Avon Pension Fund

Local Government Pension Scheme

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To: Scheme Employers

Date: 10 July 2020

Dear Employer,

Consultation on the Investment Strategy Statement 2020

As the Fund's investment strategy underpins the funding strategy, and is therefore of significant importance to our employers, we are inviting you to review our draft Investment Strategy Statement and provide us with feedback prior to the Pension Committee approving the final version at its next meeting in September. This letter sets out the background and context of the consultation.

Introduction

1. Under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, the Fund must review its Investment Strategy Statement (ISS) at least once every three years. We do this following the triennial valuation and a fundamental review of our Strategic Asset Allocation.
2. The Regulations also require that we consult all interested parties on the content of the revised Statement. This document sets out the context for this statutory consultation, highlighting the main changes to the Investment Strategy Statement and the key issues that were discussed by the Avon Pension Fund Committee during the strategic review in 2019/20 and at its meeting on 26 June 2020 when the draft ISS was agreed for consultation.
3. We would appreciate if you can submit your comments by 12 August 2020 to AvonPF_Investments@bathnes.gov.uk

Main Revisions to the Investment Strategy Statement

4. The ISS sets out how the Fund will achieve its primary strategic objective of paying the pensions due over time. This entails balancing the risk within the portfolio between generating returns and protecting capital, recognising its responsibility as a shareholder/investor and how it can contribute to resolving materially financial global issues and at the same time ensuring it maintains affordability for employers. As a consequence, the strategy includes significant investment risk mitigated where we think is optimal to protect capital and the funding plan. We acknowledge it is difficult to achieve all the differing aspirations and objectives of our stakeholders; the strategy includes those that are aligned with the primary objective and where they do not increase the risk to the Fund.

Data Protection: Avon Pension Fund is a Data Controller under the General Data Protection Regulations. We store, hold and manage your personal data in line with statutory requirements to provide you with pension administration services. For more information about how we hold your data, who we share it with and what rights you have to request information from the Fund, visit www.avonpensionfund.org.uk/privacy-notice

5. The main areas of change are changes to the asset allocation and the setting of climate objectives. The strategic asset allocation has been updated as follows:

   a) Increase allocation to Sustainable equities to 10%

   b) Increase allocation to Renewable Infrastructure to 5%

   c) Increase allocation to Secured Income to 10%

   d) New allocation to Private Debt of 5%

   These changes were made to address the climate emergency (a & b) and to provide more income generation and diversification (c &d).

6. The revised strategy builds on the Responsible Investing approach the Fund has adopted and the existing allocations to Low Carbon Global Equities and Renewable Infrastructure. There was extensive debate as to the optimal strategy during the 2019/20 strategic review across the four committee workshops, one of which was devoted to the impact of Climate Change on the assets. The Committee was advised throughout by Mercers with Brunel explaining their approach to managing ESG and climate change considerations.

7. The setting of explicit targets for reducing the carbon intensity of the portfolio and increasing the exposure to more sustainable investments reflects the Committee's belief that climate change presents a material financial risk to the Fund's assets and managing this risk is consistent with the over-arching fiduciary duty of the Fund to the scheme members.

8. The investment strategy takes the Paris Agreement on Climate Change as its guiding principle (as this will be regularly updated to reflect progress, or not, globally), with the aim that over time all investments are consistent with the goals of the Paris Agreement. Consequently, there is a commitment to invest in a $<2^0$C aligned portfolio with net zero emissions by 2050 or earlier. At the next strategic review in 2022, and ahead of the next Paris Stocktake, using work currently being undertaken by the industry, we expect to have greater understanding of what 2^0C asset portfolios should look like and will reassess this target at that point.

9. In addition, we aim to reduce the carbon intensity of the portfolio over time with the aim of being 30% less carbon intensive by 2022 and to invest at least 30% of the total assets in sustainable and low carbon investments by 2025. Lastly, we are increasing the investments in climate change mitigation e.g. renewable infrastructure.

10. The Fund aims initially to reach these targets without the need for blanket divestment decisions, but to follow a policy of engagement and select divestment where companies are clearly not on a path to be aligned with the Paris Agreement. Our policy supports a Just Transition, seeking to manage the societal and economic impacts of the transition to a low carbon economy.

11. The Fund supports wider advocacy of governments and agencies to bring in policy change consistent with the aims of the Paris Agreement such as the mandating of the Taskforce on Climate-Related Financial Disclosures Template and the removal of fossil fuel subsidies. We will do this by collaborating with organisations such as the IIGCC and LAPFF.

12. The Statement embeds the Risk Management Strategies within the overall investment strategy. These strategies are designed to provide greater certainty of investment outcome which in turn will help stabilise and minimise contribution levels for employers. There will always be a cost to having protection in place and this is considered within the context of market outlook and the funding position.

13. In respect of the pooling arrangements with Brunel, the transition of assets to Brunel is updated but there are no substantive changes. The Statement is clear that all future investments should be through Brunel wherever possible.

14. Similarly, the Statement has been updated to reflect the role of Brunel in managing the engagement with the underlying companies and in exercising the voting rights in respect of our investments. This is more important now to the Fund as Brunel manages an increasing percentage of our assets.

Main Issues Discussed by the Committee

15. The strategy to address climate change provides a clear direction of travel in terms of goals, with shorter term milestones to ensure the approach is reviewed as both the transition itself and investment opportunities evolve.

16. Acknowledgment that further work is required to develop robust metrics to assess performance of the climate objectives including the success of the engagement strategy and to determine the extent to which investment portfolios were aligned with the Paris Agreement.

17. The Committee agreed to allocate 10% of the assets to sustainable equities in addition to the 10% already invested in Low Carbon Equities. However, their long-term ambition is for all equities to be invested on a sustainable or low carbon basis. Further work however needs to be done to analyse the impact on the risk and return profile; one factor is that the Brunel is still in the process of launching its Sustainable Equities portfolio and understanding the dynamics of this portfolio is necessary before increasing any allocations.

18. The other main consideration was liquidity and the appropriate level of less liquid investments given the Fund's maturity profile. The new strategic benchmark increases the allocation to less liquid assets by 10% (5% in Private Debt and 2.5% each to Infrastructure and Secured Income). The Fund could have withstood a further 15-20% investment in such assets. These investments will be funded partially from core property, Hedge Funds and Diversified Growth Funds. However, given the current impact on markets from the COVID-19 pandemic, the commitments will be phased in more gradually than would have been otherwise.

Consultation Reponses

19. The Committee would welcome general comments on the content of the Investment Strategy Statement. Specific issues that employers may wish to consider include:

    a) Whether you think that the strategy will enable employers to sustain contributions at their present levels or do you think the Fund should take on more risk in an effort to reduce potential contributions?

b) Would you be prepared to pay for a more aggressive divestment approach or do you support the Paris alignment and the rationale of a ‘Just Transition’ approach?

c) Do you think the Fund is overly diversified and if so why?

d) Do you think that the Fund is too heavily invested in illiquid assets and if so why?

e) What do you think the key risk is to the Fund’s investment objectives and how do you think it should be addressed?

I would like to thank you in advance for taking time to participate in this consultation and providing feedback to the Avon Pension Fund Committee.

Yours sincerely,

Liz Woodyard
Group Manager - Funding, Investments & Risk
Avon Pension Fund