Pensions CIV Sectoral Joint Committee (PSJC) Meeting – 4 November 2015

Minutes of a meeting of the Pensions CIV Sectoral Joint Committee held on Wednesday 4 November 2015 at 10:30am in the Conference Suite, London Councils, 59½ Southwark Street, London SE1 0AL

Present:

City of London	Mark Boleat (Chair)
Barking and Dagenham	-
Barnet	Cllr John Marshall (Deputy)
Bexley	Cllr John Waters
Brent	-
Camden	-
Croydon	-
Ealing	Cllr Yvonne Johnson (Vice-Chair)
Enfield	-
Greenwich	-
Hackney	Cllr Roger Chapman
Hammersmith and Fulham	Cllr Iain Cassidy
Haringey	Cllr John Bevan (Deputy)
Havering	Cllr Clarence Barrett
Harrow	-
Hounslow	Cllr Mukesh Malhotra
Islington	Cllr Richard Greening
Kensington and Chelsea	-
Kingston Upon Thames	-
Lambeth	Cllr Adrian Garden
Lewisham	Cllr John Muldoon
Merton	Cllr Imran Uddin
Newham	Cllr Ted Sparrowhawk (Deputy)
Redbridge	Cllr Elaine Norman
Richmond Upon Thames	Cllr Thomas O'Malley
Southwark	-
Sutton	Cllr Sunita Gorden
Tower Hamlets	Cllr Clare Harrisson
Waltham Forest	-
Wandsworth	Cllr Maurice Heaster (Vice Chair)
City of Westminster	-

Apologies:

Barnet	Cllr Mark Shooter
Brent	Cllr George Crane
Croydon	Cllr Simon Hall
Haringey	Cllr Clare Bull
Havering	Cllr Philippa Crowder
Harrow	Cllr Adam Swersky
Kensington & Chelsea	Cllr Quentin Marshall
Kingston upon Thames	Cllr Eric Humphrey
Newham	Cllr Forhad Hussain
Southwark	Cllr Fiona Colley
Westminster	Cllr Suhail Rahuja

Officers of London Councils were in attendance as were:

- Lord Bob Kerslake – Non-Executive Chair, London CIV
- Hugh Grover – CEO, London CIV
- Brian Lee – Chief Operations Officer, London CIV
- Julian Pendock – Investment Oversight Director, London CIV
- Chris Bisland – Non-Executive Director, London CIV
- Chris Buss - Chair, Investment Advisory Committee
- Ian Williams – Deputy Chair, Investment Advisory Committee
- Andrew Cornelius – HM Treasury (in attendance for Item 4)
- Isla Cully – Financial Conducts Authority (in attendance for Item 4)
- Rebecca Young – Financial Conducts Authority (in attendance for Item 4)
- Peter Hotbauer – Head of Hermes Infrastructure (in attendance for Item 6)
- Mark Miller – Head of UK & MENA Institutional, Hermes Investment Management (in attendance for Item 6)

The Chair welcomed Lord Bob Kerslake and invited him to address the Committee.

Lord Kerslake noted that:

- The creation of the Pensions CIV afforded a significant advantage to London, providing the opportunity to pool resources and be in a position to influence the government agenda.
- Good progress on the CIV has been made so far, especially in the last couple of months. The CIV now has a full board of appointments, and has had its first full meeting.
- There was a huge potential for the expansion of CIV into new areas, such as infrastructure funding.
- In response to member questions about the discrepancy between the CIV's £6 billion target and the Treasury's £25-30 billion target, the Lord Kerslake replied that the government was unlikely to impose hard targets on the CIV; government intervention would only implemented if expected progress was not being made.

Hugh Grover then introduced the two newly appointed Executive Directors of CIV - Brian Lee - Chief Operations Officer, and Julian Pendock – Investment Oversight Director, and said that a biography of each of the Directors will be circulated shortly.

1. Announcement of Deputies

1.1. Apologies for absence and deputies were as listed above.

2. Declarations of Interest

2.1. There were no declarations of interest that were of relevance to this meeting.

3. Minutes of the AGM held on 21 July 2015

3.1. The minutes were agreed.

3.2. In relation to point 4.3, members asked whether invoices had been issued to boroughs and whether they had been paid. Mr Grover replied that the invoices had been issued and that all boroughs bar one had already paid; the remaining borough was aiming to pay by the end of the week.

4. Potential changes to the LGPS

4.1. Mr Grover introduced the paper which covered three main areas of potential change:

- The government's LGPS reform agenda and the Chancellor's Budget Update/Conservative Conference Speech;
- Separation of the Pension Fund from the Host Authority; and
- The Impact of Markets in Financial Instruments Directive (MiFID II) and its implementation in the UK.

4.2. Mr Cornelius was invited to comment on the government's LGPS reform agenda noting that:

- The government was interested in structural reforms to the LGPS and was focusing on engaging with the local government sector to secure good outcomes, efficiencies, and alternative ways to invest, for example in infrastructure projects.
- Ministers would not be setting targets for efficiencies, but will instead create conditions in order that sensible investment decisions are made.
- The Treasury believes that LGPS pools of around £25 billion each would represent reasonable scale. This investment should consist of liquid assets which could be moved across fairly quickly, and medium terms investments, which will be moved in due course, due to liabilities. Some assets, such as property, could be held outside the pool.
- In response to member queries about the upcoming consultation, Mr Cornelius confirmed that the government's consultation was due in November 2015 and that local authorities would get the opportunity to shape the new proposals.
- In response to member comments about boroughs' responsibility for the performance of the riskier investments such as infrastructure, Mr Cornelius said that it was important for CIV's to invest in projects with the appropriate risk/reward ratio. The bigger scale means that expertise can be brought in to help local authorities mitigate the political and economic risks inherent to infrastructure projects.

4.3. Ms Isla Cully from the FCA gave a presentation on MiFID II noting that:

- MiFID I (Directive 2004/39/EC) has been in force since 2007 and is implemented domestically through COBS 3 ("Client Categorisation").
- The regime recognises that investors have different levels of knowledge and expertise. Regulatory protections are therefore calibrated according to client category (i.e. the client's level of sophistication) – retail client, professional client, eligible counterparty.
- MiFID II was agreed in June 2014 and it was brought in to improve the functioning of financial markets and the protection of investors. MiFID II means that authorities will be required to receive additional information

requirements (e.g. in relation to costs and charges, information and marketing communications must be fair, clear and not misleading), as well as suitability (for advised services) and appropriateness assessments (for non-advised services or portfolio management).

- The key change to the client categorisation regime under MiFID II is the re-categorisation of local authorities under Annex II, Part 2 (i.e. as retail clients with the possibility to opt-up to professional client status). This is because local authorities were considered vulnerable during financial crisis and did not always fully appreciate the risks they were exposed to, especially in the case of complex financial products. EU policy-makers therefore decided that local authorities should no longer automatically be categorised as professional clients, as they can no longer be presumed to have the knowledge and experience required to understand the risks associated with the investments they make.
- In order to opt-up to professional status, investors must pass a series of qualitative tests; this includes experience of working in the financial sector, the size of an investment portfolio. The quantitative tests include procedures such as the investor providing statements in writing that they are aware of the protection and investor compensation rights they may lose. In response to member questions, Ms Cully confirmed that the qualitative tests would be performed on the individuals making the decisions, and the quantitative tests would be performed by the local authority. CIV may be used as a filter to the market, but this would depend on the legal structure.
- The FCA intended to exercise the discretion to apply alternative criteria for local authorities wishing to opt-up to professional client status, in order to ensure proper regulatory protection for smaller, less sophisticated local authorities (e.g. Parish & Town Councils) by ensuring that they are not opted-up by firms without the requisite knowledge and expertise needed to understand investment risks.
- The FCA was currently reviewing policy options with the intention of applying a proportionate quantitative threshold that will allow local authorities the flexibility to opt-up where appropriate.
- All stakeholders will have the opportunity to comment on the proposed policy approach when the MiFID II Consultation Paper is published in early 2016.

4.4. In response to member questions, Ms Cully noted that every Investment Manager will need to go through the opt-up procedure with each borough.

4.5. Members commented that the new regulations in relation to opting-up seemed excessively bureaucratic, and would only serve to increase the administrative burden on local authorities. The Chair said that London CIV should seek advice to minimise the adverse impact of the relevant legislation.

5. Progress update and risk register

5.1. Mr Grover presented the report which was noted.

6. Investing in Infrastructure

6.1. Mr Julian Pendrock introduced the report and provided further information through a presentation noting the following:

- Infrastructure can take many forms, for example social infrastructure, utilities infrastructure, transport infrastructure, and quasi infrastructure (e.g. motorway services stations, ATM networks).
- There is currently an infrastructure funding gap, due to a decline in government spending on infrastructure and high levels of public sector indebtedness, which increases the need for private sector investment.
- Low interest rates have led to lower discount rates, lower funding levels and lower cash yields. This, in turn, has led to higher asset prices, which have resulted in lower expected future returns.
- LGPS is currently under-invested, but it does have great potential for economies of scale, especially through London CIV. Pooled resources mean that an increased number of global and UK-based infrastructure investment opportunities were now a more viable option.

6.2. Peter Hotbauer and Mark Miller from Hermes Investment Management gave a presentation on Hermes' view on infrastructure investment, and made the following points:

- Hermes' view of infrastructure involved three separate investment strategies that target opportunities according to clearly defined investment characteristics:
  - ➢ Core (low volatility): these are high yield, high inflation protection, limited or no leverage, such as solar PV, regulated utilities and social infrastructure. The expected range of returns for this kind of investment is 7%-9%.
  - ➢ Value added (medium volatility): these are long term, robust income streams with an expected a returns range of 10%-12%. Examples of this kinds of investment are transport infrastructure and power generation (merchant).
  - ➢ Opp (higher volatility): these include emerging markets or early stage projects, and expect returns of 12%+. Examples of this are construction and infrastructure services.
- Pension funds typically have long-dated liabilities, which results in significant exposure to inflation.
- Hermes' approach to infrastructure investment is through direct investments, which are heavily UK based (due to its open and transparent jurisdictions and regulatory frameworks) and made up of mainly core and value added strategies.
- Hermes welcomes a Pensions CIV initiative; the scale of the CIV can bring additional benefits in terms of fees and access to a shared platform.

6.3. Members said that they were generally supportive of investing in infrastructure, and that they would prefer to invest in 'core' infrastructure investment rather than the more risky options.

6.4. The Chair asked Mr Grover to develop the case for investing in infrastructure in more detail, and to set up concrete proposals over the next year.

7. Investment Advisory Committee

7.1. This report was noted.

8. Dates of meetings for 2016

8.1. The dates were agreed.

The meeting closed at 12.30pm