	Pension Fund Committee **24 February 2021**
Title	**Investment Strategy and Manager Appointments**
Report of	Director of Finance
Wards	N/A
Status	Public except for exempt Appendices.
Urgent	No
Key	No
Enclosures	Appendices (**all exempt**):– (A) Equity Portfolio Review (B) Suitability Note – LGIM Future Worlds (C) Suitability Note – LCIV Sustainable Exclusion Equity (D) Suitability Note - Adams Street Global Secondary Fund 7 **(to follow)** (E) Suitability Note – LCIV Private Debt **(to follow)** **Exempt enclosure - Not for publication by virtue of paragraphs 3 of Part 1 of Schedule 12A of the Local Government Act 1972 as amended (information relating to the financial or business affairs of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).**
Officer Contact Details	George Bruce, Head of Treasury, george.bruce@barnet.gov.uk - 0208 359 7126

Summary

The Committee have been considering opportunities to increase both sustainability and pooling within the Pension Fund's investments. Following feedback at recent training Hymans Robertson, investment advisor, are making new investment recommendations, which are discussed in the paper.

Officers Recommendations
1. That the Pension Fund Committee agree to: a) Invest 5% of the Fund into the LCIV Sustainable Exclusion Equities Fund. b) Invest 25% of the fund in the LGIM Future Worlds Index. c) Reduce the allocation to LGIM RAFI equities from 20% to 10% of the Fund. d) To dispose of the entire holding in LGIM Market Capitalised Index Funds. e) To transact the above changes over a two-year period but to authorise the Finance Director (in consultation with Chairman and Investment Advisor) to amend the implementation period. f) Invest US dollar equivalent of £40 million in Adams Street Global Secondary Fund 7. g) Invest £50 million [tbc] in the LCIV private debt fund. h) Investments (f) and (g) to be funded firstly by using available cash resources and secondly by realisations from existing investments in diversified growth funds

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 This paper discusses allocations to the following asset classes & Funds:

Listed Equities
Private Equity Secondaries
LCIV Private Debt

Background

1.3 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. As a consequence training was provided immediately prior to the October meeting and at a subsequent November training session considering listed equity products available from either Legal & General (LGIM) or the London CIV that offer strong sustainability characteristics. At the November training, Hymans also discussed attractive opportunities within distressed debt and private equity secondaries that could redeploy monies currently invested with Schroders and Newton diversified growth funds (DGF) that have been identified for liquidation in the current strategy. This was followed up with training from Barings (distressed debt) and Adams Street (private equity secondaries) on 4 February 2021. Recommendation in respect of each of the above is contained within the paper.

1.4 London CIV will be attending training immediately before this meeting to discuss three new funds they are making available to London Boroughs – Private Debt, Renewables Infrastructure and London Fund. There is a recommendation herein for private debt but consideration of the other two funds will be held over until the May meeting.

Listed Equities

1.5 Currently most of the Scheme's listed equities are invested with LGIM index tracking portfolios (current value £541 million), with a further £76 million invested in LCIV Emerging Market equities. The LGIM equity allocations is 40% of the total fund (actual 40.5%). Following the November training the Committee members expressed a preference to switch part of the LGIM equity into both LCIV Sustainable Exclusion Equity Fund and the LGIM Future World Index Fund. The LCIV offers two versions of their sustainability fund and the Committee preferred the Exclusion Fund which will not invest in alcohol, tobacco, adult entertainment, gambling, small arms, weapons & extracting, processing or transporting coal, oil or natural gas. In practice, there are three companies (Anheuser-Busch InBev, EOG Resources & Neste) out of 36 currently in the non-exclusion fund that are excluded.

1.6 Following the training, Hymans Robertson were asked to provide advice on the amount to be invested in each, the particular LGIM funds that were to be realised and the period over which the switch was to take place, taking account of the impact on geographic, sector and currency exposures. Hymans recommendations are attached (appendix A).

1.7 In summary the recommendations are to alter the 40% currently allocated to LGIM as follows:

i. Invest 25% (£333 million) in the LGIM Future Worlds Index Fund.
ii. Invest 10% (£134 million) into LGIM RAFI Fund
iii. Invest 5% (£67 million in the LCIV Sustainable Exclusion Equity Fund.

[NB: The monetary values quoted above may alter slightly during implementation.]

1.8 Hymans views on the suitability of LGIM Future Worlds and LCIV Sustainability Exclusion Equity are contained within appendix B & C.

1.9 The implications of the above is that the current 20% allocation to market capitalisation-based equity indices will be fully sold and the RAFI allocation reduced by half from 20% to 10%.

1.10 In terms of implementation, Hymans have two recommendations:

i. That transactions are made in six instalments over a two-year period, and
ii. That the Future World holdings are split between hedged and unhedged share classes to achieve a 55% currency hedge of non-sterling denominated assets, slightly less than the current hedge ratio reflecting Sterling's recent recovery v the US dollar.

1.11 Hymans rational for the above recommendation are contained within appendix A. Their confirmation of the suitability of the two new funds are also attached (appendix B & C). The proposals involve significant changes to style factors, geographic and sector allocations and Hymans are of the view that these should be implemented over an extended period. In particular, the RAFI index with it's value tilt has underperformed market capitalisation indices in recent years and reducing the holding over a prolonged period may lessen the risk of selling 'at the bottom'. LGIM have been asked to comment on the implementation plan and it is suggested that authority be given to the Finance Director in consultation with the Chairman and Investment Advisor to amend the timing of purchases and sales if this is deemed appropriate.

Private Equity Secondaries

1.12 The Committee currently has a 5% allocation to private equity with Adams Street, although the amount invested is only £6 million. The Committee has committed $67.5 million (£50 million) and this will be drawn down over the next 3-5 years. As was known at the time, the existing commitment will not absorb the full allocation, probably a maximum of 3 ½ %. It was always intended that there would be further private equity commitments. Hymans are suggestions (appendix D) that the Committee commit the US$ equivalent to £40 million to Adams Street Global Secondary Fund 7. Adams Street attended training on 4 February 2021 to discuss this fund. The difference between the secondaries fund and the existing Adams Street fund is that the secondaries fund will purchase investments that are already partly or fully drawn meaning that our money will be invested quicker (and realised more quickly). This will be contained within the existing 5% allocation to private equity.

1.13 There will be no LCIV option for private equity in the foreseeable future. Private equity funds have limited lives and distribute capital when underlying investments are sold. Thus to maintain a 5% allocation will require future commitments, which may be with the London CIV if an option is available

Distressed Debt

1.14 Hymans see distressed debt as a favourable opportunity at the moment and a way of absorbing cash from DGF realisations. Training was provided on distressed debt by Barings on 4 February, in particular the Barings Global Special Situations Credit Fund. Hymans are currently reflecting on how an allocation to this fund will fit into the investment strategy and may revert with a recommendation to the May meeting.

LCIV Private Debt

1.15 Barnet’s allocation to private debt is contained within the illiquid alternatives allocation. As at 31 December 2020 £98 million (7.3%) is currently invested with Partners Group and Alcentra European Direct Lending Fund. These funds have a limited life (around 8 years) and distribute Capital when the underlying investments are sold. As an example, the Partners 2015 fund has now distributed 70% of its initial capital. Thus to maintain an allocation requires regular new commitment, which is why we are invested in the 2015, 2017 and 2019 funds from Partners Group. Previously (July 2019) the Committee agreed to commit £30 million to the LCIV private debt fund. Unfortunately, the fund was never launched as only two boroughs were willing to commit. However, LCIV have now identified two managers and will re-launched this fund provided that it attracts at least £150 million of investments from London Boroughs. Hymans have proposed (appendix E) that we make a commitment to this fund. The amount to be committed will be confirmed at the meeting. The LCIV Private Debt Fund will initially have two underlying managers, Churchill & Pemberton, but LCIV will be able to change or add additional managers. The managers’ were selected by LCIV with the support of external consultants. Hymans consider the LCIV fund a suitable vehicle for our private debt as an alternative to either Partners or Alcentra. We have not invited Churchill or Pemberton to the meeting but LCIV will be attending training immediately before the Committee meeting and will comment on the manager selection process.

Additional Cash Contributions from the Council

1.16 Last March the Council advanced paid three years of deficit contribution to the Pension Fund with a value of £21 million. This cash was used to finance the final investment with LCIV Emerging Market equities. The advance payment is repaid by a reduction of contributions over three years. The advantage of the Council is that the Actuary calculates a suitable discount rate that the Council expect to be greater than they could earn holding cash. The advantage for the Pension Fund is that our expected investment return is higher than the discount rate. Advance payment also improves the funding level. The Council are looking to advance pay a large proportion of four years of standard contributions circa £45 million. The Actuary has been asked to calculate a suitable discount rate. If agreed, this will be paid to the Pension Fund in April and provide funding for any new mandates discussed above. A QC opinion has been received on the legality and accounting for advance payments.

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

6.2 Investment Strategy, Responsible Investment and Pooling report (item 8) Pension Fund Committee 7 October 2020

https://barnet.moderngov.co.uk/ieListDocuments.aspx?CId=191&MId=10150&Ver=4