City of Westminster

Committee Report

Decision Maker:	**PENSION FUND COMMITTEE**
Date:	**18 October 2018**
Classification:	**General Release**
Title:	**Equity Protection Strategy**
Wards Affected:	**All**
Policy Context:	**Effective control over Council Activities**
Financial Summary:	**There are no immediate financial implications arising from this report, although investment performance has an impact on the Council's employer contribution to the Pension Fund and this is a charge to the General Fund.**
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1. EXECUTIVE SUMMARY

1.1 This paper updates Members on:

- The different types of equity protection.
- The proposed characteristics of these different options.
- Potential solutions appropriate for the City of Westminster Pension Fund.

2. RECOMMENDATIONS

2.1 That the Committee:

- Notes and comments on the different types of equity protection strategies available, with consideration to be given to exploring this possibility further if deemed an attractive prospect.

3. EQUITY PROTECTION BACKGROUND

3.1 The Fund has currently a large allocation to equity investments. Although a decision was taken to reduce equity exposure by £90m at the 20 August 2018 meeting, even excluding this, the current equity portfolio stands at around £1bn, held with four different investment managers: Longview, Majedie, Legal and General Investment Management (LGIM) and Ballie Gifford.

3.2 With equity valuations at all-time highs, it should be considered whether the Fund is carrying a significant amount of risk in this area.

3.3 At the last Committee meeting on 20 August 2018, the decision was taken to take further consideration to this area, with a special training session to be held on the subject to ensure the Committee is fully briefed on all areas of equity protection.

3.4 The Fund's investment consultant, Deloitte, will host this training on 16 October 2018.

3.5 Currently, a number of Local Government Pension Schemes, including Surrey County Council and LB Islington Pension Fund have implemented strategies over the last year.

3. EQUITY PROTECTION STRATEGIES

4.1 Appendix 1 to this report talks through in detail the different types of strategies available that provide downside equity protection, but the key areas are whether they are pooled or segregated, and at cost or nil cost.

4.2 Pooled solutions are often overlaid by the incumbent manager of the portfolio, who will manage the derivatives required. Segregated solutions require the Fund to own the derivatives. This is not desirable due to the complexity and potential risk that this brings, so a pooled approach would be the preferred solution.

4.3 Often the Fund can achieve protection on the downside by relinquishing some of the upside. A possible scenario is that the Fund could forsake any gains above 7% on the portfolio, but will be protected on any losses from -5% downwards towards -30%.

4.4 It should be noted that this strategy is proven not to work in the long term due to the large amounts of upside lost, but is useful for managing risk over a shorter period of time (such as a year before the triennial cycle or maybe the entirety of a triennial cycle).

4.5 The other option is to purchase protection for a certain amount of downside. This would remove the upside loss, but it can be very expensive to implement depending on the level of protection and the duration.

4.6 One of the most effective ways to manage equity downside is still to sell equities and move into a less risky asset class.

5 WESTMINSTER EQUITY PROTECTION APPROACH

5.1 Given that the Pension Fund has four separate equity managers, it would be quite an undertaking to ensure protection was applied across the whole portfolio.

5.2 If the Committee did wish to implement an equity protection strategy, the proposal would be to utilise the Fund's passive equity manager, LGIM, to overlay a pooled equity protection solution over the largest of the Fund's equity portfolios. The reason for this is:

- The Fund would still have protection on around a third of its equity holdings without giving up too much upside. This results in a hedge without making a bet on the market.
- LGIM have a ready-made pooled solution easy to implement.
- The solution can be implemented for a specified timescale that works for the Fund's objectives.

5.3 It should be noted that, as pricing moves for derivatives, the price on a nil cost basis to implement may no longer work for the Fund. If the upside forsaken is too much, it will be contrary to the actuarial rate of return and impact the discount rate of the liabilities.

If you have any questions about this report, or wish to inspect one of the background papers, please contact the report author:

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BACKGROUND PAPERS: None

APPENDICES:

Appendix 1: Equity Protection Paper