

MINUTES OF THE PENSION INVESTMENT COMMITTEE

Thursday 28 June 2018 at 7pm

Present: Councillor Ingleby (Chair), Councillor Krupski (Vice-Chair), Councillor Best, Councillor Codd, Councillor Feis-Bryce, Councillor Muldoon, Councillor Sheikh

Also Present: David Austin (Head of Corporate Resources), Robert Browning (Principal Accountant), Nick Jellema (Hymans Robertson), Rebecca Craddock-Taylor (Hymans Robertson)

Apologies: Councillor Maslin

1. Election of Chair and Vice Chair

Councillor Ingleby was nominated and elected as Chair of this Committee
Councillor Krupski was nominated and elected as Vice Chair of this Committee

2. Declarations of Interest

Councillor Best declared an interest as a recipient of the pension scheme.

3. Minutes

The minutes of the last meeting were amended as follows:

- In para 3.2, reference to “training” to be removed.

4. London Borough of Hackney Presentation

Cllr Robert Chapman, the Pensions Committee Chair of Hackney Council and Ian Williams, the Group Director of Finance and Corporate Resources both attended the meeting to present a report on their Council’s report on Carbon Risk. The following points were discussed:

- 4.1. The Hackney Fund has £1.4bn in assets with a 77% funding level as recorded at the 2016 valuation. Its equity allocation is significant (60% of AUM) and involves both active and passive mandates.
- 4.2. Hackney recently completed a significant restructure of the equity portfolio moving to pooled structures, including an active mandate with the London CIV and a passive mandate with BlackRock. The portfolio also incorporates changes as part of review of carbon exposure.
- 4.3. Hackney have a broad interest in sustainability and environment. Its Pensions Committee has longstanding interest in ESG issues and responsible investment but maintains its focus on the primary duty of the Fund - to pay benefits.

- 4.4. Hackney has an active, local divestment group. It presents both moral and financial arguments for divestment. Members and officers meet regularly and the pressure to divest is maintained but a contrastive dialogue within the committee has been helpful.
- 4.5. With regards to the approach on carbon risk, the focus must be on financial risks as the fiduciary duty is to ensure returns for member's benefits. The general consensus is that the greatest environmental risk is posed by climate change. There is also a material risk to the business model of fossil fuel companies if carbon reduction commitments are observed, which could result in stranded assets.
- 4.6. Whilst stranded assets may pose a material financial risk, however, it is challenging to justify an exclusionary investment policy as this causes severe restrictions in the investment universe. Hackney acknowledge that fossil fuels are currently a major part of the economy and that some fuels, like gas, are likely to have a role in the future transition to a lower carbon economy. Instead, the risk across the portfolio, in terms of both operational CO2 emissions and exposure to fossil fuel reserves are considered by Hackney.
- 4.7. Hackney has implemented changes to the investment strategy to help reduce carbon exposures which has affected both passive and active equity allocations. Some changes to wider strategy naturally help reduce exposure e.g. reduction in exposure to FTSE Allshare.
- 4.8. Hackney Investment Committee has received some initial key recommendations regards to its Fund's approach to investment, some of which are still ongoing and the rest which is now complete. Completed recommendations are: develop a policy statement on the Fund's approach to fossil fuel investment with inclusions within the ISS; carry out carbon footprint of the Fund's holdings; review options for the Pension Fund's passive equity mandate; consider options for an initial active investment of approximately 5% of the Fund in a sustainability/low carbon or clean energy fund; review options for switching some of the existing property mandate into a low carbon property fund; and include risk within the Fund's risk register. The ongoing practice includes continuing engagement activities with the Fund's investment managers on their approach to fossil fuel and maintaining an active engagement approach to climate change issues with investee companies.
- 4.9. A carbon footprint exercise was carried out to assess where risk lies within the portfolio- this helps in adjusting the investment strategy to illustrate where it might be practical to reduce risk. A significant proportion of the Fund's exposure to both CO2 emissions and fossil fuel reserves is through its passive investments. The results of the exercise will be updated periodically and incorporated into the ISS after the next investment strategy review/ valuation.
- 4.10. The Council's ISS (Investment Strategy Statement) was newly developed after the 2016 valuation. The council is committed to cutting exposure to future CO2 emissions by 50% over the next 6 years, to bring the Fund in line with the Paris Agreement's 2% scenario. Hackney worked with Hymans to

develop a carbon reduction commitment that fitted with the Fund's overall investment strategy objective i.e. that investment decisions were driven by strategic considerations first and foremost.

- 4.11. The Committee will move to new pooled equity structures with BlackRock (passive) and LCIV/TBC (active). It will need to consider a new engagement strategy, particularly for actively managed assets. They would also like to make positive contributions to transition to a low carbon economy. The ISS includes a 0-5% opportunistic allocation to e.g. infrastructure. The committee will be considering the opportunities available.
- 4.12. In terms of performance, the Fund has continued to grow since the last triennial valuation. However it is a long term strategic direction, and the results lowering the exposure to climate change risk might not come through for a few years. It is important to bear this in mind when looking at performance.

Action: After the presentation, the committee agreed for officers to procure the carbon footprint exercise where they will ask tenders for quotes etc. with the help of Hymans. They will present it as a formal report in the September meeting for the exercise to take place later in the year of early 2019, if agreed by the Committee.

RESOLVED that the report is noted.

5. Exclusion of the Press and Public

6. Investment Beliefs Questionnaire

The Head of Corporate Resources presented this report. The following was discussed:

- 6.1. This questionnaire was useful for the Committee in the previous financial year as it helped in setting the investment beliefs of the Fund, helping members consider what is important.
- 6.2. The questionnaire is the similar to the version presented last year. The questionnaire will be sent in Excel format to members to complete. Hymans advised that members answer questions from the competence survey from a personal perspective but the rest of the questionnaire should be answered based on what members believe the Committee should be and/or have. An assessment exercise will follow to be carried out by Hymans.

Action: to cascade question to Members with Hymans to assess results thereafter.

RESOLVED that the committee will discuss the results in September.

7. Risk Register

The Principal Accountant presented a paper which set out the Fund's risk register for the financial year 2018/19.

- 7.1. A number of potential risks to the Fund were listed in the report, in different areas, and the likelihood of those risks occurring. These numbers are calculated to produce a risk rating as set out in the appendix of the report.
- 7.2. There were not any risks which needed immediate action, but there were some which required the attention of senior management. The risk register will be going to the Pension Board as they do have a fiduciary duty to scrutinise this also.
- 7.3. The risk register is a live document and the intention is for the Committee to consider it annually. The risk register is based on the administering authority; the governance risk and related external bodies.

RESOLVED that the report is noted.

8. Quarterly Investment Monitoring Report

Hymans Robertson presented this report which covers performance over the first quarter of 2018.

- 8.1. The key market developments in Q1 were the return of volatility in equity markets, particularly in late January and February. With wage inflation showing a sharp rise according to US data, investors fretted that corporate profits would be negatively impacted.
- 8.2. A recovery in equity markets swiftly followed in March, however speculation over tariffs and a potential 'trade war' brought more uncertainty to the future outlook. As a result, growth expectations fell. .
- 8.3. Generally the global economy is performing well, with the UK slightly behind its peers, which has been a recent trend in 2017 and 2018 due to the uncertainty of Brexit terms. The strong global economy has supported strong earnings from companies however, on most valuation metrics, equity prices appear high. For the prices to be credible, the earnings will need to continue to increase; currently the earnings are slightly lagging behind the prices paid in order to receive back those earnings. Generally Hymans is advising clients who are holding overweight equity allocations that now is a sensible time to start rebalancing back to strategic targets.
- 8.4. Another trend in Q1 is a reverse of QE (quantitative easing) across the world. Due to its stronger economic performance, the US is slightly ahead of other developed countries in its approach, and the UK is beginning to follow.. QE has far-reaching implications, but most notably may lead to rising yields (falling prices) on bonds, and during 2017 and 2018 we have begun to see small, but notable yield rises. Despite this, gilts remain very expensive in part

due to steady demand from maturing defined benefit pension schemes looking to hedge liability exposures.

- 8.5. The value of the Fund's assets decreased by c. £37.5m over the quarter to £1,309m as at 31 March 2018. The Fund had negative performance over the quarter alongside its benchmark however, the Fund still had positive absolute performance over the 12 month and 3 year period, with 3 year especially strong.
- 8.6. Both the UBS and Blackrock passive mandates tracked their benchmarks to a reasonable tolerance. The M&G and Harbourvest funds both beat the respective benchmarks while Invesco and Schroder both met their benchmarks over the quarter.
- 8.7. The Pemberton European Mid-Market Debt Fund II has begun the drawdown process. The PIC has also agreed to invest in the Partners Group Fund however, as at the end of the quarter the drawdown has not begun. The Fund currently has 6.4% cash which will be used to fund both the Partners and Pemberton Investments.

RESOLVED that the report is noted.

9. General Update

The Head of Corporate Resources presented this report, summarising the following:

- 9.1. A letter from the Chief Executive of the CIV sent to London Boroughs on 13 June set out the new governance framework to be implemented from 12 July onwards, pending approval at the AGM.
- 9.2. The Fund's current pension advisors, Hymans Robertson, have been contracted to the Council on a rolling contract basis. Good procurement practice recommends regular retendering of services to ensure that the scope, service standards and cost effectiveness of suppliers is challenged to support continuous improvement. Officers propose to review the Council's procurement strategy for both the advisory and actuarial elements of support.

Action: officers to bring invitation to tender in draft form to Committee to approve.

- 9.3. The 6% investment into the JPM Infrastructure Investments Fund will require the sale of equities from our passive mandates with BlackRock and UBS. As at 31 March 2018, the commitment to the infrastructure fund equated to approximately £78m. For the first phase of the Fund's rebalancing and the procurement of the two multi asset credit funds, equities were sold in equal proportion across both passive mandates. Members are asked to instruct officers how to allocate the equity sales between managers to generate the cash required for the infrastructure investment (available cash holdings in the portfolio will part-fund the investment):

The options available to Members are as follows:

- a) Sell equities in equal proportion between UBS and BlackRock
- b) Sell equities from BlackRock only
- c) Sell equities from UBS only

RESOLVED that Members choose option C.

10. Draft Pension Fund Accounts

The Principal Accountant presented the draft Pension Fund accounts report for the financial year ending 31 March 2018 and summarised the following:

- 10.1. The accounts were signed off and presented to the external auditors Grant Thornton at the end of May 2018 which must be completed in time for the accounts to be published by the statutory deadline of 31 July 2018.
- 10.2. 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 and the Net Assets Statement, which details the Fund's asset holdings and liabilities, and essentially represents the Fund's balance sheet.
- 10.3. Members should note that these accounts are draft and may be subject to change between now and final sign-off. Any such changes will be detailed in working papers for presentation to external audit.

RESOLVED that the report is noted.

The meeting finished at 9.53pm