ISLINGTON

For a more equal future

Finance Department
222 Upper Street
London N1 1XR

Report of: Corporate Director of Resources

Meeting of: Pensions Committee

Date: 24th July 2024

Ward(s): n/a

Appendix 1and 2 are exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information relating to the financial or business affairs of any particular person (including the authority holding that information).

SUBJECT: INVESTMENT STRATEGY REVIEW UPDATE ON IMPLEMENTATION

1. Synopsis

1.1 This report is an update report after Members agreed the full investment strategy review and allocation as part of the 2022 Actuarial review process. The themes taken into consideration included liquidity, risk and net zero decarbonisation targets.

1.2 An action plan was agreed to implement the agreed strategy, and this is a progress report to update members on actions completed and further work required.

1.3 Following discussions on our impact strategy, options of strategic asset allocation is presented for discussion and agreement

2. Recommendations

2.1 To note the progress made to date on the implementing the agreed strategy.

2.2 To note progress on emerging market portfolio review and recommendations (attached as exempt appendix 1)

2.3 To receive and note the presentation from Mercers, on the Private debt commitment gap required to fulfil the strategic asset allocation and agree to officers and Mercer to assess the type of strategy to prioritise (e.g. geographic exposure, risk/return).

2.4 To agree to adopt Strawman 3a or 3b as the new strategic asset allocation

2.5 Subject to 2.4 agree next steps to consider specific investments on impact and natural capital

2.6 To agree to receive a further progress report at the next meeting in September 2024.

3. Background

3.1 The 2022 actuarial valuation was finalised in March 2023, and as part of the process, work was undertaken to produce an investment strategy to support sustainable contributions from employers.

3.1.1 The Pensions Committee agreed a revised investment strategy for the Fund at its June 2020 meeting. The revised strategy maintained the Fund's 75% growth, 25% defensive split and included an allocation to Multi Asset Credit ("MAC") and Private Debt, the majority of which has now been implemented.

3.1.2 At the 6th March 2023 meeting, members discussed the initial Mercer presentation considering the current strategy and funding level following the 2022 valuation and post valuation market outlook. The options of Strawman 1 and 2 were discussed extensively on the themes of liquidity, return and risk. However, it was agreed that officers and Mercer would provide an alternative Strawman 3 portfolio option, modelled with the goal of achieving an increase in the allocation to alternatives compared to the current strategy, but with a lower risk profile. Members agreed the new strawman 3 strategy at their July meeting and an action plan to implement the strategy.

3.1.3 Members received a further progress report in March 2024 and agreed the following:
(i) a procurement process to consider one suitable manager for the Fund,
(ii) ask Mercer to review the current Strawman 3 to incorporate impact strategy across the whole fund.
(iii) ask Mercer to review private debt commitments and identify any gap commitments.
(iv) consider further some specific investments on impact and natural capital

3.1.4 The table 1- below shows the agreed New Strawman 3 allocation, actual allocation of assets as at July'23 and progress made to March'24
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3.1.5

	Current Strawman 3	Actual Allocation As at July'23	Actual Allocation As at March'24
Equity	**45**	56	55
Alternatives	**27.5(5% to Impact)**	16.6	17.4
Property	**20**	15.6	18.1
Liquid Fixed income	**7.5**	4.5	4.5
DGF/Corporate bonds	**0**	7.3	5.0
Expected return	**CPI+5.2%**		
Downside risk	**688m**		

3.1.6 **Implementation plan- actions outstanding**
The implementation plan still has some actions outstanding and is listed in the table 2 below.

3.1.7 Table 2

Asset Allocation	Action	Responsible person
Emerging market equities	Bfinance/ officers/Members- Shortlisting and interviewing in Marh. Agree recommended manager(s)	Members
Impact	Review current Strawman 3 strategic asset allocation	Mercer/Officers
Private Debt	Commitment analysis to identify gap complete. Agree to procure an European strategy	Members/Advisors /officers

3.2 **Update March to June'24**

3.2.1 **Emerging markets**- **background**
Members tasked officers to do further work on cost of transition including the passive mandate and then take a view of any changes to the mandates**.** Officers met with Mercer research team on emerging markets and discussed other strategies in the

market. They covered value, growth and core style strategies and their performances over the last 3 to 5years'.

Our current active manager has a growth style and the passive manager is a value manager. Style biases have been the key driver of performance since 2021 and our current active manager has underperformed since inception.

Transitions cost estimates.
The cost of transition for the Rafi passive fund default bid is 18 basis points before fees, taxes and commissions and subject to market conditions and the Polen fund estimates around 15 basis points that could rise to 52basis points after fees, taxes, commission and market impact.

The London CIV
The London CIV has an emerging market manager who is rated highly by Mercer and has good ESG credentials. However, it has a growth style bias and as such has underperformed over the last 3 years. The London CIV does not have any immediate plans to appoint an alternative manager because there has been no demand. This single manager for the size of our mandate would not be beneficial to the Islington fund.

3.2.2 **Members agreed in March to conduct due diligience on a short list of managers who met the preferred characteristics below .**

3.2.2.1 (i) no style bias
(ii) can demonstrate performance consistency in different market cycles
(iii) demonstrate ESG integration in investment process and aiming for a net zero target
(iv) competitive fees in a pooled vehicle

3.2.2.2 Officers engaged the services of BFinance (advisors manager selection) and the results of the exercise and recommendations is attached in Exempt appendix 1

3.2.3 **Impact investment/Strategic allocation**
The fund had an agreed 5% allocation to impact investment. Mercer (our advisors) presented a training session on our required returns and risk from this allocation, what impacts means, how to measure and monitor and types of investments in the market. A briefing prepared by Karen Shackleton scoping current investment managers that have some element of inclusive economy approach and biotech/life sciences was presented at the March meeting.

3.2.3.1 The current market is quite small and so whilst further work is undertaken on managers and governance structure, Members are asked to revisit the current strategic asset allocation to include impact through the whole portfolio.

3.2.3.2 Mercer have now modelled the agreed Strawman Portfolios 3 for the purpose of demonstrating the estimated risk/return impact of 1) allocating to Natural Capital within the Infrastructure 'bucket' and 2) removing the 'impact' allocation and re-distributing this amongst the other private market mandates, with a view to making 'impact' focused commitments within the other asset class buckets without having a standalone allocation

Mercer have prepared 2 further options to our current strategy and the recommendation is to adopt option 3a or 3b

Asset Category	Asset Class	Strawman 3 Current	Strawman 3a	Strawman 3b
Equity	Global Developed Equity	40.0	40.0	40.0
	Frontier/Emerging Market Equity	5.0	5.0	5.0
	Sub-Total	**45.0**	**45.0**	**45.0**
Diversified Alternatives	Private Equity	0.0	0.0	2.0
	Infrastructure (including Natural Capital)	12.5	14.5	14.5
	Private Debt	10.0	10.0	11.0
	Diversified Growth Fund	-	-	-
	'Impact' Investments	5.0	3.0	-
	Sub-Total	**27.5**	**27.5**	**27.5**
Property	Core Property	10.0	10.0	10.0
	HLV Property	10.0	10.0	10.0
	Social/Affordable Housing	-	-	-
	Residential Property	-	-	-
	Sub-Total	**20.0**	**20.0**	**20.0**
Liquid Fixed Income	Multi-Asset Credit	7.5	7.5	7.5
	Investment Grade Credit	-	-	-
	Sub-Total	**7.5**	**7.5**	**7.5**
	Total	**100.0**	**100.0**	**100.0**
Modelling Results	Expected Return	CPI + 5.16%	CPI + 5.12%	CPI + 5.10%
	Probability of attaining Past Service Discount Rate ("PSDR")	87%	87%	87%
	Probability of attaining Future Service Discount Rate ("FSDR")	84%	84%	84%
	3 year, 95% Value at Risk (VaR)	£688m	£680m	£671m

3.2.4 **Private Debt Gap Analysis**

The analysis conducted by Mercer is attached as exempt appendix 2 and this shows a projected gap of £120m over the next 3 years. Members are asked to consider the executive summary and how to deploy this capital, either via the Fund's existing manager(s) or by new commitments, with Mercer working with Officers to assess the type of strategy to prioritise (e.g. geographic exposure, risk/return). The results of reviewing the market for suitable candidates that are expected to be fund-raising in the short to medium term will be reported to members at the September meeting.

4. Implications

4.1 Financial implications

4.1.1 The cost of providing independent investment advice is part of fund management and administration fees charged to the pension fund.

4.2 Legal Implications

Section 7(1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 requires the council, after taking proper advice, to formulate an investment strategy which must be in accordance with government guidance issued from time to time. The council must publish a statement of its investment strategy and review it at least once every three years.

4.3 Environmental Implications and contribution to achieving a net zero carbon Islington by 2030:

Environmental implications will be included in each report to the Pension Board Committee as necessary. The current agreed investment strategy statement for pensions outlines the policies and targets set to April 2022 to reduce the current and future carbon exposure by 50% and 75% respectively compared to when it was measured in 2016 and also invest 15% of the fund in green opportunities. The link to the full document is https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonboroughofislingtonpensionfundinvestmentstrategystatement.pdf

4.4 Equalities Impact Assessment

Nonapplicable 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

An equalities impact assessment has not been conducted because this report is seeking opinions on updating an existing document and therefore no specific equality implications arising from this report.

5. Conclusion and reasons for recommendation

5.1 Members are asked to note progress to date, considers the progress made from March to June. To agree the recommendation in exempt appendix 1 on emerging markets. Consider asset allocation changes in Strawman3a and 3b and subject to agreement consider next steps on impact and natural capital. Exempt appendix2 is also attached for further discussions on private debt and future commitments.

Appendices: Exempt Appendix 1- BFinance briefing on emerging markets review and due diligence
Exempt Appendix 2- Mercer private debt gap analysis

Background papers:
None

Final report clearance:

Authorised by: Corporate Director of Resources

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