Agenda Item 7

Leicestershire County Council

INVESTMENT SUB-COMMITTEE – 11 OCTOBER 2023

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

LISTED EQUITY TRANSITION UPDATE

Purpose of Report

1. The purpose of the report is to provide an update on progress with respect to the listed equity changes as approved at the 19 April 2023 meeting of the Investment Sub-Committee (ISC).

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. At the 20 January 2023 Local Pension Committee meeting, the 2023 SAA was approved. The new SAA included significant exposure changes to listed equity as set out below.

Asset Group	Asset Class	2022 SAA	2023 SAA	Change from 2022 SAA
Growth	Listed equities	42.00% (40% - 44%)	37.50%	- 4.5%

3. In line with the agreed SAA Hymans reviewed the listed equity asset group in advance of the April 2023 Sub-Committee meeting. 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.

4. At its meeting on 19 April 2023 the ISC approved the listed equity recommendations. As a reminder these are set out below.

   a. Enact the reduction from 42.0% to 37.5% of listed equities as 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.

Transition advisor update

5. As part of the changes agreed to the listed equity mandates, officers commenced a process to procure specialist transition advisor services in line with the recommendations agreed. A procurement exercise was commenced and there were seven suppliers who were able to bid for the work. The Fund has appointed Hymans Robertson who were ranked the best for value for money and able to satisfy the scope provided.

6. The advisor has now prepared a strategy and timing of the agreed listed equity changes. It is proposed that the transition take place in stages to achieve the agreed strategic changes while managing transition costs and market exposure.

7. The transition is progressing as planned and a high-level approach is set out below as produced by the transition advisor in conjunction with the Fund's investment consultant Hymans Robertson (Hymans) who ensures the transition advice is in keeping with the wider investment strategy for the Fund.

a. Phase 1: Completed. The recommended reduced exposure to LGPS Central Climate Multi Factor Fund (from 15.7% AUM to 12%) has been completed at no cost to the Fund due to utilising a crossing opportunity with another partner fund within LGPS Central. This was completed in a timely manner; cash proceeds (£220million) have been remitted to the Fund and the weighting to listed equity has reduced towards the 37.5% target.

b. Phase 2: The Fund will reorganise the LGIM holdings (15.9% of AUM) utilising the LGIM pooled fund team to the LGIM UK Equity Fund (2%), All

World Equity Fund (8%) and Low Carbon Transition (3.5%). This approach is optimal from a cost perspective versus the alternative options. The alternative option of utilising an external transition manager was discounted primarily due to projected costs being higher by £400k. This change will reduce holdings at LGIM by c£150million.

i. The transition manager has noted a dependency related with the LGPS Central Global Equity fund which is undergoing a review. If the Fund cannot reinvest cash released from the LGIM reorganisation into the Central Global Equity fund an option to invest the proceeds into a world equity passive fund at LGIM is being investigated. The recommendation will be investigated further between officers, the transition advisor and the Fund's investment consultant Hymans, as the direction and timing of the Central Global Equity fund becomes clearer. Leaving this option available gives the Fund flexibility to manage various risks such as higher levels of cash and the rates available versus expected returns from staying invested in equity markets for the shorter term.

c. Phase 3: The Fund will manage the divestment of the Central Emerging Market Fund which will bring the overall equity allocation broadly in line with the agreed strategic target of 37.5% of total Fund assets. It is envisaged currently that this would be complete by the end of the current financial year.

d. Phase 4: Subject to due diligence and suitability of a fourth manager being added to the LGPS Central Global Equity fund, it is proposed the remaining funds that were invested in the passive developed world equity fund in Phase 2, be invested into the Central Global Equity fund noting that the Fund may be advised differently as timings and situations change during Central's review of the Global Equity fund. Awaiting appointment of the fourth manager allows the Fund and investment advisor to critically review the appointment for appropriateness to the Fund's investment objectives and avoiding fees from transactions were the appointment deemed unsatisfactory.

8. It is forecasted that all transitions will be completed by the end of the current financial year subject to the dependencies highlighted. Dialogue between officers, the transition advisor, investment consultant, LGIM and LGPS Central on timing, managing market exposure and pending any late market events will continue as necessary and may mean that the transition is delayed later into 2023/24.

9. As a result of the strategy agreed between the transition advisor, the Fund's investment advisor and officers for the Fund, the level of cash being held will be higher than in previous years whilst awaiting to be called by managers where the

Fund has made investment commitments. There is risk that whilst holding cash the return may be lower than could have been were the equity allocation held until private markets calls were made. This was taken into consideration and given the reduction in equity allocation approved at the January 2023 Local Pension Committee meeting and levels of return that can be made on cash, the investment advisor is comfortable with the option of more cash being held.

10. The Local Pension Committee and Investment Sub-Committee will be kept updated on progress of the transition as required.

Recommendation

11. The Investment Sub-Committee is asked to note the update provided.

Environmental Implications

12. 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.

13. It is expected that all else being equal the reduction to emerging market equities, which traditionally have a higher carbon intensity, and a tilt towards lower carbon intensity funds should result in a lower carbon intensity

Equality Implications

14. 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

15. 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.

Background Papers

16. Local Pension Committee 20 January 2023, Overview of the Current Asset Strategy and Proposed 2023 Asset Strategy (Minute Item 98)

    http://cexmodgov01/ieListDocuments.aspx?CId=740&MId=7201&Ver=

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

    https://politics.leics.gov.uk/documents/s175745/Cash%20update%20and%20infra%20top%20ups%2023%2024.pdf

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