London Borough of Hammersmith & Fulham

Pension Fund Sub-Committee

Minutes

Tuesday 23 June 2020

PRESENT

Committee members: Councillors Iain Cassidy, Rebecca Harvey, PJ Murphy and Matt Thorley

Co-opted members: Michael Adam

Other Councillors: Phil Triggs (Director of Treasury and Pensions), Timothy Mpofu (Pension Fund Manager), Trevor Webster (Human Resources), Mary Lamont (Head of People & Talent), Dawn Aunger (Assistant Director People and Talent), Rhian Davies (Director of Resources), Matt Hopson (Strategic Investment Manager), Emily Hill (Director of Finance), Amrita Gill (Clerk)

Officers: Kevin Humpherson (Deloitte)

1. MINUTES OF THE PREVIOUS MEETING

RESOLVED –
THAT, the minutes of the meeting held on 11th February 9th March 22nd April were approved by the chair

2. APOLOGIES FOR ABSENCE

There were no apologies for absence.

3. DECLARATIONS OF INTEREST

There were no declarations of Interest.

4. H&F PENSION ABATEMENT - PROPOSED ABOLISHMENT

Trevor Webster, (Human Resources) introduced the item and explained that this report recommended that from 1st July the Council should cease operating the abatement of pension benefits for certain H&F pensioners who were re-employed by an employer that operated the Local Government Pension Scheme (LGPS). This would bring the Council inline with most other London local authorities and would eliminate all current discrepancies in the treatment of pensioners who may be re-employed following their retirement.

Until 31 March 1998 abatement was mandatory in the LGPS. From 1 April 1998 until 31 March 2014 it was discretionary. Trevor Webster also explained the reasons why this policy was no longer relevant to the Council and the rational for ceasing the abatement.

Trevor Webster (Human Resources) noted that currently the Council had four pensioners whose pension was abated. The responsibility fell on the re-employed pensioner to inform the Surrey Pensions Team of any re-employment to which abatement may be applied.

Councillor PJ Murphy asked if there was any financial impact on the four pensioners whose pension was abated. In response Trevor Webster explained that the four pensioners would receive their full pension from 1st July, however they wouldn't be entitled to any backdated pension if the recommendations were agreed by the Pension Fund Sub-Committee. Contact would be made with the pensioners and their pension would be increased by a relatively small amount to bring it inline with the changes. For these pensioners, the estimated increased pension costs were under £50,000 a year. The longer-term impact would depend on the number of LBHF pensioners with pre-2014 service who had re-employed, however the impact was expected to be insignificant compared to the total liabilities of the Fund.

RESOLVED -
THAT, the Council from 1st July ceased the abatement of pension benefits for eligible H&F pensioners who were re-employed by an employer that operates the LGPS.

5. INVESTMENT STRATEGY UPDATE

Kevin Humpherson (Deloitte) provided an update and noted that the pension fund had been invested in the M&G Inflation Opportunities Fund (IOF) since 2015. As at 30 April 2020, the pension fund had £113.0m invested with the Fund. In February 2020, the pension fund approved an asset allocation of 10% to inflation strategies and 5% to property. To meet the inflation objectives of this mandate, the M&G IOF had a sizeable allocation to long lease property. This allocation effectively meant that the pension fund's exposure to long lease property was around 9%, and exposure to UK commercial property (including income strips and ground rents) was around 13.5%. Whilst the Fund had outperformed its return objective since inception, it had largely underperformed its expected sector allocation. 84% of the Fund was exposed to UK commercial property compared with the expected 55% target allocation. The Fund had a larger exposure to the office, hotel and leisure sectors which had been significantly impacted by the lockdown measures put in place earlier this year as a means to minimise the spread of the coronavirus disease. In addition, the Fund had faced some challenges in rent collection which had led to more rent deferrals from the tenants. As a result, the pension fund faced an increase to its cash flow risk which could lead to increased difficulties in paying out pension benefits if this was not addressed.

Therefore, the Pension Fund Sub-Committee was recommended to either partially or fully disinvest from the M&G IOF and commence the search for a replacement manager to achieve the Fund's diversification targets.

The earliest point of redemption would be 1st September and monies would be distributed 30 business days after. The fund manager had discretion whereby they don't have to distribute more than 5% in any one dealing date. The Council's total holding within the Fund was 22% therefore a full disinvestment could be distributed over a 5-month period should this be necessary. In addition, there would be an option to keep the income strip allocation. However, it was felt that this wouldn't be a viable option. In addition, a dilution levy would be applied purely based on market pricing in September 2020. This would be 25 basis points as an estimate.

Kevin Humpherson explained that going forward the Council would need to explore alternative options to reallocate the investment. Some of the factors to consider when reviewing alternative options would be exposure to UK property, exposure to UK linkage and expected return on the Fund as a whole. A number of discussions had been held with some fund managers as a possible alternative to M&G. In the long term, the proceeds should be invested in assets which delivered inflation linked income while adding diversification to the Fund, such as infrastructure debt. Recognising this would take time to identify and select, and was not helped by the current market conditions,

Phil Triggs (Director of Treasury and Pensions), commented that officers agreed with Deloitte's suggested approach, primarily on the basis that the existing M&G portfolio was over exposed in several sectors and this was exemplified with the impact of Covid-19 and the potential downturn possibility that it placed on the future prospects for that part of the portfolio.

Councillor Matt Thorley asked whether there was a risk of a longer exit from the Fund due to the 5% cap if the Council partially disinvested and at what stage would the Council need to allocate the capital. Kevin Humpherson provided an outline on what it would mean to partially disinvest and how long this could take. He noted that the fund manager had discretion to defer a full redemption request and implement on successive dealing dates. The fund manager would review the liquidity of the portfolio at the time to determine how much of the redemption could be executed on the dealing date.

Councillor PJ Murphy asked for clarification around the total property exposure to the Fund. He also asked if a partial disinvestment was carried out, were Officers confident that the Fund would perform whilst the Council explored other investment options, particularly around sustaining the inflation balance. Kevin Humpherson explained that the over total exposure to property was 13.5%. Full sale of M&G would take this down to 5% and a partial disinvestment would bring this to 9.25%. The Council would have expected a 7.5% exposure to the property market via the M&G fund if the recent changes to the market had not taken place. It was difficult to predict the performance at this stage. This would depend on how quickly tenants were able to pay their leasing.

Michael Adam felt that a full divestment would result in a better outcome, given M&G's exposure to certain chains. In addition, it was important to consider retaining high RPI linkage in the Fund and if there was an opportunity to replace it with other RPI linked assets in the future, this would be beneficial.

The Chair asked for further clarification to be provided around timescales for an alternative investment option. Phil Triggs said that further discussions around potential options could be discussed as part of the weekly calls with the Chair, with the view to present a few other products at the next meeting.

Phil Triggs (Director of Treasury and Pensions), explained that following the disinvestment from the LCIV UK Equity Fund, completed in December 2019, the Fund's 45% strategic allocation to equities was entirely invested in the Legal & General World Low Carbon Equity Index Fund. As at 31 March 2020, the Fund had £411.5m of its investment portfolio invested in the passive Fund. In April 2020, the Sub-Committee, met with the pension fund's officers and investment consultant to discuss how best to position itself to minimise its downside risk exposure and take advantage, via active management, of the prevailing uncertainty in the financial markets at the time.

Subsequently, the Sub-Committee decided to allocate a third of the pension fund's equity allocation (15% of its overall investment portfolio) to an active equity manager and requested its investment consultant to present a shortlist of suitable strategies for the pension fund. On 11th May 2020, four investment managers presented their strategies to the Sub-Committee. Following this an agreement was reached to appoint Morgan Stanley, who managed the LCIV Global Equity Sustain Fund, as the pension fund's new active equity manager. This decision was taken outside of the Sub-Committee and this paper had been brought to this Sub-Committee for formal ratification and approval.

The Sub-Committee expressed a clear preference for Morgan Stanley's investment process, citing the concentrated portfolio and lower correlation to the market. The Sub-Committee was particularly impressed with how the investment manager integrated environmental, social and governance (ESG) factors into their investment process. The pension fund considered ESG related risks to be a significant factor in the long-term sustainability of the global environment.

The Chair asked for an update to be provided on how this investment had an impact on the Fund's overall carbon footprint. In response Phil Triggs said that the Council's ESG dashboard was being monitored and updated on a regular basis. The exact figures would be included as an agenda item for the next Sub-Committee meeting.

RESOLVED -
THAT, the Sub-Committee

a. Formally approved the investment decision to investment 15% of the pension fund’s investment assets into the LCIV Global Equity Sustain Fund.
b. Approved the decision to a full disinvestment from the M&G Inflation Opportunities Fund and commence the search for a replacement manager.

6. EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED –

THAT, under section 100A (4) of the Local Government Act 1972, the public and press be excluded from the meeting during the consideration of the following items of business, on the grounds that they contain the likely disclosure of exempt information, as defined by paragraph 3 of Schedule 12A of the said Act and that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

7. EXEMPT MINUTES OF A PREVIOUS MEETING

RESOLVED –

THAT, the minutes of the meeting held on 9th were approved by the chair

8. INVESTMENT STRATEGY UPDATE - EXEMPT APPENDICES

The exempt elements of the report were noted.

Meeting started: 6:30pm
Meeting ended: 7:30pm

Chair ....

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