

Pension Fund Committee

Thursday, 11 March 2021

Pension Fund Administrator's Report

For Decision

Local Councillor(s): All

Executive Director: A Dunn, Executive Director, Corporate Development

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Report Status: Public

Recommendation:

That the Committee review and comment upon the activity and overall performance of the pension fund.

Reason for Recommendation:

To ensure that the pension fund has the appropriate management arrangements in place and are being monitored, and to keep the asset allocation in line with the strategic target.

1. Executive Summary

The purpose of this report is to update the Committee on the pension fund's funding position, and the valuation and overall performance of the pension fund's investments as at 31 December 2020. The report provides a summary of the performance of all external investment managers and addresses other topical issues for the pension fund that do not require a separate report.

The estimated value of the pension fund's assets at 31 December 2020 was £3,260M compared to £2,696M at the start of the financial year. This has been driven by rises across all listed markets after the falls in March 2020 in reaction to the impact of COVID 19.

The pension fund's estimated funding position at 31 December 2020 is 85% - that is, assets were estimated to be 85% of the value needed pay for the expected benefits accrued to that date. This compares to 92% calculated by the pension fund's actuary following their full assessment as at 31 March 2019 for the most recent triennial valuation.

The total return from the pension fund's investments over the financial year to 31 December 2020 was 20.8%, compared to the combined benchmark return of 17.3%. Over the last 12 months the pension fund's investments have returned 3.1%, compared to the combined benchmark return of 2.8% and the actuarial discount rate of 5.0%.

As at 31 December 2020, approximately 32% of the pension fund's liabilities were hedged against inflation sensitivity through the Liability Driven Investment (LDI) mandate with Insight Investment.

As at 31 December 2020, approximately 48% of the pension fund's assets were under the management of Brunel Pension Partnership.

2. Financial Implications

The Local Government Pension Scheme (LGPS) is a national pension scheme administered locally. Dorset Council is the administering authority for the LGPS in Dorset which provides pensions and other benefits for employees of the Council, other councils and a range of other organisations within the county.

The LGPS is a 'defined benefit' scheme which means that benefits for scheme members are calculated based on factors such as age, length of membership and salary. Member benefits are not calculated on the basis of investment performance as they would be in a 'defined contribution' scheme.

Administering authorities are required to maintain a pension fund for the payment of benefits to scheme members funded by contributions from scheme members and their employers, and from returns on contributions invested prior to benefits becoming payable.

Contribution levels for scheme members are set nationally, and contribution levels for scheme employers are set locally by actuaries engaged by administering authorities.

As scheme member rates cannot be changed locally and benefits are defined, the risk of investment underperformance is effectively borne by scheme employers.

3. Wellbeing and Health Implications

No wellbeing and health implications arising from this report have been identified.

4. Climate implications

The pension fund's Investment Strategy Statement requires all external investment managers to consider and manage all financially material risks arising from environmental issues, including those associated with climate change.

At its meeting in September 2020, the Committee agreed to a strategy of decarbonisation meaning a reduction in allocations of investment to companies which are high carbon emitters and looking to influence the demand for fossil fuels and their financing, not just their supply.

5. Other Implications

No other implications arising from this report have been identified.

6. Risk Assessment

The pension fund's Investment Strategy Statement requires all external investment managers to consider and manage all financially material risks

The risks associated with the pension fund's investments are assessed in detail and considered as part of the strategic asset allocation.

7. Equalities Impact Assessment

There are no equalities implications arising from this report.

8. Appendices

Appendix 1: Corporate Bonds (RLAM) Q4 2020

Appendix 2: Multi Asset Credit (CQS) Q4 2020

Appendix 3: Property (CBRE) Q4 2020

Appendix 4: Liability Driven Investment (Insight) Q4 2020

9. Background Papers

Investment Strategy Statement (March 2018)

Funding Strategy Statement (March 2020)

10. Asset Valuation Summary

10.1 The table below shows the pension fund's asset valuation by asset class at the beginning of the financial year and as at 31 December 2020,

together with the target allocation as agreed at the meeting of the Committee on 10 September 2020.

Asset Class	31-Mar-20		31-Dec-20		Target Allocation	
	£M	%	£M	%	£M	%
UK Equities	491.0	18.2%	343.6	10.5%	326.0	10.0%
Overseas Equities	682.8	25.3%	1,190.0	36.5%	1,141.0	35.0%
Emerging Markets Equities	83.8	3.1%	119.9	3.7%	163.0	5.0%
Total Listed Equities	1,257.6	46.6%	1,653.5	50.7%	1,630.1	50.0%
Corporate Bonds	220.6	8.2%	253.2	7.8%	130.4	4.0%
Multi Asset Credit	120.4	4.5%	147.4	4.5%	163.0	5.0%
Diversified Returns	152.8	5.7%	166.5	5.1%	195.6	6.0%
Infrastructure	195.3	7.2%	216.9	6.7%	260.8	8.0%
Private Equity	98.1	3.6%	99.7	3.1%	163.0	5.0%
Property	301.0	11.2%	298.2	9.1%	326.0	10.0%
Cash	53.4	2.0%	50.1	1.5%	-	0.0%
F/X Hedging	-9.7	-0.4%	7.6	0.2%	-	0.0%
Total Return Seeking Assets	2,389.5	88.6%	2,893.1	88.7%	2,868.9	88.0%
Liability Matching Assets	306.8	11.4%	367.0	11.3%	391.2	12.0%
Total Asset Valuation	2,696.3	100.0%	3,260.1	100.0%	3,260.1	100.0%

10.2 As at 31 December 2020, approximately 48% of the pension fund's assets were under the management of Brunel Pension Partnership.

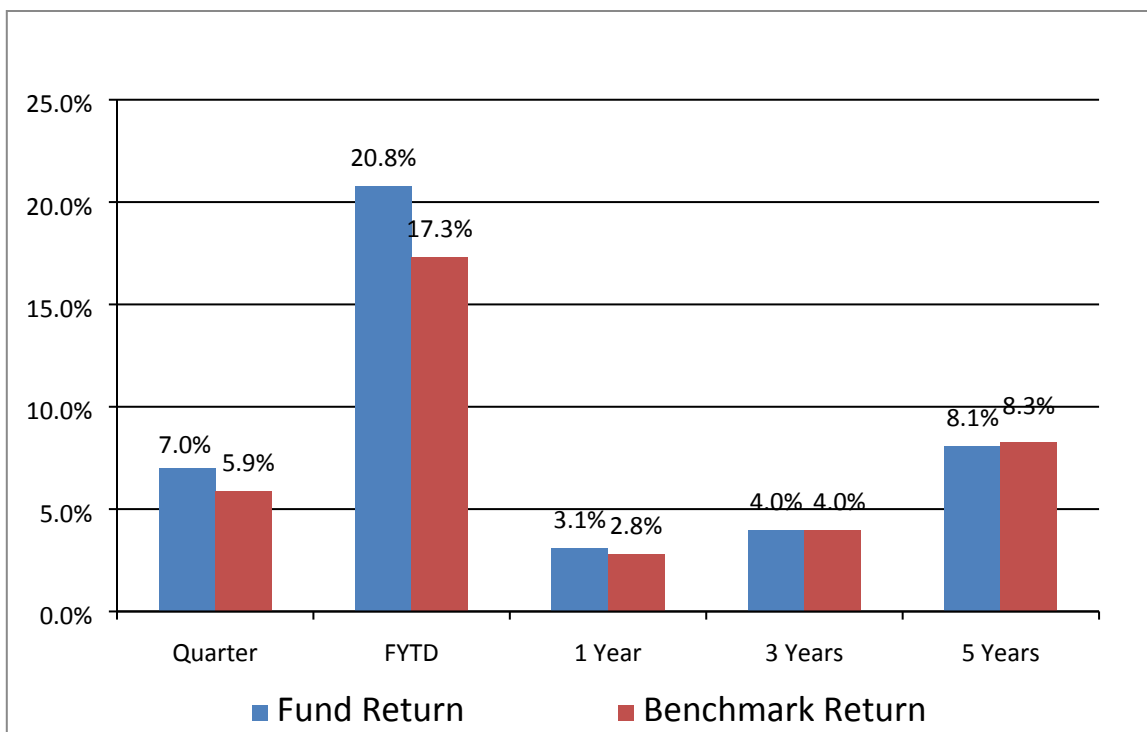
11. Funding Update

11.1 The pension fund's actuary, Barnett Waddingham, undertakes a full assessment of the funding position every three years. This was last completed as at 31 March 2019 when the pension fund had a funding level of 92% i.e. assets were estimated to be 92% of the value that they would have needed to be to pay for the expected benefits accrued to that date, based on the assumptions used.

11.2 Barnett Waddingham also carry out an indicative update on the funding position at the end of each quarter. Whilst this is not a full review it is intended to give an understanding of movements in the pension fund's overall funding position between triennial valuations. As at 31 December 2020 the estimated funding position was approximately 85%.

12. Investment Performance Summary

12.1 The overall performance of the pension fund's investments to 31 December 2020 is summarised below (returns for three and five years are annualised figures).



12.2 The Brunel Pension Partnership's performance report for the quarter ending 31 December 2020 is attached as a separate agenda item. This report includes market summaries from Brunel's investment officers and an overall performance summary for the pension fund, together with more detailed information in relation to Dorset's assets under Brunel's management.

13. Performance by Asset Class and Investment Manager

UK Equities

13.1 The performance of the pension fund's external managers is summarised in the tables below.

Brunel/LGIM Passive - £101.9m assets under management (AUM)

	Performance	Benchmark	Relative
Quarter	12.7%	12.6%	0.1%
Financial Year to Date	20.7%	20.5%	0.2%
12 months	-9.7%	-9.8%	0.1%
Since inception p.a.	-2.0%	-2.0%	0.0%

Brunel UK Active - £159.2m AUM

	Performance	Benchmark	Relative
Quarter	11.0%	11.9%	-0.9%
Financial Year to Date	21.9%	18.4%	3.5%
12 months	-10.5%	-11.8%	1.3%
Since inception p.a.	1.6%	0.8%	0.8%

Schroders - £67.7m AUM

	Performance	Benchmark	Relative
Quarter	25.7%	30.7%	-5.0%
Financial Year to Date	61.8%	48.5%	13.3%
12 months	9.7%	0.4%	9.3%
3 years p.a.	5.8%	0.6%	5.2%
5 years p.a.	12.1%	5.8%	6.3%
Since inception p.a.	10.7%	6.3%	4.4%

Global Developed Markets Equities

- 13.2 The performance of the pension fund's external global equities managers is summarised in the tables below.

Wellington - £235.7m AUM

	Performance	Benchmark	Relative
Quarter	8.1%	7.8%	0.3%
Financial Year to Date	35.9%	33.2%	2.7%
12 months	15.6%	12.3%	3.3%
3 years p.a.	12.3%	10.2%	2.1%
Since inception p.a.	15.3%	13.7%	1.6%

Brunel/LGIM Smart Beta - £153.4m AUM

	Performance	Benchmark	Relative
Quarter	7.6%	7.8%	-0.2%
Financial Year to Date	26.2%	26.3%	-0.1%
12 months	3.1%	3.3%	-0.2%
Since inception p.a.	6.3%	6.6%	-0.3%

Brunel/LGIM Smart Beta (Hedged) - £160.6m AUM

	Performance	Benchmark	Relative
Quarter	11.8%	11.9%	-0.1%
Financial Year to Date	33.6%	33.6%	0.0%
12 months	2.6%	2.9%	-0.3%
Since inception p.a.	6.3%	6.6%	-0.3%

Brunel/LGIM Passive Developed - £101.0m AUM

	Performance	Benchmark	Relative
Quarter	8.2%	8.2%	0.0%
Financial Year to Date	33.9%	33.9%	0.0%
Since inception p.a.	9.7%	9.8%	-0.1%

Brunel/LGIM Passive Developed (Hedged) - £131.0m AUM

	Performance	Benchmark	Relative
Quarter	12.2%	12.2%	0.0%
Financial Year to Date	41.2%	41.4%	-0.2%
Since inception p.a.	12.6%	12.8%	-0.2%

Brunel Global High Alpha Equity - £239.5 AUM

	Performance	Benchmark	Relative
Quarter	9.2%	7.9%	1.3%
Financial Year to Date	45.4%	33.6%	11.8%
12 months	28.3%	12.9%	15.4%
Since inception p.a.	26.3%	12.6%	13.7%

Brunel Emerging Markets Equities - £119.9m AUM

- 13.3 The performance of the Brunel Emerging Markets Equity Fund is summarised below.

	Performance	Benchmark	Relative
Quarter	13.9%	13.3%	0.6%
Financial Year to Date	43.1%	40.9%	2.2%
12 months	13.9%	15.0%	-1.1%
Since inception	14.6%	15.6%	-1.0%

Corporate Bonds - £253.3m AUM

- 13.4 The performance of the pension fund's external Corporate Bonds manager, RLAM, is detailed in Appendix 1, and summarised below.

	Performance	Benchmark	Relative
Quarter	4.8%	4.1%	0.7%
Financial Year to Date	14.8%	15.1%	-0.3%
12 months	10.4%	10.3%	0.1%
3 years p.a.	7.0%	6.5%	0.5%
5 years p.a.	8.4%	7.7%	0.7%
Since inception p.a.	8.8%	8.7%	0.1%

Multi Asset Credit (MAC) - £147.4m AUM

- 13.5 The performance of the Fund's external MAC manager, CQS, is detailed in Appendix 2 and summarised below.

	Performance	Benchmark	Relative
Quarter	5.4%	1.0%	4.4%
Financial Year to Date	22.4%	3.1%	19.3%
12 months	2.0%	4.3%	-2.3%
3 years p.a.	2.9%	4.6%	-1.7%
Since inception p.a.	2.9%	4.6%	-1.7%

- 13.6 The target for the CQS fund is cash (1 month LIBOR) plus 4% over the longer term, and this is used as the benchmark for the investment.

Property (CBRE) - £291.8m AUM

- 13.7 The performance of the Fund's external property manager, CBRE, is detailed in Appendix 3, and summarised below.

	Performance	Benchmark	Relative
Quarter	0.3%	1.0%	-0.7%
Financial Year to Date	0.9%	-2.9%	3.8%
12 months	-1.7%	-2.0%	0.3%
3 years p.a.	2.3%	1.8%	0.5%
5 years p.a.	4.4%	3.8%	0.6%
Since inception p.a.	7.2%	7.0%	0.2%

- 13.8 In addition to assets under the management of CBRE, the pension fund also has some holdings in secured long income property funds under the management of Brunel.

Private Equity

- 13.9 Private Equity is an asset class that takes several years for commitments to be fully invested. The table below summarises the commitment the pension fund has made in total to each manager, the drawdowns that have taken place to date and the percentage of the total drawdown against commitments. It also shows the distributions that have been returned to the pension fund, the valuation as at 31 December 2020 and the total gains or losses on investments.

<u>Manager</u>	<u>Commitment</u>	<u>Drawdown</u>		<u>Distribution</u>	<u>Valuation</u>
	<u>£m</u>	<u>£m</u>	<u>%</u>	<u>£m</u>	<u>£m</u>
HarbourVest	103.4	81.0	78%	83.1	56.4
Aberdeen Standard	75.9	60.1	79%	70.6	29.3
Brunel	60.0	13.4	22%	0.0	14.0
Total	239.3	154.5	65%	153.6	99.7

- 13.10 In order to meet the target allocation, there is a requirement to keep committing to Private Equity funds. Officers are in regular discussions with HarbourVest, Aberdeen Standard and the Brunel private markets team to identify further opportunities for investment.
- 13.11 The tables below summarise performance to date for the pension fund's two legacy managers, HarbourVest and Aberdeen Standard.

HarbourVest - £56.4m AUM

	Performance	Benchmark	Relative
Quarter	7.1%	12.6%	-5.5%
Financial Year to Date	7.5%	20.5%	-13.0%
12 months	14.4%	-9.8%	24.2%
3 years p.a.	18.2%	-0.9%	19.1%
5 years p.a.	17.2%	5.1%	12.1%
Since inception p.a.	11.9%	4.9%	7.0%

Aberdeen Standard - £29.3m AUM

	Performance	Benchmark	Relative
Quarter	1.2%	12.6%	-11.4%
Financial Year to Date	-7.7%	20.5%	-28.2%
12 months	2.0%	-9.8%	11.8%
3 years p.a.	10.9%	-0.9%	11.8%
5 years p.a.	10.1%	5.1%	5.0%
Since inception p.a.	3.4%	5.3%	-1.9%

- 13.12 The benchmark used for these investments is the FTSE All Share index and the investments are held in US dollars and Euros, currency movements can contribute to volatility in relative performance.

Infrastructure

- 13.13 As with Private Equity, Infrastructure is a long-term investment that takes several years for commitments to be fully invested. The pension fund has two external infrastructure managers, Hermes and IFM. The target for each manager is a 10% absolute annual return and this is used as the benchmark for these investments. Performance is summarised in the tables below:

Hermes - £93.7m AUM

	Performance	Benchmark	Relative
Quarter	-0.2%	2.4%	-2.6%
Financial Year to Date	-5.1%	7.4%	-12.5%
12 months	0.1%	10.0%	-9.9%
3 years p.a.	3.8%	10.0%	-6.2%
Since inception p.a.	6.6%	10.0%	-3.4%

IFM - £107.1m AUM

	Performance	Benchmark	Relative
Quarter	1.3%	2.4%	-1.1%
Financial Year to Date	2.5%	7.4%	-4.9%
12 months	0.7%	10.0%	-9.3%
3 years p.a.	11.1%	10.0%	1.1%
Since inception p.a.	12.6%	10.0%	2.6%

- 13.14 The investments with IFM are denominated in US dollars but performance is measured in sterling, therefore currency movements can contribute to volatility in performance.

Liability Driven Investment (LDI) - £367.1m AUM

- 13.15 A proportion of the pension fund's assets are held in an inflation hedging strategy, managed by Insight Investments. These assets are not held to add growth, but to match the movements in the pension fund's liabilities.
- 13.16 LDI strategies allow pension schemes to continue investing in return-seeking assets while hedging out their liability risks through the use of leverage. As at 31 December 2020, 11.3% of the pension fund's assets

were invested in the mandate but 32% of the pension fund's liabilities were hedged against inflation sensitivity i.e. if liabilities increased by £100M as a result of changes to inflation expectations, the value of the assets under management would be expected to increase by approximately £32M.

13.17 The liability matching strategy is intended to hedge against the impact of increasing pensions liabilities which are linked to the Consumer Prices Index (CPI). CPI cannot currently be hedged as there is not a sufficiently developed futures market, so the Fund's strategy targets the Retail Prices Index (RPI) swaps market to act as a proxy for CPI which tends to be lower than RPI.

13.18 The performance of the manager is detailed in Appendix 4 and summarised below.

	Performance	Benchmark	Relative
Quarter	2.5%	2.1%	0.4%
12 months	1.8%	1.7%	0.2%
3 years p.a.	-1.0%	-2.0%	0.9%
5 years p.a.	8.0%	5.6%	2.4%
Since inception p.a.	8.5%	7.5%	1.1%

14. Brunel Pension Partnership Governance Review

14.1 James Russell-Stracey, Brunel's Chief Stakeholder Officer, continues to facilitate a review of the partnership governance arrangements. The review is being undertaken at the request of shareholders, the Oversight Board and Client Group to provide assurance about the governance structure and operations of the Brunel Pension Partnership and ensure best practice governance.

14.2 The aim of the review is to facilitate the achievement of the strategic objectives of Brunel and will take in to account the interests of shareholders and the responsibility of the company's board to deliver those objectives. The review will establish the operational requirements of the company's management to deliver the following outcomes:

- to update the contents of the Shareholder Agreement and the Service Agreement to better reflect current operations of Brunel and its shareholders and the changes in requirements since the company was formed three years ago;

- to ensure that Brunel can operate effectively and with the flexibility to adapt to changes in the pension industry and regulatory environment;
- to deliver value for shareholders as the business progresses from its start-up phase and operates as an asset management company;
- to establish an effective Shareholder Forum;
- to establish a consultation process to resolve governance related issues.

14.5 To date, the following changes have been made as a result of the review:

14.6 The composition and appraisal process of the company board:

An additional non-executive director (NED) will be added to the board, and it will then comprise of five NEDs and four executive directors. There will be an annual appraisal of the Chair and Shareholder Non-Executive Director (SNED) with formal input from shareholders.

14.7 The establishment of a forum for Shareholder Representatives:

This forum will facilitate shareholder discussions and provide a structured, regular opportunity for the SNED to meet with all shareholders. There will be two scheduled meetings each year plus the ability to call ad hoc meetings at other times, with the first meeting taking place 25 March 2021.

14.8 Revisions to the text of the original Shareholder Agreement:

The first round of these revisions has been completed and are currently awaiting approval from shareholders by way of a Special Reserved Matter (SRM). A second round covering issues including reporting requirements and regulatory capital will be issued as an SRM as soon as possible.

14.9 A Strategy and Governance sub-group has been set up comprising members of the company, Oversight Board and Client Group to consider further modifications to clarify and update the Shareholder Agreement and Brunel's operating model. Any suggested changes arising from this process will be proposed to the Client Group and the Oversight Board before they are presented to shareholders for formal approval.

Footnote:

Issues relating to financial, legal, environmental, economic and equalities implications have been considered and any information relevant to the decision is included within the report.