

CLWYD PENSION FUND COMMITTEE	
<b>Date of Meeting</b>	Wednesday, 20 March 2024
<b>Report Subject</b>	Investment Strategy Review Phase 1 and Update the Investment Strategy Statement
<b>Report Author</b>	Head of Clwyd Pension Fund

### **EXECUTIVE SUMMARY**

At the Committee meeting on 29 November 2023, a proposal to undertake a further investment strategy review was agreed in two phases as follows:

Phase one objectives:

- Formalise a plan to fully fund the WPP Sustainable Active equity allocation;
- Increase the liquidity of the available assets in order to help meet ongoing cashflow and Private Market capital drawdown requirements;
- Consider the impact on the Fund's climate related objectives from the above.

Phase two of the review considers the options available to the Committee to ensure the Fund is well prepared to make further changes should it achieve the 110% funding position in the future. This paper covers the first phase of the review.

Under the LGPS Investment Regulations, there is a requirement to produce, and maintain an Investment Strategy Statement (ISS). The current ISS was approved in November 2023. The latest ISS reflecting the investment strategy review covers the changes and is included for review and approval.

### **RECOMMENDATIONS**

1.	The Committee to agree the proposed strategic asset allocation for the Fund (as shown in paragraph 1.05).
2.	The Committee to approve the updated ISS.

## **REPORT DETAILS**

<b>1.00</b>	<b>INVESTMENT STRATEGY REVIEW - PHASE 1</b>
1.01	<p>In order to meet the objectives of Phase 1 of the review, Mercer modelled candidate portfolios, which assessed expected return, risk and funding implications. The candidate portfolios included removing a number of the existing mandates (Hedge Funds and Emerging Market Equity allocations) whilst also using synthetic equity, as required, in order to broadly maintain risk and return. The candidate portfolios also assessed the implications to liquidity, collateral and climate sustainability characteristics as a result of the proposed changes.</p>
1.02	<p><b>Expected cashflow requirements</b></p> <p>The analysis highlighted the Fund's existing cashflow requirements, which were split into two categories: ongoing cashflows (i.e. covering pensioner payroll) and private market commitments (i.e. drawdown payments).</p> <p>Analysis was conducted on the next two years' worth of estimated cashflows. It was identified that ongoing pensioner payments are expected to exceed contributions by c. £34m p.a. and private market commitments could total c. £92m p.a. (on a prudent estimation basis). Therefore, a cumulative combined total of c. £250m may be required over the next 2 years, based on the information available at the time of the analysis.</p>
1.03	<p><b>Liquidity waterfall considerations</b></p> <p>To support the potential cash requirements a liquidity waterfall has been developed as part of the review to identify options available for the Fund to support liquidity needs.</p> <p>The waterfall identified a number of options available to the Fund:</p> <ul style="list-style-type: none"><li>• Receiving income from the WPP Sustainable Active Equity and Multi-Asset Credit (MAC) mandates.</li><li>• Use of synthetic equities and investigating synthesising MAC with synthetic high yield exposure (a proxy for MAC).</li><li>• Releasing cash from the Tactical Asset Allocation (TAA) portfolio.</li><li>• Releasing cash (as and when available) from the Risk Management Framework, subject to minimum Yield Headroom threshold.</li><li>• Divesting from Private Market investments (this option isn't ideal given the timeframe constraints and haircuts likely required to divest, however it is still an option to consider).</li></ul>
1.04	<p><b>Emerging Market Equity review</b></p> <p>The Fund currently has exposure to Emerging Market equities through the WPP Sustainable Active Equity Fund and the WPP Emerging Market Equity Fund. Analysis highlights that:</p> <ul style="list-style-type: none"><li>- In aggregate, the Fund has a relatively large overweight exposure (at least two times more) to Emerging Market equities in comparison to global equity indices.</li><li>- Emerging Market equities are expected to have greater risks (financial</li></ul>

	<p>and non-financial) than developed equities.</p> <ul style="list-style-type: none"> <li>- The top five countries within the MSCI Emerging Market Index have a net zero target of 2050 or higher. Notably, China (net zero target 2060) and India (net zero target 2070) make up c.45% of the index combined and are accountable for c.40% of global emissions (China 32%, India 8%).</li> <li>- Recent analysis identifies that the WPP Emerging Market Equity Fund accounts for c. 80% of the Fund's carbon intensity and footprint metrics.</li> <li>- On balance, it is considered that the existing strategic allocation to Emerging Market equities is not required in order to support the Fund's expected return requirements, and allowing for the overall funding position.</li> </ul>
1.05	<p><b>Proposed strategy refinements</b></p> <p>Following discussions and refinements to the initial modelling, the proposed strategic asset allocation (SAA) has been put forward. The key changes and rationale are provided below:</p> <ul style="list-style-type: none"> <li>• <b>Sell Emerging Market Equities:</b> <ul style="list-style-type: none"> <li>○ Switch assets into WPP Sustainable Active Equity Fund.</li> <li>○ Will provide some ongoing exposure to Emerging Market equities in a way that is better aligned with the with Fund's Responsible Investment beliefs and objectives.</li> <li>○ Overall expected risk and return broadly maintained.</li> </ul> </li> <li>• <b>Sell Hedge Funds:</b> <ul style="list-style-type: none"> <li>○ The Fund's RMF can support the Fund in diversifying and managing risk exposures, without the need to hold Hedge Funds.</li> <li>○ Reallocating sale proceeds will support funding the WPP Sustainable Active Equity Fund and cashflow requirements.</li> </ul> </li> <li>• <b>Introduction of Strategic Cash allocation:</b> <ul style="list-style-type: none"> <li>○ The Fund currently has cash within the CRMF (Cash and Risk Management) mandate. Given the potential cash and liquidity requirements of the Fund in future, a strategic cash allocation is deemed appropriate.</li> <li>○ The strategic cash allocation is supported by the current relatively attractive returns available but would be subject to review if these returns were to materially change. The CRMF can now be renamed RMF given the Cash part of the mandate has been removed and held separately.</li> </ul> </li> <li>• <b>Maintain risk and return levels through synthetic equity exposure within the RMF:</b> <ul style="list-style-type: none"> <li>○ The Fund is able to achieve exposure to Paris Aligned Benchmark equities through the RMF, which will enable the Fund to broadly maintain its target level of risk and return.</li> </ul> </li> <li>• <b>Turning on income from the existing WPP Equity and MAC Funds:</b> <ul style="list-style-type: none"> <li>○ The Fund has previously reinvested all income from the WPP</li> </ul> </li> </ul>

mandates. It has been agreed to switch the income from accumulating to distributing units in order to support liquidity needs. This has now been implemented.

- **Reclassify the Capital Dynamics Clean Energy Wales Separately Managed Accounts (SMA) mandate under Local/Impact instead of Infrastructure:**

- The Capital Dynamics SMA is specifically designed to make a positive and long-lasting impact at the local level. It supports renewable energy initiatives and contributes to the UK “Levelling Up” agenda. These characteristics align with the objectives of the Local/Impact category. It is important to note that this reclassification (from Infrastructure to Local/Impact) will not have any impact on the risk/return metrics of the overall Fund.

A summary of the current and proposed SAA is provided below:

	Current SAA	Proposed SAA
Sustainable Developed Global Equity	15.0%	15.0%
WPP Emerging Market Equity	5.0%	-
Multi-Asset Credit	12.0%	12.0%
Hedge Funds	5.0%	-
TAA	11.0%	11.0%
Risk Management Framework	23.0%	28.0%
Cash	-	5.0%
Private Markets	29.0%	29.0%
<i>Property</i>	4.0%	4.0%
<i>Private Equity</i>	8.0%	8.0%
<i>Local/Impact</i>	6.0%	8.0%
<i>Infrastructure</i>	8.0%	6.0%
<i>Private Credit</i>	3.0%	3.0%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Expected Median absolute return, p.a.</b>	<b>9.0%</b>	<b>8.9%</b>
<b>Expected Median return over CPI, p.a.</b>	<b>6.2%</b>	<b>6.2%</b>
<b>3 Year 95% VaR</b>	<b>£868m</b>	<b>£902m</b>
<b>Total cash 'freed up'<sup>1</sup> after funding WPP Sustainable Active Equity</b>	<b>-</b>	<b>£126.4m</b>
<b>Estimated income from Physical Equity &amp; MAC</b>	<b>£23.9m</b>	<b>£21.5m</b>

The proposed strategic changes result in:

- **Expected Return:** No major change to expected return (0.1% p.a below previous on an absolute return basis).
- **Risk (3 Year 95% VaR):** c.4% higher, but no concern as RMF in place to manage overall risk.
- **Climate Metrics:** Anticipation of improved climate metrics expected due to removal of Emerging Market Equities.

	<ul style="list-style-type: none"> <li>• <b>Cash freed up:</b> It is expected that c. £126m would be freed up after funding the WPP Sustainable Active Equity Fund, which could be used to support cashflow needs.</li> <li>• <b>Note:</b> the expected return and downside risk figures are not guaranteed and are subject to change.</li> </ul>
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<b>2.00</b>	<b>INVESTMENT STRATEGY STATEMENT</b>
2.01	<p><b>ISS update</b></p> <p>Following the above proposed SAA, the ISS has been updated to reflect the changes. The key changes to the ISS include:</p> <ul style="list-style-type: none"> <li>• Update to the SAA table;</li> <li>• Renaming of the Cash and Risk Management Framework to Risk Management Framework, due to the new separate strategic allocation to Cash.</li> </ul> <p>In addition to the above changes, the ISS has been updated to reduce unnecessary information and improve its accessibility.</p> <p>Committee members are asked to approve the ISS included within the appendix.</p>

<b>3.00</b>	<b>RESOURCE IMPLICATIONS</b>
3.01	None directly as a result of this report.

<b>4.00</b>	<b>CONSULTATION</b>
4.01	<p>The LGPS Investment regulations require that the Fund “consults with such persons as it considers appropriate as to the proposed contents of its investment strategy”.</p> <p>The Fund will not consult with its employers, given there are no material change to the levels of risk and expected return from the Fund’s investment strategy.</p> <p>The updated ISS will be shared with employers.</p>

<b>5.00</b>	<b>RISK MANAGEMENT</b>
5.01	<p>This report addresses some of the risks identified in the Fund’s Risk Register. Specifically, this covers the following (either in whole or in part):</p> <ul style="list-style-type: none"> <li>• Governance risk: G2</li> <li>• Funding and Investment risks: F1 - F6 and F8 – F9</li> </ul>

<b>6.00</b>	<b>APPENDICES</b>
6.01	Appendix 1 – Investment Strategy Statement (ISS)

<b>7.00</b>	<b>LIST OF ACCESSIBLE BACKGROUND DOCUMENTS</b>
7.01	<p>1. Current ISS available in the strategies and policies section of the CPF website - <a href="https://mss.clwydpensionfund.org.uk/home/investments-and-governance/">https://mss.clwydpensionfund.org.uk/home/investments-and-governance/</a></p> <p><b>Contact Officer:</b> Philip Latham, Head of the Clwyd Pension Fund  <b>Telephone:</b> 01352 702264  <b>E-mail:</b> <a href="mailto:philip.latham@flintshire.gov.uk">philip.latham@flintshire.gov.uk</a></p>

<b>8.00</b>	<b>GLOSSARY OF TERMS</b>
8.01	<p>A list of commonly used terms are as follows:</p> <p>(a) <b>CPF – Clwyd Pension Fund</b> – 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) <b>Administering authority or scheme manager</b> – 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> <p>(c) <b>Absolute Return</b> – The actual return, as opposed to the return relative to a benchmark.</p> <p>(d) <b>Annualised</b> – Figures expressed as applying to 1 year.</p> <p>(e) <b>Duration</b> – The weighted average time to payment of cashflows (in years), calculated by reference to the time and amount of each payment. It is a measure of the sensitivity of price/value to movements in yields.</p> <p>(f) <b>Market Volatility</b> – The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change and inflation impact.</p> <p>(g) <b>Money-Weighted Rate of Return</b> – The rate of return on an investment including the amount and timing of cashflows.</p> <p>(h) <b>Relative Return</b> – The return on a fund compared to the return on index or benchmark. This is defined as: Return on Fund minus Return on Index or Benchmark.</p> <p>(i) <b>Three-Year Return</b> – The total return on the fund over a three year period expressed in percent per annum.</p>

(j) **Time-Weighted Rate of Return** – The rate of return on an investment removing the effect of the amount and timing of cashflows.

(k) **Yield (Gross Redemption Yield)** – The return expected from a bond if held to maturity. It is calculated by finding the rate of return that equates the current market price to the value of future cash-flows.

**A comprehensive list of investment terms can be found via the following link:**

<https://www.schroders.com/en/uk/adviser/tools/glossary/>