Minutes of IMWP held on 6th September 2023

Attendees

Name	Initials	Organisation
Councillor Julie McManus(Chair)	CP	WBC
Councillor Andrew Gardner	AG	WBC
Councillor Ruth Molyneux	RM	WBC
Councillor George Davies	GD	WBC
Councillor Brian Kenny	BK	WBC
Councillor Brenda Hall	BH	WBC
Councillor Pat Cleary	PC	WBC
Councillor Cherry Povall	JM	WBC
Councillor Ann Ainsworth	AA	WBC
Councillor Chris Carubia	CC	WBC
Councillor Peter Norris	PN	LCC
Councillor Tom Cardwell	TC	LCC
Jill Davys	JD	Redington
Tom Pilcher	TP	Redington
Edina Molnar	EM	Redington
Paul Watson	PWa	Independent Advisor
Peter Wallach	PW	MPF
Adil Manzoor	AM	MPF
Owen Thorne	OT	MPF
Alex Abela-Stevenson	AA	MPF
Emma Jones	EJ	MPF
Greg Campbell	GC	MPF
Allister Goulding	AGa	MPF
Ciaran Sharp	CS	MPF
Dan Proudfoot	DP	MPF
Susanna Friar	SF	MPF
Roksana Klapkowska	RK	MPF
Yu-Jhu Lin	YL	MPF

1. Apologies

Councillor Paulette Lappin

2. Minutes of IMWP 7 June 2023

Noted, no amendments.

3. Market Commentary - Paul Watson (PWa)

In Q2 2023 equity performance was strong while government bonds underperformed with rising bond yields. A few key trends have been driving the overall market including artificial intelligence (AI), contributing to the outperformance of US tech stocks.

4. MPF Investment Update - Peter Wallach (PW)

Overall, the Fund's mandates are delivering on performance but there are several mandates, highlighted in the monitoring report which are failing to meet expectations. No significant actions have been taken prior to Redington's strategic review. MPF continue to monitor the mandates closely.

Cherry Povall (CP) asked if a granular monitoring of the mandates is required and for how long. PW advised that there is no specific timeline for escalation. Managers may underperform due to the market environment. Concerns will be more significant when managers deviate from their investment philosophy, there is style drift or turnover of staff. Factors that are monitored in addition to performance include turnover, change in style of investment and change in managers.

CP sought for assurance that the board does not need to be concerned about the mandates highlighted in red in the report. PW responded that there are ongoing concerns regarding the Unigestion and Newton mandates. The Fund has been reducing the capital allocated to them. Several changes to the mandates are expected after the strategic review is completed.

Paul Watson (PWa) requested more attributions around the internal UK equity performance in the next IMWP meeting. PW confirmed that this would be provided.

Chris Carubia (CC) questioned what criteria is used to measure investment performance. PW responded that market benchmarks are used based on the performance achieved by managers over the quarter, 1-year, 3-year and 5-year periods. MPF's focus was on longer-term performance i.e. 3-year and 5-year numbers which allow for short-term performance deviations to be smoothed and seen in context. He cited Unigestion as an example, where their minimum variance factor philosophy was out of favour with the market.

CC further asked how long an investment is allowed to underperform before change of managers. PW advised that an immediate change or divestment can occur if there is a serious concern over underperformance, change in managers or personnel.

5. Responsible Investment - Owen Thorne (OT)

OT discussed the report from PIRC and their focus on governance around the systemic risks in supply chains. He continued to discuss LAPFF engagement programmes and the support for shareholder resolutions and effective exercise of voting rights. OT also mentioned the FCA proposals to change the listing rules at the London Stock Exchange, and MPF as well as other pension funds are preparing a proposal to FCA regarding this.

Ann Ainsworth (AA) asked how excess pay is measured. OT replied that it can be defined in several dimensions. Companies in the UK are required to publish remuneration policy and remuneration reports to shareholders which present the metrics and the best practice in terms of issues like gender pay gap.

CP was concerned whether companies are taking actions to tackle the pay issue or are simply acknowledging it. OT responded that companies are required to respond to such concerns and that is how investors can engage with them. It is investors' responsibility to establish expectations and manage how these expectations are met through engagement.

Julie McManus (JM) asked if MPF invests in those organisations mentioned in the report and how effective it is in terms of engagement. She further expressed her concern if MPF supports businesses involved in issues such as child labour and modern slavery. OT confirmed that MPF is exposed to some if not all of the businesses, at least through index investments. In terms of the effectiveness of engagement and stewardship, investors are taking more actions to deal with relevant issues across sectors and industries.

JM requested a closer monitoring on how companies are truly acting on those issues rather than merely paying attention to them. OT confirmed that an engagement framework can be used to prioritise actions.

AA asked how MPF avoid investing in companies involved in issues like child labour and modern slavery in the passive index funds without active management. OT confirmed that some regulations at the EU level have been incorporated into UK regulations, for instance, disclosure requirements for index providers to report on minimum sustainability standards, screening of human rights risks, controversial weapons, and decisions on climate. In the meantime, MPF is reviewing the passive mandate and the existing index providers are planning to introduce this screening at the product level to address the relevant issues in the UN Global Compact. The key is to address and mitigate these risks instead of removing them from MPF portfolio which does not improve the real-world situation.

CC commented that it would be great to know what influences pension funds have on corporations.

Brian Kenny (BK) expressed concerns over forced labour issue and would like to see MPF uses its voice and influence for the right practice.

https://lapfforum.org/engagements/q2-quarterly-engagement-report/

https://northernlgps.org/assets/pdf/stewardq2_2023.pdf

6. Strategic Asset Allocation Update - Redington

Recap

Tom Pilcher (TP) restated Redington's ROSIE (Research, Objectives, Strategy, Implementation and Evaluation) process to assess and establish the new strategic asset allocation (SAA) which is strongly referenced to MPF's Pension Risk Management Framework (PRMF).

In the current PRMF, MPF has a 106% funding level based on the latest valuation. Some changes may be required to adjust MPF's strategic asset allocation.

Pat Cleary (PC) pointed out that the 106% funding level is out of date. TP confirmed that the number dated back to 2022 valuation and the current liability level would be higher considering the inflation level. A slightly higher expected return will be required to accommodate the pension payments.

The long-term goal of MPF SAA is to retain the funding level with target return and lower risk within 13% budget while increasing cashflows to cover 60% of the average projected cashflow deficit. To achieve this the required asset income is more than £140m compared to current liquidity of £107m. In addition, the MPF ESG target is to incorporate net zero by 2050 into the investment strategy alongside the increase in environmental as well as social impact, and levelling up investments in the local Merseyside area.

TP recapped the proposed SAA to increase return drivers in fixed income with contractual cashflows and geographical diversification. Additionally, another change is to reduce climate risks by adopting investment strategy to increase impacts along with returns.

AA asked about the expected percentage of increased cashflows. TP confirmed that the purpose is to stabilise the current cashflow deficit and reassured that it is a common practice to meet pension commitment by asset sales. The target is to increase the cashflow proportion generated from MPF assets in order to cover 60% of the average projected cashflow deficit.

Peter Norris (PN) questioned how confident Redington is that the assets can generate the long-term target return of CPI+4.9%. TP responded that the expected return is based on backward looking data over a rather long period of time instead of considering the current market condition. PC stated that the long-term return is around 3% and the timeframe is key.

Fixed Income

TP presented the details in the proposed SAA, which is expected to reduce risk materially from 13.9% to 12% by increasing the target risk-adjusted return. The current weight of fixed income is 17% and is 100% exposed to the UK market in broadly two asset classes - investment grade and UK government bonds. Redington is proposing to increase the current exposure to around 30% and to add new diversifying credit exposure such as asset-backed securities, multi-class credit, absolute return bonds and structured credit. Redington also proposes to increase the geographical diversification to the wider developed market.

Equity

Redington has modelled proposals including a reduction in equity weight from 43% to 30%. Though a relatively large reduction, equity is still a major source of long-term return and provides inflation hedging. The current equity exposure overweights the UK market and underweights emerging market as well as the US. Many studies have shown that geographical diversification can produce better risk-adjusted returns over a long-term horizon. Secondly TP discussed about optimising style investing as the current strategy is tilting to value.

CC asked about the rationale of reducing equity weight if it is viewed as a good investment and the increase of emerging market exposure would expect to bring volatility. TP reinforced that the reduction in equity is to increase fixed income investments which provides contractual and predictable returns in addition to the reduction of overall portfolio risks.

Andrew Gardner (AG) asked if the major risk factor is equity. TP confirmed and further explained that equity risk contributes 12% to the overall portfolio risk of 13.9% in a 1-in-20 downside scenario. From the stress tests we can see the impact of equity on the overall portfolio, which show that a 40% reduction in equity would contribute to a 22% fall in the entire portfolio value.

CC asked what the VaR and stress tests results would be if MPF invests in emerging markets. TP emphasised that the increase in emerging markets investment will not create much difference and the purpose of emerging markets exposure is to improve the long-term risk-adjusted returns.

CC pointed out that investments in emerging markets may bring about ESG concerns. TP agreed that as at today investments in emerging markets could contribute to carbon intensity of the portfolio while forward-looking investors tend to find opportunities to invest in companies that try to improve their environmental issues, and stewardship plays a key role in helping achieve the real-world decarbonisation target.

AA expressed concerns over emerging markets investments where present more human and labour rights issues, and requested how we ensure the increase in emerging markets investments will not support human abuses and poor labour standards. Jill Davys (JD) stressed that it is a matter of how and who we invest in as there are certainly some fund managers value and exercise ESG principles. Moreover, it is important to engage with managers and make it clear that MPF does not invest in companies with human rights issues and poor labour conditions.

OT further emphasised the importance of active management and active engagement. AA raised concerns over fees of active management. OT confirmed that fees may be higher but there are more options of managers who are active in ESG.

PC commented on MPF's need to address ESG issues and is investing in weapon manufacturing, and proposed to include the description of our narrative in addressing those issues in the report. In addition, PC supported that diversifying UK investments and increasing emerging markets investments are not necessarily bad from the ESG standpoint as UK is energy intensive.

ESG

TP addressed the ESG impacts on financial materiality and the positive impacts investments can bring to environmental, social and governance. TP confirmed that the private market book is well structured and fewer adjustments are needed. A few changes are proposed including the reductions in infrastructure, private equity and property portfolios and the increase of investments in natural-based solutions which can, for example, generate profits through harvesting timber in a sustainable approach along with positive ESG impact.

Redington also proposed investments in affordable housing with a local focus such as Merseyside and impact private equity, which will contribute to levelling up and create social impact. In terms of hedge funds, Redington proposed transitioning to other investments that are also uncorrelated to the overall portfolio but are more transparent and liquid at lower costs.

CP stressed that the fiduciary duty of MPF is to generate the best returns for our pensioners before making any changes.

CC noted that in one of the survey questions about key themes to engage with investment managers, cyber security is the least option. CC asked what the reason will be and if it is due to lack of knowledge about the theme. JD responded that the ESG themes may be prioritised and pushes cyber security to the lower rank. However, it is certainly an important theme as MPF hosts and deals with large data of pensioners.

7. Responsible Investment Survey Results – JD

JD mentioned that responsible investment is an important growing area and can create value to the overall portfolio.

PC asked if ESG belief is detrimental to investment returns and how these two contribute to meet MPF's fiduciary duty. JD replied that the recognition and implementation of ESG factors in investments can provide enhanced returns.

CP asked how Redington determines ESG credentials as there are concerns over greenwashing and ESG buzz words. JD reassured that Redington conducts annual ESG survey, and it is important to set ESG beliefs clearly when engaging with managers on a regular basis.

PC noted that 35% of respondents to survey questions strongly disagree that ESG factors present financially material risks to MPF, and therefore what MPF can do to address the importance of climate risk to them. JD confirmed that further ESG training can be provided in addition to the materials included in the report.

Brenda Hall (BH) questioned if the views presented in the survey represent those of the majority. OT responded that it is the views of about 60% of the total respondents. AA further commented that the interpretation of survey questions and the options of answers may affect the survey results. CC confirmed that the survey questions cover a wide range of areas and a lack of certain knowledge in some areas would contribute to the result skewness.

CC asked about the reason why some respondents disagree with the statement that 'the Fund should set a net zero target in line with Local Authority Targets'. JD confirmed that there is more a local authority can do to achieve net zero target such as controlling buildings carbon emissions.

PC questioned how frequently the ESG surveys will be revisited. JD suggested that the review shall be in line with SAA review every 3 years.

8. Climate Target Setting - Edina Molnar (EM)

Edina Molnar (EM) discussed the climate target setting and pointed out that stakeholders agree that MPF should invest in alignment with the goals of the Paris Agreement. MPF has made several key climate-related decisions since 2017 when MPF joins IIGCC and it is important to set science-based targets and measure investment outcomes against those targets.

PC asked if any of Redington's clients has set an ambitious climate change target. EM responded that some are setting targets very early before taking any actions. OT confirmed that setting an ambitious target also has a signalling effect to the market.

CC asked about the impacts on climate change timescale if US leaves Paris Agreement again. EM confirmed that it depends on the influence of government policies on climate initiatives, for example, US Inflation Reduction Act includes some climate-related incentives which have a great impact on US renewables investments.

EM further discussed MPF's current total portfolio emissions metrics covering listed equities and investment grade bond mandates (c. 50% of MPF portfolio) prepared by S&P Global Sustainable, which serves as a baseline for climate target-setting. The results show that MPF is performing better than the benchmark in terms of carbon emissions.

CC asked that if the other 50% of MPF portfolio performed poorly compared to the benchmark. EM responded that we do not know without looking into it. OT stated that the other half portfolio sits in the private market, and it is still challenging to evaluate and validate the data quality from it. One of the metrics that MPF reports on TCFD is how we determine the data quality.

EM emphasised that it is easier to remove high carbon emitters than creating actual impacts on the real-world situation. Therefore, it is important to target net-zero real economy which will lead to portfolio decarbonisation in the long term.

EM further introduced the concept of asset alignment to climate change trajectory and ensure decarbonisation at the asset level. For example, MPF has invested in a few renewables in the private market portfolio which will contribute to clean energy transition.

PWa stated the negative impacts resulting from investments and stressed MPF's ambition to create a big impact now and then bigger impacts over the longer term. He questioned the effectiveness of engagement and emphasised the importance of considering divestments at the right time.

PN asked if Redington assesses the individual investment. JD replied with confirmation and Redington evaluates if companies have set targets to address climate change and move towards net zero.