MINUTES OF THE PENSIONS INVESTMENT COMMITTEE MEETING

Tuesday 7 February 2017 at 7pm

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

Also present: David Austin (Head of Corporate Finance), Helen Glass (Principal Lawyer), William Marshall (Hymans Robertson Consultant), Rebecca Craddock- Taylor (Hymans Robertson Consultant),

Apologies: Councillor Best and Councillor Ogunbadewa

1. **Declarations of Interest**

   No interests were declared by Members

2. **Minutes**

   RESOLVED that the Minutes of the last meeting held on 15 November 2016 are agreed and signed as a correct record.

   The order of items were agreed to be changed by the Chair as follows
   The Chair pointed out that the government requires new FSS and investment strategy principles therefore the outcome of this meeting is crucial to that. Results will be on the triennial valuation.

3. **Valuation and Investment Strategy**

   William and Rebecca presented this report on behalf of Hymans Robertson. The following statements were made by them.
   The key driver of a good fund is Strategy- the 5 other key factors are Objectives, Investment Beliefs, Structure, Fit-for-purpose managers and Review and ongoing monitoring.
   The primary investment objective of the Fund is to ensure that the assets are invested to secure the benefits of the Fund's members under the Scheme
   Explaining the importance of bridging the gap between objectives and strategy, the committee looked at Actual objectives for 2 local government pension funds were displayed on slide 6. A pension funds strategy to achieving its objectives will vary, dependent on varying investment beliefs. Speaking on the investment beliefs of Hymans set out on slide 7, William advised that the Committee set out their own investment beliefs and ensure that match with the assets the Pension Fund holds. This will provide clarity, context and continuity. William also pointed out that it is important to have investment beliefs for the sake of public scrutiny as a public fund. For example, the belief that diversification provides stability goes with the belief that diversifying helps to reduce risk, in particular some of the potential extremes of risk, although it has its limits.

On slide 8, the graph showed that the probability of achieving funding was broadly the same under a high equity strategy or low equity strategy. However, both strategies displayed have a similar chance of obtaining the objective- but the one that is more diversified and more exposed to income assets gives much more of a “downside cushion” if markets were not in favour, thus making the diversified approach more attractive.

Three main asset classes- diversified growth fund, alternative credit and infrastructure. A 3% allocation of the DGF has already been agreed and selected- this is a low governance way of increasing the diversification within the portfolio. They target generally absolute returns but with much lower equity volatility, making it manageable within active markets.
Alternative credit is income generated from assets. Hymans suggest increase the allocation from 10% to 15%. It also has benefit of providing income. The income generated from those assets could be used to pay out some of the benefits that are going out at the moment.
Infrastructure provides a good source of income too. It is inflation linked to meet income requirements. There’s currently quite an attraction to infrastructure. There is a scope to increase this allocation to approximately 6%, however, there is a consideration that comes with infrastructure that takes time so this is likely to be more of a long term target.

Further explaining the capital structure of alternative credit, HR explained that a lot of institutional investors are investing in this diversifier. They have a lower credit rating, so they carry more risk than corporate bonds, but default rates are quite low the return is high. The reason this would be preferable despite its high its high risk is because alternative credit assets are securitised, so have assets backing the bonds and loans that companies are taking out. Generally, the default rates that they carry have been quite low, and if there has been a default, the recovery of the asset has been relatively high. As a result, HR would deem this asset as attractive at this time.

In regards to infrastructure, HR suggested, for the fund, to focus more on income than growth when considering the range of options for risk and return. There are different stages to invest in infrastructure- there is a higher return opportunity in taking projects from the “opportunistic/greenfield” stage to the operating stage, but with the trade-off of higher development risk. The “core/brownfield” stage is where there is an existing income producing assets and where there is more focus on income.

Speaking on Blackrock’s Global Renewable Power Fund and Foresight Solar Fund, HR stated that both a relatively specialist, particularly Foresight, focusing only on solar funds and assets. The investment company focuses on providing shareholders with dividend income by investing in UK ground based solar assets. Blackrock’s fund is slightly more diversified globally. The Fund focuses on equity ownership in utility-scale wind and solar power projects. Their investment philosophy is based on a fundamental understanding of the investment manager’s strategy, aligning incentives between manager and investor, exercising independent judgement and a focus on market inefficiencies.

Concluding and summarising potential diversifiers, HR asked the Committee to consider that it would take some time to invest in Infrastructure and the capital to be

drawn by the fund managers, excluding the consideration of the CIV as that would add a significant amount of time. They suggested having an interim period- so the overall strategic aim is to invest, so prioritising that, they suggested increasing the allocation of Diversified Growth to 6%.
For alternative credit, it would be preferable to have a multi-asset credit manager so they can so they can change between the different scopes of alternative credit. The recommendation would be to increase this allocation by 6%, bringing it up to 7%.

HR recommended requesting fund specifics from managers to review the progression of Infrastructure.

RESOLVED The Committee agreed the allocation increase of 6% under Diversified Growth.

4. Blackrock- Fund manager briefing

Blackrock representatives, presented LBL Investment Portfolio. They made the following points during their presentation

- Asset allocation as at 31 December 2016 totalled a value of £525m invested
- The relevant performance of Aquila life-relative performance being any difference in returns between the first fund and the index- he indices are being tracked very carefully

Blackrock have been carefully considering the best approach for their clients regarding the London CIV. The government has set certain specific constraints under the authorised contractual scheme which states that there can no longer be investments in life policies- which LBL are currently invested in. Blackrock have built a final solution for LBL which does not use life policies and have prepared a proposal to move into the final state solution. Based on feedback from other boroughs, Blackrock are confident that after the forthcoming meeting, Lewisham will have solutions to all their questions and that they will have a final solution they are pleased with.

Speaking on low carbon and ESG optimisation, these are 2 index options to consider for investors who are looking to reduce carbon exposure or increase exposure to positive environmental, social and governance (ESG) factors, while restricting tracking error to the market capitalisation weighed index. Either approach would result in more variability. The average/mean will still be the market return but in a recording cycle a 0.5% volatility difference could be expected.

Blackrock has conducted research to research to determine how a portfolio's Carbon Emissions and ESG ratings can change as tracking error limits vs the Parent Indices increase. For MSCI World, it was found that significant improvement could be made in reducing portfolio carbon emissions with 30bp tracking error to the parent index, which BR present in a diagram in their presentation. Similarly, ESG ratings improved with 50bp tracking error (also shown in their presentation). If we attempt to outperform a benchmark and we simply use positive ESG scores, we will outperform by a smaller margin. If we incorporate non-ESG indicators, like their dividend history for example, into the decision making process, the outperformance is higher because of the combination of the two, as BlackRock have experienced

The move from life policies -to which Is where historically funds have been for years- to authorised contractual schemes, has displayed a big theme arising on the back of pooling. Within the authorised contractual scheme, to hold something within it, it has to be very transparent and, the life funds are not transparent. Other rivals have not launched an ACS and have kept their life fund policies, and in some way, this sector/industry appears to be working well. It appears to be a work-in-progress. It would have been beneficial for the committee to have seen something in writing from Blackrock on this topic.

The way HR view ESG, is that it is an additional aspect that managers should be looking at- it is a risk to the value that investors could eventually receive and it is their duty to then look at it. It is also the fiducial duty of LBL to ensure that the managers assessing all the risks across the board. There are 2 ways to look at the ESG "responsible" investment of which there are 2 aspects- the sustainable investment, which is incorporating ESG risks, additional opportunities within the decision making, probably more or active managers; and then the stewardship and governments aspect of investment, of which asset managers really ought to be showing their strengths because they are every long term holders of these assets. The only way they can really protect value is to ensure that company management are on the side of the investors

5. Hymans performance report

Given the American outcome, markets were relatively stable and quite strong performance from equities. Unlike previous periods, bonds fell in value due to increasing yields- that's was a result of the expectation of less supportive central bank policy, and in particularly inflation. Property was relatively strong as well, there was an increase in capital values. In the UK interest rate stayed at 0.25%. US equities reached an all-time high and they continue to climb as do UK equities. The only region that struggled was emerging markets. That was the view from the market that the President has quite a protectionist policy, so there are concerns around emerging markets. The oil price rose, so that supported commodities in the oil and gas industry and since the end of December we have continued to see rising performance of equities.

Assets at the end of December were at £1.2bn- an increase of £38m over the quarter. Most of those returns came from Lewisham's equity holdings within passive managers. There is a divergence in Lewisham strategic allocation to the actual allocation- there is potential to consider some rebalancing here. HR believe it is a very good scheme to have and maintain within the strategic allocation.

Returns over the quarter for the total fund were 3.7% against a benchmark of 3.6%. Over the longer term, it is visible that the fund falls very much in line with the benchmark and that is due to fact the Lewisham has largely passive holders. Last year the fund was particularly strong at 22.5%, although a similar type of return is not expected over the next year just due to the volatility expected.
RESOLVED the report was noted.

6. Pension Fund update/ London CIV

The Chair asked Hymans representatives to briefly discussing the nature of the strategies below before the Committee moved onto the final item.

Funding Strategy Statement
As mentioned in the February meeting, the FSS is part of the LGPS, set up by the UK government to provide retirement and death benefits for local government employees. The Lewisham Pension Fund uses the assets to pay Fund benefits to the members. Hymans asked that the strategy (set out in the report) is agreed to delegate this back and have it agreed, consulted and in place by 31 March 2017.

Investment Strategy Statement
The Fund historically has a statement of investment principles and the new investment regulations (2016) remove many of the investment restrictions that were in place for the LGPS and allow Funds considerable discretion about where and how to invest. Funds must have an ISS approved by April 2017 as a replacement of the statement of investment principles. Hymans discussed the rebalancing operation for the 2 main managers, UBS and Blackrock and the importance of ensuring these arrangements are in place for their passive multi-asset mandates.

Key priorities for the Business Plan include:

- rebalancing within the fund managers
- multi-asset credit- the scope is to go up to 12% (take 6% out of equities and hold in cash in advance of the start of the process). HR recommended taking this out of non-emerging markets
- consideration of investing in pooled funds- this is an investment decision rather than appointing a manager
- Infrastructure exploration and training

RESOLVED the reports were noted.

The meeting finished at 9:32p.m.