

## **Committee: Pension Fund Advisory Committee**

**Date: 1st December 2016**

Agenda item: 4

Wards: All

### **Subject: Investment Strategy Review**

Lead officer: Caroline Holland, Director of Corporate Services

Lead member: Councillor Imran Uddin

Forward Plan reference number: N/A

Contact officer: Paul Dale

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### **Recommendations:**

- a) To determine revised investment categories, weightings and benchmarks with JLT.
- b) To identify what alternative investments the committee would like to recommend for the balance of the fund in conjunction with JLT.
- c) To determine what investments should be procured directly and what should be procured via the London CIV.
- d) To agree the recommended approach:
  - i) Procure passive directly
  - ii) Select active funds from the CIV
  - iii) Review the CIV's offering on fixed income and preferably select from their sub-funds. If they are unsuitable for LB Merton then go to the market
  - iv) Look to the CIV for property and assess their offer before making a decision
  - v) Review what the CIV offer in infrastructure investment and assess whether it meets the needs of the Merton Fund
  - vi) Clarify what the benefits of multi asset funds and other alternative investments would be before making any decision to invest
- e) To agree outline timetable for procurement.

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## **1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY**

- 1.1 This report updates the advisory Committee on the options they have to re-tender the und investments and seeks decisions in the changed environment.

## **2. PREVIOUS DECISIONS**

- 2.1 At the meeting of this committee on 17<sup>th</sup> March 2014 the panel agreed asset allocations for the Fund in the future.

Asset Class	Current		
	Actual	Target	Proposed
Equities	70%	70%	70%
Fixed interest	26%	25%	20%
Property	4%	5%	5%
Alternatives (at this point Equity like DGF was proposed)	0%	0%	5%
<b>Total</b>		<b>100%</b>	<b>100%</b>
<b>Equity Split</b>			
Passive	60%	60%	40%
Active	40%	40%	60%

- 2.2 The selection of active equity managers will be a crucial decision because currently the return on passive equities are substantially higher than on active equities and the latter generally has higher fees.
- 2.3 Since the last discussion at the Committee on 17<sup>th</sup> March 2014, the Council has appointed JLT as investment advisers and they have different views on asset allocation.
- 2.4. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1<sup>st</sup> 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.
- 2.5 Performance of the investment classes.

Asset class	Return	
	3 years	
Passive equity		8.50%
Active Equity	Manager 1	4.5%
	Manager 2	5%
Fixed income		11.10%
Property	Manager 1	14%
	Manager 2	10.6%

### 3. REVIEW OF ASSET CLASSES

- 3.1 Passive equities:

The committee decided to reduce passive equity exposure from 60% of equity investments to 40%. This equates to a reduction from 42% of total investments to 28%.

Currently the split of passive investments between markets is:

Analysis of Passive Equities	
UK	55%
Other European	12%
American	21%
Japanese	6%
Other Overseas	6%

- 3.2 This weighting is disproportionately in the UK given the size of the market relative to the world market. Benchmarks are an issue that need thorough review. The current benchmark is detailed below.

From 26.10.07

	Aberdeen Global Equity	Aberdeen Global Bonds	BlackRock Property	UBS Global Equity Active	UBS Global Equity Passive	UBS Property	Total Fund
UK Equities	55.0			87.3	55.0		41.7
Overseas Equities	45.0				45.0		28.2
North America	6.0				21.0		9.6
Europe ex UK	14.5				12.0		7.7
Pacific Basin ex Japan	7.25				6.0		3.8
Japan	7.25				6.0		3.8
Pacific Inc Japan							0.0
Emerging Markets	10.00			12.7			3.3
UK Bonds		25.0					6.3
Overseas Bonds		25.0					6.3
UK Index-Linked		50.0					12.5
Property			100.0			100.0	5.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: State Street Quarterly Performance Report – Periods to end September 2016

- 3.3 A decision is required about which markets to reinvest passive monies in. Despite trying the London CIV was unable to develop suitable vehicles for passive equities. Passive managers appear to have reduced their fees significantly. The council will need to procure passive investments independently.
- 3.4 The next steps and proposed timeline for activity is given below:

<b>Activity</b>	<b>Date</b>	<b>By Whom /Dependency</b>
Provide training on asset classes to Committee	1 December 2016	JLT/Officers
Update the Committee on Investment Strategy Review work – asset allocation ideas	1 December 2016	JLT/Officers
JLT to receive final cashflows from Fund actuary	16 December 2016	JLT/Barnett Waddingham
Presentation of Investment Strategy Review report	Mid January 2017	JLT/Officers
Preparatory work for strategy implementation - develop ISS, Mandates, Governance, Procurement	Jan – Mar 2017	JLT/Officers

#### **4. ACTIVE EQUITIES**

- 4.1 The committee decided to increase this from 40% of Equity investments to 60%. This represents an increase from 28% of total investments to 42%.
- 4.2 The London CIV has gone out to tender for active investments which they intend to put in place throughout 2017. They intend to have a mixture of broad and targeted funds.
- 4.3 This seems to be the main area where the Council should invest in the CIV. The process of investment would be simpler and quicker than an individual tender. This is also the main area where the Council needs to improve performance. Benchmarks are an issue that need thorough review along with the style of managers.
- 4.4 These funds would be placed with the CIV throughout 2017.

#### **5. FIXED INCOME**

- 5.1 The CIV has identified that there is no common practice amongst Boroughs about the pattern of investment. It intends to get pooled funds in place by late 2017.
- 5.2 This has been the Council's best returning asset class over a five, three and one year period, there is therefore less urgency about replacing this.

5.3 It would be sensible to await the outcomes of the CIV's work before embarking on a tendering exercise.

## **6. PROPERTY**

6.1. The CIV are seeking to put in place innovative high return investments. There is no timescale for this at the moment.

6.2 The council is getting a reasonable return from property so it would pay to await the outcome of the CIV's work before making a firm decision.

## **7. INFRASTRUCTURE**

7.1 Infrastructure must be seen as a long term investment, but one that requires a governance structure that allows speedy decisions without long drawn out procurement routes. The CIV intends to explore this later.

## **8. MULTI ASSET FUNDS**

8.1 The CIV has 4 multi asset funds in place created by bringing together existing investments.

## **9. ADVICE OF THE HEAD OF COMMERCIAL SERVICES**

9.1 Discussion is still 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.

9.2 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.

## **10. CONSULTATION UNDERTAKEN OR PROPOSED**

10.1 N/A

## **11. FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS**

11.1 The investment strategy chosen will affect the return on the fund, its actuarial valuation and the cost to the council.

11.2 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

## **12. LEGAL AND STATUTORY IMPLICATIONS**

12.1 Contracts resulting from the proposal chosen will have legal implications for the Fund. Whichever procurement route is followed and whether or not 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.

**13. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS**

13.1 N/A

**14. CRIME AND DISORDER IMPLICATIONS**

14.1 N/A

**15. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS**

15.1 The use of the CIV would enable a quicker, simpler process

**16. BACKGROUND PAPERS**

16.1 Report to March 2015 meeting and papers in pension team