HYMANS ROBERTSON

Conference highlights

LGC Investment & Pensions Summit – 5-6 September 2019, Celtic Manor

ESG (Environment, Social & Governance) issues featured heavily in this year's Celtic Manor* LGC summit, focussed on how to keep the Local Government Pension Scheme sustainable, fair and justly rewarding. Please speak to your usual Hymans Robertson contact if you would like to discuss any topic in more detail.

(Note that we were not able to attend all sessions, so some have been omitted from this highlights document).

Session 1: Keynote - Implications of economic outlook from a global and UK perspective

- James Ashley, Market Strategist, Strategic Advisory Solutions, Goldman Sachs Asset Management

- Are we in a "HUNGOVER" world – High Uncertainty, Neutral Growth Outlook, Volatile Exchange Rates?
- Stick with your long-term plans, despite short term fluctuations: even a few days in or out of the market can have a huge impact on annualised returns over the past 20 years;
- The world's calculated "economic centre of gravity" is gradually moving eastwards: was western Europe c.1980, is in the Middle East now, expected to be China in 20 or 30 years' time;
- We may be in a "hungover" world, but we are not dying: believes markets overly gloomy re imminent recessions (remember the market has a very poor track record of forecasting eg US interest rates);
- The UK is the EU's major importer of toilet roll, so is this something to be stockpiled ahead of Brexit!?

Session 2: The next investment opportunities and the challenges ahead

- Mark Mansley, Chief Investment Officer, Brunel Pension Partnership

- Simon Davy, Head of Private Markets, LPP Investments, the Alternative - Investment Fund Manager (AIFM) for GLIL

- Rob Hall, Head of Equity, London CIV

- Jason Fletcher, Chief Investment Officer, LGPS Central

- All agreed that diversification is key, and ESG is fundamental to all investment approaches and classes: further individually expressed views were as follows:
- Some comfort to be taken by widespread market caution;
- UK equities may be attractive due to high yields and Price/Earnings ratios, and remember c.70% exposure to overseas markets so also act as a form of hedging?
- Core infrastructure can provide high quality highly predictable income;
- Index-linked gilts' negative yields mean you give the Government a loaf of bread and in 40 years' time they give you back a dozen slices!

Session 3: World café round table discussion session

Joanne Segars, summarising at the end of these six simultaneous discussions, identified common themes of capacity, transparency, and avoidance of "one size fits all" approaches: these are consistent with the Good Governance project.

(a) LGPS Good Governance Project

- There is general support for the project's direction and the suggested outcomes-focussed approach;
- The challenge will be how to see improvements without prescribing actions;
- S151 and Elected Members at the Administering Authority will be key, so their prior experience plus subsequent training will be very valuable;
- What is the role of the Pools in this new environment?

(b) Should LGPS funds be de-risking?

- Different forms of de-risking are being considered by different funds;
- Also, different approaches to de-risking vs contribution reduction;
- What is the question that "de-risking" is the answer to?
- Would different employer investment strategies be the sustainable way forward?

(c) The cost cap and McCloud

- Impact of the ruling will be much less on the LGPS than on other (unfunded) public service schemes;
- However there is a concern that the issues and solutions for the unfunded schemes may be inappropriately imposed on the LGPS too;
- Remember that McCloud may, or may not, remove the need for further changes under the national cost management process.

(d) Investing in local housing

- There is hesitancy and questions to be asked regarding this asset class;
- Need to be clear on the governance, management of perceived conflicts etc;
- How local is local? Does "housing" refer to social housing only?
- There are particular skill sets required to implement this asset class.

(e) Investing in local infrastructure

- There is currently little allocation to this asset class across LGPS funds;
- As for local housing, need to address governance and perceived conflict issues;
- Shouldn't compromise on the return target; suggestion that the target should be explicitly higher?

(f) National Section 13 Valuation

- Commonly-expressed views from Funds that the Government Actuary's Department seemed to be inflexible and unduly wedded to results from its methodology;
- Also, surprise that the 2017 Scottish report has still not been published, leading to questions as to how this exercise is intended to influence future valuations if it comes so late in the cycle;
- Perhaps one positive outcome from the 2016 exercise is that there is now more involvement of Committees, including challenges by them, in the valuation process;
- Funds should be aware of GAD flags if contributions reduced while deficit recovery periods increased;
- Concerns regarding possible imposition of standardised funding assumptions on funds.

Business and risk workstream 3 - What does a well-run Fund look like?

- Chair: John Raisin, Independent investment adviser
- Douglas Green, Partner, Actuarial and Benefits, Hymans Robertson LLP
- Nick Jellema, Investment Consultant, Investments, Hymans Robertson LLP

- A well-run fund can make positive differences to people, around the four "sides" of the LGPS:
- Funds can take action now, given the known direction of travel of the Scheme Advisory Board's Good **Governance** project, to identify outcomes-focussed next steps;
- Global survey of large pension funds shows common **investment** governance themes: clear objectives & accountability, aligned risk management, focussed reporting & challenge, and reflection & evolution;
- **Funding** myths regarding long term council costs, employers who "can't afford to stay, can't afford to leave", and a single investment strategy for all employers, were addressed;
- **Administration** steps could include workstream planning, and mapping on to resourcing requirements.

Business and risk workstream 4- Dealing with multiple employers – impact on investment strategies and administration

- Chair: John Raisin, Independent investment adviser
- Lorraine Bennett, Senior Pensions Adviser, Local Government Association
- Rachel Brothwood, Director of Pensions, West Midlands Pension Fund

- LGPS has massively more employers than all the other public service pension schemes combined;
- There is a great range and diversity among these c.15,000 employers, and employers "breed" employers due to outsourcing: high turnover including cessations gives large administration impact;
- Things can look very different to many employers, and perhaps different investment strategies would be one way to help address this;
- SAB Simplification project is focussing on Assumed Pensionable Pay and short-term unpaid leave;
- SAB Tier 3 project is currently whittling down 84 options to 6 recommendations;
- SAB Academies project is looking at standardised data collection; the funding sub-group has been disbanded.

Session 6: Oxford Union Debate - "This house believes that investing sustainably can only deliver better performance"

- Introduction: Natalie Fee, Founder, City to Sea

- There has been a generational awakening of climate concern arising from the issue of plastics pollution, given its high visibility and immediate connection to our everyday lives;
- What if organisations gave Nature a seat at the table, becoming one of the beneficiaries/stakeholders?
- Change needn't involve sacrifice.

- Debate moderated by: Peter Walsh, Head, Robeco UK
- For the motion: Andrien Meyers, Deputy Chair of Social Investment Board, City of London,
- Against the motion: Chris Buss, former Director of Finance at London Borough of Wandsworth and Chair of Waltham Forest Pension Board

- Andrien had previously thought this issue a "tick box", "feel good" aspect, but evidence shows that adoption of ESG principles improves performance, particularly due to the "S" (social impact) element;
- There is a generational change with different values, eg part of the rise in veganism is due to concerns for the environmental impact of the meat industry;

- Chris conceded the "G" (governance) element of ESG, as a company needs to be run well to be successful. However, it is too simplistic to say sustainability adds value;
- "Sin stocks" can become sustainable in their own right (eg Shell moving into renewable energy);
- The motion was carried 60:40, albeit the room's opinion had been 75:25 at the outset.

Session 3: World café round table discussion session
(a) Climate Change: impact on investment strategies

- There has been a huge change in attitudes in recent years, and local authorities are increasingly adopting environmentally friendly initiatives, so it is a natural extension to the pension fund;
- Whilst the divestment option is necessary, engagement with companies can be more effective in bringing about actual change in corporate actions;
- It was acknowledged that challenges remain around bringing this huge topic down to manageable levels, what to do if "China and the US just ignore the topic", and how to ensure meaningful reporting from investment managers and Pools.

(b) Managing Brexit and market uncertainties

- Whilst this is a major turning point for the UK, do the markets already price in a hard Brexit, meaning there will be positive results from flexibility and agility emerging in practice?
- The main risk to funds is a rise in Sterling and therefore impact on unhedged overseas holdings;
- There could be political fallout leading to other market impacts, eg Scottish independence?
- Main message is not to panic, but be aware of potential further issues.

(c) Changes in investment strategies from the 2019 valuation?

- Most funds will see appreciable funding level increases (on unchanged discount rates) which open up options around de-risking, reducing contributions (and/or keeping them within a sustainable corridor), explicitly holding surplus reserves, etc;
- Feasible options will vary by employer, opening up the question of having different employer investment strategies, as well as the existing different funding strategies;
- There is no single right answer, so discussion between fund and advisers is essential. However it was agreed that wholesale risk reduction is unlikely as the LGPS is an open scheme.

(d) What are the urgent scheme issues to be addressed?

- Which employers should remain in the LGPS? Continuing issues being addressed by SAB [see "Dealing with multiple employers" session summarised above];
- Watch the impact of actuarial valuation results on cashflow, and hence on investment strategy;
- Resourcing in pension teams and systems has been flagged by the Good Governance project;
- McCloud and cost management impact on benefit structure: no idea of changes or timescales yet.

(e) Looking forward three years, what are topical issues to be addressed?

- Pensions is much longer term, so next 3 years' actions should be a positive longer-term influence;
- How should funds react to global geopolitical issues?
- Should funds be able to access more than one LGPS Pool?
  Administration will need to become less paper-based, more electronic and online.

Session 8: The safest & least safe investments in the current climate

- Erik Norland, Senior Chief Economist, CME Group

- (note that none of the following constitutes investment advice of course)
- Starting to see the first real market impacts of right wing populism;
- Trade war between US and China likely to be long term;
- Once Brexit completed, Sterling will soar – currency hedging is a form of agnosticism;
- Watch the risk of high yield bonds – credit spreads likely to rise materially in near future?
- Inflation could be making a return.

Session 9: LGPS and MHCLG update

- Jeff Houston, Board Secretary to the Scheme Advisory Board

- Outstanding matters include Pooling guidance, Fair Deal, Higher & Further Education employers in the LGPS, £95k exit payment cap, quadrennial valuations;
- The CMA view is that LGPS Pools are excluded from "remedy 1" of the forthcoming Order however "remedy 7" (investment consultant objectives) will apply. Whilst discussions are ongoing with the FCA regarding formal changes, the CMA have indicated they will police this in line with their view;
- The SAB Compliance and Reporting system will assist the Code of Transparency reporting and benchmarking without revealing data other than to the investment manager and Fund concerned;
- Does the Walker case mean that survivors' benefits are set by the scheme rules at date of death as opposed to (the previously widely held belief) the rules at date of retirement/leaving?
- John McDonnell recently flatly denied to a journalist that Labour would de-fund the LGPS;
- A forthcoming report from the Pensions Regulator is likely to raise concerns re the LGPS;
- There are continuing questions regarding passive vs active asset management, and LGA likely to be asking for volunteers for further analysis on this.

- Teresa Clay, Head of Local Government Pensions, Ministry for Housing, Communities and Local Government

- Realistically, regulations can't be laid or consultations started, unless Parliament is sitting;
- Pooling guidance: 92 consultation responses have been taken into account, and revised guidance will be issued with formal consultation when possible;
- Must be an advantage that we have a Chief Secretary to the Treasury (Rishi Sunak) who has knowledge of the LGPS.

***This was the last year of this Summit being at Celtic Manor: next year's event (9-11 September 2020) will be at The Armouries, Leeds.**