Nottinghamshire County Council

Report to Pensions Sub-Committee

10 November 2016

Agenda Item:8

REPORT OF SERVICE DIRECTOR – FINANCE, PROCUREMENT & IMPROVEMENT

LGC INVESTMENT SUMMIT 2016

Purpose of the Report

1. To report on the LGC Investment Summit 2016.

Information and Advice

2. The 28th LGC Investment Summit was held on 8 to 9 September 2015 at the Celtic Manor Resort, Newport. In accordance with prior approval and as part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills, the conference was attended by Mayor Kate Allsop, Alan Woodward (GMB) and Keith Palframan (Group Manager – Financial Strategy & Compliance).

Day One - Chaired by Mike Ellsmore, Chair of CIPFA Pensions Panel.

3. ***New Approach to Investment Strategy (Chris Hitchen, Chief Executive, RPMI and Railpen Investments)***
   Chris is managing an organisation that is similar to the expected structure of Pooled funds and he set out some of the issues he has dealt with during his time in charge.

   He stressed the importance of being clear on your aims (his mission statement is "To pay pensions securely, affordably and sustainably".) He stressed the education journey they have been on with their employers - now they get employers to "articulate their objectives" (growth, income or protection, and liquidity requirements) as opposed to "choosing asset types".

   He also reviewed some of their recent work on costs which highlighted
   - "Hidden" investment costs were 3 times the size of cheques written
   - 20% of assets gave rise to 2/3 of costs
   - Costs matter more when returns are low

4. ***Investment Solutions Vol. 1 – fixed income and credit (David Buckle of Fidelity, Stephen Marsh of T Rowe Price and Stephen Thariyan of HGI)***
   David kicked off this session providing initial background to recent events and current market conditions. This included the challenges that funds face in the current low yield environment with many global fixed income markets offering negative yields. However, he also set out the potential opportunities if investors are willing to look beyond the traditional

mainstream areas of the markets. This included Asian bond markets as one specific area that UK investors have tended to ignore and which he believes offers good value.

Stephen M then outlined how he believes investors can generate attractive returns in this climate through focussing on income based assets that generate attractive coupons but also active management to manage risk. Their approach was to promote a hedge fund style strategy to access fixed income markets that can capture the divergence that exists across global markets.

Stephen T outlined some of the challenges and uncertainties facing investors. However, he demonstrated how some credit markets have strengthened in terms of quality of credit and depth of market. He set out a yield curve for fixed income which allowed investors to capture the higher yields they needed by investing across a wider range of credit classes.

5. ***Managing assets and liabilities in the new pooling structures (Andy Green, CIO, Hymans Robertson)***

   Andy started out by looking at the progress of the LGPS as a whole since 2013, highlighting how the strong asset returns over the last three years have, on a like for like basis, improved the funding position of the scheme as a whole. However, he went on to show that when the gloomier economic outlook is taken into account the average return that Funds require to target full funding over the same time horizon has remained the same.

   Andy reminded us that most LGPS Funds are very reliant on equities and other assets dependent on global growth to drive that return. He proposed that these growth assets have a potentially limited upside over the medium term and considerable downside risks. He drew the attention of Funds to the predictable and reasonably attractive returns available on income asset classes such as high yielding debt, emerging market debt and property: these may enable Funds to still meet their required return target while running considerably less downside risk. He also noted that the very low interest rate environment should be favourable in creating more opportunities for Funds to invest in infrastructure projects.

   Andy concluded by looking at the challenges faced by investing through the new pooling arrangements in England & Wales. He highlighted the importance of clear investment beliefs held at Fund level in this structure. Finally, he noted that in a low return environment, the need to achieve whatever marginal gains are available through cost saving is even stronger.

6. ***Break out - focus 1 – finding the frontier (diversification) (John Roe of L&G)***

   John set out how he approaches allocating to investment markets including the role of diversification, the impact of asset allocation decisions and how he believes cheap methods of accessing markets can be more effective than active management. He then outlined how the approach could be applied to the LGPS to reshape investment strategies and improve outcomes with a focus on controlling investment costs.

7. ***Break out – focus 2 - maximising impact of asset allocation in pooled world (Matt Bullock of Wellington)***

   Matt gave insights into diversification of risks and whether investors are as diversified as they think against different economic scenarios. He referred to modelling that they have done for their funds and then extended the presentation into the construction of pools - will the managers chosen by pools give the desired diversification for funds?

8. ***Break out - focus 3 – investing to meet cash flows (Liam Kelly of Insight)***
   A common theme from the conference was the shifting cashflow profile of the LGPS and the need to meet net outflows from investments. Liam outlined the importance of managing the timing of growth asset sales and the risks of volatility in some asset classes in a cashflow negative environment. He then discussed the importance of contractual cashflows and how to build a strategy to generate required yields: this would be by investing across a range of credit asset classes and also meet ongoing income requirements.

9. ***Break out - focus 4 – harnessing the power of factors (Dimitris Melas of MSCI)***
   Dimitris outlined the work that MSCI had done in looking at the impact of different factors on investment outcomes. The question for investors remains whether active managers are replicating factor investing or if factor based index approaches are an efficient way of capturing returns within equity markets.

10. ***Info exchange - large pools and governance***
    Part 1 - Gavin Ralston from Schroders covered the features of big public funds around the world. The differing approaches of two (Alberta and Victoria) were particularly highlighted. The importance of asset allocation within these arrangements was highlighted as a driver of investment returns. Gavin also stressed the importance of schemes having a clear mission and highlighted the impact of "investment excellence" on deficit recovery.

    Part 2 - Jeff Houston from LGA: a quick update on pooling developments covering the changing political influence given the new government (shift to DCLG control? more constructive dialogue re infrastructure?), a timeline update and governance issues.

    The delegates then broke up into groups based on their proposed pools, and debated five questions before nominated group representatives fed back briefly. The responses from each pool were very consistent.

    Questions were - should pools have asset allocation capabilities (yes), what is the role of elected members (oversight of pool) and Local Pension Board (oversight of fund), will they invest in other pools (possibly, if deemed appropriate), any infrastructure they won't invest in (none if it delivers the required returns).

Day Two - Chaired by Nicola Mark, Norfolk Pension Fund.

11. ***Investment solutions vol 2 – growth assets and alternatives (Bill Landes, CTI and Vis Nayar, HSBC)***
    Bill's presentation set out the basics of alternative beta and how it can be used to take advantage of systematic risks and has diversification value. He then outlined how the strategy could be applied in a variety of client solutions.

    Vis's presentation mentioned that smart beta should be customised to the investors' needs and that the investor needs to ensure that their smart beta is what they sought and that it has not become "polluted". This included ways of incorporating ESG beliefs into a strategy without resulting in unintended portfolio biases.

12. ***LGPS investment framework – evolution, revolution or devolution? (Bob Holloway, DCLG)***

This was Bob's final presentation from his current role in DCLG before he leaves to join LGA in October. He updated us on the current status of the new investment regulations - with the Minister over the weekend and hopefully laid in the house in the next few weeks.

He noted that DCLG will not be as well-resourced going forward as it has been previously. He highlighted the important role that the Scheme Advisory Board will have going forward in providing a forum for both employer and member representatives, to develop and agree solutions to LGPS issues and take to ministers.

13. ***Investment solutions vol 3 – the search for income (Martyn Hole, Capital Group and Matthew Bance/Peter Cazalet of UBS)***

In contrast to many of the other sessions Martyn set out the case for equities and how they could be used as a solution to meeting the changing cashflow needs of the LGPS. He set out how dividend focussed equity strategies could both generate higher returns and be used as a source of income.

Peter was another speaker to highlight the potential cashflow challenges facing the LGPS. The problem being how to target growth while meeting short term cash outflows and managing long term liabilities.

Matt then provided some analysis showing the returns required to meet different income levels and how they believe a multi asset solution with a specific income sleeve can both meet the return requirements of the LGPS and also solve the cashflow problem.

14. ***Changes to come in the LGPS world (Councillor Roger Phillips, Chair of LGPS Scheme Advisory Board)***

In this final session, Roger reminded the audience of the environment within which the SAB's work is undertaken (local authority austerity, high levels of scrutiny, etc), before going on to set out the recent work of the Board. He quickly covered:

- The latest on the makeup of the Board and the politicians that they are dealing with.
- Echoing Bob Holloway's earlier talk he suggested that a lack of resource at DCLG is likely to mean more of a role for the SAB (and those who input to it) and others in driving the LGPS forward.
- Cost management – a reminder of the process and the role of the Scheme Advisory Board. Included was an explanation of the two (SAB and HMT) processes and why they are different. The SAB's commitment to (i) keeping costs as measured by the SAB process at the level agreed by the Heads of Agreement, and (ii) ensuring that the yield from employee contributions is achieved. It was also emphasised that bad (or good) investment returns fall outside the processes.
- Deficit management – a comparison of the funding positions of the unfunded and funded public sector schemes. Comments on the changing face of LGPS employers (e.g. recent changes in the education sector). A suggestion that the 2016 valuations look like being "not spectacularly good news". A quick reference to the GAD Section 13 work and a view that funding decisions should be made locally.
- Academy work - why they feel they need to do something and what they are looking for from PwC. In response to a question from the floor, he acknowledged the significance of the academy issue for both LEAs and LGPS funds and then referred to the "open" attitude of DfE and HMT personnel so far.
- Transparency of investment costs – a "template" for reporting based on a Dutch approach is expected to be launched in the next few months

In closing, Roger stressed the importance that he will place on transparency and communication. His aim is that the SAB "will be an asset for the LGPS" by working with all stakeholders to ensure that they can advise the minister wisely, which in turn will mean that the SAB will have more influence in the corridors of Westminster.

Statutory and Policy Implications

15. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That it be noted that attendance at key conferences is part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills.
2) That the report be noted

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Constitutional Comments

16. Because this report is for noting only, no Constitutional Comments are required.

Financial Comments (KRP 17/10/16)

17. There are no financial implications arising from this report.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

None