

Pension Fund Committee

Tuesday, 30 November 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:

- i. review and comment upon the activity and overall performance of the pension fund's investments;
- ii. approve the revised Investment Strategy Statement (ISS) for publication;
- iii. approve the revised Funding Strategy Statement (FSS) for publication;
- iv. approve the proposed additional commitments to private markets' investments.

Reason for Recommendation:

To ensure that the pension fund has the appropriate management and monitoring arrangements in place, and to ensure that asset allocation in line with agreed strategic targets.

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 30 September 2021. 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 30 September 2021 was £3,626M compared to £3,340M at the start of the financial year.

As at 30 September 2021, approximately 63% of the pension fund's assets were under the management of Brunel Pension Partnership. (Brunel), the pension fund's Local Government Pension Scheme (LGPS) investment pooling manager.

Target allocations to most asset classes have been achieved or exceeded but achieving target allocations for private market assets continues to be a challenge. It is therefore proposed that commitments are made to Brunel's cycle three private markets' portfolios - Private Equity (£60M) and Infrastructure (£60M).

The estimated funding position at 30 September 2021 was approximately 88% - that is, assets were estimated to be 88% 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 quarter to 30 September 2021 was 2.5%, compared to the combined benchmark return of 2.4%. The financial year to date showed a return of 8.5% against the benchmark of 7.2%, and the total return for the 12 months to 30 September 2021 was 16.9% compared to the benchmark return of 16.7%. Over the longer term, annualised returns for three and five years are both slightly ahead of benchmark.

As at 30 September 2021, approximately 30% of the pension fund's liabilities were hedged against inflation sensitivity through the Liability Driven Investment (LDI) mandate with Insight Investment.

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.

The pension fund no longer has any direct investments in individual companies, including 'fossil fuel' companies, but it does have indirect exposure to such companies through its holdings in pooled investment vehicles. As at 31 March 2021, the value of the pension fund's investments in companies primarily involved in the exploration, production, mining and/or refining of fossil fuels was estimated at approximately £41M (1.2% of total investment assets).

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: Investment Strategy Statement

Appendix 2: Funding Strategy Statement

Appendix 3: Brunel Pension Partnership Q3 2021

Appendix 4: Corporate Bonds (RLAM) Q3 2021

Appendix 5: Property (CBRE) Q3 2021

Appendix 6: Liability Driven Investment (Insight) Q3 2021

9. Background Papers

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 30 September 2021, together with the target allocation as agreed at the meeting of the Committee on 10 September 2020.

Asset Class	31-Mar-21		30-Sep-21		Target Allocation	
	£M	%	£M	%	£M	%
UK Equities	348.6	10.4%	378.2	10.4%	362.6	10.0%
Global Equities	1,210.2	36.2%	1,333.5	36.8%	1,269.2	35.0%
Emerging Markets Equities	169.3	5.1%	165.7	4.6%	181.3	5.0%
Total Listed Equities	1,728.1	51.7%	1,877.4	51.8%	1,813.2	50.0%
Corporate Bonds	192.3	5.8%	198.1	5.5%	145.1	4.0%
Multi Asset Credit	170.4	5.1%	173.5	4.8%	181.3	5.0%
Diversified Returns	164.2	4.9%	241.2	6.7%	217.6	6.0%
Infrastructure	220.0	6.6%	235.0	6.5%	290.1	8.0%
Private Equity	96.1	2.9%	120.5	3.3%	181.3	5.0%
Property	313.2	9.4%	325.7	9.0%	362.6	10.0%
Cash	74.1	2.2%	34.8	1.0%	-	0.0%
F/X Hedging	0.7	0.0%	-7.6	-0.2%	-	0.0%
Total Return Seeking Assets	2,959.1	88.6%	3,198.6	88.2%	3,191.1	88.0%
Liability Matching Assets	381.3	11.4%	427.7	11.8%	435.2	12.0%
Total Asset Valuation	3,340.4	100.0%	3,626.3	100.0%	3,626.3	100.0%

10.2 The pension fund's Investment Strategy Statement (ISS) has been updated to reflect the changes in strategy previously approved by the Committee (see Appendix 1). It is not proposed that any further changes are made to the investment strategy at this time.

10.3 Target allocations to most asset classes have been achieved or exceeded but achieving target allocations for private market assets continues to be a challenge. It is therefore proposed that the following commitments are made to Brunel's cycle three private markets' portfolios:

- Private Equity - £60M
- Infrastructure - £60M
- Private Debt - £0M
- Secured Income - £0M

11. Funding Update

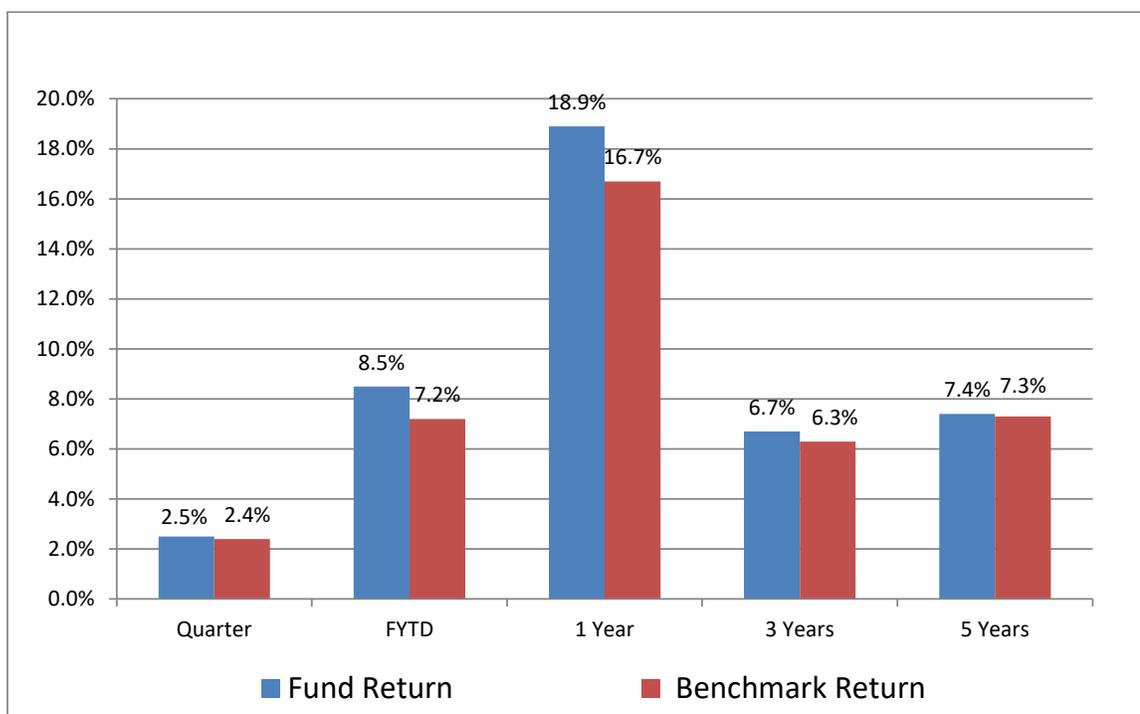
11.1 The pension fund's actuary, Barnett Waddingham, undertakes a full assessment of the funding position every three years. This was last completed as at 31 March 2019 when the pension fund had a funding level of 92% i.e. assets were estimated to be 92% of the value that they would have needed to be to pay for the expected benefits accrued to that date, based on the assumptions used. The next full assessment of the funding position will be undertaken as at 31 March 2022.

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 30 September 2021 the estimated funding position was approximately 88% compared to 85% as at 31 March 2021.

11.3 The pension fund's Funding Strategy Statement (FSS) has been updated to reflect the new policies previously approved by the Committee in response to changes in regulations that extended flexibilities when dealing with exiting employers and the ability to review employer contribution rates in between valuations (see Appendix 2).

12. Investment Performance Summary

12.1 The overall performance of the pension fund's investments to 30 September 2021 is summarised below (returns for three and five years are annualised figures).



Investment Pooling

- 13.1 In accordance with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, Dorset participates with nine other LGPS funds to pool investment assets through the Brunel Pension Partnership. Brunel is wholly owned in equal shares by the ten administering authorities that participate in the pool and is authorised by the Financial Conduct Authority (FCA).
- 13.2 As at 30 September 2021, approximately 63% of the pension fund's assets were under the management of Brunel.
- 13.3 Brunel's performance report for the quarter ending 30 September 2021 is attached as Appendix 3 to this report. This 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.
- 13.4 Working with FTSE Russell, Brunel have recently launched a new series of Paris Climate Agreement aligned equity benchmarks, which enable investors to access the benefits of passively managed funds whilst also aligning themselves to Net Zero. Brunel have been asked to provide a

training session and on these new passive opportunities for members of the Committee prior to the next meeting in March 2022.

14. Performance by Asset Class and Investment Manager

14.1 The following tables summarise by asset class and investment manager the value of Assets Under Management (AUM) as at 30 September 2021 plus each investment's return compared to its benchmark for the quarter, Financial Year To Date (FYTD), one, three and five years, and Since Initial Investment (SII). All percentages quoted for periods over one year are annualised returns.

Global Equities (Brunel and LGIM)

14.2 The performance of the pension fund's global equities investments is summarised in the table below.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%	%
Brunel Global Sustainable Equities	365.5	3.6	12.3	-	-	-	15.7
MSCI AC World GBP Index		1.5	8.9	-	-	-	12.8
Excess		2.1	3.4	-	-	-	2.9
Brunel Global High Alpha Equity	274.7	1.7	11.2	25.2	-	-	23.8
MSCI World TR Index		2.6	10.5	24.0	-	-	15.7
Excess		-0.9	0.7	1.2	-	-	8.1
Brunel Smaller Companies Equities	181.6	3.9	10.3	-	-	-	11.8
MSCI World Small Cap		1.1	6.1	-	-	-	8.2
Excess		2.8	4.2	-	-	-	3.6
Brunel Emerging Market Equity	165.7	-6.5	-2.2	13.7	-	-	8.8
MSCI Emerging Markets		-5.7	-1.0	13.7	-	-	9.7
Excess		-0.8	-1.2	0.0	-	-	-0.9
LGIM Passive Developed Equities	98.7	2.2	9.9	23.7	-	-	14.4
FTSE World Developed		2.2	9.9	23.8	-	-	14.5
Excess		0.0	0.0	-0.1	-	-	-0.1
LGIM Passive Dev. Equities (Hedged)	100.9	0.4	7.9	28.8	-	-	16.6
FTSE World Developed Hedged		0.4	8.0	28.9	-	-	16.8
Excess		0.0	-0.1	-0.1	-	-	-0.2
LGIM Passive Smart Beta	146.4	1.5	7.3	22.9	8.8	-	9.3
SciBeta Multifactor Composite		1.5	7.4	23.1	9.0	-	9.5
Excess		0.0	-0.1	-0.2	-0.2	-	-0.2
LGIM Passive Smart Beta (Hedged)	146.0	-0.3	5.3	28.1	8.9	-	9.3
SciBeta Multifactor Hgd Composite		-0.2	5.4	28.1	9.1	-	9.6
Excess		-0.1	-0.1	0.0	-0.2	-	-0.3

14.3 Emerging markets lost ground over the quarter driven by negative returns in China, the largest constituent of the benchmark, driven by concerns about harsher regulation and government influence in various sectors.

UK Equities (Brunel, LGIM and Schroders)

14.4 The performance of the pension fund's UK equities investments is summarised in the table below.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%	%
Brunel UK Active Equity	179.5	2.5	7.8	25.2	-	-	5.5
FTSE All Share ex Investment Trusts		2.2	7.9	27.4	-	-	5.2
Excess		0.3	-0.1	-2.2	-	-	0.3
LGIM Passive UK Equities	115.9	2.3	8.0	28.2	3.2		2.5
FTSE All Share		2.3	7.9	27.9	3.1	-	2.4
Excess		0.0	0.1	0.3	0.1	-	0.1
Schroders UK Small Cap	82.8	1.4	10.7	53.6	12.1	15.3	11.6
FTSE Small Cap Ex Investment Trusts		2.6	13.5	72.4	11.0	10.2	7.9
Excess		-1.2	-2.8	-18.8	1.1	5.1	3.7

14.5 Please note that in addition to these UK specific holdings the pension fund may also be exposed to UK equities through its holdings in global equities funds.

Fixed Income (Royal London and Brunel)

14.6 The performance of the pension fund's fixed income investments is summarised in the table below.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%	%
Royal London Corporate Bonds	198.1	-0.2	3.0	3.2	7.1	4.8	8.2
iBoxx Sterling Non Gilts > 5 Years		-1.4	0.9	-1.1	5.6	3.1	7.8
Excess		1.2	2.1	4.3	1.5	1.7	0.4
Brunel Multi Asset Credit	173.4	0.6	-	-	-	-	0.8
SONIA + 4%		1.0	-	-	-	-	1.4
Excess		-0.4	-	-	-	-	-0.6

14.7 Further information on the performance of Royal London is included in Appendix 4.

Diversifying Returns (Brunel)

14.8 The performance of the pension fund's investment in diversifying returns funds is summarised below.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%	%
Brunel Diversifying Returns Fund	241.2	0.6	6.4	8.4	-	-	6.1
SONIA		0.0	0.0	0.1	-	-	0.1
Excess		0.6	6.4	8.3	-	-	6.0

Property (CBRE)

14.9 The performance of the pension fund's property investments managed by CBRE is detailed in Appendix 5 and summarised below.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%	%
CBRE / Property	283.7	3.2	6.9	9.3	3.8	5.5	7.3
MSCI UK All Properties (Quarterly)		4.1	5.2	10.7	3.2	5.4	7.0
Excess		-0.9	1.7	-1.4	0.6	0.1	0.3

14.10 In addition to the assets under the management of CBRE, the pension fund also has holdings valued at £42M in secured long income property funds under the management of Brunel (see Secured Income below).

Private Equity (HarbourVest, Aberdeen Standard and Brunel)

14.11 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 and the valuation as at 30 September 2021.

<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	104.1	84.8	81%	97.5	74.6
Aberdeen Standard	75.1	71.4	95%	78.3	22.5
Brunel	60.0	19.6	33%	1.9	23.5
Total	239.2	175.8	74%	177.7	120.6

14.12 The table below summarises performance to date for the pension fund's two legacy managers, HarbourVest and Aberdeen Standard, and Brunel.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
Harbourvest / Private Equity	74.6	13.0	16.2	67.2	29.3	24.4	14.6
FTSE All Share		2.2	8.0	27.9	3.0	5.4	5.6
Excess		10.8	8.2	39.3	26.3	19.0	9.0
Aberdeen Standard / Private Equity	22.4	12.4	16.2	19.2	9.6	10.6	4.4
FTSE All Share		2.2	8.0	27.9	3.1	5.4	5.9
Excess		10.2	8.2	-8.7	6.5	5.2	-1.5
Brunel Private Equity	23.5	19.7	33.3	33.5	-	-	27.2
MSCI AC World Index		1.5	8.9	22.7	-	-	16.3

14.13 The benchmark used for HarbourVest and Aberdeen Standard is the FTSE All Share index. However, as the investments are held in US dollars and Euros, currency movements can contribute to volatility in relative performance.

Infrastructure (Federated Hermes and IFM)

14.14 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 at the benchmark for these investments.

14.15 Performance for both managers is summarised in the table below, and in addition there is a separate presentation from Federated Hermes on the agenda to understand their performance in more detail.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
Federated Hermes / Infrastructure	95.4	1.6	2.0	4.6	3.7	5.5	6.6
10% Absolute Return		2.5	5.0	10.0	10.0	10.0	10.0
Excess		-0.9	-3.0	-5.4	-6.3	-4.5	-3.4
IFM / Infrastructure	122.6	6.3	14.1	15.9	9.7	12.3	13.5
10% Absolute Return		2.5	5.0	10.0	10.0	10.0	10.0
Excess		3.8	9.1	5.9	-0.3	2.3	3.5

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

14.17 In addition to the assets under the management of Federated Hermes and IFM, the pension fund also has holdings valued at £17M in infrastructure funds under the management of Brunel (see Secured Income below).

Secured Income (Brunel)

14.18 The performance of the pension fund's investments in Brunel's Secured Income is summarised below.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
Brunel Secure Income	60.0	3.5	6.5	10.7	-	-	5.2
CPI		1.0	2.8	3.0	-	-	1.8
Excess		2.5	3.7	7.7	-	-	3.4

14.19 The portfolio consists of long lease property funds and operating infrastructure funds, with a focus on long term, secure income s

Liability Driven Investment (LDI) (Insight Investment)

14.20 A proportion of the pension fund's assets are held in an inflation hedging strategy, managed by Insight Investment. These assets are not held to add growth, but to match the movements in the pension fund's liabilities.

14.21 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 30 September 2021 11.8% of the pension fund's assets were invested in the mandate but 30% 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 £30M.

14.22 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 pension 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.

14.23 The performance of the manager is detailed in Appendix 6 and summarised below.

Manager / Investment	AUM	Qtr	FYTD	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%	%
Insight Liability Driven Investment (LDI)	427.7	9.8	12.2	22.4	5.1	5.4	9.9
Manager Supplied Benchmark		10.0	12.4	21.9	5.2	4.1	8.9
Excess		-0.2	-0.2	0.5	-0.1	1.3	1.0

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.