Options regarding a reduction in the allocation to the UK Active Equity Portfolio

Introduction

At the March meeting of the Pension Fund Committee, it was agreed to a) reduce the current exposure to the UK market from 29% of the current equity allocation to bring it closer into line with the 4% the UK forms of the global benchmark and b) to consider options for any remaining exposure to the UK market so that it better reflected the UK economy and reduce the current carbon/climate risk exposures.

This paper looks at the potential options to meet the requirements of the Pension Fund Committee with particular focus on climate risks.

Options

In respect of the proposal to reduce the exposure to the UK, the Committee identified the current PAB passive portfolio, and the actively managed sustainable equities portfolio as the two most suitable alternatives within the current suite of portfolios offered by Brunel. The Committee also has a current allocation to the Global High Alpha actively managed portfolio, although this was not included as an option by the Committee. Details of the portfolio are though included in the analysis below for completeness.

<u>Market Coverage</u> – The three alternative global portfolios managed by Brunel are all benchmarked against different benchmarks, and this will have an impact on country exposure, including the weighting to the UK. Both the Global High Alpha and Paris Aligned portfolios are benchmarked against developed world only indices (MSCI World and FTSE Developed World respectively), whereas the Sustainable Equity portfolio is benchmarked against the MSCI All world index including the emerging markets. Excluding the emerging markets increases the exposure within the benchmark to the UK above 4%.

<u>Weighted Average Carbon Intensity (WACI)</u> – The WACI figures for the three portfolios from the most recent carbon metrics report for Oxfordshire show all three portfolios are well below their benchmarks

Global High Alpha	WACI	180	Benchmark	285
PAB Passive	WACI	179	Benchmark	286
Sustainable Equities	WACI	264	Benchmark	317

These compare to the current allocation as follows

UK Active	WACI	220	Benchmark	306

Whilst the figures suggest allocation to either the Global High Alpha portfolio or the PAB passive portfolio would reduce the current WACI for the Fund as a whole, the figures indicate an allocation to the Sustainable Equities portfolio would actually lead to an increase in the overall WACI score.

This though demonstrates the danger of a focus on a single carbon metric. The latest carbon metric report from Brunel also includes metrics for exposure to fossil fuel reserves and the percentage of green revenues within the total revenues of the portfolio. These figures suggest a different story

	Reserves Exposure v Benchmark		Green Revenues
Global High Alpha	3.7%	5.1%	9.1%
PAB Passive	0	4.9%	12.2%
Sustainable Equities	0	5.1%	13.1%
UK Active	12.0%	17.2%	3.4%

On these two metrics, the Sustainable Equities portfolio scores the highest, having eliminated the fossil fuel reserve risk and having a higher allocation to Green Revenues. The PAB Passive portfolio also shows zero risk in respect of fossil fuel reserves and green revenues less than 1% lower than the sustainable equity portfolio, whereas the Global High Alpha Fund is weaker on both measures. The active UK portfolio has significantly the poorest scores on both these measures, reflecting the high weighting to the major oil producers in the UK index.

The working Group are invited to discuss the figures and any advice they wish to offer to the Pension Fund Committee on this issue.

On the second issue of retaining an allocation to the UK market, the only option available through the current range of Brunel portfolios is the UK Climate Transition Benchmark passive portfolio. The committee have asked Brunel to explore the option of either developing a new FTSE 250 active portfolio or switching the benchmark for the current UK Active portfolio to the FTSE 250. The other Brunel Funds invested in the UK Active portfolio have all indicated a willingness to switch the current benchmark. This option has not been considered further at this time due to staffing issues within Brunel. It is clear though that an index based on the FTSE 250 would meet both the criteria to reduce the current carbon/climate risks and to better reflect the UK economy, and the nature of the liabilities of the Pension Fund.

We have been able to complete some analysis of the merits of the Climate Transition Benchmark (CTB) passive UK portfolio which is already an investible product within Brunel's suite of portfolios. We are currently waiting confirmation of the latest carbon metric scores for this portfolio from Brunel, but we have been able to analyse the underlying holdings within the portfolio, compared to those within the current UK active portfolio.

This analysis is set out in the annex to this report and shows that 113 companies are represented in both portfolios, and between them account for 75% of the value in both portfolios. For the UK Active portfolio, the other 25% of value comes from investments in a further 37 companies, whereas for the CTB passive portfolio, there are 143 much smaller investments.

The analysis shows the split between the main industrial sectors, with the biggest variation in the Financial Sector, with the active portfolio having 24.6% in the sector compared to 16.4% for the CTB. The biggest single variation in this sector is the 3.2%

weight to HSBC in the active portfolio, with no corresponding allocation in the CTB. The rest of the variation comprises additional 1% allocations to Legal & General, St James Place and 3i plus numerous smaller variations.

Allocations to the Energy sector are broadly the same in total (7.36% active v 7.15% CTB) although the detail differs, with a 3.93% allocation to Shell within the active portfolio (nil in CTB), whereas the CTB allocation of 5.3% to BP exceeds the 3.1% allocation in the active portfolio. The CTB portfolio also has higher allocations to The John Wood Group and Capricorn Energy.

The CTB portfolio has a significantly higher allocation to Utilities 9.2% compared to 1.1%. This includes allocations of 5.1% to the National Grid, and3.7% to SSE. Within Basic Materials, the 3.2% allocation to Anglo American in the CTB portfolio is more than offset by a 3.2% allocation to Rio Tinto and a 2% allocation to Glencore within the active portfolio.

The Working Group are invited to consider the analysis and offer any advice to the Pension Fund Committee.

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