Minutes of IMWP held on 07 June 2023

Attendees

		Organisation
Councillor Pat Cleary	PC	WBC
Councillor Julie McManus (Chair)	JM	WBC
Councillor Chris Carubia	CC	WBC
Councillor George Davies	GD	WBC
Councillor Brenda Hall	BH	WBC
Roger Bannister	RB	Unison Member rep
Ruth Molyneux	RM	WBC
Ann Ainsworth	AA	WBC
Jill Davys	JD	Redington
Tom Pilcher	TP	Redington
Anastasia Guha	AG	Redington
Rohan Worrall	RW	Independent Advisor
Paul Watson	PWa	Independent Advisor
Peter Wallach	PW	MPF
Adil Manzoor	AM	MPF
Owen Thorne	OT	MPF
Alex Abela-Stevenson	AAb	MPF
Dragos Serbanica	DS	MPF
Elizabeth Barlow	EB	MPF
Emma Jones	EJ	MPF
Allister Goulding	AG	MPF
Dan Proudfoot	DP	MPF
Neil Gill	NG	MPF
Joe Hull	JH	MPF
Roksana Klapkowska	RK	MPF

1. Apologies

Councillor Paulette Lappin
Councillor Brian Kenny
Councillor Brenda Hall

2. Minutes of IMWP 02 March 2023

Noted, no amendments.

3. Market Update

RW updated the market review for Q1 2023. A major event was SVB failure and stress in banking environment resulting from it, especially for regional banks. The economic performance last year was weak, but there was a rebound in Q1 2023.

Manufacturing is weak, while services are quite strong. CPI has been gradually, but very slowly coming down and that's expected to continue. Equity markets performance was positive in the last quarter, particularly in Europe and Japan. Negative performance in the US and Emerging Markets can be attributed to their heavy exposure to technology and other growth stocks that underperformed over the last 12 months relatively to value stocks. However, there was a rebound in Q1. MPF has more exposure to value stocks than growth.

Regarding fixed income, yields started going down in Q1 with prices going up. US investment grade credit spreads were steady and slightly narrowing.

Sterling has slightly appreciated against all major currencies in the last 3 months, however, has weakened significantly in the last 12 months, particularly against the Dollar and Euro.

Headline inflation has been going down as the oil price is falling.

Outlook: As the tight monetary policy with interest rates going up takes time to feed through to the economy, we should expect the next 9-12 months to be tough. Equities are expected to remain vulnerable, however with the inflation going down, bonds should perform reasonably well.

4. Overview of the last 12 months – Peter Wallach (PW) – Director of Pensions

PW gave an overview of the last 12 months. Funding position has improved to 106%. Despite negative return of -3.7 the Fund outperformed its benchmark of -5%. UK gilts and index linked gilts fell sharply. The Fund underperformed with respect to UK equities, however outperformed in overseas equity. Alternative assets did well. Property Portfolio declined in value, however significantly less that the average property in that period.

PW highlighted the achievements in the last 12 months: appointing Redington and initiating the Change Programme that is related to reviewing the Fund's investment beliefs, sustainability, and stewardship. Completion of actuarial valuation and continued growth of assets within GLIL (infrastructure) and NPEP (private equity). The fund is significantly invested in renewable energy assets.

With respect to local investments MPF has been investing in Mersey Heat (district heating) and Wirral Waters. Since the year-end there have been two more local projects: a loan to Legacie, a large project of building 650 apartments over the next 2-3 years and revitalisation of the Albert Dock.

The fund keeps looking for efficiencies, hence the costs have not increased as much as they otherwise would. In the future, MPF is implementing its actuarial valuation which is also tied to the revision of the investment strategy. The Fund is working with Redington on delivering further efficiencies, simplifying governance, and improving investment returns. MPF is looking for cost savings through pooling and increasing the proportion of assets managed by the internal team. There are ongoing consultations related to the above objectives as well as managing and mitigating climate risk (TCFD) and 'Levelling up' (Edinburgh Reforms). The Fund has also an important objective of signing up to the Stewardship Code.

Chris (CC) asked what the outlook for equities looks like going forward. PW replied that positive returns from bonds and equities in the last 3 months indicate that the markets are driven by sentiment and not fundamentals. Fundamentally, the economy remains strong, and this should feed through into company valuations. Valuations are more stretched in the US, and the Fund has high level of investment in the UK. Equities should be worth more tomorrow than today. We are not in recession in the UK despite the headwinds.

PC asked why the property portfolio outperformed the benchmark. PW explained that half of the property portfolio is direct property, and its valuation is transaction based and is relatively close to the benchmark. The other half is indirect property valued infrequently, and the lag might be the reason for the higher valuation overall. MPF also holds Fort Halstead and that asset performed very well against a difficult market.

5. **Stewardship and Responsible Investment – Owen Thorne (OT) - Portfolio Manager – Monitoring & Responsible Investment**

Owen (OT) discussed the MPF's stewardship efforts and shareholders' activism. He also mentioned the Fund' engagement with PIRC (Pensions & Investment Research Consultants Ltd) - shareholder advisory consultancy providing stewardship and proxy research services to institutional investors on environmental, social and governance issues. During the ongoing voting season as part of its activism, MPF filed for shareholders resolution at the Starbucks AGM calling for independent assessment of their human rights policies. The resolution was widely supported. OT further discussed shareholder resolutions, proxy voting and climate transition and MPF's plans of improved sustainability reporting and monitoring.

Pat (PC) commented on establishing framework for divestments from companies that do not align with the Fund's philosophy. Other pension funds are divesting from companies such as Walmart or Ryanair. He pointed out that MPF should keep it on its radar as well.

https://lapfforum.org/engagements/q1-quarterly-engagement-report/

https://northernlgps.org/node/114

6. **Presentation: Jill Davys (JD) - Director, Tom Pilcher (TP) - Senior VP from Redington**

Jill (JD) discussed the survey conducted aiming to capture the members' views and the fund's current position needs. Since the last meeting Redington have been working with the officers on measures to achieve strategic objectives. The focus of future meetings will be on actioning and implementing strategic changes. JD discussed the ultimate purpose of the Fund that is to provide secure pensions whilst ensuring the cost of running the scheme is contained to prevent a need for increase in contribution rates and the role of the Committee in ensuring the Fund delivers the required investment returns.

Paul (PWa) asked how Redington balances the objectives of risk and return. JD replied that it is about diversifying the portfolio and understanding where the risks are coming from and added that this will be discussed later by Tom (TP).

JD discussed the current funding level of the Fund and its progress over the years. RW noted that with the interest rates up, the level of the rate of interest that was used to discount the liabilities is very favourable.

JD summarised the survey results, objective of maintaining good funding level, and the preference for generating similar returns to keep contributions stable. Given the increasing maturity of the Fund, Cash Flow constraints, and the impact of the inflation, most officers support increasing the proportion of income yielding assets. Stakeholders are keen to invest in an environmentally positive way if it doesn't negatively impact the returns. They also want to invest locally but are neutral on the Levelling Up agenda. Redington will conduct a more detailed survey to capture specific views of the members.

JD presented the current and the proposed strategic asset allocation, that should enable the fund to achieve its strategic objectives. She discussed the status on achieving the Fund's goals. One area for concern is the level of income from assets that is currently not sufficient to cover the Fund's liabilities.

PWa requested explaining Value at Risk metrics to the new Members. JD explained VaR is the scale of loss in the event of sudden shocks in the investment markets, perhaps more important for private sector pension funds.

CC asked to explain the liquidity and cash flow in relation to assets producing a contractual income. JD explained that for assets, such as fixed income, there is a fixed coupon. Some infrastructure assets can also have a contractual inflation linkage. This helps to ensure the Fund can meet its pension obligation. For equities there is no certainty regarding the income levels.

CC asked what the consequence is of not satisfying the contractual arrangement. JD replied it is in relation to income producing assets, not in relation to the Fund's obligation to pay pensions. PW clarified that MPF paid out £360 million in pensions last year and 50% of it was paid from income. The Fund is aiming to achieve 100%. Equities don't provide contractual income and satisfactory level of certainty. Therefore, the Fund needs to move its asset allocation to achieve that objective.

Anne (AA) asked why circles for some objectives in the presentation are white. JD responded that formal targets on those goals have not been set yet and should be established based on the results of the upcoming survey.

JD discussed the objectives of maintaining or improving the returns on investments, reducing the overall risk in the portfolio, increasing the contractual income flow to meet future Cash Flow needs and improve the Fund's liquidity. With respect to the climate, the goal is to reduce risks in relation to climate change, but also to seek opportunities. Regarding local investments and Levelling Up agenda a future consultation is planned.

AA asked why the Council is transferring some property assets while the Fund is seeking to increase the proportion if income yielding assets. PW explained that the Council assets are different from MPF's assets but added that the possible reason for that is high cost of running the assets.

TP discussed current and proposed strategic asset allocation, adding that the portfolio is already well diversified. As the Fund's liabilities are inflation linked, MPF should seek inflation linkage in its assets. This is currently present in, for example, property. MPF has a reasonable proportion of income yielding assets but that should increase to meet the objectives. Redington's propositions are:

1. Enhancing diversifications by adding new return drivers, improving the geographical diversification (especially within fixed income) to reduce the overall level of risk in the portfolio, while keeping the returns at the current level.
2. Aiming to harvest income from the assets and stabilise the current cash flow.
3. Reducing ESG risk in the portfolio (especially climate related), generate positive impact as well as income and risk adjusted return.

PWa asked how the current bond yields compare to the diversification.TP replied it comes down to the risk adjusted returns. Currently the expected return on fixed income assets is good and that is the function of the current high-yield environment, but from a long-term investor perspective there is still good value in those types of assets.

PC asked about specific ESG factors. JD assured that Redington prepared a detailed survey to capture officers' views and what should be targeted in terms of ESG (for example, human rights, diversity). It is difficult to set out the new objectives before receiving the feedback from the survey. OT added there will be training sessions related to ESG.

AA asked about the Climate Risk Metric (current 16.9% vs proposed 12%) on page 11. TP explained it is a result of stress tests in different climate scenarios and the values indicate the reduction in assets under different scenarios.

AA noted that the carbon footprint increases under the proposed SAA. TP explained that climate risk is a multifactor issue and should be looked at assessing multiple metrics. He agreed that the carbon footprint is expected to increase but in the long-term should decrease at a faster rate than under the current SAA. AG suggested it is worth discussing during the climate training.

TP discussed fixed income assets and suggested increasing their proportion in the portfolio due to their cash flow generation. MPF currently holds mainly Gilts and UK investment grade corporate bonds. Redington considers the Fund's fixed income portfolio not sufficiently diversified and lacking other assets (such as loans and Asset Backed Securities) and other geographies, mainly US corporate bonds. Thanks to the size of the US bond market concentration risk would be mitigated.

CC asked about the Fund's risk appetite. TP replied the goal is to reduce the current VaR at the portfolio level. PW added that as per the survey results, members are keen on maintaining the current level of risk in the portfolio.

RW suggested that reducing the Fund's exposure to Gilts could result in increased risk without affecting returns. TP assured Gilts would be still important in the portfolio and a reduction in exposure is not anticipated.

AA asked what proportion of the risk is hedged. PW replied the about 25% of risk from equities is hedged and explained that the Fund's long-term perspective and diversification provide a degree of risk mitigation in the portfolio. RW added that hedging is expensive and as a long-term fund, MPF can deal with volatility.

TP discussed the role of equities, being a driver of returns. He pointed out they are expected to remain a strong allocation, however they are also the main risk driver in the portfolio and that should be taken into consideration. Redington propose a reduction of 13% from the current allocation to equities. Within the equities portfolio they proposed an optimisation, primarily from the geographical exposure perspective. As MPF is overexposed to the UK equities, the proposal is to reduce the allocation according to the size of the UK market or UK GDP.

RW asked how other Redington's LGPS clients manage diversification as 30% allocation in equities seems to be lower than others LGPSs. TP explained the reduction would be aligned to what is observed elsewhere but confirmed it might be lower than average. JD added that exposure to equities within LGPSs has been changing and is widely spread. In terms of split between UK and global assets majority are much closer to the global benchmark specifically allocated to UK.

TP explained that reducing the exposure to the UK aligns with the net zero target as the UK market is more emissions intensive than other developed economies due to its heavy reliance on the energy sector.

TP discussed alternative assets, highlighting their illiquidity, diversification benefits, and opportunity for integrating ESG factors. Redington is proposing improving ESG with alternative assets portfolio – increasing the proportion of assets generating positive impact environmentally and socially, while still generating satisfactory returns (for example: affordable housing within the property portfolio and nature-based solutions, like sustainable forestry).

PC noted that according to the survey, members are keen on impact investing and asked whether reducing the allocation to equities prevents the Fund from making a positive impact within that asset class and whether this would be counteracted with alternative assets. PC also asked if the environmental and social benefits of investments would be tracked. TP didn't believe any potential for impact would be given up by reducing public equities and agreed that alternative assets universe is the best place to look for impact thanks to its long-term investment periods, especially within renewable energy, infrastructure, and affordable housing. JD added that with respect to carbon footprint form equities Redington was referring to mainly to the UK being much higher carbon intensive and highlighted that it is harder to measure climate impact within alternatives than measuring carbon footprint within public equities.

CC voiced concerns about regionalising impact – making a positive difference locally, but at the same time causing negative implications elsewhere. JD responded the impact would be assessed holistically and referred to Anastasia. AG responded that the impact measurement is difficult but essential. She discussed scopes of emissions (1,2, and 3) as a measure to ensure that the climate issues are not being outsourced.

7. Climate Change & Net Zero Training Anastasia Guha (AG) – Redington

AG discussed global warming and its cause and consequences that we can already observe. AG explained the risks associated with climate change: transition risks, stranded assets risk, and physical risks (the highest for physical assets, like property or infrastructure) that are becoming uninsurable in some parts of the world. She discussed the importance of technology. AG also discussed the scopes of emissions, focusing on the scope 3 emissions and difficulty for measuring them in different sectors. She also introduced the term of 'Scope 4 Emissions'. She explained how greenhouse gas emissions work.

AG then moved on to discussing the 2015 Paris Agreement and how the 1.5C target was agreed upon. She explained what moving to net zero by 2050 means and how this can be reached. AG later discussed GFANZ – Glasgow Financial Alliance for Net Zero.

AG stated that fossil fuels emissions are still rising and explained where they are coming from and what sectors are the largest contributors. She explained carbon budgeting and illustrated the difference between 1.5C and 2C targets. She then discussed the policies supporting the transition and the issue of an 'economic way out'. AG characterised natural capital and carbon sinks in the context of reaching net zero carbon emissions by 2050.

AG stated that to achieve net zero, we need strategic changes, mandate changes, and active engagement. She discussed different approaches to responding to the climate change and the importance of regulations.

JD summarised the next steps:

- Getting back responses from the survey that will feed into future engagements.
- Work to start to develop net zero climate targets and engagement framework.
- Bringing in responsible investment policy review and Stewardship Code.
- Looking at TCFD, further net zero considerations.

AG: summarised net zero targets' considerations.

AA asked how much we can trace with respect to the ESG responsibilities, such as human rights and what we are able to monitor when investing. OT explained there are datasets that provide ratings. There is an element of subjectivity, sometimes making them hard to compare but It's being constantly improved.

AA wanted to confirm that the categories of questions that we are asking companies may help us decide what we want to have in our framework as we know what's measurable. OT replied that a lot of engagement with companies is focused on this issue of disclousure and the dialogue on what issues we think are material. The other dimension is the regulatory environment, whether the companies use the set definitions around sustainable activities and means how they should be measured. That's what we call integrating ESG into decision-making processes.

CC asked how long it's going to take to transition from coal and oil. AG explained that most coal producers are state-owned. China is one of the largest producers and yet they have more incentive policies around renewable energy than all other countries put together. Therefore, the transition might be simpler and quicker than forecasted, as China is known for its under promising and overdelivering. They committed to phasing out coal by 2060.

CC asked if there are sufficient resources / minerals for continued development and what is the future role of nuclear power. AG replied that nuclear is going to be an important, but not the main part of the energy mix. Regarding the rare minerals, this has now become a problem that everyone is incentivised to solve. Technology is looking for ways to build a battery that isn't based on this much of rare metals.

PC stated that with respect to the transition, the targets that were aspirational just a few years ago are achievable today, so the main concern for funds such as MPF is the risk of holding stranded assets issue. He highlighted the urgency of taking actions not only on climate but reducing the risk for the scheme members.

AG: There highlighted the importance of diversification from coal energy adding there are many other and cheaper ways to generate electricity.

OT highlighted the risk that the market suddenly reprices carbon intensive businesses, and it might be impossible to time that. Therefore, the Fund should be getting ahead of that prospect. PC confirmed the Fund needs to stay on top of that as the shifts can be rapid.