HYMANS ROBERTSON

Conference highlights

LGC Investment Seminar, Carden Park, Cheshire, 28 February – 1 March 2019

Chris Bilsland opened the conference by highlighting the improvement in funding since the 2016 valuation and the key theme of how the LGPS should respond to a great deal of economic and political uncertainty.

Financial Resilience of Local Authorities - Peter Moore (CIPFA)

- Local government funding squeeze is seemingly only going to continue as local authorities see increased demand for services and flat funding.
- The cost-efficiency of local authority operations - i.e. how services-per-pound-spent can be improved - will continue to be of interest to Westminster and scrutiny to be expected.
- The resilience of local authority finances is a real worry to CIPFA with many councils having limited reserves - CIPFA are advocating Principles of Good Financial Management.

Emerging Issues in the LGPS - Jeff Houston (LGA)

Jeff provided updates on several topics:

- 'Good Governance' project - this SAB commissioned project is underway. Following an initial fact find Hymans will be consulting widely with LGPS stakeholders with the aim of improving governance structures for the future. Further details can be found on the SAB website or contact Catherine.McFadyen@hymans.co.uk directly.
- Tier 3 employers - SAB is reviewing the comprehensive list of options in the Tier 3 report to decide which should be taken forward.
- Simplification - some employers have been consulted on which areas of the scheme are problematic. Unsurprisingly, assumed pensionable pay has been identified as a problem area and some consideration is being given to whether this could be simplified.
- Fair Deal guidance - currently out for consultation. Proposals put forward include the end of the broadly comparable route and the introduction of deemed employers.
- Pensions tax - discussions are underway with HMT and HMRC regarding problems caused by breaches of annual allowance limits and possible solutions to alleviate the issues for some members.
- £95k exit cap on members - progress towards the implementation of this is expected from MHCLG by end March.

- 4 yearly valuation and employer exit credits - expect an update from MHCLG in March on these issues.
- McCloud ruling - the Appeal Court in December found that the protections for those within 10 years of retirement had "given rise to unlawful direct age discrimination". We are still awaiting a date when the Supreme Court will hear this case. The cost management process has been paused meantime - GAD has estimated that the impact could be equivalent to £4bn per annum across the LGPS. Please respond to SAB's question about what guidance you would like on handling these issues during the formal valuation.

Pooling and asset transitions - Rachel Elwell (Border to Coast), Larissa Benbow (London CIV) & Kevin McDonald (Essex)

- Rachel discussed the progress made by pools and funds in the past year, and explained how B2C agreed the pool's guiding principles with partner funds at creation of the pool. These principles, combined with strong, ongoing communications with the partner funds, have helped determine sub-fund launches for B2C. Communication with officers and committees remains vitally important.
- B2C is trying to ensure the longevity of sub-funds by considering whether some of the strategies are resilient to the market-cycle and demand. B2C has revised downwards the number of sub-funds they plan to launch, relative to expectations a year ago.
- Larissa discussed her experience of pooling and noting the structure of LCIV as akin to a procurement platform, and therefore somewhat different to other pools.
- Engagement with the 32 funds that form LCIV has generally improved over the past year. A governance review of LCIV in early 2018 had been a catalyst for change ("humble pie has been eaten"), with a new shareholders committee now in place amongst other measures.
- The creation of sub-funds in LCIV for illiquid assets (property, infrastructure) has posed particular challenges due to unitisation, as has setting timelines for the launch of sub-funds.
- Kevin discussed his experience of pooling in ACCESS, with pooling being just one aspect of a very challenging workload for officers and committee.
- Essex has worked with its investment adviser, Hymans, to put investment beliefs in place that anchor decision-making for the Fund. The Fund's positive cashflow position is set to change in the coming years and this has driven a strategic reduction in equity investments from 60% to 50% and moves towards income-generating assets.
- It's been important to liaise with ACCESS to discuss the Fund's direction of travel, to inform sub-fund launches which meet Essex's needs. Circa 50% of Essex's assets are now pooled with material fee savings to the Fund of £2m p.a.

World café round table discussion - led by various LGPS moderators

Delegates addressed the following questions with conclusions shared via Sli.do "tweets". A selection of tweets are shown.

1. **Is the LGPS sustainable and affordable?**
    - Yes, meantime, but will need to be looked at again given the bleak state of LG finance.
    - It's only as sustainable as its employers.
    - It's undervalued and misunderstood by employees.
    - CARE is fairer but 1/49th is too generous.

2. **Do politics really matter in the long term?**
   - LGPS is a political football - does the government want the assets?
   - Political interference on global issues can make positive change e.g. Climate Change & Paris Agreement.
   - Political impact has the potential to influence positively and negatively over the long term.

3. **Should LGPS funds continue to hold most of their assets in the UK?**
   - Possibly overlooking wider opportunities and the benefits of diversification.
   - Can benefit from different markets, different cycles.

4. **What will be the key investment themes for the LGPS over the next 5 years?**
   - Alternatives including real assets, property, CDI, intangibles and residential.
   - Investment beliefs would remain critical to development of investment strategies in the LGPS.
   - Sustainable investment for a world worth living in, engagement not dis-investment, move from equities to alternatives, protective and defensive strategies.

5. **What significant changes in investment thinking did we see in 2018?**
   - Investing for cashflow and to give secure income.
   - What do we do when we are 100% funded?
   - Doubt after the bull run, confusion, downturn protection, equity hedging prior to the triennial valuations.

What happens after 29 March? - John Roe (LGIM)

- John placed Brexit in context by considering other long-term risks e.g. political populism, ageing world population and ESG factors.
- Growth in real incomes over the past decade had been heavily concentrated amongst the wealthiest parts of the global population. Bearing this in mind, it is unlikely that populism is set for a decline.
- LGIM is considering Brexit risks by assessing potential voting patterns across the House of Commons. There still remains a material minority in support for 'No Deal'.
- His advice on handling political risks was to "prepare, don't predict" and explained that economic and financial crises are rarely comparable in their cause or effects. Scenario analysis can help improve our understanding of portfolio risk.

How ESG factors can be embedded in investment strategy- Philip Ripman (Storebrand Global Solutions) & Dawn Turner (Brunel pool)

- Philip highlighted the increasing demand for funds to have 100% of capital aligned with UN ESGs or its sustainability beliefs.
- Storebrand follow a 5 step process taking a standard index fund to one with a 75% reduced carbon footprint but with a <1% tracking error. Analysis shows that this sort of approach does not involve a lowering of returns.
- Dawn spoke about Brunel's vision of "investing for a world worth living in".
- Brunel's approach to RI has involved integrating it into the pools' decision making, and collaborating with partner funds and outside organisations to drive change and share best ideas.

The 2019 Actuarial Valuation and reaching the best possible funding solutions- Barry McKay (Barnett Waddingham)

Barry spoke about the following valuation risks. Overall, 2019 contribution rates might not differ greatly from those at 2016.

- Data - despite the challenges of the CARE scheme, we need to improve data. Clean data results in more accurate, and often lower, liabilities as prudence can be reduced on the grounds of less uncertainty.
- Demographics - Lower life expectancy (due to slowing improvements) at this valuation compared with 2016 will result in liability savings at the 2019 valuation.
- Employer risk - funds should carefully consider the covenant of employers post Carillion and to evaluate the probability of both balance sheet insolvency and cashflow insolvency.
- Cashflow negativity - for some funds this will have changed considerably since 2016 and the tipping point at which Funds become cashflow negative, including investment income, could be as soon as 2021/22.
- Multi-employer strategies - align strategy with the covenant risks of individual employers.

An update of the review of the UK Stewardship Code - Jen Sisson (FRC)

The review will incorporate 5 key changes as below. Please feedback on the consultation.

- A new section on purpose, objectives and governance.
- Stewardship beyond UK listed equity (existing code is UK equity focused).
- Inclusion of ESG factors.
- Differentiation between roles.
- Reporting on polices, activities and outcomes.

Keynote speech: Making sense of current political turbulence - Andrew Rawnsley (The Observer)

- Andrew reeled off a political 'cast list' - Osborne, Cameron, Clegg, Miliband, Corbyn, May etc - that had gone through astonishing change over the past 4 years.
- Democracy and capitalism had spread inexorably around the globe during the 20th century but recent years suggest that the 21st century may follow a different trajectory. 9/11 and the 2007/8 financial crisis are still being acutely felt globally.
- Responses to the global financial crisis has led to widening inequality and economic discontent around the world and hastened the rise of populism. Popular opinion concludes that those who caused the crisis have suffered little in the way of penalties.
- On UK politics, the splintering of political parties potentially leads to coalitions and a slower pace of change. He believes a No Deal Brexit will be avoided due to a lack of a Commons majority and that Theresa May's much-maligned deal may rise in popularity (amongst Brexiteers) as the prospect of an extension becomes tangible.
- Andrew finished by reiterating that the only constant in uncertain times is volatility.