MINUTES OF THE PENSIONS INVESTMENT COMMITTEE

Tuesday 15th November 2016

PRESENT: Councillors Ingleby (Chair), Hooks, Johnston-Franklin, Hilton, Maslin, Muldoon, Ogunbadewa

Also Present: David Austin, Albert Chen, Geoff Nathan and William Marshall (Hymans Robertson Consultants), Carolina Espanal, Olav Konig and Emily Archer (HarbourVest representatives), Digby Armstrong (UBS representative), Janet Senior and Helen Glass

Apologies: Councillor Best

1. **Declarations of Interest**

   Councillor Muldoon declared an interest as a substitute member of the Advisory Board for the Local Government and as a Councillor with preserved benefits in the LGPS.

2. **Minutes**

   RESOLVED that the Minutes of the meeting held on 9 June 2016 be agreed as a correct record

3. **Funding Manager Briefing- UBS**

   Digby Armstrong gave a presentation on the UBS Lewisham Pension Fund Mandate. The report covered the mandate, Lewisham performance, market context and UBS asset management.

   In regards to the mandate, Mr Armstrong mentioned that Lewisham is 77% invested in equities. He also stated that US election bears good news for the UK in terms of the negotiation position with Europe, hence why the pound rallied quite strongly.
   In regards to the performance of Lewisham, over the last year, the benchmark sat at 26% which demonstrates the current weakness of the GBP, but is still a good period. A 6/7% return (as demonstrated by the UK) per annum is what should be expected over long term performance.

   UBS run a lot of index tracking assets, in both equities and bonds. Tracking does not just include buying the index, waiting for it to change and then replicating it- there is skill involved in anticipating what changes to the index are taking place over a 2-3 week period. It is about stock lending, minimising trading costs, avoiding price distortions caused by index changes, adding value in corporate events and active corporate governance. Another efficient index tracking development on its way is Carbon Aware Investing. When considering investing and engaging with different companies, UBS will look at where they stand in terms of their carbon footprint

Mr Armstrong also discussed alternative indexation and smart BETA, which he described as passive investment, but investing money in companies that are ranked by different factors e.g. value, minimum volatility and quality. The UBS recommendation is a blended approach of different factor-based investment strategies

Albert Chen made the following observations of the points made in the UBS presentation:

- Regarding the alternative indices and smart BETA, the funds have not been in existence (shown on slide 13) and neither have the indices, so what has been demonstrated is regarding testing
- The performance of the smart BETA indices, the drop in equities (in value, quality, momentum etc.) are still quite volatile.
- Although, this does offer something different to the market gap. However, there are higher strategic priorities.

4. Fund Manager Briefing- HarbourVest

Olav Konig, Managing Director of HarbourVest Partners, Corilina Espinal, also Managing Director and Emily Archer, Vice President, gave a presentation on the Lewisham Pension Fund mandate. Their presentation gave an overview of HarbourVest, an overview of the commitments regarding the Lewisham Pension Fund and their 2017 Cycle 4 strategy. The following was mentioned in their presentation.

The company has extensive knowledge of private equity attracts a strong base of institutional investors worldwide and manage more than $4billion for 22 LGPS clients. The representatives pointed out that over the years, Lewisham's overall portfolio has performed well for a majority fraction of the time- with 2008 and 2009 being the only years it fell below the contribution line between 2006 and 2016.

Discussing the assets managed by HarbourVest as of June 30 2016, in cycles 1 and 3, Lewisham's status started at maturing and moved to 'investing' by the vintage year 2014. The total values have been above water and HarbourVest expressed that they are pleased with the performance.

In regards to the diversification of the Portfolio commitment, Lewisham are well diversified in the underlying company level. Vintage Year diversification is crucial for a successful private equity strategy- there has been a positive performance across vintages in the Lewisham portfolio.

Absolute returns have been strong- relative to the public markets- performance generally has been positive, although there have been some laggards from 2007 onwards due to some challenges faced during the financial crisis. During cycle 3, 2014 onwards, investment performance has improved.

Albert Chen and William Marshall observed that volatility in private equity can be higher but the investments are valuated every quarter. Private equity is viewed as a long term application which funds can invest in, however there are more attractive opportunities in other parts of the market and other asset classes without the exposure of the same level of volatility investing in equity.

5. **Review of Investment Strategy and Statement of Investment Principles- Hymans Robertson**

Geoff Nathan presented reports on the "Lewisham Pension Fund- Funding Strategy Statement (FSS)". The legislative basis and requirements of FSS can be found in regulation 58 of LGPS Regulations 2013- this regulation has regard to GIPFA guidance. The FSS documents must contain a clear and transparent strategy of how employers' liabilities are best met. It must also ensure solvency and Long Term Cost Efficiency is met- this essentially means that there should be enough assets to cover liabilities that may unexpectedly arise and implies that the rate must not be set at a level that gives rise to additional costs.
The key aspects of the funding strategy, as explained further in the report provided, are:

- Solvency & Long term Cost Efficiency (LTCE)
- Consider own valuation vs DCLG/GAD (section 13 analysis)
- How funding and investment strategies link
- Identify risks and counter-measures
- Employer database
- Involvement of Local Pension Board
- Employer consultation
- Clarity and transparency

Geoff Nathan went on further to discuss the initial results of the 2016 Actuarial Valuation. He discussed the following regarding 2016 assumptions;

Future investment returns are based on bond yields (plus allowance) for the fact that the investment is in an equity type investment. In 2013 the bond yields were around 3% plus 1.6% allowance for asset performance. In 2016, they had fallen to 2.2%, with an allowance of 1.8%, which was seen as a reasonable assumption (based on modelling to see if it was sustainable). There was also a drop in long term pay growth from 4.3% to 2.9% which is a blended rate allowing for 1% pa to 2020 and RPI +0.5% thereafter, and excluding promotional increases.

The actual results set out in the presentation showed that the funding level had risen to 78% from 71% in 2013. The bottom line here is that deficit has fallen from £348m to £288m. Membership data displayed that active member salary had increased to £133.5m in 2016 from £123.9m in 2013. The change in market conditions meant that falling bond yields have increased liabilities, but asset returns have been stronger than expected.

The whole fund valuation based on the SAB (School Advisory Board) have put out a funding level assumptions of 94%- a funding basis is required to be prudent by regulations

Mr Nathan then discussed the modelling results for the Council- the purpose of modelling is to consider the investment and contribution strategies that might be used within the Lewisham Pension Fund to help inform the Administering Authority of the level of risk associated with different combinations of funding and investment strategy. For each outcome, 5000 projections per scenario, the position at each valuation during the 24-year period is calculated, using cash flows and membership data. In projecting forward future funding levels, projected market conditions at each future data are used to see where the Council is likely to be, in as far as 20 years' time. The assessment of the likelihood of different outcomes was displayed in the presentation.

In the decision making framework, the probability of achieving set target of 100% funding is considered, as well as the time horizon and the downside risk.

There are 3 investment strategies; current, diversified and lower growth. The inputs were modelled in the presentation as well as the outcomes. It was further explained that with the current strategy, the probability of achieving target in 2037 around 66%, the current diversified strategy at around the same% and the lower growth at just above 64%. The risk by 2037, based on the average of the worst 5% outcomes with the current strategy is at 31%, diversified at 38% and lower growth at 42%. The last 3 graphs displayed what would happen under the 3 strategies with contributions. Which steps up or down by 0.5% on average.

RESOLVED that the report be noted

6. Investment Performance Report- Hymans Robertson

Albert Chen and William Marshall, presented a report outlining the portfolio options for diversification. The following was presented by Hymans Robertson and discussed among the Committee.
The purpose of this paper is solely to provide overviews of a number of asset classes, to help inform the Council in deciding upon those that could be considered further for inclusion in the Fund's investment strategy. The paper was presented in 3 parts; Rationale for diversifying the Fund's portfolio, Overviews of asset classes (multi-asset, alternative credit, infrastructure, insurance linked bonds); and points for discussion and next steps for the Committee.

The consultants presented various explanations as to why Lewisham may want to diversify, including opportunities to improve the efficiency of the Fund's investment portfolio by maintaining or improving the level of expected return while reducing risk, equities have performed well over recent years and the market outlook for risky assets is fairly uncertain and there are always the possibilities of setbacks in the short or medium term. Regarding asset classes, reducing equity exposure and investing in assets offering illiquidity premiums and diversification from economic growth driven returns is likely to increase the resilience of the portfolio and help protect capital. The representatives also made the point and showed a graph that displayed that the Fund's strategic need for income is increasing over time.

Multi-asset strategies are seeking to deliver "equity-like" returns with lower volatility. The funds will typically be invested across a range of asset classes and strategies. A large range of different approaches and highly reliant on manager skill.
Speaking on alternative credit, credit is higher than equity in terms of the capital structure. However, within credit there are a different set of risks, mainly default risks and liquidity.

The representatives explained a graph in the presentation, which explained the investment stages of Infrastructure. There is a higher return opportunity in taking projects from the “greenfield” stage to operating stage, but with the trade-off of higher development risk. In the later stage, greenfield is not invested in until the financial close, reducing risk. The fundamental risk of Infrastructure, highlighted by Albert Chen was that of political and regulatory risk which can vary over time, impacting potential returns from affected infrastructure assets.
Specialist infrastructure funds typically focus on a particular sub-sector or region, and therefore typically to specific sector and/or regional risks, which require consideration relative to a core, diversified fund that invests across sectors and regions.
Insurance linked (IL) bonds are issued by insurers and re-insurers seeking to transfer catastrophe insurance risk. Cat-bonds will typically have a 3 year term (to 5 years) that pays coupons over the term and return principal upon maturity. The key risk for IL bonds is fundamentally disconnected from the Fund’s other investment risks.
In terms of the asset classes, in relation to the market environment, Alternative Credit in particular has been and are of interest over the last few years
It was recommended that the Committee discuss whether they believe in diversification and is there contentment in a 30% reduction in equity if adopting a lower-risk investment strategy.
It was recommended that for the February 2017 meeting that Hymans will present structure risk and return modelling for a range of portfolios based on Committee preferences. The potential for manager interviews, prior to, and at the next meeting, subject to agreement on asset classes and implementation process.

RESOLVED that the report be noted. The Committee agreed to look further into diversification.

7. Pension Fund Annual Report

Due to the over-running of time, this report will be presented at the February meeting

The meeting finished at 10:05pm