	Pension Fund Committee **24 October 2017**
Title	**Barnet Council Pension Fund – Review of Strategic Allocations**
Report of	Director of Resources
Wards	n/a
Status	Public
Urgent	No
Key	No
Enclosures	Appendix A – Hymans Robertson Strategy Slides Appendix B – Model Portfolios
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Summary

The current investment strategy retains a reasonable probability of achieving the funding objective. However the Hymans report examines opportunities to improve the efficiency of the portfolio including modestly higher equity allocations and creating an allocation to UK real estate.

Recommendations

The Pension Fund Committee agree that:

I. The strategic equity allocation is increased by 4% to 40% with 2% reductions to each of DGFs and corporate bonds.
II. Realisations to meet funding commitments will be drawn from the strategic bond fund, DGFs and corporate bonds in that order.
III. Training is provided on UK property, private equity and emerging market equities and opportunities to invest in these assets classes via the London CIV will be monitored.

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 Council to ensure that the Pension Fund complies with legislation and effectively manages the Fund's financial affairs.

1.2 Following the completion of the triennial valuation as at March 2016, Hymans Robertson have used the revised projections of the scheme liabilities to review the likelihood that the current investment strategy will deliver the funding objective – a 'sufficient' probability of being fully funded. In addition, Hymans has also modelled variations in the investment strategy to identify potential enhancements that will deliver improved funding outcomes.

1.3 The current strategy was set in October 2015. The main change compared with the previous strategy was the inclusion of a 36% allocation to passive equities with consequential reductions to corporate bond and DGF allocations. The strategy was modified in March 2016 with the creation of four new mandates (Partners 2015 MAC, Alcentra (Clareant) multi-asset credit and European direct lending and Barings high yield) and further modified in March 2017 with a further four mandates (Partners 2017 MAC, Insight secured finance, M&G asset backed securities and IFM Infrastructure). These new mandates are being funded from disinvestment from the Schroder's strategic bond fund and rebalancing other assets classes.

1.4 Details of the current structure are given within the quarterly investment report. Many of the mandates currently in place are therefore relatively new and some are still being funded e.g. IFM Infrastructure and Partners 2017 MAC.

1.5 The probability of the current strategy delivering a fully funded scheme in twenty years is modelled on slide 2 of the Hymans report. This indicates a probability of around two thirds assuming contribution are set and paid in line with the current Funding Strategy Statement. This success probability is normally deemed sufficient, although there remains a significant (one third) probability of a funding level below 100% at the end of this period.

1.6 The modelling indicates that the current strategy remains 'fit for purpose' and that there is no imperative to alter. However, opportunities to improve the expected outcome are considered within the slide pack.

<u>Future Opportunities</u>

1.7 Hymans modelling considers the impact of increasing the equity allocation by 16% (to 52%) and by including 10% private equity at the expenses of lower DGF and corporate bond allocations. Unsurprisingly, these changes increase the probability of achieving full funding but also lead to poorer funding levels for the worst 5% of outcomes. See slide 8. The increased likelihood of full

funding is not as great (circa 5%) as might be expected. As also detailed on slide 8, more modest equity increases offer some benefits with only marginal changes in the 5% worst outcomes. The analysis supports further modest increases in the long term equity allocation funded from realisations of DGFs and corporate bonds. The fund is currently overweight on its equity allocation target (36%) and it is proposed to set a target equity allocation of 40% reflecting the current position. The increase has been reflected in 2% reductions in corporate bonds and DGFs. No additional funds will be moved into equities as a consequence of this change.

1.8 Hymans has used the results of the modelling to created two model portfolios (new 1 and 2) shown on appendix 2. The main features of these portfolios are:

- Increasing the global equity weighting to 40% as discussed above,
- Introducing property, private equity and a specific allocation to global emerging markets, and
- Reducing the allocations to DGFs and corporate bonds.

1.9 Two asset classes absent from the current strategic asset allocation that are commonly held by LGPS funds are property and private equity. Property offers a real asset with a high income yield. Private equity offers an illiquidity premium and the potential for returns in excess of public markets partially due to the leverage inherent in these investments.

1.10 Both of these asset classes can involve costly fund of fund (FoF) structures. Significant cost savings are available with increased mandate sizes, particularly if FoFs are replaced by funds or even direct holdings. It is proposed that opportunities to invest in these asset classes via the London CIV are reviewed when they become available and consideration given to inclusion within the strategy. In the meantime training on the characteristics and opportunity set for these asset classes can be provided.

<u>Funding the new mandates and rebalancing</u>

1.11 The current holdings have the following overweights:

4% - Schroder Strategic Bonds (to be fully redeemed)

7% - DGFs (after reduction in the target from 22% to 20%)

1% - Schroder's corporate bonds (2% reduction in target from 12% to 10%)

1.12 Talking these positions into account it is proposed that the funding sources for the new mandates are, in order:

Schroders Strategic Bond Fund, then

DGFs, then

Corporate bonds.

Conclusion

1.13 The current strategic allocations retain a satisfactory probability of achieving full funding in 20 years. Although modestly higher equity allocations will improve this probability of achieving full funding the impact is tempered by increases in the volatility of returns and hence the downside risk. Long term, moderate (up to 5%) higher equity allocations are justified and a proposal is included to increase the equity allocation by 4%.

1.14 It is proposed that opportunities to invest in property and private equity are reviewed when available through the London CIV and that training on property, private equity and emerging market equities is provided, but in the meantime no changes are made.

1.15 Those mandates not fully funded will receive funds drawn from the strategic bond fund, DGFs and corporate bonds in that order.

2. REASONS FOR RECOMMENDATIONS

2.1 The LGPS (Management and Investment of Funds) Regulations 2016 (clause 7(7)) requires the Committee to periodically (at least every three years) to review the investment strategy. The proposal recognises that the strategy has been enhanced in 2015, 2016 and 2017. Modelling indicates that the current strategy, while expected to achieve the funding objective, can be enhanced. The proposal to provide training and monitor the availability of suitable mandates through the London CIV recognises that the management of costs is important.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 The various alternatives are discussed in the paper and modelled within the Hymans slide pack. The recommendations are based on the modelling results.

4. POST DECISION IMPLEMENTATION

4.1 The Director of Resources will carry out any actions considered necessary.

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.

5.3 **Social Value**

5.3.1 The Public Services (Social Value) Act 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 (clause 7(7)) requires the Committee to periodically (at least every three years) to review the investment strategy.

5.4.2 The Council's Constitution – Part 15, Annex A, Responsibility for Functions details the responsibilities of the Committee, including to periodically review at least triennially the Investment Strategy Statement. 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. LGPS pension funds 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 Equalities 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.

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 **Consultation and Engagement**

5.7.1 Not applicable.

5.8 **Insight**

5.8.1 Not applicable

6. BACKGROUND PAPERS

6.1 None