MINUTES OF THE PENSIONS INVESTMENT COMMITTEE MEETING

Thursday 22 June 2017 at 7p.m.

PRESENT: Councillors Ingleby, Hooks, Milne, Muldoon, Ogunbadewa

Also present: William Marshall (Partner, Hymans Robertson), Clare Cairney (Senior Investment Research Consultant, Hymans Robertson), Nimisha Sodha (Investment Analyst, Hymans Robertson), David Austin (Officer, Head of Corporate Resources), Robert Browning (Principal Accountant), Sarah Assibey (Committee Support Officer)

Apologies: Councillors Best, Johnston-Franklin and Maslin

1. Election of the Chair and Vice Chair

Councillor Ingleby was nominated and elected for the position of Chair for this committee for the municipal year 2017-2018

Councillor Hooks was nominated and elected for the position of Vice-Chair for this committee for the municipal year 2017-2018

2. Declarations of Interest

Councillor Hooks declared he now works in the Life Insurance and Pensions field

3. Minutes

The Vice-Chair suggested having Hymans review the Minutes for accuracy.

David Austin noted the report from the last meeting had 4 recommendations of which the Committee had agreed and the minutes of the last meeting need to be amended to be made more explicit the following:

The minutes under Item 6 – “Pension Fund Update/London CIV” record that the Chair asked for the Funding Strategy Statement (FSS), Investment Strategy Statement (ISS) & Business Plan to be discussed before moving onto Item 6. However, the minutes do not record that actions recommended against these strategies were agreed, only that reports were noted (which should apply to Item 6 alone and not those items listed previously.)

The report submitted by David Austin for Item 3 “Valuation and Investment Strategy” submitted the following recommendations for agreement:

i. review and agree the Funding Strategy Statement (FSS) appended to this report and ask officers to finalise the presentation of the FSS by the 31 March 2017 to include any comments from the Committee;

ii. review and agree the Investment Strategy (IS) appended to this report and ask officers to finalise the presentation of the IS by the 31 March 2017 to include any comments from the Committee;

iii. receive the presentation appended to this report on Portfolio Considerations from the Fund's advisors, Hymans Robertson, and instruct officers on the investment options to take forward in line with the IS; and

iv. agree the draft business plan appended to this report and presented by the Fund's advisors, Hymans Robertson, and instruct officers to begin work in line with this plan.

4. Introduction to investment beliefs- Hymans Belief

William Marshall presented the item and reported the following:

4.1. The ultimate objective is to pay pension and lump sum benefits whilst targeting stability in contribution rates. An illustrative long term cash flow graph demonstrating what a public sectors own cash flows are like.

4.2. To determine how pensions are going to be paid and the stability of the pension fund, the fund has to be well run. An academic study of what makes a good pension fund and the characteristics these funds have, was illustrated in the presentation. In the context of objectives, beliefs and strategies form the core attributes of a good fund as well as strong management.

4.3. In reference to a "steady state", this implies what is trying to be achieved (from a long term investment perspective). Private sector funds have a desire to run as low risk as possible whereas local government considers future generations and keeping pension funds affordable. Therefore there must be some level of balance between contributions and steady state funding and investments.

4.4. From a governance perspective, alongside the objectives and investment beliefs, comes the regulations and guidance. The new regulations (LGPS Management and Investment of Funds Regulations 2016) which were announced last year, meant that a new investment strategy was put together replacing the former principles, which must be adhered to.

4.5. Challenges for the LBLPF (London Borough of Lewisham Pension Fund) include the need to grow; the need to generate income; and the need to protect and provide insurance for the value of the existing assets. It is vital to strike a balance between all three needs, although returns have been good for LBLPF.

4.6. One of the investment strategy journey's key priorities is to generate returns- as the LBLPF matures, the aim is to develop high tolerance for volatility. This will see a gradual move away from equities to more yielding type assets.

4.7. The importance of having and strong beliefs system is that it is the key driver in helping translate the objectives into a well-defined investment strategy. It also supports the decision making process by proving the committee with clarity, priority and consistency. Consistency is particularly important for the sake of public scrutiny

4.8. LBL's investment strategy is made up of implicit (based on underlying holdings) beliefs: equities are expected to generate superior long term returns; alternative asset class investments provide diversification; and protection against yield movements is not a priority for the Fund. Another implicit belief is that passive management has a role to play in the Fund's investment structure, most notably in the more efficient investment markets.

4.9. A move from implicit beliefs to explicit beliefs would be necessary now at this point for LBLPF. To explore this, the Fund should look into its fund appetite, scope for diversification and flexibilities of investment. HR presented some basic questions LBL might want to consider to explore such beliefs further, with room to make the questions more complex and detailed to draw a more concise conclusion. HR aims to then, bring out results to a future meeting and develop a statement that is specific to LBLPF.

RESOLVED that the committee will add 3 more questions to the questionnaire provided by HR so there are no more than 12, of which will me a more challenging and detailed set of questions specifically around the Fund and ESG. The results of the questionnaire will outcome a set of beliefs which will eventually be included in the Mission Statement.

5. Alternative Credit Procurement

Before introducing HR to present the next item on the agenda, the chair noted that is agreed in the last minutes, LBL will be increasing their outgoings to Invesco's multi-asset credit programme. As part of strategic change and the Fund's strategic evolution, it was agreed within the Committee to reduce the equity allocation and allocate more into yielding assets to produce a bigger income return and capital growth. Under this item, Clare Cairney discussed the different range of alternative credit markets and the preference of private over the more public sector alternative credit markets:

5.1. The background of these opportunities (to take more risk the investment based allocations) came from the financial crisis, banks changing regulations in their ability to lend. This has created opportunities for investors to gain exposure to these markets and benefit from the dislocation in market, particularly for long term investors, which means long term illiquid positions can be taken.

5.2. HR presented a table of the main asset classes which showed the types of yield within these markets as well as the credit rating and their liquidity profile- all of which supported the argument of the preference of private debt over traded markets, which followed.

5.3. While spreads across sub-investment credit markets have tightened, they continue to offer attractive risk and return and diversification benefits relative to equity markets. There is security of income these asset markets give and are part of LBLs growth/income allocation i.e. equity-like returns but with more certainty

5.4. It is currently a benign, default environment so there are not many companies who have defaulted in debt which is where you would typically see returns- although this will not last and there will be a more attractive time to go into these markets.

5.5. What has not been seen in the private debt market is the same kind of returns- it is quite a polarised market so there are managers are not getting attractive investments. However the more established managers can negotiate terms and therefore receive better returns over the same credit quality as the traded markets. The traded markets have become more borrower friendly, so companies are going into the market because there is such demand for these type of returns

5.6. HR have now been looking at private markets for 5 years- they have continued to see managers raising their 2nd/3rd funds and they are still getting similar type returns.

5.7. The key characteristics of private lending includes growth like returns (5-6% p.a. net of fees); good diversification of overall investment strategy and across the underlying assets held in the private lending strategy; it is senior in the capital structure and secured on borrower assets. It is secured on underlying assets held so there is transparency, so there is an understanding of what assets are behind this loan. It is a short to medium term investment period; relatively low volatility in loan pricing and stability of capital value and stable cash flows.

5.8. A key risk is that the borrower defaults on their loan. This can be mitigated through due diligence performed by the investment manager and a strong workout capability in the event of default- a manager would have the knowledge of how to get as much as possible back from that loan.

5.9. There is also an implementation risk- investors are dependent upon the manager to source sufficient opportunities to get money invested and for the quality of the lending to be proportionate to the yield paid by the borrower. Insufficient sourcing will potentially lead to an extended drawdown period and loss of yield.

5.10. How the exchange rate of the Fund is managed would be dependent on the manager that is chosen by the committee. There are 3 recommended managers to select from- 2 are global managers and the other, a European manager. One of the global managers and the European manager provides a GBP hedge class- therefore there is no currency risk. The other global managers only provide a USD sheer class, so many clients would do their own hedging

5.11. In terms of lending markets, the US market is quite significantly ahead of Europe in terms of investors lending in these markets. It can only continually as banks face pressures- HR would recommend getting exposure to Europe as it is a structural changing market which will continue to be this way. There will always be opportunities in the US which is why a global approach can be very attractive.

5.12. HR has done a lot of work with managers and looked at over 30 private debt managers. Looking at the key characteristics in the mandate, that was a driver to narrow this number further down- these were the key areas to assess managers on as well as their ability to structure a covenant and transactions; possessions of the required legal resource; their record of defaulting; and their lending record.

RESOLVED to agree Stage 1 and 2 of the investment strategy provided by HR. Stage 2 of the investment strategy will take place as part of the infrastructure process.

RESOLVED also to hold the interviews and manager selection during an extraordinary session of PIC with a quorate number of members to be held in an evening session in July and hold off investing until September

6. Investment Monitoring Report

Nimisha Sodha presented this report on the quarterly performance of the Pension Fund investment portfolio. It has been a very strong market for equities, a large part of which is because of the currency falling back. In local currency terms, global equity indices have risen over the quarter as demonstrated in the report. Bonds have performed well (but not to the same extent) which is positive for the Fund. Overall there have been strong returns from assets.

HR also stated that assets have outperformed expectations: asset pooling is something to consider for the Fund- these means that a number of Pension Committees' existing responsibilities will soon be delegated to their funds' pools.

6.1. Assets have grown over 51.1m over the quarter; Blackrock and UBS have tracked their benchmark passive funds, Blackrock being the strongest performer. Equities and bonds were up over the quarter which is reflected in the passive funds.

6.2. There have been no changes to the manager ratings over this period. In terms of performance, it has been positive in all funds in absolute terms. The HarbourVest venture fund over the 3 months and 12 month period but it is important to note that the performance outlined in the report is a quarter in lag, so will not be accurate to the current quarter discussed.

6.3. BlackRock and UBS have been added to the local government national framework which is good for the fund. Schroders is a Fund of funds which means that (in terms of pooling) they are unlikely to be chosen for accessing property markets, so therefore there is some uncertainty over the structure and stability of it.

RESOLVED the report be noted.

7. Pension Fund Update

David Austin presented this report to the Committee and gave the following updates:

7.1. The Pension Board has not met in the last quarter. Efforts are now being made to contact existing Board members to confirm their continued interest in serving, as the membership has changed, before any forthcoming meetings can be scheduled. The terms of reference and the constitution requires there is "balance" within the membership.

7.2. On the London CIV, they are bringing forth a multi-asset credit mandate and a fixed term strategy as well.

7.3. Of the two passive funds, both are structured with life funds which cannot be adopted by the CIV. Nonetheless, BlackRock have created a structure and are prepared to transfer LBL funds from the life funds. LBL still will not hold this directly, however, because it will be in the ACS structure this can be directed into the mandate. They have provided the costs and the fee reductions they are prepared to offer. However, they have also stated that is LBL were to stay as a life fund then the fee reduction will be given anyway.

7.4. Also, looking at rebalancing of the Fund, LBL needs to continually update and monitor the investment strategy to avoid fund managers buying back what was sold.

7.5. There have been no specific changes- some minor developments with regards to the MiFID II legislation coming into force on 1 January 2018. Pressure has continued to be applied to the Financial Conduct Authority (FCA) to consider its position with regards to the classification of local authority pension funds and treasury operations. No formal response has been received, however, feedback from the LGA and a recent meeting of the All Parliamentary Party Group for LGPS suggest that the opt-up process from retail to professional status will be simplified from initial proposals.

RESOLVED

i. that the revision to the Investment Strategy Statement for rebalancing as set out in the table at 4.15. is agreed.

ii. to maintain the current life fund structure within the BlackRock mandate and take advantage of the fee reduction backdated to January 2017.

iii. to ask officers to approach UBS with a view to discussing similar arrangements to the BlackRock offer for a fee reduction.

iv. the committee agreed and noted the Work Programme for 17/18

v. a date is agreed and set by officers for Members Training at Hymans Robertson

8. Draft Pension Fund Accounts

8.1. The Council, as an administering authority under the Local Government Pension Scheme Regulations, is required to produce a separate set of accounts for the scheme's financial activities, assets and liabilities.

8.2. The accounts comprise two main statements with supporting notes. The main statements are:

- The Fund Account, which details dealings with members, employers and others directly involved in the scheme as well as returns on investments, and essentially represents the Fund's revenue account.

- The Net Assets Statement, which details the Fund's asset holdings and liabilities, and essentially represents the Fund's balance sheet.

RESOLVED Members are asked to note the draft Pension Fund accounts for the year ended 31 March 2017, as set out in Appendix 1.

The Chair thanked Members and representatives from Hymans Robertson.

The meeting finished at 9:01p.m.