



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

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Item 13

4th March 2020

### Investment Advisory Panel – Quarterly Report

#### Purpose of Report:

To provide the committee with a summary of the Investment Advisory Panel meeting held on Wednesday 5<sup>th</sup> February 2020.

#### Recommendation:

The Committee is asked to **NOTE** the contents of this report.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes  No  consulted: Yes  No

#### **PLEASE NOTE THE FOLLOWING:**

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## **1 Background**

As a key element of its governance arrangements, the Strathclyde Pension Fund (SPF) maintains an Investment Advisory Panel (IAP). The role of the IAP, together with details of membership and meeting arrangements, is summarised in **Schedule 1**.

## **2 IAP Meeting – Thursday 5<sup>th</sup> February 2020**

**Present:** Professor Geoffrey Wood, Eric Lambert, Iain Beattie, David Walker (Hymans Robertson), Andy Green (Hymans Robertson, part meeting only), Richard McIndoe, Jacqueline Gillies, Richard Keery, Ian Jamison (part meeting only).

### **Agenda: Strategy Development Session**

- 1) Minutes from last meeting and any matters arising
- 2) Investment Strategy and Structure
- 3) Monitoring
- 4) Allocation
- 5) Governance
- 6) Manager Reviews
- 7) AOCB

## **3 Minutes from Last Meeting & any Matters Arising**

The minutes of the previous meeting were agreed to be an accurate record.

At the previous IAP meeting, Partners Group had presented a proposal to invest the remainder of their current private equity allocation from the Fund - £350m - in their long term value assets strategy. The Panel was supportive of the concept of the strategy, but had concerns over the fees and the level of allocation proposed by Partners Group.

Officers updated the Panel on discussions with Partners Group. A revised proposal will be presented for consideration by the Panel at a future meeting.

## **4 Investment Strategy and Structure**

### **4.1 Progress towards Alt 2.**

Good progress has been made in the implementation of the Alt 2 investment strategy, but 1% of the Short Term Enhanced Yield (STEY) allocation remains unallocated.

The Fund currently holds £600m in cash. This will reduce as it is used to fund new private debt mandates, as well as anticipated drawdowns to existing private markets programmes, during the coming year. Given the scale of these programmes and their cashflows, it is likely that the Fund will hold a minimum of 1% in cash for the foreseeable future. To reflect this, the 1% balance of the STEY allocation will be benchmarked to cash. This will be re-visited as part of the 2020/21 Investment strategy review.

### **4.2 2020/21 Review of Investment Strategy**

A further review of investment strategy in conjunction with the actuarial valuation of the Fund as at 31<sup>st</sup> March 2020 will be one of the major items in the SPF 2020/21 business plan.

Given the lengthy transition period experienced by the Fund in recent years, the Panel had previously agreed that once implementation of Alt 2 was complete, a period of minimal strategic change would be welcome to allow time to fully assess the attributes and performance of the revised structure.

Within this context, Hymans Robertson had produced and circulated an outline investment workplan for 2020. The Panel discussed this at some length and agreed the following priorities:

- asset liability modelling to better understand and if necessary re-state the long-term objectives and return target for the Fund;
- explicit consideration of the risk which inflation poses to the long term objectives;
- climate risk scenario modelling;
- review of credit spread triggers; and
- review of the current equity structure.

It was noted that review of investment consultancy contracts will also be a priority in the 2020/21 business plan.

#### **4.3 Review of Climate Related Risks and Opportunities**

An early draft of a report on climate-related risks and opportunities had been circulated and was discussed.

The Panel acknowledged the growing perception of climate change as a significant economic issue and noted the potential next steps in terms of SPF strategy. The Panel was wholly supportive of the paper's conclusions in respect of the inefficacy of fossil fuel divestment. The Panel was also supportive of SPF investigating the potential to achieve a net-zero objective, but expressed some reservations, in particular with regard to:

- potential conflicts with SPF's primary duty to pay pensions;
- resource requirements; and
- whether and how SPF can achieve the objective if the global economy does not transition sufficiently rapidly for the opportunities to be present.

A final version of the report would be considered by the Committee at its meeting on 4<sup>th</sup> March 2020.

#### **4.4 No. 3 Fund**

Officers updated the Panel on progress of the merger of the Strathclyde No. 3 Fund into the Aberdeen City Council Transport Fund, which is administered by the North East of Scotland Pension Fund (NESPF).

- Total proceeds of £30m from the sale of the Strathclyde No 3 Fund growth assets were transferred to NESPF in September 2019.
- The majority of remaining LDI assets were sold and transferred as cash during January 2020; the active corporate bond holding was transferred *in specie* on 3<sup>rd</sup> February 2020.
- £1.5m was being held by SPF to cover any residual No 3 Fund costs. A full cash reconciliation will be completed when final invoices have been received. Any remaining cash balance will be transferred to NESPF once all outstanding payments have been made.

## 5 Monitoring

### 5.1 Quarterly Investment Performance Review (Main Fund)

The Panel reviewed the Northern Trust investment performance monitoring report. The Fund's return for Q4 2019 was positive (+2.4%), and above benchmark (+0.5%). Performance for the year to 31<sup>st</sup> December 2019 was positive (+14.6%), and above benchmark (+1.2%). Both absolute and relative performance had been positive over the three and five-year periods.

### 5.2 Quarterly Investment Performance Review (No. 3 Fund)

The Panel reviewed the Northern Trust investment performance monitoring report for the No. 3 Fund. The Fund's return for Q4 2019 was negative (-6.5%) but above benchmark (+0.1%). The No.3 Fund had outperformed over one, three and five years and since inception.

### 5.3 Manager Ratings

Current officer assessments of the Fund's investment managers had been circulated, together with Hymans Robertson's manager update. On a Red, Amber, and Green (RAG) analysis:

- nineteen of the Fund's managers were rated green
- two rated amber and
- none red.

This was an improvement from previous periods, two managers having moved from amber to green largely as a result of improvement in performance.

### 5.4 Direct Investment Portfolio Monitoring Report

The Panel reviewed the quarterly monitoring report for the Direct Investment Portfolio (DIP). The portfolio and most of its investments were progressing well. On a Red, Amber, Green (RAG) analysis:

- thirty seven investments were rated green
- three amber and
- none red.

### 5.5 Estimated Funding Levels

The funding level update report had not been circulated pending a response from Hymans Robertson to a previous query on a material revision of the figures during Q4 2019. Hymans Robertson provided a verbal update on the query. Estimated funding level at 31<sup>st</sup> December was 110.2%. The No.3 Fund update had been discontinued.

## 6 Allocation

### 6.1 Private Market Allocations

The Panel reviewed a schedule of estimated cash flows for the Fund's private market investment programmes - private equity, global real estate, the Direct Investment Portfolio, and private debt commitments. Totals as at 31<sup>st</sup> December 2019 were as follows.

	2019 Estimate (£m)	2019 Actual YTD (£m)	2020 Estimate (£m)
Distributions	449	404	678
Calls	-570	-550	-897
<b>Net</b>	<b>-121</b>	<b>-147</b>	<b>-219</b>

The total net cash flow for 2019 was **(£147m)**, **£26m** more than had been estimated. The projected total net cash flow to private markets programmes in 2020 is **(£219m)**. The Fund's private debt and Direct Investment portfolios are still building their investment exposure and drawdowns to these investments are expected to exceed distributions. The Pantheon private equity and the Partners Group private equity and real estate programmes are mature portfolios and distributions is predicted to exceed the anticipated drawdowns to more recent fund commitments.

The Fund's central cash balance at 31<sup>st</sup> December 2019 was **£608m**. This had increased by **£27m** since September 2019. During Quarter 4 2019, £230m of cash had been received as a result of reductions in the Lazard and Veritas portfolios in line with the passive rebalancing strategy; and £150m was drawn from the Legal and General cash balance to fund the first tranche of investment into ICG Longbow and a property purchase by DTZ. Cash balances were further reduced as money was transferred to fund benefits cash flow and drawdowns to private market programmes.

## **6.2 Investment Income 10 Year Forecast**

A paper providing an updated analysis of current and future investment income had been circulated and was discussed.

The analysis separately identified:

- Income that is currently distributed within portfolios and available for drawdown;
- Income that is earned within portfolios but not currently distributed ("re-invested income"); and
- Income that is not currently distributed but could be in future.

Main conclusions from the updated analysis were that:

- The Fund's investments currently distribute much more income than is required to pay pensions.
- Distributed income will be more than adequate to pay pensions for the foreseeable future.
- Should this change, up to 50% of income which is currently re-invested could be made available for distribution to the Fund.
- Less than 20% of distributed income is currently required to pay pensions, but this will increase and may be in the region of 40% (net of managers' fees) within 10 years.
- Ongoing consideration therefore needs to be given to which portfolios should be the source of funds.

## **6.3 Re-balancing strategy**

The Panel reviewed a re-balancing report as at 31<sup>st</sup> December 2019.

There were a number of breaches of ranges but the Panel agreed that no additional action is required as these will be resolved as the implementation of the Fund's investment strategy progresses.

## **7 Governance**

### **7.1 Strathclyde Pension Fund Committee**

The Panel noted the draft agenda for the next committee meeting on Wednesday

4<sup>th</sup> March 2020.

## 7.2 CMA Order for Investment Consultant Services

Strategic objectives had now been agreed for both the IAP and the investment consultants in line with the requirements of the Order issued in 2019 by the Competition and Markets Authority (CMA).

There was a brief discussion of the other provisions of the CMA Order including FCA regulation of all advisers. It was not clear if and how these are to apply to the Local Government Pension Scheme. The Panel will continue to monitor developments.

## 8 Manager Reviews

The following investment managers attended the Investment Advisory Panel.

- PIMCO
- DTZ
- Alcentra
- Ruffer

Performance of each of the managers was reviewed.

### **PIMCO**

The PIMCO absolute return portfolio is currently valued at £1,111m, or 4.7% of total Fund, versus a target weight of 5.0%. PIMCO provided an update on the Fund's existing investment in PARS III.

### **DTZ**

The DTZ UK property portfolio is currently valued at £2,198m, or 9.3% of total Fund, versus a target weight of 10.0%. DTZ provided an update on the Fund's existing UK property portfolio including the most recent acquisitions and the indirect holding in the Co-Living Fund completed in 2019, together with an outline of investment objectives for the forthcoming year. The Panel agreed that, since the portfolio is under its target weight, the manager should continue to seek opportunities to re-invest rental income.

### **Alcentra**

The Alcentra portfolio is currently valued at £228m, or 1.0% of total Fund, versus a target weight of 1.3%. Alcentra provided an update to the Panel on the Fund's existing investment in Alcentra European Direct Lending Fund II, on its more recent commitment of £250m to Alcentra European Direct Lending Fund III, and on senior personnel changes at Alcentra.

### **Ruffer**

The Ruffer absolute return portfolio is currently valued at £213m, or 0.9% of total Fund, versus a target weight of 1.0%. Ruffer provided an update on the Fund's existing investment.

## 9 Policy and Resource Implications Resource Implications:

*Financial:*

None

<i>Legal:</i>	None
<i>Personnel:</i>	None
<i>Procurement:</i>	None
<b>Council Strategic Plan:</b>	Strathclyde Pension Fund aligns with the theme of a well governed city.
<b>Equality and Socio Economic Impacts:</b>	
<i>Does the proposal support the Council's Equality Outcomes 2017-21</i>	Equalities issues are addressed in the Fund's Responsible Investment strategy.
<i>What are the potential equality impacts as a result of this report?</i>	No specific equalities impacts.
<i>Please highlight if the policy/proposal will help address socio economic disadvantage.</i>	N/a.
<b>Sustainability Impacts:</b>	
<i>Environmental:</i>	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
Social, including opportunities under Article 20 of the European Public Procurement Directive:	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
<i>Economic:</i>	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
<b>Privacy and Data Protection impacts:</b>	None.

**10 Recommendations**

The Committee is asked to **NOTE** the contents of this report.

## Strathclyde Pension Fund Investment Advisory Panel Overview

### 1. Role of Investment Advisory Panel

The role of the IAP, as described in the Fund's Statement of Investment Principles, is to provide support and advice to the Strathclyde Pension Fund Committee and to carry out certain functions on behalf of the Committee.

The functions of the IAP include:

- developing investment strategy
- monitoring investment performance
- assisting in the selection and appointment of investment managers
- setting and reviewing detailed investment mandate terms and guidelines
- implementation of the passive rebalancing strategy
- monitoring cash flows
- implementation of the private markets programmes.

### 2 Membership

The IAP comprises:

- 3 independent advisors;
- a representative from the Fund's investment and actuarial consultants;
- the Director (SPFO);
- the Chief Investment Officer (SPFO) and
- the Investment Manager (SPFO).

### 3 Meeting Arrangements

The IAP meets quarterly. Meetings usually comprise a strategy development session and a series of reviews of investment performance with the Fund's investment managers. IAP members also attend Committee meetings and occasional *ad hoc* IAP meetings.