

## Minutes of IMWP held on 02 March 2023

### Attendees

Councillor Pat Cleary (Chair)	PC	WBC
Councillor Cherry Povall (Vice-chair)	CP	WBC
Councillor Chris Carubia	CC	WBC
Councillor Tom Cardwell	TC	LCC
Councillor George Davies	GD	WBC
Councillor Brian Kenny	BK	WBC
Councillor Paulette Lappin	PL	SBC
Roger Bannister	RB	Unison Member rep
Peter Fieldsend	PF	Pension Board
Donna Ridland	DR	Pension Board
Robin Dawson	RD	Pension Board
Roger Irvine	RI	Pension Board
Pat Maloney	PM	Pension Board
Jill Davys	JD	Redington
Tom Pilcher	TP	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	AA	MPF
Elizabeth Barlow	EB	MPF
Emma Jones	EJ	MPF
Greg Campbell	GC	MPF
Allister Goulding	AG	MPF
Dan Proudfoot	DP	MPF
Neil Gill	NG	MPF
Joe Hull	JH	MPF
Roksana Klapkowska	RK	MPF
Yu-Jhu Lin	YL	MPF

### Apologies

Councillor Andrew Gardner
Councillor Karl Greaney

#### 1. Declarations of Interest

As notified.

#### 2. Minutes of IMWP 15 November 2022

Noted, no amendments.

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

JD presented the management framework focusing on funding objectives, risk budgets, liquidity and cash flow, ESG and local investment. A detailed survey has been carried out to support Redington's analysis.

#### **Long-Term Funding Objective**

TP presented the funding objective and pointed to the fund valuation reaching 106% funded at actuarial valuation in 2022. According to the survey in terms of the fund's primary objective, the top three options are consistently related to its funding position and funding level.

In the breakdown of current Strategic Asset Allocation (SAA), public equities account for the majority (UK equity 0.8% and overseas equity 1.5%) of the expected return. Overall, the expected return is higher than the minimum return required to maintain the Fund's fully funded position.

Rohan (RW) asked if the expected return should be lower in terms of risks. TP agreed that the expected returns could feasibly be reduced in the context of risk management.

Paul (PWa) asked about the current funding position and JD responded that they have consulted with Mercer and they do not have concerns about the funding position.

#### **Risk Budget**

In terms of the risk drivers, value at risk (VaR) and stress tests are used to analyse the current SAA portfolio. The VaR shows that in a 1-in-20 downside scenario, the Fund's assets would fall by 13.9%. The exposure to individual risk factors across the portfolio has led to a good level of diversification in the portfolio. Among all the factors, equity has shown to be the biggest risk which is also reflected in the stress tests. A supporting survey shows that more respondents agree to prioritise risk management even to sacrifice some investment returns. Redington proposed a 13% risk budget which means that asset value should not decline more than 13% in the 1-in-20 downside scenario.

RW asked what period and volatility were used to create the VaR as the inputs would affect the estimated output. TP explained that a hundred plus years of data has been pulled together to work around the assumptions. Redington understands that there are limitations of using VaR and other measures are also used in combination to help monitor risks.

Pat (PC) asked about the risk attitude among committee members and officers. JD shared that committee members tend to be happy to spend more time on understanding what a risk portfolio means. Committee members would like more clarity on the investment approach toward risks.

PWa asked about what risk factors are considered in setting up a risk framework. TP addressed that in a perfect world a framework can bring all risk factors

together. Longevity is one risk factor and some LGPS funds have managed this risk specifically. Proportionately the longevity risk factor will be relatively small compared to the investment risks in the framework.

Donna (DR) asked about the Fund's risk strategy compared to other funds. TP confirmed that the Fund's strategy is sensible and falls in the middle range among most LGPS funds in terms of risk taking. Since the majority of the Fund's risks come from equity, diversification of that risk can potentially improve the risk adjusted return of the portfolio.

### **Liquidity and Cash Flow**

There are three ways of funding the regular pension payments, including pension contributions, asset income and proceeds of asset sales. The higher net cash outflows, the greater the need to hold liquid assets. Poor management of cash flows may lead to material consequences for example to liquidate assets at distressed prices. A secondary order of associated risk is the lack of flexibility of the Fund's portfolio, and which may cause the Fund to miss investment opportunities when they appear. The extreme scenario is to fail to make pension payments, resulting in reputational and legal consequences.

The current cashflow position shows significant negative cash outflows, while the estimated £150 million to £200 million income from private markets is not incorporated into the cashflows position. After taking the private market assets into account, a 2% divestment of assets is still required per year. This number is relatively high compared to other LGPS funds.

In terms of liquidity, the Fund currently holds about 35% private market assets that are expected to take longer time to liquidate at a fair price.

A supporting survey has shown sentiment of increasing the holding in income yielding assets in order to meet the cashflow deficit. Redington has proposed at least 60% of the projected cashflow deficit to be covered by investment income, and to target 50% of total asset value in liquid assets in a 1-in-20 downside scenario.

RW asked for further clarification on the definition of liquid assets. TP emphasised that Redington takes a broad definition and considers gilts as a liquid asset. The way they define overall liquidity is the current dealing terms on the assets and how long it takes to turn assets into cash.

PWa asked if equity dividends are included in cash calculation and TP responded that currently they do not allow for equity dividends and the Fund should not rely on equity dividends for regular cash income.

### **ESG**

JD recognised responsible investments as core to fiduciary duty and demonstrated how to integrate ESG investments with traditional investment objectives. Respondents to relevant survey also shows strong agreement to ESG

investments if opportunities arise. In Redington's assessment the Fund is seeking to generate positive ESG impact alongside financial returns.

Chris (CC) questioned which should take priority in the decision-making process, financial returns or ESG related fiduciary duty. JD concluded that the Fund's ultimate responsibility is to meet pension payments while the Fund could also face detrimental risk if it fails to transit into net zero by 2050.

Owen (OT) explained that since the Fund's responsibility to make pension payments falls in a longer timeline over 2050, it is worth taking actions in the near term to mitigate the systemic risks in issues like climate change and human rights. Ultimately it is all about risk management in the very long term.

PWa asked if Redington provides information on manager ratings. JD confirms that can be done and it depends on how the Fund engages with its managers. Some objectives can be set to evaluate against managers.

PC highlighted that the Fund has taken significant steps in managing ESG related risks and should move fast to be ahead of the curve. JD would like to gain permission for a deep survey on ESG to help build up the framework. There are various ways to achieve climate related targets, for example the Fund can decarbonise the portfolio or invest in assets that help in the fossil fuel transition.

PC suggested to compare with peers in terms of meeting the net zero target. OT emphasised that accounting carbon footprint is an useful matrix to quantify while the decarbonisation approach may not really create an impact on the real world emission. Peers are now moving towards the target alignment of Paris agreement to limiting 1.5<sup>0</sup>C temperature increase.

Cherry (CP) highlighted the importance of managing ESG risks instead of greenwashing. CC suggested that training on ESG risks will be useful. Peter (PW) confirmed that two things are to be done, one is to undertake a survey as proposed by Redington on ESG and the other is an event to help understand the portfolio decarbonisation, greenwashing, and energy transition.

Redington has proposed a further discussion about what the Fund wants to achieve to set some targets and measurements. JD explained that carbon footprint in scope 1 and scope 2 are relatively easier to capture, while scope 3 is more difficult to measure. Therefore, it is important to set long term targets while allowing short term fluctuations. TP further highlighted that climate issues are multiple faceted, and more measures should be investigated in assessing the climate risks.

### **Levelling up / Local Investments**

A levelling up white paper that was released last year is currently awaiting further regulation, in which local means UK wide and up to 5% of LGPS assets are expected in levelling up agenda. Some targets are achievable for local pension funds such as affordable housings. Redington survey has shown that a desire to pursue more local investment toward Merseyside region. A formal target is still waiting for additional guidance and discussion.

PC confirmed that the committee would like more local investments and wished that government has set an appropriate framework for local pension funds to utilise investments while aiming at the levelling up target.

RW asked about the rationales behind the scenario analysis regarding the climate stress testing. TP further explained that the scenario test is about the transition risk under cases from orderly transition into net zero to insufficient efforts been done. While physical risk is not considered in the test.

PC highlighted the committee consensus in human rights and the importance of establishing a structural framework to address critical issues. JD agrees that further expansion in ESG to include engagement and stewardship. Exclusion can also be put in place in screening companies. CC would like to see clear measures on how changes in the real world would impact the financial returns of the Fund.

#### **4. Market Update**

RW updated the market review. UK bonds have significantly fallen over 2022 (-40.1% for UK FT all government Gilts, -46.9% for UK index-linked Gilts). PMI, an indicator for economic activity, shows a downward trend below 50 and indicates a potential recession. The annualised CPIs for major developed economies have shown a sharp increase since December 2020.

In terms of equity market, the US S&P500 peaked around the end of year 2021 and then moved in a downward trend, while UK all-share has shown to be underperforming compared to other markets. The US market outperforms mainly due to the large constituents of growth stocks, and in the UK a large component is financial services and energy that tend to perform relatively even across the cycle. The difference between the MSCI World Value Index and the MSCI World Growth Index have been narrower over the year. The Fund has a significant weight tilting toward value stocks.

Regarding the fixed income markets, yields in US, Germany and the UK grow significantly reflecting the high inflation and Central Banks monetary policies. Corporate bond yields have appeared to be average compared to history, and the spread would be expected to widen if the economy goes into recession.

In currency market, Sterling rose sharply against US dollar and Chinese yuan. While the Brent crude oil price has come down. Emerging market equities are looking more interesting, sector wise retails may continue to suffer.

PC asked about the situation in the labour market. RW responded that manufacturing sector is getting weaker and the service sector is trying to pick up the demand constrained during lockdowns. In terms of the labour market in the manufacturing sector, less layoffs are seen due to the difficulty of rehiring labours.

#### **5. Monitoring Report**

PW pointed out that there are two mandates of particular concern, one is Unigestion Europe ex-UK equity and the other is Newton UK equity. Both have

underperformed significantly and they are the ones that the Fund is using for liquidity so as to meet pension payments.

PC asked about the wide variation in performance against benchmarks given the volatility. PW responded that the Fund has not seen the value tilted portfolio benefiting as expected.

## **6. Responsible Investment**

OT introduced the engagement working paper seeking for further comments, and the document provides corporate lens to construct engagement in a structural approach. JD further explained the three levers in responsible investments - invest, engage and exclude. It establishes a mechanism to assess the engagement level and financial materiality, the ability to influence decisions and to collaborate with a wider sector on global issues.

CC pointed out the material issues when the Fund stops investing in certain companies where there may have human rights issues. JD confirmed that the importance to check with external managers to understand if they have a consistent approach in dealing with companies with relevant issues. PC further commented that the key will be how we engage with invested companies that are of concern. PWA also requested for an engagement pipeline and also assessment of the engagement for decision making going forward. OT clarified that the likelihood of influence over what time period and what changes are looked after as sometimes the influence and changes may not be reflected on immediate results.

RW asked about Redington's views on carbon offset. JD confirmed that at some points in time there are opportunities to invest in good companies involving assets such as Timberland as OT mentioned.

The remainder of the agenda including an update on Russian investments and the quarterly voting and engagement reports were for noting.

LAPFF Q4 2022 QER: <https://lapfforum.org/wp-content/uploads/2023/01/LAPFF-Q4-QER.pdf>

Northern LGPS Stewardship report:  
[https://northernlgps.org/assets/pdf/stewardq4\\_2022.pdf](https://northernlgps.org/assets/pdf/stewardq4_2022.pdf)