



City of Westminster

Committee Report

Decision Maker:	PENSION FUND COMMITTEE
Date:	29 June 2023
Classification:	General Release (Appendices 1 & 2: exempt)
Title:	Strategic Investment Strategy Review
Wards Affected:	All
Policy Context:	Effective control over council activities
Financial Summary:	There are no direct financial implications arising from this report.
Report of:	Phil Triggs <i>Tri-Borough Director of Treasury and Pensions</i> pdriggs@westminster.gov.uk 020 7641 4136

1. EXECUTIVE SUMMARY

- 1.1 Following the Pension Fund Committee meeting on 9 March 2023, the Fund's investment advisor, Isio, has prepared an investment strategy review follow up for the Fund.
- 1.2 This report highlights findings, recommendations and implementation considerations to consider reference the revised pension fund investment strategy, shown as Appendix 1.

2. RECOMMENDATIONS

- 2.1 The Committee is recommended to:
 - discuss the recommendations set out within Isio's investment strategy review follow up, and agree an appropriate strategic asset allocation for the Fund going forward.
 - approve that Appendices 1 and 2 to this report are not for publication on the basis that they contain information relating to the financial or business affairs of any particular person (including

the authority holding that information) as set out in paragraph 3 of Schedule 12A of the Local Government Act 1972 (as amended).

3. PROPOSALS AND ISSUES

Investment Strategy Review

- 3.1 The Fund's current strategic asset allocation is 60% of assets within equities, 19% in fixed income, 6% in renewable energy infrastructure, 5% within infrastructure, 5% within property and 5% to affordable housing.
- 3.2 Since the 2019 actuarial valuation, the then funding position (99%) has significantly improved, rising to 149% at 31 March 2023. Given the stronger funding position, there is an opportunity to reduce investment risk within the portfolio, taking into consideration wider investment market dynamics.
- 3.3 Currently, the largest contributor to funding risk is the Fund's large allocation to equities, with the 2.5% target allocation to affordable housing still to be allocated. The Fund is cashflow neutral and additional income generation is not an immediate concern for the Fund, with the infrastructure mandates expected to start generating supplementary income going forward.

De-risking

- 3.4 During the investment strategy review, Isio proposed to transition 5% from global equities into the Insight Buy and Maintain Bond fund. This would be expected to reduce the Fund's volatility to 11.0% per annum from 12.0% and improve the risk adjusted returns by 0.3% p.a.
- 3.5 The key driver behind this proposal is to ensure member benefits can be met as they fall due and fulfil the fiduciary duty of the Pension Fund Committee. Typically, as funding levels increase, schemes opt to reduce their investment and funding risks by transitioning into less volatile asset classes.
- 3.6 Seeking to increase risk at this stage poses a risk to the funding gains and surpluses achieved since the 2019 valuation, with a potential for these to be reduced by negative market movements.

Other Considerations

- 3.7 Following the meeting on 9 March 2023, Isio agreed to prepare a revised strategic asset allocation model, taking into consideration three scenarios for the 5% equity transition: bonds, renewable infrastructure and private equity. All three proposals are expected to return the same risk adjusted returns of 6.1% p.a. However, allocations to renewable infrastructure and private equity are expected to come at a higher level

of volatility with only a marginal increase in expected returns. Please see appendix 2 for an introduction to private equity.

- 3.8 While further investments in renewable energy infrastructure can provide diversification and investment growth, the asset class is highly susceptible to movements in the energy market, as highlighted by recent volatility. Private equity funds can deliver relatively uncorrelated returns to traditional markets. However, they take on a higher level of risk and are not subject to the same level of regulation as an exchange.
- 3.9 Isio maintains that the most appropriate strategy to de-risk would be to increase the Fund's credit allocation by 5%, with the reduction to come from the equity mandates. Going forward, Isio has proposed to consider renewable infrastructure as a replacement for parts of the fixed income allocation, provided it meets the lower risk profile. Alongside this, private equity could be used as a source of further diversification and risk reduction from the remaining equity allocation.
- 3.10 Officers are supportive of the Isio proposed approach.

4. IMPLEMENTATION CONSIDERATIONS

- 4.1 The Pension Fund Committee needs to consider the most appropriate source of the 5% reduction in equity allocation, with a third managed passively by LGIM and the remaining held in active portfolios managed by Baillie Gifford and Morgan Stanley. All of the funds have ESG considerations integrated into their investment processes.
- 4.2 Within Appendix 1, Isio explores the fund metrics, performance, sector allocations and the cost implications of divestment across the three equity funds. Given the lower cost of the passive portfolio and greater levels of diversification, the investment advisor recommends the 5% allocation to be taken from the active mandates, with the split to be agreed by the Committee.

5. RECOMMENDATIONS AND NEXT STEPS

Recommendations

- 5.1 Isio has set out the following recommendations for the Fund's investment strategy, with the aim of reducing equity allocation risk and funding level risk:

Rebalance: rebalance the overweight and underweight allocations within the equity and fixed income mandates. Any excess cash to be held for the purpose of illiquid fund draw down requests.

De-risk: transition 5% from the active global equity mandates into the Insight Buy and Maintain Bond fund. The Committee is recommended to take 2.5% from each of the two active equity funds.

Affordable housing: undertake a manager selection exercise to identify a mandate for the 2.5% affordable housing allocation.

- 5.2 The Committee should discuss and agree the most appropriate strategic asset allocation for the Fund going forward. Upon agreement of the above recommendations, a timeline for implementation, setting out a plan for 2023 in order of preference, will be established.

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: Investment Strategy Review Follow Up (Exempt)

Appendix 2: Introduction to Private Equity (Exempt)