

MINUTES OF THE PENSIONS INVESTMENT COMMITTEE

Thursday 27 June 2019 at 7pm

Present: Councillor Ingleby (Chair), Councillor Krupski, Councillors Codd, Maslin, Muldoon, and Penfold.

Also Present: David Austin (Head of Corporate Resources) Nick Jellema and Simon Jones (Hymans Robertson),

Apologies: Councillor Best and Sheikh.

1. Election of Chair and Vice Chair.

RESOLVED that Councillor Ingleby be elected Chair, and Councillor Krupski be elected Vice Chair of the Pensions Investment Committee for the municipal year 2019-20.

2. Declarations of Interest

Councillor Ingleby declared an interest because he is on Lewisham Homes.

Councillor Muldoon declared an interest because he is a beneficiary of the Lewisham Pension Fund.

3. Minutes

The Chair referred to the resolution in minute 5, Asset Pooling Update. He asked whether the response has been produced. Mr Austin said that it is the response to the consultation and agreed to circulate it to members of the Committee.

RESOLVED that the minutes of the meeting of the Pensions Investment Committee held on 14 February 2019 be confirmed and signed.

4. Investment Performance for the Quarter end March 2019

4.1 Nick Jellema presented this report. He said that in Q1 there was a recovery in the market, particularly with regard to equity markets which produced a c. 10% return. Property returns were positive and credit-based mandates rebounded during Q1 2019. Markets have stabilised since the end of March 2019. Total asset value has increased from £1.31bn to £1.39bn. This was driven by strong equity markets. Overall in this quarter, the fund is showing 6.7% return.

4.2 The Chair said that he understood that we had gone into the next vintage of Harbour Vest, and he asked why the HarbourVest allocation had reduced. Mr

Jellema said that in September, there was a commitment of £25m to a new HarbourVest fund. The money has not been drawn down yet and the strategy will take up to 5 years to draw that money. Since this additional commitment had not yet been drawn, and private equity performance had been below that of other asset classes, the % allocation to private equity had fallen.

- 4,3 Councillor Codd asked why the cash allocation fell during Q1 2019.. Mr Jellema said that at the end of the last quarter, December 2018, there was a 6% holding in cash to fund J P Morgan infrastructure and the money was drawn down on 2 January 2019.
- 4.4 Mr Jellema said that the passive management with UBS and Blackrock gave good returns in Q1 mainly because the portfolio is made up of Equities, Corporate Bonds and Gilts that performed well. Other mandates did not perform as well. Although recently Invesco's performance had been poor, they did give a positive return in this quarter although they have not performed in line with expectations. He said that HarbourVest returns were also disappointing relative to other asset classes. The private equity portfolio had performed differently to other listed equities which had performed very well. The reason for the poor performance was the value of the private equity portfolio which, more or less, did not move and due to the lag in asset valuations associated with unlisted assets such as private equity. The longer term returns for HarbourVest on an absolute basis are better. The three year returns are at 15.2% per annum and since inception 9.5%. These performances are good but not as good as the performance of listed equities in that period.
- 4.5 Mr Austin asked why Pemberton, Partners Group and JP Morgan have not been included on the table on page 8 of the monitoring report. Mr Jellema said that the returns for the quarter for JP Morgan has not been added in because it went live on the 2 January 2019 but it will be in the next version of the report. The other two companies were not included because the commitment to the private debts funds have not been fully drawn down. They will be added into the next quarter's monitoring report.
- 4.6 Mr Jellema said that generally all of the fund managers are at the 'preferred' highest rating with the exception of Schrodgers who are on a 'suitable' rating because there is concern about the viability of the property management business because many of their clients have LGPS funds and due to the onset of pooling. These are long term rather than medium term concerns and have been discussed with the PIC in recent meetings.
- 4.7 Mr Jellema said that although the Invesco mandate is relatively new for the Fund, the performance of Invesco is of concern and returns have been poor. The reason for this is that stock selection has been consistently poor and their 'hit rate' which is the proportion of their positions which lead to a positive

return, , has been below 50%. Councillor Krupski asked at what point Hymans would recommend pulling out of this fund. Mr Jellema said that although performance has been poor, the Hymans research team compare quality of individuals, the philosophy they have and process; these are considered to be a good indicator of the potential long term returns to the fund. Their researchers believe that Invesco are still considered to be one of the best multi asset teams.. Mr Jellema recommended that a decision to come out of this fund should not be considered for at least a 3 year period following the inception date (late 2017). In addition, Mr Jellema said that a pooling timing table was discussed at the meeting in February which noted that there are four similar mandates available on the London CIV with cheaper management fees. Over the next 6-12 months, this mandate will be considered with other similar LCIV options.

RESOLVED the report be noted.

At 7.45 the meeting went in to closed session to discuss the confidential business, item 9 General Pensions Update. At 8.05pm, the meeting went in to open session and the remaining open reports were considered.

5. Draft Pension Fund Accounts – Year Ending 31 March 2019

- 5.1 Mr Austin presented the report. He said that the draft accounts are accurate and provision may need to be made following the McCloud case. He said that performance has been good in the last year and the fund has increased. Membership has decreased slightly but active is improving. A further positive is that Active, deferred and drawdown are in equal proportion of 1/3. Draw down is greater than contributions and cash flow will be kept under review.
- 5.2 Councillor Krupski asked what system is used for preparing the accounts. Mr Austin said that Oracle is used. Between Lewisham and fund managers, there is also a custodian in Northern Trust. Their role is to hold Lewisham accountable for the money and every movement within the fund.
- 5.3 Councillor Maslin asked for more information with regard to the contribution rates outlined in section L. There are higher rates for higher salaries. He asked how that is split between employers and employees. He also asked what the relevance is of the 50/50 section in the table. Mr Austin referred to the employee contributions in the report; the Council then contributes at least 22 ½% which then goes into the pension fund to be invested. Levels are used for the LGPS's, it is not something Lewisham chooses, it is agreed in national negotiations. The 50/50 is because in the scheme, when they moved to auto enrolment, the choice staff were given was either to join, not to join or join and pay half contributions for half the benefit. Staff can change this decision at any time.

RESOLVED the report be noted.

6. Invesco Presentation

- 6.1 The Chair welcomed representatives from Invesco to the meeting: Stuart Boucher, Georgina Taylor and Scott Thomas (Product Director). Introductions were made.
- 6.2 Ms Taylor addressed the Committee. She gave an overview of the mandate since September 2018 and strategy. The team managing the fund has not changed. Invesco have not delivered the performance that was promised but the situation has changed since December 2018 and performance has improved, although there is a way to go before performance is back on track.
- 6.3 Invesco invest through 20-30 ideas. She said that crucial to the performance is the type of ideas, and how they are behaving in this environment. Since Q4 last year, there have been changes in the market and the certain views that they have taken that have helped to turn around performance.
- 6.4 Performance –Over the last 6 months in terms of trying to achieve cash plus 5% over a rolling 3 year period, on a growth basis the fund is at 3% or 2.68% net. The fund is looking better than 1 year ago, this is because a number of Invesco's ideas are working. Over the last 6-7 months 2/3 of the portfolio has been working.
- 6.5 Mr Jellema referred to Invesco's ideas working – the 'hit rate'. He asked whether some of those ideas that were losing money or not performing as they hoped a year ago, have turned the corner and now making a profit or is it new ideas that are performing. If the latter, one could argue that have Invesco sold out of some of the former positions in which case a loss has been crystallised. Ms Taylor said that when managers put the ideas into the fund they have to be reviewed if it is believed that they have something wrong. A number of the ideas were not working last year but not all of them were taken out of the portfolio. However, ideas were taken out if it was considered that they were wrong. Ms Taylor gave an example of Italian bonds that they got wrong because the political outcome was different to the one that they expected. Similarly they had some exposure in Russia. Sanctions were announced and Invesco came out of this within 24hours.
- 6.6 Ms Taylor then explained the contribution of ideas for 2019. During 2017-2018 there had been low inflation and low growth and high interest rates were not expected globally. But during periods of 2017-2018 the market deviated from that. She referred to the dark green colour ideas Inflation Pan Europe, Short UK and US vs UK. As ideas, they were not bad but it was an area that Invesco expected inflation expectations to fall. In the first quarter of 2019 inflation rates rose considerably and this was not expected in a relatively short period of time. This is one reason for the loss in return to the fund last year.

- 6.7 Volatility and commodities lost some money last year and this year. There has been a better balance across the whole fund. Equity markets have done well this year but if they underperform there is a broad spread of asset types and the portfolio will survive because other ideas will be adding to the fund.
- 6.8 Councillor Krupski asked about Asia Equities versus US equities. They are still in the fund but performance has not been particularly good. Ms Taylor said that the market pricing risk for these is similar so it was assumed that the risk in US market is similar to Asian markets.
- 6.9 Mr Jellema referred to the chart outlining the quarterly hit rate, skew and quarterly performance. It indicated a 45% hit rate, which is not dissimilar to previous quarters but the total negative return is greater than any of the others. He had concerns about portfolio construction and how diverse their ideas are. He asked what, in that quarter, drove this negative 2% performance return in a three month period. Ms Taylor said that in Q4 there were two distinct periods. The first one went from October when there was a fall in equity markets, things stabilised, and then there was a big move down in equity markets of about 13-15% in December. In the first month, when equities originally went down, there was a significant event in commodity markets due to the supply and demand of natural gas. In October/November it was decided that the exposure to this commodity should be scaled back, in particular the exposure to natural gas prices, but by that time the portfolio was down more than 2%.
- 6.10 Ms Taylor said that after this activity there were a number of themes emerging. Equities were less of a distraction from returns and there was a shift in the micro backdrop which meant all of the other component parts started to work and the further shift down in equities had less of an impact on the portfolio.
- 6.11 Ms Taylor addressed the question of what drove the large supply and demand change in Q4. She said that there was a perceived change. There was an imbalance between the inventory side and the demand as well as perception that there was going to be a far worse winter and therefore high demand for natural gas.
- 6.12 The Chair said that Lewisham are looking at decarbonising funds. He asked to what extent carbon monitoring is feeding into managers' ideas. Ms Taylor explained that Invesco's ESG team include ESG at stock selection level. In terms of the stock screening, they have company cross ranking and assess how ESG factors are considered. In Global equities for example, Invesco do not always go by the index as they have on the energy side, there is stock selection and they integrate ESG into their decision making. It is not an automatic exclusion; voting rights and influencing behaviour is an important part of ESG outside of the areas that we do not want to have exposure to. With regard to high yield, it is difficult to avoid some of the commodity related companies. When a research note is written, a comment about ESG will be included.

- 6.13 The Chair said that members are aware that there are fiduciary consequences to the decisions made with regard to the pension fund. Ms Thomas said that they have an Australian client in a version of this strategy which is in tobacco, specifically screened tobacco, that is a separate mandate. It is not stock specific and Invesco are working out the best way to do this but there is potential for expansion.
- 6.14 Councillor Codd referred to the majority of assets having given negative returns in 2018. He said that there is a large swing in the percentage of assets with a negative total return between 2017 and 2018. He asked whether they believe that diversification is dead and whether this swing is just a one off and what is the implication for pension funds. Ms Taylor said that is a huge issue. If you have the ability just to buy asset types then it is very challenging. One of the macro factors that drives this is that in a low interest rate world, everything is driven by the same thing. When there is a change, everything goes down very quickly. In order to address this, Invesco do not just buy a market, they buy a market relative to another. If the Relative value is right, it ensures that money is made even when there are sharp changes in the percentages of assets and Invesco have the tools that help to navigate this market. Bonds have performed well this year, but it does not mean that they are risk free.
- 6.15 Mr Jones referred to page 18 in the booklet. He said that Invesco's hit rate in 2017, by their own admission, had been poor and some of their predictions were not correct. One of the common features seen over the period is the increase in political rhetoric and the influence that politics is having on the market. He asked whether their processes and strategies can cope with this. Ms Taylor said that performance in 2018 was not good enough. She referred to the themes, including interest rates staying low for longer and inflation staying lower. Invesco did not keep up when there was economic recovery. . 2018 was more idea specific with a couple of events that went against them including exposure in Russian and Italian markets. Politics impacts the behaviour of investors and policy makers. She said that it looks as though there are some excellent opportunities across markets at the moment in Europe, but Invesco will not buy them if they are in areas of huge political risk. Any positions in the fund are there because Invesco believe that they will produce good returns. In Q1 there was a return to where politics and the fundamentals came together and where policy has had to change or where inflation has not moved. These were reasons why performance during 2017-2018 was poor but performance and hit rate is now showing some sign of recovery.
- 6.16 The Chair thanked Invesco for attending the meeting and they left the room.
- 6.17 Members of the Committee agreed that the presentation had not been convincing. Mr Jellema said some of the comments about portfolio construction and how diverse ideas are, were not convincing. Even comments about political risk and the impact that might have; there are still ideas in the portfolio that will be affected by political risk in the U.K. He said

that during the last strategy review 3 years ago, Hymans were recommending a greater diversity around infrastructure and particularly private debt, and that this area would be reconsidered as part of the actuarial valuation process during 2019-20.

- 6.18 Councillor Krupski said that looking at what the CIV has and the management cost, then weighing that up with looking at the performance and what is happening in the CIV is key. Mr Jellema agreed and said that of all the multi asset funds of that nature, that Invesco is probably one of the worst performing but generally over the last 3 -5 years the performance of the peer group of funds has generally been disappointing. It has been struggling to get cash plus 3-5% net of returns and struggled to produce predictable returns.
- 6.19 Councillor Maslin asked what the Fund's portfolio would look like with a more risky strategy. Mr Jellema said that there would be another credit based asset. There is already private debt. If we did not want that sort of diversification there are riskier high yielding bonds that are more liquid and there is more certainty of return in the long term. Illiquid holdings could also be added, whether private debt or infrastructure or even property.
- 6.20 Mr Austin referred to the reason why Invesco was picked rather than any other fund manager. He said that as complex as it is, relatively little of what they are doing is in equities. The steer agreed was diversifying out of equities. Rather than diversification, others would have been active management of standard investment options – equities, bonds, cash. He said that the LCIV options should be revisited at some point, in line with the advice to give this mandate a little longer to settle.
- 6.21 Councillor Codd asked about the floor of risk and how much could be lost on this particular mandate. Mr Jellema said that from Q1 it should be $\pm 2\%$. It is not a huge risk and is quite a small part of the fund, representing only 5-6% of assets. It has given a slight negative return. Councillor Krupski said with regard to diversification, officers need to ensure managers do not keep buying more equities.

RESOLVED that the report be noted.

7. Addressing Climate Change

- 7.1 The Chair referred to the Hymans paper entitled 'addressing climate risk' He said that he was disappointed to receive the papers so late. The content is weighted towards asking for members' thoughts again and both he and the Vice Chair had hoped for more practical suggestions from the paper.
- 7.2 The Chair said that there were inaccuracies in the report with regard to looking at other funds. It is not true that Southwark have done very little on climate change. He has just been in contact with Southwark's Pensions Chair who told him that they have transferred £600m into low carbon or fossil free

funds and £65m into a renewable infrastructure fund taking their footprint down to at least 40%. He said that things have been done and should be reflected in the report; members need to have information about what other London boroughs are doing with regard to divestment. Members need more information about exclusion funds compared with carbon tilt funds and what the fees are.

- 7.3 Mr Jellema apologised that the report was late. This was due, in part, to the delay in receiving the TruCost carbon footprinting data which was out of their control. In addition, the go ahead to produce this paper was only received one month ago.
- 7.4 Referring to page 143 of the report, the Chair questioned whether Hymans have the data already. Mr Jellema said he does not believe that this question was asked before. In the past, Hymans have sent the Committee a statement of beliefs questionnaire that had some questions around climate risk but were not to this level of detail. He agreed to check their records. He said that the questions are important because they will help to drive client policy that can then be implemented.
- 7.5 Referring to page 145, 2rd point - The Chair did not agree with this statement, noting that Infrastructure mandates have reasonable allocations to renewables.
3rd point – The Chair believed that this did not accurately reflect Lewisham Fund’s divestment objective because it does not take into account exclusion mandates. Mr Jellema said that it would be included in that objective because companies with large fossil fuel reserves are materially exposed to climate related risk. The Chair said that he is looking for more practical examples in the paper presented.
- 7.6 Referring to page 149, 2nd point – the Chair acknowledged that the exclusion or tilting process needs to be considered and needs strong data supporting any fund selection.
- 7.7 Mr Jones referred to page 16 and asked for clarity regarding the definition of exclusions. The Chair said that it should include companies that have fossil fuels direct and companies that burn carbon to generate energy. Mr Jones said that Hymans are excluding thermal coal where at least 30% of revenue derives from burning coal. The Chair said that if this affects Lewisham’s fee return then it needs to be looked at again. This could be done as part of the selection of any Low Carbon or Exclusion mandates.
- 7.8 Mr Jones explained the transition pathway initiative. Councillor Krupski said that BP are still investing in large amounts of their money in extraction; buying sites and researching new sites for extraction. If extraction is still going ahead in that company she does not agree with it. Mr Jones said that BP/Shell are

not going to change in the near future. The world needs oil and gas. He said that it is important that definitions are clear so the Committee understands the nature of the Fund's exposures. The Chair said that members need to be aware of their fiduciary duty and they need data on this to support their understanding of options and decisions to tilt away and/or divest.

- 7.9 The Chair referred to the steps and time line on page 30. He said that the CIV options need to be considered along with a possible further allocation to renewable infrastructure as part of this project.
- 7.10 For clarity, Mr Austin said that the requested amendments would be addressed. He said that he understands that definitions are very important as some of the examples given were very specific. If these definitions are followed, Mr Austin said that the only option he sees for an acceptable investment mandate would be an active one and suggested some caution given the higher fees and governance required on such a mandate. Moving from a majority passive investment strategy to an active one would reverse the Committee's decision of 2013. He recommended that Members initially consider passive equity funds, looking for those that most closely fit with the ultimate objectives. Members agreed this approach because it would not require as great an amount of research and, therefore, management fees.
- 7.11 Councillor Krupski said that she would like Lewisham to invest in low carbon sustainable infrastructure projects because they offer a really good long term sustained return. There is evidence to show that they perform as well as bonds or better. It was agreed that equities must be passive.
- 7.12 Councillor Maslin said that members need to know what options there are leading within the market place. He said that members need to follow the best advice and not be influenced by marketing information.

RESOLVED that

- (i) the contents of the report be noted included the attached Appendix;
- (ii) the amendments raised by the Chair be agreed and the paper amended accordingly;
- (iii) the Committee's climate risk beliefs be agreed and the Statement of Investment Beliefs be updated, along with the drafting of a climate policy for the Fund;
- (iv) the extent to which focus should be on exclusion, reduction in exposure to carbon omissions/intensity or the inclusion of forward looking metrics be agreed; and
- (v) the proposed timetable outlining the first steps of a low carbon approach be agreed.

8 Exclusion of the Press and Public

RESOLVED that under Section 100 (A) (4) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12 (A) of the Act, as amended by the Local Authorities (Executive Arrangements) (Access to Information) (Amendments) (England) Regulations 2006 and the public interest in maintaining the exemption outweighed the public interest in disclosing the information:

9. General Pensions Update

The following is a summary of the item considered in the closed part of the meeting.

9. General Pensions Update

- (i) the report was noted; and
- (ii) the LCIV draft SLA and members' comments were noted and will be reported back to the LCIV

The meeting ended at 9.10pm.

Chair