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# Pensions Committee

**Date:** **MONDAY, 21 JANUARY 2019**

**Time:** **5.00 PM**

**Venue:** **COMMITTEE ROOM 4 - CIVIC CENTRE, HIGH STREET, UXBRIDGE**

**Meeting Details:** Members of the Public and Media are welcome to attend.

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**To Members of the Committee:**

Philip Corthorne (Chairman)
Martin Goddard (Vice-Chairman)
Teji Barnes
Tony Eginton
John Morse

**Published:** Friday, 11 January 2019

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**Putting our residents first**

**Lloyd White**
**Head of Democratic Services**
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# Agenda

## CHAIRMAN'S ANNOUNCEMENTS



## PART I - Members, Public and Press



## PART II - Members Only

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# Minutes

**PENSIONS COMMITTEE**

**29 October 2018**

**Meeting held at Committee Room 4 - Civic Centre, High Street, Uxbridge**

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| | Councillors Philip Corthorne (Chairman)<br>Martin Goddard (Vice-Chairman)<br>Teji Barnes<br>Tony Eginton<br>John Morse<br><br>**LBH Officers Present**:<br>Tunde Adekoya<br>Paul Whaymand<br>Ken Chisholm<br>Sian Kunert<br>James Lake<br>Hayley Seabrook, Pensions Board Member<br>Liz Penny - Democratic Services Officer<br><br>**Also Present**:<br>Dave Lyons, KPMG Representative<br>Scott Jamieson - Investment Advisor<br>Roger Hackett - Pensions Board Member<br>Zak Muneer - Pensions Board Member | |
| 11. | **APOLOGIES FOR ABSENCE** *(Agenda Item 1)*<br><br>There were no apologies for absence. | |
| 12. | **DECLARATIONS OF INTEREST IN MATTERS COMING BEFORE THIS MEETING** *(Agenda Item 2)*<br><br>Councillor Philip Corthorne and Councillor Teji Barnes declared a Non-Pecuniary interest in all agenda items because they were deferred members of the Local Government Pension Scheme. They both remained in the room during discussion of the items.<br><br>Councillor Tony Eginton declared a Non-Pecuniary interest in all agenda items as he was a retired member of the Local Government Pension Scheme. He remained in the room during discussion of the items. | |
| 13. | **MINUTES OF THE MEETING DATED 18 JULY 2018** *(Agenda Item 3)*<br><br>**RESOLVED That: the minutes of the meeting on 18 July 2018 be approved as an accurate record.** | |

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| 14. | **TO CONFIRM THAT ITEMS MARKED PART I WILL BE CONSIDERED IN PUBLIC AND THOSE MARKED PART II WILL BE CONSIDERED IN PRIVATE** *(Agenda Item 4)*<br><br>It was confirmed that the items marked Part I would be considered in public and those marked Part II would be considered in private. | |
| 15. | **INVESTMENT STRATEGY AND FUND MANAGER PERFORMANCE PART 1** *(Agenda Item 5)*<br><br>This item was preceded by a training item from KPMG on investing in infrastructure. Key points highlighted were as follows:-<br><br>• There were two main categories of infrastructure: economic and social. Economic infrastructure could be broken down into three types - throughput (e.g. roads), regulated (e.g. energy and utilities) and contracted (e.g. telecommunication assets).<br>• Infrastructure assets were classified as brownfield or greenfield; brownfield assets were established and less risky while Greenfield assets were slightly more risky but usually offered a higher return.<br>• Infrastructure assets were considered to be a good investment for the LGPS fund as they generally offered a long term and stable option.<br>• Infrastructure projects were typically financed with a small element of equity capital and significant borrowing (debt).<br>• The Fund currently employed Macquarie to invest in the equity of infrastructure projects.<br>• There were eight key areas of risk. Councillors were advised that the Manager of the Fund needed to be mindful of political risk and operational risk and able to identify areas of good value. It was recommended that any commitment to this type of investment be proportionate - it could take time to identify appropriate areas for investment.<br>• Members were informed that Infrastructure Equity offered an attractive long term return and a relatively high, stable and secure income.<br>• With regards to Infrastructure Debt, a key risk of both senior and junior debt was credit risk (risk of default). The risks of both senior and junior debt were similar with the exception of Concentration risk which applied exclusively to senior debt.<br><br>Members requested clarification regarding the variation in risk relating to brownfield / greenfield assets and enquired as to how the additional risk associated with investing in greenfield assets could be compensated for. It was confirmed that greenfield and brownfield projects had different risk profiles but a reasonable premium would be sought if investing in greenfield assets.<br><br>It was confirmed that the return of 2% / 3% cited in the report was a relative return. Members were referred to the management report which detailed the assets currently held and the returns on each. | |

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| | Councillors were informed that index-linked senior debt offered a lower margin of approximately -1.8% which was poor value; positive values would be expected as a minimum.<br><br>Members expressed concern regarding the security of investments in China. It was confirmed that total investment across America, India, China and Europe was minimal. Investment in China and India had been less profitable due to governance issues in those areas; however, it would be difficult to draw back said money as it had already been committed.<br><br>The Committee commented that the situation regarding Ruffer was an area of concern hence it was recommended that other options be explored. The nature of any potential offer from the LCIV was unknown at this stage and it was agreed that readily accessible investment options would be preferable. Immediate savings would be made in the move from Ruffer which would mitigate any transfer costs involved in such a move. It was reported that Members of the Pensions Board were supportive of the Committee's recommendations.<br><br>The Committee discussed the implementation of the allocation to long dated inflation linked property. The short listed funds were considered, as was a further delay in implementation of this asset allocation to consider waiting for the London CIV to provide an offering in this space. Due to the significant unknowns of what the LCIV would offer, or when, Members agreed it best carry out fiduciary duties in relation to management of the fund and implement the strategic asset allocation by awarding to Legal and General.<br><br>Members discussed ESG issues noted in the report and highlighted that climate change was a risk to the fund.<br><br>In Part II of the agenda, the Committee received information on the current market update which covered the current market climate and the performance of various investment vehicles, together with update on Managers' reports.<br><br>**RESOLVED That the Committee:-**<br><br>**1. Considered and discussed the issues raised in the training item;**<br>**2. Agreed to disinvest in Ruffer and bring alternative options for consideration to the next Pensions Committee;**<br>**3. Agreed to award the Long-Dated inflation linked property mandate to Legal and General (LGIM);**<br>**4. Agreed to delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group.** | |
| 16. | **ADMINISTRATION REPORT** *(Agenda Item 6)*<br><br>The report was for information and provided an update on the administration of the London Borough of Hillingdon Fund of the LGPS, both in relation to Surrey and internally at Hillingdon.<br><br>Members were informed that new appointments had been made to the | |

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| | senior team in Surrey. Sian Kunert (Head of Pensions Treasury and Statutory Accounts) and Ken Chisholm (Corporate Pensions Manager) would be meeting the new members of staff in due course.<br><br>It was noted that there had been a few minor issues lately but Surrey had been quick to react when a problem was identified. Members were informed that all external scheme employers had been invited to "Meet the Actuary"; unfortunately attendance had been disappointing. Councillors were advised that the Council had not been informed of a proposal to increase charges in the light of increased security.<br><br>**RESOLVED That: the Pensions Administration Report be noted.** | |
| 17. | **RISK MANAGEMENT REPORT** *(Agenda Item 7)*<br><br>The report aimed to identify the main risks to the Pension Fund and to enable Members to monitor and review these going forward.<br><br>Climate change was flagged up as an additional risk factor and it was suggested that this be included on the risk register. It was reported that the Cyber Security risk was low.<br><br>Members requested further clarification regarding risk factors 1) and 4) as detailed in the Pension Fund Risk Register 2018/19. It was agreed that Sian Kunert (Head of Pensions Treasury and Statutory Accounts) would review these and provide Councillors with a detailed response at the next meeting of the Pensions Committee in January 2019.<br><br>**RESOLVED That:-**<br><br>**1. The Pensions Committee considered the Risk Register in terms of the approach, the specific risks identified and measures being taken to mitigate those current risks. It was noted that there were no risks currently rated as red.**<br><br>**2. Sian Kunert (Head of Pensions Treasury and Statutory Accounts) review risk factors 1) and 4) and provide Councillors with a detailed update at the next meeting of the Pensions Committee in January 2019.** | |
| 18. | **TRAINING UPDATE REPORT - OCTOBER 2018** *(Agenda Item 8)*<br><br>The report provided an update on training and development of Pensions Committee Members in line with the Training Policy approved by Pensions Committee in December 2015 and an update report to Committee in March 2017.<br><br>Gratitude was expressed to all Members who had attended training sessions; particularly the newly elected Councillors. It was noted that self-assessment and targeted training were beneficial and to be recommended.<br><br>Councillor Teji Barnes commented that she had attended an AON Training Day and had found it extremely useful. | |

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| | Scott Jamieson, Investment Advisor, reported that he would no longer be involved with the Pensions Committee forthwith and stated that he had very much enjoyed working with Hillingdon Council. Thanks were extended to him for his commitment and hard work to date and the Committee wished him all the best for the future.<br><br>**RESOLVED That:**<br><br>**1. The contents of the Training Update report be noted.** | |
| 19. | **INVESTMENT STRATEGY AND FUND MANAGER PERFORMANCE PART II** *(Agenda Item 9)*<br><br>*This item was discussed as a Part II item without the press or public present as the information under discussion contained confidential or exempt information as defined by law in the Local Government (Access to Information) Act 1985. This was because it discussed 'information relating to the financial or business affairs of any particular person (including the authority holding that information)' (paragraph 3 of the schedule to the Act).*<br><br>The Committee received confidential information on the current market update which covered details on the current market climate and performance of various investment vehicles and updates on Managers' reports<br><br>**RESOLVED: That the information be noted, together with the performance of Fund Managers.** | |
| | The meeting, which commenced at 5.00 pm, closed at 5.56 pm. | |

These are the minutes of the above meeting. For more information on any of the resolutions please contact Liz Penny on 01895 250636. Circulation of these minutes is to Councillors, Officers, the Press and Members of the Public.

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| INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I) | |
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|---|---|
| *Contact Officers* | Sian Kunert, 01895 556578<br>Scott Jamieson<br>David O'Hara, KPMG |
| *Papers with this report* | Northern Trust Performance Report<br>DGF Strategic options |

## SUMMARY

This item will be preceded with a training item from KPMG on Roles and responsibilities of the Pensions Committee.

The total size of the fund was £1,065m at 30 September 2018 an increase £11m from £1,054m at the end of previous quarter. There was an overall investment return over the quarter of 1.08%. The estimated funding position at 30 September 2018 is 80.2% (78.9% as at June 2018).

Part II includes an update on each Fund Manager and the detailed current market backdrop. The papers all form background reading to inform Committee and to aid discussion.

## RECOMMENDATIONS

**It is recommended that Pensions Committee, following consideration of the Part II papers:**

1. **Consider and discuss any issues raised in the training item**
2. **Discuss the Fund performance update and agree any required decisions in respect of mandates or Fund Managers;**
3. **Agree to reduce strategic asset allocation in relation to diversified Growth fund allocation to zero and increase allocation to both index linked bonds and infrastructure by 5%**
4. **Delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group.**

## INFORMATION

### 1. Fund Performance

Over the last quarter to 30 September 2018, the Fund returned 1.08%, underperforming its benchmark return of 1.45% by 37 basis points. The Fund value increased over the quarter by £11m, to £1,065m compared to the previous quarter.

| Period of measurement | Fund Return % | Benchmark % | Arithmetic Excess |
|---|---|---|---|
| **Quarter** | 1.08 | 1.45 | (0.37) |
| **1 Year** | 5.63 | 6.85 | (1.22) |
| **3 Year** | 10.69 | 10.41 | +0.28 |
| **5 Year** | 8.43 | 8.28 | +0.15 |
| **Since Inception (09/1995)** | 7.11 | 7.02 | +0.09 |

During the quarter, distributions received from Alternative investments were $1.4m, €1.2m & £3.7m. The cash was utilised to fund drawdowns of outstanding commitments in both Permira and Macquarie. The biggest drag on performance in the quarter under review came mainly from the Private Equity portfolios of Adams Street and LGT (-1.46 & -2.68) behind their respective benchmarks. Macquarie with relative outperformance of 2.55 was the biggest contributor to the performance in the quarter under review.

Relative performance over a one-year rolling period was 1.14% behind the benchmark with the largest detractor again being JP Morgan; with a return of -3.63% less than benchmark, whilst Macquarie with 10.49% relative excess performance the largest contributor.

Funding position at 30 September was estimated at 80.2%.

**2. Asset Allocation**

The current asset allocation, the key strategic tool for the Committee, is in the table below. The assets of the Fund is invested across 11 different Fund Managers in a range of passive and active mandates, including a mix of liquid and illiquid allocations to reflect the Fund's long-term horizon.

**Current Asset Allocation by Asset Class**

| ASSET CLASS | Market Value As at 30 September 2018 £'000 | Actual Asset Allocation % | Benchmark Allocation % |
|---|---|---|---|
| UK Equities | 231,644 | 21.75 | 44.0 |
| Global Equities | 274,862 | 25.82 | |
| UK Index Linked Gilts | 84,744 | 7.96 | 14.0 |
| Multi Asset Credit | 81,095 | 7.62 | |
| Corporate Bonds (Global) | 31,207 | 2.93 | |
| Property | 133,776 | 12.56 | 12.0 |
| DGF/Absolute Returns | 105,302 | 9.89 | 10.0 |
| Private Equity | 18,723 | 1.76 | 2.0 |
| Infrastructure | 27,935 | 2.62 | 3.0 |
| Private Credit | 72,570 | 6.82 | 10.0 |
| Long Lease Property | 0 | 0 | 5.0 |
| Cash & Cash Equivalents | 2,928 | 0.27 | 0.0 |
| **Totals** | **1,064,786** | **100.0** | **100.0** |

The overweight positions in both Equities and Bonds will adjust itself once the cash allocated to Long lease property is drawn-down. A total of 5% fund assets has been allocated for investments in this asset class and in the queue awaiting drawdown.

**Current Asset Allocation by Manager**

| | | Market Value As at 30 September 2018 | Actual Asset Allocation |
|---|---|---|---|
| **FUND MANAGER** | **ASSET CLASS** | **£'000** | **%** |
| ADAMS STREET | Private Equity | 13,078 | 1.23 |
| LGT | Private Equity | 5,604 | 0.53 |
| AEW | Property | 57,057 | 5.36 |
| JP MORGAN | Corporate Bonds (Global) | 81,095 | 7.62 |
| LCIV - EPOCH | Global Equities | 144,315 | 13.55 |
| LCIV - RUFFER | DGF/Absolute Returns | 105,302 | 9.89 |
| M&G | Private Credit | 9,587 | 0.90 |
| MACQUARIE | Infrastructure | 27,935 | 2.62 |
| PERMIRA | Private Credit | 62,983 | 5.92 |
| LGIM | UK Equities | 93,574 | 8.79 |
| | Global Equities | 130,547 | 12.26 |
| | UK Index Linked Gilts | 84,744 | 7.96 |
| | Corporate Bonds (Global) | 31,207 | 2.93 |
| UBS EQUITIES | UK Equities | 138,070 | 12.97 |
| | Property | 22 | 0 |
| | Private Equity | 41 | 0 |
| | Cash & Cash Equivalents | 1,617 | 0.15 |
| UBS PROPERTY | Property | 76,697 | 7.20 |
| | Cash & Cash Equivalents | 228 | 0.02 |
| Non Custody | Cash & Cash Equivalents | 1,083 | 0.10 |
| | | **1,064,786** | **100** |

Note: Asset Market Valuation is at BID price, as per accounting requirements, which differs from the attached Northern Trust Performance report, which is measured at MID price.

**3. Market and Financial climate overview**

The FTSE All-Share fell 0.8% amid Brexit uncertainty and a tempering of the global growth outlook, as a result of the escalating trade war between the US and China. Any slowdown in global growth and trade tends to have an outsized impact on emerging markets (EM). EM-exposed areas of the UK stock market, including financials and miners, performed poorly as a consequence. Closer to home, fears of a “no deal”

Brexit weighed on the share prices of many UK domestic companies, driving a poor relative performance from the mid caps, with the FTSE 250 (ex investment companies) index falling by 2.7%. Fears for UK economy were also clearly reflected in the value of sterling, which resumed its downward trajectory over the period. Notwithstanding this, the near-term outlook for the domestic economy improved, as growth recovered from the slowdown seen in the first quarter, prompting the Bank of England (BoE) to increase interest rates by 25 basis points to 0.75%.

US equities advanced in Q3 to significantly outperform other major regions. Economic growth and earnings data remained robust, and this ultimately overshadowed simmering concerns around the escalating US-China trade war. Stability in growth and employment figures allowed the Federal Reserve (Fed) to enact its widely anticipated increase in the federal funds rate by 25 basis points.

Eurozone equities posted a modest gain in the third quarter with the MSCI EMU index returning 0.4%. Energy and industrials stocks were among the leading gainers. By contrast, real estate, telecommunications and consumer staples were the main laggards. Financials made a positive contribution overall, but banks were weaker. August saw sharp declines for eurozone banks amid concerns over their exposure to emerging markets (notably Turkey) as well as worries over the Italian budget. These concerns eased in September but the last trading day of the month saw Italy propose a deficit of 2.4%. This is within the EU's 3% threshold but higher than some had anticipated.

Emerging markets equities lost value in what was a volatile third quarter, with US dollar strength and the US/China trade dispute weighing on risk appetite. The MSCI Emerging Markets index decreased in value and underperformed the MSCI World. Turkey was the weakest index market amid a sharp sell-off in the lira. The market is vulnerable to global liquidity tightening given the economy's twin deficits, and Q2 GDP growth disappointed, slowing to 0.4% year-on-year. Although trade tensions continued to escalate during the quarter, the Japanese stock market ended September above its recent range to show a total return of 5.9% for the quarter. The Japanese yen weakened against the US dollar during the period, which tended to improve sentiment in the equity market.

Core government bond yields rose over the quarter due to positive economic data, particularly from the US. This outweighed a bout of safe haven demand in August caused by concerns related to emerging market instability, trade tensions and political issues in Europe. US 10-year yields rose from 2.86% to 3.06%, with Bund and UK gilt 10-year yields rising from 0.30% to 0.47% and 1.42% to 1.57% respectively.
Italian 10-year government bond yields rose from 2.68% to 3.15% amid political concerns.

**4. Strategy Update**

At the Pensions Committee in October it was agreed that the strategic asset allocation of 10% managed by Ruffer via the London CIV should be removed due to high fees and poor performance of the strategy in current markets. Included with this report is a paper by KMPG on recommended options to alternatively invest this allocation and

amend the strategic asset allocation. As at 31 December 2018, the Pension Fund assets valuation was £1,014m.

**5. LCIV update**

Currently open on the London CIV are
1 UK Equity sub fund
7 Global equity sub funds
4 Diversified Growth / Absolute Return funds
1 Multi Asset Credit fund

In the pipeline the London CIV plan to have Infrastructure, Liquid loans and private debt open in the first quarter of 2019, all managers have been appointed for these mandates. In addition, inflation plus and equity core look to be the next sub funds in the later part of Q1 2019. Next in the pipeline the London CIV are working on UK property and an exclusionary sustainable equity portfolio.

**Hillingdon Fund Investment with the London CIV**

The Hillingdon Pension Fund currently invests in Ruffer and Epoch on the LCIV platform and LGIM, which sits alongside the LCIV Platform accessing the economies of scale created via the LCIV. The Fund has total LCIV holdings of £590m at 30 September 2018 accounting for 55% of total assets of the Pension Fund. Data from the London CIV suggests the Hillingdon fund has saved £233k through lower fees net of costs through investing via the pool.

**6. ESG, Voting and Engagement**

As part of the Pension Committees role in making investment decisions it is required to take into account factors that are financially material to the performance of an investment and balancing returns against risks. This includes risks to the long-term sustainability of a company's performance, due to a number of factors including poor governance, environmental degradation, or the risks to a company's reputation arising from the way it treats its customers, suppliers or employees.

During the quarter ended 30 September 2018 the Hillingdon, investment managers made the following votes:

| Fund Manager | Meetings Voted | Resolutions | Votes With Management | Votes Against Management | Abstentions |
|---|---|---|---|---|---|
| UBS | 1,223 | 10,274 | 8,830 | 1,444 | 0 |
| LGIM | 515 | 5,527 | 4,873 | 726 | 16 |

UBS were the most active fund manager by attending and voting at more meetings. On average, the reported managers opposed about 14% of proposals at meetings attended.

ESG and climate change within the pension investments has been prominent, as it has been in other sectors of the media and within parliament in the last quarter. The

Department of Work and Pensions, laid revised regulations before parliament in September 2018, requiring occupational pension schemes to include a policy on how they take account of financially material ESG considerations, including specifically climate change, “over the appropriate time horizon of the investments” in their statement of investment principles (SIP) by October 2019.

## FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

## LEGAL IMPLICATIONS

There are no legal implications in the report.

NORTHERN TRUST

# London Borough of Hillingdon

## Investment Risk & Analytical Services

September 30, 2018

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# Client Commentary

## Total Scheme Commentary

September ended a relatively quiet quarter by recent standards, possibly heralding the storm to come with a period of relative calm. Other than the ongoing US vs China trade war in which the US has emplaced tariffs on $250bn of goods vs Chinese tariffs on $110bn of imports and escalating situations in Emerging Markets, some extreme weather across the globe was the main talking point.
The divergence between US Equity markets and those of Europe and the Emerging Countries is significant and increasing.

The UK economy remained on a steady upward trajectory during the July-September period, albeit tempered by mounting concerns over the potential impact of a no-deal Brexit. The IHS Markit/CIPS Manufacturing PMI saw a mild improvement in September, rising to 53.8 from an upwardly revised 53.0 in August. Demand for UK exports staged a small recovery as manufacturers experienced more demand from the US and Europe. Nevertheless conditions remain challenging with Brexit concerns and heightened political uncertainty likely to impede stronger growth. Consumer price inflation unexpectedly accelerated to a six month high of 2.7% in August, pushed upwards by the rising cost of recreational goods, transport and clothes. In an attempt to cool the economy, the Bank of England voted unanimously for a milestone 25 basis point increase at its August meet, pushing the base rate to 0.75% and its highest level since March 2009. UK gilt yields climbed on the back of stronger than expected inflation data and a sell-off in dollar rates. The benchmark 10-year gilt hit a high of 1.63% before easing back to 1.57% at period end.

In the UK, Q3 2018 saw Sterling lose ground against the Dollar and Euro but strengthen slightly compared to the Yen. The Nationwide House Price Index showed the annual rate of house price growth in September at 2.0%, in line with the August figure. The North was the weakest performing region this quarter with prices down 1.7% year on year. The national average house price is now £214,922.
The UK unemployment rate came in at its lowest rate since 1975 at 4.0% in the three months to July 2018. This was in line with market expectations. The number of unemployed people between the ages of 16 and 65 is 1.36 million.

Within this environment the London Borough of Hillingdon returned +1.08% which was below the Total Plan benchmark of +1.45%. In monetary terms this is a gain in assets of £11.4 million and the value of the combined scheme now stands at £1,065 million as at 30th September 2018. Looking further into the analysis the results seen were caused by selection effects particularly within Epoch and UBS, these managers performed below their respective benchmark over quarter three. While Asset allocation effects overall were marginal over the 3 month period, the overweight position in Epoch did provide some boost to relative performance.
The Scheme's one year return of 5.63% is 1.14% behind the benchmark of 6.85% following four consecutive quarters of underperformance. While over the longer periods, with eleven positive quarters over the last 3 years, the Scheme has outperformed, producing a return of 10.69% over three year versus 10.41%. Then the excess marginally falls to 0.13% for the 5 year period where we see figures of 8.43% versus 8.28% per annum. Then since inception in September 1995, the Fund remains ahead of target by 9 basis points with an annualised return of 7.11% against a target of 7.02%.

## Manager Commentary

### AEW UK

Over the third quarter AEW UK Property produced a growth of 1.05%, which was 0.54% below the IPD UK PPFI All Balanced Funds index figure of 1.60%. They remain ahead of target over the year, and continue to be ahead over the three year period returning 10.54% against the benchmark of 8.87%. This translates as a +1.53% relative return. With positive absolute returns in all but one period and only four quarters in the red on a relative basis, growth ahead of benchmark is seen since the fund incepted. Since the funds inception date of July 2014, the fund return is 11.64%, leading to an outperformance of 1.75% when compared to the IPD figure of 9.72%.

### JP Morgan

In the latest quarter JP Morgan posted a increase in assets of +4.52% leading to an outperformance of 0.85% when compared to the 3.64% target for the 3 Month LIBOR + 3% p.a. Then with positive results in only two of the last four quarters, the one year return of -0.06% is in negative territory and is behind the 3.70% target by 3.63%. Then over three and five years they post returns closer to the benchmark with figures of 4.52% vs 3.64% and 3.52% vs 3.63% respectively. Since the mandate funded their return of 3.63% is 3 basis points below the target return of 3.66% on an annualised basis.

### Legal & General 1

Over the last three months the Legal & General No. 1 mandate post a return of +0.89% against +0.88% for the custom fixed weight blended benchmark, a marginal outperformance of +2 basis points. In the short period since inception in October 2016, they return 6.92%, which is below the benchmark return of 7.01%.

### Legal & General 2

During February 2017 the Legal & General mandate was funded, now in its first full year of investment they post a return of 0.54% against 0.43% for the third quarter against the custom fixed weight blended benchmark consisting of FTSE Global Equity Hedged and Emerging Markets, FTSE Index Linked 15+ years and iBoxx UK Non-Gilts. In the short period since inception, they return 4.89% against 5.03% for the benchmark.

# Client Commentary (cntd)

**Manager Commentary**

### London CIV Ruffer

This quarter assets within the London CIV Ruffer portfolio saw a negative return at -0.33% when compared to the LIBOR 3 Month GBP figure of 0.22%, this leads to a relative return of -0.54%. This has dampened the results from quarter 2 and the one year period now shows a positive return of 2.01% against the target of 0.70%. Outperformance remains in the longer periods. This is seen in a three year return of 4.74% versus 0.63%, then similarly for the five years with figures of 4.57% against 0.64%, culminating in since inception (May 2010) figures of 5.38% versus 0.82% per annum, which translates as a relative return of 4.53%. This manager shows the largest outperformance of all the schemes managers over the since inception period.

### M&G Investments

M&G posted a loss (albeit small) in Q3 by producing a return of -0.07% against the 3 Month LIBOR +4% p.a. target of 1.20%, demonstrating an underperformance of 1.25%. This is the second consecutive quarter of underperformance and the full year return now trails behind the benchmark by 2.70%, coming from figures of 1.87% against 4.70%. Over the three and five year the account registers figures of 9.26% vs 4.63% and 8.32% vs 4.62% respectively; since inception (May 2010) return falls slightly to 7.06% pa whilst the benchmark is 4.69% pa. Although the since inception Internal Rate of Return moves further ahead of target with a figure of 8.49% opposed to the comparator of 4.60%.

### Macquarie

Over the last three months, Macquarie produced a growth of 3.53%, against the 0.95% for the 3 Month LIBOR +3% p.a. this translates as an outperformance of 2.55%. With twelve consecutive quarters of positive absolute and relative returns, outperformance is seen in all longer periods. Over the rolling year a growth of 14.57% beats the target of 3.70% by 10.49%, similarly the three year result of 18.27% versus 3.63% exhibits the best relative return at 14.13%. The annualised return over 5 years falls to 15.22%, but still ahead of the 3.62% seen for the benchmark; then since inception (September 2010) the 5.68% is ahead of the target of 3.68%. Although the since inception Internal Rate of Return for this portfolio jumps to 12.97%, which is ahead of the benchmark figure of 3.65%.

### UBS

During Q3 the UBS UK Equity investments returned -1.80%, behind the -0.82% for the FTSE All Share. Looking into the attribution analysis this underperformance was a combined result of selection effects and allocation effects. The most significant being the selection decisions in Financials (-63bps) and Industrials (-62bps), while the largest positve impact comes from Telecommunications (+20 bps). Allocation effects also had a negative impact with the most significant being the underweighting in Health Care (-6 bps) as well as overweighting in Telecommunications (-6bps). The manager is now ahead over the one year, stemming from figures of 6.16% vs 5.87% translates as a relative return of +0.27%. This is largely attributable to allocation effects, the biggest impacts come from both underweighting Consumer Goods (+117bps) and overweighting Oil & Gas (+77 bps). The longer time periods show a positive picture, with three and five years ahead of the index, culminating in a since inception (January 1989) return of 10.18% versus 8.80% on an annualised basis.

**Manager Commentary**

### Premira Credit

The Premira Credit Fund saw a growth of 1.19% over the third quarter of 2018, this was just behind the 3 Month LIBOR +4% p.a. target of 1.20%. The fund has outperformed in three of last four quarter's and are still ahead of target, leading to an outperformance of 1.90%, created from figures of 6.69% against 4.70%. Then since the start of December 2014 when the fund incepted, the fund posts a return of 8.85% against the benchmark of 4.60%, leading to a relative position of 4.06%.

### UBS Property

In contrast from the previous period, the latest quarter for the UBS Property posted an underperformance of -0.10%, generated from a return of 1.50% against the IPD UK PPFI All Balanced Funds index of 1.60%. Over the one year the manager is in line with the index, with a full year return of +8.86% vs +8.87%. The previous good run of results particularly during 2015 leads to high absolute returns staying ahead of the IPD target over the longer periods, peaking over the five year with a return of 11.29% against 10.43%. Then since inception, in March 2006, the fund return falls to 4.13% per annum which manages to stay just ahead of the benchmark figure of 4.07%.

### Private Equity

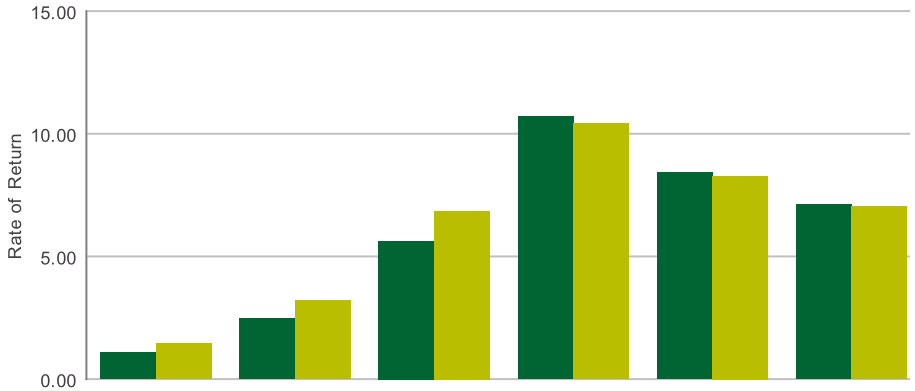
The private equity assets saw a 3.69% rise in value for LGT. Adam Street saw an increase of 4.99%. Over the longer periods, the outlook over which private equity investments should be measured, returns remain positive. LGT maintain a run of over 3 years of growth with figures of 20.06%, 23.14% and 17.92% for the one, three and five year periods respectively, while Adam Street posted 18.79%, 14.47% and 17.78% over the same periods. Although Adam St falls short of the proxy benchmark of MSCI AC World +4% p.a. over the three and five year period (which shows 23.89% and 18.00%). LGT also fall somewhat short over the three and five year underperforming by 60bps and 8bps respectively. Then since their respective inceptions in January 2005 and May 2004, Adam Street drops to 7.16% pa, while LGT sees a more modest dip to 11.55%.

### Epoch

Over the third quarter the relatively new investment in Epoch's income equity fund generated a return of +4.59%. Since inception (November 2017) the fund has observed a rise in value +1.87% compared to the MSCI World figure of +8.91%, this leads to a relative return of -6.46%.

# Executive Summary

## LONDON BOROUGH OF HILLINGDON TOTAL FUND GROSS OF FEES




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Fund | 1.08 | 2.47 | 5.63 | 10.69 | 8.43 | 7.11 |
| Index | 1.45 | 3.20 | 6.85 | 10.41 | 8.28 | 7.02 |

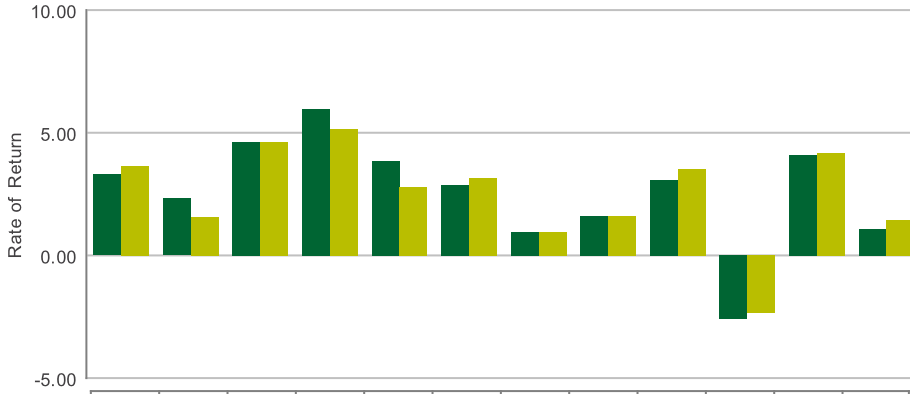
*Index: Total Plan Benchmark*

| RISK STATISTICS | 1 Yr | 3 Yrs | 5 Yrs |
|---|---|---|---|
| Return | 5.63 | 10.69 | 8.43 |
| Index Return | 6.85 | 10.41 | 8.28 |
| Relative Excess Return | -1.14 | 0.25 | 0.13 |
| | | | |
| Standard Deviation | 3.79 | 4.54 | 4.66 |
| Index Standard Deviation | 3.91 | 4.13 | 4.48 |
| | | | |
| Tracking Error | 1.12 | 1.25 | 1.09 |
| Information Ratio | -1.09 | 0.22 | 0.13 |
| Sharpe Ratio | 1.31 | 2.21 | 1.68 |
| Index Sharpe Ratio | 1.57 | 2.37 | 1.71 |
| Sortino Ratio | - | - | 3.54 |
| Treynor Ratio | 5.34 | 9.51 | 7.72 |
| | | | |
| Jensen's Alpha | -0.71 | -0.27 | 0.07 |
| Relative Volatility (Beta) | 0.93 | 1.06 | 1.01 |
| R Squared | 0.92 | 0.93 | 0.95 |

*Index: Total Plan Benchmark. Risk Free Index: JP Morgan 3 month Cash (GBP)*
*Category: Total Fund Gross of Fees. Calculation Frequency: Monthly*



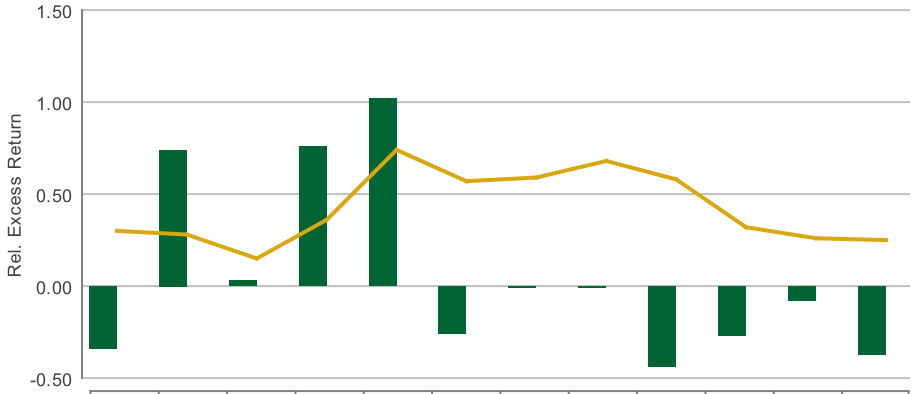
## LONDON BOROUGH OF HILLINGDON ROLLING QUARTERS TOTAL FUND GROSS OF FEES




| | Q4 '15 | Q1 '16 | Q2 '16 | Q3 '16 | Q4 '16 | Q1 '17 | Q2 '17 | Q3 '17 | Q4 '17 | Q1 '18 | Q2 '18 | Q3 '18 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fund | 3.30 | 2.32 | 4.64 | 5.96 | 3.85 | 2.88 | 0.94 | 1.59 | 3.08 | -2.60 | 4.08 | 1.08 |
| Index | 3.64 | 1.57 | 4.61 | 5.17 | 2.79 | 3.14 | 0.95 | 1.60 | 3.53 | -2.34 | 4.16 | 1.45 |

*Index: Total Plan Benchmark*

## LONDON BOROUGH OF HILLINGDON ROLLING QUARTERS TOTAL FUND GROSS OF FEES




| | Q4 '15 | Q1 '16 | Q2 '16 | Q3 '16 | Q4 '16 | Q1 '17 | Q2 '17 | Q3 '17 | Q4 '17 | Q1 '18 | Q2 '18 | Q3 '18 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 3M R.Excess | -0.34 | 0.74 | 0.03 | 0.76 | 1.02 | -0.26 | -0.01 | -0.01 | -0.44 | -0.27 | -0.08 | -0.37 |
| 3Y R.Excess | 0.30 | 0.28 | 0.15 | 0.36 | 0.74 | 0.57 | 0.59 | 0.68 | 0.58 | 0.32 | 0.26 | 0.25 |

*Index: Total Plan Benchmark*

# Investment Hierarchy

| Account/Group -% Rate of Return | Ending Market Value GBP | Ending Weight | Three Months Port | Three Months Index | Three Months Relative Excess | Year to Date Port | Year to Date Index | Year to Date Relative Excess | One Year Port | One Year Index | One Year Relative Excess |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **London Borough of Hillingdon** | **1,064,786,331** | **100.00** | **1.08** | **1.45** | **-0.37** | **2.47** | **3.20** | **-0.71** | **5.63** | **6.85** | **-1.14** |
| Total Plan Benchmark | | | | | | | | | | | |
| **AEW UK** | **57,057,176** | **5.36** | **1.05** | **1.60** | **-0.54** | **7.51** | **5.60** | **1.80** | **10.54** | **8.87** | **1.53** |
| LBH22 AEW Benchmark | | | | | | | | | | | |
| **JP Morgan** | **81,095,195** | **7.62** | **1.30** | **0.95** | **0.35** | **-0.82** | **2.85** | **-3.57** | **-0.06** | **3.70** | **-3.63** |
| LBH15 JPM LIBOR +3%pa | | | | | | | | | | | |
| **Legal & General 1** | **242,384,488** | **22.76** | **0.89** | **0.88** | **0.02** | **1.46** | **1.60** | **-0.14** | **6.07** | **6.21** | **-0.13** |
| LBH26 L&G Benchmark | | | | | | | | | | | |
| **Legal & General 2** | **97,688,102** | **9.17** | **0.54** | **0.43** | **0.11** | **-0.43** | **-0.49** | **0.07** | **4.12** | **4.06** | **0.06** |
| LBH27 L&G Benchmark | | | | | | | | | | | |
| **M&G Investments** | **10,445,644** | **0.98** | **-0.07** | **1.20** | **-1.25** | **1.25** | **3.59** | **-2.26** | **1.87** | **4.70** | **-2.70** |
| LBH10 3 Month LIBOR +4%pa | | | | | | | | | | | |
| **Macquarie** | **27,934,674** | **2.62** | **3.53** | **0.95** | **2.55** | **12.00** | **2.85** | **8.90** | **14.57** | **3.70** | **10.49** |
| LBH14 Macquarie LIBOR +3%pa | | | | | | | | | | | |
| **Premira Credit** | **62,982,650** | **5.92** | **1.19** | **1.20** | **-0.01** | **4.90** | **3.59** | **1.26** | **6.69** | **4.70** | **1.90** |
| LBH24 Premira LIBOR +4%pa | | | | | | | | | | | |
| **UBS** | **139,750,694** | **13.12** | **-1.80** | **-0.82** | **-0.99** | **2.17** | **0.86** | **1.30** | **6.16** | **5.87** | **0.27** |
| LBH04 UBS Benchmark | | | | | | | | | | | |
| **UBS Property** | **76,924,973** | **7.22** | **1.50** | **1.60** | **-0.10** | **5.46** | **5.60** | **-0.13** | **8.86** | **8.87** | **-0.01** |
| LBH06 UBS Property Benchmark | | | | | | | | | | | |
| **Adam Street** | **13,078,032** | **1.23** | **4.99** | **6.55** | **-1.46** | **15.40** | **11.14** | **3.83** | **18.79** | **17.53** | **1.08** |
| Adam Street PE Bmark | | | | | | | | | | | |
| **LGT** | **5,605,104** | **0.53** | **3.69** | **6.55** | **-2.68** | **16.46** | **11.14** | **4.79** | **20.06** | **17.53** | **2.16** |
| LGT PE Bmark | | | | | | | | | | | |
| **Epoch Investment P Income** | **144,315,276** | **13.55** | **4.59** | **6.28** | **-1.60** | **2.80** | **9.37** | **-6.01** | **-** | **-** | **-** |
| LBH11001 MSCI World ND | | | | | | | | | | | |
| **London CIV Ruffer** | **105,308,406** | **9.89** | **-0.33** | **0.22** | **-0.54** | **-0.63** | **0.61** | **-1.23** | **2.01** | **0.70** | **1.30** |
| LBH11003 Ruffer BM Libor | | | | | | | | | | | |

# Investment Hierarchy(2)

| Account/Group -% Rate of Return | Three Years Port | Three Years Index | Three Years Relative Excess | Five Years Port | Five Years Index | Five Years Relative Excess | Inception to Date Port | Inception to Date Index | Inception to Date Relative Excess | Inception Date |
|---|---|---|---|---|---|---|---|---|---|---|
| **London Borough of Hillingdon** | **10.69** | **10.41** | **0.25** | **8.43** | **8.28** | **0.13** | **7.11** | **7.02** | **0.09** | **30/09/1995** |
| Total Plan Benchmark | | | | | | | | | | |
| **AEW UK** | **10.22** | **7.62** | **2.42** | **-** | **-** | **-** | **11.64** | **9.72** | **1.75** | **30/06/2014** |
| LBH22 AEW Benchmark | | | | | | | | | | |
| **JP Morgan** | **4.52** | **3.64** | **0.85** | **3.52** | **3.63** | **-0.11** | **3.63** | **3.66** | **-0.03** | **08/11/2011** |
| LBH15 JPM LIBOR +3%pa | | | | | | | | | | |
| **Legal & General 1** | **-** | **-** | **-** | **-** | **-** | **-** | **6.92** | **7.01** | **-0.08** | **31/10/2016** |
| LBH26 L&G Benchmark | | | | | | | | | | |
| **Legal & General 2** | **-** | **-** | **-** | **-** | **-** | **-** | **4.89** | **5.03** | **-0.14** | **22/02/2017** |
| LBH27 L&G Benchmark | | | | | | | | | | |
| **M&G Investments** | **9.26** | **4.63** | **4.42** | **8.32** | **4.62** | **3.54** | **7.06** | **4.69** | **2.26** | **31/05/2010** |
| LBH10 3 Month LIBOR +4%pa | | | | | | | | | | |
| **Macquarie** | **18.27** | **3.63** | **14.13** | **15.22** | **3.62** | **11.20** | **5.68** | **3.68** | **1.93** | **30/09/2010** |
| LBH14 Macquarie LIBOR +3%pa | | | | | | | | | | |
| **Premira Credit** | **2.71** | **4.63** | **-1.84** | **-** | **-** | **-** | **8.85** | **4.60** | **4.06** | **30/11/2014** |
| LBH24 Premira LIBOR +4%pa | | | | | | | | | | |
| **UBS** | **15.50** | **11.45** | **3.63** | **8.88** | **7.49** | **1.29** | **10.18** | **8.80** | **1.26** | **31/12/1988** |
| LBH04 UBS Benchmark | | | | | | | | | | |
| **UBS Property** | **7.77** | **7.12** | **0.61** | **11.29** | **10.43** | **0.78** | **4.13** | **4.07** | **0.06** | **31/03/2006** |
| LBH06 UBS Property Benchmark | | | | | | | | | | |
| **Adam Street** | **14.47** | **23.89** | **-7.60** | **17.78** | **18.00** | **-0.19** | **7.16** | **-** | **-** | **31/01/2005** |
| Adam Street PE Bmark | | | | | | | | | | |
| **LGT** | **23.14** | **23.89** | **-0.60** | **17.92** | **18.00** | **-0.08** | **11.55** | **-** | **-** | **31/05/2004** |
| LGT PE Bmark | | | | | | | | | | |
| **Epoch Investment P Income** | **-** | **-** | **-** | **-** | **-** | **-** | **1.87** | **8.91** | **-6.46** | **08/11/2017** |
| LBH11001 MSCI World ND | | | | | | | | | | |
| **London CIV Ruffer** | **4.74** | **0.63** | **4.08** | **4.57** | **0.64** | **3.91** | **5.38** | **0.82** | **4.53** | **28/05/2010** |
| LBH11003 Ruffer BM Libor | | | | | | | | | | |

# Market Value Summary - Three Months

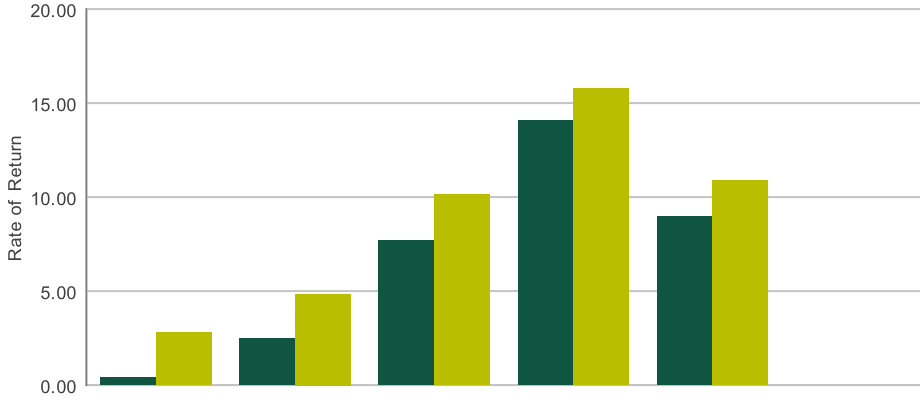
| Account/Group | 30/06/2018 Market Value | 30/06/2018 Weight | Net Contribution* | Income | Fees | Appreciation | 30/09/2018 Market Value | 30/09/2018 Weight | Change in Weight |
|---|---|---|---|---|---|---|---|---|---|
| **London Borough of Hillingdon** | **1,053,934,020** | **100.00** | **-508,427** | **6,771,149** | **8,427** | **4,589,589** | **1,064,786,331** | **100.00** | **0.00** |
| AEW UK | 56,463,582 | 5.36 | 0 | 0 | 0 | 593,594 | 57,057,176 | 5.36 | 0.00 |
| JP Morgan | 80,050,834 | 7.60 | 0 | 0 | 0 | 1,044,362 | 81,095,195 | 7.62 | 0.02 |
| Legal & General 1 | 240,240,695 | 22.79 | -4,386 | 0 | 4,386 | 2,148,179 | 242,384,488 | 22.76 | -0.03 |
| Legal & General 2 | 86,794,371 | 8.24 | 10,495,958 | 0 | 4,042 | 397,774 | 97,688,102 | 9.17 | 0.94 |
| M&G Investments | 11,254,872 | 1.07 | -802,353 | 1,309 | 0 | -8,183 | 10,445,644 | 0.98 | -0.09 |
| Macquarie | 28,263,882 | 2.68 | -1,285,241 | 107 | 0 | 955,926 | 27,934,674 | 2.62 | -0.06 |
| Newton | 0 | 0.00 | 0 | 0 | 0 | 0 | - | - | - |
| Premira Credit | 60,350,532 | 5.73 | 1,904,024 | 1,807,200 | 0 | -1,079,106 | 62,982,650 | 5.92 | 0.19 |
| UBS | 144,266,926 | 13.69 | -1,942,965 | 1,640,101 | 0 | -4,213,367 | 139,750,694 | 13.12 | -0.56 |
| UBS Property | 76,278,886 | 7.24 | -491,023 | 712,439 | 0 | 424,672 | 76,924,973 | 7.22 | -0.01 |
| Adam Street | 13,593,963 | 1.29 | -1,147,679 | 0 | 0 | 631,748 | 13,078,032 | 1.23 | -0.06 |
| LGT | 6,467,233 | 0.61 | -1,078,269 | 10 | 0 | 216,129 | 5,605,104 | 0.53 | -0.09 |
| Cash & Other Assets | 6,271,425 | 0.60 | -6,156,493 | 18,857 | 0 | 82,128 | 215,917 | 0.02 | -0.57 |
| Epoch Investment P Income | 137,982,661 | 13.09 | 0 | 2,081,511 | 0 | 4,251,104 | 144,315,276 | 13.55 | 0.46 |
| London CIV Ruffer | 105,654,158 | 10.02 | 0 | 509,616 | 0 | -855,368 | 105,308,406 | 9.89 | -0.13 |
| Cash & Other Assets | 0 | 0.00 | 0 | 0 | 0 | 0 | 0 | 0.00 | -0.00 |
| Transition | 0 | 0.00 | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 |

Min -0.57 0.94 Max

**Net Contributions include Cash Contributions/Distributions, Security Deliveries/Receipts, Fees/Fee Rebates, Inter Account transfers for Consolidations & Benefits Payments.*
*Copied History or Backloaded Data may not display the correct Contributions/Withdrawals creating misrepresentation.*

# Historical Performance

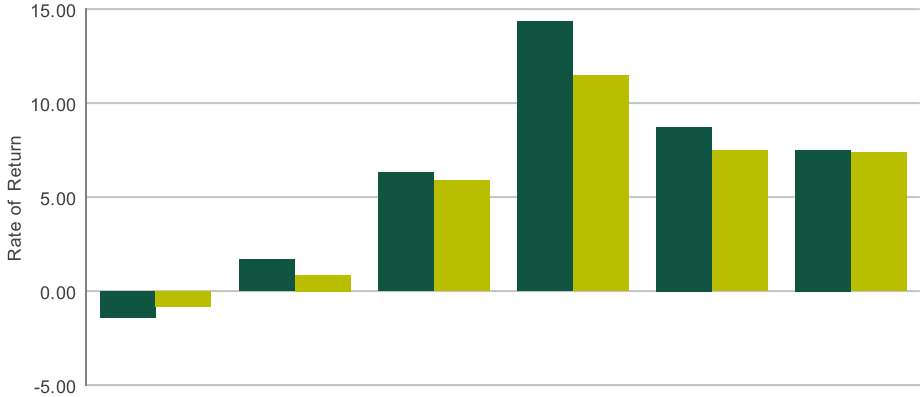
## EQUITY




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 0.39 | 2.46 | 7.71 | 14.06 | 8.96 | - |
| Index | 2.80 | 4.85 | 10.16 | 15.78 | 10.87 | - |

*Index: Total Equity Benchmark*

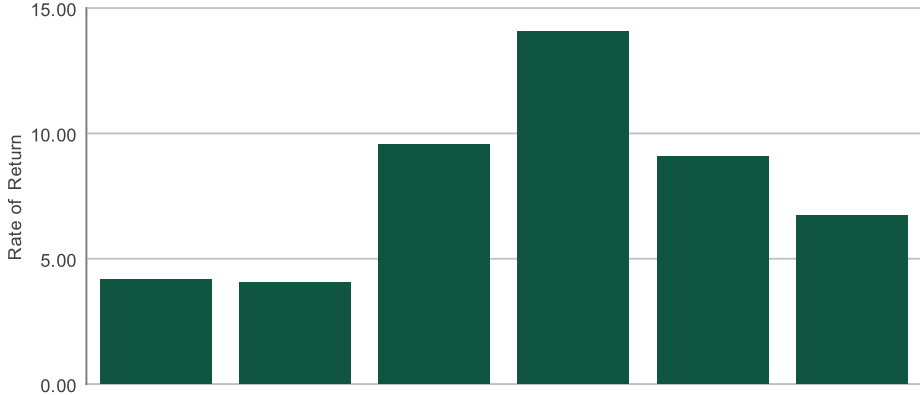
## UNITED KINGDOM




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | -1.43 | 1.69 | 6.33 | 14.33 | 8.73 | 7.51 |
| Index | -0.82 | 0.86 | 5.87 | 11.45 | 7.49 | 7.38 |

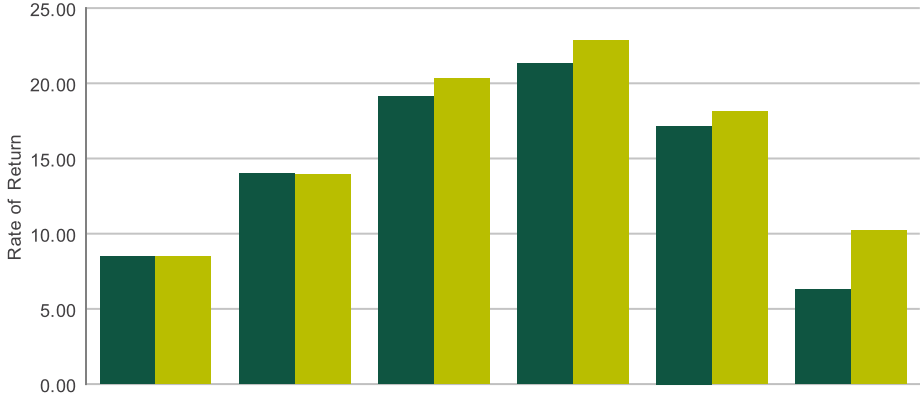
*Index: FTSE All Share UK Equity*

## OVERSEAS EQUITIES




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 4.17 | 4.06 | 9.55 | 14.07 | 9.09 | 6.71 |

## NORTH AMERICA

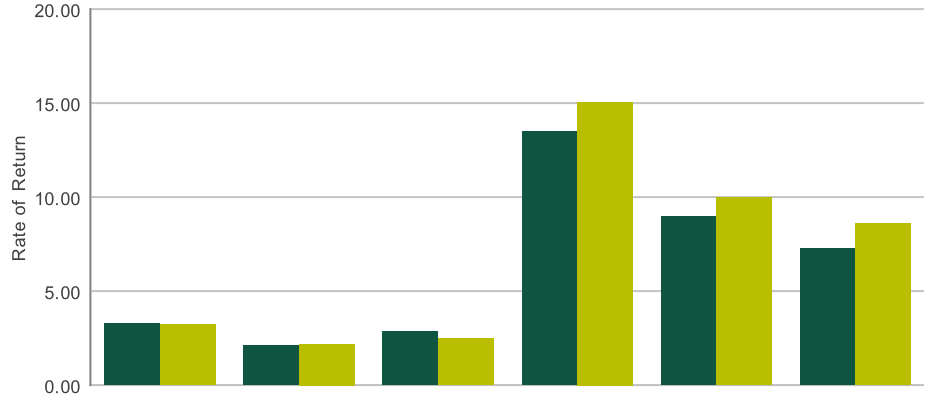



| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 8.49 | 14.00 | 19.14 | 21.32 | 17.16 | 6.27 |
| Index | 8.46 | 13.94 | 20.30 | 22.85 | 18.15 | 10.24 |

*Index: FTSE North America*

# Historical Performance

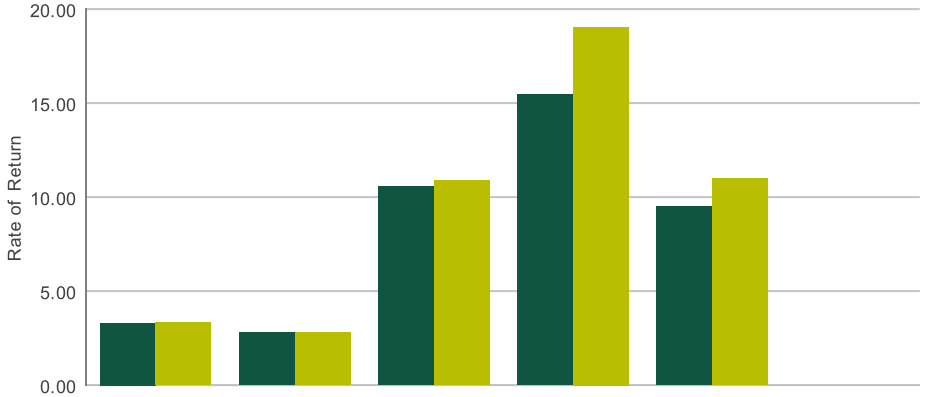
## EUROPE EX UK




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 3.27 | 2.10 | 2.85 | 13.50 | 8.97 | 7.28 |
| Index | 3.23 | 2.19 | 2.48 | 15.06 | 9.97 | 8.61 |

*Index: FTSE AW Dev Europe ex UK*

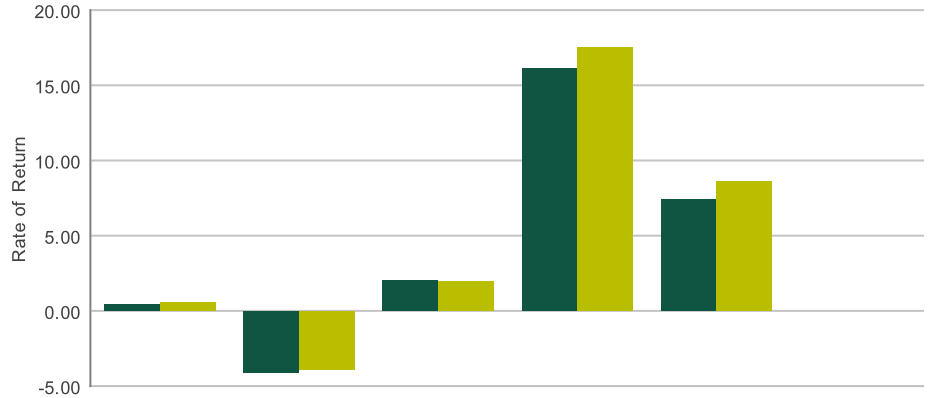
## ASIA PACIFIC INC JAPAN




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 3.30 | 2.78 | 10.56 | 15.44 | 9.49 | - |
| Index | 3.33 | 2.78 | 10.87 | 19.05 | 10.97 | - |

*Index: FTSE AW Dev Asia Pacific*

## EMERGING MARKETS

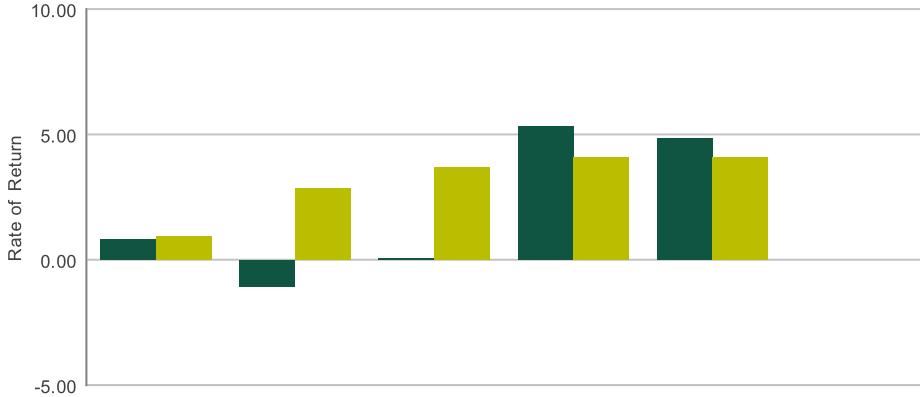



| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 0.45 | -4.10 | 2.03 | 16.13 | 7.43 | - |
| Index | 0.59 | -3.91 | 1.97 | 17.53 | 8.64 | - |

*Index: LBH Emerging Markets*

# Historical Performance

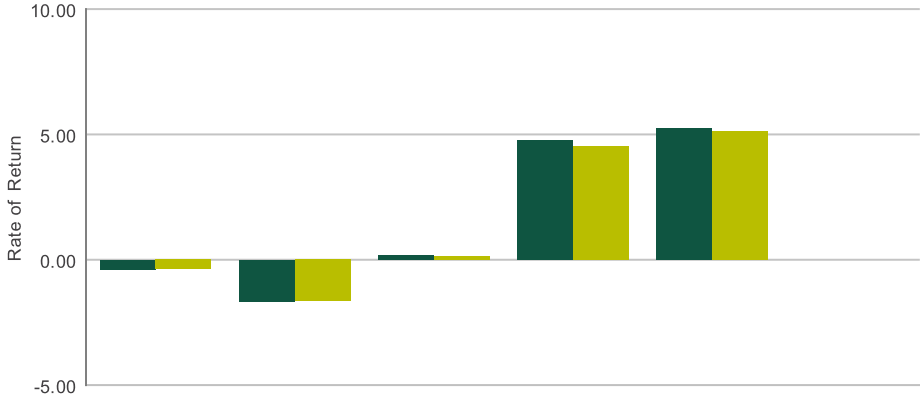
## FIXED INCOME




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 0.83 | -1.07 | 0.08 | 5.31 | 4.84 | - |
| Index | 0.95 | 2.85 | 3.70 | 4.07 | 4.08 | - |

*Index: LBH Fixed Income Benchmark*

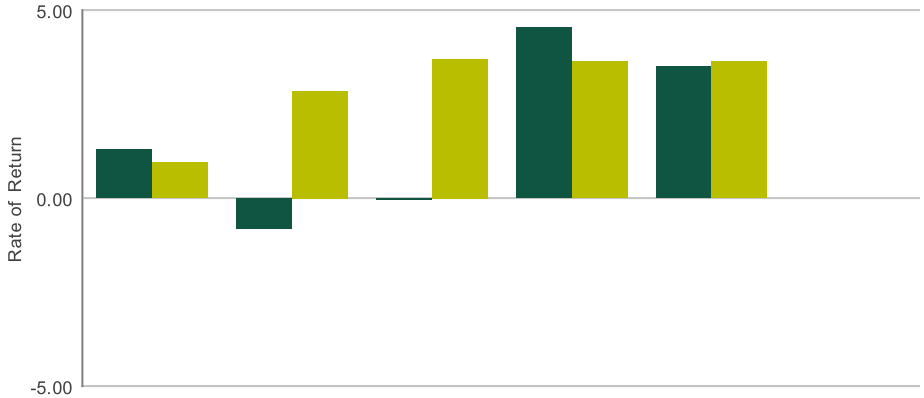
## UK CORPORATE BONDS




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | -0.39 | -1.66 | 0.19 | 4.77 | 5.25 | - |
| Index | -0.36 | -1.65 | 0.15 | 4.52 | 5.11 | - |

*Index: LBH Non-Gilts Benchmark*

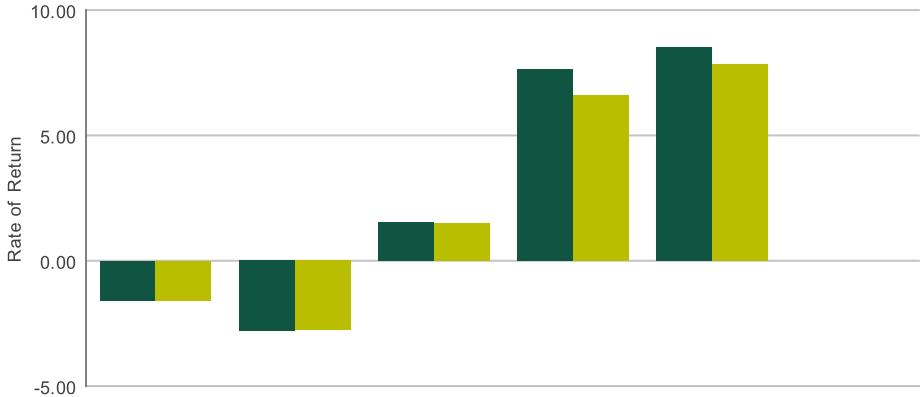
## GLOBAL CORPORATE BONDS




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 1.30 | -0.80 | -0.05 | 4.53 | 3.49 | - |
| Index | 0.95 | 2.85 | 3.70 | 3.64 | 3.63 | - |

*Index: LIBOR GBP 3 Month +3% pa*

## INDEX LINKED GILTS

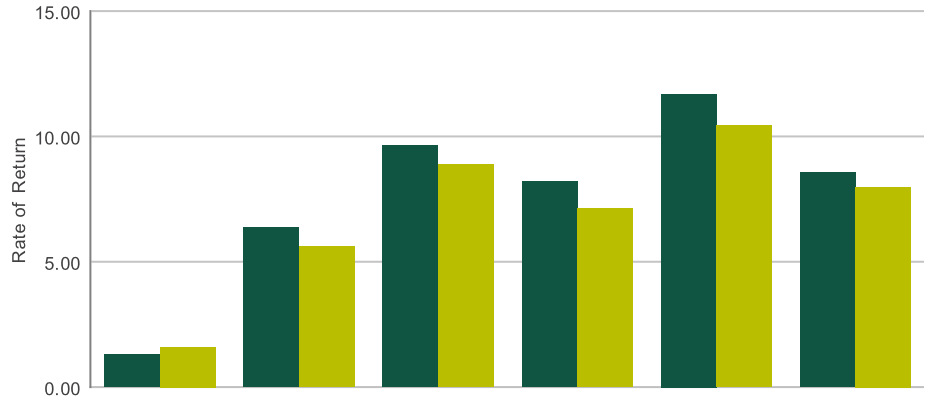



| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | -1.58 | -2.80 | 1.54 | 7.65 | 8.51 | - |
| Index | -1.58 | -2.77 | 1.51 | 6.62 | 7.82 | - |

*Index: LBH Index Linked Benchmark*

# Historical Performance

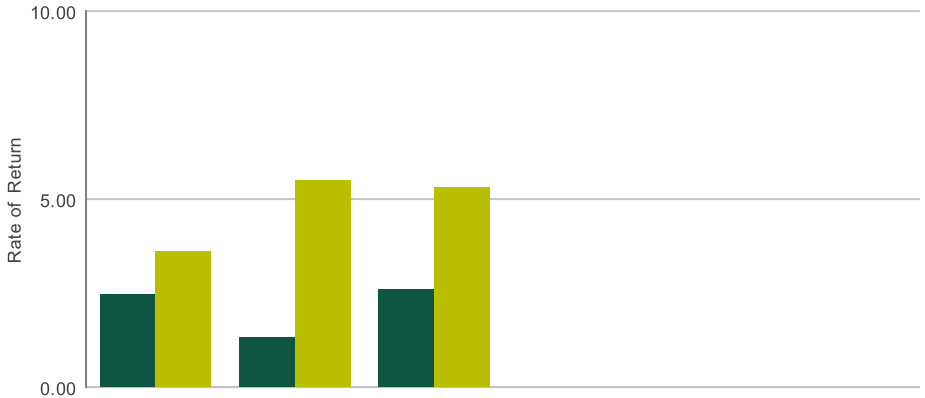
## REAL ESTATES




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 1.31 | 6.36 | 9.64 | 8.21 | 11.69 | 8.56 |
| Index | 1.60 | 5.60 | 8.87 | 7.12 | 10.43 | 7.98 |

*Index: IPD UK PPFI All Bal Funds Index*

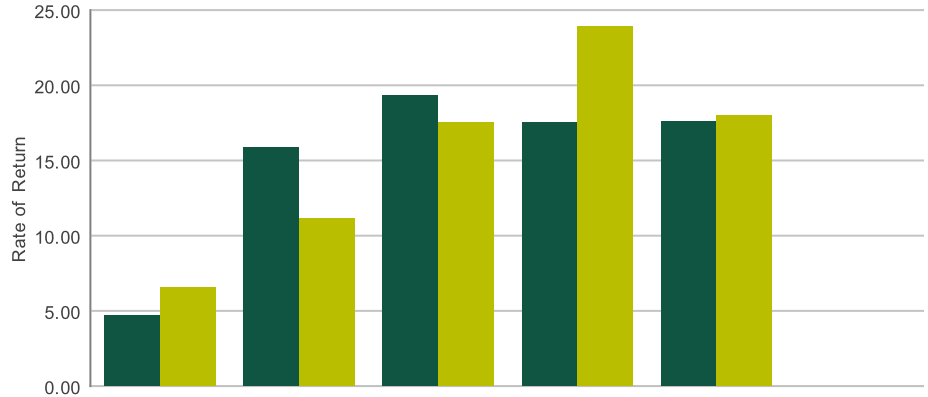
## BALANCED FUNDS




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 2.46 | 1.32 | 2.59 | - | - | - |
| Index | 3.60 | 5.50 | 5.30 | - | - | - |

*Index: Balanced Fund Benchmark*

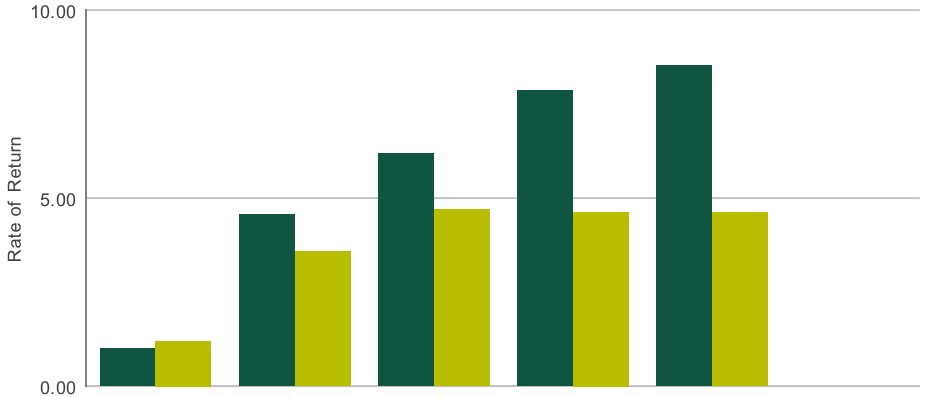
## PRIVATE EQUITY




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 4.69 | 15.86 | 19.33 | 17.51 | 17.57 | - |
| Index | 6.55 | 11.14 | 17.53 | 23.89 | 18.00 | - |

*Index: MSCI ACWI +4% pa*

## PRIVATE CREDIT




| | Three Months | Year to Date | One Year | Three Years | Five Years | ITD |
|---|---|---|---|---|---|---|
| Category | 1.01 | 4.56 | 6.18 | 7.87 | 8.53 | - |
| Index | 1.20 | 3.59 | 4.70 | 4.63 | 4.62 | - |

*Index: LIBOR GBP 3 Month +4% pa*

# Benchmark Composition

## Total Plan Benchmark (from May 2018)

| | |
|---|---|
| 1.84 | MSCI All Countries World Index + 4% |
| 1.39 | FT Japan |
| 2.43 | FT North America |
| 0.97 | FTSE Developed Asia Pacific ex Japan |
| 2.25 | FTSE Developed Europe ex UK |
| 1.68 | FTSE Developed GBP Hedged |
| 22.78 | FTSE All Share |
| 3.60 | FTSE Index Linked Gilts |
| 4.66 | FTSE Index Linked Gilts15+ Years |
| 2.31 | FTSE Emerging Markets |
| 12.46 | IPD UK PPFI All Balanced Funds Index |
| 6.84 | 3 Month LIBOR +4%pa |
| 10.09 | 3 Month LIBOR |
| 10.25 | 3 Month LIBOR +3%pa |
| 12.85 | MSCI World |
| 0.61 | LIBID 7 Day |
| 2.99 | iBoxx Sterling Non-Gilts |

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KPMG

# London Borough of Hillingdon Pension Fund

**Diversified Growth Fund Allocation – Review of Strategic Options (Discussion Document)**

January 2019

# Background

The Committee agreed to review the strategic allocation to Diversified Growth, currently managed by Ruffer.

This report considers alternative strategic allocations for the Council to consider.

It also provides a high level summary of the benefits and considerations, as well as the risk/return impact.



## Addressee

- This report is addressed to London Borough of Hillingdon ("the Council") as administering authority of the London Borough of Hillingdon Pension Fund (the "Fund").
- This paper provides a high level summary of alternative strategies that could be considered if the existing allocation to DGF is removed.

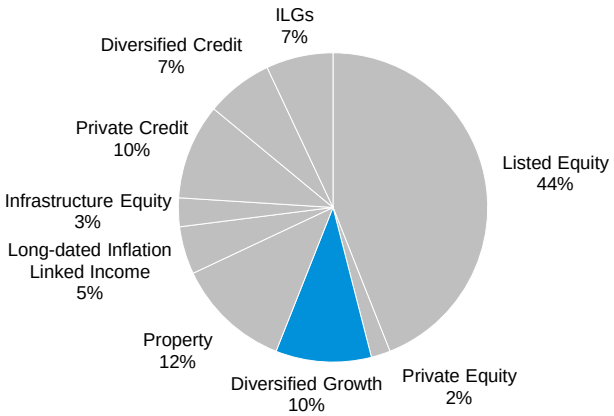
## Background

- In late 2018, the Committee reviewed the allocation to DGF and the mandate currently managed by Ruffer. The Committee did not have full confidence in the DGF allocation delivering the required performance objective. As such, the decision was taken to reallocate the Fund's capital held with Ruffer via the LCIV.

## Scope of Report

- This report provides a high level summary of the following:
  - Strategic options available to the Fund;
  - Key considerations and benefits of each option;
  - Impact on overall Fund risk and return of each alternative option;
  - Next steps.

## Current Strategic Benchmark




| Asset Classes | Actual (%) | Benchmark (%) |
|---|---|---|
| Listed Equity | 45.5% | 44.0% |
| Private Equity | 2.5% | 2.0% |
| Diversified Growth | 9.9% | 10.0% |
| Property | 13.2% | 12.0% |
| Long-dated Inflation Linked Income | - | 5.0% |
| Infrastructure Equity | 2.7% | 3.0% |
| Private Credit | 6.9% | 10.0% |
| Corporate Bonds | 3.1% | - |
| Diversified Credit | 7.7% | 7.0% |
| Index-Linked Gilts (ILG) | 7.0% | 7.0% |
| **Total** | **100.0%** | **100.0%** |

Note: Asset position as at 31 December 2018

# Current Strategy

The table opposite sets out the current Fund position and key considerations.

| Description | Benefits | Considerations | Expected Return (% p.a.) | Value at Risk |
|---|---|---|---|---|
| Maintain strategic DGF allocation at 10%. | • DGF allocation should provide downside protection should market conditions deteriorate and flexibility to adapt to capture short term opportunities. | • The Officers /Committee have reduced confidence in the ability to meet the performance target.<br>• The wider DGF universe has struggled to achieve target performance objectives and carries a high fee. | G+4.3% | £450m |

Notes: Analysis estimated by KPMG, as at 30 November 2018, based on a roll forward of the 2016 Actuarial Valuation cashflows. Asset valuations as at 30 November 2018. Expected return shown is the outperformance above gilts-based liabilities. VaR: 3 year 95% Value at Risk represents the reduction in expected funding position in 3 years time under the 1 in 20 worst investment outcome.

- We consider a range of alternatives to the existing DGF allocation overleaf. A 10% shift in the Fund's overall asset allocation will not dramatically move the risk / return characteristics of the overall Fund. We illustrate the impact of three alternative strategies overleaf.
- The proposed strategies seek to retain assets within the pool, streamline overall governance and deliver cost savings versus the status quo. We have restricted the options to avoid introducing new allocations outside of the pool.

# Alternative Strategies – Risk/Return Characteristics

We illustrate some detail on the risk and return implications for each of the alternative strategies presented.

| Asset Classes | 1. Current | 2. Index-Linked Gilts + Equity | 3. Index-Linked Gilts + Infrastructure Equity | 4. Index-Linked Gilts + Long-dated Inflation Linked Income |
|---|---|---|---|---|
| Listed Equity | 44.0% | 49.0% (+5%) | 44.0% | 44.0% |
| Private Equity | 2.0% | 2.0% | 2.0% | 2.0% |
| Diversified Growth | 10.0% | 0.0% (-10%) | 0.0% (-10%) | 0.0% (-10%) |
| Balanced Property | 12.0% | 12.0% | 12.0% | 12.0% |
| Long Lease Property | 5.0% | 5.0% | 5.0% | 5.0% |
| Long-dated Inflation Linked Income *(The proposed LCIV mandate is > 75% LLP)* | - | - | - | 5.0% (+5%) |
| Infrastructure Equity | 3.0% | 3.0% | 8.0% (+5%) | 3.0% |
| Private Credit | 10.0% | 10.0% | 10.0% | 10.0% |
| Diversified Credit | 7.0% | 7.0% | 7.0% | 7.0% |
| Index-Linked Gilts (ILG) | 7.0% | 12.0% (+5%) | 12.0% (+5%) | 12.0% (+5%) |
| Exp. Return (Gilts + p.a.) | Gilts+4.3% | Gilts+4.2% | Gilts+4.2% | Gilts+4.1% |
| 3 year Value at Risk (1 in 20 chance) | £450m | £450m | £440m | £435m |

Notes: Analysis estimated by KPMG, as at 30 November 2018, based on a roll forward of the 2016 Actuarial Valuation cashflows. Asset valuations as at 30 November 2018. Expected return shown is the outperformance above gilts-based liabilities. VaR: 3 year 95% Value at Risk represents the reduction in expected funding position in 3 years time under the 1 in 20 worst investment outcome.

# Potential Options for Reinvestment

We outline the key considerations for each strategy in the table opposite.

| Option | Description | Benefits | Considerations | Expected Return (% p.a.) | Value at Risk |
|---|---|---|---|---|---|
| **2. ILGs + Equity (Passive)** | DGF allocation is reinvested 5% into ILGs and 5% in passive global equities (reflecting Ruffer's current positioning). | • Provides similar protection against rising inflation and a similar expected return.<br>• Cheap to run and assets remain under LCIV. | • Would increase the exposure to directional equity risk. Global equity markets have fallen significantly over Q4 2018.<br>• ILGs are currently expensive versus historical levels. | G+4.2% | £450m |
| **3. Index-Linked Gilts + Infrastructure Equity** | DGF allocation is reinvested 5% into ILGs and 5% in infrastructure equity via the LCIV. | • Infrastructure equity provides access to an illiquidity premium and increases the contractual nature of the Fund's assets.<br>• Provides increased protection against a rise in inflation.<br>• Intention is to increase the strategic allocation to Infrastructure above 5%. | • The Fund will need to queue to deploy assets in infrastructure equity. The Fund will need to assess the LCIV proposition.<br>• ILGs are currently expensive versus historical levels. | G+4.2% | £440m |
| **4. ILGs + Long Dated Inflation-Linked Income** | DGF allocation is reinvested 5% into ILGs and 5% in the LCIV Inflation-linked income fund (a blend of LLP and infrastructure debt). | • Provides increased protection against a rise in inflation. | • The Fund may have to queue to deploy assets in the inflation-linked fund.<br>• ILGs are currently expensive versus historical levels.<br>• Overall exposure to commercial property (> 20%) is a concern. It would be preferable for any future allocation to long-dated inflation to be funded from the existing UBS property allocation.<br>• Expected return is slightly reduced. | G+4.1% | £435m |

Notes: Analysis estimated by KPMG, as at 30 November 2018, based on a roll forward of the 2016 Actuarial Valuation cashflows. Asset valuations as at 30 November 2018. Expected return shown is the outperformance above gilts-based liabilities. VaR: 3 year 95% Value at Risk represents the reduction in expected funding position in 3 years time under the 1 in 20 worst investment outcome.

# Summary and Next Steps

The Officers and Committee should consider each of the options outlined in this paper.



**Summary**

- The Officers/Committee is considering potential strategic options for the capital currently invested in the Ruffer diversified growth mandate.
- The Fund has previously discussed its intention to increase the allocation to infrastructure equity and we believe that using part of the existing DGF allocation to do so would be preferable if the Committee is confident in the LCIV infrastructure proposition. We believe retaining an element of index-linked gilts to provide inflation protection and reduce overall costs is appealing.
- An alternative approach of creating an allocation that mirrors Ruffer's neutral 50:50 allocation to 'Greed' (equities) and 'Fear' (inflation-linked gilts) is also reasonable, particularly given the recent falls in equity markets. This can be implemented via passive management to provide a low cost portfolio.
- We are not convinced that redeploying the Ruffer allocation to the LCIV, long-dated inflation vehicle is optimal given the overall concentration in UK commercial property that would result. An allocation to this vehicle could be funded from the UBS property holding in due course.
- The Committee could consider whether allocating to non UK inflation linked bonds was appealing if an appropriate vehicle is available on the LGIM platform under the LCIV arrangements. The yield on global index linked bonds remains higher than UK yields.

# Appendices

# Asset Class Assumptions - 30 September 2018

## Introduction to the Assumptions

— These are our "best estimate" asset class return, volatility and correlation assumptions. We believe there is a 50:50 chance that the actual outcome will be above/below our assumptions.

— The assumptions are long-term, for a 10-year period, expressed in Sterling terms.

— Return assumptions are:

- Annualised (i.e. geometric averages), rounded to the nearest 0.1%.
- Expressed relative to the yield on fixed interest gilts (the annual yield at the 10-year tenor on the Bank of England spot curve). This yield was 1.6% at 30 September 2018.
- Net of management fees.
- Before tax. UK pension schemes are exempt from tax on investments. The impact of taxation may reduce returns for other investors.

— Volatility assumptions are based on the standard deviation of annual returns over a 10-year period, rounded to the nearest 0.5%.

- Bond volatilities are sensitive to the duration of the index. Our Fixed Interest Gilts (FIG) and Index-Linked Gilts (ILG) assumptions both relate to Over 15 Year indices, but the cashflow profile of the ILG index is considerably longer than the FIG index. Hence the difference in volatilities does not necessarily mean that real yields are assumed to be more volatile than fixed yields.

— Correlation assumptions are based on the correlation of annual returns over a 10-year period, rounded to the nearest 5%.

## Limitations and Risk Warnings

— There can be no guarantee that any particular asset class or investment manager will behave in accordance with the assumptions.

— The assumption setting process is subjective and based on qualitative assessments rather than a wholly quantitative process. Newer asset classes can be harder to calibrate due to the lack of a long-term history. Some asset classes may rely on active management to help deliver the assumed return.

— Where these assumptions are used within asset-liability modelling, please note that the model's projections are sensitive to the econometric assumptions. Changes to the assumptions can have a material impact upon the modelling output.

| Asset Class | Sector [1] | Return [2] | Volatility [3] |
|---|---|---|---|
| Global Equity | Developed (passive) | 4.0% | 20.0% |
| | Developed (core active) | 4.5% | 20.5% |
| | Developed (unconstrained) | 5.0% | 21.0% |
| | Emerging (passive) | 5.0% | 30.0% |
| Alternatives | Hedge Funds: Multi-Strat FoF | 2.5% | 10.0% |
| | Private Equity | 7.0% | 30.0% |
| | Diversified Alternatives | 6.0% | 22.0% |
| | Infrastructure Equity | 4.6% | 12.0% |
| Property | UK Balanced | 2.5% | 13.0% |
| | Long Lease | 2.5% | 8.0% |
| DGF | Diversified Growth Funds | 3.5% | 12.0% |
| Gilts | Fixed Interest Gilts (passive) [4] | 0.0% | 6.7% |
| | Index-Linked Gilts (passive) [4] | 0.0% | 11.3% |
| Credit | Investment Grade (passive) [4,5] | 1.1% | 7.3% |
| | Diversified Credit [5] | 2.2% | 11.0% |
| | Distressed Debt | 6.0% | 15.0% |
| | Junior CRED | 5.0% | 14.0% |
| | Senior CRED | 1.8% | 7.0% |

Source: KPMG, 30 September 2018

# Modelling Methodology

## Modelling Principles

- SOFIA is a stochastic model that simulates a large number of possible future economic outcomes, in which financial conditions develop in a number of different ways, defined by assumptions for average outcomes and the range of variability. The results of the projections are shown by ranking the calculated outcomes from best to worst and presenting the following scenarios:
  - **Median**: this is the middle outcome and can be thought of as the "expected result". Half of the modelled outcomes are better than this and half are worse.
  - **Bad:** this splits the results so that there is a one in five (20%) chance of having a worse outcome. This is a measure of risk.
  - **Very Bad:** this splits the results at a one in twenty (5%) chance of having a worse result. This is a more extreme measure of downside risk.
  - **Good and Very Good (where shown):** these illustrate possible positive outcomes.
- The "Value at Risk", where shown, is defined as the difference between the Median scenario and the Bad or Very Bad scenario, i.e. it represents the variability of funding outcomes and shows the magnitude of the possible downside from the expected result. Please note that this is not the same as the possible downside loss from the starting position.



## Investment Strategy

- We can model different investment strategies to illustrate the effects of different risk/return trade-offs. For each portfolio, the model assumes that the chosen strategy remains fixed over the full projection period. Assets are annually rebalanced back to the original allocations.

## Investment Strategy

- Where the model illustrates a scheme-specific funding basis, the funding basis is calculated in the same way across all the investment portfolios modelled. We therefore focus on the effect of investment strategies on asset values and hence surplus/deficits, without the distorting effect of differing liability methodologies. However, in cases where the discount rate allows for a risk premium, the magnitude of the risk premium may depend on the proportion of return-generating assets in the portfolio, and therefore in practice the funding basis may be different under different investment strategies.

# Disclaimers

- The information contained herein is provided for the sole benefit of the London Borough of Hillingdon Pension Fund. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.
- The output from our modelling is based on a large number of underlying assumptions. Changes to these assumptions can have a material impact on the results of the modelling.
- The outcomes shown are not intended to be the best possible, or worst possible outcomes. The actual outcome could be better than the 5th percentile, or worse than the 95th percentile.
- The modelling analysis is based on portfolios containing a wide range of asset classes and different approaches to fund management. Clients should not make decisions to invest in these asset classes or approaches to fund management based solely on the modelling analysis.
- Cashflow profile and liability figures are based the Fund's actuarial valuation and rolled forward to 30 September 2018 in line with market conditions.
- The only risk factors we have considered in our modelling are those that affect the values of pension schemes' assets and the financial assumptions used to value schemes' liabilities. Some of the risks we have not considered include demographic risks such as the life expectancy of pension schemes' members and future changes to members' benefits.
- Past performance cannot be relied upon as a guide to the future.

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# Pensions Administration Report

| | |
|---|---|
| *Contact Officers* | Sian Kunert 01895 556578 |
| *Papers with this report* | KPI report |


## SUMMARY

This report is for information and provides an update on the administration of the London Borough of Hillingdon Fund of the LGPS, both in relation to Surrey County Council (SCC) and internally at Hillingdon.

Attached to the report is the latest KPI Report from Surrey CC.


## RECOMMENDATIONS

**It is recommended that Pensions Committee:**

1. **Note this report**

## INFORMATION

### Surrey Administration Update

By the end of December 2018, the number of members who have registered for the Member Self Service (MSS) module were-
Active members 2,207 (25.7% of active membership)
Pensioner/Dependant members 228 (3.5% of Pensioner Dependant members)
Deferred Benefits 570 (6.7% Deferred Benefit members)

We are planning to increase the take up of registrations to MSS, and will be including details of how members can to sign up in all future communications.

The latest SCC newsletter has been uploaded to the Hillingdon Website, and circulated to all Scheme Employers.

Staff attended a demonstration of the iConnect System, which SCC are introducing over the next calendar year. The iConnect system will allow Employers to send member scheme information directly to SCC over a secure portal, which will update the members record, on a monthly basis. This system should enable both the Employer and SCC to identify any missing, or new members within the month and will also allow for year end processing to be completed in more timely manner. An

implementation plan is to be agreed with SCC, and it is envisaged that all Employers will be uploading information through the iConnect portal by April 2020.

**Key Performance Indicators from June to September 2018.**

We have spoken to SCC about the continued reported underperformance on a number of the KPI's. SCC have stated that all Death Cases were acknowledged within 5 working days, but the workflow system which produces the KPI reports, is set up to report on when a final calculation has been run through the system to calculate if there is an under/overpayment made. It also transpired that the Estimate and Projection KPI's, do not reflect the actual processing of each task. SCC will be adjusting the parameters within the workflow system, so that more accurate reports are produced covering the activities outlined in the KPI Report.

## FINANCIAL IMPLICATIONS

There are no financial implications within this report.

## LEGAL IMPLICATIONS

There are no legal implications within this report.

## Hillingdon Pensions Administation - Key Performance

| Activity | Measure | Impact | Target | Jul-18 | | Aug-18 | | Sep-18 | | Oct-18 | | Nov-18 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Scheme members | Pensioners, Active & Deferred | | | | | | | | | | | | |
| New starters set up/welcome letters | | | | 0 | | 0 | | 0 | | 0 | | 0 | |
| ABS sent - Councillors | Statutory deadline | | Due by 31 Aug | *Achieved* | | *Achieved* | | *Achieved* | | *Achieved* | | *Achieved* | |
| ABS sent - Active | Statutory deadline | | | *Achieved* | | *Achieved* | | *Achieved* | | *Achieved* | | *Achieved* | |
| ABS sent - Deferred | Statutory deadline | | | *10 days late* | | *10 days late* | | *Achieved* | | *Achieved* | | *Achieved* | |
| | | | | Volume | Score | Volume | Score | Volume | Score | Volume | Score | Volume | Score |
| Death notification acknowledged, recorded and documentation sent | 5 working days | M | **100%** | 28 | **89%** | 24 | **100%** | 5 | **60%** | 11 | **55%** | 10 | **100%** |
| Payment of death grant made | 10 working days | H | **100%** | 3 | **33%** | 7 | **86%** | 7 | **57%** | 2 | **100%** | 0 | **N/A** |
| Retirement notification acknowledged, recorded and documentation sent | 10 working days | M | **100%** | 37 | **97%** | 15 | **100%** | 29 | **97%** | 24 | **92%** | 43 | **93%** |
| Payment of lump sum made | 10 working days | H | **100%** | 14 | **93%** | 22 | **95%** | 14 | **93%** | 14 | **71%** | 31 | **84%** |
| Calculation of spouses benefits | 10 working days | M | **100%** | 1 | **100%** | 7 | **57%** | 5 | **40%** | 0 | **N/A** | 1 | **100%** |
| Transfers In - Quotes | 20 working days | L | **100%** | 10 | **100%** | 0 | **N/A** | 6 | **17%** | 1 | **100%** | 6 | **100%** |
| Transfers In - Payments | 20 working days | L | **100%** | 2 | **100%** | 0 | **N/A** | 4 | **100%** | 1 | **100%** | 1 | **100%** |
| Transfers Out - Quote | 20 working days | L | **100%** | 26 | **73%** | 14 | **93%** | 4 | **75%** | 4 | **100%** | 10 | **100%** |
| Transfers Out - Payments | 20 working days | L | **100%** | 3 | **67%** | 6 | **83%** | 8 | **88%** | 2 | **100%** | 6 | **100%** |
| Employer estimates provided | 10 working days | M | **100%** | 7 | **100%** | 25 | **100%** | 10 | **100%** | 10 | **100%** | 4 | **50%** |
| Employee projections provided | 10 working days | L | **100%** | 7 | **100%** | 9 | **100%** | 7 | **57%** | 1 | **0%** | 14 | **43%** |
| Refunds | 20 working days | L | **100%** | 9 | **77%** | 5 | **100%** | 2 | **100%** | 1 | **100%** | 25 | **92%** |
| Deferred benefit notifications | 20 working days | L | **100%** | 47 | **91%** | 27 | **67%** | 48 | **79%** | 14 | **100%** | 40 | **95%** |
| Complaints received- Admin | | | | 0 | | 1 | | 1 | | 0 | | 0 | |
| Complaints received- Regulatory | | | | 0 | | 0 | | 0 | | 0 | | 0 | |
| Compliments received | | | | 0 | | 0 | | 0 | | 0 | | 0 | |
| Queries Handled by Helpdesk | | | | 685 | | 733 | | 623 | | 697 | | 502 | |

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# Pension Fund Risk Register

| | |
|---|---|
| *Contact Officers* | Sian Kunert, 01895 556578 |
| *Papers with this report* | Pension Fund Risk Register |

**REASON FOR ITEM**

The purpose of this report is to identify to the Pension Committee the main risk's to the Pension Fund and to enable them to monitor and review going forward (see Appendix).

**RECOMMENDATIONS TO THE PENSIONS COMMITTEE**

1. **It is recommended that Pensions Committee consider the attached Risk Register in terms of the approach, the specific risks identified and the measures being taken to mitigate those current risks. There are no risks currently rated as red.**

**Information**

The specific risk matrix for the Pension Fund allows better classification of the risks than would be possible through the Council's standard risk matrix. The significance of risks is measured by interaction of the likelihood of occurrence (likelihood) and by the potential damage that might be caused by an occurrence (impact). The risks are also RAG rated to identify level.

There are currently 9 risks being reported upon. Whilst there are many more risks which could be identified for the Fund, those identified are the most significant and those which are actively managed.

Each risk has been explained, along with details of the actions in place to mitigate that risk. The progress comment column provides the latest update in respect of the impact of those mitigating actions. The Direction of Travel (DOT) has also been included.

There have been no changes to the status of existing risks from those reported in October.

**Additional risk**

There is a new risk in addition to those reported in October for Impact of Climate Change as requested by members in October. In October, an intergovernmental panel on Climate Change reported that the world was currently on course for 3 degrees of global warming which is outside the 2 degree 2015 Paris agreement. A change is essential in the transition to becoming less carbon intensive. Companies

listen to their major investors so the fund can have an impact in the value of its investments through engagement.

Examples of risks to the fund as investors from a climate change perspective can result from

- regulatory action designed to reduce climate risks such as fines for worst carbon emissions in a given industry can reduce the value of investment in a poorly managed company
- Physical damage to buildings, supplies and equipment as a result of flooding or other extreme weather events can be costly to recover, affecting dividend distribution and /or share price.
- Disruption of Food and Water Supply can affect many sectors
- fossil fuel reserves may become stranded due to new regulatory policy to stop extrication to reduce emissions.
- Risk to supply and distribution chains as a result for example from haulage emissions and reliance on fossil fuels
- Cost of Insurance and the insurance industry impact from increased claims from natural disasters

Active managers carry out an ESG overlay on stock selection within their mandates, however passive funds will match the index and will not take into account carbon emissions or EGS issues. The fund should investigate options to tilt exposure to climate risk through a tilt on the passive fund to reduce this risk.

**Existing risks - additional information**

In follow up to a query at Pension Committee in October over risks 1 and 3 further details over risk rating classification is provided.

Risk 1 – Fund assets fail to deliver returns in line with anticipated returns underpinning the valuation of liabilities in the long term. This risk has been rated as Medium likelihood and large impact. Large impact has been assessed due to the annual return built into the long-term valuation being 4% return on assets, this would equate to £40m income in investment returns per annum.

Risk 4 – Pay and price inflation significantly more than anticipated. This risk is nuanced towards the employer risk and impact of affordability of contribution rates for Pension fund income. Contributions collected are currently around £42m per annum in total. The risk is around the real increase on salary growth above inflation which can be controlled and mitigated. The impact to the Council, who are the funds biggest employer, for pay growth of 1% results in additional budget of £1.2k, resulting in a medium impact risk.
Inflation risk to liabilities in relation to a CPI significantly increasing would be damaging to the funding position of the fund, the fund cannot control the level of CPI inflation however is increasing the exposure to inflation linkage products to mitigate the impact.

## FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

## LEGAL IMPLICATIONS

The legal implications are mentioned within the report.

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# Pension Fund Risk Register 2018/19

| Description | Actions in Place | Progress Comment | Risk Category / Rating / DOT | Lead Officer / Cabinet Member |
|---|---|---|---|---|
| **PEN 01 - Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term** | 1. Anticipate long-term return on a relatively prudent basis to reduce risk of failing to meet return expectations.<br>2. Analyse progress at three yearly valuations for all employers.<br>3. Undertake Inter-valuation monitoring. | With the assistance of the KPMG 'Fusion' tool - the position is kept under regular review and Pension Committee informed of the impact of prevailing market conditions on the funding level. | Strategic risk<br>Likelihood = Medium<br>Impact = Large<br>**Rating = D2**<br>**(Static)** | Sian Kunert / Cllr P Corthorne |
| **PEN 02 - Inappropriate long-term investment strategy** | 1. Set Pension Fund specific strategic asset allocation benchmark after taking advice from investment advisers, balancing risk and reward, based on historical data.<br>2. Keep risk and expected reward from strategic asset allocation under review.<br>3. Review asset allocation formally on an annual basis.<br>4. Investment strategy group actively monitors this risk. | A separate Officer and Advisor working group, Investment Strategy Group (ISG) has been formed to regularly monitor the investment strategy and to develop proposals for change / adjustment for Pension Committee consideration.<br>The impact of each decision is careflly tracked against the risk budget for the Fund to ensure that long-term returns are being acheived and are kept in line with liabilities. | Strategic risk<br>Likelihood = Low<br>Impact = Large<br>**Rating = E2**<br>**(Static)** | Sian Kunert / Cllr P Corthorne |
| **PEN 03 - Active investment manager under-performance relative to benchmark** | 1. The structure includes active and passive mandates and several managers are employed to diversify the risk of underperformance by any single manager.<br>2. Short term investment monitoring provides alerts on significant changes to key personnel or changes of process at the manager.<br>3. Regular monitoring measures performance in absolute terms and relative to the manager's index benchmark, supplemented with an analysis of absolute returns against those underpinning the valuation.<br>4. Investment managers would be changed following persistent or severe under-performance. | The Fund is widely diversified, limiting the impact of any single manager on the Fund.<br>Active monitoirng of each manager is undertaken with Advisors and Officers meeting managers on a quarterly basis and communicating regularly.<br>Comments on whether mandates should be maintained or reviewed are included and where needed specific performance issues will be discussed and reviewed. | Strategic risk<br>Likelihood = Low<br>Impact = Small<br>**Rating = E4**<br>**(Static)** | Sian Kunert / Cllr P Corthorne |

| Description | Actions in Place | Progress Comment | Risk Category / Rating / DOT | Lead Officer / Cabinet Member |
|---|---|---|---|---|
| **PEN 04 - Pay and price inflation significantly more than anticipated** | 1. The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. The actuarial basis examines disparity between the inflation linking which applies to benefits, the escalation of pensionable payroll costs, which only applies to active members, and on which employer and employee contributions are based.<br>2. Inter-valuation monitoring gives early warning and investment in index-linked bonds also helps to mitigate this risk.<br>3. Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees. | The impact of pay and price inflation is monitoried as part of the Council's MTFF processes and any potential impact on pension fund contributions is kept under review and factored into the Council's overall position.<br>However, there is an increasing likliehood of rising inflation impacting on the overall liabilities of the Fund however the risk rating takes this into account. | Strategic risk<br>Likelihood = Low<br>Impact = Medium<br>**Rating = E3**<br>**(Static)** | Sian Kunert / Cllr P Corthorne |
| **PEN 05 - Pensioners living longer.** | 1. Mortality assumptions are set with some allowance for future increases in life expectancy. Sensitivity analysis in triennial valuation helps employers understand the impact of changes in life expectancy.<br>2. Club Vita monitoring provides fund specific data for the valuation, enabling better forecasting. | The Fund is part of Club Vita, a subsiduary of the Fund Actuary, which monitors mortality data and feeds directly into the valuation.<br>In addition, further mortality monitoring in undertaken by CEB, the fund's administrators. | Strategic risk<br>Likelihood = Low<br>Impact = Small<br>**Rating = E4**<br>**(Static)** | Ken Chisholm / Cllr P Corthorne |
| **PEN 06 - Poor Performance of Outsourced Administrator leading to poor quality information supplied to both members and the Fund Actuary** | 1. Quarterly review meetings held<br>2. Weekly update calls with officers<br>3. Quarterly KPI reports are provided to track and monitor performance | New cases are being dealt with and improvements in processes within the contract. There are signs of improvement in the quality of data inherited by SCC from Capita. | Strategic risk<br>Likelihood = Low<br>Impact = Large<br>**Rating = E2**<br>**(Static)** | Ken Chisholm / Cllr P Corthorne |

| Description | Actions in Place | Progress Comment | Risk Category / Rating / DOT | Lead Officer / Cabinet Member |
|---|---|---|---|---|
| **PEN 07 - Failure to invest in appropriate investment vehicles as a result of MiFID II regulations in place from 3 Januray 2018** | 1. Applications have been made to sustain "Professional Status" of the pension fund to enable continuation of the existing investment strategy.<br>2. All current application's have successfully been resolved confirming professional status | This is a risk identified as a result of regulatory changes and is continually assessed. The fund is required to show an appropriate level of knowelgde and skills for investment decision markers. Changes in circumstances including committee membership or change in officers must be reported and could effect the ongoing investment relationship. | Strategic risk<br>Likelihood =Very Low<br>Impact = Large<br>**Rating = F2**<br>**(Static)** | Sian Kunert / Cllr P Corthorne |
| **PEN 08 - Cyber Security - Pension schemes hold large amounts of personal data and assets which can make them a target for fraudsters and criminals** | 1. Council wide policies and processes in place around:<br>acceptable use of devices, email and internet<br>use of passwords and other authentication<br>home and mobile working<br>data access, protection (including encryption), use and transmission of data<br>2. Risk is on teh Corporate risk register with risk mitigation in place.<br>3.All member and transactional data flowing from SCC and Hillingdon is sent via encryption software<br>4.Data detween the fund, SCC and Hymans is distibuted via upload to an encrypted portal<br>5. Systems at Hillindon and SCC are protected against<br>viruses and other system threats<br>6. SCC are accredited to ISO27001:2013 and applying for Cyber Essentials Plus accreditation. SCC are also PSN compliant (to June 2019) | This risk has been recognised in response to recommendations by the Pensions Regulator<br><br>Certificates on SCC accreditation received<br><br>SCC have an incident response plan which is required to develop mitigation of this risk. A copy will be sent to the fund. | Strategic risk<br>Likelihood = Low<br>Impact = Medium<br>**Rating = E3**<br>**(Static)** | Sian Kunert / Cllr P Corthorne |

| Description | Actions in Place | Progress Comment | Risk Category / Rating / DOT | Lead Officer / Cabinet Member |
|---|---|---|---|---|
| **PEN 09 - Climate Change - Risk of financial lose through Climate change impacts** | 1. The fund have an ESG policy in place.<br>2. Active equities within fossil fuel sector have been assessed in relation to the Transition pathway anaysis tool to identify those complanies transitioning to a lower carbon world.<br>3. Manger selections take into account ESG policy<br>4. Mangers are expedcted to be signed up to the stewardship Code<br>5. Managers are expected to have signed up to the UN Principles for Responsible Investment (UK PRI)<br>6. ESG Issues are discussed with managers at review meetings | The investment stratey should be updated with a statement on climate change risk.<br><br>Follow up required to confirm all mamangers are now signatories to the UK PRI<br><br>The fund biggest risk exposure to poorly managed companies in respect of carbon emissions will be through the passive allocation. Tilts on this allocation will be reviewed and considered to reduce this risk. | Strategic risk<br>Likelihood = Low<br>Impact = Large<br>**Rating = E2**<br>**(New)** | Sian Kunert / Cllr P Corthorne |

| Attributes: | | | Risk rating | Score | Risk rating | Score | Risk rating | Score | Risk rating | Score |
|---|---|---|---|---|---|---|---|---|---|---|
| Greater than 90% | This week | **Very High (A)** | **A4** | 6 | **A3** | 12 | **A2** | 18 | **A1** | 24 |
| 70% to 90% | Next week / this month | **High (B)** | **B4** | 5 | **B3** | 10 | **B2** | 15 | **B1** | 20 |
| 50% to 70% | This year | **Significant (C)** | **C4** | 2 | **C3** | 4 | **C2** | 6 | **C1** | 8 |
| 30% to 50% | Next year | **Medium (D)** | **D4** | 1 | **D3** | 2 | **D2** | 3 | **D1** | 4 |
| 10% to 30% | Next year to five years | **Low (E)** | **E4** | 0 | **E3** | 0 | **E2** | 0 | **E1** | 0 |
| Less than 10% | Next ten years | **Very Low (F)** | **F4** | 0 | **F3** | 0 | **F2** | 0 | **F1** | 0 |

**THREATS:**

| **Attributes:** | **Small (4)** | **Medium (3)** | **Large (2)** | **Very Large (1)** |
|---|---|---|---|---|
| | **IMPACT** | | | |
| Financial | up to £500k | Between £500k and £10m | Between £10m and £50m | Over £50m |
| Reputation | Minor complaint, no media interest | One off local media interest | Adverse national media interest or sustained local interest | Ministerial intervention, public inquiry, remembered for years |

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# ANNUAL REPORT TO PENSIONS COMMITTEE

| | |
|---|---|
| **Committee** | Local Pension Board |
| **Officer Reporting** | Sian Kunert |
| **Papers with report** | None |

**REASON FOR ITEM**

The report is compiled to provide feedback to Pensions Committee on the work undertaken by the Local Pension Board since the last report presented in Pensions Committee in September 2017 and to meet the legislative requirement for producing an annual report.

**RECOMMENDATIONS**

**It is recommended that Pensions Committee note the contents of this report.**

**INFORMATION**

1. The Public Service Pensions Act 2013 introduced the requirement to have a Local Pensions Board to assist in the good governance of the scheme.

2. The purpose of the Board is to assist the Administering Authority in its role as a Scheme Manager of the Scheme. Such assistance is to:

    - Secure compliance with the regulations and any other legislation relating to the governance and administration of the Scheme, and requirements imposed by the Pensions Regulator in relation to the Scheme; and
    - To ensure the effective and efficient administration of the Scheme.

3. London Borough of Hillingdon Council ratified the establishment of the Board on 6th November 2014 to commence with effect from 1st April 2015. Council at its meeting 02 November 2017 agreed to change the structure of the Board and its membership to improve the overall effectiveness of the Board. The Board meets four times a year and consists of two Employer representatives, and two scheme member representatives.

**Membership and Attendance at Meetings**

4. The membership of the local Pension Board is:

    *Employer Representatives:*

Hayley Seabrook (Hillingdon Council)
Zak Muneer (LHC)

*Scheme Member Representatives:*
Venetia Rogers
Roger Hackett

5. Attendance at meetings has been high with all members in attendance where positions have been filled.

6. AON Hewitt is appointed as Governance advisers to support the development and work of the local Pension Board and attend meetings as necessary.

**Training**

7. Relevant external training opportunities are made available to Board Members and have been well supported, in particular with regular attendance at quarterly local board specific training sessions held by CIPFA. Pension Board members also utilise internal training opportunities by attending Pension Committee where a training item starts each meeting.

8. Using CIPFA's Training Needs analysis, specific training needs have been identified, and will continue to be identified, and will be built into future training. The new members plan to complete their frameworks within the next quarter.

**Work of the Local Pension Board**

9. Meetings are held shortly after each Pensions Committee. Since the annual report in September 2017, there was one meeting held under the old board structure in October 2017 and three since the structural changes in November 18; April 18, September 18 and November 18.

10. Each meeting undertakes a review of the most recent Pensions Committee reports and decisions, raising any issues for clarification with officers. To date there have been no issues referred back to Pensions Committee. All committee papers are shared with Board Members who are encouraged to attend committee meetings to fully understand the reports.

11. Terms of Reference for the Board:

    i. The Pensions Board will be chaired by a member chosen by the group
    ii. The frequency of the Pensions Board will be determined by the Board.
    iii. Reports to the Board will either reflect decisions taken by Pensions Committee or be reports for noting already seen by Pensions Committee.
    iv. The role of the Board will be to assist London Borough of Hillingdon Administering Authority as Scheme Manager: to secure compliance

with the LGPS regulations and any other legislation relating to the governance and administration of the LGPS;

v. To secure compliance with requirements imposed in relation to the LGPS by the Pensions Regulator; and in such other matters as the LGPS regulations may specify.

vi. To secure the effective and efficient governance and administration of the LGPS for the London Borough of Hillingdon Pension Fund.

vii. To provide the Scheme Manager with such information as it requires to ensure that any member of the Pension Board or person to be appointed to the Pension Board does not have a conflict of interest. (NB: Being a member of the LGPS is not seen as a conflict of interest.)

12. The key work of the Pension Board in the past year have related to understanding changes in regulation, reviewing performance of the administration of the fund and to improve Fund governance and in ensuring compliance with the Pension Regulator's code of practice by carrying out a refresh to monitor improvements. Pension Board have undertaken some significant pieces over the past year including:

- Reviewed publications to fund members
- Carried out a refresh against Pension regulator's compliance checklist and agreement of actions for improvement; and
- Monitoring the performance of the Pensions Administration by Surrey County Council.

13. In understanding governance of the Fund the Pension Board have challenged officers in specific areas of administration and governance arrangements including:

- Whether the fund has sufficient resources available,
- Implementation and publicity of self service module for pensioners, actives and deferred members
- Data quality and improvement
- GMP
- GDPR
- Cyber Security
- ABS production
- Member training
- Review of Pension Committee papers and decision making process

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