Havering
LONDON BOROUGH

PENSIONS (SPECIAL) COMMITTEE 24 July 2019

Subject Heading:	**Strategic Rationale for Managing Currency Risk**
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Policy context:	In line with Pension Fund's Investment Strategy dated November 2017
Financial summary:	Mitigate 100% of selected overseas currency exposure

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[X]
Places making Havering	[X]
Opportunities making Havering	[X]
Connections making Havering	[X]

SUMMARY

In line with progression of the Investment Strategy this report contains a paper produced by the Fund's Investment Advisor, the purpose of this paper is to outline the strategic rationale for managing currency risk within the Funds investment strategy and to make a recommendation on the most appropriate implementation approach.

RECOMMENDATIONS

That the Committee:

Consider Hymans Managing Currency Risk paper (Appendix A Exempt) and agrees to:

1) Seek to manage the currency risk associated with investment in Real Assets and Private Debt;
2) Initially seeks to mitigate US Dollar, Euro and Australian Dollar exposure only, but extend currency hedging arrangements to include any further material currency exposures that may arise within the mandates.
3) Mitigate 100% of selected overseas currency exposure, subject to gaining comfort on practical consideration.
4) Manage currency risk passively
5) Appoint Russell Investments to implement a currency hedge for the Fund for an initial four year contract, subject to due diligence and formal advice on suitability,
6) Ensure future collateral requirements of a currency management programme are reviewed alongside the review of cashflow management processes.

REPORT DETAIL

Background

1. The Pensions Committee on the 24 July 2018 agreed that further considerations be given to the management of currency associated with the Real Asset mandates. Developments in the Investment Strategy since that meeting, has resulted in commitments made to three Real Asset funds and two Private Debt funds, thus adding further impetus to the need to consider the management of currency risk within the Fund's investment strategy.

2. These investments were agreed following a review of the Fund's investment strategy, in total c20% of total Fund's assets will be invested in non-sterling denominated assets. The primary rationale for these investments was to access attractive but stable long term returns for the Fund. A significant proportion of these returns will be driven by income. The current economic climate provides an environment for currency movements on the returns from overseas investments to be relatively volatile in future.

3. It has been noted that the currency exposure associated with the Funds overseas equity is unhedged, the source from equity investing consist of both income and capital returns, with the latter showing material levels of short term volatility. Currency management would not be expected to reduce volatility associated with overseas equity exposure significantly so it is considered that managing currency risk within the equity structure is not a priority at this time. It has also been noted that retaining some unhedged currency exposure (in particular US Dollar) can provide protection relative to falls in interest rates.

4. It is suggested that the Fund does not seek to manage currency risk on a tactical basis; this implies a passive approach would be appropriate and the management of currency exposure should be regarded only as a risk management process. A passive approach is usually cheap and simple to implement, it is believed that Russell Investment offers the most attractive approach for a currency hedging arrangement.

5. Currency Management training was provided to members on 11th July 2019.

IMPLICATIONS AND RISKS

Financial implications and risks:

The primary risk associated with the implementation of a currency hedge is one of liquidity. The Fund will require a process for ensuring that cash calls from the currency overlay can be met within a timescale of around 10 days from notification.

Gains and losses from the currency hedge would be expected to have an offsetting effect from currency movements impacting on the value of the Real Assets and Private Debt mandates, which is not expected to be a rewarded risk over time. However, given the fixed nature of the investments – particularly the Private Debt investments – this reduces the risk that currency will erode the capital value of the Fund’s investments.

Therefore arrangements to meet future collateral requirements of a currency management programme should be reviewed alongside the review of cash flow management processes.

In line with procurement rules, contract values less than £99,999 are subject to obtaining three quotes. These quotes have been set out in Hymans paper attached (within Appendix 2).

Total currency exposure could reach c. £100m once the Real Assets & Private Debt mandates are fully funded, at which stage annual fees would equate to c.

£20,000 per annum. Costs are based on the Fund hedging 100% of the overseas currency.

If the Fund hedges 100% of currency exposure in Private Debt and 50% of exposure in Real Assets, the currency exposure to be hedged c£75mil the fees would reduce to £15,000 per annum

If the Fund hedges 100% of currency exposure in Private Debt and 75% of exposure in Real Assets, the currency exposure to be hedged c£87m the fees would be £17,500 per annum.

Given that there is also the potential for the London CIV to develop their currency management capabilities over the next few years, it is suggested that the initial contract length will be for 4 years. The total cost expected to be in the region of £80,000.

Costs arising from the implementation of the currency management contract will be met from the Pension Fund.

Legal implications and risks:

The Committee has been constituted by the Council to perform the role of administering authority to manage the London Borough of Havering Local Government Pension Scheme Fund (LGPS) and as such has legal authority to make the decisions sought by the recommendations.

Committee Members have a legal responsibility for the prudent and effective stewardship of LGPS funds, and in more general terms, have a fiduciary duty in the performance of their functions. Investments or pension's committee members are often referred to as quasi-trustees. LGPS quasi-trustees are responsible for the:

- oversight of the management and resourcing of all fund activities
- ensuring the best possible outcome for the fund, employers and members
- ensuring the fund is managed in accordance with legal and regulatory requirements
- taking decisions in accordance with the standing orders of the investments or pensions committee
- acting prudently and impartially on behalf of all the beneficiaries ensuring all decisions are for the benefit of the fund contributors and beneficiaries.

The Local Government Pension Scheme Regulations 2013 provide various powers and duties to the Administering Authority to manage the pension fund, choice of Investment managers and the investment and use of fund money including investment policy and principles

The procurement proposed is not caught by the Public Contract Regulations 2015 by virtue of Regulation 10 which exempts certain investment contracts, although any award must comply with the requirements of openness and transparency.

The procurement is for a services contract with an estimated value of £80k. It must comply with the Council's Contracts Procedure Rules relating to contracts of a value between £25k - £99,999.

The contract for the services should be subject to legal review prior to being entered into.

Human Resources implications and risks:

None arise from this report.

Equalities implications and risks:

There are no equality implications or risks as a result of this report.

BACKGROUND PAPERS

None