	Pension Fund Committee **7 October 2020**
Title	**Investment Strategy, Responsible Investment and Pooling.**
Report of	Director of Finance
Wards	N/A
Status	Public except for exempt Appendix.
Urgent	No
Key	No
Enclosures	Appendix – Hymans Robertson slides (exempt) **Exempt enclosure - Not for publication by virtue of paragraphs 3 of Part 1 of Schedule 12A of the Local Government Act 1972 as amended (information relating to the financial or business affairs of any particular person (including the authority holding that information).**
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Summary

The Pension Fund Committee on 27th July 2020 requested proposals to enhance both pooling and responsible investment influence in the selection of the pension fund's investments. Discussions with Hymans Robertson have identified four products available through the London CIV that achieve these objectives and training will be provided on each in advance of the meeting, followed by discussion at the meeting.

Officers Recommendations

1. That the Pension Fund Committee consider which of the four funds named in paragraph 1.4 best achieves their ESG and pooling aspirations.

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 the July meeting the Committee discussed both their appetite for incorporating Environmental, Social and Governance ("ESG") factors into the investment portfolio and the progress of pooling with the London CIV. The Committee agreed that there should be increased emphasis on sustainability and pooling and that Members were keen for actions to take place.

1.3 Discussions with the investment adviser, Hymans Robertson, concluded that the best place to start was with the 40% allocation to equities managed by Legal and General. Reasons are the longer history of ESG focused portfolios in equities compared with other asset classes; the LCIV has equity offerings in these areas but not currently in other asset classes and the Committee and Hymans have raised concerns with the rationale for continuing with an allocation to RAFI equities. The LCIV has plans to launch two non equity offerings that offer sustainability characteristics – renewable infrastructure and London Impact. However, the LCIV is currently seeking to appoint an advisor to assist in fund selection and it is likely to be mid 2021 before an investment opportunity arises.

1.4 Four products were identified in discussion with Hymans that have the potential to replace part of the existing equity holdings. These are:

LGIM – FTSE4Good (LGIM Ethical)
LGIM – MSCI Low Carbon
LGIM – Future Worlds Equity Index
LCIV Sustainable Equities and Sustainable Equities Exclusion Funds.

1.5 A short Hymans note on these funds is attached. An hour's training will be provided before the Committee that will highlight how ESG factors are incorporated into each fund. There will then be a discussion at the Committee led by Hymans to identify the ESG characteristics of each fund and the differences between them. Following this discussion, it is hoped that sufficient guidance will be provided by the Committee to enable Hymans and officers to develop implementation proposals.

1.6 One point to note is the LCIV Sustainable Equity portfolios are active in that they seek to outperform the returns of an agreed index. Some time ago the Committee determined that their preference was for 'passive / index tracking' forms of equity investments, which aim to replicate the performance of a specified index. The most common approach to constructing an index is to weight the constituents by their market capitalisation (a 'market cap' index). The LGIM RAFI fund aims to replicate the performance of an index, but not a market cap index. Instead, it specifies an index that is constructed based on companies' fundamental measures, rather than their market caps. Of the four options above, the LCIV fund(s) are active and the LGIM funds aim to track specified indices.

1.7 A critical consideration when switching equity holdings will be timing. For example RAFI has underperformed because of its low allocation to technology stocks e.g. Apple, Microsoft, Google etc and the prominence in its holdings of asset rich industries that were previously expected to out-perform in the long term. Buying at the top and selling

at the bottom has its risks, although these can be partially managed by phasing transactions. These issues are exacerbated by some of the ESG focused funds having above mark cap exposure to technology stocks, potentially increasing the risk of buying stocks that have been favourites for some years.

1.8 In addition to reviewing the equity holdings, remaining issues include the unused 5% allocation to UK commercial property and the cash currently invested in diversified growth funds awaiting investment to both UK commercial property and private equity. Hymans were asked to bring forward areas of particular interest at the current time and their comments are:

"There are three areas of the market we think are particularly attractive at the moment, although there would need to be some further training for the Committee and/or suitability advice provided prior to any investment decision being made:

- **special situations financing**, which is an extension of the traditional core direct lending that you invest in already, and focuses on providing bespoke solutions to mid-market corporate borrowers with fundamentally strong businesses that are facing specific challenges or strategic opportunities relating to the pandemic;
- **distressed debt**, which is the riskiest of the three opportunities and focuses on debt issued by viable businesses that have become unsustainable, usually after a period of significant operational and financial underperformance, and can generate high returns by restructuring either the debt or the company; and
- **fund secondaries**, as the pandemic has forced fund managers to restructure their portfolios, which will provide a real boost to the secondaries market and an opportunity to acquire assets at significant discounts in asset classes such as private equity, private debt and infrastructure.

Some of the Fund's existing managers will be able to offer these opportunities – Adams Street and Partners Group are raising money for their secondaries funds, and Barings and M&G may be suitable candidates for distressed debt, although we're still doing our due diligence there. All the opportunities are accessed via closed-ended fixed-term [funds that distribute proceeds after the underlying investment are realised] vehicles".

1.9 Hymans will expand on these comments at the meeting.

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 and if necessary, revise 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.

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 The Committee supports the delivery of the Council's strategic objectives and priorities, as expressed through the 2019-2024 Corporate Plan, to be an efficient and effective Council through managing our finances and contracts robustly, by assisting in maintaining the integrity of the Pension Fund by monitoring the investments and administration of the Pension Fund.

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 and if necessary, revise 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 to act in accordance with its principles 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. The Council also has regard to the additional protected characteristic of marriage and civil partnership even though this does not apply to the public-sector equality duty.

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 Responsible Investment and Pooling agenda items (7and 8) Pension Fund Committee 27 July 2020.

https://barnet.moderngov.co.uk/ieListDocuments.aspx?CId=191&MId=10149&Ver=4