

TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 6

PENSION FUND COMMITTEE REPORT

9 DECEMBER 2020

DIRECTOR OF FINANCE – IAN WRIGHT

EXTERNAL MANAGERS' REPORTS

1. PURPOSE OF THE REPORT

1.1 To provide Members with:

- Quarterly investment reports in respect of funds invested externally with Border to Coast Pensions Partnership Limited ('Border to Coast') and with State Street Global Advisers ('State Street') and;
- Details of a recent change to the benchmarks State Street is tracking within the four passive overseas funds the Fund is invested in, the rationale behind that change, and a comparison with the approach taken by Border to Coast.

2. RECOMMENDATION

2.1 That Members note the report and pass any comments.

3. FINANCIAL IMPLICATIONS

3.1 Any decisions taken by Members, in light of information contained within this report, will have an impact on the performance of the Fund.

4. PERFORMANCE

4.1 As at 30 September 2020 the Fund had investments in the following two Border to Coast listed equity sub-funds:

- The Border to Coast UK Listed Equity Fund, which has an active UK equity portfolio aiming to produce long term returns of at least 1% above the FTSE All Share index.
- The Border to Coast Overseas Developed Markets Equity Fund, which has an active overseas equity portfolio aiming to produce total returns of at least 1% above the total return of the benchmark (40% S&P 500, 30% FTSE Developed Europe ex UK, 20% FTSE Developed Asia Pacific ex Japan, 10% FTSE Japan).

For both sub-funds the return target is an annual amount, expected to be delivered over rolling 3 year periods, before calculation of the management fee.

The Fund also has investments in the Border to Coast Private Equity sub-fund and the Border to Coast Infrastructure sub-fund. Total commitments of £50 million were made to each of these sub-funds for 2020/21, in addition to £100 million commitments to each sub-fund in 2019/20. Up to 30 September 2020 only a small proportion of this total had been invested. These investments are not reflected within the Border to Coast report (at Appendix A).

- 4.2 The Border to Coast report shows the market value of the portfolio as at 30 September 2020 and the investment performance over the preceding quarter, year, and since the Fund's investments began. Border to Coast has also provided additional information within an appendix to that report in relation to the Overseas Developed Markets Equity Fund, giving a breakdown of key drivers of and detractors from performance in relation to each of its four regional elements. Market background information and an update of some news items related to Border to Coast are also included.
- 4.3 State Street has a passive global equity portfolio invested across four different region tracking indices appropriate to each region. The State Street report (at Appendix B) shows the market value of the State Street passive equity portfolio and the proportions invested in each region as at 30 September 2020. Performance figures are also shown in the report over a number of time periods and from inception – the date the Fund started investing passively with State Street in that region: for Japan and Asia Pacific ex Japan the inception date is 1 June 2001, as the Fund has been investing a small proportion of its assets in these regions passively for since then; for North America and Europe ex UK the inception date was in September 2018 so performance figures only cover just over two years as this represents a comparatively new investment for the Fund. The nature of passive investment – where an index is closely tracked in an automated or semi-automated way – means deviation from the index should always be low.
- 4.4 State Street continues to include additional information with their report this quarter, giving details of how the portfolio compares to the benchmark in terms of environmental, social and governance factors including separate sections on climate and stewardship issues. As the State Street investments are passive and closely track the appropriate regional equity indices, the portfolio's rating in these terms closely matches the benchmark indices ratings.
- 4.5 Members will be aware that the Fund holds equity investments over the long term, and performance can only realistic be judged over a significantly longer time-frame than a single quarter. However, it is important to monitor investment performance regularly and to understand the reasons behind any under of over performance against benchmarks and targets.

5. **CHANGES TO STATE STREET'S BENCHMARKS – EXCLUSION OF CERTAIN COMPANIES**

- 5.1 State Street has advised investors in a number of its passively-invested funds, including the four State Street equity funds the Fund invests in, that it has decided to exclude UN Global Compact violators and controversial weapons companies from those funds and the indices they track.

5.2 The Ten Principles of the United Nations Global Compact (derived from the Universal Declaration of Human Rights, the International Labour Organisation’s Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption) are as follows (shown against four sub-categories):

Human Rights

- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.

Labour

- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labour;
- Principle 5: the effective abolition of child labour; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

- Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

5.3 State Street has produced a Q&A document (included at Appendix C) setting out more detail of the potential investment impact of the change to benchmarks. For the four State Street funds the Fund is invested in the combined effect of applying this change to benchmarks to exclude around 3.6% by value of the companies / securities across the regions (as at 30 June 2020) as shown in the following table:

Fund Name	Number of companies / securities excluded	% of Parent Index Excluded	Number of companies / securities in fund (after exclusions)
FTSE Developed Europe ex UK ex Controversies ex CW Index	7	3.93	646
FTSE North America ex Controversies ex CW Index	18	4.26	451
FTSE Japan ex Controversies ex CW Index	3	0.56	504
FTSE Developed Asia Pacific ex Japan ex Controversies ex CW Index	9	4.07	373
Combined Fund State Street investments	37	3.59	1,974

5.4 Appendix C also shows a backward-looking assessment of the performance difference and the ‘tracking error’ between funds tracking the original ‘parent’ indices and the funds had they tracked the revised excluding controversies and excluding controversial weapons indices. Members will be well aware that past performance is no guarantee of future results, however the data State Street has provided gives an indication of the extent to which the changes they are making to their indices could change the performance of these funds and so the Fund’s investments in them, as shown in the following table:

Fund Name	Performance Data (Annualised %)						Tracking Error % (ex post)	
	1yr Perf <i>Screened</i>	1yr Perf (Parent)	3yr Perf <i>Screened</i>	3yr Perf (Parent)	5yr Perf <i>Screened</i>	5yr Perf (Parent)	3yr (Annualised)	5yr (Annualised)
FTSE Developed Europe ex UK ex Controversies ex CW Index	0.63	0.70	3.23	3.83	8.54	8.92	0.51	0.44
FTSE North America ex Controversies ex CW Index	11.95	10.91	13.05	12.47	16.19	15.84	0.35	0.37
FTSE Japan ex Controversies ex CW Index	6.85	6.76	4.84	4.87	9.00	9.03	0.17	0.21
FTSE Developed Asia Pacific ex Japan ex Controversies ex CW Index	-5.27	-5.37	1.65	2.18	8.32	8.69	0.78	0.79

5.5 The ‘tracking error’ figure is an indication of how closely the revised benchmarks can be expected to match their original benchmarks. As a comparison, efficient index tracking funds can expect to show a tracking error of around 0.05% whereas actively managed funds will have a higher tracking error – the target tracking error for Border to Coast Overseas Equity sub-fund for example is 1.00% to 3.00% although it is currently at the bottom end of that range.

6. PASSIVE V ACTIVE – EXCLUSION V ENGAGEMENT

6.1 The approach State Street is taking to companies that they do not wish to invest in is to exclude these companies from the underlying benchmarks. As a passive investor, this is one of the few approaches available as passive investment typically requires holdings in all the main components of a particular stock market index. Active equity investors, such as Border to Coast, are able to make decisions on which companies to hold or the weighting to apply to each company based on a wide range of factors, including responsible investment – environmental, social and governance issues and the likely impact of those issues on the finance performance of that company.

6.2 Border to Coast has provided an explanation of their approach to responsible investment at Appendix D, and why they favour engagement over divestment. In summary this involves incorporating environmental social and governance (ESG) factors into their investment

analysis and decision-making, enabling long-term sustainable performance. Border to Coast's approach means they will sometimes hold stocks that are on State Street's exclusion list because (for example) they believe the company's direction of travel in relation to ESG issues is positive, they are better than their peers in these areas, or they are able to take into account a wider range of assessments from providers of ESG information. More information on Border to Coast's approach to Responsible Investment is included in a subsequent agenda item.

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