



## Pension Fund Committee Friday, 6 March 2020

### ADDENDA

#### 7. Investment Strategy Statement including the Fundamental Asset Allocation and Climate Change Policy (Pages 1 - 38)

10:25

This report includes the review of the Investment Strategy Statement and the new draft Climate Change Policy and the proposed changes to the Asset Allocation consistent with the revised Statement.

*The Committee is RECOMMENDED to*

- (a) *approve the draft Investment Strategy Statement including the Climate Change Policy as the basis for formal consultation and*
- (b) *approve the interim changes to the Strategic Asset Allocation as recommended by the Independent Financial Advisor and summarised in paragraphs 39 – 45 of this report.*

#### 9. Annual Business Plan (Pages 39 - 58)

11:50

This report covers the business plan for the Pension Fund for the forthcoming financial year and includes the key objectives for the forthcoming year, the proposed budget and the cash management strategy. Progress against the objectives set for the current financial year is also set out to provide the context for the forthcoming year.

*The Committee is RECOMMENDED to:*

- (a) *approve the Business Plan and Budget for 2020/21 as set out at Annex 1;*
- (b) *approve the Pension Fund Cash Management Strategy for 2020/21.*
- (c) *delegate authority to the Director of Finance to make changes necessary to the Pension Fund Cash Management Strategy during the year, in line with changes to the County Council's Treasury Management Strategy;*
- (d) *delegate authority to the Director of Finance to open separate pension*

- fund bank, deposit and investment accounts as appropriate;*
- (e) *delegate authority to the Director of Finance to borrow money for the pension fund in accordance with the regulations.***

Division(s):n/a

## **PENSION FUND COMMITTEE – 6 MARCH 2020**

### **INVESTMENT STRATEGY**

**Report by the Director of Finance**

#### **RECOMMENDATION**

1. **The Committee is RECOMMENDED to**
  - (a) **approve the draft Investment Strategy Statement including the Climate Change Policy as the basis for formal consultation and**
  - (b) **approve the interim changes to the Strategic Asset Allocation as recommended by the Independent Financial Advisor and summarised in paragraphs 39 – 45 of this report.**

#### **Introduction**

2. This Committee reviews its Investment Strategy Statement on an annual basis, and carries out a fundamental review of its asset allocation every three years following on from the tri-ennial Fund Valuation.
3. This report brings together the latest review of the Investment Strategy Statement including a new annex covering our Policy regarding Climate Change, and the formal advice of our Independent Financial Adviser in respect of our fundamental asset allocation.
4. Due to the restrictions on the investment cycles in respect of the allocations to the private market allocations within Brunel, the Committee are asked to approve a number of immediate proposals on asset allocations effective from 1 April 2020, as well as approving the draft Investment Strategy Statement and Climate Policy for formal consultation.

#### **Investment Strategy Statement and Climate Change Policy**

5. The key change to the Investment Strategy Statement is the addition of a separate annex in respect of our Climate Change Policy (see Annex 1). This Policy has been informed by the Climate Change Workshop held in November, plus 2 meetings of the Climate Change Working Group established at the December meeting of this Committee.
6. The draft Climate Change Policy should be seen as an initial position statement which will be subject to regular review reflecting the rapidly changing environment in which this initial policy has been established. In particular, the Policy itself recognises a number of shortfalls in the current availability of international accepted metrics used to assess the suitability of investments against the requirements of the Paris Agreement, and therefore

includes commitments to work with Brunel and others in the investment industry to establish such metrics. This will in turn allow more specific targets to be set within the Policy in future years.

7. The draft Policy was agreed for publication by the Working Group, although differences of opinion remain between the working group members. In particular, there was considerable discussion about the inclusion of clauses requiring the divestment of all investments in fossil fuel companies. The overall consensus was that such clauses were unnecessary and potential unhelpful.
8. The Policy as drafted makes it clear that the Fund should be looking to ensure all investments are consistent with the Paris Agreement. To the extent that any fossil fuel company does not have a clear action plan to ensure it is aligned with the Paris Agreement, it will fall foul of the principles within the draft Policy. As such we would be looking to Brunel to challenge any Fund Manager retaining an investment in that company and seeking changes to address the issue (whether that be via divestment by the Fund Manager or the potential removal of the Fund Manager).
9. A blanket policy on immediate divestment from fossil fuel companies runs the risk of ignoring the other key sectors which are contributing to the current climate emergency, including the transportation, energy and food sectors, as well as penalising any of the fossil fuel companies which are seeking to take the actions required to ensure compliance with the Paris Agreement and support the development of a renewable and sustainable future.
10. In addition to the changes to the Investment Strategy Statement to reflect the new Climate Change Policy, the Statement has been updated to reflect the changes in responsibilities as more of our assets transition to Brunel.
11. At the present time, the draft Investment Strategy Statement has not been amended for the proposed changes to the Strategic Asset Allocation. Subject to the decisions by this Committee in respect of the Strategic Asset Allocation, the draft Investment Strategy Statement will be updated before being issued for formal consultation.

## **Strategic Asset Allocation**

12. As previously stated, the determination of the Strategic Asset Allocation is arguably the most important decision this Committee makes in terms of delivering its responsibilities. To support the Committee in making this decision, Officers procured advice from the Fund's Independent Financial Adviser, as well as further modelling of options and the implications of the current cashflow projections from MJ Hudson. The report of the Independent Financial Adviser is included as Annex 2 to this report, with the Executive Summary of the report from MJ Hudson included as an appendix.
13. The key objectives of the fundamental review of the asset allocation are to ensure that the Fund has sufficient liquid resources to meet the pension

liabilities as they fall due, and that all surplus assets are invested to ensure the appropriate level of return for any given level of risk. The asset allocation agreed should also be fully consistent with the Investment Strategy Statement, including the new Climate Change Policy.

14. The work undertaken by MJ Hudson which itself was informed by cash flow projections produced by the Fund Actuary found that in the short term, whilst cash flow from dealings with members was expected to go negative (i.e. total payment of pensions would exceed the current level of pension contributions), the levels involved could be met from within current cash balances and did not require a major switch to income releasing assets.
15. The report from MJ Hudson then looked at modelling levels of return against levels of risk/volatility to establish the “efficient frontier”, where the level of return is maximised for any given level of risk.
16. MJ Hudson identified that our current asset allocation falls somewhat short of the efficient frontier, and indeed short of the current Strategic Asset Allocation. This reflects the underweights in the private markets whilst we wait for Brunel to identify suitable investment opportunities, and these Funds to call down the committed cash. Moving towards the strategic asset allocation would both improve the potential investment returns as well as reducing risk/volatility through the greater diversification of the portfolios.
17. MJ Hudson therefore produced a number of options which brought the asset allocation closer to the efficient frontier, either by increasing investment returns for the same level of risk/volatility or reducing risk/volatility whilst achieving the same levels of investment return.
18. The report and recommendations of the Independent Financial Adviser then build on the conclusions from MJ Hudson to produce a more detailed proposal for changes to the asset allocation. In bringing forward his proposals, the Independent Financial Adviser also look to ensure that any changes were consistent with the revised Investment Strategy Statement and Climate Change Policy.
19. Included in the proposals from MJ Hudson and endorsed by the Independent Financial Adviser was a proposal to implement a new investment in the Private Debt Portfolio offered by Brunel. Under the investment arrangements for all the private markets, commitments must be made by 31 March 2020 to be included in the next 2 year cycle, although further top-up commitments can be made in April 2021 where an allocation has been made in April 2020. Any new allocation to Private Debt must therefore be agreed at this time to be registered with Brunel by 31 March 2010.
20. The Independent Financial Adviser is recommending an immediate commitment of £80m or around 3% of the Fund. This can be topped up in April 2021 to the 5% recommended in the MJ Hudson report following further detailed review of the proposal.

21. The MJ Hudson report also recommended a 5% allocation to multi asset credit. At the present time, this portfolio is not available through Brunel, but should be developed during 2020/21. This enables further consideration of the proposal to be made before any final decision is made.
22. The MJ Hudson report also proposed further increases in the allocations to Infrastructure and Private Equity. The report from the Independent Financial Adviser indicates reservations on this proposal due to the increase in illiquidity that would result. In particular, further work needs to be undertaken to assess the ability of the Fund to meet its existing commitments to the private markets and pay pension liabilities as they fall due in the event of another financial crisis of the level experienced in 2008. As the existing asset allocation already requires significant allocations to the private market and infrastructure portfolios, any delay in agreeing an increase in these allocations is not seen to be critical and could be implemented in April 2021 if necessary.
23. In respect of ensuring consistency with the draft Climate Change Policy, the report from the Independent Financial Adviser is recommending an immediate switch of 5% of the Fund from the UK passive portfolio to the global low carbon passive portfolio. The proposal reflects the high weighting to the fossil fuel and mining sectors within the current UK passive index, and the lower levels of carbon intensity within the low carbon fund.
24. At this stage it is not recommended to make further allocations to the low carbon or sustainable equities portfolio, until further work can be completed on developing the metrics to assess the suitability of the products against the principles established in the draft Climate Change Policy. Once this work is completed, further transitions can be proposed, or further requests can be made to Brunel for the development of additional portfolios which more closely reflect the need to align all investments with the requirements of the Paris Agreement.
25. It should also be noted that the allocation to infrastructure to bring the actual investment in line with the current asset allocation will include a significant investment in renewable infrastructure.

LORNA BAXTER  
Director of Finance

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February 2020

# Investment Strategy Statement

## Introduction

The Pension Fund Committee has drawn up this Investment Strategy Statement (ISS) to comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and the accompanying Guidance on Preparing and Maintaining an Investment Strategy Statement. The Authority has consulted its Actuary and Independent Financial Adviser in preparing this statement.

The ISS is subject to periodic review at least every three years and more frequently if there are any developments that impact significantly on the suitability of the ISS currently in place. Investment performance is monitored by the Committee on a quarterly basis and may be used to check whether actual results are in-line with those expected under the ISS.

The Committee will invest any Fund money not immediately required to make payments from the Fund in accordance with the ISS. The ISS should be read in conjunction with the Fund's Funding Strategy Statement.

## Governance Overview

Oxfordshire County Council is the designated statutory body responsible for administering the Oxfordshire Pension Fund. The Pension Fund Committee acts on the delegated authority of the Administering Authority and is responsible for setting investment policy, appointing suitable persons to implement that policy and carrying out regular reviews and monitoring of investments.

The Director of Finance has delegated powers for investing the Oxfordshire Pension Fund in accordance with the policies determined by the Pension Fund Committee. The Committee is comprised of nine County Councillors plus two District Council representatives. A beneficiaries' representative attends Committee meetings as a non-voting member.

The Committee meets quarterly and is advised by the Director of Finance and the Fund's Independent Financial Adviser. The Committee members are not trustees, although they have similar responsibilities.

## Investment Objectives

The Fund's primary objective is to ensure that over the life of the Fund it has sufficient funds to meet all pension liabilities as they fall due. In seeking to achieve this aim, the investment objectives of the Fund are:

1. to achieve and maintain a 100% funding level;
2. to ensure there are sufficient liquid resources available to meet the Fund's current liabilities and investment commitments;

3. for the overall Fund to outperform the benchmark, set out in the next section, by 1.0% per annum over a rolling three-year period (N/B The Secured Income, Diversified Growth Fund and Infrastructure portfolios do not have a benchmark as such, but target cash returns plus a given percentage. They do not therefore contribute to the outperformance target).

## **Asset Allocation**

The decision on asset allocation determines the allocation of the Fund's assets between different asset classes. The Committee believes that this is the single most important factor in the determination of the Fund's investment outcomes. In setting the asset allocation the Fund has considered advice from its Independent Financial Adviser and a report from advisers MJ Hudson on investment scenarios against the efficient frontier and the investment implications of the latest cash flow forecasts produced by the Fund Actuary.

Every three years, following the actuarial valuation, there is a fundamental review of how the assets are managed. This review considers the most appropriate asset allocation for the Fund in order to achieve its investment objectives and considers advice from the Fund's Independent Financial Adviser. A balance is sought between risk, return and liquidity. The most recent review was undertaken in February 2020.

Diversification is the Fund's primary tool for managing investment risk. Diversification can improve returns and reduce portfolio volatility by ensuring that investment risk is not concentrated in a particular asset class or investment style and by reducing exposure to losses through poor performance of an individual asset class. In considering asset class correlations it is acknowledged that these vary over time and as such, are not indicators of how assets will behave relative to each other in the future. Taking this into account, the Committee believes that spreading investments over a wide range of asset classes is the most appropriate way to benefit from diversification having considered the factors that may cause values for various asset classes to move in the future.

The Committee has developed the following guidelines to assist in ensuring appropriate diversification is maintained:

1. Exposure to a single security will be limited to 10% of the total portfolio.
2. No single investment shall exceed 35% of the Fund's total portfolio.
3. Not more than 10% of the Fund may be held as a deposit in any single bank, institution or person.

In considering the asset classes used to build the Fund's overall portfolio, consideration has been given to the suitability of those investments given the Fund's investment objectives and advice has been taken from the Fund's Independent Financial Adviser. The fund broadly defines assets as either return-seeking or liability-matching assets and seeks to develop an appropriate balance between these categories. Each asset class should be understood by the Committee, be consistent with the Fund's risk/return objectives, and provide the most effective solution for delivering a target outcome.



The Fund currently constructs its investment portfolio using eleven distinct asset classes. A target allocation and range is set for each asset class as shown in the table below.

<b>Asset Class</b>	<b>Target Allocation (%)</b>	<b>Range (%)</b>
UK Equities	26	24 - 28
Overseas Equities	28	26 - 30
Emerging Market Equities		
<b>Total Equities</b>	<b>54</b>	<b>50 - 58</b>
UK Gilts	3	
Corporate Bonds	6	
Index-Linked Bonds	5	
Overseas Bonds	2	
<b>Total Bonds</b>	<b>16</b>	<b>14 - 18</b>
Property	8	6 - 10
Private Equity	9	7 - 11
Multi-Asset	5	4 - 6
Infrastructure	3	2 - 4
Secured Income	5	4 - 6
Cash	0	0 - 5
<b>Total Other Assets</b>	<b>25</b>	<b>18 - 31</b>

## Investment Implementation

It is the Fund's Policy to implement its asset allocation through the portfolios offered by Brunel. Where Brunel do not offer a current portfolio, a request will be made under the agreed Brunel policy for the creation of new portfolios. New investments will only be made outside the pool where Brunel are unable to offer a requested portfolio, normally as a result of the current FCA permissions, or as an interim measure whilst waiting for a Brunel Portfolio to be established, or commitments to the private markets to be called.

When overseeing the selection processes of the Brunel Pension Partnership, the Pension Fund will look at the most cost-effective way of delivering the required investment outperformance rather than have a narrow focus on cost. Ultimately, it is the investment performance net of costs achieved by the Fund Managers which determines the success of the Fund in meeting its objectives.

When making asset allocation decisions for some asset classes there is a choice available between active and passive management. The Fund believes that active management can provide benefits above passive management in some situations. Active management gives the potential for outperformance relative to the passive benchmark through the selection of holdings expected to outperform the general market and through the use of cash to protect against downside risk. In considering the most appropriate type of mandate the Fund will consider the potential for outperformance, fees and risk. For some investment classes there are not passive

investment solutions currently available but the Fund will work with Brunel to monitor the market to identify any new products that are developed in the passive arena.

Where directly appointed, the individual managers' performance, current activity and transactions are monitored quarterly by the Pension Fund Committee. Where the portfolios are now managed by the Brunel Company, it is their responsibility to monitor individual Fund Manager performance, with the Pension Fund Committee responsible for monitoring the performance of the Brunel Company, and getting assurance that they are monitoring the underlying Fund Managers appropriately.

The assets are currently managed as set out in the following table.

<b>Asset Class</b>	<b>Investment Manager</b>	<b>Benchmark</b>	<b>Annual Target</b>
UK Equities	Brunel	FTSE All-Share	+1.25%
	Brunel	FTSE All Share	Passive
Developed World Equities	Brunel	FTSE Developed	Passive
Global Equities	Brunel	MSCI World	+ 2.0 – 3.0%
	UBS	MSCI All Countries World Index	+ 3.0%
Emerging Market Equities	Brunel	MSCI Emerging Market	+2.0 – 3.0%
Bonds & Index Linked - UK Gilts - Index Linked - Corporate bonds - Overseas bonds	Legal & General	FTSE A All Gilts Stocks FTSE A Over 5 year IBoxx Sterling Non-Gilts JPMorgan Global Govt (ex UK) traded bond	+ 0.6%
Property	UBS Global Asset Management	IPD UK All Balanced Funds Index	+1.0%
Private Equity - Quoted Inv. Trusts  - Limited Partnerships	Director of Finance  Adams Street	FTSE Smaller Companies (Including Investment Trusts)	+ 1.0%

	Partners Group		
	Brunel	MSCI ACWI	+3.0%
Diversified Growth Fund	Insight	3 month Libor	+ 3.0 – 5.0%
Infrastructure	Brunel	CPI	+4.0%
Secured Income	Brunel	CPI	+2.0%
Cash	Internal	3 month Libor	-

Target performance is based on rolling 3-year periods

## Rebalancing

The primary goal of the rebalancing strategy is to minimize risk relative to a target asset allocation, rather than to maximize returns. Asset allocation is the major determinant of the portfolio's risk-and-return characteristics. Over time, asset classes produce different returns, so the portfolio's asset allocation changes. Therefore, to recapture the portfolio's original risk-and-return characteristics, the portfolio needs to be rebalanced.

The Fund has set ranges for the different assets included in the asset allocation, these are not hard limits but there would need to be a clear rationale for maintaining an allocation outside the ranges for any significant length of time. The fund takes a pragmatic approach to rebalancing and is cognisant that rebalancing latitude is important and can significantly affect the performance of the portfolio. Blind adherence to narrow ranges increases transaction costs without a documented increase in performance. While a rebalancing range that is too wide may cause undesired changes in the asset allocation fundamentally altering its risk/return characteristics.

Rebalancing meetings take place on a quarterly basis where the most recent asset allocation is reviewed against the target allocations and the ranges in place. A number of factors are taken into account in the decision on whether to rebalance which includes, but is not limited to; current and forecast market dynamics, and known future investment activity at the Fund level.

Where a decision is made to undertake rebalancing the Fund aims to use cash to rebalance as far as possible, as this will minimise transaction costs and keep the cash holding closer to target avoiding the need for future transactions with associated costs. The rebalancing action will not necessarily take place immediately after a decision has been made as consideration is given to market opportunities and transaction costs.

## Restrictions on Investments

The Regulations have removed the previous restrictions that applied under the Local Government Pension Scheme (Management and Investment of Funds) Regulations

2009. These restrictions set limits for types of investment vehicles but not for asset classes. The Committee's approach to setting its investment strategy and assessing the suitability of different types of investment takes into account the various risks involved and rebalancing is undertaken as described above to ensure asset allocations are kept at appropriate levels. When making investment decisions the suitability of the proposed investment structure is considered to ensure that it is the most efficient in meeting the Fund's objectives. Therefore, it is not felt necessary to set any additional restrictions on investments.

In accordance with the regulations the Fund is not permitted to invest more than 5% of the total value of all investments of fund money in entities which are connected with the Administering Authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007(d).

## **Risk**

The overall risk for the Fund is that its assets will be insufficient to meet its liabilities. The Funding Strategy Statement, which is drawn up following the triennial actuarial valuation of the Fund, sets out how any deficit in assets compared with liabilities is to be addressed.

Underlying the overall risk, the Fund is exposed to demographic risks, regulatory risks, governance risks and financial risks (including investment risk). The measures taken by the Fund to control these risks are included in the Funding Strategy Statement and are reviewed periodically by the Committee via the Fund's risk register. Further details on the risk management process and risks faced by the Pension Fund are also included in the Annual Report and Accounts document produced by the Fund. The primary investment risk is that the Fund fails to deliver the returns anticipated in the actuarial valuation over the long term. The Committee anticipates expected market returns on a prudent basis to reduce the risk of underperforming expectations.

It is important to note that the Fund is exposed to external, market driven, fluctuations in asset prices which affect the liabilities (liabilities are estimated with reference to government bond yields) as well as the valuation of the Fund's assets. Holding a proportion of the assets in government bonds helps to mitigate the effect of falling bond yields on the liabilities to a certain extent. Further measures taken to control/mitigate investment risks are set out in more detail below:

### Concentration

The Committee manages the risk of exposure to a single asset class by holding different categories of investments (e.g. equities, bonds, property, alternatives and cash) and by holding a diversified portfolio spread by geography, currency, investment style and market sectors. Each asset class is managed within an agreed permitted range to ensure that the Fund does not deviate too far away from the Benchmark, which has been designed to meet the required level of return with an appropriate level of exposure to risk, taking into consideration the level of correlation between the asset classes.

### Volatility

The Benchmark contains a high proportion of equities with a commensurate high degree of volatility. The strong covenant of the major employing bodies and the current forecast cashflow position enables the Committee to take a long term perspective and to access the forecast inflation plus returns from equities.

### Performance

Investment managers are expected to outperform the individual asset class benchmarks detailed in the overall Strategic Asset Allocation Benchmark. The Committee takes a long term approach to the evaluation of investment performance but will take steps to address persistent underperformance. Investment managers are required to implement appropriate risk management measures and to operate in such a way that the possibility of undershooting the performance target is kept within acceptable limits. The Fund Managers report on portfolio risk each quarter and are required to provide internal control reports to the Fund for review on an annual basis. A proportion of assets are invested passively to reduce the risks from manager underperformance.

Where Brunel are responsible for the management of a portfolio, it is their responsibility to monitor the performance of the underlying investment managers and take any action necessary to address any performance issues. The Committee will receive reports from Brunel on the performance of their portfolios and can challenge them at Committee meetings. Brunel will also provide assurance reports to the Client Group and Oversight Board detailing the results of their monitoring processes, including setting out actions they are taking to address performance.

### Illiquidity

Close attention is paid to the Fund's projected cash flows; the Fund is currently cash flow positive, in that annually there is an excess of cash paid into the Fund from contributions and investment income after pension benefits are paid out. The Fund expects to be cash flow positive for the short to medium term. Despite the significant proportion of illiquid investments in the Fund, a large proportion of the assets are held in liquid assets and can be realised quickly, in normal circumstances, in order for the Fund to pay its immediate liabilities.

### Currency

The Fund's liabilities are denominated in sterling which means that investing in overseas assets exposes the Fund to a degree of currency risk. The Committee regards the currency exposure associated with investing in overseas equities as part of the return on the overseas equities; the currency exposure on overseas bonds is hedged back to sterling.

### Custody

The risk of losing economic rights to the Fund's assets is managed by the use of a global custodian for custody of the assets. Custodian services are provided by State Street. In accordance with normal practice, the Scheme's share certificates are registered in the name of the custodian's own nominee company with designation for the Scheme. Officers receive and review internal control reports produced by the custodian. The custodian regularly reconciles their records with the investment manager records, providing a regular report to officers which they in turn review.

### Stock Lending

The Council allows the Custodian to lend stock and share the proceeds with the Council. This is done to generate income for the Fund and to minimise the cost of custody. To minimise risk of loss the counterparty is required to provide suitable collateral to the Custodian. The levels of collateral and the list of eligible counterparties have been agreed by the Fund. The Committee will ensure that robust controls are in place to protect the security of the Fund's assets before entering into any stock lending arrangements.

### **Pooling**

The Oxfordshire Pension Fund is working with nine other administering authorities to pool investment assets through the Brunel Pension Partnership Ltd. (BPP Ltd).

The Oxfordshire Pension Fund, through the Pension Committee, retains the responsibility for setting the detailed Strategic Asset Allocation for the Fund and allocating investment assets to the portfolios provided by BPP Ltd.

The Brunel Pension Partnership Ltd was established in 2017 and became operational in 2018 after receiving authorisation from the Financial Conduct Authority (FCA) to act as the operator of an unregulated Collective Investment Scheme. It is owned jointly by the 10 Administering Authorities. It is responsible for implementing the detailed Strategic Asset Allocations of the participating funds by investing Funds' assets within defined outcome focused investment portfolios. In particular, it will research and select the Fund Managers needed to meet the requirements of the detailed Strategic Asset Allocations. The Oxfordshire Pension Fund is a client of BPP Ltd and as a client will have the right to expect certain standards and quality of service. A detailed service agreement has been agreed which sets out the duties and responsibilities of BPP Ltd, and the rights of the Oxfordshire Pension Fund as a client. It includes a duty of care of BPP to act in its clients' interests.

An Oversight Board has been established, which comprises of representatives from each of the Administering Authorities. It was set up by them according to an agreed constitution and terms of reference. Acting for the Administering Authorities, it has ultimate responsibility for ensuring that BPP Ltd delivers the services required to achieve investment pooling. It will therefore have a monitoring and oversight function. Subject to its terms of reference it will be able to consider relevant matters on behalf of the Administering Authorities, but will not have delegated powers to take decisions requiring shareholder approval. These will be remitted back to each Administering Authority individually.

The Oversight Board is supported by the Client Group, comprised primarily of pension investment officers drawn from each of the Administering Authorities but will also draw on Administering Authorities finance and legal officers from time to time. It will have a primary role in reviewing the implementation of pooling by BPP Ltd, and provide a forum for discussing technical and practical matters, confirming priorities, and resolving differences. It will be responsible for providing practical support to enable the Oversight Board to fulfil its monitoring and oversight function.

The proposed arrangements for asset pooling for the Brunel pool have been formulated to meet the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and Government guidance.

Oxfordshire County Council approved the full business case for the Brunel Pension Partnership. Currently investment assets are being transitioned across from the Oxfordshire Pension Fund's existing investment managers to the portfolios managed by BPP Ltd with the final transition due by August 2021 in accordance with a timetable agreed by all parties. Until transitions take place, the Oxfordshire Pension Fund will continue to maintain the relationship with its current investment managers and oversee their investment performance, working in partnership with BPP Ltd. where appropriate.

Following the completion of the transition plan outlined above, it is envisaged that all of the Oxfordshire Pension Fund's assets will be invested through BPP Ltd. However, the Fund has certain commitments to long term illiquid investment funds which will take longer to transition across to the new portfolios to be set up by BPP Ltd. These assets will be managed in partnership with BPP Ltd. until such time as they are liquidated, and capital is returned.

## **ESG Policy**

The Committee recognises that environmental, social and corporate governance (ESG) issues, including climate change, can have materially significant investment implications. The Fund therefore seeks to be a responsible investor and to consider ESG risks as part of the investment process across all investments. The objective of responsible investment is to decrease investor risk and improve risk-adjusted returns. Responsible investment principles are at the foundation of the Fund's approach to stewardship and underpin the Fund's fulfilment of its fiduciary duty to scheme beneficiaries.

Given the systemic nature of climate change risk to the Fund's investments the Pension Fund has produced a separate Climate Change Policy covering its approach on this topic. The Policy was developed following a Climate Change Workshop held by the Fund in November 2019 with participants including a range of stakeholders and expert speakers. Following the Workshop, a smaller working group was formed to develop a draft Climate Change Policy based on the outcomes of the Workshop. This Policy is contained as Annex 1 to the Statement.

The Committee's principal concern is to invest in the best financial interests of the Fund's employing bodies and beneficiaries. Its Investment Managers are given performance objectives accordingly. The Council requires its Investment Managers to monitor and assess the environmental, social and governance considerations, which may impact on financial performance when selecting and retaining investments, and to engage with companies on these issues where appropriate. The Council believes that the operation of such a policy will ensure the sustainability of a company's earnings and hence its merits as an investment.

The Investment Managers report at quarterly intervals on the selection, retention and realisation of investments on the Council's behalf and on any engagement activities undertaken. These Reports/Review Meetings provide an opportunity for the Council

to influence the Investment Manager's choice of investments and to review/challenge their stewardship activities but the Council is careful to preserve the Investment Manager's autonomy in pursuit of their given performance.

Just because concerns have been registered about a company's performance on ESG issues, doesn't mean our fund managers will be instructed not to invest in that company. It is then through active ownership we aim to drive change. Where engagement is not seen to be resulting in sufficient progress, and so the risk associated with a holding is increasing or not reducing sufficiently, the Fund will consider divesting.

As a passive investor, the Fund accepts that it will hold companies of varying ESG quality due to the requirement to hold all securities in the target index. The committee believes that passive investing offers a number of benefits that need to be weighed against this and requires passive managers to demonstrate effective engagement, as is the case for active managers. It is important to note that ownership of a security in a company does not signify that the Oxfordshire Pension Fund approves of all of the company's practices or its products

The Committee is open to investing in Social Investments; investments where social impact is delivered alongside financial return. The Committee further believes that the goal of social impact is inherently compatible with generating sustainable financial returns by meeting societal needs. The Fund has made investments in this area and will continue to review whether further opportunities are available that offer an appropriate risk/return profile. Stakeholders' views are taken into account through the representation of different parties on the Pension Fund Committee, which includes a beneficiaries' representative, and the Local Pension Board, which consists of equal numbers of employer and member representatives.

The Fund will not use pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

One of the principal benefits, outlined in the Brunel Pension Partnership business case, achieved through the enhanced scale and resources as a result of pooling is the improved implementation of responsible investment and stewardship. Once established and fully operational the Brunel Company will deliver best practice standards in responsible investment and stewardship as outlined in the BPP Investment Principles.

Every portfolio under the Brunel Pension Partnership explicitly includes responsible investment and an assessment of how social, environment and corporate governance considerations may present financial risks to the delivery of the portfolio objectives. These considerations will therefore be taken into account in the selection, non-selection, retention and realisation of assets. The approach undertaken will vary in order to be the most effective in mitigating risks and enhancing investor value in relation to each portfolio and its objectives.

In January 2020 Brunel released its Climate Change Policy setting out how it will deal with climate related risks and opportunities in its investment approach.



## **Policy on Exercise of Rights**

As an investor with a very long-term investment horizon and expected life, the success of the Oxfordshire Pension Fund is linked to long term global economic growth and prosperity. Actions and activities that detract from the likelihood and potential of global growth are not in the long-term interests of the Fund. Since the Fund is a long-term investor, short-term gains at the expense of long-term gains are not in the best interest of the Fund. Sustainable returns over long periods are in the economic interest of the Fund.

The Fund recognises that encouraging the highest standards of corporate governance and promoting corporate responsibility by investee companies protects the financial interests of pension fund members over the long term. Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure and corporate governance, including culture and remuneration.

The Fund's commitment to actively exercising the ownership rights attached to its investments reflects the Fund's conviction that responsible asset owners should maintain oversight of the way in which the enterprises they invest in are managed and how their activities impact upon customers, clients, employees, stakeholders, and wider society.

The routes for exercising ownership influence vary across asset types and a range of activities are undertaken on the Fund's behalf by Fund Managers and Brunel, including engagement with senior management of companies, voting of shares, direct representation on company boards, presence on investor & advisory committees and participation in partnerships and collaborations with other investors. Where the Pension Fund invests in pooled vehicles it will seek to gain representation on investor committees if considered appropriate.

Brunel are responsible for the exercise of voting rights in respect of the Council's holdings in the pool portfolios. The Fund expects Brunel to exercise its voting rights in all markets and its investment managers are required to vote at all company meetings where practicable. Market conventions in some countries may mean voting shares is not in the best interests of the Fund, for example where share-blocking is in operation.

The Fund will look to sign up to the new Stewardship Code during the course of 2020/21.

Similarly, Brunel has developed a Stewardship Policy consistent with the requirements of the UK Stewardship Code and publishes an annual report covering their voting practices and their engagement work. Brunel has entered partnerships with a number of other like-minded investors to strengthen their voice in all stewardship activities.

March 2020

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# Appendix to Annex 1

## **Oxfordshire Pension Fund Climate Change Policy**

### **Foreword**

The Pension Fund has a fiduciary duty to invest in the best financial interests of its members. The investment goals of the Pension Fund are set out in its Investment Strategy Statement. Climate change presents a material risk to the Pension Fund's investment returns over the long-term. It follows that the Fund's fiduciary duty inherently requires that it is managing climate related risks to its investments, particularly given the Pension Fund's long-term investment horizon; even if the fund closed to future accrual today the fund would still be operating 80 years later. The Pension Fund currently views climate change risk as the single most important factor that could materially impact its long-term investment performance given its systemic nature and the effects it could have on global financial markets and has thus determined to produce this policy document on its approach to climate change.

### **Background**

Climate change refers to long-term changes to climate patterns, such as changes to temperatures or precipitation. A significant element of climate change is global warming; the long-term rise in the average temperature of the Earth's climate system. Global warming has been demonstrated to have increased significantly over recent decades. The Intergovernmental Panel on Climate Change (IPCC) Fifth Assessment Report concluded, *"It is extremely likely that more than half of the observed increase in global average surface temperature from 1951 to 2010 was caused by the anthropogenic increase in greenhouse gas (GHG) concentrations and other anthropogenic forcings together"* <sup>(1)</sup>.

The impacts of climate change are wide ranging and include more extreme temperatures, more natural disasters (flooding, fires etc), permanent loss of land due to rising sea levels, disruption to infrastructure networks (e.g. electricity, water supply), loss of ecosystems, and a severe impact on food supplies. There are also secondary impacts, such as on migration patterns. All of these have the potential to impact on both individual investments and financial markets more generally. A business as usual approach could have a material negative impact on global investment markets <sup>(2) (3)</sup>.

In 2015 the United Nations Climate Change Conference (COP21) was held in Paris. The agreement <sup>(4)</sup> that was reached brought most of the world's nations together to undertake ambitious efforts to combat climate change and adapt to its effects, with enhanced support to assist developing countries. The central aim of the Paris Agreement is to keep a global temperature rise this century to below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5°C.

The Paris Agreement has been ratified by 186 states, including the European Union, China and India. Although the United States served notice in November 2019 that it

will withdraw as soon as it can legally do so (November 2020), the agreement has international momentum. Rules for implementation were agreed at a meeting in Poland in 2018, including a requirement for countries to be transparent about their emissions and progress towards emissions reduction targets. There continues to be growing focus on climate change globally and in November 2020 COP26 will be hosted in Glasgow.

In order to meet the Paris Agreement goals countries will have to take significant policy action. What these policies are and how they operate will be key drivers in how climate change mitigation impacts on investments. The United Nations Principles for Responsible Investment has produced a document forecasting some of the likely policy responses <sup>(5)</sup>.

It is acknowledged that irrespective of the action taken to reduce global warming some climate related impacts, such as rising sea levels <sup>(6)</sup>, are already expected to occur due the greenhouse gas emissions to date <sup>(7)</sup>. Even if global temperature rises are limited to 1.5°C, climate related risks for natural and human systems are greater than they are at present. As such, climate change presents investors with both investment risks associated with these impacts and investment opportunities in terms of mitigation (reducing GHG emissions) and adaptation (adapting to the climate change taking place).

### **Beliefs**

The Paris Agreement was reached based on the best available science and is clear that in order to prevent significant negative impacts, including to the global economy, from climate change the Agreement's goal of keeping global temperature rises to well below two degrees Celsius must be achieved. The investment returns of the Pension Fund are reliant on a healthy, functioning global economy, as such the Pensions Fund's financial interests are best served by the delivery of Paris goal and the Pension Fund should therefore actively contribute to its achievement.

From an investment perspective the Pension Fund believes that climate change should be an integral part of the assessment of risks as well as a factor in identifying investment opportunities arising from the transition to a low carbon economy.

### **Commitment**

The Pension Fund commits to transitioning its investment portfolios to net-zero GHG emissions by 2050. Taking into account the best available scientific knowledge, including the findings of the Intergovernmental Panel on Climate Change, this is consistent with the Paris Agreement goal to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels. The Pension Fund will regularly report on progress, including establishing intermediate targets every five years in line with Paris Agreement Article 4.9.

The Pension Fund will seek to reach this Commitment through its investment activity as well as through advocating for, and engaging on, corporate and industry action, as well as public policies, for a low-carbon transition of economic sectors in line with science and under consideration of associated social impacts. This Commitment is

made in the expectation that governments will follow through on their own commitments to ensure the objectives of the Paris Agreement are met.

This commitment covers all investments made by the Pension Fund over all asset classes. The Pension Fund is cognisant that some asset classes are more progressed in the level of disclosure and transparency around climate risks and so may take longer to reach a point where assessment can be undertaken appropriately.

The Pension Fund also commits to achieving net-zero GHG emissions on its own operations by 2030

### **Delivery**

The Pension Fund Committee has responsibility for the direction of policy and the committee will have access to expert advice and have members with appropriate skills and knowledge. Responsibility for the implementation of this policy lies with the Service Manager - Pensions.

The Fund views two strands to its approach to climate change; aiming to be part of the solution in seeking to deliver its commitment and risk mitigation where actions may not directly contribute to a reduction in global warming but protect the fund from climate change related risks.

This second part becomes increasingly important if it becomes clear that efforts may be unsuccessful in achieving the goals of the Paris Agreement – based on current commitments temperatures are forecast to increase by  $\sim 3^{\circ}\text{C}$  <sup>(8)</sup>. If this is the case the Pension Fund will need to focus on the physical and economic impacts associated with climate change and how these manifest in investment risk so that it can position itself to minimise its exposure to these risks.

A Paris aligned world requires significant changes to industry; this has significant societal implications in terms of employment, access to energy and the affordability of energy. The Pension Fund supports the Just Transition <sup>(9)</sup>, seeking to manage the social and economic impacts of the transition to a low carbon economy on communities, and will reflect this in its policy advocacy activity.

### **Asset Allocation**

When determining the Fund's asset allocation, the Fund will consider climate change in terms of mitigating climate risks, and opportunities through investments seeking to deliver solutions to the low carbon transition. Where there are two investment options that broadly aim to deliver the same investment objective the Pension Fund will prioritise the option that delivers the best fit to its climate change commitment. For example, if making an allocation to passive equities the Fund may select a low-carbon index as opposed to a regular market-cap index as a means of reducing exposure to climate risk.

The Fund will seek to increase investments in climate change mitigation and adaptation and will report on the level of relevant investments.

The Pension Fund considers that currently there are limited opportunities to invest in companies focused on climate change solutions in the public markets with more opportunities existing in the private markets across private equity, private debt, infrastructure and real assets. This has asset allocation implications due to the illiquidity and complexity of some of these asset classes.

### Investment Options

The Pension Fund makes investments through the portfolios made available by the Brunel Pension Partnership. Where the fund determines that it has climate related policies not deliverable by existing Brunel portfolios it will seek to make these available through the agreed process for the creation and amendment of portfolios. This may require the Fund to seek support from other Brunel client funds.

The operating model chosen for Brunel utilises external fund managers and so the Pension Fund is reliant on the investment products available in the market. With Brunel, the Pension Fund will work with the asset management industry to ensure that appropriate products are made available that deliver against its climate commitment while meeting its investment goals.

### Investment Monitoring

The Pension Fund will hold Brunel to account for the delivery of the Fund's investment objectives including its approach to climate change as set out in this policy. In turn, Brunel will hold to account the fund managers it has appointed, and the Fund will assess whether this is working effectively.

The Pension Fund expects investee companies to be transparent in their climate related disclosures and at a minimum expects the adoption of globally accepted disclosure standards such as the Task Force on Climate-related Financial Disclosures. The Pension Fund will itself work towards reporting in-line with the TCFD recommendations.

Fund managers are typically benchmarked against a market index. The fund manager will typically set risk limits against the index, such as tracking error. Therefore, there is a risk that the choice of benchmark could lead to managers being unwilling to take significant sector positions. The Pension Fund will therefore work with Brunel to ensure the benchmarks used for portfolios do not encourage positions inconsistent with the Fund's climate commitment, whether this is non-index based benchmarking or the use of indices that reflect a Paris aligned world.

### Engagement

The Pension Fund believes that engagement is a key tool in pursuing the achievement of its climate change commitment. Engagement has led to some progress on climate change matters, but overall the Pension Fund believes the magnitude and pace of change needs to increase. The Pension Fund does not view engagement and divestment as mutually exclusive but rather as two complementary tools that can be used in the escalation of climate concerns with companies. The

Pension Fund further believes that divestment is primarily a way of reducing the climate risk of its investments rather than in actively supporting the transition to a low carbon economy.

Engagement on behalf of the Pension Fund will primarily take place through Brunel, their appointed fund managers, and their engagement provider, in accordance with the approach set out in Brunel's Climate Change Policy <sup>(10)</sup>. The Pension Fund expects engagement to take place with clear targets and timescales and will monitor and report on the engagement activities undertaken by Brunel on the Fund's behalf. The Fund will also monitor the effectiveness of the engagement approach adopted by Brunel. Engagement will also be undertaken on behalf of the Fund by investor groups of which it is a member, such as the Local Authority Pension Fund Forum.

The Pension Fund believes there is still time for companies not currently aligned with the Paris Agreement to respond to the requirements of the low carbon transition and so believes the most appropriate approach is to continue engaging with these companies. To be clear, any such investments will only be held where they still present a sound investment case over the medium term and there is the belief that climate risk can be managed to appropriate levels, not for the primary purpose of maintaining the ability to engage. Although fundamental business change may be difficult the Pension Fund believes it can be achieved.

For passive investments although there is still the ability to engage with investee companies the ultimate sanction of divesting is not an option, as such the Pension Fund will need to be mindful of climate risks in passive portfolios. If insufficient progress is made by companies in an index as a whole the Pension Fund will need to consider the appropriateness of these investments and consider alternative options such as exclusion-based or tilted indices.

### Voting

As a shareholder in listed companies the Pension Fund has voting rights. The Pension Fund will utilise its voting rights to the fullest extent practicable. Ultimately voting is undertaken on behalf of the Fund by Brunel utilising the expertise of their voting and engagement provider and appointed managers.

Voting will be used to support climate concerns and to promote good practice by supporting appropriate climate related shareholder proposals, supporting increased disclosure of climate risks and scenario planning, and voting against boards where insufficient progress is seen to be made on climate risk. Voting activity will take account of the ongoing engagement with a company so that if progress is seen to be being made through engagement voting action may be postponed allowing time for any changes to be implemented.

We support the Brunel approach to voting escalation whereby they will escalate voting activity from voting against the reappointment of the Chair to other board members where they have not met their climate disclosure expectations. These expectations will increase over time with the aspiration of all their material holdings being on TPI Level 4 by 2022 and having made meaningful progress to alignment

with a 2 degree or below pathway. In some sectors, e.g. oil and gas, they will aim to stimulate more rapid change.

### Policy Advocacy

The Pension Fund will seek to influence policy development in the climate change arena, particularly where investment focused, through engagement with policymakers and regulators. The Fund may seek to do this through Brunel, on its own, in collaboration with other like-minded investors, or through a combination of these depending on how it thinks maximum impact will be achieved. In particular, the Pension Fund will look for the development of a meaningful carbon price, mandatory climate risk disclosures by listed companies, and the removal of fossil fuel subsidies.

The Fund sees policy development as being an important driver in providing the impetus needed for industry to deliver the changes required to achieve the Paris goals. By participating in policy development, the Pension Fund will also be in a strong position in terms of understanding the developing regulatory landscape and how this could affect the Fund's investments.

### Collaboration

We believe collaboration with other investors helps influence and improve market best practice standards as well as strengthening the voice of asset owners and their pension beneficiaries. Consequently, through our own activities and by our membership of groups such as the Local Authority Pension Fund Forum, we aim to support the goals of the Paris Agreement.

The Pension Fund will also work closely with Brunel and the other Brunel clients in the development of Brunel's approach to climate change. This will include ensuring that the investment offering from Brunel incorporates comprehensive climate change assessment into all portfolios. To this end the Pension Fund has been engaged in the production of and fully supports the Brunel Climate Change Policy.

The Pension Fund will also seek to collaborate with the wider investment community in order to promote its climate change goals. This may include signing investor statements, co-filing AGM resolutions, policy consultation responses and developing reporting standards. The Pension Fund will also seek to join groups, climate change specific or otherwise, whose aims on climate change correspond with those of the Fund.

### Monitoring and Reporting

To enable effective assessment of the climate change risk faced by investee companies and how this is being managed investors need accurate and comparable information. To this end the Pension Fund supports efforts to increase transparency of climate risk management and related metrics in the investment industry and work to develop globally accepted disclosure standards such as the Task Force on Climate-related Financial Disclosures.



In order to track progress in meeting its climate change commitment the Pension Fund will utilise relevant metrics. The Pension Fund will work to understand the best available metrics, being aware of any inherent limitations, and to develop new metrics where deemed beneficial. As set out in their Climate Change Policy Brunel are seeking to assess whether their listed equity portfolios are at least 2°C aligned by 2022.

As a minimum the Pension Fund will utilise the following metrics where applicable to given investments:

- Carbon Intensity
- Extractive Exposure
- Transition Pathway Initiative Scores

The Committee supports the Transition Pathway Initiative <sup>(11)</sup>. The TPI assess both management quality, through review of public disclosures, and carbon performance, including the benchmarking of companies' emissions pathways against the international targets and national pledges made as part of the 2015 United Nations Paris Agreement.

The Pension Fund will explore opportunities to undertake scenario analysis on its investment portfolio which provides estimations of the relative performance of asset classes and sectors under different climate change scenarios.

## **Review**

The Pension Fund wishes to adopt a flexible approach, enabling it to respond to changes in the science, policy action, or investment markets. As with all forecasting, as more detailed analysis is undertaken there are likely to be changes to the current understanding. Accordingly, the policy should be subject to regular review. The Pension Fund will also seek to undertake training to ensure that it remains abreast of the latest developments in climate change and related policy action.

The Pension Fund will produce an annual report on the operation of the Climate Change Policy including any actions undertaken, such as engagement results and the level of investment in climate change mitigation and adaptation. The Policy will be formally reviewed in 2022 to tie-in with Brunel's stocktake on the outcomes achieved through the operation of their Climate Change Policy.

## References

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- (10) <https://www.brunelpensionpartnership.org/wp-content/uploads/2020/01/Brunel-Climate-Change-Policy-rev01.pdf>
- (11) <https://www.transitionpathwayinitiative.org/>

## ANNEX 2

This document is directed only at the Oxfordshire Pension Fund (the “Plan”) on the basis of our investment advisory agreement. No liability is admitted to any other user of this report and if you are not the named recipient you should not seek to rely upon it. The contents of this document are generally intended to constitute investment advice as such term is defined in the Regulated Activities Order but strategic advice intended to inform, along with Strategic Asset Allocation Review referred to in paragraph 5, the development of the Plan’s Investment Strategy Statement (“ISS”).

Notwithstanding the above paragraph 22, 23, 24, 27 and 39 - 45 constitutes investment advice on the basis that the ISS is updated to reflect the strategic advice. If the Trustees are in any doubt as to whether the ISS will be updated to reflect the strategic advice they should not seek to rely on the investment advice.

This document has been prepared by MJ Hudson Investment Advisers Ltd an appointed representative of MJ Hudson Advisers Ltd which is authorised and regulated by the FCA.

**PENSION FUND COMMITTEE – 6 MARCH 2020**  
**FUNDAMENTAL REVIEW OF ASSET ALLOCATION**

**Report by the Independent Financial Adviser**

**Introduction**

1. A Fundamental Review of the Asset Allocation of the Pension Fund is undertaken once every three years, to synchronise with the triennial Actuarial Valuation carried out by the Scheme Actuary. Its purpose is to take a hard look at the existing structure of the Fund's assets, to assess the need for changes and to make recommendations to the Pension Fund Committee accordingly.
2. In my previous Review (presented to the March 2017 Committee), the main recommendation was to reduce the Equity weight by 5% and to increase the Fixed Interest weight by 5%. This switch was implemented later in 2017.
3. Once the Brunel Pension Partnership had been established, I wrote 'Transfer of Assets to Brunel Partnership' for the March 2018 Committee. This made recommendations as to how the Oxfordshire Fund should transition its assets into the different sub-funds being set up by Brunel.
4. In this report I shall revisit those transition proposals, showing which ones have been implemented, and considering how the remainder of the Oxfordshire Fund should be transitioned to Brunel sub-funds within an updated asset allocation strategy. (paras 8-24)
5. To assist in formulating this strategy, I have drawn on the results of a Strategic Asset Allocation Review prepared by a separate team within MJ Hudson Allenbridge. A summary of this review is contained in the Appendix, and my comments on it are in paras 25 - 28.
6. The next section of the paper (paras 29-38) deals with the structure of the Fund – covering several choices as to how the broad asset allocation strategy can be implemented. My recommendations are summarised in paras 39-45.
7. Previous Fundamental Reviews have included an assessment of each external investment manager's performance, with a recommendation as to whether they should be retained. As the Fund's remaining externally-managed mandates will be transitioning to Brunel within the next year, it is not felt necessary to carry out a similar assessment in this report.

**The transition to Brunel**

8. By the end of 2019 almost 50% of the Oxfordshire Fund had been transitioned into sub-funds run by Brunel. The progress by asset class is shown in the following tables, which are based on tables from my 2018 'Transfer of Assets' paper.

9. Passive Equities – both the UK and the Global Equities were moved to Brunel's funds (also managed by Legal & General) in Q3 2018

Fund code	Benchmark	UK %	O/S Dev'd %	Emerging %	Allocation	Action
EPU	FTSE All-Share	100	0	0	7.2	Q3 '18
EPD	MSCI World	7	93	0	9.0	Q3 '18
EPE	MSCI Emerging	0	0	100	0	
EPL	MSCI World	7	93	0	0	
EPS	MSCI World	7	93	0	0	
	Combined	7.8	8.4	0.0		

**Table 1 – Allocation to Passive Equity Portfolios**

10. **Active Equities** – in Q4 2018 the UK portfolio managed by Baillie Gifford transitioned to the Brunel portfolio managed by Invesco, Baillie Gifford and Aberdeen Standard Investments. In Q4 '19, the bulk of Wellington's Global Equity portfolio (which was closing at the end of 2019 in any event) was moved into Brunel's High Alpha Developed Equity product (managed by AllianceBernstein, Baillie Gifford, Fiera Capital, Harris Associates and Royal London Asset Management). At the same time, Brunel's Emerging Market Equities sub-fund (managed by Genesis, Wellington and Investec Asset Management) was funded from Oxfordshire's Wellington and UBS portfolios, together with some cash.

Fund code	Target return	UK	O/S Dev'd (%)	Emerging	Allocation (%)	Action
EUK	FTSE All-Share +2%	100	0	0	17	Q4 '18
EGC	MSCI ACWI +1-2%	6	82	12	8.8	
EDH	MSCI World +2-3%	7	93	0	9.0	Q4 '19
ELV	MSCI ACWI +	6	82	12	0	
ESG	MSCI ACWI +2%	6	82	12	0	
ESC	MSCI Sm Cos +2%					
EEM	MSCI Emerging +2-3%	0	0	100	3	Q4 '19
	Combined	18.0	15.8	4.0		

**Table 2 – Allocation to Active Equity Portfolios**

11. **Fixed Interest** – Brunel are at the stage of defining their Fixed Interest offerings, in consultation with the clients, so it is still too early to make any recommendations regarding the sub-funds on offer. Brunel held a consultation session with funds and advisers in January 2020, and the next stage will be Brunel’s publication of their list of Fixed Income funds on offer. As Oxfordshire will want to transition its existing Legal & General Fixed Income portfolio en bloc into a selection of Brunel’s funds, the transition may not happen until the first half of 2021 when the full list of Brunel funds becomes available.
12. **Alternative Assets** – the allocations adopted in March 2018 are shown in the Table below, with notes on how each asset class is intended to be integrated into the BPP portfolio.

%	Target	Range	
<b>Property</b>	<b>8</b>	<b>6-10</b>	<b>Fund-of-funds to transfer (2020?)</b>
<b>Private Equity</b>	<b>9</b>	<b>7-11</b>	<b>£100m committed to BPP</b>
<b>Multi-Asset (DGF)</b>	<b>5</b>	<b>4-6</b>	<b>To be decided</b>
<b>Infrastructure</b>	<b>3</b>	<b>2-4</b>	<b>£50m committed to BPP</b>
<b>Secured Income</b>	<b>5</b>	<b>4-6</b>	<b>£60m committed to BPP (from FI)</b>
<b>Cash</b>	<b>0</b>	<b>0-5</b>	

**Table 3– Allocation to Alternative Assets**

13. Oxfordshire’s 5% allocation to **Multi-Asset**, in the form of a Diversified Growth Fund (DGF) managed by Insight, was made in 2014. This formed part of a switch from Equity (4%), Private Equity (1%) and Hedge Funds (3%) into Multi-Asset (5%) and Infrastructure (3%). The intention of Multi-Asset was to achieve equity-like returns over 5-year periods but with lower volatility than equities (and at a lower cost than via Hedge Funds). In the past five years Insight’s Fund has delivered (gross of fees) [Cash +3.74% p.a.] compared with its target of [Cash +4.5% p.a.] with much lower volatility than global equities. Insight’s strategy is based on actively-managed allocations to traditional asset classes (Equities, Fixed Income, Real Assets) in addition to an array of Total Return strategies.
14. Brunel’s approach to multi-asset is very different from Oxfordshire’s. The four managers in Brunel’s DGF product are:
- Lombard Odier adopt a quantitative tactical asset allocation approach on traditional assets. 80% of return is driven by asset allocation with the remaining 20% driven by alternative risk premia

- JPMorgan offer pure quantitative exposure to alternative risk premia across traditional asset classes. The strategy focusses on Value, Momentum, Carry & Quality risk premia
  - William Blair undertake a forward-looking qualitative macro approach, which allocates between beta, security selection, currency and total risk. The strategy has a disciplined valuation framework based on 30 years of analysis
  - UBS invest purely in wide range of currencies via forward contracts. The strategy targets currencies that deviate from its long-term fundamental value in terms of its real purchasing power parity
15. Leaving aside the complexity of this arrangement, there is very little common ground with Insight's approach, which has served Oxfordshire well. Consequently, Oxfordshire has declined to invest in Brunel's DGF product.
16. Although **Secured Income** is classified by Brunel as an Alternative portfolio, Oxfordshire decided to commit 5% to this fund from its existing Fixed Interest allocation. To date £60m has been committed to Brunel who committed £22m each to two Secured Income funds based on long-lease property in October 2018. Because of the queues of investors for both funds, only £2.9m of this sum has so far been drawn down. £16.4m has recently been committed to an Operating Infrastructure Fund. The undrawn money is being held in Oxfordshire's Fixed Interest portfolio until required.
17. My 'Review of Private Equity' for the December 2019 Committee included forecasts from Adams Street, Partners Group and Epiris showing that some **£63m** of net distributions is expected to flow back to the Oxfordshire Fund from them in the four years 2020-23. In addition, the listed portfolio is expected to distribute **£11m** in dividends during these four years. This combined total of **£74m** is more than sufficient to meet the remaining commitments of Oxfordshire's Private Equity (**£6.4m**), Real Estate (**£14.4m**) and Infrastructure (**£9.8m**).
18. The balance, some **£43m**, will be needed to meet the commitments to Brunel in respect of Alternative Assets. Less than 10% of the Brunel Private Equity commitment, and less than 20% of the Infrastructure and Secured Income commitments, have been drawn to date. The undrawn balances on Brunel commitments at end-2019 stood at:
- **Private Equity: £91.7m**
  - **Infrastructure: £41.5m**
  - **Secured Income: £49.3m**
19. Member funds need to submit plans for new commitments to Brunel Private Markets by the end of March 2020, to cover their requirements for the next two years. My proposals for these new commitments are as follows.

## Private Equity

20. There is inevitably a delay between the date when Oxfordshire makes a commitment to Brunel and the date when investment takes place. As a first stage the Brunel Private Markets team needs to identify PE funds which meet their requirements, and then conduct detailed analysis and due diligence before making a commitment. At the second stage, the managers ('GPs') of the selected funds will then need to identify and analyse attractive companies to invest in. This second stage may be shorter in the case of Secondaries funds, or Co-Investment funds, but overall it may be 5 years or more before an Oxfordshire commitment to Brunel has been fully invested.
21. Based on this pace of investment and using cashflow projections on Oxfordshire's own portfolio from my Annual Review of Private Equity, I have estimated the effect which March 2020 commitments to Brunel would have on Oxfordshire's overall PE exposure during the next four years. (This estimate disregards any distributions to be received from Brunel's existing investments, which would tend to reduce the %-age exposures shown in the table).

Committed 3/20	End-2020	End-2021	End-2022	End-2023
£100m	8.3%	9.1 %	10.2%	11.2%
£ 80m	8.3%	9.0 %	9.9%	10.8%

**Table 3– Effect of Private Equity Commitments**

22. It is clear that new commitments in 2020 will have very little effect on the overall exposure at the end of 2021, because of the delays described above. They will, however, increase the PE weighting in subsequent years. I estimate that £100m committed now will translate into an investment equal to 1.5% of the overall fund at end-2022, and 2.2% of the fund at end-2023. As the current target allocation to PE is 9%, with an upper limit of 11%, **I recommend that Oxfordshire commits a further £100m to Brunel in March 2020.** It appears unlikely that the 11% ceiling will be reached before March 2022, when the decision on committing to Round 3 of the Brunel PE programme will be made, but new projections can be run at that time to review progress.

## Infrastructure

23. Of the commitments made to date by Brunel, two-thirds have been into Renewables Funds, the remainder into a General Fund. Oxfordshire's target weighting in Infrastructure is 3% (£82m at present values). Existing commitments to Infrastructure total £72m, of which some £20m has been invested with very few distributions to date. In order to increase the Infrastructure exposure towards its target level more rapidly, **I am recommending a commitment of £40m to Brunel's Infrastructure programme in March 2020.**



## Secured Income

24. Oxfordshire's target weighting to Secured Income is 5% (£136m at present values). As detailed in para 16, the whole of Oxfordshire's £60m commitment to Brunel has been allocated by Brunel, but only £10.7m has been drawn down to date because of investor queues at the two long-lease property funds. In order to move Oxfordshire's Secured Income exposure towards its target level, **I am recommending an £80m commitment to Brunel's Secured Income programme in March 2020.**

## Strategic Asset Allocation Review

25. As detailed in the **Appendix**, the review analyses the expected long-term annual return and the associated volatility of a number of variants of Oxfordshire's existing Strategic Asset Allocation ('SAA'). The first comparison to be studied here is the difference between Oxfordshire's current portfolio at end-2019 ('CP') and the SAA. As the CP is below its target allocation in Private Equity, Infrastructure and Secured Income because of the delay in investing commitments (see preceding paragraphs) it is overweight in lower-returning classes (notably Fixed Interest and Cash). This results in a lower expected return and higher volatility, as shown in the following table:

	Current portfolio	Strategic AA
Expected annual return	<b>4.60%</b>	<b>4.84%</b>
Expected annual volatility	<b>9.33%</b>	<b>9.05%</b>
Sharpe Ratio (Risk-free rate = 1.80%)	<b>0.30</b>	<b>0.34</b>

**Table 4– Risk/return comparison (1)**

26. As explained above, it will take several years for the current portfolio to reach its target allocations in the Alternative asset classes. Meanwhile, the Strategic Review analyses two portfolios which are expected to deliver annual returns above 5.2% with slightly less volatility than the SAA portfolio. The first of these – the **Targeted Return** - makes these changes to the existing SAA:
- 5% allocated to Multi-Asset Credit
  - 5% allocated to Private Debt
  - 4% more in Infrastructure
  - 1% more in Private Equity

These are funded by:

- 4% reduction in Listed Equity (but with 2% more in Emerging Markets)
- 6% reduction in Fixed Interest
- 5% reduction (to nil) in DGF

The enhanced risk-return characteristics of Targeted Return compared with CP and SAA are shown in the following table:

	Current portfolio	Strategic AA	Targeted Return
Expected annual return	<b>4.60%</b>	<b>4.84%</b>	<b>5.24%</b>
Expected annual volatility	<b>9.33%</b>	<b>9.05%</b>	<b>9.00%</b>
Sharpe Ratio (Risk-free rate: 1.80%)	<b>0.30</b>	<b>0.34</b>	<b>0.38</b>

**Table 4– Risk/return comparison (2)**

27. A Private Debt product (PPD) is now being offered by Brunel, with initial commitments due by end-March 2020. As this appears from the portfolio modelling to be an attractive asset class, **I recommend that Oxfordshire makes an initial commitment of £80m (or 3%) to Private Debt via Brunel.** Multi-Asset Credit is due to be one of the suite of Fixed Interest funds from Brunel (labelled BMA), and will be dealt with as part of the re-allocation of Fixed Interest mentioned in para 11. The increased allocations to Infrastructure and Private Equity would have to be made via Brunel, and would be additional to the new commitments recommended in paras 22 and 23.
28. My one reservation about the Targeted Return portfolio is its heavy concentration of 40% in illiquid assets. If the Fund needed to realise assets at a time when global markets were stressed (as in 2008), it would have a thin layer of just 10% in Fixed Interest to draw on before being forced to sell equities or to seek a buyer for some of its illiquid assets. Neither of these would be an attractive scenario.

## **Investment Structure**

### **Active or Passive management?**

29. The basic distinction here is that an active manager will attempt to run a portfolio to produce a return which *exceeds* the return on a relevant index of that asset class (e.g. the FTSE All Share Index for a UK Equity portfolio) whereas a passive manager will aim to produce a return *equal to* the index return. The active manager may use a number of different techniques to select stocks for his portfolio, while the passive manager will normally operate a system of index-replication which generates a portfolio as close as possible to the notional portfolio underlying the relevant index. The passive manager will utilise very little discretion in managing his 'tracker' fund, as computer programs will be used to ensure the holdings continue to match the index constituents closely. There are significant economies of scale for a passive manager, as a larger fund can replicate more of the smaller constituents in an index, while the overheads remain relatively constant. As a result of all these

factors, the fee charged to the investor under a passive mandate is far smaller than for an active one.

30. One of the considerations for the Pension Fund is whether the active manager can generate sufficient performance (gross of fees) in excess of the index to compensate for the lower fee charged by the passive manager. There are also, however, other considerations. By its nature, a market index is always fully-invested, whereas an active manager has the freedom to hold a certain amount of cash if he expects a general fall in the market. If the active manager uses this freedom at the right time, he can cushion the impact of a general market decline. Similarly, the active manager can – and should – hold a lower weight than the index in sectors he expects to be relatively weak, whereas the passive manager is obliged to maintain the index weight in every sector at all times.
31. The recent focus on fees charged by active managers – without delivering out-performance of their benchmark index – has caused a worldwide shift from active to passive equity funds. The need for passive funds to deploy new money immediately according to the market weights of the index components brings with it the danger that the prices of large stocks on expensive ratings will be inflated even further as the new money floods in.
32. At present some **29%** of the Fund's UK Equities, and **32%** of the Overseas Equities, are managed passively. These equate to **7.6%** and **9.8%** of the overall Fund respectively. This has reduced the management fees payable, and reduced the risk of overall under-performance. The current passive holdings are:
  - £195m - UK Equities (EPU) tracking the FTSE All Share Index**
  - £283m - Global Developed Equities (EPD) tracking the FTSE World Developed Index.**
33. Another passive sub-fund offered by Brunel is **Passive Low Carbon Equities (EPL)**. This is based on the **MSCI ACWI Low Carbon Target Index**, which in turn aims to track the MSCI ACWI Index with a tracking error of 0.30% while minimising the carbon exposure. It does this 'by overweighting companies with low carbon emissions (relative to sales) and those with low potential carbon emissions (per dollar of market capitalisation)'. The only significant difference in factor exposures relative to the MSCI ACWI Index is that the Low Carbon Index is underweight in smaller companies.
34. At present EPL is the only passive sub-fund within Brunel which specifically addresses the climate change issue in its choice of benchmark index. It merits inclusion in Oxfordshire's portfolio as an initial move to reduce the carbon footprint of the Fund. With new indices being established at a rapid rate, it is quite possible that in time other 'climate change aware' indices will be included in Brunel's range of sub-funds. I am therefore recommending an initial investment of 5% of the Oxfordshire Fund (£135m) in EPL, with the intention of examining other suitable passive vehicles as they become available.

## Separate Allocation to UK equities?

35. Over the past 21 years, allocations to UK equities by LGPS Funds as a proportion of overall equities has reduced steadily, from 73% in 1998 to just 25% in 2019 [State Street/PIRC Local Authority Annual League Tables, March 2019]. Even 25% vastly overstates the size of the UK equity market (some 5% of World Equities by market value) and it is worth asking whether a specific allocation to UK equities is still necessary, rather than a single Global Equity allocation.
36. A number of arguments are advanced in favour of retaining a UK allocation:
- Historically, up to 2013, UK equities had performed well relative to other world markets, although in the three years 2014-16 Global Equities' return was some 8% p.a. ahead of UK Equities – partly due to the weakness of sterling in 2016. This trend continued in 2017-19, when Global Equities returned 4% p.a. more than UK Equities.
  - Holding £-denominated assets matches the currency of the liabilities for a UK Pension Fund, thereby removing one source of mismatch risk
  - UK equities give an investor exposure to global businesses, and are not solely linked to the fortunes of the UK economy\*
  - Active managers of UK equity portfolios have a greater knowledge of, and access to, UK- based companies, and are therefore in a better position to out-perform than managers of global equity portfolios
  - Global Equity managers tend to focus on the large-cap stocks, whereas a UK-only manager can delve into the mid- and small-cap stocks in search of value.
  - UK-listed companies are better regulated than those listed on many foreign exchanges

\* Although this 'global exposure' point is frequently made, it masks the fact that the sectoral choices available to a UK investor are very different from those for a global investor. As the following table shows, the UK has higher exposure to Oil & Gas, Financials and Basic Materials, but is massively underweight in Technology relative to the All-World Index.

Industry	All-Share weight (%)	All-World weight (%)	Difference
<b>Oil &amp; Gas</b>	<b>11.8</b>	<b>5.3</b>	<b>+6.5</b>
<b>Financials</b>	<b>27.1</b>	<b>21.2</b>	<b>+5.9</b>
<b>Basic Materials</b>	<b>7.6</b>	<b>4.1</b>	<b>+3.5</b>
<b>Consumer Goods</b>	<b>14.0</b>	<b>10.9</b>	<b>+3.1</b>
<b>Consumer Services</b>	<b>12.0</b>	<b>11.5</b>	<b>+0.5</b>
<b>Industrials</b>	<b>11.6</b>	<b>12.8</b>	<b>-1.2</b>
<b>Telecommunications</b>	<b>2.5</b>	<b>2.7</b>	<b>-0.2</b>
<b>Utilities</b>	<b>3.0</b>	<b>3.3</b>	<b>-0.3</b>
<b>Health Care</b>	<b>9.3</b>	<b>11.1</b>	<b>-1.8</b>

<b>Technology</b>	<b>1.1</b>	<b>17.1</b>	<b>-16.0</b>
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**Table 5. UK and Global sector weightings**

[Source: FTSE Russell All-Share, All-World Reports, December 2019]

37. Although there are still valid reasons to retain investments in active UK Equity funds, my recommendation from this analysis is to reduce the Oxfordshire Fund's weighting in **passive** UK Equities, and switch into **passive** Global Equities. This gives the portfolio greater exposure to growth sectors and reduces the weighting in extractive industries. This switch could be most effectively achieved by moving money from the FTSE All-Share tracker (EPU) into the Passive Low Carbon Equities tracker (EPL) (see para 33); this would satisfy the dual objectives of reducing the UK Equity weight and at the same time reducing the carbon exposure of the portfolio.

### **Responsible investment**

38. As one of the members of the Brunel Pension Partnership, the Oxfordshire Fund is fully committed to Brunel's policies as set out in:
- 'Responsible Stewardship Policy Statement' (October 2018)
  - 'Responsible Investment Policy Statement' (June 2019)
  - 'Climate Change Policy' (January 2020)

The text of the Fund's Climate Change Policy – to be included in the Investment Strategy Statement – is currently under discussion following the Climate Change workshop held in November 2019 and the Climate Change Working Group which started work in December.

### **Recommendations**

#### **Immediate**

39. To reduce the UK Equity target by 5% to 21%, and to increase the Overseas Equity target by 5% to 33%.
40. To implement this change by switching 5% of the Fund (c. £135m) from the FTSE All-Share Tracker (EPU) to the Passive Low Carbon Equities Tracker (EPL), and to examine other 'climate change aware' tracker funds for potential future investment.
41. To commit a further £100m to Brunel for investment in Private Equity.
42. To commit a further £40m to Brunel for investment in Infrastructure.
43. To commit a further £80m to Brunel for investment in Secured Income.
44. To commit £80m to Brunel for investment in Private Debt.

#### **Medium-term**

45. To seriously consider investing 5% of the Fund into Multi-Asset Credit when the vehicle for this class becomes available from Brunel.

**Peter Davies**

**Senior Adviser – MJ Hudson Investment Advisers**

**February 24<sup>th</sup>, 2020**

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# Executive Summary to the Strategy Review

The current portfolio (i.e. the current “tactical” asset allocation) yields an expected annual return of 4.6% with an expected volatility of 9.33%, based on the modelling using our Long-Term Capital Market Assumptions (“LTCMA”). This return is already sufficient to exceed the discount rate assumed by the actuary (i.e. 4.3%) and thus would be expected to improve the funding position of the Fund over time. However, when compared to the Fund’s current strategic asset allocation (“SAA”), the current portfolio has a materially less efficient risk-return characteristic. This suggests that the delays in deployment (as per the SAA) experienced by the Fund has resulted in lower expected returns and higher risk. Rebalancing the Fund back to its existing SAA, increases the expected return and reduces the expected volatility.

Nonetheless, our analysis shows that the investment portfolio can be made more efficient than the current SAA, targeting higher returns for a given level of risk, or reducing the level of risk for similar levels of expected annual return. As such, in order to improve expected returns, reduce downside risk (as measured by Value at Risk (“VaR”) and hence increase probability of being fully funded over the medium to long term, we would propose a number of alterations to the SAA.

We outline three proposed portfolios for consideration below: “Portfolio A – Targeted Return”; “Portfolio B – Higher Return” and “Portfolio C – Lower Risk”. The first two portfolios target higher expected returns with similar levels of expected volatility to the existing SAA and lower than the current portfolio whilst reducing the Fund’s VaR in both cases.

- Portfolio A – (Exp return: 5.2; Exp Volatility 8.9). Re-allocates a portion of equities to private equity and infrastructure, and traditional fixed income assets to multi-asset credit and private debt; diversified growth funds (“DGFs”) have been removed in favour of the aforementioned asset classes.
- Portfolio B – (Exp return: 5.4; Exp Volatility 9.0). Builds on the same theme as Portfolio A and but shifts a greater proportion of assets to these illiquid asset classes, and as such is expected to generate higher long-term returns, but the level of liquidity risk is greater which in the event of an economic downturn would be challenging for the Fund.
- Portfolio C – (Exp return: 5.0; Exp Volatility 8.3). Represents an overall lower risk option with marginally better expected returns than the current SAA. The proposal re-allocates a larger proportion of the equity exposure and some traditional fixed income, to income-generating alternatives, resulting in materially reduced liquidity risk and higher proportions of fixed income assets than either Portfolio A or B.

Overall, we would believe Portfolio A – Targeted Return to be the most attractive in the current environment.

Additionally, we were asked to explore whether the Fund could tilt its portfolio to embrace ESG (“Environmental Social and Governance”) considerations in the investment strategy, based on the investments available through the Brunel Pension Partnership (“Brunel”). We have considered this and included these considerations in the proposals. We have also presented this option in isolation in the Other Scenarios section in the full report, to illustrate the stand-alone impact of the changes.

Lastly, based on the cash flows and expected contributions provided by the Fund’s actuary and our cash-flow analysis, the Fund is expected to become only marginally cashflow negative in the near-term. When considering the current commitments made to illiquid assets (including private equity, infrastructure and secured income), and assumed deployment rates, this results in substantial negative cashflows but these would be funded from any proceeds from asset sales resulting from this portfolio rebalancing exercise. It is important to note that under the current portfolio and all proposed portfolios, the Fund has sufficient liquid investments to meet the near term cashflow obligations should this be required. Nonetheless, our view is that it would be more efficient to re-allocate some of the investments to income-generating assets rather than selling growth assets (such as equities) in future, prematurely at potentially inopportune times in order to raise cash. This is considered in the proposed scenarios and is part of the rationale behind the choice of investments.

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Division(s): NA

## **PENSION FUND COMMITTEE – 6 MARCH 2020**

### **BUSINESS PLAN 2020/21**

#### **Report by the Director of Finance**

#### **RECOMMENDATION**

1. **The Committee is RECOMMENDED to:**
  - (a) **approve the Business Plan and Budget for 2020/21 as set out at Annex 1;**
  - (b) **approve the Pension Fund Cash Management Strategy for 2020/21.**
  - (c) **delegate authority to the Director of Finance to make changes necessary to the Pension Fund Cash Management Strategy during the year, in line with changes to the County Council's Treasury Management Strategy;**
  - (d) **delegate authority to the Director of Finance to open separate pension fund bank, deposit and investment accounts as appropriate;**
  - (e) **delegate authority to the Director of Finance to borrow money for the pension fund in accordance with the regulations.**

#### **Introduction**

2. This report sets out the business plan for the Pension Fund for 2020/21. The Plan sets out the key objectives of the Fund, details the key service activities for the year, and includes the proposed budget and cash management strategy for the service.
3. The report also reviews the progress against the key service priorities included in the 2019/20 Plan as context for setting the key priorities going into the next financial year.
4. The key objectives for the Oxfordshire Pension Fund are set out on the first page of the Business Plan for 2020/21 (contained in annex 1), and remain consistent with those agreed for previous years. These are summarised as:
  - To administer pension benefits in accordance with the LGPS regulations, and the guidance set out by the Pensions Regulator
  - To achieve a 100% funding level
  - To ensure there are sufficient liquid resources to meet the liabilities of the Fund as they fall due, and
  - To maintain as near stable and affordable employer contribution rates as possible.

5. Part A of the plan sets out the broad service activity undertaken by the Fund. As with the key objectives, these are unchanged from previous years. The service priorities for the forthcoming financial year are then set out in more detail in Part B. These priorities do not include the business as usual activity which will continue alongside the activities included in Part B.

### **Key Service Priorities – A review of 2019/20**

6. There were 5 service priorities included in the 2019/20 Plan and the latest position on each is as follows.
7. Contribute to the continued development of the Brunel Pension Partnership.  
There were three measures of success set out in the initial business plan which were around the development of a comprehensive suite of client assurance reports, the continued successful transition of assets to the new Brunel portfolios and meeting the objectives set out in the business case.
8. Work has progressed throughout the year on the development of the suite of client assurance reports with those for the listed markets now signed off by the Oversight Board, and those for the private markets presented to the Client Group for the first time in February. The appropriateness of these reports will be further tested as more money is transitioned into the Brunel portfolios and the they therefore cover more assets.
9. In terms of asset transitions, these have continued broadly in line with the planned timescales, with Brunel now responsible for just under 50% of Oxfordshire's assets. Call off against the commitments to the private market portfolios has been slower than initially assumed and this continues to be reviewed.
10. The transitions to date have largely been in line or better than the business case, so successfully delivering measure three within our business plan.
11. Manage the 2019 Valuation. As reported elsewhere on this agenda, the 2019 Valuation exercise is now nearly complete, with no comments received on the draft Funding Strategy Statement and scheme employers able to agree future employer contributions with the Fund Actuary within the parameters and flexibilities set out in the Statement.
12. The final element of this objective was to review the asset allocation to ensure sufficient liquid resources to pay the pension liabilities as they fall due. Proposals to cover this aspect of the objective are covered within the Investment Strategy report elsewhere on today's agenda.
13. Delivery of the Improvement Plan to ensure all Pension Fund data is received and stored in accordance with the requirements of the Pension Fund Regulator.  
Five measures of success were set for this objective and all have been delivered over the course of 2019/20. This includes the issuing of annual

benefit statements in line with statutory deadlines, data quality scores in line or better than national standards, and the delivery of business as usual activity within the performance targets set.

14. In respect of the fifth measure of success and the implementation of iConnect, whilst this has been achieved in line with the programme timescales, work will continue into 2020/21 to complete the roll out to all scheme employers including many of the larger employers who were included in the final tranches of the programme.
15. Develop a more robust approach to monitoring the performance of Fund Managers, in respect of their delivery against the Funds governance responsibilities. The measures of success targeted for this objective were to regularly publish benchmark data within the open sessions of the Committee's agenda, alongside a clear audit trail of the process for reviewing the performance of fund managers. Work has continued throughout the year on this objective in association with Brunel.
16. A key challenge in delivering this objective has been the lack of industry standard measures in this area, and a lack of a consistent approach to measuring key outputs. The Climate Change Policy elsewhere on today's agenda sets out a commitment to develop alongside Brunel a set of metrics to ensure the successful implementation of the Policy can be monitored, but much work remains to be achieved in this area.
17. Improving scheme member communications. Whilst we have now moved the default position for the publication of the annual benefit statements from paper to the electronic portal, allowing scheme members to log onto their account and view their statement as required, member engagement with the on-line service remains poor (although in line with data from other LGPS Funds who have also made the transition).
18. At the time of writing this report, the arrangements to release self-help facilities for members were being finalised, including the ability of members to obtain estimates of their future pension benefits. It is hoped that the increased functionality will improve the take up of the on-line services and this will continue to be monitored. What has been clear though is that the move of functions to the on-line portal has improved the efficiency of the Pension Services team and has contributed to the significant improvements in service levels, and a more timely service to scheme members.
19. Work against the 2019/20 business plan has been undertaken largely in line with the agreed budget with four major exceptions as seen in the table below.

	Budget	YTD	%	Forecast Outturn	Variance
	2019/20	2019/20		2019/20	2019/20
	£'000	£'000		£'000	£'000
<b>Administrative Expenses</b>					
Administrative Employee Costs	1,576	940	60	1,426	-150
Support Services Including ICT	634	1,075	170	1,075	441
Printing & Stationary	72	30	43	72	0
Advisory & Consultancy Fees	160	17	11	160	0
Other	60	3	4	60	0
<b>Total Administrative Expenses</b>	<b>2,502</b>	<b>2,065</b>	<b>83</b>	<b>2,793</b>	<b>291</b>
<b>Investment Management Expenses</b>					
Management Fees	8,484	6,500	77	9,000	516
Custody Fees	0	0	0	0	0
Brunel Contract Costs	1,043	1,164	112	1,164	121
<b>Total Investment Management Expenses</b>	<b>9,527</b>	<b>7,664</b>	<b>80</b>	<b>10,164</b>	<b>637</b>
<b>Oversight &amp; Governance</b>					
Investment Employee Costs	254	174	68	254	0
Support Services Including ICT	11	9	81	15	4
Actuarial Fees	160	195	121	180	20
External Audit Fees	35	9	27	35	0
Internal Audit Fees	15	11	73	15	0
Advisory & Consultancy Fees	95	18	19	95	0
Committee and Board Costs	49	35	71	40	-9
Subscriptions and Memberships	50	25	51	50	0
<b>Total Oversight &amp; Governance Expenses</b>	<b>669</b>	<b>476</b>	<b>71</b>	<b>684</b>	<b>15</b>
<b>Total Pension Fund Budget</b>	<b>12,698</b>	<b>10,205</b>	<b>80%</b>	<b>13,641</b>	<b>943</b>

20. It is estimated that there will be underspend against pensions administration staffing costs of £150,000 due to the level of vacancies experienced during the year. As noted above this has not impacted on performance as a result of improved efficiency through automation and the clearance of the previous backlog of work.
21. There is an estimated overspend of £441,000 on support services and ICT reflecting the requirement to renew licence fees for the pension's software as part of the renewal of the service contract following re-tendering. Unfortunately, this cost was not included in the budget prior at the start of the year.

22. There is an expected overspend of £516,000 against fund management fees reflecting the increase in asset values under management and the nature of the fee structures.
23. Finally there is an overspend on the fees for Brunel of £121,000 reflecting changes in the approved Brunel budget through special reserve matters after the agreement of the initial budget for this Committee.

### **Service Priorities for 2020/21**

24. For 2020/21 it is proposed to focus on four key priorities building on the work from the current year and picking up nationally identified issues. The detail of the key actions and measures of success are set out in Part B of the Business Plan. A summary of each of the 4 key priorities is as follows.
25. In respect of Brunel, the key priority for 2020/21 is to complete the transition of all assets to the new Brunel Portfolios and to bed down the new performance monitoring and assurance arrangements, including monitoring against the initial business case. This will include developing the Brunel reporting to this Committee, including the attendance of relevant officers at future Committee meetings.
26. The second priority focusses on the implementation of the Climate Change Policy as recommended elsewhere on this agenda. The Policy sets out several ambitious targets for the Pension Fund with the priority identified within the Business Plan around the development of the implementation plans to deliver these targets and to establish the monitoring arrangements against which compliance with the Policy can be established. The actions include a number of joint actions with Brunel around the investment portfolios as well as working with the wider County Council to ensure the Funds own operations address the carbon neutral target for 2030.
27. The third priority focusses on improving the overall governance arrangements of the Fund in response to the national priority being given to the issue. The actions are consistent with the guidance coming out of the work of Hymans Robertson for the Scheme Advisory Board, and include addressing any knowledge and understanding shortfalls, ensuring a robust performance management framework is in place, and that there are clear schemes of delegations and accountability for delivering the statutory duties of the Pension Fund.
28. The fourth priority looks to improve the efficiency and effectiveness of our engagement with scheme employers and scheme members. Actions in this area include the continuation of the current projects to automate processes where ever possible, including the conclusion of the iConnect Project and the further development of the on-line portal for scheme members, as well as improving the communications with scheme employers and members around how their assets are invested.

## **Budget 2020/21**

29. Part C of the Business Plan sets out the Fund's budget for 2020/21 and compares it with the budget for 2019/20. Overall there is an increase in the budget from £12,698,000 to £14,494,000. The main elements of this variation are explained in more detail below. A report comparing the Pension Fund budget for the full 2019/20 financial year against the actual expenditure will be produced for the June 2020 Committee meeting.
30. The administrative staffing budget has seen a reduction of £185,000 or 12% since last year. This in part reflects the removal of additional resources previously added into the budget to reflect the need to bring in agency support to clear the backlog of work. It also reflects the fact that with the removal of the backlog of work and the increased automation of processes through iConnect and Member Self Service, it has been possible to reduce the overall staffing establishment. A key caveat here is that this position will need to be reviewed once final decisions are known in providing a remedy to the McCloud judgement. At this time it is unclear what additional resource will be required to manage the impact and when that resource will be required.
31. There has been an increase in the budget for support services and ICT to allow for the final project costs associated with the Guaranteed Minimum Pension reconciliation work which should be completed during 2020/21 following final decisions by HMRC.
32. The major variation in the budget is on Fund Management Fees which have increased from £8.5m to 10.4m. Around half of this increase reflects the increase in the overall assets of the Fund and the fact that management fees are charged as a fixed percentage of assets under management. The remaining increase in fees reflects the implementation of the previous asset allocation decisions and the transition of assets to the private equity and infrastructure portfolios within Brunel. These portfolios attract higher fees than the previous allocations to equities. Part of the funding for these private market allocations were in fact held in cash during 2019/20 and therefore did not attract any fees. It should be noted that the increase in fees should be more than offset by improved investment returns as well as a reduction in the overall level of volatility within the investment performance of the Fund.
33. The variations in custody fees and cost of the Brunel contract largely cancel each other out and reflect a switch in responsibility for the payment of the custody fees relating to legacy assets. These costs were included in the Brunel contract costs last year but will be met directly by the Fund in 2020/21.
34. The only significant variation in the Oversight and Governance section of the budget is in the costs of advisory and consultancy fees. These have risen by £11,000 reflecting a new allowance of £20,000 to support the work of implementing the Climate Change Policy offset by a reduction in the fees paid this year to support the work of the strategic asset allocation review.

## **Training Plan**

35. Part D of the Business Plan sets out the broad Training Plan for Committee Members, based on the draft Policy previously agreed by the Committee. Alongside the provision of a core training programme, we will add additional subjects relevant to the Committee's work programme, including sessions on the governance and responsible investment guidance due to be published by the Scheme Advisory Board, the revised Code of Practice expected from the Pension Regulator and the implications of the McCloud judgement if determined during 2020/21.

## **Cash Management**

36. The final section of the business plan, Part E, provides the annual cash management strategy for the Fund. The Strategy is based on the Treasury Management Strategy for the Council, but has a significantly reduced number of counter-parties reflecting the lower sums of cash involved, and the wider set of alternative investment classes open to the Pension Fund.

LORNA BAXTER  
Director of Finance

Contact Officer  
Sean Collins  
Tel: 07554 103465

February 2020

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## Oxfordshire Pension Fund: Business Plan 2020/21

### Service Manager - Pensions: Sean Collins

#### Service Definition:

- To administer the Local Government Pension Scheme on behalf of Oxfordshire County Council

#### Our Customers:

- Scheduled scheme employers e.g. County Council, District Councils, Oxford Brookes University, other Colleges and Academies
- Designating scheme employers e.g. Town & Parish Councils
- Community Admission Bodies e.g. charitable organisations with a community of interest
- Transferee Admission Bodies i.e. bodies where services have been transferred on contract from County or Districts
- Contributory Employees
- Pensioners and their Dependants
- Council Tax payers

#### Key Objectives:

- Administer pension benefits in accordance with the LGPS regulations
- Achieve a 100% funding level;
- Ensure there are sufficient liquid resources available to meet the Fund's liabilities and commitments; and
- Maintain as nearly a constant employer contribution rate as is possible.

## Part A: Service Activities

Service Activity	Outputs	Outcomes
<b>Investment Management</b>		
Management of the Pension Fund Investments	<p>The Fund is invested in assets in accordance with the Committee's wishes.</p> <p>The Fund's assets are kept securely.</p> <p>Quarterly reports to the Pension Fund Committee.</p>	Pension Fund deficit is minimised by securing favourable returns on investments (compared to benchmarks).
Management of the Pension Fund Accounts	Completion of the Annual Report and Accounts.	No adverse comments from the Fund's auditors.
Management of the Pension Fund Cash	<p>Cash management strategy and outturn reports.</p> <p>Cash Managed in accordance with the strategy.</p>	The Pension Fund cash is managed securely and effectively.
<b>Scheme Administration</b>		
Management of the Pension Fund Administration	<p>The administration procedures are robust and in accordance with regulations and service standards</p> <p>Changes to regulatory framework of the scheme</p>	<p>The workload is completed &amp; checked in accordance with regulations and procedures. Work is completed within specified time scales</p> <p>No adverse comments from the Fund's auditors, and the Pension Regulator</p> <p>Implementation of actions arising from regulation changes</p>

## Part B – Service Priorities

Task	Actions	Measures of Success
<p>Manage the completion of the transition of assets to the new Brunel Portfolios, and contribute to delivery of the business as usual investment performance and assurance reporting for the Brunel Pension Partnership.</p>	<p>Work with the Company and Client Group to embed the new investment monitoring and assurance reporting processes, revising the reports as appropriate.</p> <p>Work with the Company, Client Group and Transition Managers on delivery of the remaining transition plan.</p> <p>Work with the company and Client Group to monitor the development of the Partnership against the initial Business Case.</p>	<p>Brunel Oversight Board and the Pension Fund Committee have all the information needed to provide assurance on the processes and performance of the Brunel company.</p> <p>Delivery of the outstanding asset transitions in accordance with the revised Transition Plan and the initial business case.</p> <p>Delivery of robust financial reports monitoring all elements of the business case, including company and investment costs, investment performance and transition costs.</p>
<p>Implement the Climate Change Policy.</p>	<p>Produce an implementation plan to transform the Pension Fund operations to be carbon neutral by 2030.</p> <p>Working with Brunel, develop a robust set of metrics to assess the investment portfolios against the requirements of the Paris Agreement, setting targets as appropriate.</p> <p>Establish monitoring arrangements to ensure Brunel and Fund Managers are compliant with the Fund's Policy.</p> <p>Work with Brunel and the Client Group to ensure a full range of portfolios compliant with the Paris Agreement, alongside portfolios tilted to companies working to deliver a sustainable future.</p>	<p>Implementation Plan in place with clear interim targets.</p> <p>Metrics and appropriate targets agreed.</p> <p>Committee able to demonstrate to all stakeholders, compliance with the Climate Change Policy.</p> <p>Fund in a position to meet full investment strategy, compliant with the Climate Change Policy through Brunel portfolios.</p>

<p>Improve the overall governance of the Pension Fund.</p>	<p>Develop a full implementation plan for the 6 key areas covered with the Good Governance in the LGPS report agreed by the Scheme Advisory Board</p> <ul style="list-style-type: none"> <li>• Governance including agreeing a Senior LGPS Officer with responsibility for all LGPS matters, and production of the Annual Governance Compliance Statement</li> <li>• Conflicts of Interest</li> <li>• Representation</li> <li>• Skills and Training</li> <li>• Service Delivery</li> <li>• Compliance and Improvement</li> </ul>	<p>Annual Governance Compliance Statement identifies no areas of significant weakness.</p> <p>Independent Governance Review as proposed under the Scheme Advisory Board proposals identifies no areas of significant weakness.</p>
<p>Improve the efficiency and effectiveness of scheme employer and scheme member engagement.</p>	<p>Complete the implementation of the iConnect project.</p> <p>Continue the development of the functionality available through the on-line portal (Member Self-Service)</p> <p>Review the current website to ensure more intuitive and user friendly and key scheme information is readily accessible</p> <p>Develop the on-line provision of investment data setting out where the Fund is invested, including key information on investments in fossil fuel companies, and carbon intensity of the Fund's investments and compliance with the Fund's Climate Change Policy</p>	<p>Improved reported satisfaction from scheme employers and scheme members from their engagement with the Fund.</p> <p>Improve data quality scores from the automation of data transfer through iConnect.</p> <p>Increased numbers of scheme members activating their on-line account and access services and data on-line.</p>

## Part C. Budget:

	<b>2020/21 Budget</b>	<b>2019/20 Budget</b>
	<b>£'000</b>	<b>£'000</b>
<b>Administrative Expenses</b>		
Administrative Employee Costs	1,391	1,576
Support Services including ICT	694	634
Printing and Stationery	72	72
Advisory and Consultancy Fees	165	160
Other	59	60
	<b>2,381</b>	<b>2,502</b>
<b>Investment Management Expenses</b>		
Management Fees	10,374	8,484
Custody Fees	25	0
Brunel Contract Costs	1,028	1,043
	<b>11,427</b>	<b>9,527</b>
<b>Oversight and Governance</b>		
Investment Employee Costs	259	254
Support Services Including ICT	11	11
Actuarial Fees	160	160
External Audit Fees	35	35
Internal Audit Fees	15	15
Advisory and Consultancy Fees	106	95
Committee and Board Costs	50	49
Subscriptions and Membership	50	50
	<b>686</b>	<b>669</b>
<b>Total Pension Fund Budget</b>	<b>14,494</b>	<b>12,698</b>

## **Part D – Committee Training Plan**

All Members to have completed either:

LGA Fundamentals 3 Day Training or  
On-Line Pension Regulators Trustee ToolKit – 5 core modules and 4  
modules specific to managing a defined benefit scheme.

Pre-Committee Training on Scheme Advisory Board Guidance on Governance  
Compliance Statements.

Pre-Committee Training on Scheme Advisory Board Guidance on Responsible  
Investment.

Pre-Committee Training on revised Codes of Practice published by the Pension  
Regulator.

All Members to complete 2 days external training or attendance at relevant  
pension conferences.

## **Part E - Pension Fund Cash Management Strategy 2020/21**

### **Introduction**

1. The Oxfordshire Pension Fund maintains a balance of cash arising from the receipt of employer and employee contributions, and income from internally managed investments. This incoming cash currently exceeds the amount of payments made on behalf of the Fund. The situation is forecast to continue for the whole of 2020/21. Income generated in investment portfolios is generally reinvested, the exceptions being listed private equity and some private market investments. Were the Pension Fund's cashflow to turn negative the Fund could look to have income generated from its portfolios paid back to the Fund as required to make up any cash shortfall. At present a number of the Brunel portfolios do not have income share classes and so the fund would need to request these. The cash managed in-house by the Administering Authority, provides a working balance for the fund to meet its short-term commitments.
2. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 state that administering authorities must hold in a separate bank account all monies held on behalf of the Pension Fund. The regulations also state that the Administering Authority must formulate an investment strategy to govern how the authority invests any Pension Fund money that is not needed immediately to make payments from the fund. This document sets out the strategy for cash for the financial year 2020/21.

### **Management Arrangements**

4. The Pension Fund cash balances are managed by the Council's Treasury Management team and Pension Fund Investments team. Cash balances are reviewed on a daily basis and withdrawals and deposits arranged in accordance with the current strategy. Pension Fund cash deposits are held separately from the County Council's cash.

### **Rebalancing**

5. The Oxfordshire County Council Pension Fund has a strategic asset allocation range of 0 - 5% for cash. The cash balance is regularly monitored and reviewed as part of a quarterly fund rebalancing exercise undertaken by officers and the Independent Financial Adviser.
6. Arrangements will be made for cash balances which are not required for cashflow purposes, to be transferred to the Pension Fund's Investment Managers in accordance with the decisions taken during the rebalancing exercise.
7. In general, a minimum cash balance of £40million will be retained following a fund rebalancing exercise, to meet cashflow requirements and private market investment transactions. This minimum level was increased from £10m in 2018/19 to accommodate the higher level of drawdowns anticipated to flow from

commitments made to private market portfolios with Brunel. The level of cash balances will fluctuate on a daily basis and may be considerably higher than the minimum balance dependent upon the timing of transactions and strategic asset allocation decisions.

### **Investment Strategy**

8. The Pension Fund cash investment policies and procedures will be in line with those of the administering authority. Priorities for the investment of cash will be:-
  - (a) The security of capital
  - (b) The liquidity of investments
  - (c) Optimum return on investments commensurate with proper levels of security and liquidity

### **Investment of Pension Fund Cash**

9. Management of the Pension Fund's cash balances will be in accordance with the Administering Authority's approved Treasury Management Strategy and policies and procedures.
10. The Pension Fund cash balances will be held predominantly in short-term instruments such as notice accounts, money market funds and short-term fixed deposits. Approved instruments for pension fund cash deposits will be the County Council's list of specified investments for maturities up to 1 year, excluding the Debt Management Account deposit facility which is not available to pension funds and UK Government Gilts which are managed by an external fund manager. The County Council's current approved list of specified investments is attached at appendix 1.
11. Pension Fund deposits will be restricted to a subset the County Council's approved counterparties at the time of deposit and will include the Fund's custodian bank. Approved counterparties as at 31<sup>st</sup> January 2020 are shown in annex 2. There will be a limit of £25m for cash held with each counterparty.

### **Borrowing for Pension Fund**

12. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 give administering authorities a limited power to borrow on behalf of the pension fund for up to 90 days. The power cannot be used to invest, but only for cashflow management in specified circumstances which should in practice be exceptional, i.e. to ensure that benefits are paid on time, and in transition management situations when the allocation of a pension fund's assets is being amended. Money can only be borrowed for these purposes if, at the time of borrowing, the administering authority reasonably believes that the sum borrowed, and any interest charged as a result, can be repaid out of the pension fund within 90 days of the date when the money is borrowed.



13. Pension Fund management arrangements presume no borrowing normally, but the possibility remains of unexpected pressures occurring and in these circumstances the power would enable the Pension Fund to avoid becoming forced sellers of fund assets due to cashflow requirements.
14. The Director of Finance (S.151 Officer) has delegated authority to borrow money for the Pension Fund in accordance with the regulations but only in exceptional circumstances. It is proposed that the authority to borrow on behalf of the Pension Fund continues to be delegated to the Director of Finance during 2020/21.

Lorna Baxter  
Director of Finance

February 2020

**Oxfordshire County Council 2020/21 Approved Specified Investments for  
Maturities up to one year**

<b>Investment Instrument</b>	<b>Minimum Credit Criteria</b>
Debt Management Agency Deposit Facility	N/A
Term Deposits – UK Government	N/A
Term Deposits – other Local Authorities	N/A
Term Deposits – Banks and Building Societies	Short-term F1, Long-term BBB+, Minimum Sovereign Rating AA+
Certificates of Deposit issued by Banks and Building Societies	A1 or P1
Money Market Funds	AAA
Other Money Market Funds and Collective Investment Schemes <sup>1</sup>	Minimum equivalent credit rating of A+. These funds do not have short-term or support ratings.
Reverse Repurchase Agreements – maturity under 1 year from arrangement and counterparty of high credit quality (not collateral)	Long-term Counterparty Rating A-
Covered Bonds – maturity under 1 year from arrangement	Minimum issue rating of A-
UK Government Gilts	N/A
Treasury Bills	N/A

<sup>1</sup> I.e., credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

**Approved Counterparties**

Aberdeen Standard Sterling Liquidity Fund

State Street Bank & Trust Company

Lloyds Bank Plc

Oversea-Chinese Banking Corp

Svenska Handelsbanken

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