Nottinghamshire County Council

Report to Pension Fund Committee

11 March 2021

Agenda Item: 8

REPORT OF SERVICE DIRECTOR – FINANCE, INFRASTRUCTURE & IMPROVEMENT

WORKING PARTY

Purpose of the Report

1. The Pension Fund Working Party meets twice a year or additionally where circumstances require and is open to all Pension Committee Members to attend. The purpose of the Working Party is to discuss key issues in more detail and to make recommendations to Pension Fund Committee. This report sets out details of the items discussed at the most recent meeting on 26 January 2021 and makes recommendations as follows.

    1) Move to the long term Strategic Asset Allocation (SAA)
    2) Make a 5% allocation to sustainable mandate when available
    3) Set a standard agenda item at the annual SAA review to monitor climate change science developments
    4) Add consideration of a reduction in the UK listed equity allocations to 35% to the Work Plan for the July Committee meeting
    5) Add 4% small cap allocation to Schroders benchmark and consolidate small cap under this mandate
    6) Formalise a 65/35 active/passive principle for listed equities
    7) Increase SAA Private Equity allocation to 6.5%
    8) Change the liabilities benchmark to the actuarial return target

Information and Advice

2. The Working Party met on 26 January 2021. The agenda and attendees are listed in Appendix A, and details of the discussions and recommendations for each item are set out below.

Strategic Asset Allocation

3. The Working Party considered a report from William Bourne, independent adviser to the fund.

4. The Fund reviews its strategic asset allocation (“SAA”) annually to ensure it is appropriate. In the last 12 months there has been a significant change in market dynamics following COVID-19. The Fund has also accepted the recommendations made by the Climate Risk Analysis presented by LGPS Central (“CRA”) which reviewed how to mitigate risks posed by climate

change. The report reviewed the Fund’s SAA in the light of both these and made the following recommendations.

Recommendation 1 - Move to long term SAA

5. The long term SAA was set two years ago with the expectation that movement towards it would take a number of years. This long term strategic asset allocation is still considered appropriate and the target allocation for 2021 will be the long term SAA.

Recommendation 2. Consider an allocation to a sustainable mandate when available within LGPS Central, funded from passive equities amounting to 5% of AUM.

6. In this context sustainable is defined more broadly than just climate change to include investments which are actively looking to find solutions to the planet’s environmental and social problems. This will reduce overall fossil fuel exposure.

Recommendation 3. Create a standing agenda item at the annual Working Party reviewing the SAA to consider developments in climate change science and carbon scoring.

7. If climate change accelerates, more actions may be necessary to mitigate the financial risk. If carbon scoring becomes more robust, it may be possible to place more reliance on it when allocating. LGPS Central should be asked to present a report on climate change science developments as part of their annual training on climate change.

8. This recommendation implements part of the Climate Risk Action Plan.

Recommendation 4. Consider a reduction to UK equity allocation of 35% of listed equity holdings – decision deferred to the July meeting.

9. The Independent Adviser recommended reducing the UK equity allocation to 35% of listed equity holdings. This would result in the Schroders benchmark changing to 40% UK and the Core Index reducing to about 35% UK. Although the allocation within Schroders and the Core Index portfolios is each 50% currently, the equity investments held through LGPS Central and in the Specialist portfolio mean the UK holdings at the time of discussion actually amounted to 43% in the UK so the proposed allocation is a lower change than it might at first appear.

10. This recommendation generated much discussion during the meeting. Members were concerned that the UK equity market was particularly depressed and the impact of Covid, Brexit and a new US president remained to be seen. It was felt that this this was not the right time to be considering a significant change to our UK weighting and requested that this decision is considered at the July meeting.

Recommendation 5. Introduce 4% Small Cap weighting into Schroders benchmark (£70m) and consolidate small cap under this mandate.

11. Previously we had an allocation of 3% of AUM, which would be around £160m. Only £56m of this has been invested and conversations with LGPS Central indicate that a fund through them is not viable. Schroders could manage a small cap allocation for us as part of their mandate. Bearing in mind that a sustainable mandate as per Recommendation 2 is likely to have a small cap bias and RWC’s portfolios will have some small cap exposure, an allocation of £70m is recommended. This amounts to 1.3% of AUM, 2.9% of total listed equities.

Recommendation 6. Formalise a 65%/35% active/passive allocation principle for listed equities.

12. This will balance the need to invest sustainably and to keep the Fund’s costs low.

Recommendation 7 – increase Private Equity SAA target allocation to 6.5% and reduce the developed markets listed equity target allocation to 45.5%. Conduct a review of the Private Equity portfolio.

13. This is a minimal change to the Private Equity allocation, but will enable continued commitment in the next year to Private Equity which is currently fully committed but awaiting drawdown. It is sensible to continue to commit to new vintages, as one of the important principles of investing in private equity is to invest across a wide spread of vintages.

Recommendation 8 - Use the actuarial return target as the liabilities benchmark.

14. The liabilities benchmark is intended to monitor the portfolio's overall asset return compared to the change in liabilities. It currently consists of the UK Gilts IL > 5 Yrs index. The reason for this is that long ago the discount rate used to derive a present value for future liabilities was based on gilts. Today gilts and corporate bonds only form 11% of the portfolio, and the actuary calculates the discount rate from the yield differently. In setting the asset target return, the actuary then makes an allowance, currently 1%, for prudence. At present, as per the 2019 Actuarial Valuation and the 2020 Investment Strategy Statement, the discount rate is 4.8% and the return target 5.8%. It is proposed that this target return figure (which will change on 1 April a year after each triennial valuation) is set as the liabilities benchmark.

Summary

15. The following table shows the current and proposed high level strategic asset allocations

Table 1

Outcome	Asset Classes	30/09/2020 portfolio %	Long term SAA %	Proposed 2021 target %	Range %
Growth	Listed and Private equity	62.4	60.0	60.0	57.5-67.5
Income and inflation protection	Property, Infrastructure	18.3	23.0	23.0	15-30
Income only	Fixed Income	9.1	10.0	10.0	5-15
Inflation protection only	Index Linked, Kames DGF	3.8	5.0	5.0	3-15
Liquidity	Cash, Kames short term	6.4	2.0	2.0	0-10

Climate Risk training

10. Climate risk training was provided by LGPS Central.

Statutory and Policy Implications

16. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and

where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATIONS

It is recommended that Committee

1) Move to the long term Strategic Asset Allocation (SAA)
2) Make a 5% allocation to sustainable mandate when available
3) Set a standard agenda item at the annual SAA review to monitor climate change science developments
4) Add consideration of a reduction in the UK listed equity allocations to 35% to the Work Plan for the July Committee meeting.
5) Add 4% small cap allocation to Schroders benchmark and consolidate small cap under this mandate
6) Formalise a 65/35 active/passive principle for listed equities
7) Increase SAA Private Equity allocation to 6.5%
8) Change the liabilities benchmark to the actuarial return target

Nigel Stevenson
Service Director for Finance, Infrastructure & Improvement and Section 151 Officer

For any enquiries about this report please contact: Tamsin Rabbitts

Constitutional Comments (KK 15/02/2021)

The proposals in this report are within the remit of the Nottinghamshire Pension Fund Committee.

Financial Comments (TMR 11/02/2021)

The financial implications are noted in the report.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

- None