Strategy review highlights and recommendations

Addressee

This note is addressed to the Pensions Committee ('the Committee') and Officers and Advisers of the South Yorkshire Pension Fund ("SYPF"). This note sets out the highlights and recommendations from the independent review of the Fund's investment strategy and should be read in conjunction with the main report "South Yorkshire Pension Fund Authority – Review of Investment Strategy".

Key Findings from strategic review

- The Fund was in a very strong position as at the March 2022 actuarial valuation with a funding level of 119% and the position will have improved since then due to rises in gilt yields. The current asset allocation remains heavily focussed on listed equities although steps have been taken to diversify this exposure through allocations to income focussed assets and assets with positive climate impact. The Committee have agreed an ambitious target for carbon emissions reduction from the Fund's assets with the aim of achieving net zero emissions by 2030
- The Fund is currently net cashflow negative by around £130m p.a. in terms of benefits payments versus contributions (i.e. excluding investment income) and this position is projected to increase in coming years
- The asset liability analysis shows there is a very high likelihood of the funding level in 20 years' time being above 100% funded on the current investment strategy, or even remaining above 115%. Despite the strong funding position there is still the potential for the funding level to fall below 100% in the worst 5% of outcomes over the next 3 years and 11% chance of the funding level falling by 20% over the valuation cycle
- Based on the assets where information is available the Fund's current strategy is not expected to achieve net zero by 2030. The UK equity solution is the most well aligned to net zero of the Fund's strategies and the Multi-asset credit strategy the least well aligned. To achieve net zero by 2030 the Fund would likely have to consider a mix of options which could include investment in negative carbon investment solutions and alternatives to existing equity and credit solutions
- The variations in strategy tested through the asset liability modelling show that;
    - Allocations from equities to assets expected to aid the Fund achieving net zero by 2030 do not have a material impact on success or risk. However, this is dependent on the underlying assumptions of the risk and return characteristics of these investments. Allocating assets from equities to income focussed assets has a positive impact on both success and risk metrics
    - Allocating asset from equities to protection assets could have a beneficial impact on risk without impacting the chances on maintaining funding levels above 100%, but the impact on net zero alignment and contribution affordability needs to be considered alongside this
- For the Fund to meet its net zero ambitions the Committee are likely to have to consider two main levers
    - Reduce emissions - Improve the current mandates by engaging with the managers, allocation to more efficient companies within sectors and engagement
    - Remove emissions - Increase allocations to assets that remove or avoid emissions in a measurable and robust way

Taking this into account the Fund could potentially invest further assets into climate opportunities or an additional allocation into assets such as renewable energy or timberland. The Committee may also wish to review the existing MAC mandate which is currently the worst aligned mandate and consider alternative credit mandates with explicit climate risk objectives.

Key conclusions:

- The strong funding position provides flexibility to consider various allocations to natural capital and renewables and the analysis suggests there is an opportunity to adopt a revised investment strategy that increases the allocation to net zero focussed assets without materially impacting funding outcomes.
- Given the timescale to 2030, we recommend an explicit allocation to timberland is considered as a priority in order to allow for the deployment of capital to this asset class. A higher allocation to timberland will increase the likelihood that the net emissions position can be reduced significantly by 2030. However, the practicalities of this and ability to achieve a diversified timberland portfolio would likely be a limiting factor.
- The development of the BCPP climate opportunities fund should be closely monitored as there could be potential for overlap in terms of South Yorkshire's ambitions and the options offered by this fund.
- Data availability and quality remains the main challenge today in assessing strategies. A combination of capital allocation and engagement activity with existing mandates will be needed.
- An allocation to climate solutions could be built up incrementally based on the capacity of the climate opportunities fund and alternative implementation routes are explored.

Recommendations

We recommend the Committee consider implementing the proposed investment strategy set out below.

Asset allocation	Current Strategic Asset Allocation	Proposed Strategy
UK equities	10.0	7.5
Global equities	35.0	30.5
Private equity	7.0	7.0
Total Growth	**52.0**	**45.0**
Multi-asset credit	6.0	2.5
Private debt	5.5	7.5
Infrastructure	10.0	9.0
Property	9.0	9.0
Natural Capital	1.0	3.5
Climate Opportunities	-	5.0
Renewable Energy	-	5.0
Total Income	**31.5**	**41.5**
UK Index-linked gilts	10.0	7.0
Corporate bonds	5.0	5.0
Cash	1.5	1.5
Total protection	**16.5**	**13.5**
Total	**100.0**	**100.0**

We recommend an annual review and evaluation of the net zero strategy as data evolves and capital is deployed. As a method of monitoring the Fund's progress, we recommend that that regular analysis of alignment with the net zero target, along with a review of actions taken is undertaken.