Agenda Item 12

Leicestershire County Council

LOCAL PENSION COMMITTEE – 16 JUNE 2023

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

ACTION AGREED BY INVESTMENT SUB COMMITTEE

Purpose of Report

1. The purpose of this report is to provide the Local Pension Committee with details on decisions agreed by the Investment Subcommittee (ISC) at its meeting held on 19 April 2023.

Policy Framework and Previous Decisions

2. The Leicestershire Pension Fund (the Fund) has a requirement to maintain investments in asset classes close to the Fund's Strategic Asset Allocation (SAA) as existing investments are returned.

3. At the January 2023 Local Pension Committee meeting, the 2023 SAA was approved. The new SAA and changes from the 2022 SAA are best described in the table below.

Asset Group	Asset Class	2022 SAA	2023 SAA	Change from 2022 SAA
Growth	Listed equities	42.00% (40% - 44%)	37.50%	- 4.5%
Growth	Private equity	5.75%	7.50%	+ 1.75%
Growth	Targeted return	7.50%	5.00%	- 2.5%
Income	Infrastructure (incl. timber)	9.75%	12.50%	+ 2.75%
Income	Property	10.00%	10.00%	
Income	Emerging market debt & Global credit – liquid sub inv grade markets	6.50%	9.00%	+ 2.5%
Income	Global credit – private debt (inc M&G/CRC)	10.50%	10.50%	
Protection	Inflation-linked bonds	4.50%	4.50%	
Protection	Investment grade credit	3.00%	2.75%	-0.25%
Protection	Currency hedge	0.50%	0.75%	+0.25%

Protection	Cash / cash equivalent	0.00%	0.00%	

4. In summary the net effect of changes approved increases the allocation to the income asset group (+5.25%) whilst equally reducing the allocation to the growth asset group.

Investment advisor planned work 2023

5. A schedule of work has been agreed with Hymans Robertson (the Fund’s investment advisor) post the January 2023 Local Pension Committee meeting to facilitate the changes to the SAA in a similar way to what was done in 2022 with proposals considered with officers in advance of presenting these to the Investment Sub-Committee at its meetings (ISC) in 2023. The following were agreed to be reviewed by Hymans:

   a. A listed equity asset group review
   b. A targeted return review
   c. A protection assets review

6. The first two reviews were concluded by Hymans in advance of the April ISC meeting and were presented to and approved by the ISC. The assets covered by the two reviews are of significant magnitude and as such a longer update is now provided below for the Committee compared to similar previous papers outlining the decisions taken by the ISC.

7. In addition, the ISC approved commitments in aggregate of £100m to three infrastructure investments which would help close the underweight to the infrastructure asset class.

Listed Equity Review

8. The listed equity review covered all the assets managed by Legal and General investment management (LGIM) and the three equity funds with LGPS Central. In total these investments are valued at £2.51 billion (44% of total assets) as of 31 March 2023.

9. Overall, as per the 2023 SAA a reduction to the listed equity asset class of 5% from 42.5% to 37.5% of total Fund assets is required.

10. It had been three years since the last listed equity review and, as one of the largest asset classes for the Fund, it was appropriate to formally review this asset class again. The timing of the review had been selected so that the review has:

    a. the benefit of clear guidance from the recently completed triennial valuation for the Fund in which future returns assumptions for the Fund were outlined;
    b. the 2022 climate risk report (CRR) findings; and
    c. the recently approved net zero climate strategy (NZCS).

11. The scope that Hymans worked to, and the findings presented to the Committee is shown below:

    a. Geographical allocations, including to what extent a ‘home’ (UK) bias is sensible and if an overweight allocation to emerging markets is sensible.

b. If investing based on the market capitalisation is appropriate (i.e., holding more of a company the larger it becomes)
c. The allocation between active and passive management
d. How to employ factor-based strategies
e. Responsible investing considerations
f. How to implement any recommendations

12. One of the proposals as a result of the review was to introduce the Legal & General (L&G) low carbon transition fund (LCT) to the portfolio. As a new investment to the Fund, Hymans carried out due diligence as part of the review and presented this to the ISC at its meeting on 19 April 2023. The LCT fund is a low-cost passive tracker with a benchmark that aims to reduce carbon emissions intensities and align with Net Zero pathways. It's weighted average carbon intensity (WACI) is around two thirds lower than a the typical all world benchmark.

13. In addition, the emerging markets (EM) overweight position the Fund has held (when compared to the overall market capitalisation for all emerging market companies) is being bought back towards neutral. This rebalancing of emerging markets exposure is via divestment from the LGPS Central multi manager fund. The Fund will maintain EM exposure via the LGPS Central global active equity mandate, LGPS Central climate multi factor mandate and via the L&G all world and LCT funds which all have EM exposure.

14. At its meeting on 19 April 2023 the ISC approved the listed equity recommendations listed below. In summary, there is an overall reduction in listed equity of 5%, an increased tilt towards lower carbon intensity funds with a net additional 0.5% of total fund assets, and a decrease in emerging market equities which traditionally have a higher carbon intensity. Taken together, higher climate titled investments and a reduction in emerging markets should result in a lower WACI, all other things being equal.

a. Enact the reduction from 42.5% to 37.5% of listed equities per the SAA.

b. Once the outcome of the Central Global Equity manager procurement is concluded and deemed satisfactory by Hymans Robertson continue with:

    i. appointing a transition advisor to aid in formalising the timeline and strategy for the changes as detailed below.

c. Collapse the regional passive LGIM portfolio including the single stock funds into three Funds with LGIM:

    i. L&G UK Equity Fund – 2% of total Fund assets
    ii. L&G All World Equity Fund – 8% of total Fund assets
    iii. L&G Low Carbon Transition Fund – 3.5% of total Fund assets

d. Decrease the allocation to the Central Climate Factor fund – 12% of total Fund assets.

e. Increase the allocation to the Central Global Equity fund – 12% of total Fund assets.

f. Divest from the Central Emerging Market multi manager fund.

Targeted Return Review

15. Similar to the listed equity review which had a SAA change, the targeted return asset class had a 2.5% reduction from 7.5% to 5% of total Fund assets approved at the January 2023 Local Pension Committee meeting.

16. A LGPS Central product, the current line up of three managers (Aspect, Pictet and Ruffer) and a revised make up of managers were compared and presented to the ISC in April 2023.

17. The ISC were informed that the current valuation of the three managers was in excess of the target weight of 5% and officers had made changes to divest from managers, as cash was needed to fund other commitments made and to rebalance underweight positions during 2022.

18. The ISC were reminded of the current three managers strategies and the LGPS Central proposal strategy alongside a proposal from Hymans consisting of a slimmed down two manager option.

19. The ISC were informed of the current returns from the current three manager approach versus their benchmark of cash + 4% pa which is summarised below. In short, although not all strategies had performed, taken together the strategy had outperformed the benchmark over all meaningful timeframes. In particular, during 2022 when many asset classes had fallen heavily, the current manager setup delivered a return of 13.6%.

Manager	1 Year (% p.a.)	3 Years (% p.a.)	5 Years (% p.a.)	10 Years (% p.a.)	Since Pictet Inception Nov 2015 (% p.a.)
Ruffer	5.4	9.3	6.1	6.3	6.0
Aspect	43.0	14.2	8.0	6.7	5.4
Pictet	-7.6	2.5	1.8		3.5
Ruffer + Aspect + Pictet	**13.6**	**9.5**	**5.9**		**5.4**
Cash +4%	**6.0**	**4.8**	**4.8**	**4.6**	**4.7**

All returns information as to 31st December 2022

20. Hymans did note that this overall return from the three manager setup may not have been achieved in the most risk efficient manner, particularly with respect to the level of equity market beta and the magnitude of the largest drawdowns. Beta is a measure that is also known as systematic risk or market risk and measures the sensitivity of an individual stock or portfolio to movements in the overall stock market, and compares the volatility of a particular asset to the volatility of the overall market.

21. Hymans have a list of 12 managers (as of March 2023) within the multi asset space which have a preferred or positive rating. Hymans reviewed the 12 managers for any strategies that may fit the requirements for the Fund to then compare alongside the LGPS Central option and current three manager option.

22. The scope of the Hymans review covered the following areas:

    a. Overview of the targeted return (absolute return) market
    b. Review of current and proposed solutions including:

i. Alignment of solutions objective to the cash + 4% target irrespective of market direction, with a focus on low correlation with equities and strong downside protection
ii. Complexity of the combined portfolio and underlying mandates
iii. Transparency and risk management of the strategy. This includes consideration on the use of leverage.
iv. Liquidity
v. Responsible investment and climate risk reporting
vi. Governance implications
vii. Performance including track record
viii. Concentration risks and strategy size
ix. Fees

23. The analysis by Hymans of the three options provided support to the revised two manager option. The associated recommendations which were approved by the ISC at its meeting on 19 April 2023:

a. That the Director of Corporate Resources be authorised to take the necessary action in order for the Fund to disinvest from two targeted return investments during 2023/24.

b. That an investment increasing to 3% of total fund assets be made to the existing Ruffer mandate over 2023/24.

c. That an investment totalling 2% of total fund assets be made to the new Fulcrum diversified core absolute return fund over 2023/24, subject to negotiation of fees via the Director of Corporate Resources.

Infrastructure investments

24. The infrastructure target allocation was raised to 12.5% from 9.75% at the January 2023 Local Pension Committee meeting. As a result, additional commitments were needed in order to close the gap which, as at the latest available actual valuations for the Fund, resulted in a c£130m underweight to the asset class. Officers concluded that at this point in the year an additional £100m should be committed in order to substantially close the underweight position as the monies called by the selected managers.

25. The Fund has eight infrastructure managers, six of which are open for new investment. The actual commitments to managers for the £100m are calculated by referring to the infrastructure review taken to the ISC in July 2022, where a framework covering risk and geographic targets was presented. Officers used the targets for risk and geographical allocation to recommend three commitments. Existing commitment forecasts and capital returns have been considered as part of this exercise.

26. The Fund’s advisor, Hymans was consulted as part of recommendations which were deemed to be suitable. The recommended commitments which were approved by the ISC were to three existing managers including LGPS Central, and are detailed below:

a. An additional £35m commitment to the LGPS Central Core / core plus infrastructure fund bringing the total commitment to £135m.

b. A $24m commitment to the JPM IIF fund.

c. A $54m commitment to the Quinbrook Net Zero Power Fund split equally between the main fund and co-investment fund.

Leicestershire Pension Fund Conflict of Interest Policy

27. Whilst not a conflict of interest, it is worth noting that the County Council also invests funds with four managers with whom the Leicestershire County Council Pension Fund invests, namely Partners Group, JP Morgan, DTZ investors and Christofferson Robb and Company (CRC). Decisions on the County Council's investments were made after the Fund had made its own commitments.

Recommendation

28. The Local Pension Committee is asked to note the report.

Environmental Implications

29. The Leicestershire LGPS has developed a Net Zero Climate Strategy (NZCS) for the Fund. This outlines the high-level approach the Fund is taking to its view on Climate Risk. This will align with the Fund's Responsible Investment approach as set out in the Principles for Responsible Investment. The Fund is committed to supporting a fair and just transition to net-zero. There are no changes to this approach as a result of this paper.

30. As described earlier in this paper, the changes approved by the ISC should have a positive impact on the WACI for the Fund. There are expected to be associated improvements in exposure to clean technology and reduction to traditional carbon intensive companies.

Equality Implications

31. There are no direct implications arising from the recommendations in this report. The Fund incorporates financially material Environmental, Social and Governance ("ESG") factors into investment processes. This has relevance both before and after the investment decision and is a core part of the Fund's fiduciary duty. The Fund will not appoint any manager unless they can show evidence that responsible investment considerations are an integral part of their decision-making processes. This is further supported by the Fund's approach to stewardship and voting through voting, and its approach to engagement in support of a fair and just transition to net zero. There are no changes to this approach as a result of this paper.

Human Rights implications

32. There are no direct implications arising from the recommendations in this report. The Fund incorporates financially material Environmental, Social and Governance ("ESG") factors into investment processes. This has relevance both before and after the investment decision and is a core part of the Fund's fiduciary duty. The Fund will not appoint any manager unless they can show evidence that responsible investment considerations are an integral part of their decision-making processes. This is further supported by the Fund's approach to stewardship and voting through voting, and its

approach to engagement in support of a fair and just transition to net zero. There are no changes to this approach as a result of this paper.

Appendices

None

Background Papers

19 April 2023 – Investment Sub Committee - Cash deployment, strategic asset allocation and infrastructure investment top ups

Officers to Contact

Mr D Keegan, Director of Corporate Resources
Tel: 0116 305 7668 Email: Declan.Keegan@leics.gov.uk

Mr B Kachra, Senior Finance Analyst - Investments
Tel: 0116 305 1449 Email: Bhuleh.Kachra@leics.gov.uk

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