	Local Pension Board **12 October 2021**
Title	**Investment Strategy and Performance Review**
Report of	Director of Resources
Wards	All
Status	Public
Urgent	No
Key	No
Enclosures	Appendix 1 – Summary of Investment Returns Appendix 2 – PIRC annual report Appendix C – Quarterly investment report to 30 June 2021
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Summary

This report summarises the findings from the 2020-21 PIRC investment performance report comparing the Barnet Pension Fund with the Local Authority average returns and discusses developments in the investment policy over recent years.

Officers Recommendations

That the Local Pension Board note the report.

1. WHY THIS REPORT IS NEEDED

1.1 Although investment matters do not feature regularly at Board meetings, they are a major factor in the determination of employers' contribution rate and not excluded from the Board's remit to assist in ensuring the effective and efficient governance and administration of the pension fund. The purpose of this paper is to review the fund's investment performance and to comment on the recent changes to strategy and manager appointments.

PIRC's Annual Report on Investment Performance

1.2 The Pension Fund Committee receives quarterly reports of investment performance that compare returns over time periods ranging from three months to since inception for each manager and the overall fund with the benchmarks set for each mandate. An example of such a report prepared by the investment advisor is attached (appendix C). Comparison with the targets set for each manager is the means by which managers are monitored. The annual report comparing returns at asset class level with other local authorities while of interest does not take into consideration each fund's risk profile. PIRC's report does not replace the quarterly monitoring undertaken by the Pension Fund Committee. However, it can be used to indicate areas that need consideration.

1.3 PIRC receives quarterly return data from 62 funds and has constructed performance league tables with a 30-year history. These comparators are provided at total return level and for five broad assets classes, although Barnet has only invested in all five of the asset classes for the last two years. A summary of the Barnet results is given on appendix 1 and the PIRC annual report for Barnet is attached at appendix 2.

1.4 Appendix 1 indicates that at asset class level e.g. equities, Barnet's returns have mostly exceeded the average of other local authorities. In particular, equity and diversified growth returns have exceeded the average in all time periods. Despite asset class outperformance, at total fund level the picture is more mixed due to asset allocation decisions. Barnet has for many years operated a lower than average allocation to equities; the most volatile (risky) asset class. These have in each time period been the highest returning asset class. The impact has been that in shorter time periods, 1 and 3 years, total fund performance has exceeded the average, while for longer periods it has been behind the average.

1.5 Interpretation of the findings is that Barnet has a good history in determining the manner in which each asset class is managed but that the lower risk approach would, as expected, lead to lower average returns over longer periods. In particular, the allocation to diversified growth funds (which was as high as 29% five years ago) has materially underperformed the equity market.

1.6 The PIRC annual report for Barnet, appendix 2, similarly notes the different approach taken to fund allocations.

1.7 When comparing investment returns with benchmarks set for each manager (page 5 of appendix C), the findings are very similar; with one year outperformance, a slight 0.2% underperformance over three years and a 1% p.a. underperformance since inception. The major drag in performance would appear to be the overseas property allocation

established two years ago, however its allocation of less than 2% means that the impact on the total fund is much lower than the diversified growth funds that as mentioned above previously represented nearly 30% of the fund.

1.8 Looking at longer term absolute returns over longer periods (appendix 1), be it the 7.0% p.a. over 10 years or 7.7% p.a. over 30 years, these are all significantly above the discount rates used by the actuary of 4.2% in 2016 and 4.4% in 2019, that indicate a positive contribution by investments to the improving funding position reported at the June meeting (agenda item 7).

Changes in Investment Managers and Strategy

1.9 Changes in strategy and managers in recent years have been informed by the following considerations:

- Exit diversified growth funds while maintaining the overall risk profile
- Diversify the strategy while taking advantage of the illiquidity premium from limited life closed ended funds
- Incorporate ESG themes into the selection of managers and strategies
- Use the products offered by the London CIV to both meet pooling obligations and generate fee savings
- Be more opportunistic in the timing of investment decisions

1.10 The impact of incorporating these changes can be seen in a comparison of the portfolio in 2016 (soon after Hymans were first appointed as investment advisor) and as of June 2021.

Allocations	**Jun-16 %**	**Jun-21 %**
Equity	38	50
Diversified Growth Funds	29	13
Bonds & Credit	33	27
Property	0	4
Infrastructure	0	5
cash	0	1
Total	100	100
Number of Mandates		
Equity	1	6
Diversified Growth Funds	2	2
Bonds & Credit	6	10
Property	0	2
Infrastructure	0	1
Total	9	21

1.11 Taking each of the considerations mentioned above, the impact on the portfolio is discussed below.

Reallocation of Diversified Growth Funds

1.12 To maintain risk, the strategy was to move the DGF allocation roughly equally to equities and other asset classes. It has proved quicker to invest in equities than the other asset classes as demonstrated by the 9% underweighting in bonds / credit shown on page 3 of appendix C. As of 30 June 2021, there was £169 million of undrawn commitment which will utilise the remaining DGF exposure, since supplemented by a new commitment of €40 million in distressed debt. One of the two DGF mandates will be fully sold by the end of September, bringing the allocation to this asset class down to 10%.

Diversity the Strategy and take advantage of illiquidity premium

1.13 Allocations have been created for property (5%), infrastructure (7%) and private equity (5%) that are all new asset classes in the last two years. Infrastructure and private equity are both illiquid (realisation either at the end of a funds life or dependant on the ability to sell the underlying assets). In addition, there is an 11% allocation within credit to private debt, which can only be redeemed when the underlying loans mature.

1.14 Incorporate ESG themes into investment selection

The underlying belief is that (1) well managed companies with good governance arrangements will outperform and (2) climate change risk needs to be managed. Incorporation of these beliefs into the investment portfolio has seen significant changes within the equity portfolio. In addition, this was a key driver of the £40 million commitment to renewables infrastructure agreed in 2021.

1.15 Within LGIM index tracking equities, at the start of 2021 there was a 20% allocation to market capitalisation equities and 20% to a value-oriented index (RAFI). This was altered to:

LGIM Future Worlds	25%
LGIM RAFI	10%
LCIV Sustainable exclusion fund	5%

1.16 Future World weights companies by their market value but incorporates ESG tilts scoring companies' by ESG and transparency factors thus allocating more to companies with lower emissions and who rate better against governance and social criteria.

1.17 RAFI weights companies based not on their market value but on fundamental factors, such as a company's free cash flow, total sales and book equity value. As a result, RAFI has a bias towards 'value' stocks (unloved or undervalued stocks that are 'cheap' relative to book value or tangible assets). Recently RAFI has been renamed as "RAFI Fundamental Global Reduced Carbon Pathway Equity Index Fund" as it now targets an annual reduction of 3-3.5% in carbon emissions.

1.18 LCIV Sustainable Equities aims, as the name implies, to invest in companies whose business model is deemed sustainable in the long term through superior integration of ESG factors. The fund will not invest in alcohol, tobacco, adult entertainment, gambling, small arms, weapons & extracting, processing or transporting coal, oil or natural gas.

1.19 The changes to the equity holdings will be implemented over a two-year period to March 2023 at the end of which the exposures to carbon emissions will have reduced by 40% and to carbon reserves by 50%.

Pooling with the London CIV

1.20 The Board will be aware that Government guidance that appointment and monitoring of managers should be delegated to the London CIV. In the last two years new commitments have been made to LCIV emerging market equities, sustainable equities, private debt and renewables infrastructure with a combined target allocation of 16%. A current review of five credit mandates with a combined allocation of 21% is underway to determine if there is currently a suitable LCIV alternative. In addition the 41% held within passive mandates with LGIM is treated as pooled as fees are agreed between LCIV and LGIM.

1.21 LCIV provide an annual report on fee savings and the report for 2021-21 indicates that Barnet has saved an annual £435,000 in fund management costs through using LCIV products.

Be more opportunistic in the timing of investment decisions

1.22 This refers to selecting investments that are particularly suitable to current economic conditions. The most recent new investment is in distressed debt i.e. companies whose business model is sound, but their financial structure is unsustainable, with an increase in such opportunities as companies suffered during lockdown. A recommendation is likely to the next Pension Fund Committee on value added property, which includes property that is suitable for repositioning i.e. retail to residential or leisure. The recent commitment to renewables infrastructure can also be seen in the light of new opportunities for renewable power sources

1.23 While members of the Pension Fund Committee have significant investment expertise, changes in strategy and managers are only undertaken if supported by advice, including modelling of outcomes, from Hymans Robertson.

2. REASONS FOR RECOMMENDATIONS

2.1 One of the Board's responsibilities is to monitor the management of risks and investment strategy and manager appointments are two of the most significant risk faced by the Fund.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 None.

4. POST DECISION IMPLEMENTATION

4.1 None.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 To ensure that the Pension Fund is being invested prudently and to the best advantage to achieve the required funding level. Effective monitoring of the Pension Fund will ensure that long term investment targeted returns are achieved and will provide support towards the Council's corporate priorities.

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

5.2.1 The Pension Fund appoints external fund managers to maximise Pension Fund assets in accordance with the Fund investment strategy. The Pension Fund is a long-term investor and short-term volatility of investment return is expected. In the longer term, the appointed fund managers are expected to deliver positive returns in accordance with the Fund benchmarks. The global diversification of the Pension Fund portfolio gives some protection against the market volatility.

5.3 Social Value

5.3.1 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 Board's Terms of Reference include "ensuring the effective and efficient governance and administration of the LGPS for the LBB Pension Fund". The investments strategy process is central to ensuring that the pension fund has sufficient assets to pay pensioners.

5.4.2 Regulation 9 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 provides the power to appoint investment managers. The regulations no longer have a specific reference to monitoring investment managers but state "the authority must reasonably believe that the investment manager's ability in and practical experience of financial matters make that investment manager suitably qualified to make investment decisions for it", Regulation 9(3) .

5.5 Risk Management

5.5.1 A key risk is that of poor investment performance. The performance of the fund managers is monitored by the Pension Fund Committee every quarter with reference to reports from Hymans Robertson, the Pension Fund investment adviser. If a fund manager's performance is considered inadequate, the fund manager may be replaced.

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 1) eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; 2) advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and 3) 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 parts 2) and 3) (above) of the public-sector equality.

5.6.2 Ensuring the long-term financial health of the Pension Fund will benefit everyone who contributes to it. Access to and participation in the Pension Fund is open to those with and those without protected characteristics, alike, provided that the criteria set out within the relevant Regulations are met

5.7 **Corporate Parenting**

5.7.1 Not applicable in the context of this report.

5.8 **Consultation and Engagement**

5.8.1 Not required.

5.9 **Insight**

5.9.1 Not applicable in the context of this report.

6. ENVIRONMENTAL IMPACT

6.1 N/A

7. BACKGROUND PAPERS

7.1 None.