Public Document Pack

**Governance and Human Resources**
**Town Hall, Upper Street, London, N1 2UD**

# AGENDA FOR THE PENSIONS SUB COMMITTEE

Members of the Pensions Sub Committee are summoned to a meeting which will be held in Committee Room 5, Town Hall, Upper Street, N1 2UD on, **14 September 2015 at 7.30 pm,** or at the rise of the of the Pensions Board, whichever is the earlier

**John Lynch**
**Head of Democratic Services**

| | | |
|---|---|---|
| Enquiries to | : | Mary Green |
| Tel | : | (020) 7527 3005 |
| E-mail | : | democracy@islington.gov.uk |
| Despatched | : | 2 September 2015 |

| Membership 2015/16 | Substitute Members |
|---|---|
| Councillor Richard Greening (Chair) | Councillor Alex Diner |
| Councillor Andy Hull | Councillor Jean Roger Kaseki |
| Councillor Michael O'Sullivan | Councillor Alice Perry |
| Councillor Rupert Perry | Councillor Paul Smith |

**Quorum is 2 members of the Sub-Committee**

| | | |
|---|---|---|
| **A.** | **Formal Matters** | **Pages (approximate times)** |
| 1. | Apologies for absence | |
| 2. | Declaration of substitutes | |
| 3. | Declaration of interests | |

If you have a Disclosable Pecuniary Interest* in an item of business:

- if it is not yet on the council's register, you must declare both the existence and details of it at the start of the meeting or when it becomes apparent;
- you may choose to declare a Disclosable Pecuniary Interest that is already in the register in the interests of openness and transparency.

In both the above cases, you must leave the room without participating in discussion of the item.

If you have a personal interest in an item of business and you intend to speak or vote on the item you must declare both the existence and details of it at the start of the meeting or when it becomes apparent but you may participate in the discussion and vote on the item.

*(a) Employment, etc - Any employment, office, trade, profession or vocation carried on for profit or gain.
(b) Sponsorship - Any payment or other financial benefit in respect of your expenses in carrying out duties as a member, or of your election; including from a trade union.
(c) Contracts - Any current contract for goods, services or works, between you or your partner (or a body in which one of you has a beneficial interest) and the council.
(d) Land - Any beneficial interest in land which is within the council's area.
(e) Licences- Any licence to occupy land in the council's area for a month or longer.
(f) Corporate tenancies - Any tenancy between the council and a body in which you or your partner have a beneficial interest.
(g) Securities - Any beneficial interest in securities of a body which has a place of business or land in the council's area, if the total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body or of any one class of its issued share capital.

This applies to all members present at the meeting.

| | | |
|---|---|---|
| 4. | Minutes of the previous meeting | 1 - 4 (19:35) |
| **B.** | **Non-exempt items** | |
| 1. | Pension Fund performance from April to June 2015 | 5 - 40 (19:40) |
| a. | Quarterly WM Company performance report (to follow) | |
| b. | Presentation from AllenbridgeEPIC Investment Advisers on quarterly performance | |

| | | |
|---|---|---|
| 2. | Currency hedging - presentation by AllenbridgeEpic | 41 - 48<br>(20:00) |
| 3. | Presentation from Standard Life Capital - private equity in Europe<br>(10 minute presentation followed by 10 minute Q&A) | (20:20) |
| 4. | Presentation from Pantheon - private equity USA<br>(10 minute presentation followed by 10 minute Q&A) | (20:40) |
| 5. | Five-year business update | 49 - 56<br>(21:00) |
| 6. | Responsible investment and engagement | 57 - 74<br>(21:20) |
| 7. | Pensions Sub-Committee - Forward Plan 2015-16 | 75 - 78<br>(21:45) |

**C. Urgent non-exempt items**

Any non-exempt items which the Chair agrees should be considered urgently by reason of special circumstances. The reasons for urgency will be agreed by the Chair and recorded in the minutes.

**D. Exclusion of press and public**

To consider whether, in view of the nature of the remaining items on the agenda, any of them are likely to involve the disclosure of exempt or confidential information within the terms of Schedule 12A of the Local Government Act 1972 and, if so, whether to exclude the press and public during discussion thereof.

**E. Confidential/exempt items (if any)**

**F. Urgent exempt items**

Any exempt items which the Chair agrees should be considered urgently by reason of special circumstances. The reasons for urgency will be agreed by the Chair and recorded in the minutes.

The next meeting of the Pensions Sub Committee will be on 9 November 2015

This page is intentionally left blank

London Borough of Islington

**Pensions Sub Committee - 11 June 2015**

Non-confidential minutes of the meeting of the Pensions Sub-Committee held at the Town Hall on 11 June 2015 at 7.30 pm.

| | | |
|---|---|---|
| **Present:** | **Councillors:** | Richard Greening (Chair), Andy Hull (Vice-Chair) and Rupert Perry |
| **Also Present:** | | Marion Oliver, pensioner member representative<br>Thelma Harvey (substitute pensioner member representative and observer)<br>Bob Anderson (observer)<br>Maggie Elliott (observer)<br>Councillor Dave Poyser (observer)<br><br>Catherine Bermingham and Nikeeta Kumar, Mercer Investment Consulting<br>Karen Shackleton, AllenbridgeEpic Investment Advisers |

**Councillor Richard Greening in the Chair**

**57** **APOLOGIES FOR ABSENCE (Item 1)**
Received from Vaughan West and Councillor Michael O'Sullivan .

**58** **DECLARATION OF SUBSTITUTES (Item 2)**
None.

**59** **DECLARATION OF INTERESTS (Item 3)**
None.

**60** **MINUTES OF THE MEETING HELD ON 9 MARCH 2015 (Item 4)**

**RESOLVED**:
That the minutes of the meeting held on 9 March 2015 be confirmed as a correct record and the Chair be authorised to sign them.

**61** **PENSIONS ADMINISTRATION PERFORMANCE FROM 1 FEBRUARY TO 31 MAY 2015 (Item B1)**
The Chair observed that the administration performance report would, in future, be submitted to the Pensions Board for consideration.

**RESOLVED:**
(a) That the performance against key performance indicators for the period from 1 February to 31 May 2015, including statistics regarding the internal dispute resolution procedure, complaints and compliments, as detailed in the report of the Corporate Director of Finance and Resources, be noted.
(b) That it be noted that Marion Oliver and Thelma Harvey (substitute) had been appointed to represent retired members, both on the Sub-Committee and the Board.

## 62 PENSION FUND PERFORMANCE FROM 1 JANUARY TO 31 MARCH 2015 (Item B2)

**RESOLVED**:
(a) That the performance of the Fund from 1 January to 31 March 2015, detailed in the report of the Corporate Director of Finance and Resources, be noted.
(b) That the quarterly WM Company report on the overall performance, updated market value and asset allocation of the Fund as at 31 March 2015, detailed in Appendix 1 to the report, be noted.
(c) That the report by AllenbridgeEpic Investment Advisers on fund managers' quarterly performance, detailed in Appendix 2 to the report and their presentation, be noted.
(d) That the information in the Mercer bulletin of May 2015, entitled "May 2015 LGPS Current Issues", attached as Appendix 3 to the report, be noted.
(e) That the information in Appendix 4 to the report, entitled "Financial Conduct Authority fine of BNY Mellon", the Fund's custodian, be also noted.

## 63 PRESENTATION FROM STATE STREET - WM ANNUAL PERFORMANCE OF FUND (Item B3)

David Cullinan, State Street Global Services, gave a presentation on the annual performance of the Fund. Copies of the presentation were circulated to members.

He reported that Islington's Fund had performed in line with the sector average over the longer term, returning 5% pa ahead of inflation. The following points were noted:

- That strong equity/property returns had boosted asset values, but equally strong bond returns had inflated liability values
- The Fund had enjoyed healthy absolute returns but had lagged the benchmark in the short to medium term
- The impact of overseas equity underperformance from 2008 -2010 remained

Members discussed the underperformance of UK equity this year compared to overseas and whether to reduce the exposure of the In-House passive fund to global exposure. It was noted that, in general, most pension funds had moved to a global approach.

In response to a question as to why Islington held a currency hedge fund and the cost of fees, it was reported that only equities were hedged and the fees were £5k per year. Karen Shackleton undertook to submit an information report to the next meeting of the Sub-Committee on currency hedging.

**RESOLVED:**
That the presentation be noted.

## 64 PRESENTATION FROM LEGAL AND GENERAL - PASSIVE GLOBAL EQUITIES (Item B4)

The Sub-Committee welcomed Chris Lyons, Client Relationship Manager at Legal and General Investment Management, to the meeting. A presentation on Islington's Fund was circulated to members. This covered the management of Islington's overall assets, portfolio activity and performance, a description of the FTSE RAFI fundamental index and the Legal and General asset allocation views at June 2015.

In response to a question about the number of basis points paid by Islington to Legal and General, Mr Lyons referred to the relevant page in the presentation and explained that the RAFI was more expensive as it carried a licence fee. He confirmed that, if Islington invested more into the Fund, the fee structure would be reviewed.

**RESOLVED:**
That the presentation be noted.

**65** **PRESENTATION FROM ACTUARY - FUNDING UPDATE (Item B5)**
Ian Kirk, Principal at Mercer, accompanied by Jonathan Perera, gave a presentation on the funding position of the Fund as at March 2015. It was noted that the deficit had increased since 2013 because both assets and liabilities had continued to rise. The 2016 actuarial valuation issues for consideration, including a recap of the 2013 position were also discussed.

Members noted the low yield on gilts, as compared with, say, property investment.

For the future, alternative approaches on assumptions and the potential impact on contributions would need to be considered.

**RESOLVED:**
That the presentation be noted.

**66** **PENSION SUB-COMMITTEE - FORWARD PLAN 2015/16 (Item B6)**
**RESOLVED:**
That the following amendments be made to the Forward Plan of business for meeting of the Sub-Committee for 2015/16, detailed in Appendix A to the report of the Corporate Director of Finance and Resources:

14 September 2015 – add “Private equity” presentation

16 November 2015 – add “Franklin Templeton” presentation

The meeting ended at 9.50 pm

**CHAIR**

This page is intentionally left blank

ISLINGTON

**Finance Department**
**7 Newington Barrow Way**
**London N7 7EP**

**Report of: Corporate Director of Finance and Resources**

| **Meeting of:** | **Date** | **Agenda item** | **Ward(s)** |
|---|---|---|---|
| Pensions Sub-Committee | 14 September 2015 | | n/a |

| **Delete as appropriate** | ~~Exempt~~ | Non-exempt |
|---|---|---|

## Subject: PENSION FUND PERFORMANCE 1 APRIL to 30 JUNE 2015

## 1. Synopsis

1.1 This is a quarterly report to the Pensions Sub-Committee to allow the Council as administering authority for the Fund to review the performance of the Fund investments at regular intervals and review the investments made by Fund Managers quarterly.

## 2. Recommendations

2.1 To note the performance of the Fund from 1 April 2015 to 30 June 2015

2.2 To note the quarterly WM Company report on the overall performance updated market value and asset allocation of the fund as at 31 march 2015 at Appendix 1 (to follow)

2.3 To receive the presentation by Allenbridge EPIC Investment Advisers, our independent investment advisers, on our fund managers' quarterly performance attached as Appendix 2.

2.4 To receive a presentation by Standard Life Capital, our private equity portfolio manager to discuss performance since inception and their future outlook.

2.4 To receive a presentation by Pantheon Investments, our private equity portfolio manager to discuss performance since inception and their future outlook.

2.5 To note for information the Mercer bulletin- LGPS Current Issues-August 2015" attached as Appendix 3.

## 3. Fund Managers Performance for April to June 2015

3.1 The fund managers' latest quarter net performance figures compared to the benchmark is shown in the table below.

| Fund Managers | Asset Allocation | Mandate | Latest Quarter Performance (April-June'15 Net of fees | | 12 Months to June 2015 Performance Net of fees | |
|---|---|---|---|---|---|---|
| | | | Portfolio | Benchmark | Portfolio | Benchmark |
| LBI-In House | 31% | UK equities | -1.0% | -1.6% | 3.6% | 2.6% |
| AllianzGI (RCM) | 9% | Global equities | -4.3% | -5.0% | 11.0% | 10.2% |
| Newton | 13% | Global equities | -4.0% | -5.0% | 13.6% | 10.2% |
| Legal & General | 7% | Global equities | -3.5% | -3.2% | 2.9% | 3.5% |
| Standard Life | 20% | Corporate bonds | -4.0% | -3.9% | 6.1% | 6.5% |
| Aviva (1) | 5% | UK property | 2.4% | -4.5%<br>3.6% | 8.3% | 11.8%<br>16.7% |
| Columbia Threadneedle Investments (TPEN) | 6% | UK commercial property | 3.5% | 3.3% | 16.1% | 15.5% |
| Hearthstone | 2% | UK residential property | 9.3% | 0.9% | 17.2% | 4.8% |

(1) -4.5% and 11.8% = original Gilts benchmark; 3.6% and 16.7% are the IPD All property index; for information

3.2 The WM Company quarterly report (enclosed as Annex A) gives a detailed analysis of our fund managers' latest quarter performance as well as the combined fund performance. The fund's June 2015 market value and asset allocation is also shown in this report. Members are asked to note this report.

3.3 The combined fund performance for the last quarter ending June 2015 is shown in the table below. The Fund's quarterly over performance of 1.5% was attributable to 1.2 % of stock selection and 0.4% of asset allocation.

| Combined Fund Performance | Latest Quarter Performance **Net** of fees | | 12 Months to June 2015 Performance Net of fees | |
|---|---|---|---|---|
| | Portfolio % | Benchmark % | Portfolio % | Benchmark % |
| LB of Islington Fund | -1.0% | -2.5% | 7.2% | 6.9% |

3.4 Copies of the latest quarter fund manager reports are available to members for information if required.

3.5

The WM local authority universe is group of pension funds of similar characteristics but different sizes and deemed as a peer group for comparison. The Islington combined fund performance over the 1, 3 and 5 years period to June 2015 compared to its customised benchmark and percentile ranking are shown in the table below.

| Period | 1 year per annum | 3 years per annum | 5 years per annum |
|---|---|---|---|
| Combined LBI fund performance | 7.2% | 10.8% | 10.0% |
| LBI customised benchmark | 6.9% | 10.3% | 9.8% |
| Percentile ranking in the peer group | 63 | 50 | 48 |

A summary page showing the fund's long term returns at asset class level with its rankings in the WM LA Universe peer group is attached as Appendix 1.

3.6 **AllianzGI (RCM)**

3.6.1 AllianzGI (formerly known as RCM) is the fund's global equity manager with a mandate to outperform the FTSE All World Index Benchmark by 3% per annum, gross of fees, measured over a 3-year rolling period from 8 June 2011.

3.6.2 In the June quarter the fund out performed net of fees by returning -4.3 % against a benchmark of -5.0%. Since inception in December 2008, portfolio has returned 12.5% against a benchmark of 13.8% net of fees with a relative underperformance of -1.3% per annum.
.

3.6.3 Stock selection in health care and technology and under weights positions in utilities and basic materials were positive while stock selection in industrials and oil and gas sectors were the main detractors on performance. US stock selection was positive while China was negative.
There was a withdrawal of £25million to fund our new DGF manager on 2 July.

3.7 **Newton Investment Management**

3.7.1 Newton is the fund's other global equity manager with an inception date of 1 December 2008. The objective of the fund is to outperform the FTSE All World Index by 2.0% per annum over rolling 3 year periods, net of fees.

3.7.2 The fund outperformed by returning -4.0% net of fees against a benchmark of -5.0% for the June quarter. Since inception the fund has delivered a relative over performance of 0.3% per annum.

3.7.3 The outperformance this quarter was driven mainly by stock selection and asset allocation within healthcare, consumer services and technology. Stock selections in healthcare sector were the main detractor.

3.8 **In House Tracker**

3.8.1 Since 1992, the UK equities portfolio of the fund has been managed in-house by officers in the Loans and Investment section by passive tracking of the FTSE 350 Index. The mandate was amended as part of the investment strategy review to now track the FTSE All Share Index within a +/- 0.5% range per annum effective from December 2008. The fund returned -1.0% against a benchmark of -1.6% for the June quarter.

3.8.2 On the last day of the quarter, a sale of around £71million was transacted in preparation for the draw down to Schroders our new DGF manager. There was also a draw down to Aviva of £5m on 10 June. The funds were transferred in July and so will be reflected in the next quarter.

3.9 **Standard Life**

3.9.1 Standard Life has been the fund's corporate bond manager since November 2009. Their objective is to outperform the Merrill Lynch UK Non Gilt All Stock Index by 0.8% per annum over a 3 year rolling period. During the June quarter, the fund returned -4.0% against a benchmark of -3.9% and a 3 year relative return of 0.7% per annum.

3.9.2 The main driver behind the underperformance during the quarter was a significant rise in underlying government bond yields and also a widening of credit spreads.

3.9.3 The forward strategy is to continue with an overweight credit risk profile relative to the benchmark index, at the expense of an underweight exposure to bonds issued by supranationals and higher quality industrials. Duration and curve positioning are being kept relatively neutral.

3.10 **Aviva**

3.10.1 Aviva manages the fund's UK High Lease to Value property portfolio. They were appointed in 2004 and the target of the mandate is to outperform their customised gilts benchmark by 1.5% (net of fees) over the long term. The portfolio is High Lease to Value Property managed under the Lime Property Unit Trust Fund.

3.10.2 The fund for this quarter delivered a return of 2.4% against a gilt market of -4.5 %. The All Property IPD benchmark returned 3.6% for this quarter. Since inception the fund has delivered an absolute return of 6.65% net of fees.

3.10.3 This June quarter saw the purchase completion of 2 offices in White City, London totalling £220m and a supermarket of £50m. Terms have also been agreed for the sale of an existing supermarket. The fund has maintained an unexpired average lease term of 20.1 years and increased diversification. Lime is well positioned to deliver attractive returns over the medium term.

3.10.4 The fund now holds 69 assets with 43 tenants and a 0% void.

3.11 **Columbia Threadneedle Property Pension Limited (TPEN)**

3.11.1 This is the fund's UK commercial pooled property portfolio that was fully funded on 14 October 2010 with an initial investment of £45 million. The net asset value at the end of June was £64.9million.

3.11.2 The agreed mandate guidelines are as listed below:

- Benchmark: AREF/IPD All Balanced Property Fund Index (Weighted Average) since I January 2014.
- Target Performance: 1.0% p.a. above the benchmark (net of fees) over three year rolling periods.
- Portfolio focus is on income generation with c. 75% of portfolio returns expected to come from income over the long term.
- Income yield on the portfolio at investment of c.8.5% p.a.
- Focus of portfolio is biased towards secondary property markets with high footfall rather than on prime markets such as Central London. The portfolio may therefore lag in speculative/bubble markets or when the property market is driven by capital growth in prime markets.

3.11.3 The fund returned 4.6% against its benchmark of 3.5% for the June quarter and a rental income yield of 6.2%. The cash balance now stands at 6.2% of the fund and the aim is to maintain it within a range of 5 to 10% throughout 2015. There is a strong asset diversification at portfolio level with a total of 259 properties, an increase of 6 from last quarter. The medium to long term prospects of commercial property will be dominated by rental income supported by modest capital value growth and the Fund is well positioned to benefit from this.

3.12 **Passive Hedge**

3.12.1 The fund currently hedges 50% of its overseas equities to the major currencies dollar, euro and yen. The passive hedge is being run by BNY Mellon our custodian. At the end of the June quarter, the hedged overseas equities returned -2.9% compared to the unhedged combined return of -4.3%. The hedged position delivered an outperformance in market value of around £4million.

3.13 **Franklin Templeton**

3.13.1 This is the fund's global property manager appointed in 2010 with an initial investment commitment of £25million. Members agreed in September 2014 to re-commit another $40million to Fund II to keep our investments at the same level following return of capital through distributions from Fund I. The agreed mandate guidelines are listed below:

- Benchmark: Absolute return
- Target Performance: Net of fees internal rate of return of 15%. Preferred rate of return of 10% p.a. with performance fee only applicable to returns above this point.
- Bulk of capital expected to be invested between 2 – 4 years following fund close.

- Distributions expected from years 6 – 8, with 100% of capital expected to be returned approximately by year 7.

3.13.2 Fund I has now been fully committed. The remaining capital commitments $10m will be drawn down in the future as per business plans. The final portfolio is comprised of nine funds and five co-investments. The funds is well diversified as shown in table below:

| Commitments | Region | % of Total Fund |
|---|---|---|
| 5 | Americas | 36 |
| 4 | Europe | 26 |
| 5 | Asia | 38 |

During the quarter there was a capital call of $4.1m and a distribution of $3.5m, bringing total distribution received to $19.5m

3.13.3 Fund II has made 2 investments to date in Europe, in the retail sector. The projected geographic exposure is 57% Asia and 43% Europe. No capital drawdowns have been requested.

3.14. **Legal and General**

3.14.1 This is the fund's passive overseas equity index manager. The fund inception date was 8 June 2011 with an initial investment of £67million funded from transfer of assets from AllianzGI (RCM). The funds are managed passively against regional indices to formulate a total FTSE All World Index series. The portfolio returned -3.5% net of fees against a benchmark of -3.2% for the quarter with a 12 months relative return -0.4%. The 3 year absolute return is 6.0% with a market value of £73m

3.15 **Hearthstone**

3.15.1 This is the fund's residential UK property manager. The fund inception date was 23 January 2013, with an initial investment of £20million funded by withdrawals from our equities portfolios**.** The agreed mandate guidelines are as follows:

- Target performance: UK HPI + 3.75% net income.
- Target modern housing with low maintenance characteristics, less than 10 years old.
- Assets subject to development risk less than 5% of portfolio.
- Regional allocation seeks to replicate distribution of UK housing stock based on data from Academics. Approximately 45% London and South East.
- 5-6 locations per region are targeted based on qualitative and quantitative assessments and data from Touchstone and Connells.
- Preference is for stock which can be let on Assured Shorthold Tenancies (ASTs) or to companies.
- Total returns expected to be between 6.75% and 8.75% p.a., with returns split equally between income and capital growth. Net yields after fund costs of 3.75% p.a.
- The fund benchmark is the LSL Academetrics House Price Index

3.15.2 For the June quarter the value of the fund investment was £25m and total funds under management are £36.2million. Performance net of fees was 9.3% compared to the benchmark of 0.9%., and 12 month relative return 11.9%. The income yield after cost was 5.0%. The portfolio has 125 properties, 56 are let on licence and leaseback agreement to house builders and 64 properties let on assured short term agreements.

3.15.3 5 properties have received notices to vacate by end of July and August. 4 of properties are reserved from July and the rest are being actively marketed. There were 5 vacant properties at the end of June for which 4 applications had been received to commence in July.

3.16 **LGPS London Common Investment Vehicle Update**

Members agreed in 2013 to commit £25,000 to the set up cost of "exploring the proposal "and be a shareholder. This allowed membership on the board and the option to invest once it was up and running.

3.16.1 In March 2015, Members considered an update on progress made and a detailed cost and benefit analyses produced by CIV working party and agreed to contribute the additional £50,000 requested to be paid in two tranches. The Council has now paid the £25,000 as invoiced

3.16.2 The CIV is progressing with the creation of governance structures and the recruitment of key staff; executive and non-executive directors. Hugh Grover has been appointed as Chief Executive and the recruitment of 2 other executives and 4 non-executive directors is underway. FCA registration approval for the company and joint investment funds is progressing and it is expected that investments will be up and running by the end of 2015.

## 4. Implications

4.1 **Financial implications:**

The fund actuary takes investment performance into account when assessing the employer contributions payable, at the triennial valuation.

Fund management and administration fees and related cost are charged to the pension fund.

4.2 **Legal Implications:**

As the administering authority for the Fund, the Council must review the performance of the Fund investments at regular intervals and review the investments made by Fund Managers quarterly.

4.3 **Equality Impact Assessment:**
The Council must, in carrying out its functions, have due regard to the need to eliminate unlawful discrimination and harassment and to promote equality of opportunity in relation to disability, race and gender and the need to take steps to take account of disabilities, even where that involves treating the disabled more favourably than others (section 49A Disability Discrimination Act 1995; section 71 Race Relations Act 1976; section 76A Sex Discrimination Act 1975."

An equalities impact assessment has not been conducted because this report is an update on performance of existing fund managers and there are no equalities issues arising**.**

4.4 **Environmental Implications**
None applicable to this report.

## 5. Conclusion and reasons for recommendations

5.1 Members are asked to note the performance of the fund for the quarter ending June 2015 as part of the regular monitoring of fund performance and receive the presentations from the Fund's two private equity managers Standard Life Capital and Pantheon

**Background papers:**
1. Quarterly management reports from the Fund Managers to the Pension Fund.
2. Quarterly performance monitoring statistics for the Pension Fund – WM Company

Final report clearance:

**Signed by:**

Corporate Director of Finance and Resources Date

**Received by:**

Head of Democratic Services Date

Report Author: Joana Marfoh
Tel: 0207-527-2382
Fax: 0207-527 -2056
Email: joana.marfoh@islington.gov.uk

APPENDIX 1

## Summary of Long Term Returns

**LONDON BOROUGH OF ISLINGTON - TOTAL COMBINED**
**Benchmark - LOCAL AUTHORITY UNIVERSE**

**Periods to end June 2015**
**Pound Sterling**

This page summarises the long term returns at asset class level
A ranking against the peer group is shown in brackets.

| | ----- 2012 ----- | | --------------- 2013 -------- ------- | | | | --------------- 2014 --------- ------ | | | | ----- 2015 ----- | | 1yr | 3yrs % pa | 5yrs % pa |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Return % | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | | | |
| Total Equity | 5.2 | 2.4 | 10.9 | -0.6 | 4.3 | 4.6 | 0.1 | 2.9 | 0.2 | 1.7 | 5.4 | -1.2 | 6.0 | 12.2 | 11.2 |
| | (10) | (90) | (97) | (67) | (19) | (75) | (56) | (1) | (95) | (85) | (97) | (2) | (86) | (82) | (55) |
| Private Eq | -1.1 | -0.3 | 3.7 | 6.9 | 0.6 | -1.6 | 2.6 | 0.6 | 1.2 | 0.9 | -0.5 | 3.8 | 5.5 | 5.6 | 7.3 |
| UK Equities | 4.5 | 3.9 | 10.8 | -1.7 | 5.5 | 5.5 | -0.3 | 2.3 | -0.9 | 0.8 | 4.8 | -1.2 | 3.5 | 11.6 | 11.5 |
| | (77) | (44) | (39) | (75) | (74) | (56) | (28) | (26) | (37) | (53) | (39) | (47) | (51) | (60) | (56) |
| O/S EQ Hedge | 7.3 | 1.0 | 12.3 | -0.4 | 3.5 | 4.6 | 0.1 | 4.0 | 1.3 | 2.9 | 7.0 | -2.1 | 9.1 | 14.2 | 11.6 |
| O/S Equities | 5.1 | 1.9 | 13.8 | -1.1 | 1.3 | 3.7 | -0.2 | 3.0 | 2.6 | 3.9 | 8.2 | -4.3 | 10.4 | 12.8 | 10.7 |
| | (16) | (93) | (53) | (73) | (63) | (70) | (82) | (18) | (48) | (46) | (63) | (10) | (51) | (67) | (58) |
| *N. America* | *4.8* | *-2.3* | *19.2* | *2.8* | *1.0* | *8.6* | *0.8* | *2.3* | *5.1* | *8.9* | *7.1* | *-3.7* | *17.9* | *18.7* | *16.6* |
| | *(14)* | *(96)* | *(15)* | *(37)* | *(16)* | *(12)* | *(85)* | *(58)* | *(76)* | *(18)* | *(35)* | *(10)* | *(25)* | *(28)* | *(25)* |
| *Europe ex UK* | *7.6* | *5.4* | *14.2* | *1.5* | *4.1* | *5.9* | *0.8* | *1.7* | *-2.0* | *0.9* | *10.1* | *-6.3* | *2.0* | *14.9* | *11.2* |
| | *(19)* | *(86)* | *(21)* | *(20)* | *(84)* | *(32)* | *(91)* | *(14)* | *(42)* | *(34)* | *(78)* | *(89)* | *(62)* | *(56)* | *(29)* |
| *Japan* | *-1.6* | *1.4* | *22.6* | *7.8* | *3.9* | *-4.0* | *-5.6* | *3.2* | *3.4* | *0.8* | *15.5* | *-3.6* | *16.1* | *14.2* | *8.7* |
| *MGJE* | *-3.5* | *5.0* | *19.5* | *4.4* | *0.3* | *0.0* | *-5.9* | *4.2* | *3.1* | *1.6* | *16.4* | *-2.3* | *19.0* | *13.9* | |
| *Pacific* | *6.1* | *3.7* | *8.7* | *-9.0* | *0.3* | *-4.8* | *-2.7* | *2.6* | *4.8* | *2.4* | *12.3* | *-5.9* | *13.5* | *5.6* | *5.7* |
| | *(80)* | *(80)* | *(81)* | *(48)* | *(68)* | *(92)* | *(90)* | *(45)* | *(9)* | *(51)* | *(13)* | *(44)* | *(25)* | *(92)* | *(92)* |
| *Other Intl.* | *5.3* | *5.3* | *5.7* | *-8.9* | *-1.2* | *-1.8* | *-0.8* | *5.3* | *1.7* | *-1.3* | *5.8* | *-3.3* | *2.7* | *3.6* | *2.3* |
| | *(36)* | *(33)* | *(64)* | *(84)* | *(63)* | *(85)* | *(54)* | *(13)* | *(61)* | *(81)* | *(76)* | *(20)* | *(84)* | *(81)* | *(78)* |
| *Bonds + IL* | *6.2* | *2.7* | *1.8* | *-2.8* | *2.5* | *0.4* | *2.8* | *2.3* | *2.6* | *4.2* | *3.4* | *-4.0* | *6.1* | *7.4* | *7.4* |
| | *(2)* | *(38)* | *(76)* | *(20)* | *(6)* | *(17)* | *(36)* | *(11)* | *(68)* | *(59)* | *(27)* | *(65)* | *(65)* | *(17)* | *(37)* |
| *Total Bonds* | 6.2 | 2.7 | 1.8 | -2.8 | 2.5 | 0.4 | 2.8 | 2.3 | 2.6 | 4.2 | 3.4 | -4.0 | 6.1 | 7.4 | 7.4 |
| | (8) | (16) | (46) | (25) | (11) | (16) | (30) | (17) | (66) | (60) | (32) | (47) | (70) | (14) | (29) |
| *UK Bonds* | *6.2* | *2.7* | *1.8* | *-2.8* | *2.5* | *0.4* | *2.8* | *2.3* | *2.6* | *4.2* | *3.4* | *-4.0* | *6.1* | *7.4* | *7.4* |
| | *(10)* | *(13)* | *(27)* | *(18)* | *(14)* | *(17)* | *(30)* | *(21)* | *(72)* | *(69)* | *(26)* | *(57)* | *(78)* | *(14)* | *(35)* |
| *UK Corp Bond* | *6.2* | *2.7* | *1.8* | *-2.8* | *2.5* | *0.4* | *2.8* | *2.3* | *2.6* | *4.2* | *3.4* | *-4.0* | *6.1* | *7.4* | *7.4* |
| | *(32)* | *(25)* | *(38)* | *(18)* | *(37)* | *(18)* | *(38)* | *(46)* | *(78)* | *(68)* | *(41)* | *(53)* | *(78)* | *(30)* | *(52)* |
| *Cash/ Alts* | 0.2 | 0.1 | 1.0 | 2.5 | 0.1 | 0.2 | 0.6 | 0.3 | 0.4 | 0.2 | 0.1 | -0.2 | 0.4 | 1.8 | 0.7 |
| | (53) | (69) | (71) | (19) | (27) | (56) | (55) | (52) | (69) | (71) | (74) | (64) | (88) | (63) | (80) |

| | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Cash* | *0.2* | *0.1* | *1.0* | *2.5* | *0.1* | *0.2* | *0.6* | *0.3* | *0.4* | *0.2* | *0.1* | *-0.2* | | *0.4* | *1.8* | *1.2* |
| | *(34)* | *(39)* | *(27)* | *(16)* | *(21)* | *(25)* | *(19)* | *(27)* | *(35)* | *(41)* | *(53)* | *(66)* | | *(67)* | *(23)* | *(34)* |
| Curr Instr | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | 364.4 | n/a | n/a | | n/a | n/a | n/a |
| | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | (17) | n/a | n/a | | n/a | n/a | n/a |
| UK Property | 0.5 | 1.3 | 0.7 | 1.8 | 1.7 | 3.2 | 2.6 | 3.9 | 3.5 | 3.1 | 2.5 | 4.1 | | 13.8 | 9.9 | 8.3 |
| | (28) | (18) | (64) | (44) | (78) | (80) | (78) | (63) | (76) | (87) | (77) | (5) | | (80) | (78) | (68) |
| Gbl Property | -11.5 | -0.8 | 5.2 | 5.3 | -7.9 | 3.7 | 1.4 | 20.7 | 9.0 | 6.8 | 9.4 | 6.6 | | 35.8 | 15.5 | |
| FRANKLIN TEM | -8.1 | 0.0 # | | | | | | | | | | | | | | |
| FRANKLIN TEM | -12.1 | 0.0 # | | | | | | | | | | | | | | |
| FRANKLIN TEM | | -0.8 # | 5.2 | 5.3 | -7.9 | 3.7 | 1.4 | 20.7 | 9.0 | 6.8 | 9.4 | 6.6 | | 35.8 | | |
| Total Assets | 4.7 | 2.3 | 7.5 | -0.7 | 3.4 | 3.5 | 0.9 | 2.9 | 1.1 | 2.4 | 4.6 | -1.0 | | 7.2 | 10.8 | 10.0 |
| | (4) | (72) | (89) | (43) | (14) | (57) | (55) | (4) | (90) | (79) | (81) | (6) | | (63) | (50) | (48) |

# not invested in this area for the entire period

This page is intentionally left blank

REPORT PREPARED FOR

# London Borough of Islington Pension Fund

18th August 2015

**Karen Shackleton**
**AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)**

karen.shackleton@allenbridge.com www.allenbridgeepic.com

## 1. Fund Manager Overview

Table 1 provides an overview of the external managers, in accordance with the Committee's terms of reference for monitoring managers.

**Table 1**

| Manager | Leavers, joiners and departure of key individuals | Performance | Assets under management | Change in strategy/risk | Manager specific concerns |
|---|---|---|---|---|---|
| **AllianzGI** | Four joiners and two leavers during the quarter. Leavers included a compliance officer. | Outperformed the Index by +0.8% for the quarter and by +0.1% p.a. over three years. Behind the target of +3.0% p.a. over three years. | £290 billion AUM as at 31st December 2014. | | |
| **Newton** | 1 joiner and 3 leavers this quarter, including Simon Pryke the CIO. | Outperformed the Index by +1.1% in the quarter. Also outperforming over three years by +1.4% per annum, and by +3.0% over 12 months. | £48.3 billion as at 30th June 2015. | | |
| **Standard Life** | 26 joiners (of whom three were in fixed income) and 10 leavers (none from fixed income) during the quarter. | Over three years the Fund has outperformed by +0.7% p.a., slightly behind the performance target of +0.8% p.a. | Underlying fund fell in value by £156m this quarter largely due to market falls. London Borough of Islington's holding remains 5.8%. | Holding 6.1% in high yield non-benchmark bonds. | |

| Manager | Leavers, joiners and departure of key individuals | Performance | Assets under management | Change in strategy/risk | Manager specific concerns |
|---|---|---|---|---|---|
| **Aviva** | Not reported. | Outperformed the gilt benchmark by 4.5% p.a. over three years and ahead of the performance target. | Fund was valued at £1.6 billion as at end Q2 2015. Firm-wide assets under management of £247 billion as at end March 2015 but profits down 22% in first half of 2015. | | |
| **Columbia Thread-needle** | Not reported. | Outperformed the benchmark by +1.8% per annum over three years – ahead of their performance target. | Combined assets of new firm £320.2 billion as at 30th June 2015. Pooled fund has assets of £1.55 billion of which Islington holds 4.8%. | | Some rationalisation of the funds under the TPEN range, of which the Property Fund is one. However, this does not affect the Property Fund itself. |
| **Legal and General** | Not reported. | Regional funds are all tracking the indices. | 12% jump in 6 months in assets under management to £715 billion at end June. 53 LGPS clients with assets under management of £34 billion. | | |

| Manager | Leavers, joiners and departure of key individuals | Performance | Assets under management | Change in strategy/risk | Manager specific concerns |
|---|---|---|---|---|---|
| **Franklin Templeton** | No additions or departures in the real estate team although some additional non-investment resources. | Fund return of +6.6% in Q2. Beating the performance target of 10% p.a. by +5.0% p.a. over three years. | | Fund 1 is now fully committed. First quarter's report for Fund 2. | |
| **Hearth-stone** | No changes to the team during the quarter. | Ahead of the benchmark during the quarter by +8.3%, and ahead by +11.9% for the twelve months to June 2015. | Fund was valued at £36.3 m at end Q2 2015. Islington's holding represents 69% of the Fund. | | |

**Key to shading in Table 1:**

Minor concern

Monitoring required

## 2. Individual Manager Reviews

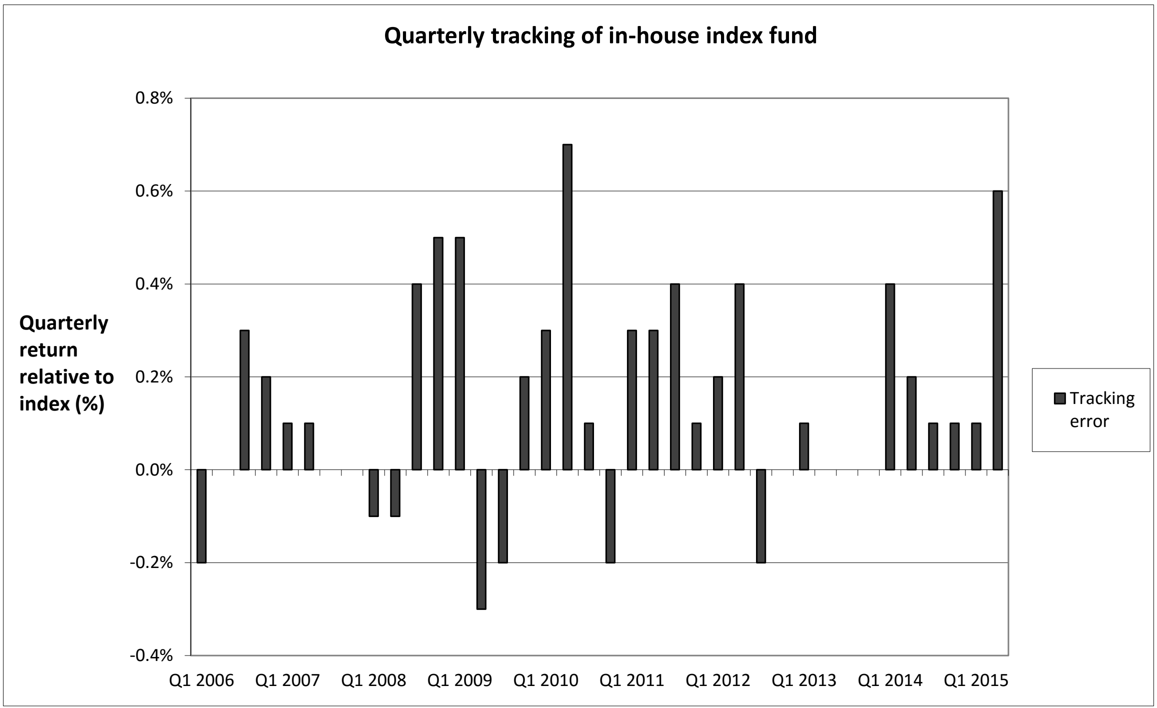
### 2.1. In-house – Passive UK Equities – FTSE All Share Index Fund

***Headline comments***: The portfolio continues to meet its objectives. The fund delivered a quarterly return which was negative in absolute terms but ahead of the index benchmark (-1.0% versus -1.6%). Over three years the fund has outperformed the index by +0.5% p.a. and delivered a return of +11.5% per annum.

***Mandate summary***: A UK equity index fund designed to match the total return on the UK FTSE All Share Index. The in-house manager uses Barra software to create a sampled portfolio whose risk/return characteristics match those of the index.

***Performance attribution:*** Chart 1 shows the tracking error of the in-house index fund against the FTSE All Share Index since Q1 2006. **There are no performance issues.** Over three years, the small quarterly positive relative returns (shown in Chart 1) have accumulated, and as a result the portfolio has outperformed its three-year benchmark by +0.5% per annum.

**Chart 1**




Source: AllenbridgeEpic based on WM figures

## 2.2. AllianzGI (RCM) – Global Active Equities

***Headline comments:*** In terms of relative performance, the fund was ahead of the benchmark return of -5.0% for Q2 2015, delivering an absolute return of -4.3%. Over three years the fund is just ahead of the benchmark by 0.1% per annum: however, this is behind the target of 3% per annum.

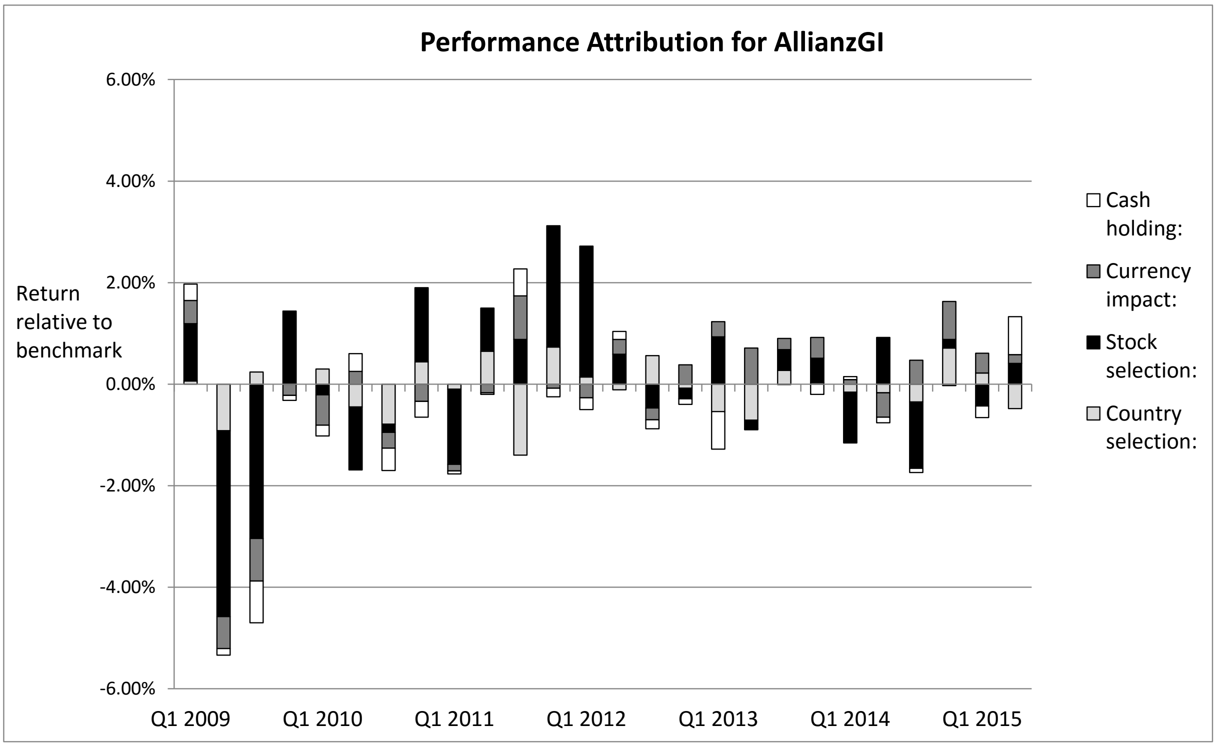
***Mandate summary:*** An active global equity portfolio. AllianzGI operates a bottom-up global stock selection approach. They employ a team of research analysts to identify undervalued stocks in each geographical region (Europe, US, Asia Pacific). A global portfolio team is responsible for constructing the final portfolio. The objective of the fund is to outperform the FTSE All World Index by 3.0% per annum over rolling 3 year periods gross of fees.

***Performance attribution:*** Chart 2 shows a breakdown of AllianzGI's quarterly performance since Q1 2009 relative to the benchmark.

Over the past three years, AllianzGI is just ahead of its benchmark by +0.1% per annum, although **they are still trailing their performance target of 3% per annum**. Stock selection, country selection and cash all detracted from performance over the past three years (-0.1%, -0.24% and -0.3% per annum, respectively). Only currency selection made a positive contribution over three years (+1.1% p.a.).

The concern is that stock selection (which is what London Borough of Islington is paying for) has had a neutral effect whereas currency (which is mainly an incidental bet arising from country selection) is the only positive contributor over the past three years.

**Chart 2**




Source: AllenbridgeEpic based on AllianzGI figures

At the end of the quarter, the portfolio was heavily overweight cash pending a £25 million withdrawal requested by London Borough of Islington. This had a positive impact on performance, in a falling market, but it does mean that the sector bets were somewhat distorted at quarter end.

Note that the portfolio managed by AllianzGI, since its inception in November 2008, is **trailing the value of a passive global equity portfolio**. The return on AllianzGI's portfolio, since inception, is +12.9% per annum compared to a passive Index return of +13.8% per annum (source: AllianzGI).

***Portfolio risk:*** In terms of sector bets, relative to the benchmark, the largest underweight sector position relative to the index was Financials (-6.4%). The fund was most overweight in Cash/other (+31.0%) pending the transfer of £25 million.

In terms of regional bets, apart from the cash overweight position, the fund remains most overweight to Europe (+4.3% overweight). The largest underweight region was North America (-12.3% underweight).

***Portfolio characteristics:*** The total number of holdings in the portfolio stood at 54 securities at the end of Q2 2015, within AllianzGI's normal range of 50-60 names. The beta on the portfolio was 0.75 at the end of June, distorted by the high cash balance (monies were transferred on 2nd July).

***Staff turnover***: There were four joiners and two leavers during the quarter. Joiners included a product specialist in the global equity team, a Head of Solutions for the UK and Ireland, and two directors on the institutional side of the business. Leavers were a compliance officer and an analyst in the CIO's team.

Johnnie Barnett has joined as director of UK institutional business development and Ian Cowell as Head of Solutions for UK and Ireland.

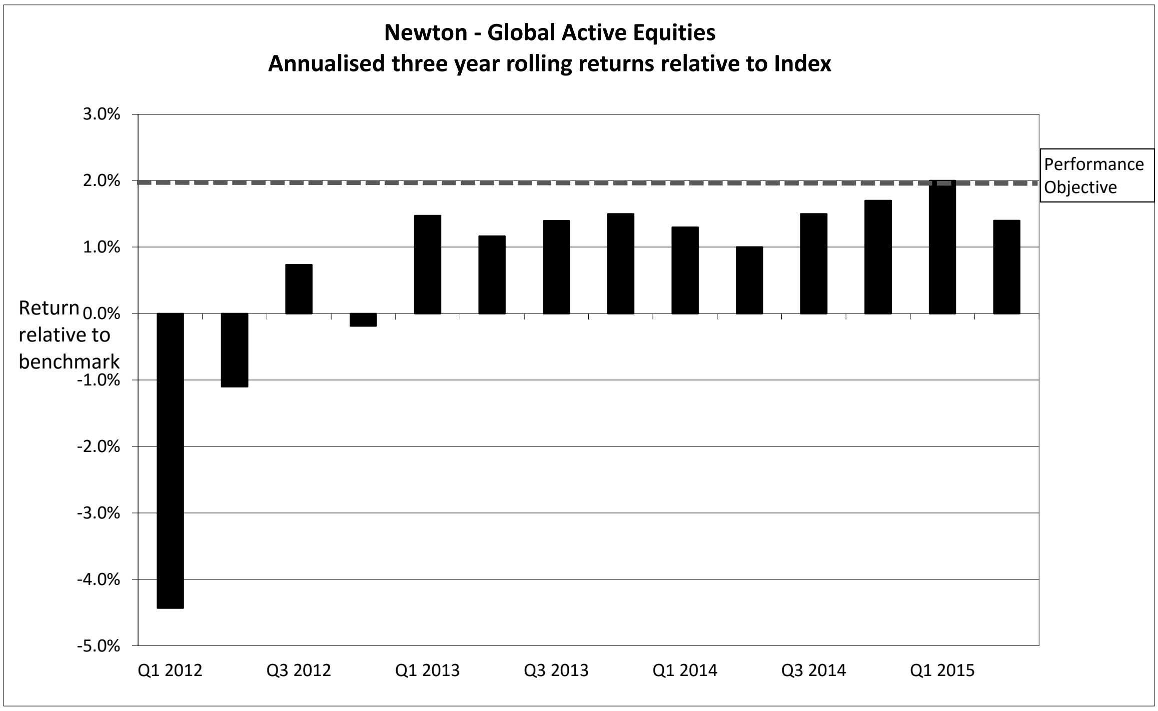
## 2.3. Newton – Global Active Equities

***Headline comments:*** Newton were ahead by +1.1% during Q2 2015 bringing their one year relative performance to an encouraging 3%. Over three years the portfolio outperformed by +1.4% per annum, although this is slightly behind the target of 2% p.a. The outperformance over three years can be attributed almost entirely to positive stock selection decisions.

***Mandate summary:*** An active global equity portfolio. Newton operates a thematic approach based on 12 key themes that impact the economy and industry. Some are broad themes that apply over the longer term; others are cyclical. Stock selection is based on the industry analysts' thematic recommendations. The objective of the fund is to outperform the FTSE All World Index by 2.0% per annum over rolling 3 year periods, net of fees.

***Performance attribution:*** Chart 3 shows the three year rolling returns of the portfolio relative to the Index (the black bars) and compares this with the performance target, shown by the dotted line.

**Chart 3**




Source: AllenbridgeEpic based on data from Newton and WM

Unfortunately, this quarter the fund has slipped a little and so is trailing the performance target again (shown by the right hand black bar in Chart 3).

Over the three years to June 2015, Newton's return was +15.2% p.a. compared to the index return of +13.6% p.a., an outperformance of +1.4% p.a. Stock selection accounted for all of the outperformance.

Since the inception of Newton's portfolio in November 2008, the pension fund is now better off than it would have been with a passive mandate. Newton's 'since inception' return is +13.5% per annum, compared with the benchmark return at 13.2% per annum *(source: Newton)*.

During the quarter the most successful sector was Consumer Services (+0.37% contribution to relative performance) where Newton held some strongly performing holdings. Technology also performed well, contributing +0.35%). The least successful sector was Financials (-0.1% from relative performance).

***Portfolio Risk:*** The largest overweight regional allocation was in European Equities (+4.7% overweight). This has been a long-standing position that has been in place since Q3 2011. Both asset allocation (-0.04%) and stock selection (-0.04%) detracted from the total relative return in Q2, however. The most underweight allocation remained Other Equities (-6.6%).

In terms of sector bets, Newton remained overweight (+9.5% relative to benchmark) in Consumer Services. The most underweight sector remained in Financials (-9.0%).

The level of active risk in the portfolio (i.e. the relative risk of the active bets being taken by Newton, or the tracking error) fell slightly from 2.6%, at the end of March, to 2.4% at the end of June. This is within the normal range of 2% and 6%.

***Portfolio characteristics:*** At the end of Q2 2015, the portfolio held 72 securities (73 as at the end of Q1 2015). Turnover over the past 12 months was 24%, at the low end of Newton's normal expected range of turnover to 30%-70%.

***Staff turnover:*** during the quarter one person joined and three left the firm. Brendan Mulhern joined the strategy team whilst Jason Pidcock, portfolio manager (Asia Equities), Sebastien Poulin (credit analyst), and Simon Pryke, (CIO) left the firm.

The departure of Simon Pryke is a concern because he had been with Newton for 20 years and had been effective in turning round the performance problems being experienced by the firm in global equities. Charles French, head of the financials and consumer research team has been promoted to head of investment, but Newton does not intend to replace the CIO role; instead Helena Morrisey (CEO) will absorb the CIO duties.

***Organisation:*** as at end June 2015, assets under management stood at £48.3 billion.

### 2.4. Standard Life – Fixed Income

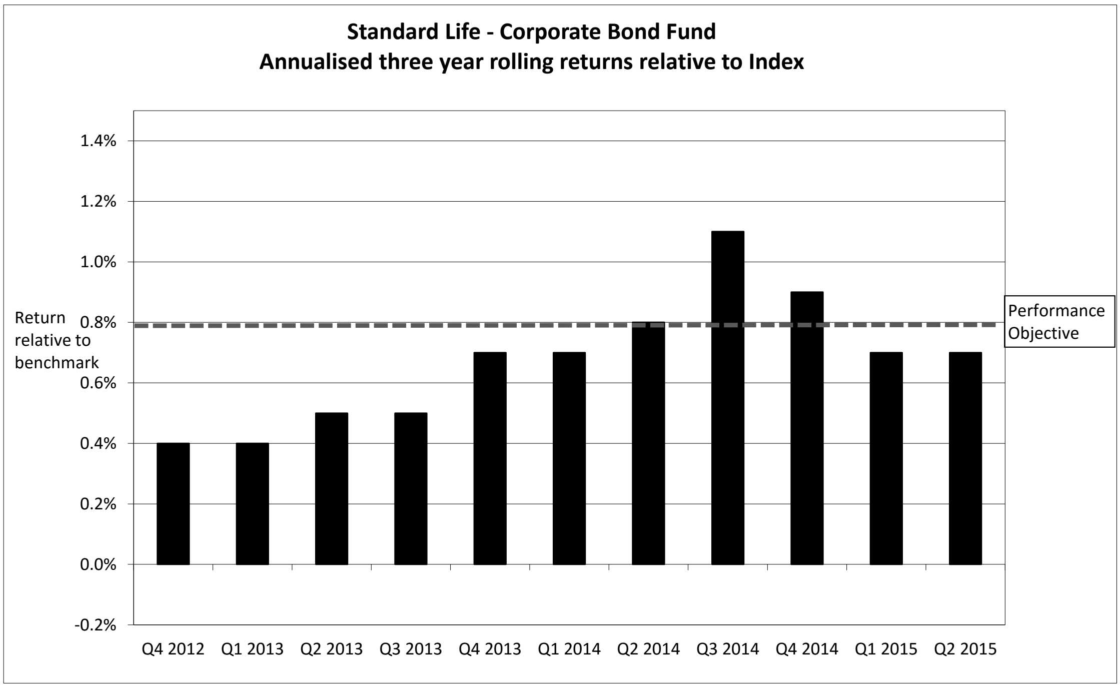
***Headline comments:*** The portfolio was slightly behind the benchmark during the quarter with a return of -4.0% versus -3.9% for the Index. Over three years, Standard Life's outperformance was +0.7% per annum. This is slightly trailing their performance target of +0.8% per annum.

***Mandate summary:*** An actively managed bond portfolio, invested in Standard Life's Corporate Bond Fund. The objective of the fund is to outperform the Merrill Lynch UK Non Gilt All Stocks Index by 0.8% per annum over rolling 3 year periods.

***Performance attribution:***

Chart 4 shows the performance the Corporate Bond Fund versus its benchmark and performance target.

**Chart 4**




Source: AllenbridgeEpic based on Standard Life figures

Over three years, the portfolio has returned +7.4% p.a. compared to the benchmark return of +6.6% p.a., an outperformance of +0.7% p.a. The fund is slightly behind its performance objective of outperforming the benchmark by +0.8% per annum.

Over the past three years, most of the outperformance has come from successful stock selection (+0.7%), with asset allocation contributing +0.3%. This was partly offset by a negative contribution to performance from curve plays.

***Portfolio Risk:*** The largest holding in the portfolio at quarter end was EIB 5.625% 2032 (1.3% of the portfolio). The largest overweight sector position remained Financials (+6.4%). The long-standing underweight position in sovereigns and sub-sovereigns remains (-18.2%); this is the largest bet in the portfolio since its inception in Q4 2009.

The fund continues to hold 6.6% of the portfolio in non-investment grade bonds (these do not form part of the benchmark).

***Portfolio characteristics:*** The value of Standard Life's total pooled fund at end June 2015 was £3,681.1 million, £156.1 million lower than at the end of Q1 2015 although most of this was due to falling bond prices. London Borough of Islington's holding of £213.6 million is 5.8% of the total fund value, no change on the previous quarter. However, when Islington first invested, the percentage holding was 3.4%.

***Staff turnover:*** there were 26 joiners during the quarter, including three fixed income specialists. There were 10 leavers, none of whom were from the fixed income division.

## 2.5. Aviva Investors – Property – Lime Property Fund

***Headline comments:*** With the fall in the bond markets this quarter, the Lime Fund outperformed the gilt benchmark by +7.4% during the quarter. This pulled the outperformance over three years to 4.5% per annum and well ahead of the performance target of +1.5% per annum outperformance.

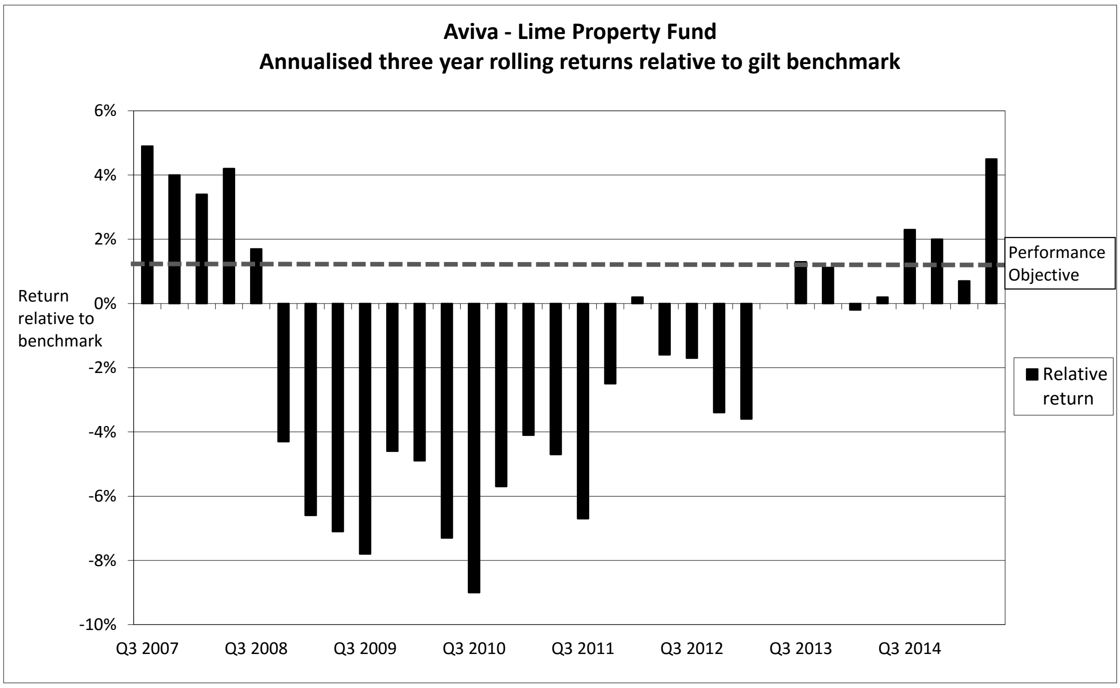
***Mandate summary:*** An actively managed UK pooled property portfolio, the Lime Fund invests in a range of property assets including healthcare, education, libraries, offices and retail. The objective of the fund is to outperform a UK gilt benchmark, constructed of an equally weighted combination of the FTSE 5-15 Years Gilt Index and the FTSE 15 Years+ Gilt Index, by +1.5% per annum, over three year rolling periods.

***Performance attribution:*** The fund was ahead of the gilt benchmark this quarter by +7.4%, as bonds fell. The fund rose 2.9% whilst the benchmark fell 4.5%. The portfolio trailed the IPD Index in Q2 2015 by 0.4%.

Over three years, the performance improved, with the fund returning +8.3% p.a. compared to the gilt benchmark of +3.8% p.a., an outperformance of +4.5% per annum. The **portfolio is ahead of its performance objective of +1.5% per annum outperformance over three years**. Of the +8.3% fund return over three years, 5.4% came from income, with the balance from capital gain.

Chart 5 shows the relative performance of the Fund compared to its gilt benchmark on a three year rolling basis.

**Chart 5**




Source: AllenbridgeEpic based on WM figures

***Portfolio risk:*** The three assets that were under offer last quarter (value £270 million) were completed in Q2. These consist of two offices and a supermarket. Terms were also agreed for the sale of another supermarket. The average unexpired lease term is now 20.1 years, with 2.8% of the portfolio's lease exposure in properties in over-35-year leases. Following the new purchases, the largest sector exposure is now offices at 27.7%. The cash allocation stood at 4.1% as at quarter end.

***Portfolio characteristics:*** As at end June 2015 the Lime Fund was valued at £1.598 billion, an increase of £196 million from the previous quarter end. London Borough of Islington's holding represents 3.3% of the total Fund's value.

**2.6. Columbia Threadneedle - Pooled Property Fund**

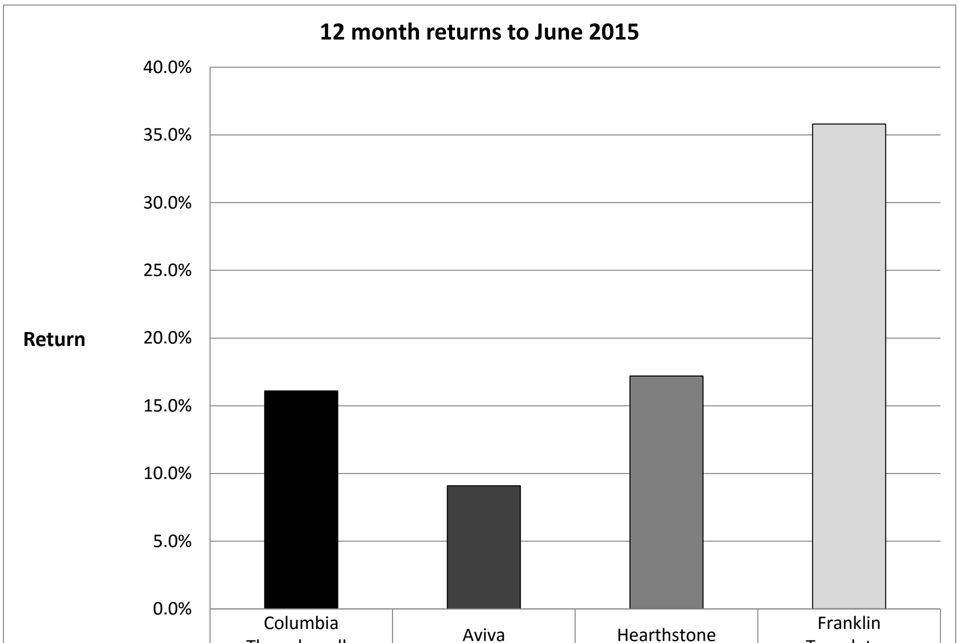
***Headline comments:*** The Fund's performance was slightly ahead of its benchmark in Q2 2015. However, over three years, the Fund has outperformed by +1.8% per annum. The Fund is ahead of its benchmark and beating the performance target of 1% p.a. above benchmark over three years.

***Mandate summary:*** An actively managed UK commercial property portfolio, the Columbia Threadneedle Pooled Property Fund invests in a diversified, multi-sector portfolio of UK property assets. Its performance objective is to outperform the AREF/IPD All Balanced – Weighted Average (PPFI) Index by at least 1% p.a., net of fees, on a rolling three year basis. The benchmark changed at the end of Q4 2013. Prior to this, the benchmark was the CAPS pooled property median fund.

***Performance attribution:*** The portfolio was slightly ahead of the benchmark in Q2 2015, by 0.1%. In terms of the three year performance, **the Fund is ahead of its benchmark by +1.8% per annum and beating the performance target of +1% per annum.** The portfolio returned +11.4% p.a. over three years compared with the benchmark return of +9.5% p.a.

Columbia Threadneedle ranked third across London Borough of Islington's property managers over the past 12 months. This is shown in Chart 6 which compares the returns for the four property managers. All have delivered acceptable 12 month absolute returns.

**Chart 6**

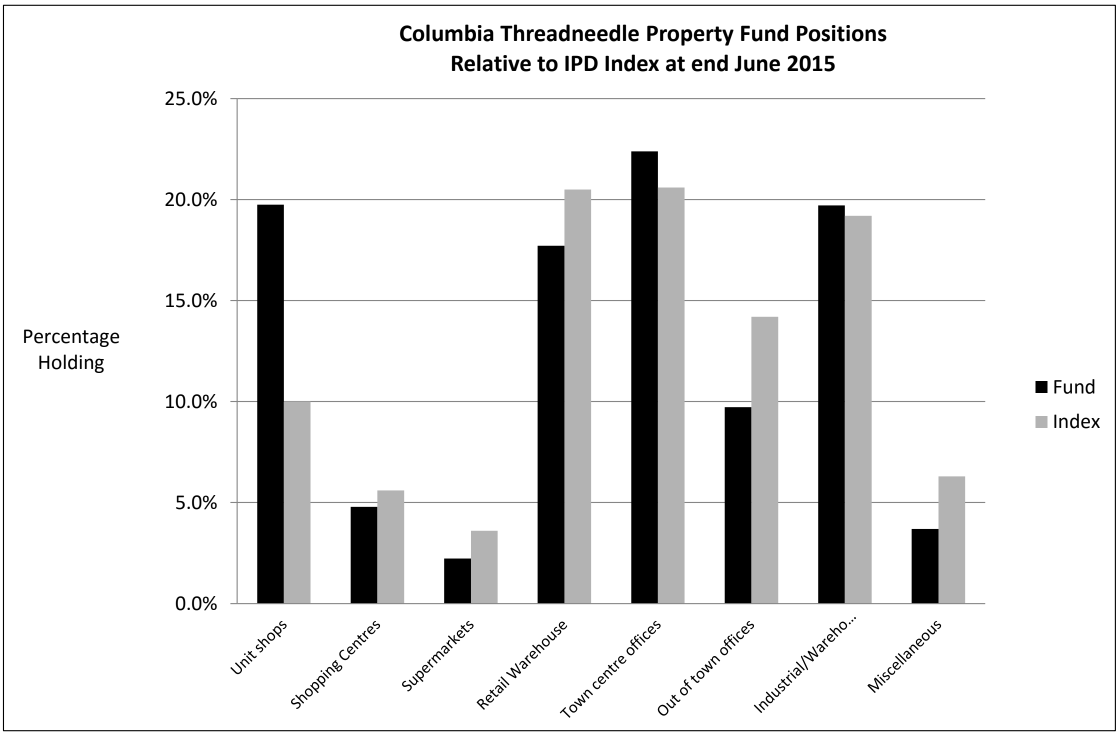



| | Columbia Threadneedle | Aviva | Hearthstone | Franklin Templeton |
|---|---|---|---|---|
| ■ 12 mths to Q2 2015 | 16.1% | 9.1% | 17.2% | 35.8% |

Source: AllenbridgeEpic based on WM data

***Portfolio Risk:*** The fund made five opportunistic purchases during the quarter, totalling £47 million, including a retail park and some industrial buildings. Chart 7 shows the current breakdown of the portfolio relative to its benchmark.

**Chart 7**




Source: AllenbridgeEpic based on Columbia Threadneedle data.

***Portfolio characteristics:*** As at 30th June 2015, the Threadneedle Property Fund was valued at £1.55 billion, an increase of £60.0 million compared with March 2015. London Borough of Islington's holding represents 4.4% of the Fund.

***Organisation:*** Threadneedle became Columbia Threadneedle in Q1 2015 and the rebranding is now complete with the combined teams now based in new offices at Cannon Place. Additionally, Columbia Threadneedle have announced that they are rationalising the range of funds under their TPEN umbrella (of which the property fund is one of many). This will not affect the property fund itself, however.

## 2.7. Legal and General Investment Management (LGIM) – Overseas Equity Index Funds

***Headline comments:*** All the index funds were within the expected tracking range when compared with their respective benchmarks and there are no issues. The fundamental FTSE-RAFI Emerging Markets index fund outperformed its market capitalisation-weighted counterpart in Q2, and was 1.7% ahead. For the 12 months to Q2 2015 the underperformance was -7.1%, however.

***Mandate summary:*** Four regional overseas equity index funds, in Europe, Japan, Asia Pacific ex Japan, and emerging markets, designed to match the total return on the FTSE All World Regional Indices. One additional index fund is designed to match the total return on the FTSE-RAFI Emerging Markets Equity Index. The FTSE All World Indices are based on capitalisation weights whereas the FTSE-RAFI Index is based on fundamental factors.

***Performance attribution:*** **The regional portfolios are all tracking their benchmarks**, as shown in Table 2.

**Table 2**

| Q2 2015 | Fund | Index | Tracking |
|---|---|---|---|
| Europe | -5.9% | -6.0% | 0.1% |
| Japan | -2.3% | -2.3% | 0.0% |
| Asia Pacific ex Japan | -8.3% | -8.3% | 0.1% |
| FTSE emerging markets | -3.7% | -3.8% | 0.1% |
| RAFI emerging markets | -2.0% | -2.0% | 0.0% |

Source: LGIM

***Portfolio Risk:*** The percentage allocation to each regional fund is based on pre-agreed band widths, which also take into account the global equity managers' allocations. The largest deviation from the benchmark allocation is North America which is 3.4% overweight.

***Organisation:*** In the six months to end June 2015, Legal & General reported a 12% jump in their assets under management to £715 billion. Organisationally, LGIM has 53 LGPS clients with assets under management of £34 billion. 90% of this is passive indexed funds. Of the 53 LGPS investors, 15 are London Boroughs.

### 2.8. Franklin Templeton – Global Property Fund

***Headline comments:*** This is a long term investment and as such a longer term assessment of performance is recommended. There are now two funds in which London Borough of Islington invests. The year to June 2015 saw steady growth and the Fund's 12 month return was +35.8% compared to its absolute return benchmark of 10% per annum. This has impacted the three year numbers and the fund is now comfortably beating its benchmark with a return of +15.5% per annum compared with the absolute return benchmark of 10% per annum.

***Mandate summary:*** A global private real estate fund of funds investing in ten sub funds. The performance objective is an absolute return benchmark over the long term of 10% per annum.

***Performance attribution:*** over the past twelve months, **Franklin Templeton is the best performing fund across all four property managers**, by some way, as shown in Chart 6. Fund 1 is now fully committed and entering its distribution phase. Distributions in Q2 2015 amounted to 9% of the total equity commitments. Fund 2 has made two investments to date, one in Finland and one in China. The strong 12 month returns have fed through to the three year numbers and the Fund is now comfortably ahead of its target absolute return of 10% per annum, with the three years to June 2015 delivering a return of 15.5% per annum.

***Portfolio risk:*** leverage in Fund 1 stood at 53% as at end June 2015. The most highly levered fund was Valla Park Co-Investment at 70%. This is a Swedish fund. Last quarter, GreenOak Japan was noted as also having a high level of leverage. Franklin Templeton have stated that 70-80% leverage is quite common for the particular strategy that GreenOak Japan is pursuing, especially given the current lending environment and the types of deals that are being acquired. Franklin Templeton are working with GreenOak to ensure that they employ debt prudently. Leverage on Fund 2 was 60% as at end June.

Of the 14 investments in Fund 1, three are on target (10%-15% projected net internal rate of return (IRR)), seven are above target (15-25% projected net IRR) and two are substantially above target (more than 25% projected net IRR). Two funds are too early to assess at this stage. The two funds which are substantially above target are: GreenOak and Project Redfish (a Toyko fund managed by Green Oak).

***Staff turnover:*** there were no joiners to or leavers from Franklin Real Asset Advisers during Q2 2015. However, the team has added three non-investment staff to support the real estate investment staff: Anthony Lessi, Director of Global Analytics, who will strengthen the reporting side, Maria Gavilanes, Analyst in Global Analytics and Greg Wilkinson, Director who will be a product specialist in New York.

### 2.9. Hearthstone – UK Residential Property Fund

***Headline comments:*** The portfolio returned +9.3% compared to the benchmark return of +0.9% for the quarter ending June 2015. Over 12 months the return was a strong +17.2% compared to the benchmark return of +4.8%. This improvement in returns places the fund 10% ahead of benchmark since inception and +11.9% ahead over 12 months.

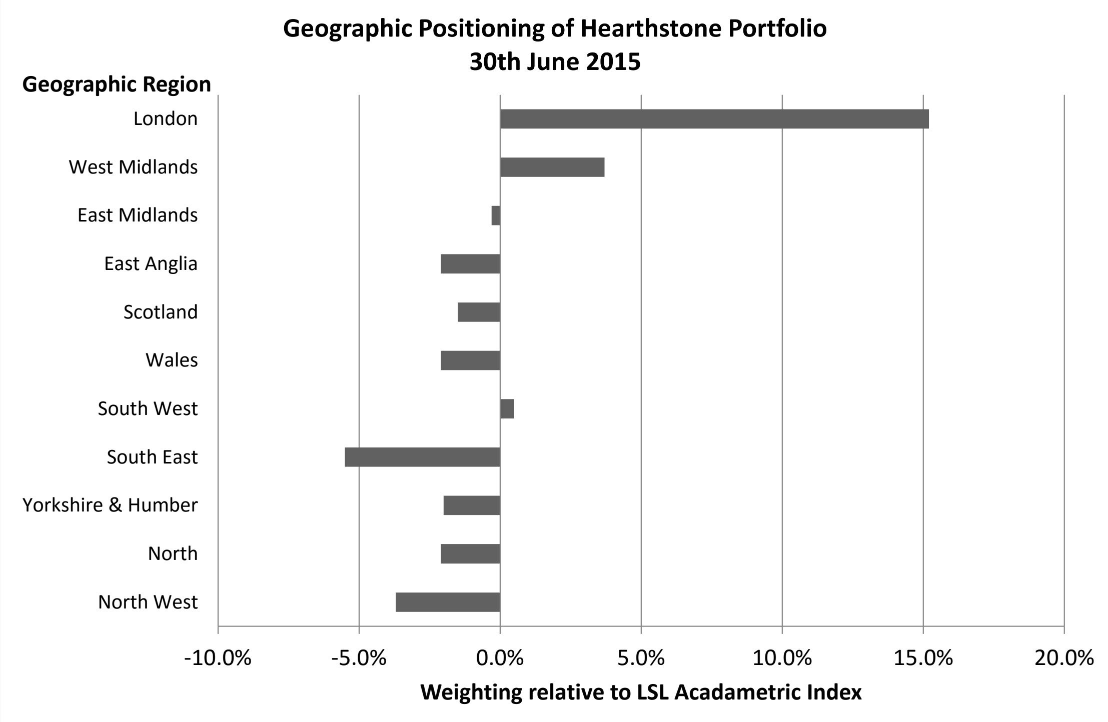
***Mandate summary:*** The Fund invests in private rented sector housing across the UK and aims to outperform the LSL Acadametrics House Price Index (note that this excludes income), as well as providing an additional income return.

***Performance attribution:*** The Fund returned +17.2% compared to the return on the index of +4.8% over the past 12 months. This places Hearthstone second out of four property managers in terms of returns over the past year (see Chart 6), ahead of Columbia Threadneedle and Aviva. The yield on the portfolio was 5.1% at the end of June, after adjusting for voids.

***Portfolio risk:*** The portfolio continues to hold a significant overweight position in London, relative to the benchmark. This is a result of the Wembley investment opportunity in which the fund invests. Hearthstone's long term strategy is to maintain broadly neutral regional bets in the portfolio. The Fund is, however, in the process of selling eight flats in London. Proceeds of sale are likely to be in regions other than London.

***Portfolio characteristics:*** Chart 8 shows the regional bets in the portfolio. The biggest overweight region is London (+15.2%). The most underweight region relative to the index was the South East (-5.5%).

**Chart 8**




Source: AllenbridgeEpic based on Hearthstone figures

The Fund has a 21% allocation to detached houses, 52% allocated to flats, 22% in terraced accommodation and 5% in semi-detached.

***Organisation and staff turnover:*** There were no leavers or joiners during the quarter. The team consists of eight people.

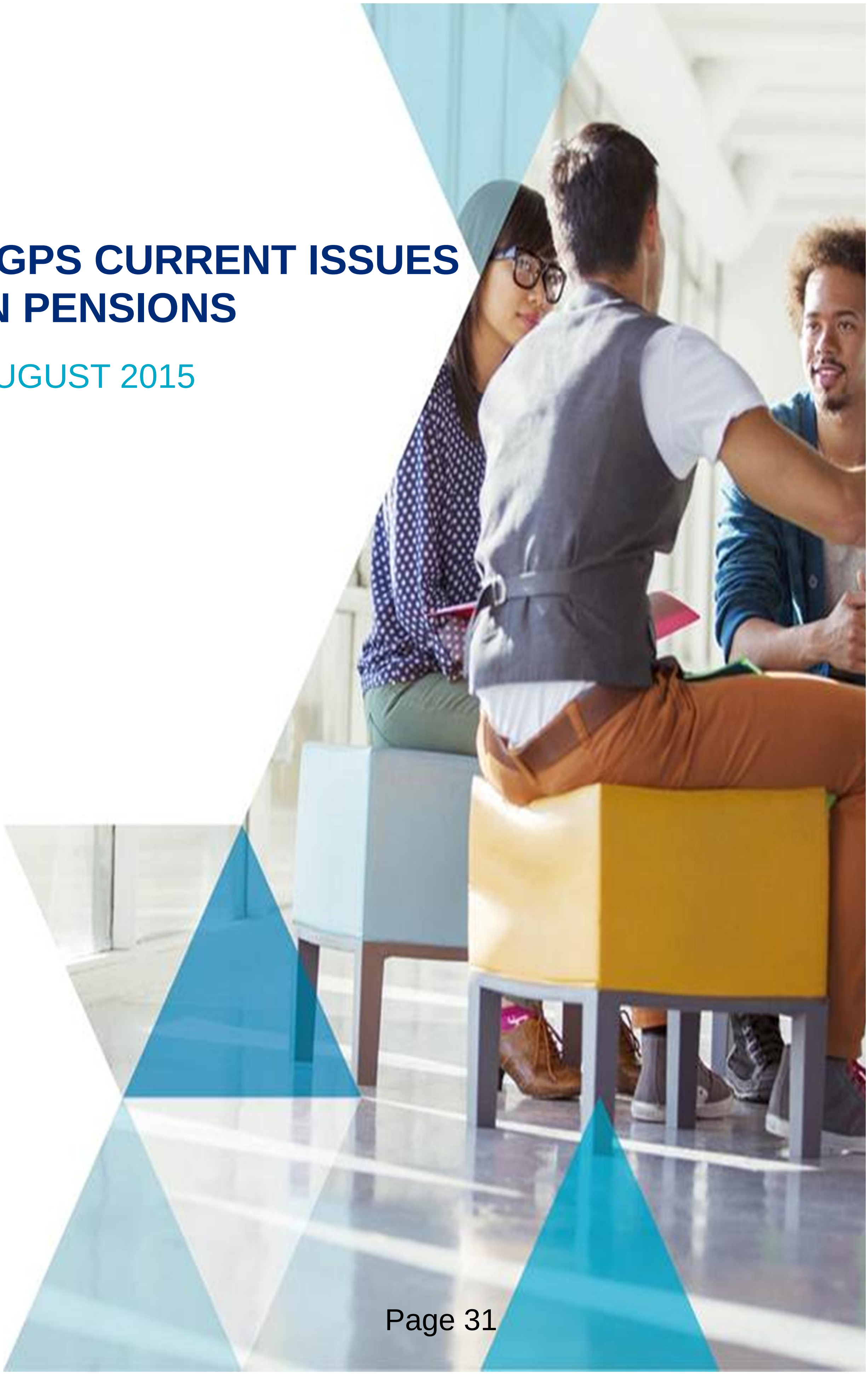
**Karen Shackleton**
**Senior Adviser**
**AllenbridgeEpic Investment Advisers Limited**
**19th August 2015**

This page is intentionally left blank

MERCER
MAKE TOMORROW, TODAY

# LGPS CURRENT ISSUES IN PENSIONS

AUGUST 2015





AUGUST 24, 2015

# IN THIS EDITION





MARSH & McLENNAN COMPANIES

# SUMMER BUDGET

## The end of meaningful tax-free pension savings?

The 2015 Summer Budget, delivered on 8 July, was the first conservative Government budget in almost 20 years, and some far-reaching changes were announced. Pension tax was once again an area of focus for the Chancellor, following on from the previously announced reduction in the lifetime allowance to £1 million.

A high-level overview of the three main pension issues announced is given below – more information can be found in our *Summer Budget 2015* paper. We will report on these areas in *Current Issues* over the coming months as further details emerge.

- The annual allowance will reduce from 6 April 2016 for high earners. This change will mean that, for individuals with "incomes" over £150,000, the annual allowance will reduce by £1 for every £2 of income, with a minimum annual allowance of £10,000. "Income" - to determine the amount of annual allowance someone has - is effectively defined as total taxable income, ***including*** the value of any pension contributions or accrual, and any income not related to main employment, such as rental income or income from other sources. Therefore many people may not be able to calculate their annual allowance until after the relevant tax year has ended and they have completed their annual tax return.

- Pension input periods to change. From 6 April 2016, all pension input periods will be the same period as the tax year. As this is not currently the case for the LGPS, 2015/16 will see a transition from the current pension input period to the tax year. The transition applies irrespective of whether or not a scheme already uses tax years. In general, the approach is that an individual can save (without an annual allowance charge) £80,000 in the current tax year but no more than £40,000 after 8 July 2015. For most individuals this approach to the transition is generous, and some may be able to save more through Additional Voluntary Contributions (AVCs) than they originally anticipated.

- Green Paper: a consultation on pension tax relief. Included in the Budget was the launch of a consultation on whether there is a case for reforming pension tax relief, or whether it is best to keep the current system. The Government has now issued its Green Paper consultation. It does not put forward any specific proposals, although it does outline some basic principles it believes any reform should meet. The paper acknowledges that there are many ways in which tax relief on pensions savings can be structured and indicates that all are open for consideration, including the option of keeping the current system of annual and lifetime allowances. At the other end of the range of options it gives the example of reversing the current position so that pension contributions would be paid out of taxed income, possibly with a government top-up of contributions, but benefits at retirement would be paid tax free.

  The paper gives the background to the consultation, highlighting increasing life expectancy and the marked shift from defined benefit to defined contribution pension provision. It sets out a framework for any reforms, citing the principles of simplicity, personal responsibility and fiscal sustainability, and the need to build on the early success of automatic enrolment.

The consultation asks for input on eight high-level questions, although respondents are encouraged to add any additional information they feel is relevant. **The closing date is 30 September 2015**.

- Annuity cash-ins. Following the earlier consultation on the establishment of a secondary market for annuities, the government will set out their plans for this in the Autumn. Implementation will be delayed until 2017 to ensure that appropriate support for consumers is in place.

---

The *annual allowance* is the maximum amount of tax-relievable pension savings that can be built up for an individual in one tax year. This includes savings made by the individual and the employer. The most that can be saved by the individual tax-free towards all of their pension arrangements is the lower of 100% of earnings and the *annual allowance*. Each pension scheme has a *pension input period*, over which an individual's savings in the scheme are measured for comparison with the *annual allowance*.

---

HM Revenue & Customs announced on 21 July that Fixed Protection 2016 and Individual Protection 2016 will be made available to individuals who are impacted by the reduction in the lifetime allowance from April 2016. These will be very similar to Fixed Protection 2014 and Individual Protection 2014; however HMRC is considering changing the deadlines for applying for these protections and potentially allowing individuals to apply for them at any time before they take their benefits. Full details of the new regime will be published later this summer.

---

# PENSION FREEDOMS: THE STORY SO FAR

## Pension freedoms gather pace in the DC world

Data released by the Association of British Insurers (ABI) in July gives us our first indication of what pension savers are doing with their funds in the new world of pension freedoms.

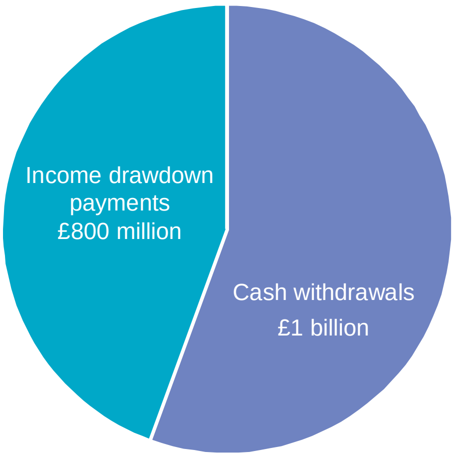
The headline conclusions are not surprising - people with small Defined Contribution pension pots tend to take them as cash (the average cash withdrawal was £15,500) and those with larger pots are more likely to buy an income, either via an annuity or income drawdown.

Digging a little deeper, the amount of money used to purchase income drawdown products has increased significantly, with £720 million used in the first two months compared to only £100 million per month in 2012. This surpasses the amount used to purchase annuities; however the actual number of people purchasing such products is still slightly less than the number purchasing annuities.

During April and May, £1.8 billion was paid out of pension pots and a further £1.35 billion was used to purchase retirement products. Figures 1 and 2 show how these amounts are broken down.

The ABI research also shows that customers are shopping around for the best deal – 45% of annuities and 52% of income drawdown products were purchased from a provider different to the one with which individuals were invested prior to taking their benefit.

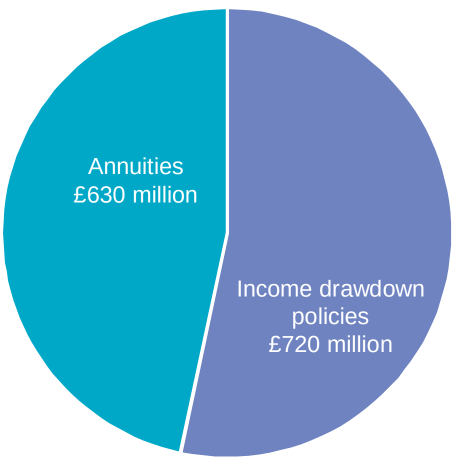
FIG 1: AMOUNT PAID OUT FROM PENSION POTS APRIL AND MAY 2015




| | |
|---|---|
| No. of cash withdrawals: | 65,000 |
| Average cash withdrawal: | £15,500 |
| No. of income drawdown payments: | 170,000 |

Data source: Association of British Insurers, 16 July 2015

FIG 2: AMOUNT SPENT ON RETIREMENT PRODUCTS APRIL AND MAY 2015




| | |
|---|---|
| No. of annuities purchased: | 11,300 |
| Average fund used for annuity purchase: | £55,750 |
| No. of income drawdown policies purchased: | 10,300 |
| Average fund put into drawdown: | £69,900 |

Data source: Association of British Insurers, 16 July 2015

It is clear from the results to date that there is a large member appetite to cash in small pension pots (less than £30,000) through trivial commutation. LGPS funds who have not yet considered running a bulk trivial commutation exercise may perhaps reconsider this in light of the survey results to date as this can be an effective way of reducing administration costs as well as longer term pensions risks.

Furthermore, although drawdown type arrangements are not directly available through the LGPS, the survey could highlight an increased trend in members transferring out of the LGPS prior to retirement to access the freedoms through a Defined Contribution arrangement.

# CESSATION OF CONTRACTING OUT

## Loss of employer and employee NI rebated and costs of GMP reconciliation

**DWP Consultation Response**

On 16 July, the Department for Work & Pensions published a response to its consultation on draft regulations concerning the upcoming abolition of contracting out. The final regulations set out the rules with which schemes that currently contract out on a defined benefit basis will need to comply, on and from 6 April 2016, in respect of accrued contracted-out benefits. They aim to ensure that members' entitlements derived from contracted-out employment continue to be preserved, and that formerly contracted-out schemes continue to be operated appropriately.

As reported previously, there is currently no proposed mechanism in the LGPS through which employers can claw back lost National Insurance rebates as a result of the cessation of contracting out. Councils as well as other LGPS employers should therefore factor in the increased net costs of LGPS provision from 6 April 2016 onwards (which for a typical membership, could average out at around 2% to 3% of payroll). Furthermore, employers should also ensure employees are adequately informed of the impact of the lost NI rebates on take home pay.

Further consultation is expected later this year on a number of issues, including changes to the regulations governing transfers of contracted-out rights between schemes, and whether employers will need to notify and consult with members in advance of the cessation of contracting out.

**GMP reconciliation**

All Funds should now have registered with HMRC's reconciliation service to assist with the reconciliation of scheme GMP membership records in advance of the State Scheme changes and cessation of contracting-out in April 2016. This is a significant exercise for Funds and the level of resource needed to reconcile these records should not be underestimated. In the results of the stage 1 reconciliations we have seen to date, it is clear that in some instances HMRC's records differ markedly to those held by Funds.

Currently, a group of bodies, including the Local Government Association (LGA) are negotiating with the Treasury on how accurately LGPS funds' data must match that held by HMRC and will report further so that the agreed level of tolerance can be factored in to funds' reconciliation exercises.

# CLOSURE OF THE EQUITABLE LIFE PAYMENT SCHEME

## Closure to new claims on 31 December 2015

The Chancellor's Summer Budget announced that the Equitable Life Payment Scheme (ELPS) will close to new claims on 31 December 2015. Prior to this, the ELPS will undertake a further effort to trace the remaining investors who are due compensation of £50 or more.

With Profits annuitants will continue to receive the annual compensation payments for their lifetimes, as originally intended. However, the Chancellor also announced that the ELPS will make a further payment to Equitable Life policyholders (presumably including members of group pension schemes) who are in receipt of Pension Credit. This further payment will be equal to the payment they have already received and will be made early in 2016.

Any LGPS funds that have some AVC's invested with Equitable Life should ensure that any ELPS work is conclude prior to the year end.

---

The Equitable Life Payment Scheme was set up to make payments to Equitable Life With-Profits policyholders who suffered financial losses as a result of the Government's maladministration in the regulation of Equitable Life. Since the ELPS began making payments in 2011, it has paid out over £1 billion (of the £1.5 billion that Government set aside in 2010) to around 87% of the eligible policyholders it has managed to contact. To be considered for compensation, a policy must have been taken out between 1 September 1992 and 31 December 2000, and a qualifying member must have contributed to the policy between 1 January 1993 and 31 December 2000.

---

# DC QUALITY FEATURES SURVEY

## Increased focus on AVC schemes

The Pensions Regulator recently published the results of its 2015 survey into the presence of the defined contribution quality features in trust-based DC schemes.

As reported in our last issue, whilst not an explicit requirement as yet, it is likely that the Regulator is going to expect public sector schemes such as the LGPS to adopt the same standards for associated AVC arrangements.

Additionally, in its Code of Practice for the governance and administration of public service pension schemes the Regulator does make clear that "Where DC or DC AVC options are offered, pension board members should also be familiar with the requirements for the payment of member contributions to the providers, the principles relating to the operation of those arrangements, the choice of investments to be offered to members, the provider's investment and fund performance report and the payment schedule for such arrangements."

The 31 quality features - as set out in the November 2013 DC code of practice and associated guidance - are designed to ensure that schemes are run to a high standard, so that they can deliver good outcomes for members.

The survey revealed that large schemes (over 1,000 members) and master trusts had a very high level of awareness of the quality features and were also able to demonstrate the presence of a higher proportion of features. In contrast, three quarters of small schemes (12-99 members) and around half of medium-sized schemes (100-999 members) had little or no knowledge or understanding of the quality features.

The results showed that the areas with greatest scope for improvement across all schemes related to assessing and improving knowledge and understanding, linking investment strategies to member needs, and maintaining robust administration systems. These areas are covered by new legal minimum governance standards for DC schemes, which came into effect in April.

We are recommending to all LGPS clients that they should review their own AVC arrangements to demonstrate compliance/best practice versus the quality features.

## LGPS COST MANAGEMENT

### Funds could face onerous data requirements

The LGA have recently written to Funds concerning the accounting data which they will need to provide in connection with the cost management process. We envisage those requirements being somewhat complex, requiring benefit payments to be split between those in relation to pre April 2014 and post April 2014 service, and a further split of benefits and contributions between those in relation to the main scheme and 50:50 benefits. We envisage this split being somewhat difficult to provide (and this is a point we have been making for over well over 18 months since this methodology was first disclosed). It is almost certain to need the involvement of the pensions administration software and pensions payroll providers. At this stage we have not seen a specification of how the benefits will need to be split, so at this stage we do not know how it will work in practice or how much it will cost. The calculation of the data required could potentially be very intricate, so the costs of provision could be very significant.

One of the current proposals is to amend the Accounts and Audit Regulations so as to require Funds to provide the split of the information. This would mean administering authorities are being asked to commit to providing information in a format which is as yet unknown, and therefore with a cost which cannot be quantified. Against the background of continuing cuts to local authority budgets, this seems to us a cost which is unnecessary. We have made these points to the DCLG, and will continue to do so.

## SINGLE FRAUD INVESTIGATION SERVICE (SFIS) – BULK TRANSFERS

### Transfer terms soon to be finalised

The Single Fraud Investigation Service (SFIS) involves the transfer of about 600 local authority staff to the DWP (2-3 staff per local authority on average). The staff will be offered membership of the Civil Service Pension Scheme, and will be given the option of transferring their LGPS benefits across to the Civil Service Scheme. We and the other local authority advisory firms have been engaged in discussions with GAD about the transfer terms which can be offered. The discussions have centred around a “share of fund” methodology for the calculation, and we expect to be approaching our clients within the next few weeks with the formal proposals. The benefits in the Civil Service Scheme to be provided from the transfers will be calculated on a "year for year" basis, adjusted to reflect the different benefit structures between the two schemes.

# HMT CONSULTATION ON PUBLIC SECTOR EXIT PAYMENTS CAP

## Consultation on new £95,000 cap closes 27 August

HM Treasury has published a consultation on a proposed public sector exit payment cap on redundancy payoffs in the public sector which could limit early pension payments from the (LGPS).

The Government is consulting on introducing a £95,000 cap on the total payments when a public sector worker loses their job in certain circumstances. This is in response to concerns over the increasing cost to the taxpayer of financing early retirement packages.

Of particular note is that the Government said the cap is to ***include*** exit payments such as employer pension contributions associated with early access to an unreduced pension.

This would conflict with LGPS regulations where members aged 55 and over are entitled as of right to an immediate and unreduced payment of accrued pension where their employment ends on the grounds of redundancy or efficiency. Currently, the employer normally has to pay a "strain cost" to the LGPS in order to "buy out" the reduction in pension benefits which the member would normally face on retiring early.

Under the proposals public sector employees would still be able to take early retirement but the extra cost to the employer of buying out part or all of the early retirement reduction should not exceed the £95,000 cap. If a lump sum redundancy payment is offered as well, this when taken together with the total employer cost of buying out the reduction in pension must not exceed the cap.

These costs can be substantial. For example, if an employer wanted to make a 55 year old LGPS employee redundant with 35 years' past service and a pensionable salary of £50,000 per annum, the cost of providing an immediate pension unreduced could be up to £150,000 (depending on the particular circumstances). This cost falls on the employer at the time of redundancy – in addition to any other non-pension related redundancy costs.

This would require a change to the current LGPS regulations to facilitate this cost cap for public sector employees and quite how this will be incorporated into the regulations remains to be seen.

In addition, it is not yet clear how the new policy would affect other (non-public sector) employers in the LGPS.

Mercer will be responding to the consultation, but we would also encourage you to respond to this consultation with a view to ensuring that there are no unintended consequences from a change to the LGPS Regulations as a result of the new policy.

# NEW FAIR DEAL

## Further consultation due September 2015

As reported in the last issue, DCLG have formed a working group, made up of the LGA, Trade Unions and practitioners, to consider how the principles of new Fair Deal might apply for the LGPS – in the spirit as it applies to the other public sector schemes.

There have been no major developments to report over the summer and it is expected that there will be a further consultation in September 2015, which will run for three months. It is hoped that any new regulations will be implemented in the second Quarter of 2016.

# TPR's PUBLIC SECTOR PENSION SCHEME SURVEY

## Take the survey now

The Pensions Regulator (TPR) are currently asking schemes to take part in their survey on the governance and administration standards in public service schemes.

TPR are strongly encouraging public sector administrators/officers to participate in this survey.

The results will play a key part in TPR's understanding of how schemes are meeting legal requirements and will help them to focus on areas where we can provide more support, help and guidance.

You can start the survey here

# OMBUDSMAN ACCEPTS LGPS MEMBER'S COMPLAINT OVER EARLY RETIREMENT ACCESS

## Consequences of not having clearly defined policies

The Pensions Ombudsman (PO) has ruled in favour of a deferred member of the Local Government Pension Scheme (LGPS) who sought early access to her pension.

Jacqueline Elliot had become a deferred member of the LGPS in 2011 after having accrued a significant amount of service and had a Rule of 85 age of 55. In August 2011, when she turned 55, Elliot wrote to the East Riding Pension Fund (ERPF) to request unreduced early retirement from deferred status and the ERPF pointed out that she would need the consent of her employer Care Trust Plus (CTP). However, CTP turned down the request on the ground that she had opted out of the LGPS before age 55.

In March 2013, the Department of Health inherited responsibility for the defunct Care Trust Plus. It told Elliott that a discretions policy regarding early retirement had come into effect from July 2012 which meant no one would have been granted employer consent to take their benefits before age 60. But Elliott argued the discretion policy was written after she applied for her benefits. She also discovered through a Freedom of Information request that other members had accessed early retirement under the rule of 85 following the employment transfers.

The Ombudsman agreed it would be unfair for Elliott's request to be considered under a discretions policy that came into effect after she made her application. He also rejected claims by Care Trust Plus that the application could only be considered alongside a ‘trigger event' (meaning when she left the LGPS scheme and not when she applied later).

The case serves as a reminder to all funds and employers to ensure appropriate up-to-date discretionary policies are in place, particularly with regard to accessing early retirement pensions from active and deferred status.

# UPDATE ON THE 50:50 SCHEME

## Take up lower than expected

Take up rates to the LGPS 50:50 scheme have been far lower than expected prior to the scheme being rolled out. Initially, it was expected that take up rates of the 50:50 would be towards the 10% mark. However, experience to date suggests that take up is only around 1% and this is primarily higher earners who would exceed the Annual Allowance of Lifetime Allowance tax charge.

It’s not clear why take up has been so much lower than expected, with some commentators suggesting that it has not been publicised adequately.

# CONTACTS

Paul Middleman
paul.middleman@mercer.com
0151 242 7402

Leanne Johnston
leanne.johnston@mercer.com
0161 837 6649

Bhavna Kumar
bhavna.kumar@mercer.com
0151 242 7404

Ian Kirk
ian.x.kirk@mercer.com
0151 242 7141

Nigel Thomas
nigel.thomas@mercer.com
0151 242 7309

Clive Lewis
clive.lewis@mercer.com
0151 242 7297

John Livesey
john.livesey@mercer.com
0151 242 7324

Cefn Willis
cefn.willis@mercer.com
0151 242 7303

MERCER

MAKE TOMORROW, TODAY

No 4 St Paul's Square,
Old Hall Street,
Liverpool
L3 9SJ

This page is intentionally left blank

ISLINGTON

**Finance Department**
**7 Newington Barrow Way**
**London N7 7EP**

**Report of:** **Corporate Director of Finance and Resources**

| **Meeting of:** | **Date** | **Agenda item** | **Ward(s)** |
|---|---|---|---|
| Pensions Sub-Committee | 14 September 2015 | | n/a |

| | | |
|---|---|---|
| **Delete as appropriate** | ~~Exempt~~ | Non-exempt |

# SUBJECT: CURRENCY HEDGING BRIEFING

## 1. Synopsis

1.1 To consider a currency hedging briefing to enable Members review of our current passive hedging strategy. The paper is prepared by AllenbridgeEpic and attached as Appendix 2

The key question is whether Members want to take on additional currency risk in addition to the risks associated with overseas equity holdings.

## 2. Recommendations

2.1 To consider the AllenbridgeEpic briefing paper on currency hedging set out in Appendix 2.

2.2 To consider the 2 options below as stated in the paper:

**Option 1 – Maintain existing 50% currency hedge on overseas equities**

Do Members have the appetite to live with the shorter term impact of currency volatility on the fund's valuation? Whilst these effects may well wash out over time, the shorter term effect could be significant and if this is a concern, then maintain the 50% currency hedging programme, notwithstanding the longer term conclusions drawn by Dimson, Marsh and Staunton.

**Option 2 – Stop hedging currency risk on overseas equities**

Members are less concerned about the shorter term impact of currency volatility on the fund's valuation on the basis that research indicates that the currency effects wash out over time, so not hedging would save the (modest) costs associated with implementing the strategic currency hedge so maintain an unhedged equity allocation.

2.3 To agree either Option 1 or Option 2 above.

## 3. Background

3.1 Following a review of the Fund's investment strategy in 2007 and final implementation stages in 2010, Members agreed to terminate their active currency mandate, that included a hedge overlay. To minimize the short term effects of currency volatility on performance in our segregated global equity portfolios, our custodian BNY Mellon was contracted to hedge 50% of the major currencies, Dollar, Yen and Euro.

3.2 Members asked for a briefing paper to review the currency hedge to determine if it was still beneficial to the Fund

## 4. Implications

4.1 **Financial implications**
Fund management and administration fees are charged directly to the pension fund. The passive hedge service fee is £5000 per annum.

4.2 **Legal Implications**
None applicable to this report.

4.3 **Environmental Implications**
None applicable to this report.

4.4 **Equality Impact Assessment**
None applicable to this report.

## 5. Conclusion and reasons for recommendation

5.1 Members are asked to consider the briefing paper Appendix 2, and agree to option1 or option 2.

**Background papers:**
None

Final report clearance:

**Signed by:**

| | | |
|---|---|---|
| | Corporate Director of Finance & Resources | Date |
| **Received by:** | | |
| | Head of Democratic Services | Date |

Report Author: Joana Marfoh
Tel: (020) 7527 2382
Email: Joana.marfoh@islington.gov.uk

REPORT ON

**CURRENCY HEDGING**

PREPARED FOR

# London Borough of Islington

20th August 2015

**Karen Shackleton**
**AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)**

karen.shackleton@allenbridge.com www.allenbridgeepic.com

This document is directed only at the person(s) identified above on the basis of our investment advisory agreement with you. No liability is admitted to any other user of this report and if you are not the named recipient you should not seek to rely upon it. It is issued by AllenbridgeEpic Investment Advisers Limited, an appointed representative of Allenbridge Capital Limited which is Authorised and Regulated by the Financial Conduct Authority.

We understand that your preference is for your adviser to issue investment advice in the first person. We recognise that this preference is a matter of style only and is not intended to alter the fact that investment advice will be given by AllenbridgeEpic Investment Advisers Limited, an authorised person under FSMA as required by the Pensions Act.

AllenbridgeEpic Investment Advisers Limited is a subsidiary of Allenbridge Investment Solutions LLP.

## Note on Currency Hedging

### Background

When a pension fund invests in foreign-denominated assets, inherent in the investment is an element of currency exposure. By entering into forward foreign exchange contracts and futures contracts, it is possible for a pension fund to eliminate that currency risk. This can be advantageous during periods when sterling is appreciating.

### Example:

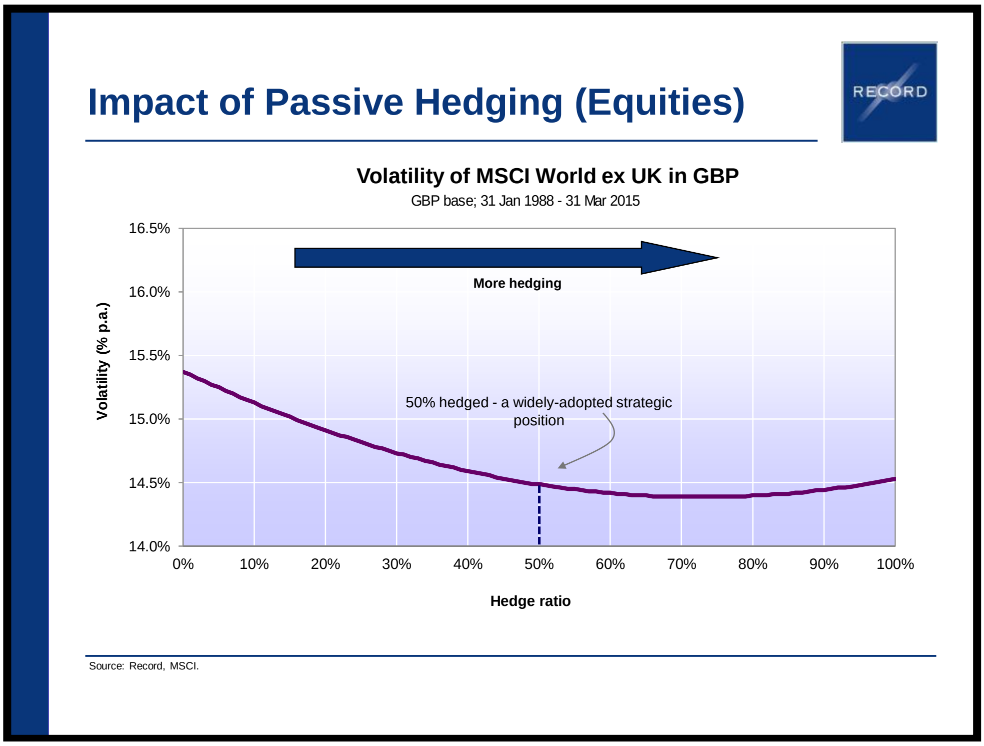
A manager has a £100 million investment in US equities. The exchange rate is $1.60, which equates to a dollar value of $160 million. If sterling appreciates to $1.70 (and assuming the equity market stays flat), the sterling value of that portfolio now falls to £94.1 million. By hedging the currency exposure, the portfolio would still be worth £100 million, because the sterling loss in value would be offset by a gain on the forward foreign exchange contract.

However, if sterling were to depreciate to $1.50, the sterling value of the holding would increase to £106.7 million. In this case, the currency hedging strategy would make a loss, offsetting the gain in the equity portfolio.

### What is the investment case for currency hedging?

Traditionally, academics used to recommend that pension funds unilaterally hedged around half of their currency exposure on risk diversification grounds. This, they argued, would lead to a more efficient risk adjusted return stream. Record Currency Management Limited, for example, have analysed the volatility of the MSCI World ex UK in sterling for different levels of currency hedging and the results are shown in Chart 1.

**Chart 1**




**Source: Record Currency Management Limited – reproduced with their permission**

Chart 1 confirms that hedging 50% of currency (as in London Borough of Islington's portfolio) did indeed result in lower volatility for a sterling investor, based on returns from January 1988 to March 2015.

However, research by Elroy Dimson, Paul Marsh, and Mike Staunton of the London Business School published in 2012, has concluded the following:

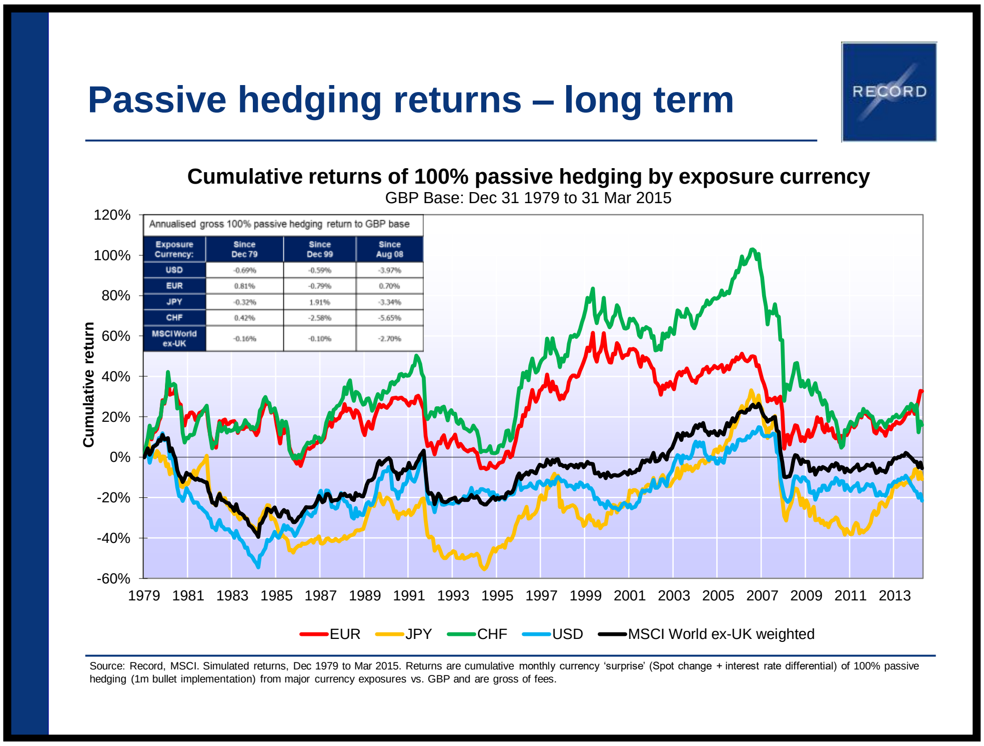
- Overseas equities perform best after periods of currency weakness. As the example above demonstrates, investors gain when a foreign currency appreciates (and sterling depreciates) and suffer losses when that currency depreciates (and sterling appreciates). Because of this diversifying relationship between equity performance and currency performance, the authors concluded that un-hedged exposure was most effective at reducing the volatility of the portfolio.

- For bonds the picture was much less clear. Overseas bond investment added to portfolio risk primarily through currency exposure. Short-term currency hedging was found to be beneficial although these benefits were reduced with longer investment horizons.

Record Management's response to the Dimson, Marsh and Staunton research is that, whilst they agree with the long term conclusion drawn by the authors, it masks a wide array of outcomes over shorter time periods.

Chart 2 shows the returns of a 100% passive hedge for some of the main currencies in a typical global equity portfolio. This chart is interesting because it demonstrates that there are shorter term divergences in the returns on currency hedges for different currencies at different points in time, some of which can be quite significant.

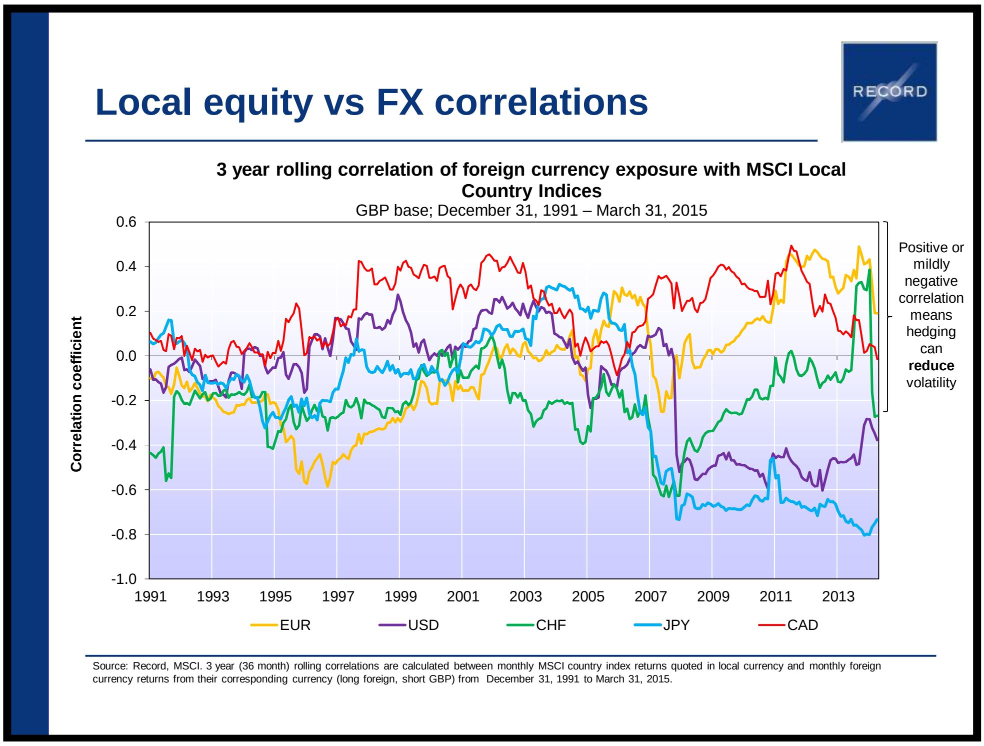
**Chart 2**




**Source: Record Currency Management Limited**

Record also argue that the correlations between the currency and the local equity market are far from static. Chart 3 shows the three year rolling correlations of foreign currency exposure with the MSCI Local Country Index for five key currencies.

**Chart 3**




**Source: Record Currency Management Limited**

When a currency is going through a period of more positive correlation with its equity market, hedging is likely to reduce volatility. When the currency is negatively correlated, however, an unhedged position is likely to be better. So the answer is: "It depends".

**How can strategic currency hedging be implemented by a pension fund?**

There are several ways a pension fund can introduce a strategic currency hedging programme into the portfolio:

- **Passive hedging.** In this case, an investment manager, or the pension fund's custodian, routinely hedges a pre-agreed, fixed percentage of the currency exposure in the portfolio, typically by entering into forward foreign exchange contracts with rolling three-month periods. At the end of each three months, the changes in currency values are cash settled and new currency forward positions are put in place.

  If sterling appreciates, the cash settlement on the forward currency is positive (this offsets the loss on the underlying portfolio). If sterling depreciates, the forward exchange contract settles at a loss and this is offset by the gain in the value of the underlying portfolio.

  Note that this means that there are occasions when the Fund will be asked to pay across cash. Although this is offset by an equivalent book gain in the underlying portfolio, in periods of continued sterling depreciation, the cash calls could become significant.

- **Dynamic hedging.** In this case, the fund manager will vary the amount hedged according to sterling's strength or weakness. The more the foreign currency appreciates, the less the manager hedges, and vice versa. The effect of this strategy is to generate an option-like payoff that captures most of the benefits of foreign currency strength but offers some protection in periods of domestic currency strength.

  Note that this strategy has similar cash payment flows as for a passive hedging approach (although the amounts will differ).

- **Active currency overlay management.** This is where a fund manager uses active skills and judgement to anticipate when currencies are appreciating and when they are weakening. Managers use fundamental and/or quantitative analysis to assess whether currencies are over- or under-valued, and position the portfolio accordingly.

  Arguably this is not a strategic currency hedging approach, as such, yet in the past some funds have argued that this approach offers them the twin benefits of both reducing portfolio risk and increasing potential return (because of the active selection decisions). Unfortunately, the poor performance of many active currency managers during the credit crunch earned active currency overlay management a bad name, and has led to a considerable number of pension funds withdrawing from this approach.

- **Tactical currency hedging as part of the underlying portfolio.** A final option is to delegate responsibility for currency hedging to the investment manager responsible for the overseas investments. Typically, managers will be happy to take tactical decisions to hedge currencies in the short term, as part of their investment decisions. Bond managers are more inclined to do this than equity managers. A major advantage of this approach is that the cash settlement on any forward foreign exchange contract must be dealt with by the investment manager as part of their portfolio administration.

**What do other LGPS Funds do?**

According to WM research, less than a quarter of LGPS funds in their universe now have a strategic currency hedging mandate in place. Active currency mandates remain relatively few and far between, and have fallen significantly from around twenty mandates, five years ago, to just two as at year end in 2014.

**Currency hedging in the London Borough of Islington portfolio**

At present, half the currency exposure of the overseas equity allocation is hedged. This is a strategic overlay hedging strategy, implemented by BONY Mellon using forward foreign exchange contracts. The bond portfolio invests in sterling-denominated corporate bonds, so there is no currency exposure in this part of the portfolio. The global property and private equity allocations are unhedged.

The committee is advised to consider whether it has the appetite to live with the shorter term impact of currency volatility on the fund's valuation. Whilst these effects may well wash out over time, the shorter term effect could be significant and if this is a concern, I would argue in favour of maintaining the 50% currency hedging programme, notwithstanding the longer term conclusions drawn by Dimson, Marsh and Staunton.

If the short term impact is not a concern, then I would recommend an unhedged equity allocation, on the basis that research indicates that the currency effects wash out over time, so not hedging would save the (modest) costs associated with implementing the strategic currency hedge.

**Karen Shackleton**
**Senior Adviser**
**AllenbridgeEpic Investment Advisers Limited**
**20th August 2015**

This page is intentionally left blank

ISLINGTON

**Finance Department**
**Municipal offices, 7 Newington Barrow Way London, N7 7EP**

**Report of:** **Corporate Director of Finance and Resources**

| Meeting of: | Date | Agenda item | Ward(s) |
|---|---|---|---|
| Pensions Sub Committee | 14 September 2015 | | n/a |

| Delete as appropriate | Exempt | Non-exempt |
|---|---|---|

## SUBJECT: ANNUAL REVIEW AND PROGRESS ON THE 2011-2015 PENSION BUSINESS PLAN

## 1. Synopsis

1.1 To report to the Pension Sub committee progress made to date on some of the action plans in the agreed four year business plan and undertake an annual review of the plan

## 2. Recommendations

2.1 To consider and note progress to date on some of the action plans on the attached business plan, Appendix A.

2.2 To review the business plan objectives and agree the required changes if any for the next 4years

## 3. Background

3.1 CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom (Guidance note issue No. 5) publication, is based on ten principles proposed by the Myners review of Institutional Investment in the United Kingdom, and was adopted by the Government as a model for best practice in 2001.

3.2 The 10 Myners principles were reviewed by the NAPF in 2007 and after consultation a response document was published in October 2008 and adopted by CLG (government department responsible for the oversight of the LGPS). The LGPS administering authorities are required to prepare, publish and maintain a statement of compliance against a set of six principles for pension fund investment, scheme governance, disclosure and consultation.

3.3 The Myners principles and compliance forms part of Islington Pension Fund's published Statement of Investment Principles. Myners Principle 1- Effective decision-making through a forward looking business plan is a key requirement. Members agreed a four year business plan to April 2015 and to review the plan annually.

3.4 The key objectives of the four year business plan agreed at the March 2011 Pensions sub-committee and last reviewed in June 2014 are

- To achieve best practice in managing our investments in order to ensure good long-term performance , sustainability of the Fund and pursue new investment opportunities
- To continually improve our administration in order to deliver an excellent and cost effective service to all Fund Members.
- To engage with companies as an active and responsible investor with a focus on good corporate governance and environmental sustainability.
- To actively monitor and challenge poor performance in managers and to pursue new investment opportunities
- To develop collaboration opportunities with other funds for sharing of services collaborate

3.5 The four year business plan with progress to June 2015 is attached as Appendix A. Members are asked to consider and note progress made and undertake a review of the plan's objectives for any amendments for the next 4 years

## 4. Implications

4.1 **Financial implications:**

4.1.1 It is envisaged that a good business plan with effective actions as a whole will lead to efficiencies in running the fund and cost savings.

4.2 **Legal Implications:**

4.2.1 Elected members have fiduciary duty to the Fund, scheme members and local council tax payers in relation to the LGPS.

4.3 **Equality Impact Assessment:**

4.3.1 The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding."

4.3.2 An equalities impact assessment has not been conducted because this report is not considering any policy changes.

4.4 **Environmental Implications**

4.4.1 None specific to this report

## 5. Conclusion and reasons for recommendations

5.1 It is good practice to have a business plan to formulate actions and enable members to make effective decisions. Members are therefore asked to note progress made and review the business plan to agree the required amendments.

**Appendix A -4 year business plan to 2015**

**Background papers:** none

Final report clearance:

**Signed by:**

| | | |
|---|---|---|
| | Corporate Director of Finance and Resources | Date |
| **Received by:** | | |
| | Head of Democratic Services | Date |

Report Author: Joana marfoh
Tel: 020-75272382
Fax: 020-75272056
Email: Joana.marfoh@islington.gov.uk

This page is intentionally left blank

APPENDIX A

| Action to be taken | Timescale | Details ( primary responsibility) | Progress to May 2013 | Progress to June 2014 | Progress to June 2015 |
|---|---|---|---|---|---|
| 1. To achieve long-tem investment performance , Fund sustainability and pursue new investment opportunities | | | | | |
| (a) Consider an interim valuation and LGPS scheme changes | Ongoing | Use results to review funding level and any potential effect of the scheme changes | Considered interim valuation and likely position for 2013 valuation. 31 March 2013 actuarial valuation is now being undertaken | 31 March 2013 actuarial completed and certified on 30/3/14 | Received an initial Funding update in June 2015 and noted that alternative approaches on assumptions would need to be considered |
| (b) Review investment strategy to reflect asset/liability position To commence as part of the 31 March 2013 actuarial valuation process | 2014-2015 | To use results and other analyses to set benchmark asset allocations and Fund outperformance targets and risk levels *(Pensions sub-cttee, Investment advisers).* | b)September meeting to consider fund objective to formulate investment strategy | b) Members agreed in November to maintain split of 75% growth and 25% matching asset allocation | A further drill down into matching assets has been considered through briefing and training of members |
| (c) Implement any resulting changes to asset allocation, portfolio and fund management structures. | Ongoing | Plan procurement and tendering process with transition of assets requirement to minimize cost and optimize value of assets | c)L& G will transition on 3 June 2013 to minimize transaction cost | c)10 % of the total fund is to invested in a Diversified growth fund(DGF) | A DGF manager was seeded on 30 June 2015-funded from UK and global equities |
| (d) Review all contracts on a rolling basis including, actuary, voting services, investment advisers and custodial services. | 2011-2015 | Committee to agree conclusions of all reviews. Director of Corporate Finance to have delegated authority to review contracts and performance and fee levels when required. *(Pensions Sub-Committee, Officers).* | d) National framework for pension advice and actuary service is now up and running and custody service is nearing final stages for completion in Autumn<br><br>-LBI will be using these frameworks going forward<br>- PIRC reappointed for a 3year contract in Jan'2013.<br><br>- | d) Signed up to use National custody framework . | BNY Mellon contract extended for 2 years. |
| (e) Closely monitor new legislation affecting the LGPS or pension provision. | Ongoing | Consider reports on the implications for the Fund and agree actions necessary to ensure full compliance when final legislation is enacted including meeting deadlines. *(Pensions sub-committee, Officers, Actuary ).* | | Council responded to Councillors pension consultation in June'13<br><br>Also responded to Call for evidence on LGPS merger of Fund and subsequent CIV consultation in September | Responded to DCLG consultation on scheme governance in August 2014<br><br>Local Pension Board has been formulated as per new regulations in April 2015.<br><br>Funding Strategy Statement was updated in March 2015 to reflect new 2013 LGPS Regulations |
| 2. To deliver an excellent and cost effective administration service to all fund members | | | | | |
| (a) Agree key performance indicators for the administration of the Fund and continue to benchmark against similar funds. | Ongoing. | Development complete by Q2 2011 with regular reporting to schedule to Pension sub cttee thereafter. Continue ongoing CIPFA benchmarking. *(Officers).*<br>Analyse survey results<br>(pension sub cttee, officers) | a)Members continue to receive quarterly monitoring rept on focused KPI | *Ongoing* | Local Pension Board will now scrutinise admin performance and will receive a semi – annual monitoring report. |

**APPENDIX A**

| **Actions to be taken** | **Timescale** | **Details (primary responsibility)** | **Progress to May 2013** | **Progress to June 2014** | **Progress to June 2015** |
|---|---|---|---|---|---|
| (b) Carry out a survey to gain feedback from pensioners and active employees on customer satisfaction. | 2012 | Changes required from survey to be implemented during 2012. *(Pensions sub cttee, Officers including LBI communications team)*<br>. | b) Pensioner's survey results were discussed at AGM in October 2012. | *Survey of satisfaction levels for active and newly retired over one year period from August 2013 was reported to Members in September Results had a high level of satisfaction.* | All members are now asked at point of accessing the service for their feedback that is logged and reported quarterly. |
| (c) Implement changes based on survey responses | Oct 2012-Mar 2013 | | Good work of admin team was highlighted and improvements are to be made to answering of telephone calls by staff. | | |
| d) To devise a communication plan and consultation to stakeholders | Ongoing | Newsletters, annual benefit statements, annual reports, AGM and employers meetings to continue as previously *(Officers).* | d)Annual benefits statement due out in June 2013<br><br>Communication plan on 2014 LGPS to be in place by September 2013 | d) Active members received their annual benefit statements (ABS) in June 2013 and deferred members in December 2013.<br><br>Publicity and letters sent out on New LGPS was reported to Members *in March '14* | Annual benefits statements were sent out in October 2014 and the same is aimed for 2015. |
| 3. To be active and responsible investors focusing on corporate governance and environment sustainability through engagement. | | | | | |
| (a) Continue to engage with companies through active membership of LAPFF, IIGCC and other suitable bodies. | Ongoing. | Key themes will be corporate governance especially relating to human rights, employment practices and protection of the environment. *(Pensions sub cttee, Investment advisers, PIRC, Officers.)* | (a) Continue to work with LAPFF and IIGCC | a) Continue to work with LAPFF and IIGCC | Work with LAPFF and IIGCC continues |
| (b) Develop improved monitoring of fund manager engagement activity. | Ongoing. | To include engagement with managers on their own corporate governance as part of terms of reference on appointment. *(Pensions sub cttee, investment advisers, Officers).* | | b) Members have attended a number of AGMs of companies as shareholder to exercise our voting rights | Members have attended a number of AGMs of companies as shareholder to exercise our voting rights and speak to company directors |
| (c) Improve communication of engagement activities to stakeholders and public. | Review during 2012 | To include potential for publication of LBI voting record. *(Officers and PIRC).* | c) Fund voting records will form part of its Annual report 2013. | PIRC service provider presented our voting records at the 2013 AGM | PIRC service provider presented our voting records and engagement at the 2014 AGM |
| (d) Integrate our responsible investment policy into the Fund's investment review | Ongoing | To include consideration of appropriate responsible investment funds. Manager policies on equalities, environment and corporate governance to form review criteria alongside performance and fee | Applied in tender procurement documents. | Members have sought Counsel advise on investors responsibilities in respect of SRI issues and a full report is to be discussed in September to update the Fund's SIP | The Fund's SIP was updated in November 2014 to incorporate amendments to the paragraphs on social, environmental and ethical considerations |

**APPENDIX A**

| Actions to be taken | Timescale | Details (primary responsibility) | Progress to May 2013 | Progress to June 2014 | Progress to June 2015 |
|---|---|---|---|---|---|
| | | considerations.<br>*(Pensions sub cttee, Investment advisers, Officers).* | | | |
| 4. To actively monitor and challenge poor performance in managers and to pursue new investment opportunities | | | | | |
| (a) Review current fund manager performance against agreed targets over three- to five year rolling periods | Ongoing | Use existing terms of reference for appointment and firing of managers as a guideline to monitor performance of fund managers *(Pensions sub cttee, Investment advisers, Officers).* | (a) Members continue to monitor fund managers performance | a)Members monitoring continues | a)Members monitoring continues |
| (b) Review current fund manager quarterly monitoring arrangements | Ongoing | Agree a forward plan for existing fund managers to meet the pension sub committee. The Corporate Director of Finance to continue monitoring managers between quarterly meetings (*Pensions sub cttee, Investment advisers, Officers).* | (b) The forward plan now schedules managers to present to the cttee. | (b)The forward plan continues to schedule managers | The forward plan continues to schedule existing managers. |
| (c) To consider new investment opportunities which can help improve the fund's financial performance | Ongoing | Pension sub committee have a long term objectives and clear investment policies to achieve them. (*Pensions sub cttee, Investment advisers, Officers).* | c) £20million Residential property mandate was funded in January 2013.<br><br>50% of emerging market passive mandate with L&G to be benchmarked against FTSE RAFI index effective from 3 June 2013 | Members have received a number of reports on investment approaches and various training sessions. | Reinvestment of $40m with Franklin Templeton our global property manager was agreed in September 2014<br><br>Additional £5m was invested in Aviva , Lime Fund to bring our investment to 5% of the total Fund in June 2015<br><br>Equities were reduced to fund the £100m DGF , in June 2015 |
| (d) To keep abreast of developments on pension and investment issues | Ongoing | Pension sub committee will agree a training plan and evaluate annually training undertaken and future needs<br>*(Pensions sub cttee, Investment advisers, Officers).* | | Members have received training sessions on Diversified Growth Funds and multi asset credits role in a portfolio to enable them to make asset allocation decisions | Training sessions are scheduled before each committee meeting and topics have included Emerging and frontier markets, infrastructure, social housing, and impact investing |
| | | | | | |
| 5. Develop collaboration opportunities with other funds for sharing of services | | | | | |
| a) Seek to collaborate with other partners to achieve efficiencies and value for money | Ongoing | To agree to share services where it is beneficial to the fund objectives of sustainability and performance | | Members have signed up to be a shareholder of the new London Collective Investment Vehicle (CIV) as an investment company for London Boroughs. The Chair of the Pensions Sub Committee will also sit on the new London Pensions CIV Joint Committee. | Progress of the CIV is continuing and should be seeded by the end of the year. |

This page is intentionally left blank

ISLINGTON

**Finance Department**
**7 Newington Barrow Way**
**London N7 7EP**

**Report of:** **Corporate Director of Finance and Resources**

| **Meeting of:** | **Date** | **Agenda item** | **Ward(s)** |
|---|---|---|---|
| Pensions Sub-Committee | 14 September 2015 | | n/a |

| | | |
|---|---|---|
| **Delete as appropriate** | | Non-exempt |

## SUBJECT: RESPONSIBLE INVESTMENT AND ENGAGEMENT

## 1. Synopsis

1.1 Appendix 1 to this report is a paper prepared by our investment advisor, Mercer on drivers and approaches to responsible investment and engagement, and options to consider on implementation.

## 2. Recommendation

2.1 To consider the paper prepared by Mercer and attached as Appendix 1

2.2 To consider and agree what, if any, action to take in implementing responsible investment principles.

## 3. Background

3.1 Regulation 12(2)(f) of the Management and Investment of Funds Regulations requires that the Statement of Investment Principles (SIP) must be a statement of the principles governing the authority's decisions about the investment of fund money, which covers the extent to which social, ethical or environmental (SEE) considerations are taken into account in the selection, retention and realisation of investments.
Our current SIP paragraphs, on social and ethical considerations were updated in November 2014 to reflect the Pension Sub committees' policy.

3.2 The Council is the administering authority for the London Borough of Islington Pension Fund, within the Local Government Pension Scheme (LGPS). It is managed within the legal framework set down in the Local Government Pension Scheme Regulations 2007/8 as amended. The body responsible for decision making in relation to the Pension Fund is the Pensions Sub-Committee of the Audit Committee.

3.3 The Pensions Sub-Committee, as the administering authority, is aware of its fiduciary responsibility to obtain the best possible financial return on investments over appropriate investment periods, within acceptable levels of risk and will apply this principle when making investment decisions on behalf of the Islington pension fund.

3.4 The Pensions Sub-Committee takes the view that well-managed companies that evaluate and assess their social and environmental impacts are likely to add shareholder value in the long term more successfully than companies that do not manage these impacts. In considering its choice of investments in segregated funds, priority will be given to achieving a wide variety of suitable investments that is best for the financial position of the Fund. It will encourage its Fund managers to work positively with companies to promote forward- looking social, environmental and ethical standards and integrate Environmental, Social and Governance (ESG) into their investment decisions.

The Islington Fund collaborates with other local authorities to use its shareholder rights in a responsible manner to influence company behaviour, through membership of the Local Authority Pension Fund Forum (LAPFF), and is a member of the Institutional Investors Group on Climate Change (IIGCC) that seeks to promote better understanding of the implications of climate change

3.5 Members agreed to consider a further paper on engagement to develop and enhance their current policies. Mercer has prepared a high level paper on drivers and approaches of responsible investment and next steps implementation for Members' consideration.

## 4. Implications

### 4.1 Financial implications

There are no financial implications arising from this report.

### 4.2 Legal Implications

Regulation 12(2)(f) of the Management and Investment of Funds Regulations requires that the Statement of Investment Principles (SIP) must be a statement of the principles governing the authority's decisions about the investment of fund money, which covers the extent to which social, ethical or environmental (SEE) considerations are taken into account in the selection, retention and realisation of investments.

### 4.3 Environmental Implications

Environmental considerations can lawfully be taken into account in investment decisions.

### 4.4 Equality Impact Assessment

4.4.1 The Council must, in carrying out its functions, have due regard to the need to eliminate unlawful discrimination and harassment and to promote equality of opportunity in relation to disability, race and gender and the need to take steps to take account of disabilities, even where that involves treating the disabled more favourably than others (section 49A Disability Discrimination Act 1995; section 71 Race Relations Act 1976; section 76A Sex Discrimination Act 1975."

4.4.2 An equalities impact assessment has not been conducted because this report is not considering any policy changes. All employers have been consulted on changes to assumptions and there are no equalities issues arising**.**

.

## 5. Conclusion and reasons for recommendation

5.1 To consider Mercer's paper Appendix 1 on drivers and approaches to responsible investment and engagement and what, if any, action to take in implementing responsible investment principles.

**Background papers:**
Islington Council Statement of Investment Principle (November 2014)

Final report clearance:

**Signed by:**

| | | |
|---|---|---|
| | Corporate Director of Finance & Resources | Date |
| **Received by:** | | |
| | Head of Democratic Services | Date |


Report Author: Joana Marfoh
Tel: (020) 7527 2382
Email: Joana.marfoh@islington.gov.uk

This page is intentionally left blank

MERCER
MAKE TOMORROW, TODAY

# RESPONSIBLE INVESTMENT AND ENGAGEMENT

## LONDON BOROUGH OF ISLINGTON PENSION FUND (THE "FUND")

This paper has been prepared for the Pensions Sub-Committee ("PSC") of the Fund to provide an introduction to both the drivers for and approaches to Responsible Investment (RI). The paper also sets out guidance for some next steps that the PSC can take in terms of developing its approach to RI and engagement.

Mercer defines RI as the integration of environmental, social and corporate governance (ESG) factors into investment management processes and ownership practices in the belief that these factors can have material impact on financial performance (please see Appendix A for examples of ESG issues). RI is distinct from ethically driven investment, which is typically guided by moral values, ethical codes or religious beliefs.

There are five main approaches that fall under the broad category of RI. These approaches can be implemented on a stand-alone basis or in combination; indeed, most investors employing a comprehensive RI programme would have elements of most, if not all, of these approaches. We have set out below a brief summary of each of these approaches:

| **1. ESG integration** | Ethically driven ✗ | Financially driven ✓ |
|---|---|---|

At the forefront of recent developments in RI is an integrated approach to considering ESG factors as part of the investment process. Integration can be applied across all asset classes, although at present the asset class where ESG integration is most developed is listed equities. Investment managers adopting this approach actively take ESG issues and themes into account in their fundamental research, analysis and stock-selection decision-making processes.

Some investors utilise ESG indicators purely for risk management purposes, while for others they are fundamental to the idea generation and portfolio construction for added-value creation. Mercer rates over 5000 investment strategies on the extent to which ESG issues are integrated into the investment process. (For more detail on Mercer's ESG ratings approach, please see Appendix A).

| **2. Active ownership (engagement)** | Ethically driven ✗ | Financially driven ✓ |
|---|---|---|

Active ownership, also referred to as stewardship, is an investment approach whereby investors seek to use their influence as shareholders to change corporate behaviour, usually to bring them in line with best practice in a particular area and most commonly to improve standards of corporate governance through engagement.
Active ownership tools range from using voting rights and undertaking engagement activity through oral and written communication with companies on specific topics, to collaborative

engagement with other shareholders often to promote systemic change within a certain sector. These tools are increasingly being pursued in an effort to reduce risk and enhance long-term shareholder value. The UK Stewardship Code was introduced in 2010 to encourage on-going dialogue between investment managers and asset owners.

| **3. Screening (Positive or Negative)** | Ethically driven ✓ | Financially driven ✓ |
|---|---|---|

Positive screening is the inclusion or overweighting of public company stocks based on whether the company has a positive impact on society through their ESG policies (such as community investing, health, public transport and renewable energy). Negative screening is the exclusion or underweighting of companies that are involved in sectors with a perceived negative impact on society, such as gambling, alcohol, animal testing, armaments manufacturing and tobacco production, or companies with poor records of ESG performance.

| **4. Thematic investing** | Ethically driven × | Financially driven ✓ |
|---|---|---|

Investing in sustainability themes offers attractive opportunities to access the growth potential of companies providing solutions to the challenges of resource scarcity, demographic changes, and changes in the evolving policy response to a range of environmental and social issues. The vast majority of themed funds have a sustainability/environmental focus. These funds have grown significantly (both in terms of number of strategies and assets being managed) in recent years with the emergence of sustainability as a key social and investment trend that may drive long-term growth and returns.

| **5. Impact investing** | Ethically driven ✓ | Financially driven ✓* |
|---|---|---|

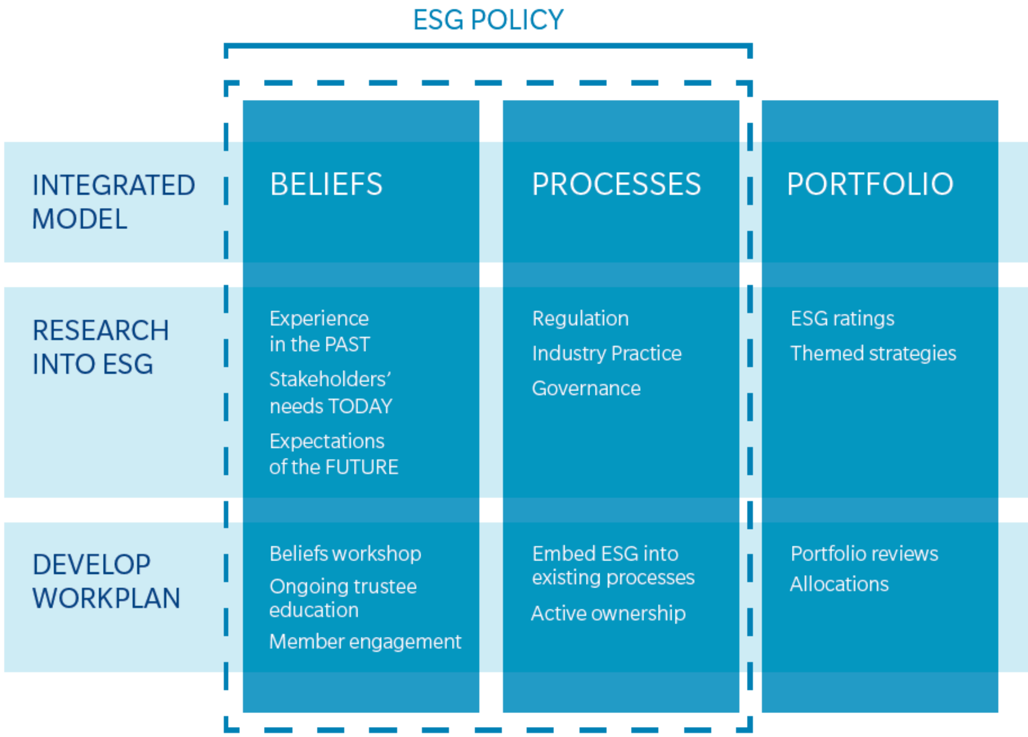
The Global Impact Investing Network defines impact investments as “investments made into companies, organisations, and funds with the intention to generate measurable social and environmental impact alongside a financial return”. Impact investing strategies are typically private equity, private debt or other alternative strategies, although more recently some listed equity strategies have emerged. There is a wide variety of potential approaches, but a common type of fund uses investor capital to support small businesses in emerging or under-served markets and typically impact investing funds seek to invest in companies or organisations that are solutions-oriented in terms of addressing environmental or social issues. The key differentiator between impact investment strategies and ESG integration is an expectation of detailed measurement and reporting of positive impact alongside financial returns.

* Impact investment strategies vary between those that target market-level investment returns (and are therefore financially driven) and those that offer below market level returns, which are sometimes referred to as “impact-first” strategies. Those strategies that would be suitable for the Fund would fall into the former category.

## Implementation and next steps

Responsible investment principles are applied most effectively when integrated into standard investment processes, providing an additional layer of insight and oversight. Mercer recommends that the PSC focuses on improving the level of ESG integration and active ownership (engagement) within its existing investment manager structure as well as considering whether, longer-term, it should expand into thematic or impact investment strategies. In particular, the PSC could consider the ESG ratings and UK Stewardship Code compliance of its investment managers in more detail.

The framework below identifies where ESG and sustainability considerations sit within the typical 'Beliefs, Processes, Portfolio' investment approach.




We would be happy to work with the PSC to help integrate RI further into the Fund's investment strategy.

## Important Notices

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.



The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer's ratings do not constitute individualised investment advice.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy in the data supplied by any third party.

This does not constitute an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products or constitute a solicitation on behalf of any of the investment managers, their affiliates, products or strategies that Mercer may evaluate or recommend.

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, contact your Mercer representative.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see www.mercer.com/conflictsofinterest.

Mercer's universes are intended to provide collective samples of strategies that best allow for robust peer group comparisons over a chosen timeframe. Mercer does not assert that the peer groups are wholly representative of and applicable to all strategies available to investors.

This does not contain regulated investment advice in respect of actions you should take. No investment decision should be made based on this information without obtaining prior specific, professional advice relating to your own circumstances.

**Nick Sykes**
August 2015

## Appendix A: Examples of ESG issues

**TABLE 1:** ESG FACTORS

| ENVIRONMENTAL FACTORS | SOCIAL FACTORS | GOVERNANCE FACTORS |
|---|---|---|
| Climate change strategy | Stakeholder relations | Board structure and diversity |
| Environmental policy | Working conditions | Independent board directors |
| Sustainability best practice | Supply chain management | Independent board leadership |
| Environmental management practices | Health and safety conditions | Separation of Chairman and CEO |
| Pollution management | Product safety measures | Executive compensation |
| Water supply management | Treatment of customers | Shareowner rights |
| Sustainable transport | Labour relations, including relationship with unions | Accounting quality |
| Waste management | Community impact assessment | Audit quality |
| Clean energy investments | | Board skills |

## Appendix B: Mercer's ESG ratings

Mercer's ESG ratings process involves rating fund managers against their ability to outperform their benchmark whilst taking ESG factors into account. The ESG ratings are applied at the strategy level (rather than the manager level) and represent Mercer's view on the extent to which ESG and active ownership practices are integrated into the manager's investment process across different asset classes. Mercer assesses how ESG factors are incorporated into idea generation, portfolio construction, implementation and business management (see below table for further detail). The extent to which fund managers have formalised their approach varies considerably and, consequently, Mercer ESG ratings can vary greatly even within asset classes and styles. We believe investment decisions should not be taken on ESG ratings alone, but as part of the overall evaluation and selection process consistent with fiduciary duty.

| Factors | Example considerations |
|---|---|
| Idea generation | Is there evidence of identifying ESG risks and opportunities at the portfolio level? |
| Portfolio construction | How effectively does the manager translate his/her ESG views into the active positions in the portfolio? |
| Implementation | Does ESG integration impact on the manager's portfolio turnover and investment horizon? Is there evidence of proxy voting and engagement activities? |
| Business Management | To what extent do the business leaders understand and accept the importance of ESG/RI and to what extent have they integrated these across the whole business? |

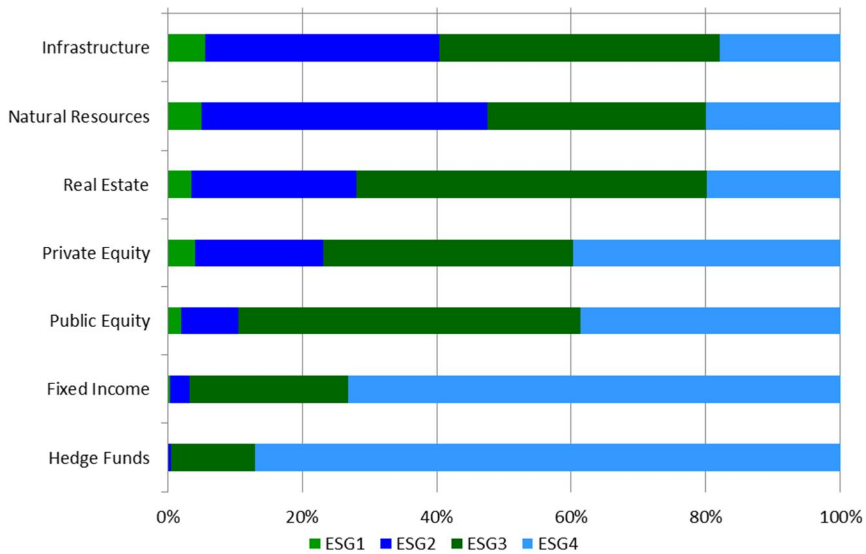
The ratings are presented as 'zones of capabilities' along a 4 point scale as follows:

| Rating | Description |
|---|---|
| **ESG1** | The highest ESG rating is assigned to strategies that Mercer believes to be leaders in integrating ESG and active ownership into their core processes, and that provide clear evidence that ESG overall, or a particular ESG theme, is core to idea generation and portfolio construction. |
| **ESG2** | The second highest rating is assigned to strategies that, in Mercer's view, include ESG factors as part of decision making, with a strong level of commitment made at the firm-wide level and some indication that data and research are being taken into account by the managers in their valuations and investment processes. |
| **ESG3** | The penultimate rating is assigned to strategies for which, in Mercer's view, the manager has made some progress with respect to ESG integration and/or active ownership, but for which there is little evidence that ESG factors are taken into consideration in valuations and investment processes. |
| **ESG4** | The lowest ESG rating is assigned to strategies for which, in Mercer's view, little has been done to integrate ESG and active ownership into their core processes. |
| **N** | Strategy not rated by Mercer. |

Figure 2 below shows the distribution of ESG ratings, across a number of different asset classes, as at the end of August 2014. Approximately 10% of those strategies with an ESG rating

(~6,000) have received our highest ratings - ESG1 or ESG2. While this is currently a relatively small percentage, we note that industry standards continue to evolve towards a greater formalisation of ESG integration. ESG1-rated strategies are often structured so that ESG issues drive the idea generation process. Examples of these types of strategies include sustainability themed funds focused on sustainable development (through ideas such as clean energy or water efficiency), and therefore ESG1-rated strategies tend to be less diversified and more volatile than “core” or other strategies. ESG2-rated strategies include some Socially Responsible Investment (SRI) funds but also a growing number of mainstream, diversified investment strategies across different regions and asset classes.

**ESG ratings distribution across asset classes – Mercer Universe as of August 2014 (n=5,970)**




## ESG ratings for passively managed equity strategies

In 2014, Mercer adapted the ESG ratings framework for passively managed equity strategies, introducing our ESG-Passive “ESGp” ratings. The ESGp ratings scale is designed to assess passive equity managers’ commitment to voting, engagement, and industry collaboration on ESG issues. This is reflected in the ESGp four factor framework, which is detailed in the table below.

| Factors | Example considerations |
|---|---|
| Voting and engagement process | Quality of engagement – is the focus only on corporate governance issues or does the team have a process in place for environment and social engagements? |
| Resources and implementation | Effectiveness of engagement outcomes – is this being measured? If so, how? |
| ESG integration and internal initiatives | What additional work is the team undertaking regarding ESG data analysis to enhance the active ownership process? |
| Industry collaboration / firm-wide activities | Does the team work with other institutional investors in collaborative initiatives and engage with regulators and policymakers? |

ESGp ratings are also assigned using an ESGp1 to ESGp4 scale (see below) but are not directly equivalent to Mercer's ESG rating scale for active equity strategies, as passive equity strategies do not consider Idea Generation or Portfolio Construction.

| Rating | Description |
|---|---|
| **ESGp1** | Leaders in voting and engagement across ESG topics, with active ownership activities and ESG initiatives undertaken consistently at a global level. |
| **ESGp2** | Strong approach to voting and engagement across ESG topics, and initiatives at a regional level, with progress made at a global level. |
| **ESGp3** | Focus tends to be on voting and engagement on governance topics only, more regionally focused with less evidence of other internal ESG initiatives. |
| **ESGp4** | Little or no initiatives taken on developing a voting and engagement capability, with little progress made on other ESG initiatives. |
| **N** | Strategy not rated by Mercer. |

MERCER
MAKE TOMORROW, TODAY

1 Tower Place West,
Tower Place,
London
EC3R 5BU.

This page is intentionally left blank

ISLINGTON

**Finance Department**
**7 Newington Barrow Way**
**London N7 7EP**

**Report of:** **Corporate Director of Finance and Resources**

| Meeting of: | Date | Agenda item | Ward(s) |
|---|---|---|---|
| Pensions Sub-Committee | 14 September 2015 | | n/a |

| | | |
|---|---|---|
| **Delete as appropriate** | | Non-exempt |

## SUBJECT: PENSIONS SUB-COMMITTEE 2015/16– FORWARD PLAN

## 1. Synopsis

1.1 The Appendix to this report provides information for Members of the Sub-Committee on agenda items for forthcoming meetings and training topics.

## 2. Recommendation

2.1 To consider and note Appendix A attached.

## 3. Background

3.1 Details of agenda items for forthcoming meetings will be reported to each meeting of the Sub-Committee for members' consideration in the form of a Forward Plan. There will be a standing item to each meeting on performance.

3.2 The Forward Plan will be updated as necessary at each meeting, to accord with Members' wishes.

## 4. Implications

4.1 **Financial implications**
None applicable to this report. Financial implications will be included in each report to the Pensions Sub-Committee as necessary.

4.2 **Legal Implications**

None applicable to this report.  Legal implications will be included in each report to the Pensions Sub-Committee as necessary.

4.3 **Environmental Implications**
None applicable to this report.  Environmental implications will be included in each report to the Pensions Sub-Committee as necessary.

4.4 **Equality Impact Assessment**
None applicable to this report. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life.  The council must have due regard to the need to tackle prejudice and promote understanding

.

## 5. Conclusion and reasons for recommendation

5.1 To advise Members of forthcoming items of business to the Sub-Committee and training topics

**Background papers:**
None

Final report clearance:

**Signed by:**

Corporate Director of Finance & Resources    Date

**Received by:**

Head of Democratic Services    Date

Report Author: Joana Marfoh
Tel: (020) 7527 2382
Email: Joana.marfoh@islington.gov.uk

# APPENDIX A

## Pensions Sub-Committee Forward Plan for June 2015– April 2016

| Date of meeting | Reports |
|---|---|
| | Please note: there will be a standing item to each meeting on:<br><br>• Performance report- quarterly performance and managers' update(include CIV update)<br>I |
| | |
| 19 October 2015 | AGM |
| 16 November 2015 | Hearthstone presentation<br>Emerging market/Frontier procurement update<br>Franklin Templeton presentation |
| 11 April 2016 | Threadneedle / Aviva presentation<br>Actuarial valuation timetable |

**Proposed training for Members before committee meetings-**

| **Date** | **Training** |
|---|---|
| 16 September 2014 | Investment in Sub Saharan Africa - 6.20-.6.50pm<br>Infrastructure - 6.55- 7.25pm |
| 25 November 2014 | Multi asset credit- 6.15-6.45pm<br>Real estate including social housing- 6.50-7.20pm |
| 9 March 2015 | Frontier Market public equity- 6.15 -6.45pm<br>Emerging market debt- 6.50- 7.20 pm |
| 11 June 2015 | Impact investing |
| 14 September 2015- 4.45pm pm | Social bonds |
| 16 November 2016 | |

This page is intentionally left blank