

TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 6

PENSION FUND COMMITTEE REPORT

13 DECEMBER 2023

INTERIM DIRECTOR OF FINANCE – DEBBIE MIDDLETON

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')
- 1.2 To provide Members with details of proposed changes to:
 - The method Border to Coast uses to apportion its costs between its investors (the Partner Funds).
 - The benchmarks State Street use for their passive equity funds.

2. RECOMMENDATION

- 2.1 That Members note the report.

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 At 30 September 2023 the Fund had investments in the following three 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).
 - The Border to Coast Emerging Markets Equity Fund, which has an active emerging markets equity portfolio aiming to produce long term returns at least 1.5% above the FTSE Emerging markets indices. Part of the Fund is managed externally (for Chinese

equities) by FountainCap and UBS, and part managed internally (for all emerging markets equities excluding China) by the team at Border to Coast.

For all three sub-funds the return target is 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. To date, total commitments of £900 million have been made to these sub-funds (£500m to infrastructure and £400m to private equity) with around 34% of this commitment invested so far. In addition, a commitment to invest £80 million over a three year period to the Border to Coast Climate Opportunities Fund has been made. These investments are not reflected within the Border to Coast report (at Appendix A) but are referenced in the Border to Coast presentation later in the agenda.

- 4.2 The Border to Coast report shows the market value of the portfolio at 30 September 2023 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. Border to Coast's UK Listed Equity Fund's returns were 0.13% below benchmark over the last year, or 1.13% under its overachievement target, whereas the Overseas Developed Markets Equity Fund has achieved returns of 2.39% above benchmark over the last year, comfortably above its 1% overachievement target. Since inception, the UK fund has delivered performance of 0.83% a year above benchmark, slightly below its long-term target, and the overseas fund has delivered performance of 1.49% above benchmark, above its long-term target. The performance of the Emerging Markets Equity Fund has been below benchmark throughout much of the period of our Fund's investment – including over the quarter and year to 30 September 2023. Since inception the Fund is 1.50% a year behind benchmark, so 3.0% a year behind target.
- 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 at 30 September 2023. 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 are around five years as this represents a relatively 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 realistically 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 or over performance against benchmarks and targets.

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

- 5.1 As reported to the 9 December 2020 Pension Fund Committee meeting, State Street advised investors in a number of its passively-invested funds, including the four State Street equity funds the Fund invests in, that it is 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 As was previously reported, for the four State Street funds the Fund is invested in the combined effect of applying this change to benchmarks excluded around 3.6% by value of the companies / securities across the regions.

- 5.4 The latest report shows performance of the State Street funds against the revised indices – excluding controversies (UN Global Compact violators) and excluding companies that manufacture controversial weapons. As expected for a passive fund, performance closely matches the performance of the respective indices.
- 5.5 State Street has recently advised that it will be making further changes to its passive equity indices and will be excluding additional sectors. The Fund has been notified that from 18th December 2023 the benchmarks of the State Street Sub-Funds the Fund invests in will apply screens to exclude certain securities related to Tobacco and Thermal Coal. Excluded companies will be any involved in production of tobacco or tobacco products and companies that extract thermal coal or have thermal coal power generation and this activity represents 10% or more of revenues. This is in addition to the current screening for UN Global Compact Violations and Controversial Weapons which came into effect on 18th November 2020. Initial indications are across the four State Street Sub-Funds these changes will cover around 0.36% of the current assets (tobacco) and 0.88% of the current assets (thermal coal) that the Fund invests via State Street.

6. BORDER TO COAST – QUARTERLY CARBON AND ESG REPORTING

- 6.1 Border to Coast has worked with its reporting providers to develop reporting which covers the Environmental Social and Governance (ESG) issues and impact of the investments it manages, together with an assessment of the carbon exposure of these investments. This is easier with some asset classes than others, and Border to Coast has initially focussed on reporting on listed equities as this is the asset class where most information is available and this type of reporting is more advanced.
- 6.2 Appendix C contains the latest available ESG and carbon exposure in relation to the three Border to Coast listed equity sub-funds the Fund invests in: UK Listed Equity, Overseas Developed Markets Equity and Emerging Markets Equity. Amongst other information, the reports include information on the highest and lowest ESG-rated companies within those Border to Coast sub-funds, together with an analysis of the carbon exposure of the sub-funds on a number of metrics. The sub-funds' ESG position and carbon exposure is also compared to benchmarks representing the 'average' rating across the investment universe of that particular benchmark.
- 6.3 A colleague from Border to Coast will be available at the meeting to answer any questions Members may have on the information shown in the Quarterly ESG Reports.

7. BORDER TO COAST – PROPOSED CHANGES TO COST SHARING APPROACH

- 7.1 When Border to Coast was established over 5 years ago its Partner Funds set out an approach to apportion the costs of setting up and running the different investment propositions (sub-funds) Border to Coast would provide. To ensure adequate funding for each of the new propositions, the initial cost-sharing approach included apportioning some ongoing management charges based on the assets Partner Funds had identified as likely to transfer into the pool. Whilst it was acknowledged that over time charging most costs on an 'assets under management' basis would be fairest, at the outset this would cause anomalies

and may in some circumstances could make it more expensive for those Partner Funds that were committing a greater proportion of their assets to pooling.

- 7.2 As reported to the 27 September 2023 Pension Fund Committee, now that Border to Coast has reached a stage where majority of the sub-funds originally envisaged have now been created, it is an appropriate time to revisit the way costs are apportioned. Over the next few months Partner Funds (or their administering authorities) will be asked to agree to make some changes to the agreements that set up Border to Coast to allow cost apportionment from the coming year to be based primarily on an 'assets under management' basis. This will not change the costs that Border to Coast charges, it will just apportion them differently – in a way that more fairly represents how Partner Funds are invested.

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