

Open Report on behalf of Pete Moore - Executive Director of Finance and Public Protection

Report to:	Pensions Committee
Date:	4 October 2018
Subject:	Asset Pooling Update and Investment Strategy

Summary:

This report updates the Committee on activity within Border to Coast Pensions Partnership, and considers how the Fund's investment strategy may be implemented in the asset pool.

Recommendation(s):

That the Committee:

- 1) notes the report;
- 2) considers the recommendations on asset allocation and investment strategy as follows:
 - a) as the opportunities arise, to reduce UK equities by 5% in favour of diversifying assets, to be allocated following further discussion at a future committee meeting.
 - b) to commit to the transition of the current Global Equity (high conviction active) assets to the Global Equity Alpha sub-fund within Border to Coast.
- 3) delegate authority to the Executive Director of Finance and Public Protection, in consultation with the Chairman and Vice Chairman of the Pensions Committee, to agree the transition of Fund assets following appropriate due diligence.

Background

1. As the Committee are aware, the Lincolnshire Fund has been working closely with 11 other partner funds since 2015, to create the asset pool now known as Border to Coast Pensions Partnership Ltd (Border to Coast). Since the last update given at the July meeting of this Committee, when Border to Coast had become fully operational, progress continues to ensure that the company is fully resourced to manage the assets of the partner funds. This paper will summarise the key progress points to date, and outline the current expectations for the transition of the Fund's assets and any potential asset allocation changes for consideration.

Border to Coast Update

2. Border to Coast now has £7bn of assets under management, following the transition of a large part of the internally managed assets of three of the partner funds. Work is also continuing on the externally managed fund capability, with the planned launch of the UK Equity fund in Q4 2018, and a Global Equity fund in Q1 2019. The process for selecting and monitoring managers, developed with input from the partner funds and Mercers, was also approved by the Board and reported to the Joint Committee.
3. Recruitment has continued to build the structure required to manage the partner fund assets. The key role of Chief Investment Officer had been undertaken by John Harrison in an interim basis, but has now been filled permanently, after the appointment of Daniel Booth, who started in early September. Daniel has significant experience across all asset classes and markets as well as in building investment functions for asset owners. He was previously responsible for leading the investment team responsible for pensions, insurance and endowment portfolios at Saudi Aramco (the Saudi Arabian Oil Company).

Joint Committee Meetings

4. The Joint Committee (JC) last met on 10th July 2018, and the papers were circulated to all Pensions Committee members. The minutes will be circulated once approved, and below are the highlights:
 - Shareholder Director appointment – following nominations and voting, Cllr John Weighall and Cllr Sue Ellis were selected as Shareholder Directors. This will be put to the Board for ratification and to shareholders for consent.
 - Chairman and Vice Chairman of JC - following nominations and voting, Cllr Doug McMurdo (Bedfordshire) and Cllr Tim Evans (Surrey) were selected as Chairman and Vice Chairman respectively.
 - Project and strategic updates – the JC were updated on progress to date, the governance charter, possible performance measures, the conflicts of interest policy, transition planning, the UK equity sub-fund launch, and the capability build of the alternatives platform.
 - Scheme member representation on the JC – representation of scheme members using the current representatives on local Boards was approved, with a paper to be brought to the November meeting to agree process and number of representatives.
5. The next JC meeting is being held on 21st November and papers will be circulated to Committee members. Any questions or comments on the papers should be directed to Cllr Strengiel, who can raise them at the meeting.

Advisor Days

6. An advisor day was held in September for the partner fund's investment consultants and advisors to enable them to meet the senior management team and to provide an update on the sub-funds being.

Transitions

7. One of the initial principles in creating Border to Coast was that costs of the initial transitioning assets into the pool would be done in an equitable way. Opinion from Legal Counsel regarding the sharing of transition costs was received and Border to Coast has been liaising with MHCLG regarding options for the Partner Funds.
8. The simplest way to avoid any potential issues is for asset changes to be transitioned from the initial portfolios to the model portfolios within the sub-fund ACS. When actioned in here, all funds take a proportionate cost of transition relative to the assets they will have under management in the new sub-fund. In some instances, particularly in some overseas markets, it is more tax efficient for assets to be transitioned outside of the ACS, but this does not currently allow for transition costs to be shared across partner funds. As part of the transition planning process, Border to Coast will provide analysis of potential costs and benefits of transitioning inside or outside of the ACS before any transitions are made into each sub-fund.

Workshops

9. Officers are working closely with Border to Coast to ensure that the sub-fund offerings and the strategic asset allocations of the Partner Funds are aligned. A number of workshops have already been held, and more are diarised over the coming months, covering alternative investments, global equities, responsible investment, the triennial valuation and fixed income. These will continue as the sub-fund offerings are developed.

Investment Strategy

10. The training session held on 11 September in County Offices covered the current investment strategy and how it might be mapped across to the Border to Coast sub-funds.
11. The Fund's asset allocation can be split into three areas; equity assets, diversifying growth assets and protection assets. The equity and the diversifying growth assets (at 86.5%) make up the return-seeking part of the Fund, and the protection assets (at 13.5%) make up the low risk element. The funding level, rolled forward to the end of August, shows an increase from the 2016 Valuation to around 86%. A full review of the investment strategy and the asset allocation will be undertaken alongside the next triennial review in 2019, however as the assets are being moved across to Border to Coast it is worthwhile to check that the overall split is still appropriate.

12. The Investment Consultant's view, as discussed at the training event, is that the 86.5:13.5 split is still appropriate, however there may be some room for manoeuvre between the equity assets and the diversifying growth assets, to marginally reduce the volatility. This is detailed further in paragraph 14.
13. A summary is shown below of the asset allocation across the three areas, with the potential destination for them within Border to Coast, and any asset allocation or investment strategy decisions that the Committee may wish to consider. This is not set in stone, merely a direction of travel. Decisions will be required from the Committee as each Border to Coast sub-fund is created, ahead of any commitments to transition assets.

Equity Assets

Current Mandate	Manager	Current allocation %	Potential plan under pooling	Target allocation %
UK Equities - passive	Legal & General	20.0	Retain with Legal and General	15.0
Global Equities ex UK (low risk active)	Invesco	22.5	Options: 1) Border to Coast active factor based fund 2) Border to Coast internal low risk active mandate 3) Index tracking against as alternative factor-based index	22.5
Global Equities (high conviction active)	Columbia Threadneedle Schroders Morgan Stanley	17.5	Border to Coast Global Equities Alpha Fund – Q1 19	17.5
Total		60.0		55.0

14. Comments and points for consideration/decision:
- a. UK equities – it was agreed at the January 2017 meeting of this Committee to reduce UK equities by 5% in favour of Global Equities. Given the increase in funding level since the valuation, the recommendation is to instead move that 5% to diversifying growth assets instead. If the Committee approve this recommendation (at 2 a), then further information on potential options will be brought to a future Pensions Committee. If the Committee would prefer to follow the original decision, then this transition would be done as part of the move to the Global Equity Alpha fund in Q1 2019, assuming approval is given for investment in that sub-fund.
 - b. Global Equities ex UK (low risk active) - there is not currently a sub-fund directly equivalent to the current mandate. Discussion is still underway with Border to Coast on whether an active factor-based sub-fund will be offered. Until there is further clarity on the Border to Coast offering, and/or a track record for the internal team's low risk active mandate, the mandate will continue to be managed by Invesco.

- c. Global Equities (high conviction active) – the Border to Coast Global Alpha externally managed sub-fund closely matches the mandates the Fund has across Columbia Threadneedle, Schroders and Morgan Stanley. It will be a blended product of a number of complementary managers, with a target return of 2% net above the benchmark. The current target the Fund has across the current managers is between 1.5% and 3% net of fees. Discussion on the final details of the sub-fund and the procurement process is still underway, however commitments to transition assets, subject to final due diligence, are required before Border to Coast can go out to tender for managers. Should the Committee approve the recommendation to move the assets into this sub-fund (at 2 b), then delegated authority is requested to agree the transition of Fund assets following appropriate due diligence (at recommendation 3).

Diversifying Growth Assets

Current Mandate	Manager	Current allocation %	Potential plan under pooling	Target allocation %
Diversified Alternatives	Morgan Stanley	15.0	Options: 1) Aggregate 2) Specific allocations to sub-funds across private equity, private debt, infrastructure, multi-asset credit and other alternatives (split as yet to be determined)	21.0 or 17.5
Property	9 funds	9.0	Direct and with some specialist funds	10.5 or 9.0
Infrastructure	5 funds	2.5	Included in Diversified alternatives above	-
Total		26.5		26.5 or 31.5

15. Comments and points for consideration:

- a. The target allocation is shown with and without the potential additional 5% from UK equities (recommendation 2 a).
- b. Diversified alternatives – Border to Coast is building a structure that will allow allocations across private equity, private debt, infrastructure and other alternatives, and will also have a multi asset credit fund. The current approach of delegating full discretion to apportion the overall mandate may be an option at Border to Coast in the future. Should the recommendation at 2a be approved, the target allocation to diversified alternatives would be increased by 3.5%, and also includes the current 2.5% allocation to infrastructure.
- c. Property – the fund currently has allocations across a number of UK commercial property funds, and some specialist or regional funds. The

intention is for Border to Coast to build a fund of direct property holdings, however this will take some time, and transacting in property is always very expensive. Given the complexity of unwinding existing property holdings, this is further down the sub-fund creation timetable for Border to Coast. Work will be undertaken to ensure that the implementation of the transfer of property assets is done in the most cost effective way.

- d. Infrastructure – the Fund currently has a separate allocation to infrastructure and some additional investments with the diversified alternatives mandate managed by Morgan Stanley. Border to Coast will be offering an Infrastructure sub-fund, however until the decision has been made as to how to manage the overall allocation to alternatives, the current arrangements will continue.

Protection Assets

Current Mandate	Manager	Current allocation %	Potential plan under pooling	Target allocation %
Composite bonds (Gilts, index linked, corporate bonds)	Blackrock	6.75	Retain index linked gilts and corporate bonds	tbc
Short dated corporate bonds	Blackrock	6.75	Potentially the Border to Coast Investment Grade Corporate Bond Fund – Q2 19	tbc
Total		13.5		13.5

16. Comments and points for consideration:

- a. The 13.5% allocation to protection assets is unchanged, however the split between the options will be decided once there is further clarity on the bond offerings at Border to Coast.

Next steps for Lincolnshire

- 17. The initial transition of any assets from the Lincolnshire Fund is not expected until early next year. Upon receipt of delegated authority (assuming recommendations are approved), officers and advisors will continue to work closely with Border to Coast to ensure that the Global Equity Alpha sub-fund is fit for purpose and meets the investment strategy objectives of the Fund.
- 18. As detailed above, much work is still to be done on the final sub-fund offerings, and it will be a number of years before all assets are transitioned into the management of Border to Coast. Officers will continue to update the Committee on progress through the quarterly meetings and monthly letters as appropriate.

Conclusion

19. Border to Coast Pensions Partnership is now live and managing assets. Officers (both Fund officers and S151 officers) are working closely with Border to Coast as sub-funds are created and assets are transitioned.
20. The first potential transition to Border to Coast will be in Q1 2019, if recommendation 2b is approved. The actual transition of assets will only happen once all due diligence has been completed and the Fund is satisfied that the sub-fund offered is an appropriate vehicle. Officers will continue to update the Committee on progress through the quarterly meetings and monthly letters as appropriate.

Consultation

a) Have Risks and Impact Analysis been carried out?

Yes

b) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the author of this report.

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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