

CLWYD PENSION FUND COMMITTEE

Date of Meeting	Wednesday, 25 November 2020
Report Subject	Asset Pooling and WPP Annual Updates
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

The purpose of this report is to provide an update on the work undertaken on behalf of the Wales Pension Partnership (WPP) with pooling investments in Wales and recommends further assets to be transitioned to the WPP from the Clwyd Pension Fund.

There has not been a Joint Governance Committee (JGC) since our last Committee on 7 October 2020 but the WPP has published their first Annual report (Appendix 1) which summarises the excellent progress made since inception.

The Committee will receive the annual presentation from the Operator and Investment Management Solution provider for the WPP. This will include:

1. A reminder of their roles and a brief summary of progress and performance
2. Performance of the WPP Global Equity Opportunities Fund (Appendix 2)
3. Background to the WPP Emerging Markets Equity Fund (Appendix 3)
4. Future work plan

This report includes the views of Mercer on the performance of the WPP Global Equity Opportunities Fund and their advice on supporting the recommendation to invest into the WPP Emerging Market Equity Fund.

The Head of Clwyd Pension Fund and Deputy continue to assist the Host Authority (Carmarthenshire County Council) and the WPP Oversight Adviser (Hymans Robertson) with their respective roles, as well as representing the interests of the Clwyd Pension Fund on the Officer Working Group. The next JGC is planned for 10th December 2020.

RECOMMENDATIONS

1.	That the Committee receive the presentation from the WPP Operator and Investment Manager.
2.	That the Committee discuss the outcome of the presentation and agree any comments or questions for WPP.
3.	That the Committee ratify the decision to invest in the Wales Pension Partnership Emerging Market Equity Fund, which will be funded from the current mandates with Wellington Management and BlackRock.
4.	That, in accordance with the reserved matter requirements of the Inter Authority Agreement regarding the timing of the transition, the Committee agree that these assets should be transitioned and delegate the specific timing to the Clwyd Fund officers on the Officer Working Group (OWG), after considering advice from a specialist transition manager.
5	That the Committee note the WPP Annual Report

REPORT DETAILS

1.00	Pooling Investment in Wales
1.01	<p>WPP Annual Report</p> <p>There has not been a Joint Governance Committee (JGC) meeting since the last Clwyd Pension Fund Committee on 7 October 2020. However, WPP has published its first Annual Report, which is attached as Appendix 1. The report includes:</p> <ul style="list-style-type: none">• Background to Pool Management• Reference to various Governance Policies• Statement of Accounts• Investment Performance• Pooling Costs and Savings <p>The Clwyd Pension Fund and Flintshire County Council are referred to in the Annual Report, including providing apologies for two of the JGCs.</p> <p>The consideration of scheme member representation at JGC is planned as an agenda item for the next JGC on 10 December 2020.</p>
1.02	<p>Performance of WPP Global Equity Opportunities Fund</p> <p>The performance of the WPP Global Equity Opportunities Fund since inception in February 2019 is included in Appendix 1. Russell Investments, the Investment Management Solutions Provider for WPP, and in this case the Investment Manager for this sub fund, will present their view on the reasons for</p>

	<p>the performance of the fund at Committee.</p> <p>The Clwyd Pension Fund has a strategic allocation of 5% or circa £100m invested in this fund. Performance since inception is marginally above benchmark but behind target.</p> <p>The Clwyd Pension Fund Investment Consultant, Mercer considers the performance of the WPP portfolio as reasonable since inception. Since the portfolio was launched just over 18 months ago, Global Equity markets have seen significant volatility. In February and March 2020, volatility in markets was at its highest levels since records began due to the impact of COVID 19. Against this background for the portfolio to marginally outperform, its benchmark is pleasing. Mercer would expect the portfolio to build on this in coming months and years and strive to achieve performance levels in line with target of 2% in excess of the benchmark index.</p> <p>Mercer would consider that the period since inception is too soon to be formally judging the strategy and would normally want a track-record of at least 3 years before making an assessment on its effectiveness. Currently there are not considered to be any concerns in the management of the portfolio.</p>
1.03	<p>Proposed WPP Emerging Market Equity Fund</p> <p>The background to the WPP Emerging Market Equity Fund is included in Appendix 2. Russell Investments, who will be the investment manager for this fund, will present their approach to managing this fund to Committee.</p> <p>The approach is similar to that for the Global Equity Opportunities Fund and uses several emerging market equity fund managers with various styles and a China equity specialist to manage risk and return. The estimated out – performance target above the benchmark is 2% gross of fees. The management fee, including an estimate for underlying managers and Russell fees as investment manager including managing a 25% carbon reduction compared with benchmark, is 40bps. The underlying fund managers are not quoted as fee negotiations are ongoing but both fund officers and Mercer are aware of the proposed fund managers.</p> <p>Whilst these fees are still proposals at this stage, they would enable the Clwyd Fund to make significant savings when compared to the current arrangements. Moving the current mandates from Wellington and BlackRock would potentially save the Fund around £500,000 per annum in fees.</p> <p>The fund is currently receiving authorisation from the FCA and should be available to receive monies in May 2021.</p> <p>Although fund officers on the WPP Officer Working Group (OWG) have been involved in the development of this fund a view has also been sought from Mercer.</p> <p><u>Mercer View</u></p> <p>Mercer have assessed the structure and proposed manager roster for the Emerging Market Equity Fund and reached a number of conclusions.</p> <p>Portfolio structure – The proposed structure includes a range of investment style factors, and as such, the portfolio is considered well diversified. It is noted</p>

	<p>that there is no exposure proposed to low volatility strategies.</p> <p>Proposed manager roster – Mercer’s manager research team covers all of the proposed managers, however it does not maintain coverage of three of the names currently. It is to be recognised that the very nature of Pooling delegates investment manager selection to the Pool. As such, whilst Mercer may have different views on individual managers, they are comfortable that the proposal is reasonable and assess the underlying investment capability as OK/Fair.</p> <p>ESG – Mercer also assess Environmental Social and Governance capabilities of investment managers. The Mercer view of the proposed managers is aligned to that of Russell. The view is that overall ESG integration is fair to good, with room for improvement in some investment managers.</p> <p>Risk/return expectations - Mercer consider that the proposed diversified portfolio is likely to optimise the risk taken within the portfolio, and are comfortable that the Russell assumptions in this area are reasonable. There was some concern, however that the level of diversification was likely to impact on the ability to achieve the anticipated level of outperformance.</p> <p>Fees – The proposed level of fees look very attractive, particularly given that all of the proposed strategies are using active management. Mercer recognise that Pooling, and the size of the proposed fund, has enabled a reduction in fees, however the proposal still generates significant savings for the Clwyd Fund.</p> <p>In conclusion, Mercer have not identified any “red flags” in the proposal and conclude that the fund is appropriate to deliver the Fund’s strategic objectives. The managers proposed offer suitable diversity, and there is a good level of comfort that the proposed fees are competitive and will offer the Fund good value and achieve significant savings. The level of volatility within the proposed diversified portfolio is acceptable; however, there are some concerns about the potential to deliver the levels of outperformance being stated.</p> <p>Overall Mercer is comfortable that the proposal is suitable for the Clwyd Fund, and are supportive of the assets being transitioned from the existing Emerging Market Equity managers, as proposed, in May 2021.</p>
1.04	<p>Emerging Market Equity Transition</p> <p>The last investment strategy review (concluded in February 2020) increased the Clwyd Fund’s strategic asset allocation to Emerging Market Equity from 6% to 10%. The original allocation of 6% has been managed by Wellington Management since 2006. The Clwyd Fund invests in two Wellington funds, designed to access different aspects of Emerging Market Equity (Emerging Markets Equity Fund and Emerging Market Local Equity Fund). Although both funds have added value since inception, neither have achieved their performance targets of benchmark +1%, and benchmark +2% respectively. The investment management fee which was competitive at the time of appointment is expensive in today’s market. If it were not for pooling this mandate would have been under closer review and possible change. Hence, our investment consultant recommended that the additional allocation of 4% was invested on a temporary basis with BlackRock and managed on a passive</p>

	<p>basis until a pooling solution was available and this was implemented in July 2020.</p> <p>In Mercer’s view an allocation to Emerging Market Equity should be managed actively for a number of reasons:</p> <ul style="list-style-type: none"> • Ability of “stock-pickers” to identify opportunities is greater as markets are not as transparent as developed countries. • The performance of different countries and stocks varies greatly, and therefore provides opportunities. Countries within the index are at different stages of development, which gives very wide spread of returns across countries and stocks. • It is simpler to integrate ESG factors when investing actively, as it is easier to avoid those investments that have questionable corporate governance standards. • Historically it is possible for active managers to outperform consistently the benchmark index. Data shows that in the five-year period to December 2019, two thirds of active managers outperformed passive investments (net of fees). <p>When the suitable alternative is available via the WPP, the Committee are asked to ratify the decision to invest in the Wales Pension Partnership Emerging Market Equity Fund, which will be funded from the current mandates with Wellington Management and BlackRock. The value of assets (as at 30 September 2020) to transfer is £202.2M (circa 10% of the total Fund).</p> <p>In accordance with the reserved matter requirements of the Inter Authority Agreement regarding the timing of the transition, the Committee need to agree that these assets should be transitioned and delegate the specific timing to the Clwyd Fund officers on the Officer Working Group (OWG) after considering advice from a specialist transition manager</p>
1.05	<p>Future Work Plan</p> <p>Officers and Mercer are currently working closely with Russell on the development of further sub funds in Private Credit, Property and Infrastructure, and updates will be given to the Committee when available.</p>

2.00	RESOURCE IMPLICATIONS
2.01	<p>The costs of the Host Authority and advisors appointed on behalf of the eight funds to assist with the implementation process are being shared equally between the eight WPP LGPS funds and are included in the 2020/21 budget. The estimated Operator costs are also included within that budget. There will also be transition costs to move the assets from Wellington Management and BlackRock to the WPP ACS and fund management fees payable as outlined in the report.</p>
2.02	<p>There has been considerable time allocated by the Head and Deputy Head of Clwyd Pension Fund on WPP matters which has affected time available for other Fund matters. This is expected to continue for the foreseeable future</p>

	and may result in greater reliance on external advisers for other matters than would otherwise be the case.
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3.00	CONSULTATIONS REQUIRED / CARRIED OUT
3.01	None.

4.00	RISK MANAGEMENT
4.01	<p>How the Wales Pension Partnership operates will be key in enabling the Fund to implement its investment strategy in the future. If performance is not in line with the assumptions in our strategy, it will impact on the cost of the scheme to employers at future Actuarial Valuations. In addition, further guidance on pooling is expected from MHCLG in 2020 and the implications of that guidance are not yet known.</p> <p>Given these points, this risk continues to be categorised as significant in the Fund's risk register.</p>

5.00	APPENDICES
5.01	<p>Appendix 1 – WPP Annual Report Appendix 2 – WPP Global Equity Opportunistic Fund Appendix 3 – WPP Emerging Market Equity Fund.</p>

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	<ul style="list-style-type: none"> • Earlier Committee reports on the progress of the WPP. • The Wales Pension Partnership Inter-Authority Agreement. <p>Contact Officer: Philip Latham, Head of Clwyd Pension Fund Telephone: 01352 702264 E-mail: philip.latham@flintshire.gov.uk</p>

7.00	GLOSSARY OF TERMS
7.01	<p>(a) The Fund – Clwyd Pension Fund – The Pension Fund managed by Flintshire County Council for local authority employees in the region and employees of other employers with links to local government in the region</p> <p>(b) Administering authority or scheme manager – Flintshire County Council is the administering authority and scheme manager for the Clwyd Pension Fund, which means it is responsible for the management and stewardship of the Fund.</p>

- (c) **The Committee – Clwyd Pension Fund Committee** - the Flintshire County Council committee responsible for the majority of decisions relating to the management of the Clwyd Pension Fund
- (d) **LGPS – Local Government Pension Scheme** – the national scheme, which Clwyd Pension Fund is part of
- (e) **Inter-Authority Agreement (IAA)** – the governance agreement between the eight Wales pension funds for purposes of pooling
- (f) **Wales Pension Partnership (WPP)** – the name agreed by the eight Wales pension funds for the Wales Pool of investments
- (g) **The Operator** – an entity regulated by the FCA, which provides both the infrastructure to enable the pooling of assets and fund management advice. For the Wales Pension Partnership, the appointed Operator is Link
- (h) **Value investing** - a broad description of various investment strategies that seek to pick stocks that appear to be trading for less than their intrinsic value (or are ‘cheap’ based on their fundamentals).
- (i) **Quality Growth** - investment managers typically look for companies with high sales and/or earnings growth rates, accompanied by quality characteristics like high profit margins, low leverage and/or indications of a strong dependable management team.
- (j) **Pragmatic Growth** - While the portfolio is typically expected to exhibit growth characteristics over the long term, the manager may be expected to manage the growth exposure up and down depending on the opportunities provided by the prevailing market environment.
- (k) **Deep Value** - investors that are expected to pick companies that are out of favour by the market. These companies are typically trading at extremely depressed valuation multiples. Deep value managers benefit from systematically exploiting investors tendency to overreact on negative news.
- (l) **Pragmatic Value** - While the portfolio is typically expected to exhibit value characteristics over the long term, the manager may be expected to manage the value exposure up and down depending on the opportunities provided by the prevailing market environment.
- (m) **Relative Value** - In contrast to deep value, investing, relative value investors may pick some companies that look less depressed on traditional valuation multiples but are still trading way below the manager’s perception of intrinsic value.
- (n) **Earnings momentum** - Earnings momentum deals with the direction, strength and potential acceleration of earnings growth. Strategies can be devised that benefited from the tendency of earnings to retain their positive momentum and the tendency for other investors to flock to companies that exhibit positive earnings momentum.

(o) **Alpha sources** - Alpha is a measurable way to determine whether a manager's skill has added value to a fund on a risk-adjusted basis.

(p) **Downside protection** - Downside protection occurs when the investor or fund manager uses techniques to limit the risk of a decrease in the value of the investment.