HYMANS ROBERTSON

Conference highlights

LGC Investment Seminar, Carden Park, Cheshire – 27-28 February 2020

This annual conference, chaired by Dawn Turner (Independent Advisor), provided the usual helpful mix of sessions on investment, governance and funding matters. Please get in touch with your usual Hymans Robertson contact if you wish to discuss something further.

27 February 2020

In conversation with…David Smith (Economics Editor, The Sunday Times)

David Smith began the conference by outlining the current uncertainties in the geopolitical and economic landscape:

- Investors are understandably concerned by the spread of the Coronavirus, with the WHO expected to announce that it had reached 'pandemic' status.
- With regards the UK, this year there was still a huge amount of work to do by the Government on Brexit – with it becoming clear that the EU and UK taking very different negotiating positions, and that the risk of a 'No Deal' departure remained and will keep UK businesses and investors on edge. Whatever the outcome on a Brexit deal, frictions would be introduced re supply-chains, and cause disruption – noting that, for example, the UK car industry relies on 'just in time' supply of parts from abroad.
- Highlighted the huge growth in private sector employment during the past 10 years, which has more than compensated for reduction in public sector employment driven by austerity.
- The US economy is now approaching 10 years of unbroken economic growth although recessionary indicators remain mixed.
- The Boris Johnson-led Tory government is clearly very interested in big, ambitious projects that catch the public attention (such as the recent headlines regarding building a bridge to Northern Ireland). With this approach there is real risk on overpromising and under-delivering. The Government is likely to spend on large infrastructure projects but we should expect far more restraint on other areas of spending.

The outcome of the 2019 valuation and its impact on investment strategies

Barry McKay (Partner and Fund Actuary, Barnett Waddingham), Jo Ray (Head of Pensions, Lincolnshire County Council), Phil Triggs (Tri-Borough Director of Pensions, Westminster City Council)

- All shared the story of the valuations from each of their perspectives. Key themes were that this has been a positive and therefore relatively straightforward valuation. Strong asset gains have led to improved funding levels and a reduction in deficits. Many funds may declare a surplus as at 31 March 2019 and there's a corresponding reduction in secondary contribution rates.

- Despite the gains, the more cautious outlook for future markets coupled with the potential added costs of both McCloud and cost management mean there is upwards pressure on primary rates. As always, a wide range of results for employers but on average total employer contribution rates are pretty stable.
- Barry gave an actuary's views on 2019 LGPS valuations which had confirmed strong average investment performance of c.10% pa during the last 3y, and considerably above 2016 discount rates. Whilst this has led to improved funding across the LGPS, Barry highlighted that there was an increasing level of divergence for individual LGPS Funds. Alongside the strong investment performance, we had generally seen life expectancy improvements slowing, and generally a fall in secondary rates being near enough offset by increases in primary rates and Funds grappling with various uncertainties – McCloud, Cost Management, Regulations, to name but a few.
- Jo gave her perspective on the 2019 valuation process from the Fund, and discussed her Fund's focus on improving data quality and stakeholder communications. With strong investment performance and improving funding levels (vs 2016) the 2019 valuation had run smoothly with overall contribution levels remaining stable and the Fund's "no surprises" approach to employer engagement being well-received.
- Phil discussed his take on investment strategy development noting the recent highs in equity markets and reflecting on the past 5 valuations he has been involved with. With material differences in funding positions for his largest employers, Phil noted that in future it may be reasonable to consider separate investment strategies depending on individual employers' circumstances. Through the 2019 valuation, Phil expected his Fund to continue its gradual shift away from listed equities and into income- assets such as property.

Investing for the climate emergency

Henrik Wold Nilsen (Senior Portfolio Manager, Storebrand Global ESG Plus), Michael Marshall (Director of Responsible Investment and Engagement, LGPS Central), Rachel Cowburn (Head of Pension Fund Investment, London Borough of Hackney)

- Henrik gave his perspective on building an equity portfolio that reflect climate risks, noting that there remains a huge lack of investment in renewable energy generation and storage - with 99% of investment in energy and energy storage still being focused on fossil fuels. Henrik noted the development of low carbon equity indices in recent years, and the need to understand how these index-strategies operate and optimise portfolio allocations. He cautioned that there was often a reallocation of risk in fossil fuel-related value chains – for example, with a reduction in allocations to oil and gas drilling often being replaced by increased allocations to oil and gas service businesses. He advocated a more rounded approach to climate risk management, rather than overly-focusing on a single, imperfect measure of climate risk exposure, such as carbon intensity.
- Rachel discussed her Fund's recent work on climate risk, explaining that historically her Fund hadn't made use of exclusionary policies but instead a preference towards engagement. However, this approach had changed in recent years, and been supported by the Council who were one of those to have declared a Climate Emergency. She discussed the Fund's engagement with local environmental activists, and their role in presenting both moral and financial reasons to lower fossil fuel exposure. The approach taken by the Fund had been to then evidence that climate change is a material financial factor, and to set a target to reduce by 50% carbon intensity of the Fund's equity portfolio over a 6 year period. She discussed the carbon risk audit carried out by the Fund in 2016 and noted the need to understand the data and its imperfections, such as the lack of inclusion of scope 3 carbon emissions.

- Michael then highlighted some concerns about some existing passive low carbon equity indices and the need to understand how portfolio allocations are affected, noting that these had been constructed to reduce carbon emissions or intensity, rather than being focussed on mitigating climate risk exposure more widely. Michael also noted that 'Paris alignment' was a challenge given the lack of progress of policymakers and government, and suggested Funds should focus on improving the resilience of their strategies to risks

What should keep LGPS awake at night?

John Roe (Head of Multi-Asset Funds, Legal & General Investment Management)

An interesting session on geopolitics and economics. John considered where the various economies are in the economic cycle and the outlook for each.

- Despite equity valuations looking full in the US, there was a lack of other indicators that the economic cycle was near its end
- The expansion of credit in China has been unprecedented and past history suggests it will be extremely difficult to deflate this bubble without material fallout
- One of the greatest risks to global economy is the lack of ammunition the central banks have to stave off, or limit the effects of, recession with government debt to GDP at record high levels.
- Given recent market falls, he considered whether the reaction of world equity markets to the coronavirus is overdone. He stated that his team re-bought equities late last night after the latest dip. The key determinant of the eventual outcome (and whether buying last night was a good decision) would be which of the two main scenarios the current outbreak falls into. One possibility is a mild pandemic, the impact of which has been more than priced into markets by recent falls, the other possibility is a serious pandemic which could ultimately result in a 20% fall.

Re-thinking Growth for the LGPS: Investing for the Long Term

Melissa Bennington (Managing Director, BlackRock)

Melissa explained the specific nature of their Private Equity Fund which aims to invest in private equity but with a much longer time horizon than typical – up to 20 years in some cases. The Fund is potentially perpetual and therefore avoids some of the challenges around the j-curve and cash drawdowns and distributions that typical LGPS funds face when investing in PE.

She shared some case studies of their typical investments

1. A family company in the luxury fragrance market. Founded 260 years, 6th generation of private/family management, long term focus. The family want to stay involved in the business but they can provide a source of capital.
2. Another private company, cycled through several PE managers in 3-4 year cycles and is now looking for an investor with a longer time horizon.

Embracing impact investing: is the LGPS making a difference?

Karen Shackleton (Founder, Pensions for Purpose), Jamie Broderick (Lead Expert for Investment Opportunities, Impact Investing Institute), Peter Wallach (Director of Pensions, Merseyside Pension Fund)

This session spent time discussing how the LGPS can think about impact investment and referred to the spectrum of capital chart. The presenters acknowledge that LGPS will never be philanthropic but can move along the spectrum and some Funds have already gone quite far on that journey. The UN sustainable development goals (SDGs) are a useful framework and Karen reported that in her experience the LGPS has prioritised three key SDGs for impact investment.

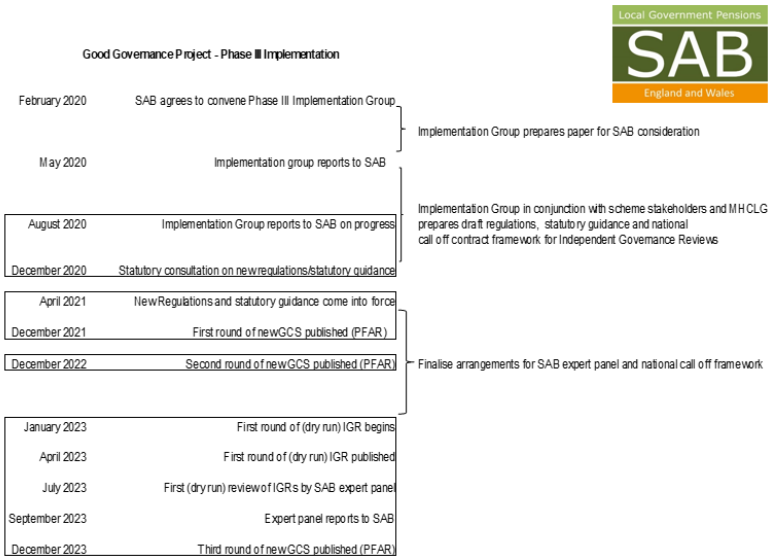
Other points of note included:

- Governance needs to be strong in this area, given it is new, but we should judge opportunities on their merits
- Karen suggested the use of the SDGs to assess Fund beliefs and focussing on 3-5 of the SDGs to be prioritised. With this narrower focus, the Fund is then able to develop actions and plans as appropriate. Whilst quantifying impact is a challenge, the Impact Management Project had recently released a report on how best to build consensus on measuring impact.

The Governance challenge ahead

Denise Le Gal (Independent Chair, Brunel Pension Partnership), Bob Holloway (Pensions Secretary, Local Government Association)

Bob provided an update on the Good governance project, explaining that the implementation group will work towards reporting to the SAB in May. The following is the proposed timetable for implementation.



Denise spoke on the future structure of the LGPS, from a personal perspective. She said it's important that the LGPS stocktake on where we are and reflect on what's working within pooling and what's not.

She cited the examples of other large funds internationally and proposed that the LGPS could be delivered better through four super funds/pools doing both administration and asset management.

LGPS and CIPFA update

Jeff Houston (Secretary, Local Government Pensions Scheme Advisory Board), Andrew Burns (Associate Director, CIPFA)

Jeff* was relentlessly positive and upbeat about the LGPS. We have the 5th largest scheme in the world, well funded, well run, increasing membership year on year, and global leaders in cost transparency and responsible investment. Our former minister, Rishi Sunak, is now Chancellor. We expect a lot of backlogged regulations to come through now**.

Andrew said that good governance comes at cost but the value exceeds the cost in many cases. A draft of the Knowledge and Skills framework refresh will be ready by end of March and they are aiming to consult in May. CIPFA are looking to influence what is required to put in Funds' annual accounts around the progress on environmental issues.

*(or an imposter who looked a lot like Jeff!)

** We have a couple of relatively minor issues to address. We'll get more certainty on the resolution to McCloud over the next month. It won't be nice, particularly for administration, but it'll be worse in the unfunded schemes. Oh, and at some point we'll have to deal with GMP equalisation/conversion too.

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