Investment Advisory Committee (IAC) Quarterly Meeting

Minutes 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

Minutes are in the order that items were dealt with at the meeting, heading numbers correspond to the agenda order.

Action

1. WELCOME, CONFLICTS, REVIEW OF PREVIOUS MINUTES AND ACTIONS

1. The Chair opened the meeting at 14.00. There were no new conflicts of interest declared. Charlotte Dalton was welcomed to the meeting and was duly appointed as Secretary for the Committee. Sadia Ghani was also welcomed to the meeting as a new member to the Investment Solutions team.

2. The minutes of the meeting held on 4 March 2022 were reviewed. An amendment was requested to the last sentence of the second paragraph of minute (5), to reflect that the Committee does not 'formally approve' the design. Subject to that amendment the minutes were approved. CD

3. The schedule of actions arising from the previous meetings was reviewed. Action ref (3) in relation to the provision of further factor analysis to assess the extent of inflation sensitivity was considered. JB advised that he would like to see further granularity. VB advised that the Aladdin platform would not be available until 2024 and he would not therefore, expect to have anything further on the factor analysis before then. EC suggested that more information could be provided in relation to the ways the funds were analysed and insight into how the portfolios were performing. It was agreed to keep the action open and for KS to discuss specifics with JB as to what could be provided. KS

The other actions marked as 'propose to close' were agreed and the outstanding actions marked with a due date of Q1 2022 were asked to be updated to Q2 2022 to reflect the quarter that the meetings fell due in rather than the reporting period being covered during the meetings. CD

2. SAA UPDATE

4. RH outlined a summary update of the SAA review. He advised that the focus of the paper was on the Balanced risk portfolios (GPs 4, 5 and 6). He commented that positive feedback had been received from the Investment Committee (IC) on the high-level direction of travel as set out in the paper, with a view to formal approval being sought from the IC to the final proposal for the SAA for all GPs in July 2022. He highlighted that approval had however, been granted by the IC to expand the tactical remit of RLAM in managing duration in the fixed interest elements of the portfolios, although this was not yet being utilised. VB confirmed that the draft proposals had also been through other committees, including the Investment Strategy Committee and no objections had been raised. PH confirmed the same and added that as part of the last SAA review, they had previously considered a larger reduction to UK weightings. It had been decided at that point, to take it in two steps. Step 1 was the SAA implemented in Q1 2021, but as set out in section 6 of the paper, upon further reflection they felt comfortable with the current UK Weighting and no further shift towards global was agreed at this time.

ES was in agreement that tactical freedom made sense, however, he had concerns with holding nominal bonds in portfolios that were designed for real returns, even though, they were expensive. He questioned whether it should be more of a tactical opportunity, rather than a requirement to change the SAA. VB talked through the models and assumptions set out on slides 10-11 of the Supplementary Pack. 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 level resilience and thus part of the proposal is to deallocate to other fixed income asset classes. He advised that the allocations being proposed on slide 7 were robust 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.

5. CK raised concerns that the IAC had not been given the chance to comment early enough in the process to be able to provide guidance. She had a concern that the allocations being proposed were more tactical than strategic. VB responded to confirm that set out on slide 10 were the long-term assumptions which had been agreed through the LEAF process. He talked through where the long-term assumptions and models were pointing towards, versus the shorter-term CMAs around sustainability of the Governed Range (GR) as a

whole. He confirmed that short term moves were in the tactical remit and RLAM do use those levers. KS added that historically shorter-term considerations had been taken into account but not always explicitly, whereas there was now both a desire and the capability to do so. CK advised that it should, in that case, be more clearly defined in the SAA objectives and formally included in every annual review. JB agreed and commented that LEAF insight was not included in the pack being presented and the detail behind the proposals was not visible.

6. With regards to GP4 versus competitors on slide 7, JB asked if the input data fully reflected disinflationary scenarios, as the deflation case looked too sanguine. His view was that there appeared to be more focus on an inflationary shock (which was unlikely), versus stagflation, which could have a profound effect on portfolios. He commented that a better sense of LEAF conversations was needed by the Committee and insight as to how assumptions were being set. CK agreed and added that she would also like to see more detail on the following:

- consistency of global exposure on the bond front;
- bias deviation – to understand why it was a concern;
- the limited hedging in global bonds;
- active versus passive.

It was agreed that a deep dive should be carried out with the IAC and KS agreed to arrange this. VB re-assured the Committee of the governance cycle and confirmed that the proposals had not yet gone to the IC for approval, just for comment and there was still an approval stage to go through. It was not yet a complete presentation and the IAC did have opportunity to influence it, however, all of the comments being raised, he confirmed, had been considered in the proposals. JB raised concerns about commercial risk being a driver of change in light of 2020 performance versus peers. CJ confirmed that was not the aim and they wanted to be sure to have conviction in what they do. JB commented that the RL differentiator was robustness of the property portfolio. It would also be good to get a view on what was being discussed on the ceiling on commodities. VB advised that RL were driven by long-term thinking and their investment philosophy and beliefs, this was now moving to the next level down on the strategy. Themes will then guide that over the short-term, and all that knowledge feeds into the long-term assumptions at LEAF, subject to strict investment governance to then construct these proposals. JB commented that the IAC role was to ensure that the design process was robust, and to challenge the underlying assumptions. KS agreed that the paper presented was largely the same as had been presented to the IC for approval, and it would be worth re-considering the detail of papers for the IAC, given its different remit. 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. CK added that she also had a concern with GP6 and falls in real assets for people 5 years out from retirement and also with the investment pathway 1 average age being 58. KS advised that pathways mapping would be looked at as the second stage of the process, but for now we were reviewing individual portfolios and optimizing within their defined risk budgets.

KS

KS/All

3. STRATEGIC PACK

7. The Strategic Pack for the quarter ending 31 March 2022 was noted. RH referred to the GRIPs 1 and 2 risk metrics which were flagging red and asked for IAC views on those, and also on the timing set out on page 6 of the paper. He referred to the 6% reduction in equity and highlighted that page 10 showed the magnitude of that change. He noted that the

calibration of the Moody's risk metrics, were slightly different to what they used as the SAA process. When looking at a 'best views' basis, they did not flag red. CK asked what the reason was for the two different measures. RH advised that it stemmed back toa different system being used prior to all of the reports and calculations being moved onto the Moody's Portfolios Risk Analytic tool. KS added that they needed to work through the differences and work out the best one to use, they just wanted to make the Committee aware of it.

RH referred to the tactical positions which were underweight in equities and fixed income, and overweight in cash. The metrics flagging red were doing so based on the SAA and the current tactical positions should mitigate some of this. CJ commented that if there was a short-term issue to be addressed immediately, it would be a tactical decision to address those risks and decide if they needed to move further. CK suggested that the question presented on slide 10 was if something should be done strategically, tactically, or not at all. JB suggested options could be explored around hedging off near term equity risk; and relaxing duration controls. RH referred to slide 12, which showed that emerging market equity was the largest change. JB asked if short duration high yield was contributing to the risk. VB confirmed that the high yield numbers they were looking at were about 4.5 years in duration. CK commented that it was the second time in a quarter that these had triggered red, previously when they had triggered red, they had reverted back to green by the time of the next quarterly meeting. She asked how underweight in equities and overweight in cash they were in GRIPs 1 and 2? HH confirmed it was more modest than 6%, which is what it would take to bring GRIPs 1 and 2 withing risk tolerance, and investor sentiment may mean that they move back to neutral, even if Moody's figures haven't. VB advised that the cost benefit comes in when looking at buying 'puts' at this level, if it is decided to do anything, then it would go through the appropriate governance to get that decision ratified.

ES considered that the situation and the risks would be different between new and existing customers. He suggested looking at real performance of portfolios for existing customers to track what has happened relative to the fundamentals; also consider looking at what the income is providing, then consider what we should be advising these customers. If no change, then guidance would be needed to advisers on the current risk levels. CJ agreed and added that a red flag did not necessarily mean action needed to be taken, but it was an indicator to stop and think about it. PH advised that documenting the discussion covering off the issues was important, he considered the challenge to be in the quantitative models and the relative delta and time duration that can give changes in the outcomes.

CK summarised that the Committee seemed to be reaching the conclusion that nothing strategic needed to be done beyond the ongoing SAA review, she suggested that HH and Trevor Greetham (TG) look at the tactical considerations, including the views that JB had put forward on the models. CJ agreed to highlight that adviser communication may be needed. VB suggested with regards to model risk, that some scenario analysis is done based on what TG had already done to see if something should be actioned out of cycle and bring that analysis back to the Committee. HH agreed that it made sense to look at these risk metrics. PH commented that it was important to be alive to the sensitivities of how quickly the metrics move between green and red and this consideration should be visible and flagged as such in the minutes documenting these discussions. HH/ TG CJ

JB queried whether there was a more operational consideration to look at as a temporary measure. RH agreed to check if anything needed to be flagged to existing customers and report back to the Committee. RH

4. INFLATION COMMUNICATION

8. KS introduced his paper in respect communicating with customers around rising inflation and asked the Committee for views on where it would be best to focus efforts. JB advised that different demographics were affected differently. CPI as a basket, under reflects what hits households most, which is fuel and food. CK referred to '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 would affect them the most. She added some key areas to draw out might be: the pressure on DB Schemes that provide discretionary pension increases; the PPF cap on increases; the positive flexibility of DC income; and the income drawdown behaviours of 2021 versus 2020. JB added that another angle might be to consider the value of taking the full 25% tax free cash up front, in a high inflationary environment. CJ agreed and advised that some of the team were already looking at that alongside sequencing risk for those newly retired. JB commented that adviser support should also be considered for them having conversation with customers on that.

VB considered it premature to be talking specifics. With regards to GP6, this had been looked over already very carefully and will be assessed again when go through the detail with the IAC. HH agreed and advised that the GR was good and in a well-diversified position. PH commented that in addition to the benefits of diversification that had already been discussed, shortening the duration provided the ability to ride the curve of rising rates. Implied return assumptions when you buy are also important and how real asset performance links to high inflation. ES suggested that short duration high yield had a big role to play in the market. How GRIPs compare as an alternative to index linked annuities would be a useful measurement and the degree of risk that is taken away from that to keep as the purpose in mind.

PH referred to the discussion questions at the end of the paper and commented with regards to the last question on discretionary spending, that the effect on that was yet to be seen. Inflation of this size will not have been seen in many people's lifetime, and so they needed to be made alive to the inflationary challenges but with high job vacancies, the messaging needed to be different around what to do with discretionary income. VB commented that he would be cautious with regards to what was being communicated to avoid giving the wrong message. The benefits of the GR should be a key message and the choices available, then customers should be guided to lean harder on advisers (where they have them) to help guide their individual thinking. JB suggested reviewing how drawdown products were designed to work in disinflationary periods then look at the natural income portfolio and go back and appraise if it has merit and is working. He also suggested critiquing back to the 1970s and the property crisis to frame diversification slightly differently. HH referred to a paper Trevor had written about "The Curse of Long-term Cash", and another similar paper he had seen entitled "Avoiding Hidden dangers in HH
retirement" and suggested material could be used from those to bring communications to life. He agreed to circulate the papers to the Committee.

5. GLOBAL GROWTH PAPER

9. EC passed on Mike Clarkson's apologies for the meeting and advised that the report would be revised to provide more detail next quarter. In the meantime, if there were any comments on this quarter's report, he could take them away and discuss with Mike after the meeting. 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 and were not looking to move away, but there remained a

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 given input to. EC agreed to see what information was available. EC

VB queried why the fund was held and CK explained the background. EC confirmed that it formed part of the overall GR. The Committee discussed the fund performance versus the industry sector, past performance and manager style. PH commented that it had been a disappointing quarter but had a 20-year period methodology. 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. EC

6. PERFORMANCE PACK

10. EC presented the Performance Pack for the quarter ending 31 March 2022. He explained in more detail the matrix returns on page 3 of the paper, advising that a lot of active managers had been positioned in the market such that recent events 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 higher charging active fund managers relative to others to see if they can get comfort from it. EC agreed the paper only showed a snapshot and JB suggested that a better view was needed, looking at the persistency of the matrix funds versus the cost base. EC referred to the Morningstar ratings on page 18 of the paper, which showed where members were paying more for certain funds, along with the fund performance versus benchmark. JB agreed this information was helpful.

CK commented that VB had raised external funds in the past, but the matrix funds had always shown performance persistency above 50%. VB agreed the position had got worse and questioned whether the benchmarks were correct and whether customers were suffering. EC advised that the funds were designed to be in place for a minimum 5-year full business cycle range. Making rash decisions could lead to moving out of funds at the wrong time.

JB commented that it was about persistency and efficacy of how active managers perform versus the market. When they drop below 50% then there must be a discussion on approach to measuring them and don't lose sight of cost. EC advised that the numbers showed persistency versus the benchmark, not the rest of the market. CK commented that past performance should not be the only measure to choose a manager, Governance, ESG and charges were also key. EC advised that where persistency had previously been above 50% and had fallen below for 1 to 2 quarters, this did not demonstrate persistency to suggest getting rid of the fund. PH had a concern about moving too short-termist. There were reasons for keeping funds in the range that were reflective of style, and historically, it was where there had been a change in house approach from the manager that had dictated whether to keep them. He did not believe that there was anything wrong with the fundamentals, but added, the reality was, that more time was needed. VB asked why they were not investing in their own RLAM funds and PH explained there was a desire to have active manager selection in the proposition alongside the core GR and the passive BlackRock funds.

7. FUTURE OF GR

11. 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 it provides and then what that meant in terms of implementation.

CK commented that it was good to hear about what was being looked at strategically and looked forward to hearing more detail on the different components. In the interests of time, she suggested that if the Committee had any other comments on the paper that they email them to KS.

8. ANY OTHER BUSINESS

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