

Pension Fund Committee

13 June 2023

Pension Fund Investment Strategy Review For Decision

Local Councillor(s): All

Executive Director: A Dunn, Executive Director, Corporate Development

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Report Status: Public

Brief Summary:

Following the conclusion of the latest triennial actuarial valuation of the pension fund's assets and liabilities as at 31 March 2022, investment consultants, Mercer, were engaged to review the pension fund's investment strategy.

The current investment strategy was agreed by the Committee in September 2020, subsequently amended in November 2022 following the decision to terminate the LDI mandate (12% of total assets) and reinvest the sale proceeds in global equities (7%) and fixed income (5%).

After extensive modelling and consideration of a number of alternative strategies, Mercer concluded that the current investment strategy is relatively efficient with no compelling reason to make changes. Mercer estimate that the current asset allocation has a 58% probability of achieving the annual investment return rate of 4.9% used by the actuary to discount liabilities to their present value (compared to a 40% probability of meeting the then discount rate of 5.0% at the last review in 2020). It is therefore recommended that the revised target asset allocation is based on actuals at 31 March 2023 (see paragraph 1.1).

Although Mercer do not propose any change to the total allocation to equities, they do believe that there is scope to reduce the complexity of the pension fund's equity portfolio (see paragraph 2.1). It is recommended that a further review of the 'mix' of equity investments is undertaken to see whether the portfolio can be

rationalised. [This review would also take into consideration the scope for further alignment with climate emergency declarations by Dorset Council, BCP Council and other scheme employers without sacrificing returns or increasing risk.]

Mercer also conclude that they are supportive of the current policy to hedge 50% of the pension fund's foreign currency exposure across its global equities investments.

Recommendation:

That the Committee:

- i. agree the proposed investment strategy and strategic asset allocation.
- ii. agree a further review of the equity investments portfolio be undertaken.
- iii. authorise officers to update the pension fund's Investment Strategy Statement (ISS) as necessary.

Reason for Recommendation:

To ensure that the pension fund has the most efficient and effective investment strategy with respect to risk-adjusted return and the funding position.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require administering authorities of LGPS funds to formulate and to publish a statement of its investment strategy, in accordance with guidance issued from time to time by the Secretary of State. This statement must be reviewed by the administering authority at least every three years, or more frequently should any significant change occur.

1. Strategic Asset Allocation

1.1 The table below sets out (1) the target allocation agreed by the Committee September 2020, (2) the revised target allocation after the decision November 2022 to disinvest from LDI, (3) the actual allocation as at 31 March 2023, and (4) the proposed new target allocation.

<u>Asset Class</u>	<u>Sep-20</u> <u>Target</u>	<u>Nov-22</u> <u>Target</u>	<u>Mar-23</u> <u>Actual</u>	<u>Jun-23</u> <u>Target</u>
UK Equities	10.0%	10.0%	8.8%	9.0%
Global Equities	35.0%	42.0%	44.6%	45.0%
Emerging Markets Equities	5.0%	5.0%	4.0%	4.0%
<i>Total Listed Equities</i>	50.0%	57.0%	57.4%	58.0%
Corporate Bonds	4.0%	6.5%	6.5%	6.5%
Multi Asset Credit	5.0%	7.5%	6.6%	6.5%
Diversified Returns	6.0%	6.0%	6.7%	7.0%
Infrastructure	8.0%	8.0%	7.9%	8.0%
Private Equity	5.0%	5.0%	3.9%	5.0%
Property	10.0%	10.0%	8.6%	9.0%
Cash	0.0%	0.0%	1.7%	0.0%
F/X Hedging	0.0%	0.0%	0.2%	0.0%
Total Return Seeking Assets	88.0%	100.0%	99.5%	100.0%
Liability Matching Assets	12.0%	0.0%	0.5%	0.0%
Total Asset Valuation	100.0%	100.0%	100.0%	100.0%

2. Listed Equities

2.1 The table below summarises the pension fund's equity holdings as at 31 March 2023.

	AUM	AUM
	£m	£m
UK Equities:		310.0
Brunel UK Active Equity	184.9	
LGIM Passive UK Equities	125.1	
Global (Developed) Equities:		1,567.6
Brunel Global Sustainable Equities	347.7	
Brunel Global High Alpha Equity	269.9	
Brunel Smaller Companies Equities	225.5	
LGIM Passive Developed Equities	102.5	
LGIM Passive Dev. Equities (Hedged)	97.4	
LGIM Passive Dev. Equities PAB*	54.3	
LGIM Passive Dev. Equities PAB* (Hedged)	54.4	
LGIM Passive Dev. Equities CTB**	54.3	
LGIM Passive Dev. Equities CTB** (Hedged)	54.3	
LGIM Passive Smart Beta	159.4	
LGIM Passive Smart Beta (Hedged)	147.9	
Emerging Markets Equities:		142.2
Brunel Emerging Market Equity	142.2	
Total Equities	2,019.8	2,019.8

*PAB – Paris Aligned Benchmark

**CTB – Climate Transition Benchmark

3. Financial Implications

8.1 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.

8.2 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.

8.3 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 the returns on contributions invested prior to benefits becoming payable.

8.4 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.

4. **Climate Implications**

9.1 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.

9.2 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.

9.3 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 2023, the value of the pension fund's indirect investments in companies primarily involved in the exploration, production, mining and/or refining of fossil fuels was estimated at approximately £66M (1.8% of total investment assets).

5. **Well-being and Health Implications**

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

6. **Other Implications**

11.1 No other implications arising from this report have been identified.

7. **Risk Assessment**

12.1 The risks associated with the pension fund's investments are assessed in detail and considered as part of the strategic asset allocation. The pension fund's Investment Strategy Statement requires all external investment managers to consider and manage all financially material risks.

8. **Equalities Impact Assessment**

13.1 There are no equalities implications arising from this report.

9. **Appendices**

Appendix 1: Investment Strategy Review (Mercer)

15. **Background Papers**

Investment Strategy Statement (December 2020)

Funding Strategy Statement (June 2023)