Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date
23/02/2021

Present members
Candia Kingston (CK) (Chair)
Ewan Smith (ES)
JB Beckett (JB)
Dr James McCourt (JM)

In attendance
Robert Whitehouse (RW)
Carrie Johnson (CJ)
Trevor Greetham (RLAM)
Michael Clarkson (RLAM)
Kenneth Scott
Niall Aitken (NA)
Euan Craig (EC)
Ryan Hamill (RH)
Lewis Daley (LD)
Mayer Raichura
Emer Drayne
Kaisie Rayner (KR) (IO item 9)

Apologies
Piers Hillier (PH) (RLAM)

		Owner
1.	**REVIEW OF PREVIOUS MINUTES**	CK
	The minutes of the 01/12/2020 were approved. No new conflicts of interest were notified.	
2.	**STRATEGIC ASSET ALLOCATION (SAA) UPDATE**	NA
	NA provided an update on the transition to new benchmarks for the Governed Range portfolios and Global Managed fund. NA explained that SAA changes for GRIPs 1&2 are also now proceeding after temporarily being put on hold. This delay was because of a risk metric being out with tolerance for these portfolios. This has now been resolved as a result of further analysis and investigation with Moody's Analytics. ES noted that ideally GRIP SAA changes would happen at the same time as the Governed Portfolios and NA confirmed that he will pick up with RLAM to see if this was possible.	

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3. WORKPLACE DEFAULT REVIEW RH

RH presented the review of our workplace pension default which is the Balanced Lifestyle Target Drawdown. This review confirmed the continued suitability of the default for our customers looking specifically at our experience of customer choice at retirement and the appropriateness of the shape and style of our lifestyle as it de-risks towards retirement. A comparison with competitors and their risk levels was also considered by the committee.

RH highlighted that the pure modelling results showed the potential to improve long term outcomes by increasing exposure to growth assets for a new younger generation of pensions savers that has been introduced by auto enrollment; although this work is in the early stages RLI were keen for the committee's input at this stage. NA also added that it is particularly important to review this proposition as RLI see younger savers investing for longer periods than ever before. The committee agreed that it is a sound basis to consider the longer investment horizon for younger investors. CK expressed her interest in higher levels of growth asset exposure at earlier ages for default customers and supported the outcome of the initial analysis. JM also supported this outcome. ES expressed some concern on the tradeoff of diversification vs taking higher risk in earlier years, explaining that there can be large benefits from diversification at this stage of a customer's life. NA agreed and noted that further analysing the benefits of diversification over the long term was work to be done.

There was some discussion by the committee on understanding the behaviour of younger investors for this analysis and investigating behaviour over the last year during the pandemic.

The review also considered the option of de-risking over a shorter period when a default customer approaches retirement. CK had concerns about this and agreed with the proposition's conclusion that the current de-risking approach was more appropriate given that a high proportion of customers don't retire at their previous selected retirement age.

CJ queried whether any consideration had gone into pot size specific lifestyle endpoints for the default, noting that the majority of small pots are taken as cash. NA highlighted the analysis that has been done working with the data analytics team but unfortunately the data currently does not provide enough of a view to progress this further. NA highlighted the importance of a fuller picture of a customer's retirement savings, mentioning the dashboard as a key future development.

JB challenged that it might be difficult to compare default propositions across competitors until there is a more suitable value for money (VFM) metric available. NA agreed and confirmed that this review focuses on the asset allocations of competitors' defaults and that there is far more to VFM than just risk and performance.

4. STRATEGIC PACK

<u>Governed Portfolios & Managed Strategies</u>
All portfolios are within their target ranges for real volatility except for the Cautious Long Term Managed Strategy which is below the lower limit.

Governed Retirement Income Portfolios (GRIPs)
There have been no changes to the GRIPs strategic benchmark this quarter.
All portfolios remain within their target ranges for the income risk metric.
Sustainability scores have marginally declined from last quarter as annuity rates remain at historically low levels, yet the expected future returns across most asset classes have increased, which should improve future performance.

The fund risk metrics for GRIPs 4 and 5 are within tolerance, however GRIPs 1 and 3 are now flagging amber and GRIP 2 is flagging red. As a result, GRIP 2 has now been flagging red for two consecutive quarters. This was addressed and discussed in the analysis on GRIP SAAs (see section 2).

Lifestyle Strategy Analysis to update
Annuity income and real fund values for drawdown lifestyles have decreased slightly since last quarter.

2 Tactical Analysis

GPs, Managed Strategies and GRIPs

- All portfolios remain within their tactical risk budgets.

- RLAM gave the following update on their three tactical changes in the last quarter:

    - Global equities were weaker in September, although UK-based investors were helped by sterling weakness. Sentiment was affected by the slowdown in the economic recovery; rising Covid-19 cases in the UK, Europe and the US, which led to further social distancing measures and local lockdowns; and increased political risks with the UK-EU trade negotiations and US elections. While low interest rates and fiscal stimulus will support equities, we further reduced our overweight position. We remained overweight in global high yield bonds and commodities, more neutral in gilts and investment grade credit, and underweight in commercial property and cash.

    - Global equities were weaker in October, reflecting the impact of renewed national lockdowns in the UK and Europe, rising Covid-19 cases in the US and increased political risks. However, Joe Biden's election as President of the US, but without a Senate majority, and positive trial data for a potential Covid-19 vaccine boosted investor sentiment. We have increased the modest overweight in equities and the overweight in global high yield bonds, funded by reducing the holdings of gilts, investment grade credit and cash. We remained overweight in commodities and underweight in commercial property and cash.

    - Global equities rose strongly in November following the US elections and positive Covid-19 vaccine trial data. Investors were reassured by the absence of US political unrest. Likewise, the possibility of a successful vaccine rollout and 'return to normal' next year boosted sentiment. While concerned about no agreement being reached yet on a UK-EU trade deal, shorter-term Covid-19 spikes in the US and rising geopolitical risks in the Middle East, we have increased our overweight in global equities and in global high yield bonds, funded by reducing gilts, bonds and cash. We remain overweight in commodities and underweight in commercial property. The overall position as at end September was overweight equities, commodities, high yield, corporate and index-linked bonds; neutral government bonds; underweight absolute return strategies (inc. cash) and property.

5. **PERFORMANCE PACK** EC

All data is at end December 2020.

RLI Governed Range
All Governed Portfolios underperformed their benchmarks over one year to end of December 2020 except for GP7. All portfolios outperformed their benchmarks over three years with GP1, GP4, GP7 and GP8 underperforming over five years.

All five GRIPs are behind benchmark over one year. They continue to outperform over three and five years and since launch.

Global Managed
The fund outperformed benchmark over one and three years but was behind over five years.

Property
The fund outperformed benchmark over one, three and five years to end of December 2020.
As at the end of December 2020, RLPPF cash holding was 11.25%.

Commodity
The fund underperformed benchmark over one and three years to the end of December 2020. The fund was launched in June 2016 and as such lacks a longer-term track record.

Sterling Extra Yield
The fund underperformed benchmark over one and three years and outperformed over five years to the end of December 2020.

Absolute Return Government Bond
The fund outperformed benchmark over one, three and five years to the end of December 2020.

Global High Yield Bond
The fund outperformed over one and three years to the end of December 2020.

RLI Pension Funds
Equity Income
It was noted that this is flagging red in relation to a benchmark of FTSE All Share index over one, three and five years, although comparing this fund to other UK equity income funds, the performance has been strong particularly over a five-year period. EC mentioned that this fund is not something that is overly concerning at this point.

Externally Managed Matrix Funds
It was noted that the number of matrix funds that are flagging as red has fallen to one from six in Q3. This is because of the five replacements that were made over the course of Q4.

Franklin UK Mid Cap
The fund has been triggering red for two quarters and had just fallen into review cycle. 12-month performance has been poor but three and five year performance figures are just behind benchmark.

Invesco Asian
The fund had been triggering red for three consecutive quarters but is now amber and performance continues to improve. Five-year performance remains strong. EC proposed that this fund should be brought to the IAC next quarter with the consideration of removing this fund from the performance pack if it continues to show strong short-term performance.

Merian North American Equity
The fund had been triggering red but is now amber with shorter term performance picking up.

Invesco Global Equity
The fund had been triggering red but is now improving however kept on the watchlist.

It was noted that the Morningstar scorecard looks positive this quarter after replacing underperforming funds, with most funds sitting in the top two quartiles of the list.

EC proposed that for the next IAC update the team may bring a note considering potential replacements for the two Close Teams Matrix funds.

JB queried whether the Morningstar 'fund size' metric flagging red needs to be of concern and whether conversations are being had. EC mentioned that some discussions with fund managers have taken place, highlighting that their fund is reaching full capacity. EC confirmed that these managers are considering ways to prevent the fund from being too big to manage. EC also highlighted that further conversations with other managers and Morningstar are still to be had.

There was some discussion around the suitability of the equity overcode functionality and concern around members deviating from the governance structure held in the Governed Range. The committee also requested to see a further breakdown on the net flows into the Sustainable Range to better understand member behaviour.

6. **FUND CLOSURE UPDATE** EC

EC provided a recap to the committee on Matrix replacement funds and mentioned that the team will gather up the analysis completed showing time spent out of the market and price swings on transactions when these trades were made.

7. **RLP GLOBAL BLEND IMPLEMENTATION OF NEW BENCHMARK** LD

LD provided information regarding the proposed implementation plan of the new RLMIS global equity benchmark for the RLP/BlackRock ACS Global Blend fund. LD stated that the proposal to use RLAM for the emerging market component included consideration of performance, cost, ESG and operational capabilities. CK noted she was in favour of the proposal but wanted to know more about the funds and the ESG criteria applied. LD outlined that the MSCI Emerging Markets ESG Leaders Index which would be used by RLAM applies more screens than BlackRock were proposing. NA noted that analysis surrounding country and sector exposure had been carried out for the Global Managed review and that the standard EM option offered by BlackRock was not appropriate to ensure customers' needs were met.

JM questioned the communication provided to customers regarding the proposed change. LD stated that customers have already been notified of the benchmark change to the fund, this is about implementing the new fund structure to track this already approved new benchmark.

Concerns were raised by the committee regarding the name of the fund, and JB suggested that this may need to change due to the higher stake of ownership undertaken by RLAM. LD stated that no proposal was being made to change the name of the fund as over 90% of the fund would still be managed by BlackRock. NA reassured the committee that the factsheet would be updated to reflect the increased ownership and input of RLAM.

CK and JB raised concerns regarding the conflicts of interest that may be apparent. NA reiterated the importance of this point, along with the need to ensure that proper governance is taken and the need to be transparent regarding why this is the optimal solution for customers.

8. **REBALANCING & ILLIQUIDS** NA

NA provided an update to the recent activity on rebalancing across the Governed Range. Due to the high volatility in the market and the need to manage the property exposure within the Governed Range, auto-rebalancing was switched off in March 2020. Royal London will continue to manage monthly rebalancing requirements via the IAC Tactical Runs.

JB queried the occurrence of the auto-rebalancing and potential conflicts of interest to avoid the risk of front-running through the property portfolio. NA reassured the IAC that it will be rule-based to avoid active TAA and informed the IAC of the inability for RLAM to act on more information to the detriment of potential customers and underlying funds.

TG and RW reiterated the benefits of increased certainty regarding flows into and out of the property fund, as well as the need to only rebalance once a month. The importance of rebalancing monthly was noted by the committee, whether a TAA was taking place or not, to ensure T&Cs were met.

9. **RESPONSIBLE INVESTMENT AND CLIMATE CHANGE** KR

KR provided an update regarding the Responsible Investment and Climate Change Project. An update was given regarding Royal London's revised strategy and purpose, future propositional developments and the emphasis on education and training programmes to embed the capability to manage climate and ESG on an ongoing basis.

The committee were interested in the updates made to Royal London's investment philosophy and beliefs which is due to be brought back to IAC when it has gained governance approval.

KR highlighted the key focus points for the upcoming 2021 United Nations Climate Change Conference and stated the importance of the Thought Leadership Programme and the content and debates that could be used with advisers and the end customer.

The committee discussed the importance of incorporating RLI's responsible investment and climate change beliefs with RLAM and progress of this will be included in the next IAC meeting.

The IAC questioned the ways in which they could help and requested to receive any future communications regarding Royal London's responsible investment strategy.

10. **AOB** ALL

CK raised concerns regarding the RAG triggers for matrix funds and the need to look at a range of factors rather than past performance.

IMPORTANT INFORMATION

Past performance is not a guide to the future. Prices can go down as well as up. Investment returns may fluctuate and are not guaranteed so you could get back less than the amount paid in.

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