Conference highlights

LGC Investment Seminar Scotland (20-21 October 2022)

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Against a backdrop of economic and political turmoil, delegates discussed the risks and opportunities for Scottish Local Government Pension Scheme funds.

Day 1 - Welcome from LGC and the chair

Martin George, LGC; Philip Pearson, Hymans Robertson

- Welcome from Martin.
- Introduction from Philip, noting the seminar provided the opportunity to hear about, and discuss, the interesting market environment, both the challenges and the opportunities.

LGPS state of play

David Murphy, NILGOSC; Kimberly Linge, SPPA; Bob Holloway, LGPS Advisory Board

- A session on what issues in the LGPS are keeping people up at night. It started with a poll on the biggest concerns in LGPS today, with the top three being “investment returns”, “the economy” and “climate change”.
- Kimberly covered the impacts and implementation of the McCloud judgement, GAD’s Section 13 review, the follow on from the Structural Review in Scotland, and requirements for potential reporting and management relating to climate risks.
- Bob discussed in further detail the potential incoming requirements in England & Wales on the LGPS to begin reporting the measurement and management of climate risks, with the expectation that reporting will be required from 2024. It was noted how large the impact was expected to be on Fund governance and resourcing, but that frameworks were looking to be used to help Funds with this. The potential impacts of the incoming boycotts and sanctions bill were also mentioned.
- David covered four areas of scheme administration that were keeping him awake at night, namely the Union Compensation Case, the Pensions Dashboard, the potential for benefit changes (e.g. the review of state pension age), and resourcing within LGPS Funds.

Social investing: where next to invest to meet your Sustainable Development Goals

Alex Melhuish, JP Morgan Asset Management; Peter Manners-Smith, M&G Investments

- The focus of impact investing has been on Environmental and Governance issues, whilst Social issues have often been considered too difficult for investors to tackle. However, recent surveys by JP Morgan show social themes are starting to be a priority for investors and becoming a meaningful financial factor.
- It is not easy to find these investment opportunities, and investors need a disciplined approach to avoid green washing and impact washing. But opportunities exist to have positive impact whilst making a financial return in both public and private markets.
- Example in public markets – investing in a home builder that has strong aims of providing affordable homes and helping people onto the property ladder.
- Example in private markets – Rochdale town centre was in decline and council wanted to take action. The council found development and financing partners to redevelop town centre for shopping and entertainment, creating 1,400 jobs and millions of pounds to the local economy.

Emerging Markets – a sustainable investor's paradise?

Alex Khosia, Newton Investment Management

- Huge requirement in Emerging Markets for sustainable investment, but only a very small allocation is made currently. Sustainability challenges, and investment opportunities, include the energy transition, healthcare inequalities and financial inclusion and urbanisation.
- Not all companies addressing these issues will outperform. To find the right companies to invest in, it is important to consider each company within the context of the sustainability issues it appears to be addressing, whether the company is genuinely helping to address the issue with better solutions than its competitors and whether addressing these issues is a key purpose of the company.
- It is very difficult to find these companies, as reporting and data in Emerging Markets is generally poor, particularly on issues of ESG and sustainability. It therefore requires a lot of time and effort to discover the correct companies to invest in.

Commercial Property: Green or bust – the future of real estate

Lucy Swinton, Fidelity International

- Real estate is a very important sector for climate change - 40% of carbon emissions are from real estate sector, 81% of real estate stock in EU needs climate-focussed renovation, but only 1% undergo this each year.
- A key issue is that 35% of carbon emissions are from the construction of a building, but decarbonisation efforts have been focussed on reducing the operational emissions after construction. A lot of focus has been on constructing new "green" buildings, but there are 60% less carbon emissions from refurbishing existing buildings than new green ones.
- A case study was provided of an office building in Paris which was refurbished to reduce energy usage by 60%. Demand is increasing for sustainable buildings, so the refurbishment grew the income generated by the building by 10% and increased the capital value by 40%.

Macroeconomics Mayhem: helping to see the wood from the trees

John Roe, Legal & General Investment Management

- The world finds itself in a very uncertain place from a macroeconomic perspective. There are three key threats facing markets: structural inflation, short-term inflation, and possible recession.
- There are a number of key issues weighing on the economy around the world, including inflationary forces in the US, energy costs in Europe, recessionary pressures in the UK and three key issues in China of zero-COVID policies, debt in the property market and regulation of the tech industry.
- Recessionary risks on LGIM's scoring system are looking very high for the US in 2023, with around 65% likelihood being assigned to it.
- What can Funds do to help with this? Focus on the biggest issues and decisions with the biggest impact on your Fund, namely asset allocation decisions. Start by checking how your current asset allocation reflects your beliefs around areas such as risk, active vs. passive and areas of the market where you have more or less confidence.

Bird of a Feather discussion session

Richard Warden, Hymans Robertson; Nick Colley, CBRE Investment Management; James Mitchell, Newton Investment Management; David Barber, Fidelity International; Rosalind Smith-Maxwell, Quinbrook ; Claire Scott, Independent Advisor

- *Cryptocurrencies: a new investment opportunity or just too risky* – unanimous that it is too risky. Limited understanding of it, whether it meets the definition of an investment, high risk of black-market activity and adverse environmental impact.
- *Impact of Scottish independence on the LGPS* – issues of volatility in investment markets, currency uncertainty of the Scottish Pound or Euro, potential funding issues, the potential loss of employer contributions who may move to England.
- *Cost of living crisis – what it means for the LGPS* – whether the LGPS can help with issues like social housing, providing solar panels on council houses, increased local investment; but noting pressures on fiduciary duty, and potential impact of mortality on funds' liabilities.
- *Opportunities and pitfalls in investing in local infrastructure* – infrastructure seen as an attractive asset class and underinvested, but scale is required so maybe funds could work together. Fiduciary duty should drive decision-making rather than local investment. Local investment can create conflicts of interest and risk of negatively impacting local community. Need to avoid stranded asset risk as they are long-term investments.
- *Improving scheme member engagement* – technology has helped but more to be done. Should communicate better to members the value of their pension. Could better engage members on ESG issues. Plain and understandable language is important.
- *Increasing Regulator demands*; *help or hindrance?* – general concern around increased demands and bureaucracy but consensus that many changes have been positive, such as improved training and focus on risk management.

Day 2 – Welcome from the chair

Martin George, LGC; Iain Campbell, Hymans Robertson

- A brief welcome to day 2

Exploring investment opportunities in the current economic climate

Iain Campbell, Hymans Robertson

- Markets have been expensive and benign for the last decade, with constant forecasts of lower future returns.
- 2022 has seen the return of inflation and volatility, leading to large market falls and the cheapening of markets.
- This has led to some strong investment opportunities arising for Funds to capitalise on, particularly in bonds, distressed debt, sustainable equities and real assets.

Where we are now on stewardship and governance

Richard Keery, Strathclyde Pension Fund

- Richard covered the latest developments on stewardship for the LGPS.
- The impact of Russia's invasion of Ukraine on stewardship was discussed, including the questions over whether Russian companies should have been allowed within ESG prior to the invasion, the implications for funds if China invades Taiwan, and the UK's increased emphasis on North Sea gas development.
- Some reflections on the completion of the Fund's Stewardship Code were shared, including the increased importance placed on voting information and the need to report and evidence outcomes.

Infrastructure 2.0 – where should we invest next

Tania Tsoneva, CBRE Investment Management

- Tania discussed how infrastructure has been a large contributor to the climate change issue, but now has the opportunity to become part of the solution through new technologies.
- The various elements of sustainable infrastructure were covered, including digital infrastructure, renewables, sustainable transport and water infrastructure.
- It was noted that currently there is $3.3t of planned energy infrastructure globally, but that to meet a 1.5C global temperature increase, $4.4t was needed, with a much larger share required in renewable infrastructure.

How the LGPS can capitalise on opportunities in private credit

Nikita Desai, Abrdn

- Nikita gave an overview of the private credit market, noting the benefits of diversification and return increase from public markets.
- Nikita pointed out particular opportunities in commercial real estate and infrastructure debt.
- Sustainability in private credit was also discussed, noting the options available to investors were increasing. The current main two routes are through asset selection and incentivising borrowers to implement better ESG management.

Evolving dynamics of the UK Power Market – where energy security meets the Decarbonisation Agenda

Mark Burrows, Quinbrook; Rosalind Smith-Maxwell, Quinbrook

- The current position of the UK energy market was discussed, including the significant change in the makeup of the energy production sources, with a huge move away from coal towards natural gas and renewables. However, UK energy pricing was vey volatile and very strongly linked to gas prices.
- The UK was continuing to increase renewable power generation, with many targets set, but this creates challenges for how to get this power into the national grid.
- There is a requirement for new technologies to ensure the move towards a future of renewable power generation is possible.

Case Study: Lothian and Falkirk pension fund merger

David Vallery, Lothian Pension Fund

- David gave an overview of the work that had been undertaken so far on merging the two Funds.
- This set out details of the progress so far, challenges along the way and the steps ahead.
- The desired structure and way the Fund would operate was also discussed, including the important issue of how decisions may be made in future.

Closing remarks

Iain Campbell, Hymans Robertson; Jenny Vyas, EMAP

- Thanks were given to all attendees and contributors to another successful event.