Agenda Item 5

Pension Board
19 January 2022

Gloucestershire Pension Fund update
Quarter ending 30 September 2021

Report of the Head of Pensions

Summary

This report summarises the Fund's financial position and operational activities for the quarter ending 30 September 2021.

The information contained in this report was taken to the Pensions Committee on 3 December 2021 and fulfils the requirement for administering authorities, under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 must keep under review the performance of their investment managers.

This report also contains information on relevant recommendations tabled and agreed by Committee at its meeting on 3 December 2021, which are not covered in other agenda items

Funding position

The Fund is now more likely to have sufficient assets to meet earned benefit payments than at the previous valuation.

Reported funding position	31 March 2019	30 September 2021
Assets (£m)	2,379	3,100
Past service liabilities (£m)	2,338	2,596
Surplus/(Deficit) (£m)	**41**	**504**
Funding level	102%	119%
Assumed future investment return	4.2%	4.1%
Likelihood of achieving this return*	70%	70%
Fully funded target	**31 March 2019**	**30 September 2021**
Funding target	100%	100%
Future investment return required to be 100% funded	4.1%	3.0%
Likelihood of achieving this return*	**71%**	**83%**

* likelihood of the Fund's portfolio achieving these returns over the next 20 years

Past service funding position: The reported past service funding position has improved. The Fund has a surplus of £504m at 30 September 2021 (compared to a surplus of £41m at 31 March 2019). The improvement has been largely driven by strong investment performance since 31 March 2019.

Investment outlook: Prudent expectations of future investment returns have fallen to 4.1% p.a. at 30 September 2021 based on a 70% likelihood of being achieved (at 31 March 2019, the equivalent return was 4.2%p.a.).

Fully funded required return: The likelihood of achieving the future investment returns needed to have sufficient assets to pay past service benefits has increased since the last valuation (there is now an 83% chance of achieving the returns needed).

The position remains similar to the previous quarter as at 30 June 2021. The detailed funding report, prepared by Hymans, is attached at Appendix 1.

Fund Investment Performance

Over the quarter to 30 September 2021, the Fund's total market value increased by £42.261m, to £3,100.015m.

Over the quarter, total Fund assets produced a positive return of 1.3%, compared to a target of 1.1%, outperforming the strategic benchmark by 0.2%.

Performance over the 3 years to 30 September 2021 was 8.0% ahead of the benchmark by 0.4%.

A detailed investment performance report is attached as Appendix 2 to this report.

Investment Strategy and Activities

During the Quarter the following investment activity took place:

- The transition of the Funds fixed interest allocations to Sterling Corporate Bonds and Multi-Asset Credit was completed to the Brunel Portfolios. The allocations to Multi-Asset Credit and Sterling Corporate Bonds, were previously managed by Western Asset Management (WAMCO).
- The Brunel Sterling Corporate Bond portfolio will be managed by a single manager, Royal London (RLAM). The Brunel Multi-Asset Credit portfolio contains three managers, Neuberger Berman, Oaktree and CQS.
- This transition outcome have been reviewed by Officers, the Brunel Client Group, and Oversight Board. The Pensions Committee formally reviewed these outcomes in the part of their meeting that excluded the press and public on 3 December, due to the financial

information of other authorities contained in the report and concluded that the transitions had been undertaken appropriately.

- During the quarter there has been a number of substantial calls into the alternative asset class of circa £51.5m in GBP terms, resulting in the Fund moving more towards its target allocation to alternatives.

The current Strategic Asset Allocation is as follows:

Asset Class	Target Allocation %	Range +/- %	Allocation as at 30 September 2021 %	Variation from Target %
Equities	55.0	3.0	60.8	5.8
Fixed Interest	22.0	2.0	19.1	-2.9
Alternatives	23.0	2.0	20.2	-2.8

A detailed Strategic Asset Allocation report is attached as Appendix 3 to this report.

Passive & Smart Beta Allocations Review

In accordance with the agreed recommendation by Committee at its previous meeting, the Committee received a report providing the outcome of the review of the two recently launched Paris aligned passive equity funds from Brunel compared to the two existing passive portfolios held by the Fund, namely the Low Carbon Equity portfolio and the Smart Beta Equity portfolio.

As requested by the Partner Funds, Brunel have developed and have now launched 2 new investment opportunities within the passive portfolio range delivered by LGIM, with climate aligned benchmarks following extensive work with FTSE Russell in their development.

The increased range of passive investment options now offer the Fund Net Zero-aligned passive investment opportunities, that were requested to be developed by the partner funds and also provide a path forward for the wider industry. Great emphasis was placed on developing benchmark/indices that not only met current needs, but also have scope to evolve in response to rapid industry developments, so that they will continue to deliver on the partner funds investment objectives.

Addressing climate change as an investor is made all the harder by the relative lack of appropriate benchmarks. For investors seeking alignment with the ambitions of the Paris Agreement, which aims to limit global warming to two degrees above pre-industrial levels, the new benchmarks are an enormously important tool in making that ambition possible.

The new indices reflects FTSE Russell's expertise in index design. The Paris-aligned Benchmark meets the minimum requirement of the EU's Paris-aligned benchmarks by achieving a 50% reduction in carbon emissions over a ten-year period. It also integrates the Transition Pathway Initiative's analysis of how the world's largest and most carbon-exposed companies are managing the climate transition.

Within the construction of FTSE Russell's new EU Climate Benchmarks is the inclusion of recently issued guidance from the IIGCC Net Zero Investment Framework to limit investor exposure to Thermal Coal and Oil Sands. Other features involve limiting the active weight of banking sector constituents to no more than their underlying index weight, a move that reflects the sector's funding role for large carbon emitters as a contributory factor to climate change.

Therefore, within our passive investment options with Brunel/LGIM we now have the following additions:

- FTSE Russell Paris Aligned Benchmark (PAB)
    - Target reductions in both Carbon Reserves and Operational Emissions:
        - Minimum 50% reduction (reserves and emissions)
        - 7% year on year reduction (emissions only)
- FTSE Russell Climate Transition Benchmark (CTB)
    - Target reductions in both Carbon Reserves and Operational Emissions:
        - Minimum 30% reduction (reserves and emissions)
        - 7% year on year reduction (emissions only)

Both the PAB and CTB explicitly exclude 'pure play' Oils Sands and Thermal Coal companies. These are defined as companies generating 50% or more of their revenues from these activities.

These new investment options have been launched by LGIM, our passive provider at the beginning of November 2021.

David Vickers, Chief Investment Officer at Brunel attending the Committee meeting on 3 December 2021 and provided further detailed information on the constituent parts of the benchmarks and the analysis that underpins their construction. Details about how the benchmarks will continue to evolve as companies evolve was also provided.

The Committee also received a detailed report and analysis of new Paris aligned passive funds, undertaken by the Funds Independent Advisor, John Arthur. This analysis has been utilized to form the recommendation for Committee to consider.

Through the analysis undertaken, it was stated that the new Paris Aligned benchmarks launched by Brunel are well designed and can offer the Fund opportunities to incorporate further alignment to the Paris Agreement of limiting global temperature rises to below 2% and preferably 1.5%. However, it is still a belief that climate change can be better tackled by ongoing engagement by active managers who continually analyse the financial and ESG data of a company in unison.

As part of the analysis a comparison of both the CTB and PAB portfolios had been undertaken, and whilst both are aligned to the Paris agreement the CTB portfolio could be seen as a halfway house, therefore, the recommendation was to utilize the PAB portfolio if the

Committee wishes to invest in a Paris aligned passive portfolio of this type, thereby taking a larger step now than taking two steps over the course of a few years and thereby incur higher transition costs.

The balance of all risks had been analysed for the entire portfolio in formulating the strategic asset allocation, if the PAB portfolio is to be incorporating into the strategy.

This analysis has resulted in a recommendation to allocate 10% of the Fund to the PAB, whilst increasing the Fund's weighting in the Sustainable Equity portfolio by 3% and the Global High Alpha portfolio by 0.5%. These allocations will replace those of the Smart Beta (9.5%) and Low Carbon (4%).

The proposed new Strategic Asset Allocation is contained in the table below:

Asset Class	Benchmark	Target Strategic Asset Allocation	Target Asset Allocation Range (+/-)
Equities		**55.0%**	**3.0%**
UK Active Equities	FTSE All Share (excluding investment trusts)	12.0%	2.0%
Global High Alpha	MSCI World	13.5%	2.0%
Emerging Market	MSCI Emerging Markets	6.5%	1.5%
Sustainable	MSCI All Country World (ACWI)	13.0%	2.0%
Paris Aligned Passive Equities	FTSE Developed World PAB	10.0%	2.0%
Fixed Interest		**22.0%**	**2.0%**
UK Investment Grade	Iboxx Sterling Non-Gilt All Maturities Bond Index	14.5%	1.5%
Multi Asset Credit	GBP SONIA	7.5%	1.0%
Alternatives		**23.0%**	**2.0%**
Diversified Returns	GBP SONIA	0.0%	10.0%
UK Property	MSCI/AREF UK Quarterly Property Fund Index	7.5%	1.0%
International Property	Global Real Estate Fund Index	2.5%	1.0%
Infrastructure	Consumer Prices Index (CPI)	5.0%	1.0%

Private Equity	MSCI ACWI	3.0%	1.0%
Private Debt	GBP SONIA	5.0%	1.0%
Cash	-	0.0%	0.5%
Total		**100.0%**	

After further debate the Pensions Committee agreed the recommendation and therefore approved the new Investment Strategy Statement, attached as appendix 4 to this report, which incorporates the above table.

Voting and Engagement Statistics

Hermes Equity Ownership Services (EOS) are the Partnership's engagement and voting overlay provider.

Over the last quarter Hermes EOS made voting recommendations at 116 meetings (1,228 resolutions). At 41 meetings they recommended opposing one or more resolutions. They recommended voting with management by exception at 6 meetings and abstaining at 1 meeting. They supported management on all resolutions at the remaining 68 meetings. A detailed quarterly voting report is attached as Appendix 5 to this report

Hermes EOC engaged with 194 companies held in the Gloucestershire Pension portfolios on a range of 602 environmental, social and governance issues and objectives. A detailed quarterly engagement report is attached as Appendix 6 to this report.

This information is provided to ensure that appropriate levels of engagement and voting are being undertaken on the Funds behalf, but the annual Responsible Investment and Stewardship outcomes report, provides greater information on the effectiveness and outcomes of the voting and engagement undertaken and will include case studies.

Fund Administration

The Administration Team are continuing to operate under working practises that were introduced at the start of the pandemic and these continue to impact on operational delivery. However, the steps undertaken have mitigated the impact on the service delivery and we continue to monitor the balance between service delivery and staff safety.

The current performance figures for the quarter to 30 September 2021 and previous whole year comparisons are attached as appendix 7 to this report.

The quarter to 30 September sees the team issuing the Annual Benefit Statements (ABS), which is the resultant of the year end processing which takes additional resource from the team across the first 2 quarters of the Fund year.

Performance indicators for the first 2 quarters are normally challenging and not a reflection of the performance that will be achieved as the year progresses. During this period, we continue to focus on delivering an equal service level to all members, which can be demonstrated by the average days taken for cases which exceed target, as outlined to table 2 in appendix 7.

During the quarter to 30 September, we continue to see an increase in the number of retirements (461 in total with 260 within the quarter), which have now returned to pre-pandemic levels and projected to be greater than 2019/20 which had previously seen the largest yearly number. Additionally, estimates are also likely to be at their highest levels to date if current volumes continue at the same level, and based on the increasing membership this seems likely. The team continue to experience higher levels of individual member questions and engagement.

Business Plan 2021/22

The following is a summary, together with commentary of the amber key tasks from the work plan agreed as part of the business plan for 2021/22.

A detailed report against all items is attached as Appendix 8 to this report

Investment Management

Task	**2021/22**			
	Q1	**Q2**	**Q3**	**Q4**
Responsible Investment Reporting *Comment: The activity has yet to commence, but is now is scheduled to take place over multiple quarters. Anticipated to commence in Q4*	✓	✓	✓	✓
Review the recommendations of the Taskforce for Climate-related Financial Disclosure (TCFD) and requirements for UK Stewardship code signatory status *Comment: The activity has yet to commence, but is now is scheduled to take place over multiple quarters. Anticipated to commence in Q4*	✓	✓	✓	✓

Administration

Task	**2021/22**			
	Q1	**Q2**	**Q3**	**Q4**

Possible implementation of McCloud judgement *Comment: Awaiting further guidance and IT support.*	✓	✓	✓	✓
Possible implementation of revised 95k cap regulations *Comment: Awaiting revised consultation from DLUHC.*		✓	✓	✓

Governance Review

The following is a summary, together with commentary of the amber key tasks from the work plan agreed by Committee in September 2021.

A detailed report against all items is attached as Appendix 9 to this report.

Action	Reason	Timescales	Completed
Update the Fund's Governance Compliance Statement and Policy *Comment: The activity has yet to commence, but is now is scheduled to take place in Q4*	The current Compliance Statement is dated July 2017. We would anticipate this document being reviewed in conjunction with the Governance Policy statement which was last reviewed in February 2020. We understand that an updated Compliance Statement has been drafted so we assume that our input would be to review the draft updated policy	Q3 - Q4 2021/22	Will be undertaken in Q4 2021/22
Review of Scheme of Delegation *Comment: The activity has yet to commence, but is now is scheduled to take place in Q4*	Review Council's Scheme of Delegation to ensure that pension fund matters are covered. Consider this in conjunction with recommendation from SAB Good Governance review regarding LGPS senior officer.	Q3 - Q4 2021/22	Will be undertaken in Q4 2021/22

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Recommendation

That the Board notes the report.

Contact Officer

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