



Report of: Corporate Director of Resources

Meeting of: Pensions Committee

Date: 26th September 2024

Ward(s): n/a

SUBJECT: Passive Equity Portfolio Restructuring Update

1. Synopsis

- 1.1 This report provides an update on the Fund's restructuring of the Pension Fund's passive equity portfolio.
- 1.2 This report considers the cost implications and legal advice for the fund to do so.

2. Recommendation

- 2.1 The Committee is recommended to note the update.

3. Background

- 3.1 The Pension Fund pools passive equity investments with other investors in two large passive equity pooled funds which are managed by Legal & General Investment Management Ltd (LGIM). These pooled funds track the MSCI low carbon target index and the Paris Aligned World equity index. The Fee structures and investment values for these Funds are currently:
 - MSCI Low Carbon: 6.76 basis Points (149k pa), £220m invested.
 - Paris Aligned World Equity Index: 8 basis points, (146k pa) £183m invested.
- 3.1.1 These pooled funds track two separate indices, weighting stocks in the portfolio according to their relevant size in their respective index.

- 3.1.2 Currently Islington Pension Fund has no say in the composition of these indices and can ask for no amendments or exclusions. The only way to adjust holdings would be to sell assets and move out of the Fund and to track a new customised index.
- 3.1.3 The Pension Fund Committee has expressed desire to amend the current index to ensure that companies on the UN's list of businesses involved in activities in the Occupied Palestinian Territory deemed compliant in human rights abuses should be excluded from the Fund's investments.
- 3.1.4 The Fund's investment manager, LGIM, has recommended that the simplest and cheapest way of doing this would be to create a single pooled fund of one investor that combines both portfolios into one. This would enable the Fund to customise its benchmark.
- 3.1.5 Creating a pooled fund of one would give the Fund the flexibility to make other custom alterations in the future should there be a requirement.
- 3.1.6 This can be done for a total ongoing fee of 8 basis points per annum on the total portfolio. Based on the values listed above, this would be an increase in fees from £295k per annum to £322k per annum, an increase of £27k pa. This would result in both funds tracking a custom version of the Paris Aligned World Equity Index.
- 3.1.7 There would be one off transition costs for this process which would amount to an estimated £539k.
- 3.1.8 Members agreed at the meeting of 24th July 2024 this was the preferred course of action, but noted that officers would need to carrying additional compliance tasks before this decision could be taken.

Legal Considerations

- 3.2.1 The Fund must consider its legal fiduciary duty and regulatory requirements before such a decision can be taken. Of particular concern is the "Economic Activity of Public Bodies (Overseas Matters) Bill" which was previously working its way through parliament. It is not known for certain if the new government will pursue this bill, although in counsel's opinion this is unlikely.
- 3.2.2 In addition, the Council will need to perform an equality impact assessment before any decision can be taken and consult members of the Pension Fund.
- 3.2.3 Officers have sought advice from Counsel on the matter.
- 3.2.4 LGIM have advised that if the bill is still passed in its current form, they may be forced to liquidate our investments and return them to us once it is enacted.

Investment Considerations Update

- 3.3.1 The Fund will no longer track both the MSCI low carbon and the Paris Aligned World Equity Index, but a singular custom Paris Aligned World Equity Fund. The Pension Fund's investment consultants, Mercer, have provided an analysis of this change, and it is attached at exempt appendix A.

- 3.3.2 In summary, both passive equity funds have performed similarly inline with the main index, but the Paris aligned version has a higher tracking error due to taking more concentrated sector positions. Long term, performance should be in line with the benchmark, but members should note it is slightly higher risk. The fund does however bring more alignment to LBI's responsible investment policies, including a reduced carbon footprint.
- 3.3.3 The Pension Fund must take investment advice before an investment (or divestment) decision is made. Mercer, have provided this advice attached at Appendix A on the impact of the new customised benchmark. The summary is that there are no material investment risks from this change.
- 3.3.4 The investment transition costs of 0.03% of total fund value is not considered to be financially detrimental to the fund itself, but the impact must be considered against any wider investment risk or investment losses in restructuring to a new customised benchmark.
- 3.3.5 The decision to restructure the portfolio would not breach the Pension Fund's Investment Strategy or Funding Strategy Statements, as such are not in conflict with legal advice in paragraph 4.2.3.
- 3.3.6 It should be noted that moving to a pooled fund of one is not congruent with Government's pooling agenda and direction of travel for the sector. There is a risk that the Fund is forced to unwind this arrangement in the future if circumstances allow it to progress.

3.4 **Compliance Update**

- 3.4.1 Officers have progressed the equalities impact assessment with the council's equalities team, with a first draft submitted on 16th September 2024. This is currently in draft and being reviewed by the team.
- 3.4.2 A consultation exercise will need to be carried out with both pensioners and active members of the fund. Wording on this consultation is currently with the Corporate Director of Resources and the Director of Law and Governance for review.

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. Officers have been advised that the one off transition costs for the change of structure would be £539k. The ongoing change from the MSCI low carbon to the Paris Aligned world equity fund would be approximately £27k per annum.

4.2 **Legal Implications**

- 4.2.1 The local government pension scheme ("LGPS") is a statutory occupational pension scheme established by regulations made under s.7 of the Superannuation Act 1972, and has effect as if made under the Public Services Pensions Act 2013 ("PSPA 2013"). The Council has a formal statutory role to administer the Pension Fund on behalf of its members and does so through this Committee.

- 4.2.2 The primary duty of the Committee in relation to the Pension Fund it to be able to pay, from the fund, the pensions of those employees of the Council and other relevant bodies who participate in the Pension Fund.
- 4.2.3 The Council has sought advice on divesting its Pension Fund as set out in this report. Counsel advises that it would be lawful to do so taking into account the following considerations:-
- (1) The public sector equality duty ("PSED") will not prevent the proposed divestment, but it will require a conscientious consideration of the equality objectives set out in the legislation.
- (2) There does not appear to be any real likelihood of the matters in The Economic Activity of Public Bodies (Overseas Matters) Bill ("the Bill") being legislated on in the near future. The Bill may have imposed restrictions on public bodies, including councils, to campaign against, boycott, seek divestment from, or sanction a particular territory internationally unless endorsed by the Government's own foreign policy.
- (3) The Council's fiduciary duties will be met if it can demonstrate: (i) good reason to think that scheme members would share this concern; and (ii) the decision would not involve a risk of significant financial detriment to the Fund. Provided the fiduciary duties are discharged, there are unlikely to be any other public law considerations that need to be factored into the decision-making process.
- (4) The proposed divestment is congruent with the Fund's Funding Strategy Statement (2022) ("FSS") and the Investment Strategy Statement (September 2023) ("ISS")
- 4.2.4 Prior to making any decision to divest its Pension Fund, in order to minimise the risk of any legal challenge, the Council must have regards to matters raised in this report including the PSED duty, consultation with its Pension Fund members and investment advice.

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

None applicable to this report. 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/20192020/20190910londonboroughislingtonpensionfundinvestmentstrategystatement.pdf>

4.4 **Equalities Impact Assessment**

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 updating members on restructuring options and therefore no specific equality implications arising from this report. As listed above, any further decision cannot be taken until an equalities impact assessment has been carried out

5. Conclusion and reasons for recommendation

- 5.1 The Committee does not yet have enough information to make a formal decision, as such officers will work on the next steps in the process and update at the December 2024 meeting.

Background papers:

None

Final report clearance:

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