launch three new IFM products over the next 12-18 months, with presumptive support for new products into the future. Nest becomes the first non-Australian shareholder in IFM's 30-year history.

4. PRI Outcomes

4.1 The Principles for Responsible Investment (PRI) is the world's leading proponent of responsible investment, as a signatory to the PRI the Fund is required to report annually on the responsible activities that it undertakes. This represents the largest global reporting project on responsible investments. In turn, signatories receive a summary scorecard (detailed below), an Assessment Report and a transparency report which is publicly available on the PRI website.

4.2 These reports are produced using the signatories' reported information and support signatories to have internal discussions about their practices. They facilitate learning and development by outlining how signatories' responsible investment practices compare year-on-year, across asset classes, and with peers at a local and global level.

4.3 The Assessment Report is an export of the scores for all the assessed indicators and modules the Fund responded to in the PRI Reporting Framework during the 2024 reporting period. The Fund will be analysing the responses to identify activities to undertake to improve upon the current scores.

4.4 The Summary Scorecard gives an overview of the Fund's scores against the PRI median score. The Scorecard is shown below and indicates that there are still areas where the Fund can improve but that it is currently performing above the median PRI score on all areas.

SUMMARY SCORECARD



5. Stewardship Report

5.1 The Financial Reporting Council (FRC) UK Stewardship code 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.

5.1 At its meeting in November 2024 the Committee were advised that the Fund had submitted the UK Stewardship Code report to the Financial Reporting Council (FRC). The expectation was that we would receive the FRC verdict in February.

5.2 The FRC confirmed in January that they would provide an outcome on the 6 February and that their signatories list will be updated on 11 February. The Fund is pleased to confirm that it has maintained its status as a UK stewardship code signatory. The Stewardship report is now on our website along with notification that we are still signatories.

6. Competition and Markets Authority (CMA)

6.1 With effect from 10 December 2019, the East Sussex Pension Fund is required to comply with the CMA Investment Consultancy and Fiduciary Management Market Investigation Order 2019 and set strategic objectives for its investment consultant. This was brought in by the CMA investigation into the investment consultancy and fiduciary market, with the aim for Committees to better assess and evaluate the quality of their investment consultant. It is Part 7 of the order which requires trustees to set strategic objectives for their investment consultant. Specifically, Part 7 states:

6.2 “Pension Scheme Trustees must not enter into a contract with an Investment Consultancy Provider for the provision of Investment Consultancy Services or continue to obtain Investment Consultancy Services from an Investment Consultancy Provider unless the Pension Scheme Trustees have set Strategic Objectives for the Investment Consultancy Provider.”

6.3 The Committee have previously agreed strategic objectives which were updated at the March 2021 Committee meeting after the appointment of ISIO, which were prepared with reference to the Pensions Regulator’s guidance, combining a mixture of quantitative and qualitative measures.

6.4 The Fund is required to confirm that they have complied with the requirements over the last 12 months and had objectives in place. This must be re-confirmed on an annual basis. The Fund must submit a ‘compliance statement’ and ‘certificate’ stating that they have complied with the CMA requirement by 7 January annually. This was provided to the CMA on 6 January 2025.

6.5 If the Committee are aware of any failure on their own part to comply with any part of the Order, they must report such non-compliance to the CMA within 14 days of becoming aware of the failure in order to comply and provide a brief description of the steps taken to address the failure.

6.6 With the introduction of the new Investment Consultancy contract with Hymans Robertson, the Pension Committee are asked to review and approve the strategic objectives that have been set for Hymans Robertson under their new contract as laid out in Appendix 4.

7. Scheme Advisory Board

Counsel Opinion on the implications of the current events in Gaza

7.1 At its meeting in November 2024 the Committee were informed that the Scheme Advisory Board (SAB) had sought Kings Counsel in relation to investments in Israel and the potential prosecution of the administering authority in relation to war crimes.

7.2 This was requested because the SAB had been made aware that a number of administering authorities had received letters that allege that they are acting unlawfully by holding, and failing to divest from, investments in companies which have been linked to the ongoing situation in the Middle East. Specifically, Counsel was asked for an opinion on the allegation that funds might face future criminal action by the International Court of Justice or have liability in domestic law under the Terrorism Act 2000 or the International Criminal Court Act 2001, as a result of holding such investments.

7.3 In order to help administering authorities to assess these accusations and respond appropriately, the SAB has sought leading Counsel advice on behalf of the scheme. That legal advice is now available and included as Appendix 5.

7.4 This sets out that there is no potential prosecution that can be made with regard to the Fund's investments, the Counsel opinion states:

"For the purposes of this Opinion is that it is in my view clear that local authorities, in their capacity as administering authorities, are not subject to obligations imposed directly by international law. Nor, in my opinion, is there any public law obligation to have regard to such matters."

7.5 The Secretariat hopes this advice assists funds in responding to this, or similar, letters but advises that funds should still seek their own legal advice in relation to their specific circumstances and investments. The advice is also limited to the question of whether any specific criminal liability attaches to the holding of these investments, and not whether it is appropriate for funds to choose to divest.

Counsel Opinion on fiduciary duty

7.6 The SAB has now received Nigel Giffin KC's updated opinion on the fiduciary duty in the context of the LGPS – which is intended as a review of and update to the opinion provided in 2014 and is entitled "Local Government Pension Scheme: Investments and Non-Financial Considerations". It was published on the 15 January and so was too late for the ESPF to consider the content ahead of the closure of the government's 'Fit For the Future' consultation on 16 January 2025. The updated opinion is included as Appendix 2 under Agenda item 7.

7.7 This advice covers recent case law which is considered to be supportive of the previous opinion on fiduciary duty, along with opinion on climate-related factors which may certainly be non-financial in nature, but they might also be financial, and certainly an authority probably needs to have advice, when setting its investment strategy on how far climate issues need to be considered from a financial perspective.

7.8 The key point which Nigel Griffin would emphasise, so far as non-financial factors are concerned, is the desirability of addressing these issues through the process of making and reviewing the authority's investment strategy, including the required consultation, where he suggests that an authority will not normally be obliged to review its strategy with a view to the introduction of new ESG policies outside the statutory triennial cycle. An authority probably needs to have advice, when setting its investment strategy on how far climate issues need to be considered from a financial perspective within the strategy.

7.9 Nigel Griffin also considered the new consultation and although he mentions that until the government issues its new legislation which could fundamentally change the fiduciary role of authorities, it does not appear that the government's current proposals will necessarily change those key criteria around fiduciary duty. However it is pointed out that a

policy of investing so as to boost the local or national economy will normally represent taking account of non-financial factors.

7.10 The SAB will now consider whether any further advice on specific points would be helpful and will work with funds to ensure instructions cover the pertinent questions and elements of most interest.

8. Conclusion and reasons for recommendation

8.1 The Committee are recommended to note this report. 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.

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