MEETING
PENSION FUND COMMITTEE
DATE AND TIME
MONDAY 9TH SEPTEMBER, 2019
AT 7.00 PM
VENUE
HENDON TOWN HALL, THE BURROUGHS, LONDON NW4 4AX

Dear Councillors,

Please find enclosed additional papers relating to the following items for the above mentioned meeting which were not available at the time of collation of the agenda.

Item No	Title of Report	Pages
9.	INVESTMENT STRATEGY	3 - 32
10.	ADMISSION AGREEMENT	33 - 38

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Pension Fund Committee

9 September 2019

Title	**Strategy Update**
Report of	Director of Finance
Wards	N/A
Status	Public
Urgent	No
Key	No
Enclosures	Appendix 1 – Brexit Slides Appendix 2 – Currency Hedging Proposal
Officer Contact Details	George Bruce, Head of Treasury, george.bruce@barnet.gov.uk - 0208 359 7126

Summary

The report follows on from the investment strategy discussions at recent meetings and provides an update on implementation of decisions made by the Committee and contains two recommendations in respect of private debt and currency hedging.

Officers Recommendations

1. That the Pension Fund Committee reconfirm an investment of £30 million in the LCIV Global Private Debt Fund.
2. That the Pension Fund Committee agree to a 50% strategic currency hedge, with implementation proposals to be brought back to the Committee.
3. That the Pension Fund Committee agree to delegate authority to the Finance Director to take actions to implement recommendations 1.

1. WHY THIS REPORT IS NEEDED

1.1 Acting in its capacity as Administering Authority to the Barnet Pension Fund, it is the responsibility of London Borough of Barnet to ensure that the Pension Fund complies with legislation and effectively manages the Fund's financial affairs.

1.2 At recent meetings the Committee has made decisions relating to the funding of new asset classes and the appointment of additional investment managers. Progress is discussed below. The issues discussed below are:

- Private equity
- Property
- Private debt
- Emerging market equities

Private Equity (5% target allocation)

1.3 The Committee agreed at the 29 July 2019 meeting to commit £55 million to the Adams Street 2019 Global Fund. Completion of the legal agreements to participate in the fund is underway. Further commitments in 2020 and beyond will be required to achieve and maintain a 5% private equity allocation.

Property (10% target allocation)

1.4 The target is to invest 10% of the fund in property – 2.5% long lease, 2.5% overseas and 5% UK core commercial. The Fund achieved its long-lease allocation by way of the purchase of a £27 million holding in the Aberdeen Standard long lease fund on 3 June 2019. A commitment of $32 million (approximately £27 million) has been made to the CBRE Global Alpha fund, with 50% ($16 million) invested on 28th June. The remainder is expected to be called during Q3, 2019.

1.5 The final element of the property proposition was an investment in UK Core commercial property. We have indicated to the LCIV our interest in investing in their property fund but as yet there is no firm timetable to when the fund will be launched and monies invested. While concerns remain that property prices may face a correction it is considered appropriate to allow the LCIV time to identify a manager for their UK commercial property fund.

Private Debt Fund

1.6 The Committee agreed at its meeting held on 30 May 2019 to invest £30 million Partners Group MAC (multi asset credit) 2019. Documentation to support the Partners investment has been submitted and it is expected that part of the funds will be called later in 2019. The Committee also agreed at its meeting on 22 January 2019 to invest £30 million into the LCIV Global Private Debt Fund. The launch of this fund has been delayed but will shortly open for subscriptions. The fund's manager, Ares, presented to the Committee on the manager monitoring day (6th March 2019). In view of the passage of time, the Committee are asked to reconfirm their decision to invest £30 million in the LCIV Global Private Debt Fund.

Emerging Market Equities (5% target)

1.7 The Committee decision to invest (February 2019) £54 million in the LCIV Emerging Markets Equity Fund was put on hold when the investment team announced that they were leaving the manager of the fund, Janus Henderson. The LCIV has recently appointed JP Morgan (JPM) to manage this fund. They are expected to reorganise the holdings and be able to take new commitments during October. In line with regulations, the Committee should consider advice from Hymans Robertson before making an investment with a new fund manager. This advice will be presented to the November meeting at which JPM have been invited to attend.

Realisation to fund the new mandates

1.8 Currently funds are being realised from the Newton mandate when required to fund any of the new funds. This will continue and when the Newton fund is fully realised, the Schroders diversified growth fund will be realised to meet cash requirements.

Brexit Implications

1.9 There was a brief discussion on the implication of Brexit at the last Committee. Hymans have shared slides considering the implications (appendix 1). The themes arising from a 'no deal' Brexit are:

- Short term decline in economic growth,
- Weakness in sterling
- Tightening of Government bond yields,
- Widening of credit spreads,
- Property correction / loss of liquidity
- Weakening of domestically based UK businesses with implications for the FTSE250.

1.10 Other than currency hedging, considered below, there are no recommendations arising from the slide back. The delay in gaining exposure to UK core property is supported by the possible impact on commercial property values. Whether anything can or should be done in relation to scheme liabilities that are somewhat linked to gilt yields will be explored with the Actuary.

Currency Hedging

1.11 Hymans were asked to comment on the benefit of additional currency hedging in view of the weakness in sterling since the Brexit referendum and the ability to lock in recent gains. Their paper is attached (appendix 2). Their recommendation is that a 50% currency hedge is suitable to manage currency risk. At the present time the portfolio is more than 50% sterling hedged and Hymans are not advocating any immediate action. They are particularly wary of making long-term currency decisions in periods of high volatility. The Committee is asked to confirm a 50% strategic currency hedge.

2. REASONS FOR RECOMMENDATIONS

2.1 The LGPS (Management and Investment of Funds) Regulations 2016 (Regulation 7(7)) requires the Committee to periodically (at least every three years) review the investment strategy. The proposal recognises that the strategy has been enhanced in 2015, 2016

and 2017. Modelling presented to the Committee at the June 2018 meeting indicated that the current strategy, while expected to achieve the funding objective, can be enhanced.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 The various alternatives are discussed in the paper and within the Hymans Robertson reports. The recommendations are based on modelling results.

4. POST DECISION IMPLEMENTATION

4.1 Delegation is requested to the S151 officer to implement the agreed actions.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 Good management of the Pension Fund will minimise the cost of providing benefits thus enabling funds to be directed to Council priorities.

5.2 Resources (Finance and Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 There are no direct resources issues for the council however changes in the financial performance of the pension fund affects the pension fund deficit reflected in the Authority's accounts and the level of contributions payable by the Council and other employers.

5.3 Social Value

5.3.1 The Public Services (Social Value) Act 2012 came into force on 31 January 2013. It requires people who commission public services to think about how they can also secure wider social, economic and environmental benefits.

5.3.2 Before they start the procurement process, commissioners should think about whether the services they are going to buy, or the way they are going to buy them, could secure these benefits for their area or stakeholders.

5.3.3 The Act is a tool to help commissioners get more value for money out of procurement. It also encourages commissioners to talk to their local provider market or community to design better services, often finding new and innovative solutions to difficult problems.

5.3.4 There are no specific social value issues arising out of this report, however membership of the Pension Fund ensures the long term financial health of contributing employees on retirement.

5.4 Legal and Constitutional References

5.4.1 The LGPS (Management and Investment of Funds) Regulations 2016 (Regulation 7(7)) requires the Committee to periodically (at least every three years) to review the investment strategy.

5.4.2 The Council's Constitution – Article 7 – includes within the responsibilities of the Pension Fund Committee, (1) the approval of the Investment Strategy Statement and (2) the appointment of investment managers. This paper considers alterations to the asset allocation set out in the ISS.

5.5 **Risk Management**

5.5.1 Risk management is central to the LGPS; which are in themselves risk management tools, managing the risk that future employer income streams will be able to meet future pensions liabilities by creating a reserve from which future liabilities will be met.

5.5.2 Understanding the causes of sources and variabilities of scheme returns informs the management of investment and funding risk.

5.6 **Equalities and Diversity**

5.6.1 Pursuant to the Equality Act 2010, the Council is under an obligation to have due regard to eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation, marriage and civil partnership

5.6.2 The rules governing admission to and participation in the Pension Fund are in keeping with the public-sector equality duty. The Public Sector Equality Duty requires public authorities in carrying out their functions, to have due regard to the need to achieve the objectives set out under s149 of the Equality Act 2010. Good governance arrangements and monitoring of the Pension Fund's managers will benefit everyone who contributes to the fund.

5.7 **Corporate Parenting**

5.7.1 Not applicable in the context of this report.

5.8 **Consultation and Engagement**

5.8.1 Not applicable.

5.9 **Insight**

5.9.1 Not applicable

6. BACKGROUND PAPERS

6.1 See investment strategy papers and minutes of the Committee meetings on 22 January 2019, 26 March 2019, 30 May 2019 and 29 July 2019.

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Market conditions & Brexit

London Borough of Barnet Pension Fund

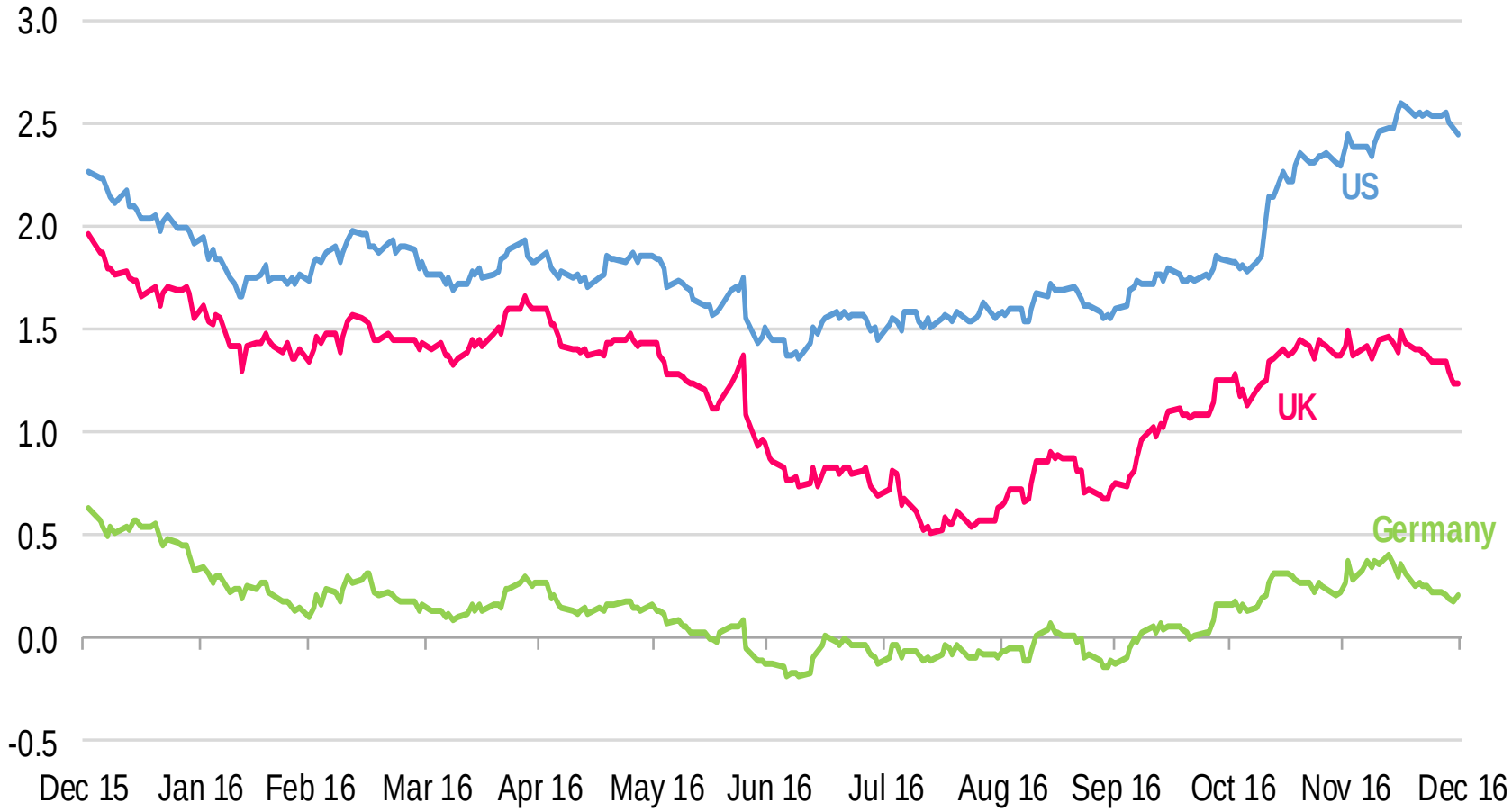
Nick Jellema, Investment Consultant
Yoel Deal, Associate Investment Consultant

HYMANS ROBERTSON

Financial markets – 2019 update

- Sterling is generally the most immediate responder in markets to Brexit headlines. Repeated rejections of Theresa May's negotiated Brexit deal, her subsequent resignation, and the election of Boris Johnson has increased the perceived likelihood of a no-deal Brexit. Trade-weighted sterling has fallen 2.4% year-to-date and is down 3.9% over the 12 months to end July 2019.
- Nominal gilt yields have fallen sharply in 2019 and are now below the record low levels touched in the wake of the Brexit referendum result in 2016. However, it is difficult to attribute the moves in gilt yields to UK–specific concerns. Global sovereign bond yields have fallen across the board amid concerns of slowing global growth and a more difficult international trading environment.
- UK inflation pricing shows a divergence from elsewhere, suggesting investors are concerned about a near-term spike in UK inflation off the back of Sterling depreciation in the event of a no-deal Brexit.
- Investment grade credit spreads have tightened (causing prices to rise), with little regional dispersion. Credit markets have been supported in 2019 by the accommodative monetary policy responses expected from central banks in the face of slowing global growth and muted inflationary pressures.
- Global equity markets have performed strongly in 2019 although there have been some significant periods of heightened volatility. Equity markets have been mainly driven by the expectations for more accommodative global monetary policy going forward, though escalations in US-China trade tensions saw markets give back some of the gains made in May and more recently in August. UK equites have underperformed global markets, and even more so when viewed in Sterling terms.
- There are signs Brexit-related uncertainty may be beginning to weigh on UK commercial property markets: In May, the MSCI IPD UK Monthly Property Index fell for the first time year-on-year since 2017, when the impact of the Brexit referendum was still being felt. Annual rental growth is as low as it has been for 5 years. Investment volumes have been low amid increased uncertainty.

10-year government bond yields: 2016



Source: Bloomberg January 2019

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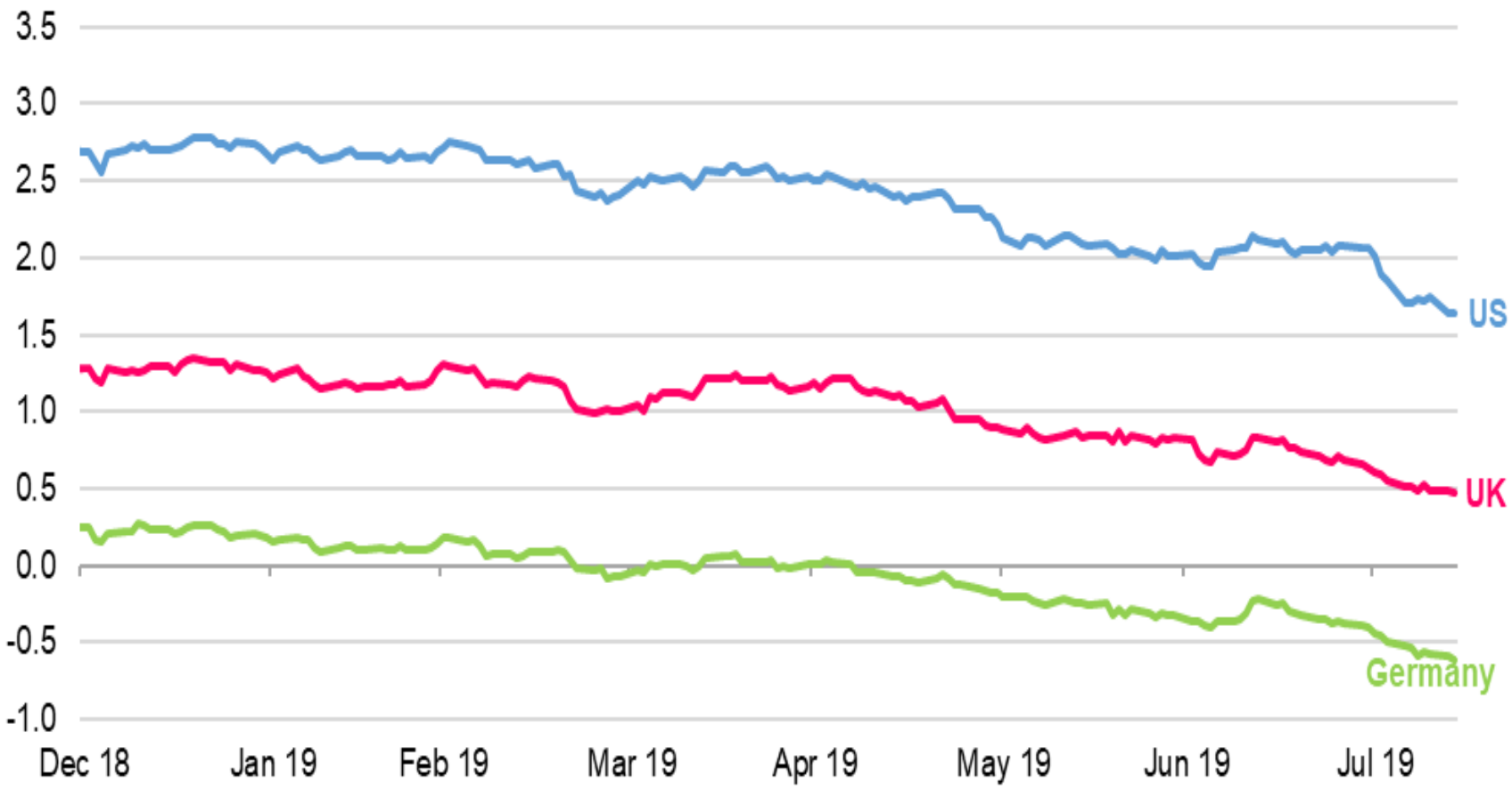
10 year government bond yields: 2019



Source: Bloomberg August 2019

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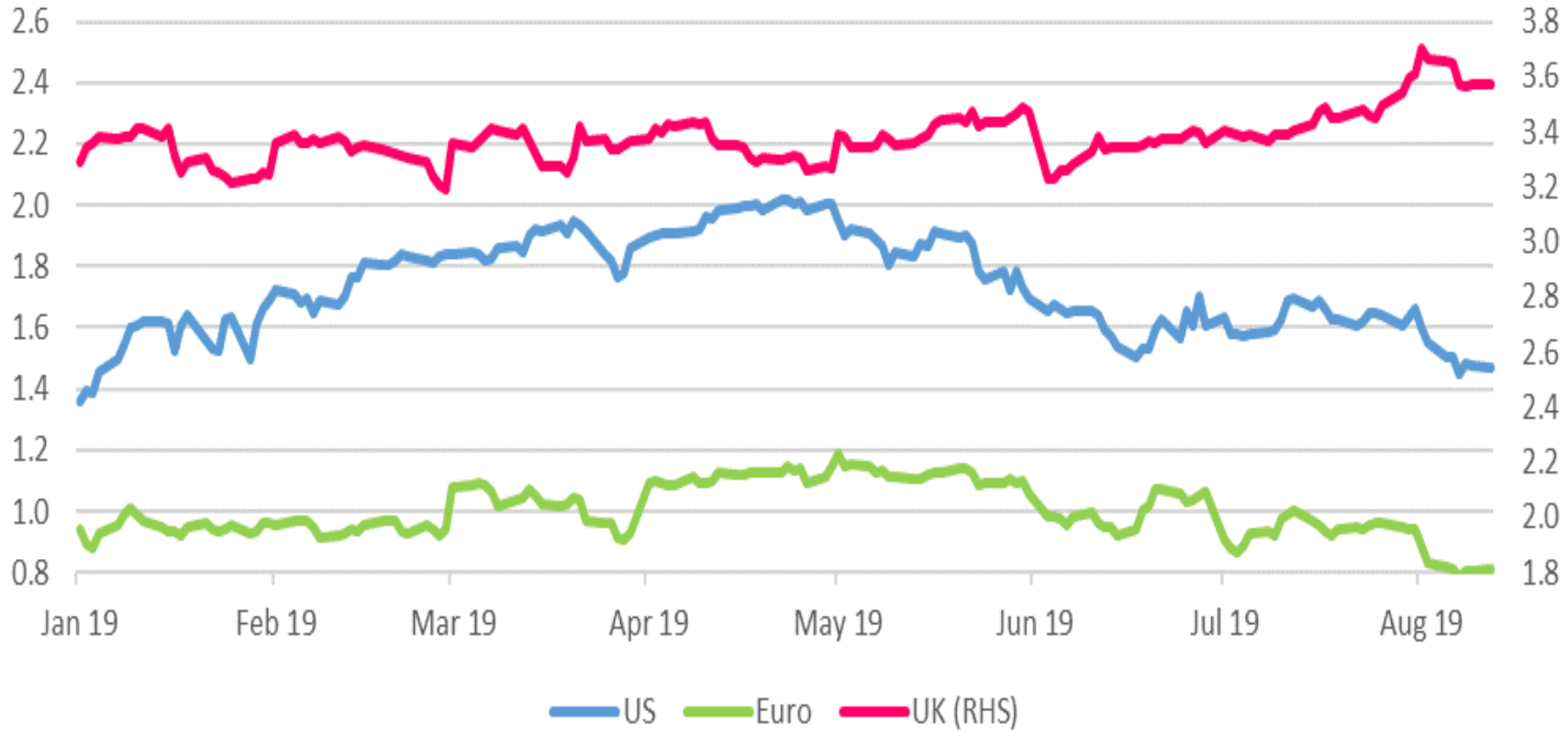
10 year inflation swaps: 2019



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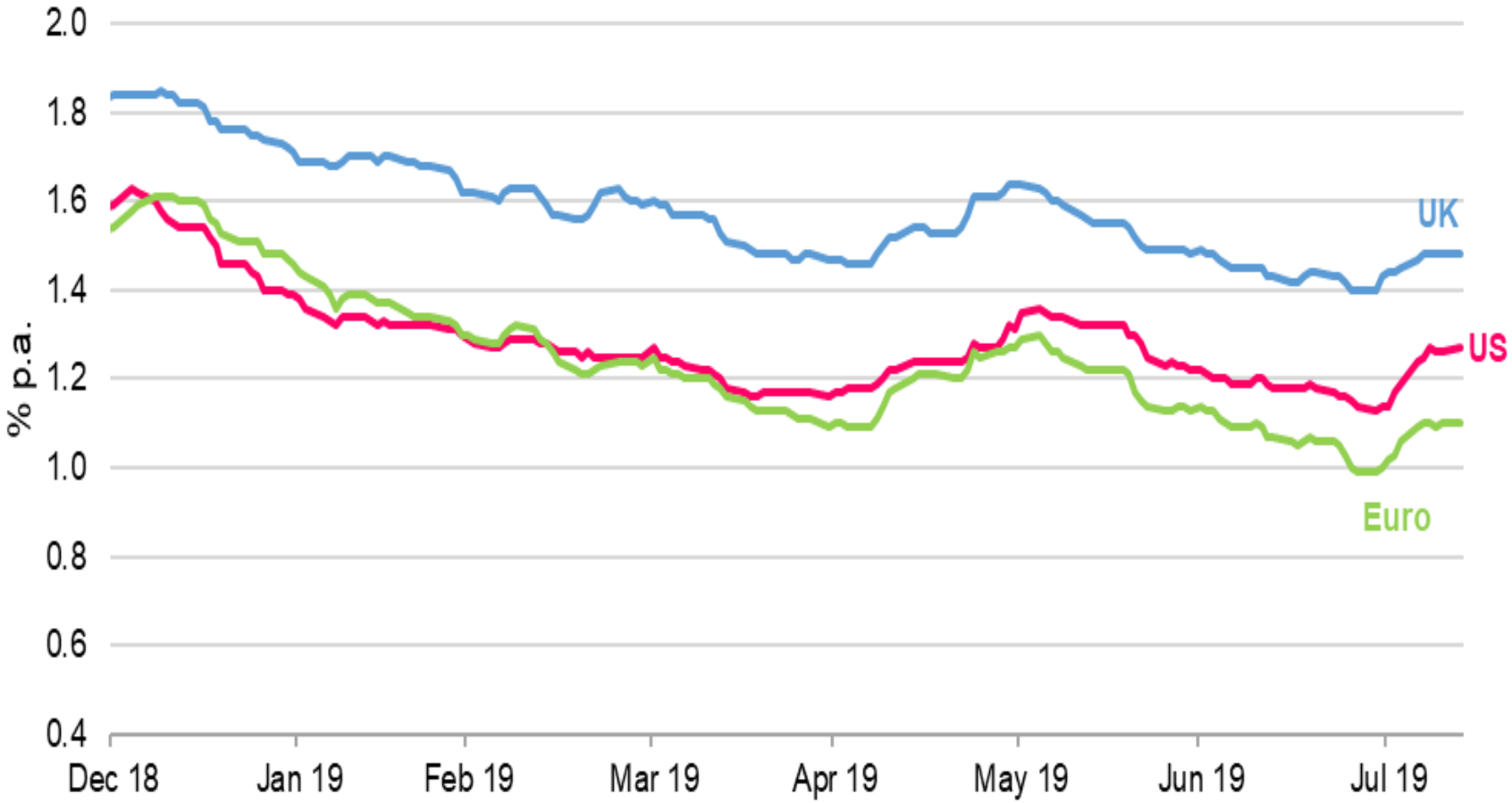
Corporate credit spreads: 2019



Source: Bloomberg August 2019

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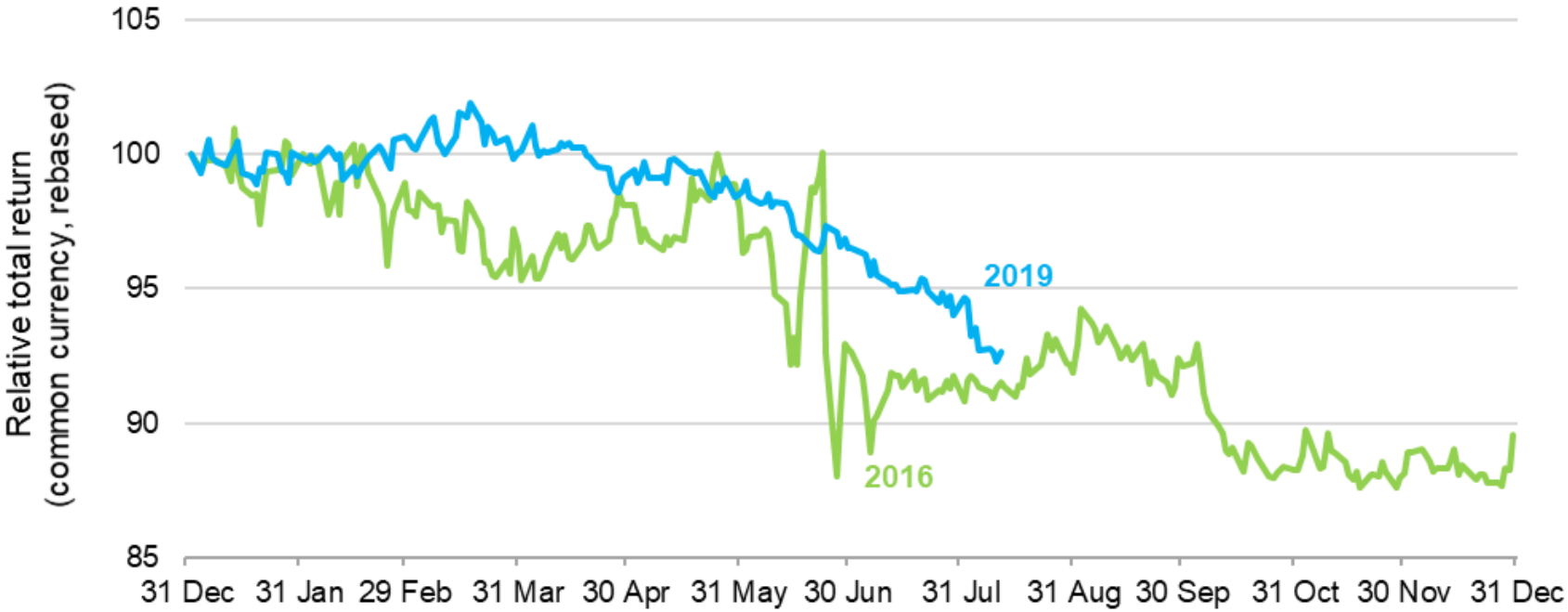
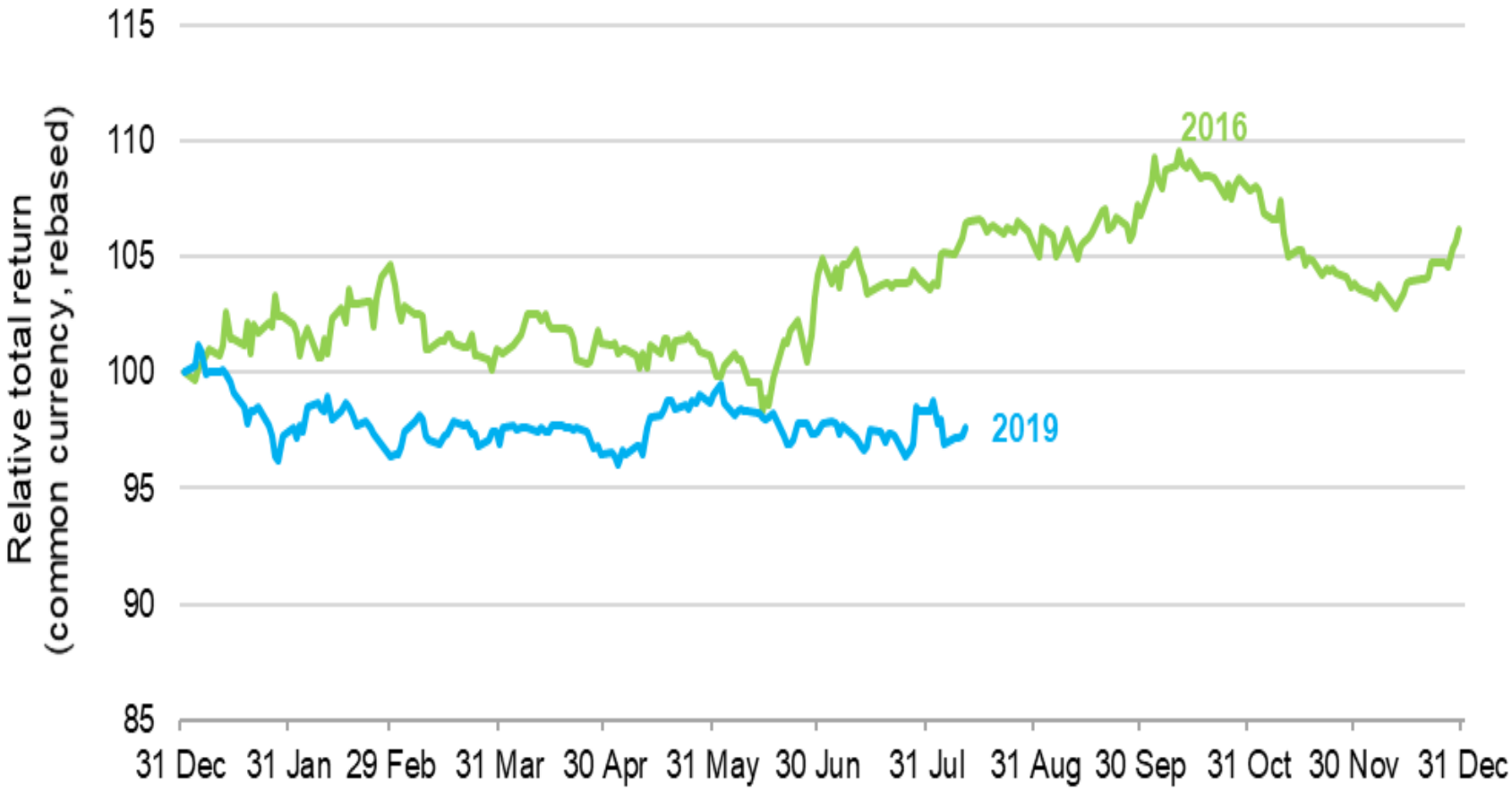
UK v overseas equities



FTSE All-share v FTSE All-World ex UK. Source: DataStream May 2019

UK v overseas equities (Local Currency)



FTSE All-share v FTSE All-World ex UK (Local Currency). Source: DataStream May 2019

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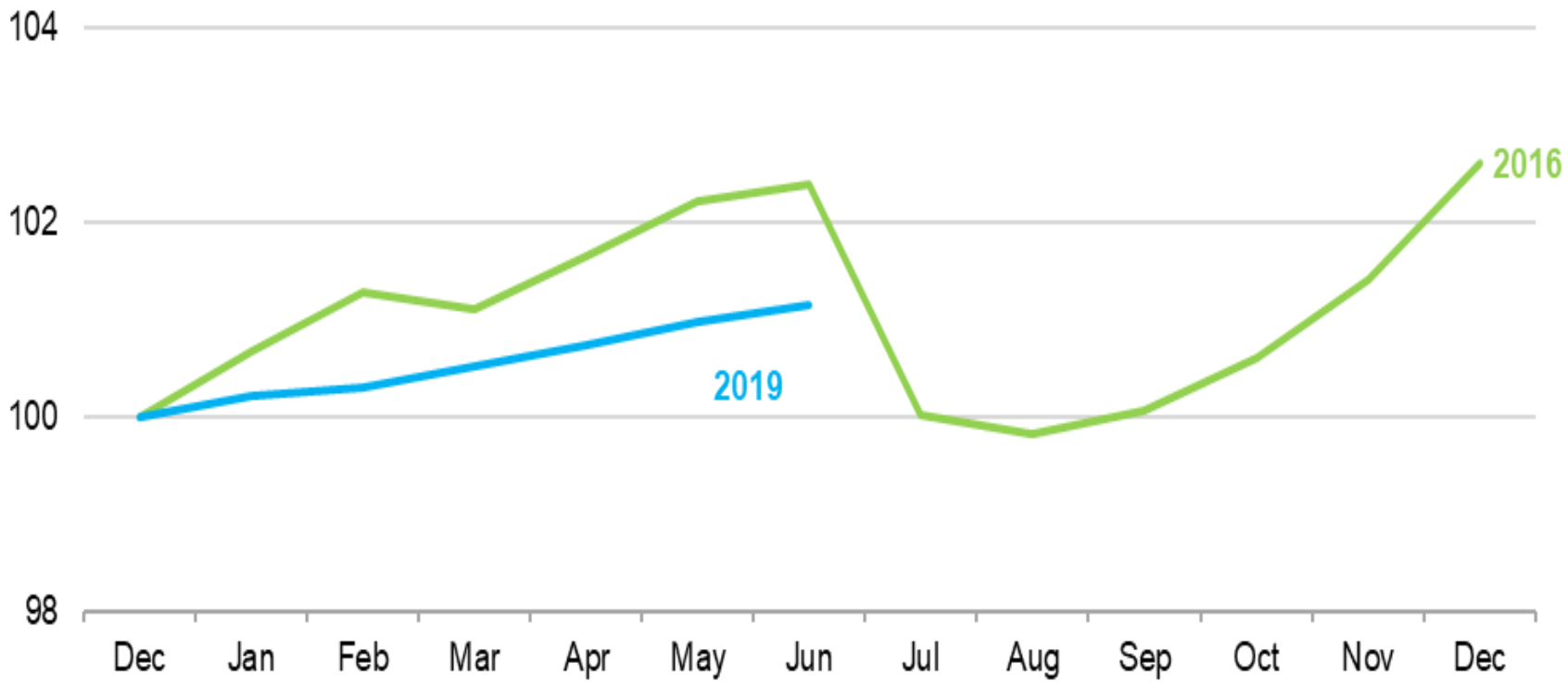
UK Property – IPD Monthly Index



Source: DataStream/MSCI August 2019

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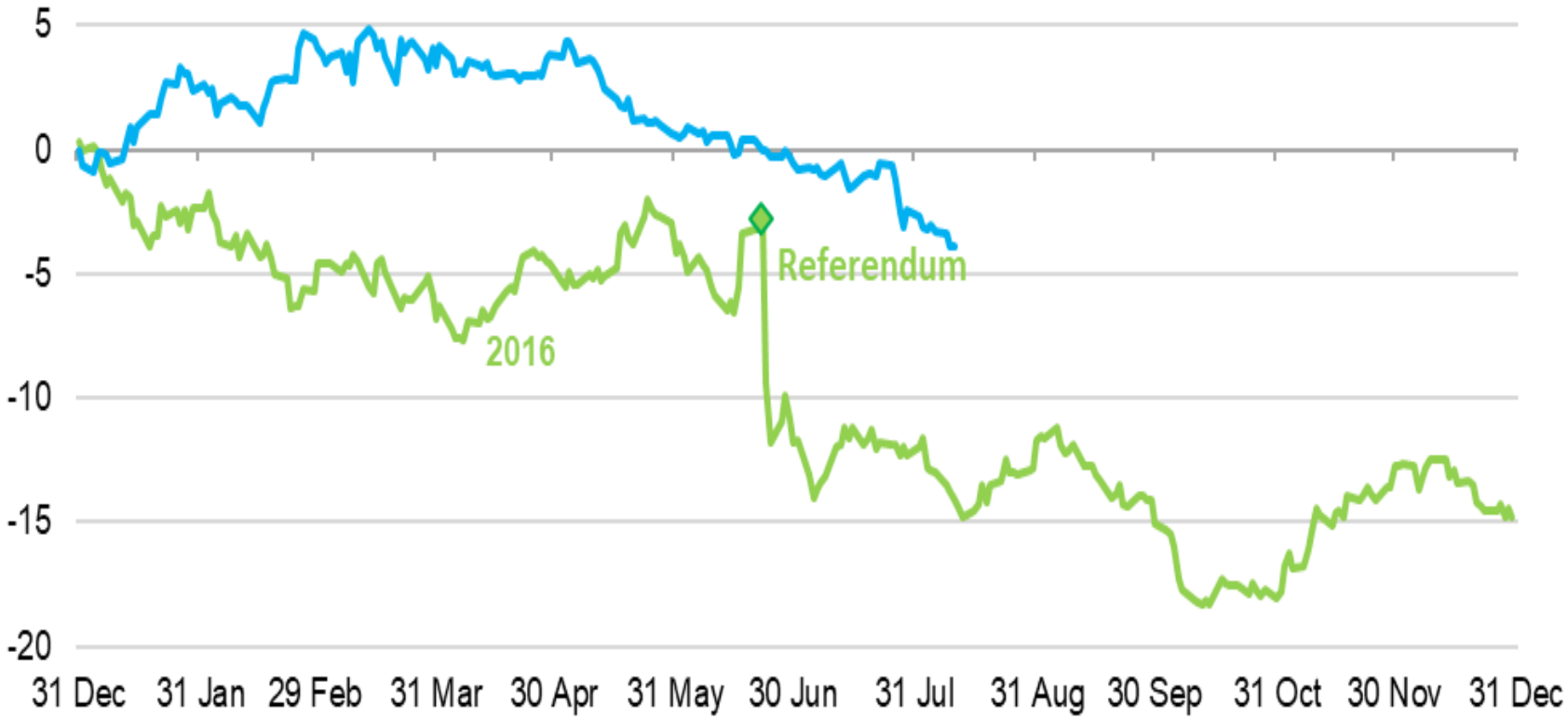
Sterling trade-weighted index



Source: DataStream August 2019

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Thank you

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Currency hedging
Executive Summary

Purpose:

The Pension Fund Committee ("the Committee") of the London Borough of Barnet Pension Fund ("the Fund") has asked for an update and advice on the level of currency hedging with relation to the Fund's assets denominated in overseas currencies.

The Committee should remain aware that there has been a heightened level of volatility in the value of sterling ever since the 'Brexit' referendum and which continues to this day, and any adjustment to the level of currency hedging needs to be to be carefully considered in this context.

Input sought/action requested:

The Committee are asked to **CONSIDER** and **APPROVE** the level of currency hedging to be employed by the Fund.

Questions/Issues:

1. Why has the Fund got exposure to overseas currencies?
2. What is the strategic rationale for currency hedging that exposure?
3. What level of currency hedging is employed by the Fund relative to its equity investments, and relative to its assets overall?
4. Given either the gains we have seen from being exposed to overseas currencies, or the current risks in the uncertain political/market climate, should we change the current level of hedging? If so, over what timeframe should this be carried out?

Background:

The Pension Fund Committee ("the Committee") of the London Borough of Barnet Pension Fund ("the Fund") has asked for an update and advice on the level of currency hedging with relation to the Fund's assets denominated in overseas currencies.

This request was prompted following a discussion at the July 2019 Committee meeting relating to the volatility in the value of sterling, and ongoing uncertainty surrounding the UK's exit from the EU. This paper provides background and information on the level of currency hedging employed by the Fund currently and considers whether the risk implicit in the unhedged currency exposure should be reduced. Following discussion of this paper, the Committee should consider and agree whether they are comfortable with the current level of currency hedging and the actions required going forward.

Conclusions:

Currency risk can be material and can be managed at low cost. In recent years, the Fund has invested in a number of new alternatives mandates that have involved exposure to overseas currencies. This is in addition to the exposure to overseas currencies via the longstanding equity mandate with LGIM, which operates with a 50% hedge on overseas currency exposure.

At a whole Fund level, we believe it is reasonable to target a strategic level of currency hedging of c.50%, which would then imply that we attempt to hedge, directly or indirectly, the overseas currency exposure of the alternatives mandates in addition to the existing currency hedging relating to equities. In terms of implementation, however, we would caution against attempting to implement this further hedging in advance of the UK's planned exit from the European Union on 31 October 2019, due to the high level of currency volatility. If the Committee are in agreement to an increase in the level of currency hedging at a whole Fund level, we would advise that this is implemented in a phased approach over a 6-12-month period in order to acknowledge the heightened level of currency volatility.

Should the Committee agree with our recommendations, the next step would be to consider an implementation plan for applying this additional currency hedging.

Reliance and Limitations:

This paper is addressed to the Officers and Pension Fund Committee of the London Borough of Barnet Pension Fund and should not be disclosed to any other third parties without our prior written permission and then only in full. We accept no liability to third parties unless expressly accepted in writing.

Please note the value of investments, and income from them, may fall as well as rise. This includes but is not limited to equities, government or corporate bonds, derivatives and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets.

Exchange rates may also affect the value of investments. As a result, an investor may not get back the full amount of originally invested. Past performance is not necessarily a guide to future performance.

1 Introduction

Background

The Fund has exposure to foreign currencies through a number of assets held in overseas markets, and therefore is exposed to the risk of exchange rate movements when these are converted back to sterling. Foreign exchange markets can be very volatile in the short and medium term. In general, this volatility is not expected to be a long term strategic source of growth and therefore is a risk with no expected long-term benefit. The risk is therefore considered 'inefficient'.

If currency is therefore a risk with no expected long-term return attached it would seem sensible to reduce this exposure if it can be achieved at low cost through currency hedging.

As part of the Fund's Investment Strategy Statement, the following statement is made regarding the Fund's approach to the management of currency risk:

> *Currency risk: The strategic asset allocation adopted by the Committee provides for an overseas allocation to enhance diversification via exposure to different economies. Such investments are, however, subject to fluctuations in exchange rates with an associated impact on performance. As such, the Committee has opted to hedge 50% of the Fund's currency risk (based on overseas exposure of the passive global equity allocation). This is considered to strike a suitable balance between dampening the volatility associated with currency fluctuations and the cost associated with currency hedging.*

Current currency risk exposures

The Fund is exposed to overseas currencies through a number of its investments, however, most of the exposure stems from the equity portfolio. Using figures as provided by the Fund's Officers, at 31 March 2019, the Fund's equity investments, totalling c.£453m, are split between four passively managed equity funds managed by Legal & General Investment Management ('LGIM') and are split as follows:

- £14m: LGIM UK Equity Index
- £220m: LGIM RAFI Developed Equity Index (GBP currency hedged)
- £199m: LGIM World ex UK Equity Index (no currency hedging)
- £20m: LGIM Emerging Market Equity Index (no currency hedging)

In practice, considering the Fund's existing *non-UK* equity investments as listed above, we estimate that c.£220m of the Fund's equity investments are not exposed to currency risk (equating to a hedging level of 50% - in line with the statement contained in the Investment Strategy Statement). This leaves equity investments totalling **c.£219m** exposed to currency risk.

Beyond the Fund's equity investments, there are a number of other alternative mandates that give some further exposure to currency risk, with the total currency risk exposure amounting to **c.£143m** in relation to the following mandates:

- The diversified growth fund mandates with Schroders and Newton. These currency exposures can be considered 'active' positions, as adopted by Schroders and Newton in their management of their portfolios and we would not seek to hedge these indirectly. It is also worth noting that in the medium-term these mandates are due to be liquidated.
- The alternative credit mandates with Partners Group (direct lending), Barings (multi-asset credit), and M&G (asset-backed securities).

- The infrastructure mandate with IFM.

When combining the currency risk exposure of the equity, diversified growth, credit and infrastructure investments, this leads to a total exposure to currency risk of **c.£362m**, which equates to c.32% of the Fund's assets.

It should be noted that the figure of £362m relates to assets denominated in overseas currencies and are referred to as 'primary' currency exposures. This is in contrast to 'secondary' currency exposures, which relate to a number of other factors, such as, for example:

- A company may be listed on the UK equity index, and therefore have shares denominated in sterling, however, it may derive its corporate revenues from multiple overseas currencies and so would be impacted by movements in sterling.
- A company may be listed on the UK equity index, but report and pay dividends in overseas currencies, or have costs that are denominated in other currencies, and therefore would be impacted by movements in sterling.

As these 'secondary' exposures are difficult to determine, and change over time, we do not consider these any further in this paper.

2 Strategic considerations

Rationale and historic performance of currency hedging

Foreign exchange markets can be very volatile in the short and medium term and some of this volatility (or 'currency risk') can be reduced at low cost through currency hedging. Currency risk is a risk that is not expected to be compensated for by additional returns over the long term and therefore, some investors (including the Fund) choose to hedge their overseas currency exposure, in full or in part. The inclusion of currency hedging can smooth the effects of currency movements in the short term for a risk that is not expected to be beneficial over the long term. In terms of relative importance, currency risk ranks below both strategic (i.e. the split between equity, bonds, credit and alternative mandates) and structure (i.e. diversification) risk, which typically are of more material impact.

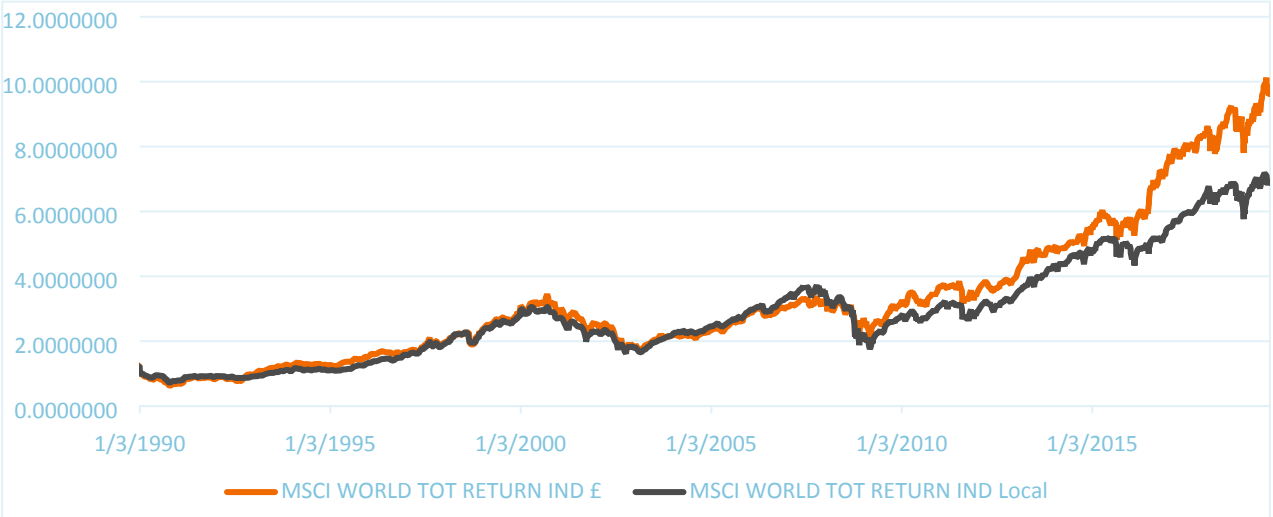
Based on empirical returns, we have assessed the impact of hedging currency on the overall risk of a global equity portfolio in the long-run for a UK investor, with a number of observations:

- For UK investors, currency hedging has generally reduced the return volatility of a global equity portfolio by circa 10- 20%, although to some extent this depends on the degree of UK and non-UK equity exposure within a portfolio and the time period assessed.
- As the level of currency hedging in an equity portfolio increases, the incremental reduction in volatility decreases, with limited benefits observable of hedging above a c.50%-75% level – at this level, or above, it would appear that retaining an amount of currency risk has acted to diversify some level of the equity risk.

Impact on performance

The chart below shows the returns of a global equity index with no currency hedging (orange line) versus the return of a currency hedged global equity index (black line), since 1990. We would caution reading too much into an individual time period, although this broadly coincides with the introduction of the new monetary policy regime that followed Bank of England independence. Two key observations are that:

- For the vast majority of the period and up until 2015-16, the performance difference between an unhedged and a hedged global equity index was limited. This is consistent with a common view that, when considered over the long-run, currency movements largely even out.
- Since 2016, as the value of sterling has depreciated since the Brexit referendum, the unhedged global equity index (orange line) has outperformed materially.



However, even if you subscribe to a more general view that currency risk will 'wash out' over time, we believe the actual outcome to an investor is more nuanced than this. The chart also shows that short-term performance deviations (such as 2016-19) can be very significant which can be important since:

- Benchmark and manager allocations change over time (e.g. rebalancing or strategic reductions in equity allocation), which in effect crystallises relative currency performance.
- Pension schemes that require asset sales to also meet benefit payments may also crystallise short term currency volatility.
- The sterling level at which you commence any hedge matters.

Overall conclusion – strategic approach to hedging

Based on the above we would draw the following conclusions:

- Currency is a risk with no long term expected benefit. We would therefore recommend some degree of hedging if this can be achieved at reasonable cost.
- The most beneficial level of currency hedging to be targeted depends on time period, impact on diversification and level of exposure to overseas currencies. However, this is very difficult to assess prospectively. We therefore believe that a 50% currency hedge is a sensible compromise that brings much of the benefit, whilst managing cost and diversification impact. This level has been supported in the past by empirical studies.
- In the past, pension funds have tended to focus on the hedge level within the equity mandate. This is a reflection that the main source of currency exposure has traditionally arisen from this source. This has changed more recently as pension schemes have increasingly diversified and we therefore believe it is now more sensible to assess currency exposure at a total fund level.

The rationale for hedging and outcomes also depend on the starting level of sterling and we discuss this more in the next section.

3 Taking account of current market conditions

Background

In the previous section, we discussed that a reasonable long term neutral position would be 50% currency hedging at a total Fund level.

The next question is then, based on current valuations, recent performance and outlook, is there a strong rationale for being at a level different from our neutral position?

This can include thinking such as:

- Has being exposed to overseas assets been a driver of positive return and should we crystallise that position to 'lock in' gains?
- What impact will further hedging have on overall portfolio risk (as opposed to equity risk in isolation)?
- Is there a strong view that sterling is undervalued and will bounce back in the medium term?

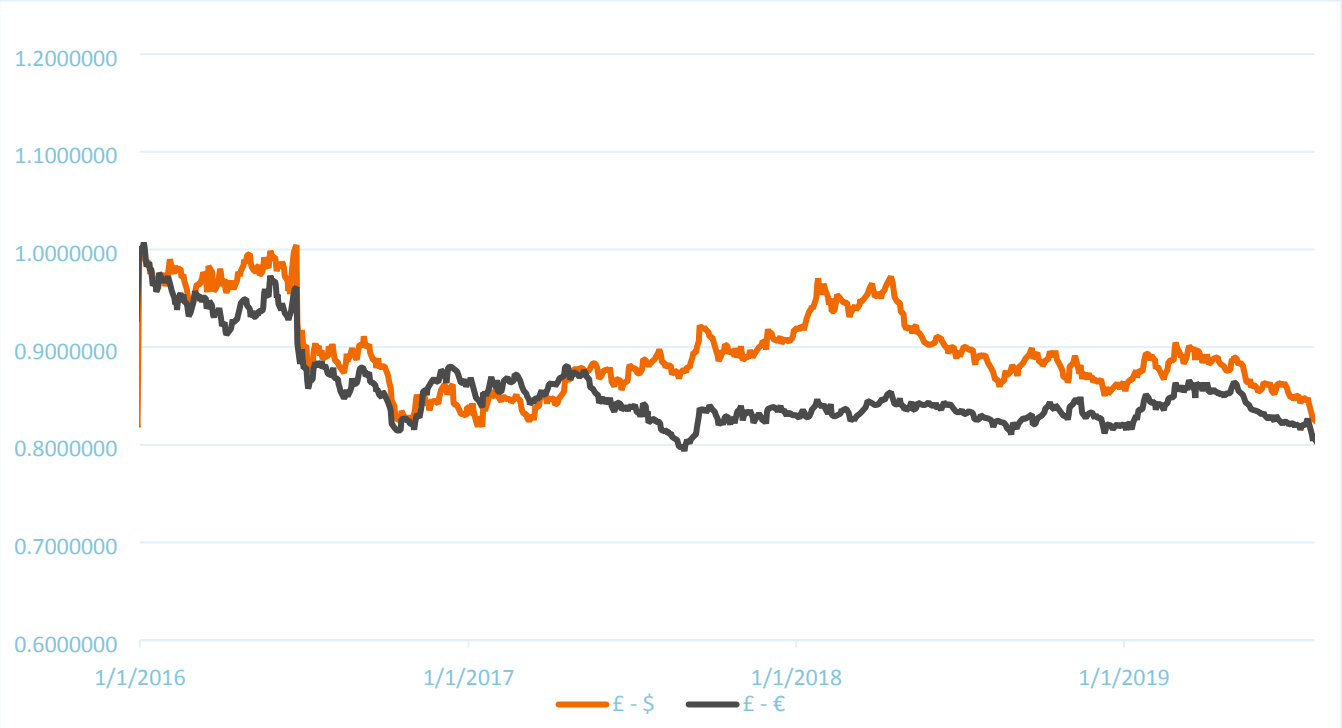
We discuss this further below.

Brexit and the fluctuations in the value of sterling

Since the Brexit referendum in mid-2016 the value of sterling, on a trade-weighted basis, has fallen significantly. As such, this depreciation in sterling will have been of benefit to the Fund (all else equal) given a proportion of its investments are denominated in overseas currencies.

With the continued uncertainty surrounding Brexit, any announcement relating to Brexit has had a significant impact on sterling. Over the last six months, the value of sterling relative to other major currencies has acted as a good gauge as to the general market sentiment towards Brexit. Any development indicating a closer relationship to the EU has yielded a boost to sterling and anything that signalled the potential for a "hard" or "no-deal" Brexit has caused the value of sterling to fall. Therefore, there may be some risk benefit of maintaining an overseas currency exposure in a bad Brexit outcome as this would probably lead to a significant weakness in UK assets and sterling (although a significant proportion of this may now be priced in).

The chart below shows the movement in the USD/GBP (orange line) and EUR/GBP (black line) exchange rate between 1 January 2016 and 31 July 2019, showing the c.20% depreciation in sterling relative to USD and EUR over this period.



Strategic versus tactical considerations

Returning to our original questions:

Particularly given the depreciation in sterling in recent years, and the benefit that this has caused to returns on unhedged overseas assets for UK investors, there is a question about whether any tactical views should be overlaid, such as a potential increase in the level of currency hedging in order to lock-in gains associated with sterling depreciation.

We are wary of employing a tactical approach of any sort, however, as currencies are volatile and difficult to predict over any given time horizon and can deviate significantly from any assessment of 'fair value'. As such we believe that any discussion regarding the potential increase in currency hedging should be predicated on strategic, rather than tactical considerations.

- Has being exposed to overseas assets been a driver of positive return and should we crystallise that position to 'lock in' gains?

Clearly, being exposed to EUR and USD has been of benefit over the past couple of years (it is more nuanced in smaller currencies). In a less uncertain period where risks to other parts of the portfolio were not so great, we might suggest crystallising this. However, we believe the wider portfolio impact needs to be considered (as discussed below).

- What impact will further hedging have on overall portfolio risk (as opposed to equity risk in isolation)?

As the Fund is only c38% hedged to overseas currency risk, we might expect a marginal reduction in long term risk from further hedging. However, the short-term impact of further hedging is very uncertain given the risk of the fallout from the prospect of a 'no deal' Brexit.

In the following table we have attempted to quantify some of the risks of different Brexit scenarios. These should not be taken as predictions as they depend on daily market moves and are subjective but give a feel for what might be considered a sensible possible outcome.

	Current Consensus	Soft Brexit		No Deal		Ongoing Uncertainty	
	3 years (p.a.)	Immediate	3 years (p.a.)	Immediate	3 years (p.a.)	Immediate	3 years (p.a.)
3 year UK GDP	1.3%		1.8%		0.0%		-0.2%
3 year RPI inflation	3.0%		3.0%		3.5%		2.5%
		Change relative to current consensus					
£ to global basket		+5%		-11%		-2% p.a.	
UK equity		0%		+5%		-2% over three years	
Unhedged Global equity		-4.5%		+10%		+5.5% over three years	
Base rates		-		-0.5%		-0.25%	
Gilt yields		+0.25%		-0.5%		-0.5% over three years	
ILG yields		+0.35%		-0.9%		-	
UK IG corporate yld spreads		-		+0.5%		+0.5% over three years	
UK property		-		-7%		-12% over three years	

As can be seen, a 'no deal' Brexit could lead to further significant weakening of sterling which may offset some level of funding impact from gilt yields in valuations (although this might be small).

- Is there a strong view that sterling is undervalued and will bounce back in the medium term?

This appears a very binary consideration to us. In the medium term, there is a huge amount of uncertainty, based on political rather than fundamental valuation outcomes, and we would be wary of taking tactical views over such a horizon.

4 Recommendation and next steps

Recommendation and next steps

In recent years, the Fund has invested in a number of new mandates, including those with Barings, Partners Group, M&G and IFM, which has gradually increased the degree of currency risk (in £-terms). As such, it is reasonable at this time to consider whether the Committee remain happy in relation to the degree of currency risk to which the Fund is exposed. Historically, the Fund has focussed on currency hedging with respect to its overseas equity mandates. However, due to the evolution of the Fund's strategy and the increased level of investment in mandates (e.g. credit, infrastructure) that give currency risk exposure, we believe it would be prudent to consider currency hedging in the context of this higher level of exposure across the Fund.

At a whole Fund level, we believe it is reasonable to target a strategic level of currency hedging of c.50%, which would then imply that we attempt to hedge, directly or indirectly, the overseas currency exposure of the alternatives mandates in addition to the existing currency hedging relating to equities. In terms of implementation, however, we would caution against attempting to implement this further hedging in advance of the UK's planned exit from the European Union on 31 October 2019, due to the high level of currency volatility and that it may be driven by political decisions rather than fundamentals.

If the Committee are in agreement to an increase in the level of currency hedging at a whole Fund level, we would advise that this is implemented in a phased approach over a 6-12-month period in order to acknowledge the heightened level of currency volatility. Should the Committee agree with our recommendations, the next step would be to consider an implementation plan for applying this additional currency hedging, which may involve hedging a greater proportion of the equity portfolio and/or considering currency-hedged share classes for the alternative mandates, if available.

The Committee should remain aware that there has been a heightened level of volatility in the value of sterling ever since the Brexit referendum and which continues to this day, and any adjustment to the level of currency hedging needs to be to be carefully considered in this context.

We look forward to discussing this paper with you at the Committee meeting on 9 September 2019.

Prepared by:-

Nick Jellema, Investment Consultant

Matt Woodman, Senior Investment Consultant

For and on behalf of Hymans Robertson LLP

Appendix

Risk warnings

Please note the value of investments, and income from them, may fall as well as rise. This includes but is not limited to equities, government or corporate bonds, derivatives and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of investments. As a result, an investor may not get back the full amount of the original investment. Past performance is not necessarily a guide to future performance.

Modelling methodology

The model takes a simplified approach to modelling a scheme's liabilities; we assume that the liability dynamics can be proxied by a suitably weighted portfolio of long and medium dated index-linked and fixed-interest gilts. Making this simplifying assumption for the schemes liabilities we then estimate the scheme's adjusted assets and liabilities for each scenario using the assumed returns as set out above.

The analysis shown is referred to as a "scenario test" analysis and it examines the impact of 3 possible scenarios As with any scenario analysis, the scenarios tested are not exhaustive in terms of the possible (actual) outcomes that may occur in future and over the specified time period. Changing the time period considered or the variables that are flexed in the scenario analysis could produce materially different results. The purpose of the analysis is therefore to inform a discussion about possible outcomes (not certain outcomes) nor the likelihood of these possible outcomes or the time frame over which they may occur.

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AGENDA ITEM 10

Pension Fund Committee

9 September 2019

Title	**Admitted Body and Bond Status Update**
Report of	Director of Finance
Wards	N/A
Status	Public
Urgent	No
Key	No
Enclosures	None.
Officer Contact Details	Nigel Keogh, Interim Pensions Manager Nigel.Keogh@barnet.gov.uk 07505074979

Summary

This report provides the Pension Fund Committee with a status update on the outstanding admitted body and bond agreements, as well as bond renewals and cessation calculations, that need arranging.

The Council has been working with relevant employers, Capita, Hymans Robertson and HB Public Law to ensure outstanding admission and bond agreements are put in place.

Recommendations

That the Pension Fund Committee note the progress on outstanding admitted body and bond agreements, including bond renewals and cessation calculations.

WHY THIS REPORT IS NEEDED

1.1 The Report is to update the Pensions Fund Committee on outstanding work in relation to admissions, cessations and bond renewals.

Admission Agreements

1.2 Due to a combination of summer leave across our employer base and resources at both Capita and Hymans focussed on preparations for the 2019 valuation, there has little progress since the last update. The employers listed below, which includes 2 new bodies, are seeking to participate in the Local Government Pension Scheme. The Council is continuing to work with the employer, HB Public Law, and Hymans Robertson to arrange the admission agreements:

	Employer	**Contract Start Date**	**No of members**
1	Caterlink (Holly Park School)		N/A
2	Caterlink (Queen Elizabeth Girls School)	01/08/2016	N/A
3	Atlas Cleaning (St Lawrence)	01/05/2018	2
4	Atlas Cleaning (Claremont)	19/01/2015	3
5	Atlas Cleaning (St Michaels)	01/09/2014	5
6	HCL	01/09/2018	1
7	Olive Dining (Archer Academy)	01/09/2018	3
8	St Andrew's C of E (Ashlyn's)	01/04/2017	3
9	Sacks Morasha	01/03/2019	N/A
10	Innovate Food	01/08/2019	N/A

1.4 As noted in the last update, a comprehensive admission agreement process, has now been agreed with key stakeholders and adopted as final.

Cessation

1.5 When the last active member leaves the Local Government Pension Scheme a cessation valuation must be calculated. The Council's actuary, Hymans Robertson, calculates both assets and liabilities in relation to the Scheme Employer to understand if there is a surplus or deficit at the end of the contract.

1.6 For the reasons outlined above, progress has again been limited, and the list of required calculations now includes a further 3 bodies:

	Employer	Contract End Date	Estimated surplus/(deficit)
1	Absolutely Catering (1) Queenswell	27/05/2016	Nil
2	GLL	31/12/2017	£519,000
3	Housing 21	30/09/2015	£1,065,000
4	Allied Healthcare	13/12/2018	(£3,000)
5	Freemantle Trust	30/06/2019	£476,000
6	Rimon	31/03/2019	(£16,000)
7	Ridgecrest	01/09/2018	£5,000
8	Absolutely Catering (2) St James' Catholic School	31/07/2019	Nil

Bonds and Bond Renewals

1.7 The table below sets out the Scheme Employers that are required to put a renewed bond in place:

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	Employer	Expired	Approx value
1	Fremantle Trust (2)	17/04/2019	£800k
2	Hestia (Domestic Violence Service)	05/12/2018	£15k
3	NSL Limited	30/04/2017	£1,037k
4	OSC Group	31/05/2017	£103k
5	Servest (Henrietta Barnet School)	01/11/2018	£7k
6	Viridian Housing	16/08/2016	£110k

1.8 Since the last update provided to the Pension Fund Committee on 29 July 2019, bond agreements are no longer required for the following organisations, as their contracts have ended or the employer has ceased:

- Absolutely Catering (2) St James' Catholic School

- Ridgecrest Cleaning

1.9 The actuary has committed to producing the required bond renewal reports (using data supplied for the 2019 valuation) shortly after the valuation results (November/December).

2. REASONS FOR RECOMMENDATIONS

2.1 There is no action required of the Committee.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 Not applicable.

4. POST DECISION IMPLEMENTATION

4.1 Not applicable.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 To maintain the integrity of the Pension Fund by monitoring admitted body organisations and ensuring all third parties comply fully with admission agreements and bond requirements. This ensures that pension fund liabilities are covered by the participating admitted bodies; this in return protects Barnet's liabilities and supports the Council's corporate priorities as expressed through the Corporate Plan.

5.2 Resources (Finance & Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 The work identified above is being done within existing resources.

5.3 Social Value

5.3.1 Membership of the Pension Fund ensures the long term financial health of the contributing employees on retirement.

5.4 Legal and Constitutional References

5.4.1 Regulation 2 and Schedule 2 of the Local Government Pension Scheme Regulations 2013 provide that a Local Authority, as an 'Administering Authority' for the Fund, may admit an organisation into the Local Government Pension Scheme, subject to that organisation, or the contractual arrangement between that organisation and the Council, meeting the criteria set out in the Regulations.

5.4.2 With respect to an admission agreement, the Regulations further provide for an assessment of the level of risk arising on premature termination of the provision of the service or assets because of insolvency, winding up or liquidation of the admission body. The assessment must be with the benefit of actuarial advice and, where the level of risk is such as to require it, the transferee admission body shall obtain an indemnity or bond to meet the level of risk identified.

5.5 **Risk Management**

5.5.1 The ongoing viability of the Pension Fund is dependent on acquiring assets that match the pension liabilities. All admitted bodies are subject to actuarial assessments and are reviewed to ensure compliance with admissions agreements and maintenance of appropriate employer contribution levels to mitigate against any risk to the financial viability of the pension fund.

5.5.2 There is a possibility of financial losses to the Pension Fund where arrangements around admitted bodies, bond agreements and contributions are not sufficiently robust. The Council is improving internal controls to ensure the Fund is protected.

5.6 **Equalities and Diversity**

Pursuant to the Equality Act 2010, the Council is under an obligation to have due regard to eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex, sexual orientation and marriage and civil partnership.

5.7 **Consultation and Engagement**

5.7.1 Not Applicable

5.8 **Insight**

5.8.1 Not applicable

6. BACKGROUND PAPERS

6.1 None

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