

Committee: Pension Fund Advisory Panel

Date: 6th December 2017

Agenda item: 4

Wards: All

Subject: Update on Pension Fund Investment Strategy Implementation

Lead officer: Caroline Holland, Director of Corporate Services

Lead member: Councillor Philip Jones

Forward Plan reference number: N/A

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Recommendations:

- a) To note the content of this report. Members of the Pension Fund Advisory Panel (PFAP) are asked to read this report in conjunction with the separate reports titled “Update on London CIV” and “Markets in Financial Instruments Directive (MiFID II)” to this Panel.
- b) To note the glacial pace in implementing the Pension Fund investment strategy approved by PFAP on 8th March 2017 primarily due to the delay in suitable products being developed by the London CIV.
- e) To agree to officers, in consultation with JLT, pursuing collaboration with other London Boroughs to develop alternative solutions to access (illiquid) asset classes, including Private Debt, Multi Asset Credit and Infrastructure, to mitigate the risk of London CIV further delaying or failing to make (suitable) products available in line with LB Merton investment strategy implementation plans.
- f) To note that Aniket Bhaduri (JLT) will attend this meeting to discuss their latest thinking around the investment strategy implementation in addition to providing training to the Panel.

1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

- 1.1 The purpose of this report is to update the Pension Fund Advisory Panel on the implementation of the Pension Fund investment strategy agreed by the Panel at their meeting on 8th March 2017.
- 1.2 Officers and JLT, the Pension Fund advisers, are continuing to explore options for selecting suitable fund managers either via the London CIV or through a competitive OJEU (or Non-OJEU) process alone or jointly with other London LGPS Funds, giving regard to the required practice under the pooling regime.

- 1.3 This report charts progress to date and seeks the Panel's decisions in the changed environment. This report also discusses latent issues with the London CIV and the impact on Boroughs to implement their own pension fund investment strategy quickly via the CIV.

2. PROGRESS TO DATE

- 2.1 The Council published its Investment Strategy Statement (ISS) on 30th March 2017, ahead of the statutory 1st April 2017 deadline, following the Panel's decision to adopt a new strategy on 8th March 2017. Officers and JLT have been seeking to implement the agreed strategy as follows:
- (i) Review the CIV's offering on fixed income and preferably select from their sub-funds. If products are unavailable or deemed unsuitable for LB Merton then go to the market
 - (ii) Review the CIV's product in infrastructure investment and assess whether it meets the requirement of the Merton Fund
 - (iii) Look to the CIV for Property and assess their offer before making a decision
 - (iv) Review the CIV's other illiquid sub-funds including Private Debt, Multi Asset Credit and other alternative investments before making any decision to invest
 - (v) Select active funds from the CIV as appropriate; and
 - (vi) Procure passive products directly
- 2.2 Generally, implementation of the investment strategy has been slow due to the delay in London CIV developing suitable products. However, there has been significant progress in reviewing Equity and other liquid products offered by the CIV whilst clarifying the CIV's proposals around the more complex illiquid investments. Officers are continuing to work with JLT to review products offered by the CIV against those available elsewhere to determine their suitability for L.B Merton. This is also to ensure that the CIV's approach and product design are compatible with Merton's investment objectives and risk appetite and that there is strategic fit with the Council's arrangement.
- 2.3 Also, there has been the additional challenge of asymmetry of information with respect to the design and suitability of some of the products offered by the CIV, for example, multi factor investing being an efficient alternative that is more of an absolute return approach rather than designing portfolios relative to benchmarks.
- 2.4 In addition, options to reflect environmental, social and governance (ESG) in the Council's segregated and pooled investments in public and private markets in a prudent manner have been evaluated to ensure compliance with current

regulations. For clarity, the new investment strategy will deliver a low carbon arrangement when implemented.

- 2.5 Officers and JLT met with the existing fund managers (Aberdeen, UBS and BlackRock) in July 2017 to review current mandates, evaluate their capabilities, fee proposals, typical transition costs, ability to transfer assets in-specie and knowledge and experience of LGPS pooling.
- 2.6 In August 2017, JLT conducted a review of the Diversified Growth Fund products offered by London CIV including combination analysis of the four fund managers (Baillie Gifford, Ruffer, Pyrford Global and Newton) used by the CIV.
- 2.7 It remains the objective to recommend and secure PFAP approval to a specific transition programme by Spring 2018.
- 2.8 The following mix of broad and targeted sub-funds are currently open on London CIV:
 - Global Equity Alpha - Allianz Global Investors
 - Diversified Growth – Baillie Gifford
 - Global Alpha Growth – Baillie Gifford
 - Global Total Return – Pyrford International
 - Absolute Return – Ruffer LLP
 - Real Return – Newton Investment Management
 - UK Equity Fund – Majedie Asset Management
 - Global Equity – Newton Investment Management
 - Global Equity – Longview Partners (Guernsey) Ltd (**Note:** This is now closed)
 - Income Equity – EPOCH Investment Partners, Inc
- 2.9 Currently, London CIV have no illiquid investment products such as Private Debt, Multi Asset Credit, Infrastructure and Property.
- 2.10 There are other issues such as complementarity of fund managers and available capacity to consider and in this respect, it is worth mentioning that the Global Equity product managed by Longview has already reached capacity with just a few Boroughs investing in the product. The pattern of investing varies amongst London Boroughs. It means that other Boroughs seeking to invest in the Longview sub-fund will not be able to do so.

3. UPDATE ON ASSET CLASSES

- 3.1 Passive equity:
Passive equity investments will remain outside the London CIV. JLT are awaiting responses/clarifications from UBS on specific matters to enable JLT to

determine the best way forward and make a firm recommendation to the Panel in March 2018.

3.2 Active equity:

Implementation of the active equity mandate will be via London CIV. JLT will make their final recommendation on manager selection to the Panel in March 2018.

3.3 Fixed Income:

It was considered prudent to wait for the CIV to launch Fixed Income by no later than September 2017. Unfortunately, the CIV is way behind schedule and some Boroughs including LB Merton are actively pursuing collaboration to develop solutions in the illiquid space to mitigate the risk of protracted delay or possible failure to deliver suitable products by Spring 2018.

3.4 Property:

London CIV plan to develop high return real estate products. However, the timescale for this is unclear at the moment. The Council currently has a good arrangement for Property so there is no urgency in this area. Notwithstanding, JLT and officers will share their thinking on Property with the Panel at this meeting.

3.5 Infrastructure:

There is mounting pressure on London CIV to engage effectively with Boroughs to develop suitable Global Infrastructure products. To mitigate the risk of further delay by the CIV, some authorities led by LB Merton are actively considering collaborating to develop solutions. High level update on the implementation of this asset class will be provided by JLT and officers at this meeting.

3.6 Multi Asset

High level update on the implementation of this asset class will be provided by JLT and officers at this meeting.

3.7 Comprehensive discussions have been taking place amongst Boroughs to understand each others strategy, between Boroughs and their respective advisers to agree their position prior to evaluating CIV's offering. Meetings have also been held between advisers and London CIV and between the CIV and Boroughs. Under pooling, the risk of underperformance remains with the Boroughs so it is the case of 'buyer beware' when selecting products on offer by the CIV.

4. NEXT STEPS

4.1 The next steps and proposed timeline for activity is given below:

Activity	Date	By Whom /Dependency
Provide training on investment strategy asset classes to the Panel	6th December 2017	JLT/Officers
Update the Panel on Investment Strategy implementation work so far	6th December 2017	JLT/Officers
JLT to make final recommendation on CIV products to the Panel	7th March 2018	JLT/Officers
Presentation of transition proposal to the Panel	7th March 2018	JLT/Officers
Preparatory work for transition (transfer of assets) to London CIV	Mar – April 2018	JLT/Officers/CIV

5. ADVICE OF THE HEAD OF COMMERCIAL SERVICES

5.1 Discussion is ongoing about which of the procurements detailed above, not done via the CIV, would be caught fully by the EU rules and hence require a full tendering process. However in any event, the Council's constitution would require something essentially as rigorous for this scale and profile of contract.

5.2 Internal procurement resources can manage the procurement process itself, but investment consultants will be required to assist with the evaluation of technical aspects of the bids received. A tender process will be required whereby the consultants are appointed by the Director of Corporate services.

6. CONSULTATION UNDERTAKEN OR PROPOSED

6.1 N/A

7. FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

7.1 The investment strategy chosen will affect the return on the Fund, its actuarial valuation and the cost to the Council.

7.2 There will be a one-off cost in procuring investment consultants to support the procurement process, estimated to be under £100k. This will be charged to the pension fund

8. LEGAL AND STATUTORY IMPLICATIONS

8.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1st November 2016. It makes investment via LGPS Pools compulsory and the Secretary of State has reserved powers of intervention where authorities are deemed non-compliant.

- 8.2 Contracts resulting from the proposal chosen will have legal implications for the Fund. Whichever procurement route is followed and whether any of the procurements fall within the EU regulations, or not, there is still the need to demonstrate fairness and transparency. There will also be a need for Legal input in drafting or approving contract terms and conditions. If use of a framework is pursued, then there is likely to be an Access Agreement required, which will also necessitate Legal input. Legal comments on the use of frameworks will be sought if required and the position on EU requirements will be resolved prior to tendering.

9. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

- 9.1 N/A

10. CRIME AND DISORDER IMPLICATIONS

- 10.1 N/A

11. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

- 11.1 Use of the CIV (if possible) would enable a quicker, simpler process. However, delay in the CIV providing suitable products will undermine the Council's ability to implement its pension fund investment strategy.

12. APPENDICES

1. L.B Merton Pension Fund Investment Strategy Review – Report by JLT
2. L.B Merton Pension Fund Draft Investment Strategy Statement (ISS)

13. BACKGROUND PAPERS

1. Report to PFAP on 8th March 2017 and in-house material
2. Various information regarding London CIV and discussions with the CIV