

Merton Council

Pension Fund Investment Advisory Panel Agenda

Membership

Councillors:

Cllr Imran Uddin (Chair)
Cllr Adam Bush (Vice-Chair)
Cllr Mark Allison

Officers:

Tina Pickard (Pensioner Rep)
Gwyn Isaac (GMB Union Rep)
Caroline Holland (LBM)
Paul Dale (LBM)
Paul Audu (LBM)

Date: Wednesday 8 March 2017

Time: 7.00 pm

Venue: Merton Civic Centre

This is a public meeting and attendance by the public is encouraged and welcomed.
For more information about the agenda please contact
Merton.PensionFund@merton.gov.uk or telephone [020 8545 3458](tel:02085453458).

All Press contacts: communications@merton.gov.uk, 020 8545 3181

Pension Fund Investment Advisory Panel Agenda

8 March 2017

- | | | |
|---|--|---------|
| 1 | Apologies for absence | |
| 2 | Declarations of pecuniary interest | |
| 3 | Minutes of Previous Meeting | 1 - 4 |
| 4 | Quarterly Performance Review (1st Oct-31st Dec 2016) | 5 - 14 |
| 5 | Pension Fund Investment Strategy Review | 15 - 20 |
| 6 | Update on London CIV | 21 - 24 |
| 7 | Future meeting dates | |
| | 14 th June 2017 | |
| | 30 th August 2017 | |
| | 6 th December 2017 | |
| | 7 th March 2018 | |

Note on declarations of interest

Members are advised to declare any Disclosable Pecuniary Interest in any matter to be considered at the meeting. If a pecuniary interest is declared they should withdraw from the meeting room during the whole of the consideration of that matter and must not participate in any vote on that matter. If members consider they should not participate because of a non-pecuniary interest which may give rise to a perception of bias, they should declare this, withdraw and not participate in consideration of the item. For further advice please speak with the Assistant Director of Corporate Governance.

Attendance:

Cllr Imran Uddin (Chair)
Cllr Adam Bush (Vice Chair)
Paul Dale (Assistant Director of Resources LBM)
Tina Pickard (Pensioner Rep - Unison)
Gwyn Isaac (GMB Union Rep)
Paul Audu (Interim Head of Treasury and Pensions)

Additional Attendees: Aniket Bhaduri (JLT)

1. MEETING

- 1.1 Welcome and Introduction by Chair
- 1.2 Apologies for lateness: None
- 1.3 Apologies for absence: Cllr Mark Allison;
Caroline Holland (Director of Corporate Services)
- 1.4 Members Declaration of Interest – Adam Bush (Employee of BDO who are tendering for Council business)

2. PRESENTATION OF MINUTES OF LAST MEETING (28.9.16)

- 2.1 The key actions were:
 - JLT to bring ideas to the Committee meeting on 1st December 2016 and provide training to support Members' decision-making during the strategy review process.
 - The strategy review to resolve the issue of eclectic holdings within some mandates.
 - Fund actuary to release cashflows to JLT at the earliest opportunity to facilitate the required modelling for the investment strategy review.
 - Officers to develop Investment Strategy Statement in consultation with JLT and bring a draft to the PFAC meeting to be held on 8th March 2017. The approved ISS to be published by no later than 1st April 2017.
 - PD to brief the Committee on the outcome of his meeting with the London CIV.
 - Risk register to be taken to Committee, with action noted of failure to MPF19 and Section 13 Report to be introduced.

3. QUARTERLY PERFORMANCE REVIEW (1st July – 30th September 2016)

- 3.1 The market value of the Fund was £609.2m at the end of September 2016 up by £42.3m from the end of June 2016. Total Fund return was 7.5% marginally underperforming the benchmark return of 7.9% with stock selection a slight drag on total performance.
- 3.2 PA discussed the performance report in brief mindful of JLT's attendance at the meeting to discuss their initial strategy work and provide training to the

Committee. He said all investment portfolios bar the passive equity portfolio managed by UBS had underperformed during the quarter and that JLT might contextualise the performance in their presentation.

4. PRESENTATION BY JLT

The Chair welcomed Aniket Bhaduri (AB), Lead Consultant from JLT to the meeting and invited him to introduce himself including professional background being his first attendance at PFAC meetings. The Chair explained the revised order of the Agenda and the Committee's stewardship role and ensuring proper management of the Fund's investments from an effective strategic decision-making perspective.

- 4.1 There was some discussion and high-level update by PA on the London CIV as preamble to JLT's presentation. The Committee asked how a Fund invested with the London CIV would monitor its exposure. PA clarified that the CIV operated unitised arrangement with transparent valuation and investment management and governance structure supporting the pool.
- 4.2 In his introduction, AB gave a brief summary of his professional background. He said he proposed to cover Part 1 of the training material in the time allotted.
- 4.3 He sketched the global economic environment and markets and there was some discussion on the implications for the global economy and markets of a Trump presidency. The Committee sought JLT's view on the likely policy impact of the incoming US administration and any impact on pension funds in the short-term.
- 4.4 In his update, AB said that, going by the President-elect's initial statements, the policy impact of the incoming US administration was of some concern.
- 4.5 JLT was working closely with officers and the Fund actuary to ensure an integrated approach to developing the new investment strategy. Using an inverted pyramid to illustrate the impact of decisions, he advised that the Committee's decision on strategic asset allocation had the highest financial significance in setting investment strategy.
- 4.6 The Chair commented that manager selection was important in so far as the fund manager's decision-making ability was consistent with the flexibility granted to the manager under the mandate. There was some discussion on manager monitoring. Then, a discussion on the liquidity requirement of the pension fund over the medium to long-term ensued. AB gave the Committee some insights on how illiquid assets could be structured to provide liquidity in the long-term to address the Fund's cashflow profile.
- 4.7 The Committee probed the Fund's current solution with respect to contributions and split between income and growth assets and impact on asset allocation. PA advised that the Fund was still cashflow positive. The Committee favoured growth and was less keen on taking defensive stance on asset allocation.

- 4.8 AB broadly agreed that growth was important, but he asked whether the Committee was comfortable with taking risk. Preference for growth required greater appetite for risk.
- 4.9 There was some discussion of funding strategy. The Chair commented that, from the Committee's perspective, it was desirable to get the funding level to 100% as soon as possible. There was the need for assets to work harder to guarantee the required return. He asked AB to clarify next steps.
- 4.10 AB advised that, in terms of moving forward, there was the urgent need to agree on strategic allocation.
- 4.11 PD said that the Committee had already formed a view prior to the appointment of JLT. It was important to ensure that the decision on strategy reflected the Committee's view and preference.
- 4.12 PD suggested that another meeting in January/February to explore the proposed strategy further. The Chair commented that the proposed special PFAC meeting would enable the Committee to consider the proposal and make key strategic decisions.
- 4.13 PA confirmed that the Fund actuary was finalising the required cashflows to facilitate JLT's work and he anticipated the information would be released by the actuary latest by early January 2017.
- 4.14 There was broad agreement for a special meeting to be held in mid-February. The Chair said that there was need to get some momentum behind the investment strategy review process.

5. COMMITTEE TRAINING

- 5.1 AB advised that JLT, Barnett Waddingham the Fund actuary and Council officers were working expeditiously to bring ideas to committee for consideration at the earliest opportunity. He said the comprehensive exercise involved training for the Committee to support Members' decision-making during the strategy review process.
- 5.2 The training focussed on investment strategy development. AB discussed the attributes of a good Fund to set the scene for some insights into the development of investment strategy.
- 5.3 There was lengthy discussion on mandate design and the shape of portfolios. AB explored key aspects of JLT's approach with the Committee including modelling risk/return efficient frontier, risk diversification across strategies and management of unrewarded risk. Then he touched on asset returns and core assumptions, opportunity in some asset classes, the need to strike a balance between growth and stabilising assets and linkage to effective governance.
- 5.4 AB offered to provide training on asset classes at the next (special) meeting.

- 5.5 The Chair asked JLT to provide the strategy review report ahead of the special Committee meeting. The Committee wanted to review the proposal in advance and direct any initial queries and comments via officers to JLT.
- 5.6 AB advised that the split between growth and matching assets would not alter significantly in the new proposal. The Committee agreed to consider JLT's recommendation on appropriate asset classes to achieve the required return.
- 5.7 The Chair thanked AB for the presentation. AB departed the meeting.
- 5.8 The Chair directed that items 4 and 5 on the agenda be deferred to the next meeting to be held on 8th March 2017.

6.0 ANY OTHER BUSINESS

- 6.1 None
- 6.2 The Chair declared the meeting closed at 8:40pm

Date of Next Meetings:

8th March 2017

Special meeting to be held in mid-February (PA to arrange)

London Borough of Merton Pension Fund Advisory Committee

Date: 8 March 2017

Agenda item: **3**

Wards: All

Subject: Performance of the Pension Fund for the Quarter Ending December 2016

Lead officer: Caroline Holland Director of Corporate Services

Lead member: Councillor Imran Uddin

Contact officer: Paul Dale

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RECOMMENDATION

Members are asked to note the content of this report, in particular, the market values and performance of the total fund and component portfolios for the quarter ending 31 December 2016, attribution of the results and the market environment during the period.

1.0 PURPOSE OF REPORT

- 1.1 To report the investment performance at total Fund level, and of the individual fund managers, for the quarter to 31 December 2016.
- 1.2 The report gives the Committee a consistent basis on which to review the performance of the Fund as at 31 December 2016 and provide information to support future actions including periodic rebalancing and review of investment strategy and investment management arrangement.

2.0 PERFORMANCE REPORT

- 2.1 The attached Fund Analysis & Performance Report (**Appendix 1**) produced by State Street Performance Services provides useful analysis and insights on the Pension Fund activity and results for the quarter to 31 December 2016.
- 2.2 The report highlights the performance of the total Fund by asset class compared to the customised benchmark. It also includes comprehensive analysis of the performance of each manager against their specific benchmark and a comparison of performance over longer periods.
- 2.3 At 31 December 2016 the total Fund was valued at £622.4m, up by £13.2m (or 2.2%) since 30 September 2016.

3.0 Market Background/Outlook

3.1 2016 ended with global equities entering a bull market from the low point seen in February. After an initial fall upon the US election results, developed equity markets quickly recovered and advanced on the anticipation of fiscal stimulus under the new Trump administration. The mood was unbroken by Italian referendum voters rejecting proposed constitutional reform and the decision by the US Federal Reserve to increase interest rates in December. The renewed focus on fiscal rather than monetary stimulus helped drive government bond yields higher from the low levels seen during the third quarter. Positive sentiment was further boosted on news of a global agreement to cut supplies of oil, driving prices sharply higher. The resilience of UK economy post-referendum saw an upward revision to the 2016 Q3 GDP from 0.5% to 0.6% reflecting strong growth in the services sector.

4.0 PERFORMANCE OF THE FUND

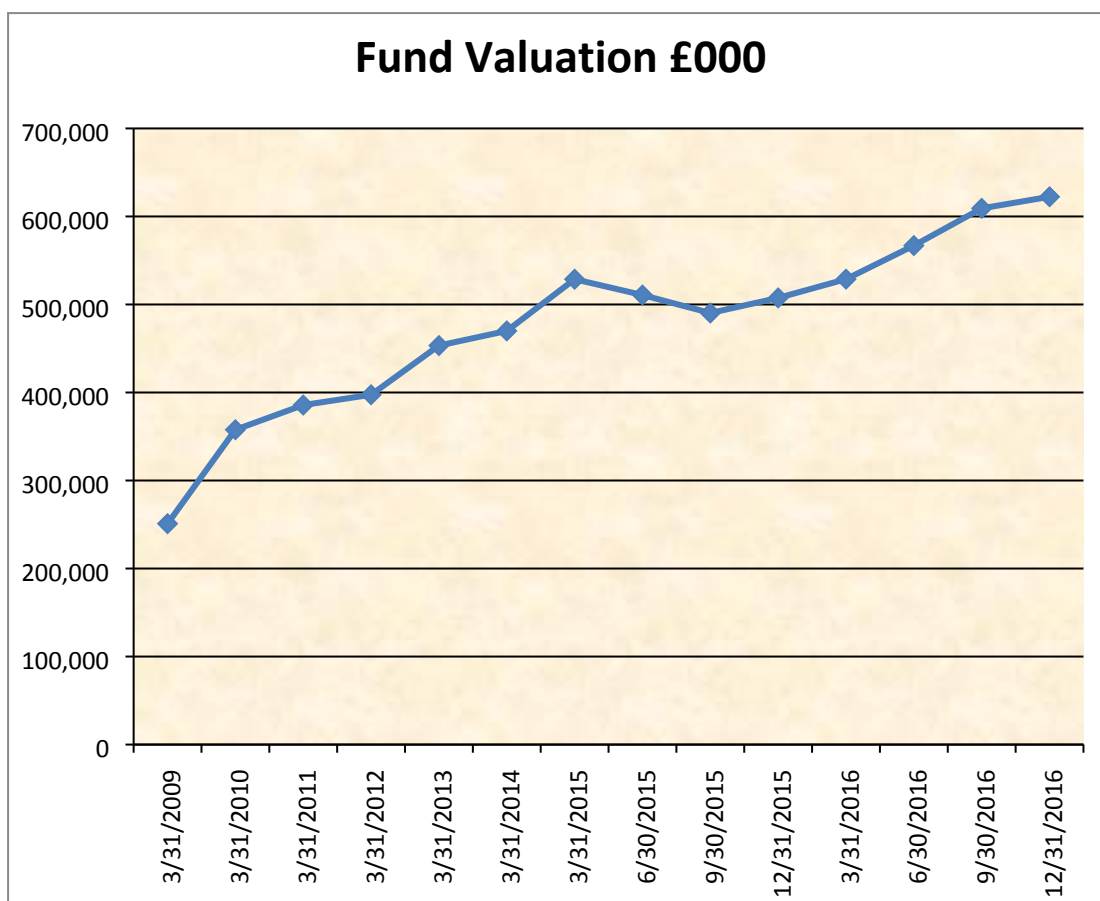
4.1 The table below shows the Fund's strategic asset allocation as at 31 December 2016 against the benchmark allocation. The Fund was overweight in Equities and Bonds and underweight in Property compared to the benchmark.

At 31/12/2016	Total Equity %	Total Bonds %	Cash/Alts %	Property %	Total Fund %
Fund Asset Allocation	72.2	24.2	0.2	3.4	100
Benchmark	71.4	23.6	N/A	5.0	100
Difference overweight / (underweight)	0.8	0.6	N/A	(1.6)	-

4.2 The Fund underperformed the benchmark by 0.3% for the quarter ending 31 December 2016. It gained 2.1% compared to the benchmark return of 2.4% for the period.

4.3 The 0.3% underperformance was due wholly to stock selection. The manager's results are discussed in more detail below in section 5.

4.4 The following graph illustrates the Fund's market value trend between 31 March 2009 and 31 December 2016. It shows that the market value of the Fund has appreciated by £371m or 148% over the 8 ¾ yr. period.



4.5 The table below shows the market value of each portfolio at the start and end of the quarter. The change in value over the period is a combination of the net money flows into or out of each portfolio and any gain or loss on the capital value of investments.

<i>Fund</i>	Market Value 30/09/16 £000	Capital Gain/loss £000	Income £000	Market Value 31/12/16 £000	% of Total Fund
UBS Passive Equity	260,290	12,318	556	273,222	44
Aberdeen Fixed Income	155,778	(5,087)	(58)	150,483	24
Aberdeen Active Equity	111,806	2,286	175	114,277	19
UBS Active Equity	59,720	2,285	150	62,328	10
UBS Property	14,917	206	118	15,241	2
BlackRock Property	6,693	68	29	6,807	1
Total External Fund	609,205	12,077	972	622,358	100
Internal Investments	150			150	
Total	609,355			622,508	

4.6 The following table provides detailed analysis of the return on the Fund's investment for the period relative to the benchmark.

Sector	Market Value		Fund Return		Benchmark	
	Sept 2016		Dec 2016		Dec 2016	
	£000	£000	%	%		
UK Equities	251,121	264,747	3.7	3.9		
Overseas Equities	178,054	184,413	4.7	5.4		
• <i>North America</i>	61,358	63,627	8.9	9.0		
• <i>Continental Europe</i>	46,736	49,570	3.7	4.8		
• <i>Total Far East</i>	49,830	51,044	2.3	3.0		
• <i>Other Intl Equities</i>	20,130	20,171	0.5	1.4		
UK Bonds	38,175	36,788	(5.4)	(5.6)		
Overseas Bonds	37,307	37,462	(2.4)	(2.3)		
UK Index-Linked	80,271	76,206	(2.6)	(3.0)		
Cash Alternatives	3,347	1,491	(3.8)	-		
Property	20,930	21,251	2.1	2.3		
Total	609,205	622,358				

4.7 The Fund's assets are invested across sectors and markets globally. During the quarter to 31 December 2016, equities and property yielded positive returns albeit below benchmark. Bonds and cash alternatives yielded negative returns.

5.0 FUND MANAGER PERFORMANCE

UBS

5.1 UBS manages three portfolios for LB Merton Pension Fund.

(1) UBS Active Global Equity

5.2 The market value of the active equity portfolio managed by UBS was £62.3m (£59.7m in September 2016). During the quarter the manager's return of 4.1% outperformed the benchmark of 3.6%.

The table below shows the movement during the period within the portfolio.

UBS Active Equity	30/09/2016		Purchases	Sales	Gain/Loss	Income	31/12/2016	
	£000	%					£000	£000
Total Equities	59,143	99	6,927	6,475	2,285	217	61,880	99
Cash & Cash Alternatives	577	1	6,798	6,927	-	0	449	1
Total	59,720	100	13,725	13,402	2,285	150	62,328	100

The manager's mandate is summarised in the following:

- For the portion of the Active Portfolio invested in UK Equities, the manager shall seek to outperform the benchmark by 1% p.a.
- For the portion of the Active Portfolio invested in Emerging Markets, the manager shall seek to outperform the benchmark by 2.0% p.a.

Performance of the UBS Active Equity over various time periods

<i>Period</i>	Manager %	Benchmark %	Variance %	Comment
Last 3 months	4.1	3.6	0.5	Outperformed
Last 12 months	17.1	19.0	(1.9)	Underperformed
Last 3 years	5.6	6.5	(0.9)	Underperformed
Last 5 years	9.7	10.2	(0.5)	Underperformed

(2) UBS Global Equity (Passive)

- 5.3 The passive equity portfolio was valued at £273.2m (£260.3m in September 2016). During the quarter the manager's performance of 4.9% underperformed the benchmark of 5.0%.

The table below shows the movement of assets during the quarter.

<i>UBS Passive</i>	30/09/2016		Purchases	Sales	Gain/ Loss	Income	31/12/2016	
	£000	%	£000	£000	£000	£000	£000	%
UK Equities	143,095	55	7,131	4,429	4,828	583	150,625	55
North America	54,597	21	-	2,000	4,929	-	57,526	21
Continental Europe	30,665	12	-	-	1,491	6	32,156	12
Japan	15,757	6	-	-	814	-	16,571	6
Total Pacific (ex Japan)	16,219	6	-	-	255	-	16,474	6
Cash & Alternatives	(42)	-	7,042	7,131	-	1	(131)	0
Total	260,290	100	14,173	13,560	12,318	556	273,222	100

The manager is to track the Benchmark index over rolling three year periods. This table shows the performance of the portfolio.

Period	Manager %	Benchmark %	Variance %	Comment
Last 3 months	4.9	5.0	(0.1)	Underperformed
Last 12 months	21.7	21.8	(0.1)	Underperformed
Last 3 years	9.7	9.7	-	In line
Last 5 years	12.7	12.7	-	In line

(3) UBS Property Fund

- 5.4 The market value of the property portfolio managed by UBS was £15.2m (£14.9m in September 2016). During the quarter the manager's performance of 2.2% underperformed the benchmark of 2.3%.

The table below shows the movement during the period within the portfolio.

<i>UBS Triton (Property)</i>	30/09/2016		Purchases	Sales	Gain/Loss	Income	31/12/2016	
	£000	%	£000	£000	£000	£000	£000	%
Property	14,238	95	-	-	206	118	14,444	95
Cash & Cash Alternatives	680	5	118	-	-	-	797	5
Total	14,917	100	118	-	206	118	15,241	100

The manager is to track the Benchmark index over rolling three year periods.

This table shows the performance of the portfolio.

Period	Manager	Benchmark	Variance	Comment
	%	%	%	
Last 3 months	2.2	2.3	(0.1)	Underperformed
Last 12 months	2.5	2.8	(0.3)	Underperformed
Last 3 years	11.6	10.7	0.9	outperformed
Last 5 years	6.3	8.2	(1.9)	Underperformed

Aberdeen Asset Management

- 5.5 Aberdeen manages two portfolios for the LB Merton Pension Fund.

(1) Aberdeen Active Global Equity

- 5.6 The market value of the active equity portfolio managed by Aberdeen was £114.3m (£111.8m in September 2016). During the quarter the manager's performance of 2.2% underperformed the benchmark of 3.8%.

The table below shows the movement during the period within the portfolio.

<i>Aberdeen Active Equity</i>	30/09/2016		Purchases	Sales	Gain/Loss	Income	31/12/2016	
	£000	%	£000	£000	£000	£000	£000	%
UK Equities	56,327	51	4,583	2,611	1,557	235	59,856	52
North America	6,761	6	-	1,142	482	-	6,101	5
Continental Europe	16,071	14	2,359	1,240	223	29	17,414	15
Japan	9,932	9	1,140	1,041	113	-	10,144	9
Total Pacific (ex Japan)	7,923	7	-	41	(27)	-	7,855	7
Other Intl Equities	12,686	11	-	66	(63)	-	12,558	11
Cash & Alternatives	2,107	2	9,206	10,964	-	1	350	0
Total	111,806	100	17,288	17,103	2,286	175	114,277	100

5.7 Although this portfolio is an active mandate, 36% is held in pooled funds. The Manager is required to outperform the benchmark by 1.25% p.a over rolling 3yr periods.

This table shows the performance of the portfolio

Period	Manager %	Benchmark %	Variance %	Comment
Last 3 months	2.2	3.8	(1.6)	underperformed
Last 12 months	19.6	21.1	(1.5)	underperformed
Last 3 years	6.6	8.3	(1.7)	underperformed
Last 5 years	9.8	11.1	(1.3)	underperformed

(2) Aberdeen (Bonds)

5.8 The market value of the bonds portfolio was £150.5m (£155.8m in September 2016). During the quarter the manager's performance of -3.3% outperformed the benchmark of -3.5%.

The table below shows the movement during the period within the portfolio.

<i>Aberdeen (Bonds)</i>	30/09/2016		Purchases	Sales	Gain/Loss	Income	31/12/2016	
	£000	%	£000	£000	£000	£000	£000	%
UK Bonds	38,175	25	742	15	(2,113)	36	36,788	24
Overseas Bonds	37,307	24	1,104	20	(928)	-	37,462	25
UK Index Linked	80,271	52	1	2,020	(2,046)	1	76,206	51
Cash & Alternatives	25	0	2,055	2,054	-	-	26	0
Total	155,778	100	3,902	4,110	(5,087)	(58)	150,483	100

The manager is required to outperform its benchmark by 0.60% p.a. over a rolling three year period.

This table shows the performance of the portfolio.

Period	Manager %	Benchmark %	Variance	Comment
Last 3 months	(3.3)	(3.5)	0.2	Outperformed
Last 12 months	23.2	23.5	(0.3)	Underperformed
Last 3 years	13.1	13.4	(0.3)	Underperformed
Last 5 Years	7.8	7.9	(0.1)	Underperformed

BlackRock (Property)

5.9 The market value of the property portfolio managed by BlackRock was £6.8m (£6.7m in September 2016). During the quarter the manager's performance of 1.5% underperformed the benchmark of 2.3%.

The following table below shows the movement in the portfolio during the period.

<i>Blackrock</i>	30/09/2016		Purchases £000	Sales £000	Gain/Loss £000	Income £000	31/12/2016	
	£000	%					£000	%
Property	6,693	100	46	-	68	46	6,807	100
Cash & Cash Alternatives	-	-	46	46	-	-	0	0
Total	6,693	100	93	46	68	29	6,807	100

The manager is required to outperform the average of similar institutional pooled vehicles by investing in a diversified range of property throughout the UK, principally, but not exclusively, in the retail, office and industrial/warehouse sectors.

This table shows the performance of the portfolio.

Period	Manager %	Benchmark %	Variance %	Comment
Last 3 months	1.5	2.3	(0.8)	underperformed
Last 12 months	0.8	2.8	(2.0)	underperformed
Last 3 years	8.0	10.7	(2.7)	underperformed

6. OTHER ISSUES AFFECTING THE FUND

6.1 Review of the pension fund investment strategy and investment management arrangements is in progress. This is the subject of a separate report to this meeting.

7. FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

7.1 All relevant implications are included in the report.

8. LEGAL AND STATUTORY IMPLICATIONS

8.1 All relevant implications are included in the report.

9. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

9.1 N/A

10. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

10.1 Risk management is an integral part of designing the investment portfolio of the fund particularly in the current volatile economic environment.

11. BACKGROUND PAPERS

11.1 StateStreet Analytics performance report and individual Fund Managers investment reports.

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Committee: Pension Fund Advisory Committee

Date: 8th March 2017

Agenda item: 4

Wards: All

Subject: Pension Fund Investment Strategy Review

Lead officer: Caroline Holland, Director of Corporate Services

Lead member: Councillor Imran Uddin

Forward Plan reference number: N/A

Contact officer: Paul Dale

This document is a public document

Recommendations:

- a) To consider JLT's investment strategy review report and determine revised investment categories, weightings and benchmarks with JLT.
- b) To identify what alternative investments the committee would like to recommend for the balance of the fund in conjunction with JLT.
- c) To determine what investments should be procured directly and what should be procured via the London CIV.
- d) To agree the recommended approach:
 - i) Procure passive directly
 - ii) Select active funds from the CIV
 - iii) Review the CIV's offering on fixed income and preferably select from their sub-funds. If they are unsuitable for LB Merton then go to the market
 - iv) Look to the CIV for property and assess their offer before making a decision
 - v) Review what the CIV offer in infrastructure investment and assess whether it meets the needs of the Merton Fund
 - vi) Clarify what the benefits of multi asset funds and other alternative investments would be before making any decision to invest
- e) To agree outline timetable for procurement.
- f) To approve the draft Investment Strategy Statement (ISS), subject to any amendments, and authorise officers to publish the ISS by no later than 1st April 2017 per the LGPS Regulations.

1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

- 1.1 JLT will present their investment review report at this meeting. This report discusses the options available to the Pension Fund Advisory Committee to re-tender the management of the Fund investments and seeks decisions in the changed environment.

2. PREVIOUS DECISIONS

2.1 At the meeting of this committee on 17th March 2014 the panel agreed asset allocations for the Fund in the future.

Asset Class	Current		
	Actual	Target	Proposed
Equities	70%	70%	70%
Fixed interest	26%	25%	20%
Property	4%	5%	5%
Alternatives (at this point Equity like DGF was proposed)	0%	0%	5%
Total		100%	100%
Equity Split			
Passive	60%	60%	40%
Active	40%	40%	60%

2.2 The selection of active equity managers will be a crucial decision because currently the return on passive equities are substantially higher than on active equities and the latter generally has higher fees.

2.3 Since the last discussion at the Committee on 17th March 2014, the Council has appointed JLT as investment advisers and they have different views on asset allocation. JLT's investment strategy report is attached.

2.4 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1st November 2016. It makes investment via LGPS Pools compulsory and the Secretary of State has reserved powers of intervention where authorities are deemed non-compliant.

2.5 Under the new LGPS investment regulations, administering authorities must publish the ISS by no later than 1st April 2017.

2.6 Performance of the investment classes.

Asset class	Return
	3 years % pa
Passive equity	9.7%
Active Equity	Manager 1 6.6%
	Manager 2 5.6%
Fixed income	13.1%
Property	Manager 1 11.6%
	Manager 2 8.0%

3. REVIEW OF ASSET CLASSES

3.1 Passive equities:

The committee decided to reduce passive equity exposure from 60% of equity investments to 40%. This equates to a reduction from 42% of total investments to 28%.

Currently the split of passive investments between markets is:

Analysis of Passive Equities	
UK	55%
Other European	12%
American	21%
Japanese	6%
Other Overseas	6%

3.2 This weighting is disproportionately in the UK given the size of the market relative to the world market. Benchmarks are an issue that need thorough review. The current benchmark is detailed below.

From 26.10.07	Aberdeen Global Equity	Aberdeen Global Bonds	BlackRock Property	UBS Global Equity Active	UBS Global Equity Passive	UBS Property	Total Fund
UK Equities	55.0			87.3	55.0		41.7
Overseas Equities	45.0				45.0		28.2
North America	6.0				21.0		9.6
Europe ex UK	14.5				12.0		7.7
Pacific Basin ex Japan	7.25				6.0		3.8
Japan	7.25				6.0		3.8
Pacific Inc Japan							0.0
Emerging Markets	10.00			12.7			3.3
UK Bonds		25.0					6.3
Overseas Bonds		25.0					6.3
UK Index-Linked		50.0					12.5
Property			100.0			100.0	5.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: State Street Quarterly Performance Report – Periods to end December 2016

3.3 A decision is required about which markets to reinvest passive monies in. Despite trying the London CIV was unable to develop suitable vehicles for passive equities. Passive managers appear to have reduced their fees significantly. The Council will need to procure passive investments independently.

3.4 The next steps and proposed timeline for activity is given below:

Activity	Date	By Whom /Dependency
Provide training on asset classes to Committee	1 December 2016	JLT/Officers
Update the Committee on Investment Strategy Review work – asset allocation ideas	1 December 2016	JLT/Officers
JLT to receive final cashflows from Fund actuary	31 January 2017	JLT/Barnett Waddingham
Presentation of Investment Strategy Review report	8 March 2017	JLT/Officers
Preparatory work for strategy implementation - develop ISS, Mandates, Governance, Procurement	Mar – July 2017	JLT/Officers

4. ACTIVE EQUITIES

4.1 The committee decided to increase this from 40% of Equity investments to 60%. This represents an increase from 28% of total investments to 42%.

4.2 The London CIV has gone out to tender for active investments which they intend to put in place throughout 2017. They intend to have a mixture of broad and targeted funds.

4.3 This seems to be the main area where the Council should invest in the CIV. The process of investment would be simpler and quicker than an individual tender. This is also the main area where the Council needs to improve performance. Benchmarks are an issue that need thorough review along with the style of managers.

4.4 These funds would be placed with the CIV throughout 2017/18.

5. FIXED INCOME

5.1 The CIV has identified that there is no common practice amongst Boroughs about the pattern of investment. It intends to get pooled funds in place by late 2017.

5.2 This has been the Council's best returning asset class over a five, three and one year period, there is therefore less urgency about replacing this.

5.3 It would be sensible to await the outcomes of the CIV's work before embarking on a tendering exercise.

6. PROPERTY

6.1 The CIV are seeking to put in place innovative high return investments. There is no timescale for this at the moment.

6.2 The Council is getting a reasonable return from property so it would pay to await the outcome of the CIV's work before making a firm decision.

7. INFRASTRUCTURE

7.1 Infrastructure must be seen as a long term investment, but one that requires a governance structure that allows speedy decisions without long drawn out procurement routes. The CIV intends to explore this later.

8. MULTI ASSET FUNDS

8.1 The CIV has 4 multi asset funds in place created by bringing together existing investments.

9. ADVICE OF THE HEAD OF COMMERCIAL SERVICES

9.1 Discussion is still ongoing about which of the procurements detailed above, not done via the CIV, would be caught fully by the EU rules and hence require a full tendering process. However in any event, the Council's constitution would require something essentially as rigorous for this scale and profile of contract.

9.2 Internal procurement resources can manage the procurement process itself, but investment consultants will be required to assist with the evaluation of technical aspects of the bids received. A tender process will be required whereby the consultants are appointed by the Director of Corporate services.

10. CONSULTATION UNDERTAKEN OR PROPOSED

10.1 N/A

11. FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

11.1 The investment strategy chosen will affect the return on the Fund, its actuarial valuation and the cost to the Council.

11.2 There will be a one off cost in procuring investment consultants to support the procurement process, estimated to be under £100k. This will be charged to the pension fund

12. LEGAL AND STATUTORY IMPLICATIONS

12.1 Contracts resulting from the proposal chosen will have legal implications for the Fund. Whichever procurement route is followed and whether any of the procurements fall within the EU regulations, or not, there is still the need to demonstrate fairness and transparency. There will also be a need for Legal input in drafting or approving contract terms and conditions. If use of a framework is pursued, then there is likely to be an Access Agreement required, which will also necessitate Legal input. Legal comments on the use of frameworks will be sought if required and the position on EU requirements will be resolved prior to tendering.

13. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

13.1 N/A

14. CRIME AND DISORDER IMPLICATIONS

14.1 N/A

15. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

15.1 The use of the CIV would enable a quicker, simpler process

16. APPENDICES

1. L.B Merton Pension Fund Investment Strategy Review – Report by JLT
2. L.B Merton Pension Fund Draft Investment Strategy Statement (ISS)

17. BACKGROUND PAPERS

1. Report to March 2015 meeting and papers in pension team
2. CIV communication (Feb 2017) - Suggested wording for Pooling, ESG and Voting

Committee: Pension Fund Advisory Committee

Date: 8th March 2017

Agenda item: 5

Wards: All

Subject: UPDATE ON LONDON COLLECTIVE INVESTMENT VEHICLE (CIV)

Lead officer: Caroline Holland, Director of Corporate Services

Lead member: Councillor Imran Uddin

Forward Plan reference number: N/A

Contact officer: Paul Dale

This document is a public document

Recommendations:

- a) Note the content of this report. The report is related to a separate report to this meeting titled "Pension Fund Investment Strategy Review".
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1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

- 1.1 The purpose of this report is to update the Committee on the progress of the London CIV since the last update to the Committee on 28 September 2016, on the CIV's recent and upcoming activity, membership, current fund management arrangement and plans to expand its offering.
- 1.2 Pooling LGPS assets is enshrined in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 which came into force on 1st November 2016 and the London CIV is the vehicle through which London boroughs seek to comply with regulatory requirement.

2. CIV UPDATE

- 2.1 On 2nd December 2016, London CIV marked its first anniversary of the launch of its first sub-fund. The CIV is continuing to develop more sub-funds across many asset classes to cater for the borough members' as they seek to implement their investment strategies.
- 2.2 On 8 February 2017 shareholders approved the CIV's 2017/18 budget and 5-year forward plan.
- 2.3 The CIV launched a new sub-fund (The London CIV NW Real Return) in December 2016. The sub-fund is managed by Newton Investment Management. In addition, two sub-funds (a global equity and UK equity) are being launched (early 2017) to be managed by Newton Investment Management and Majedie Asset Management respectively. Then, Longview

global equity sub-fund is proposed to complete the offering: global equity income; sustainable equities; emerging markets and value strategies.

- 2.4 The CIV is making good progress in the search for global equity managers for four separate lots: Generic Global Equity with 6 different strategies, Emerging Markets, Sustainable Equity and Incubator Managers. The tender attracted over 200 submissions with 58 fund managers making it to the first round of interviews. The outcome of the selection process will be reported to the Committee at the earliest opportunity.
- 2.5 The CIV had assets under management of circa £3 billion at the end of 2016 and anticipates it will have approximately £5.5 billion by the end of 2017. Also, the CIV is taking active steps to strengthen its team, internal systems and processes.
- 2.6 The CIV met with the Minister for Local Government, Marcus Jones MP in December 2016 to discuss progress on pooling and the Minister has since recognised the CIV's efforts.

3. LONDON BOROUGH OF MERTON'S ACTIVITY WITH LONDON CIV

- 3.1 The outcome of the on-going review of the Pension Fund investment strategy will support the Committee in developing a pragmatic approach to pooling some assets via the London CIV to strike the right balance between maintaining a strong risk management, performance, cost and governance perspective on the one hand and demonstrating commitment to pooling to comply with the Government's reform of the LGPS on the other.

4. CONSULTATION UNDERTAKEN OR PROPOSED

- 4.1 N/A

5. FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

- 5.1 The investment strategy chosen will affect the return on the Fund, its actuarial valuation and the cost to the Council.

6. LEGAL AND STATUTORY IMPLICATIONS

- 6.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1st November 2016. The new Regulations clarify how LGPS funds should manage and invest their assets and their relationship with investment pools. The Regulations give the Secretary of State power of Direction to intervene in an administering authority's investment function if it failed to bring forward credible proposals for pooling

7. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

7.1 N/A

8. CRIME AND DISORDER IMPLICATIONS

8.1 N/A

9. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

9.1 The use of the CIV would enable a quicker, simpler process, but any delays in their ability to take investments could impinge on the Council's ability to have the new allocations and fund managers in place during 2017/18.

10. APPENDICES

None

11. BACKGROUND PAPERS

1. Notes from LB Merton/London CIV officers' meetings
2. London CIV communication – emails (October - November 2016)
3. London CIV Conference pack – 1 March 2017

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