Investment Advisory Committee (IAC) Quarterly Meeting

Summary of Meeting

Date and Time	1 June 2022 at 14.00
Place	RLMIS, Thistle Street, Edinburgh and by MS Teams Video Conference (VC)

Members

Name	Organisation	Role	Present
Candia Kingston (CK)	Independent	Chair	Y
JB Beckett (JB)	Independent	Non-Exec member	Y
Ewan Smith (ES)	RLMIS	CEO Office Director	Y
Vidur Bahree (VB)	RLMIS	Group Investment Director	Y (VC)
Piers Hillier (PH)	RLAM	RLAM Chief Investment Officer	Y (VC)

Others in attendance

Name	Organisation	Role
Charlotte Dalton (CD)	RLMIS	Secretary (VC)
Carrie Johnson (CJ)	RLMIS	UK Product Director
Dr James McCourt (JM)	RLMIS	Group Chief Risk Officer
Robert Whitehouse (RW)	RLMIS	Unit Linked Actuary, Investment Office
Hiroki Hashimoto (HH)	RLAM	Fund Manager (VC)
Ken Scott (KS)	RLMIS	Head of Investment Solutions
Euan Craig (EC)	RLMIS	Proposition Manager, Investment Solutions
Ryan Hamill (RH)	RLMIS	Investment Actuary, Investment Solutions
Lewis Daley (LD)	RLMIS	Proposition Manager, Investment Solutions
Sadia Ghani (SG)	RLMIS	Proposition Manager, Investment Solutions

1. STRATEGIC ASSET ALLOCATION (SAA) UPDATE

RH took the Committee through a proposed adjustment to the Governed Portfolios SAA. He highlighted that approval had been granted by the Investment Committee to expand the tactical remit RLAM have to manage duration in the fixed interest elements of the portfolios. At the time of this meeting, this was not yet being utilised.

PH reminded the Committee of discussions as part of the last SAA review about equity allocations: it had been decided at that point to reduce the UK holding from 50% to 35% but that, in the future, a further reduction may be appropriate. As set out in the paper presented to IAC, latest view is that RLMIS remain comfortable with the current regional weighting.

ES agreed that RLAM tactical freedom made sense, however, he had concerns with holding significant quantities of nominal bonds in portfolios that were designed for real returns, even though IL bonds were expensive. He questioned whether a reduction in IL bonds was more of a tactical opportunity than something to change in the SAA. VB talked through the investment assumptions which led to the recommended changes. He advised that, although nominal bonds do not offer real returns, they add resilience to the portfolios against a range of adverse scenarios. The same cannot be said for index-linked bonds which do not offer the same resilience. He advised that the allocations being proposed produced robust performance across most scenarios, outside of a surprise deflationary shock, and that the inflation protection in the portfolios is driven more by equities and commodities than by index-linked bonds.

CK raised a concern that the allocations being proposed were more tactical than strategic. It was confirmed that the assumptions the proposal was based on were long-term, as agreed at the RL Long-Term Economic Assumptions Forum (LEAF). VB talked through where the long-term assumptions and models were pointing towards, relative to the shorter-term assumptions. He confirmed that short term moves were in the tactical remit of RLAM. KS noted that, historically, shorter-term considerations had been factored into SAA recommendations implicitly, whereas there was now both a desire and the capability to do so more explicitly. CK advised that it should, in that case, be more clearly defined in the SAA objectives and short-term considerations should formally be included in annual reviews. JB agreed and commented that LEAF insight was not included in the pack being presented to IAC.

A scenario comparison of GP4 with competitors' workplace default growth portfolios was presented. JB asked if the input data fully reflected disinflationary scenarios, as the deflation scenario presented looked too sanguine. His view was that there appeared to be more focus on an inflationary shock (which was less likely), versus stagflation, which could have a profound effect on portfolios. CK agreed and added that she would also like to see more detail on:

- global exposure in the bond allocations;
- style bias deviation; and
- the extent of hedging in global bonds.

It was agreed that a deep dive should be carried out with the IAC.

VB noted that all of the comments being raised by IAC had been considered in developing the proposals. JB raised concerns about commercial risk being a driver of change, referencing the weaker 2020 performance relative to peers. CJ confirmed that was not the intention and that RLMIS must have our own conviction in the recommendations. JB commented that an RL differentiator was robustness of the property portfolio. VB advised that RL were driven by long-term thinking and their investment philosophy and beliefs. That knowledge feeds into the long-term assumptions at LEAF. JB commented that the IAC role was to ensure that the design process was robust, and to challenge the underlying assumptions.

It was agreed to have an off-cycle meeting to go through the Governed Retirement Income Portfolios (GRIPs) proposals in July ahead of them going to the IC in September.

Outcome: Update the committee on bullets detailed above. Share the final IC paper on GR SAA at next IAC. Set up additional IAC meeting in July to discuss GRIPs proposal.

3. STRATEGIC PACK

RH provided an update to the Committee on the strategic positioning of the Governed Range.

Governed Portfolios
All portfolios are within their target ranges for real volatility.

Governed Retirement Income Portfolios
All portfolios remain within their target ranges for the income risk metric. Increased expectations of inflation in the short term by Moody's translates to lower short-term real returns. This had increased the maximum 1-year real loss from last quarter for all five portfolios. This impact can be seen particularly for GRIPs 1 and 2, which are now outside the target range for this metric. It was noted that the nature of this risk metric means that it's sensitive to short-term changes in risk characteristics such as inflation. RH commented that it would require a reduction in equities of c6% in GRIP1 to bring these metrics back inside target ranges. Everyone agreed that doing this would be detrimental to members as the portfolios would be de-risking at the wrong time and this would reduce long-term outlook.

CK summarised that the Committee reached the conclusion that nothing strategic needed to be done immediately that wasn't being addressed in the ongoing GRIP SAA review.

Outcome: The Committee agreed that no short-term remedy is required and the current GRIP SAA review covers any actions the Committee would suggest.

4. INFLATION COMMUNICATION

KS introduced a paper on communicating with customers around rising inflation. He asked the Committee for views on where it would be best to focus efforts. JB advised that different demographics were affected differently: CPI is a general basket and under-reflects what hits poorer households most, which is fuel and food. CK referred to work done previously on 'Silver RPI' and suggested that the information in those stories could be resurrected, with a view to looking at the customer base and considering which sectors would be affected most. She added some key areas to draw out might be: the pressure on DB Schemes to provide discretionary pension increases; the PPF cap on increases; the positive flexibility of DC income; and the income drawdown behaviour observed in 2021 versus 2020. JB added that another angle might be to consider whether customers really needed to take the full 25% tax free cash up front, in a high inflationary environment. CJ agreed and advised that the team were already looking at that in respect of sequencing risk for those newly retired. JB commented that adviser support should also be considered for them having conversation with customers on these subjects.

Outcome: The benefits of the GR should be a key customer message and the flexibility available within the RL proposition. Then customers should be guided to lean harder on advisers (where they have them) to help guide their individual thinking.

5. GLOBAL GROWTH PAPER

EC offered Mike Clarkson's apologies for the meeting and advised that this was a preliminary report, which Mike would provide more detail on next quarter. EC highlighted that short-term performance had been poor, but the long-term belief – coupled with Mike's track record on other portfolios – meant that they believed there remained potential. At this stage, RLMIS are not looking to move away from this investment, but the fund remained on watching brief. He also highlighted Mike's comment on 'blending' which had worked over the long term, but underperformance had been greater than upside performance for this fund.

ES agreed with the decision to stick with the fund. JB referred to the original switch out of the previous Rathbones fund and suggested it would be helpful to see a proxy comparison of swapping out of that to appraise the decisions that the IAC had supported. EC agreed to see what information was available, but noted the Rathbones fund had closed, so direct comparison was not available.

CK suggested that responses to the reservations raised by the IAC should be incorporated into a cover paper by the proposition team for next time.

Outcome: Further analysis to be undertaken on how this fund has compared to the previous fund it replaced.

6. PERFORMANCE PACK

EC presented the Performance Pack for the quarter ending 31 March 2022. He explained in more detail the Matrix returns presented in the paper, advising that a lot of active managers had been positioned in the market such that events in Ukraine had been detrimental. Given the metrics show a rolling period, he didn't expect next quarter to be much improved, with the number of funds flagged as underperforming potentially increasing in the next quarter. JB commented that there was a diminishing pool of value investment managers in the market and it would be worth looking at comparisons of higher charging active fund managers relative to others to see if they could take any comfort from relative overall value for money outcomes. JB suggested looking at the persistency of the Matrix funds versus the cost base. EC referred to the Morningstar ratings shown in the pack, which showed where members were paying more for certain funds, along with the fund performance versus benchmark. JB agreed this information was helpful.

EC added that efforts were made to report this to advisers by providing a 'performance watch list' and by publishing the minutes of these meetings. He added that the funds were designed to be in place for a minimum on 5-years, which would capture a typical business cycle range. Making rash decisions could lead to moving out of funds at the bottom of the market.

The following internal and external funds have been flagging red for two or more quarters and are being reported to the committee and a watching brief maintained:

- RLP Short (5yr) Index Linked
- Baillie Gifford UK Equity Alpha
- Jupiter North American Equity
- Baillie Gifford Japanese Income Growth
- Baillie Gifford Japanese

There are no plans to replace any of these funds in the short-term.

Outcome: Continue to monitor the above funds and report back to the Committee next quarter.

7. FUTURE OF GR

CJ provided an introduction to the paper, highlighting areas that the RL Board were looking to re-visit with regards to the options and solutions that the GR provides and then what that meant in terms of implementation. This was described as an “evolution, not revolution”, acknowledging the continued success of the GR, but also the evolving needs of customers over time.

CK summarized that it was good to hear about what was being looked at strategically and looked forward to hearing more detail on the different components.

8. ANY OTHER BUSINESS

There was no other business to be discussed and the meeting closed at 17.05.