PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.00 pm on 13 September 2018

Present

Councillor Keith Onslow (Chairman)
Councillor Russell Mellor (Vice-Chairman)
Councillors Gareth Allatt, Simon Fawthrop, Simon Jeal, David Jefferys and Gary Stevens

Also Present

Councillor Graham Arthur, Resources Portfolio
John Arthur, MJ Hudson Allenbridge Investment Advisers

52 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies for non-attendance were received from Mr. Geoffrey Wright, Member Representative, Local Pensions Board.

53 DECLARATIONS OF INTEREST

Cllr Russell Mellor, Cllr Simon Fawthrop, and Cllr David Jefferys each declared an interest as deferred Members of the Local Government Pension Scheme.

54 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 24TH JULY 2018 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The Minutes were agreed.

55 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

56 RE-ORDER OF AGENDA ITEMS

Following the previous item, and with no members of the public present at the meeting, Members agreed to move into Part 2 proceedings at this point to take item 10 *(London CIV – Governance Update and Due Diligence Review)* and Item 9 *(Confirmation of Exempt Minutes of the Meeting held on 24th July 2018)*. This enabled Members to consider item 10 ahead of item 6 *(London CIV Due Diligence - attendance by LCIV Representatives)*.

Members also agreed to take item 5 *(Chairman's Update)* under Part 2 proceedings to receive briefing on issues in preparation for item 6.

Following item 5, Members agreed to move back to Part 1 proceedings and take item 6 and then item 7 *(Pension Fund Performance Q1 2018/19)*.

57 CHAIRMAN'S UPDATE

This item was considered under Part 2 proceedings so that the Director of Finance, with the Chairman's agreement, could brief Members on issues in preparation for item 6.

58 LONDON CIV DUE DILIGENCE - ATTENDANCE BY LONDON CIV REPRESENTATIVES

London CIV representatives attending for the item comprised Mr. Mark Hyde-Harrison, Interim CEO, and Mr Kevin Cullen, Client Relations Director.

John Arthur also returned to the room for all Part 1 proceedings of the meeting.

Mr Hyde-Harrison began the presentation with a brief background on the history of LGPS Fund Investment pools, the primary purpose of which is to achieve cost savings for member funds. Pooling LGPS funds became mandatory in 2015/16. Some Pools are now established with others on the way to being so. The presentation slides were circulated to those at the meeting.

Formerly having 33 Funds of London Boroughs, the LCIV now had 32 Funds as the L B Richmond and L B Wandsworth pension funds merged on 1st October 2016. Fund investments managed by the LCIV ranged from almost 80% for L B Tower Hamlets to approximately 16% for the City of London authority, and currently nil for Bromley.

The LCIV currently has £16.5bn of assets under management. The LCIV has equity products and other funds and has launched a number of fixed income funds. There is also a wide range of passive funds. Pooling began as soon as the LCIV started. Set up costs are therefore relatively low and savings are exceeding projected costs resulting in savings for boroughs.

Through an extensive investment consultation over the previous quarter, the LCIV are obtaining an understanding of the current asset allocation of boroughs and what future allocations might look like. The consultations also covered a client engagement framework to ensure regular ongoing information updates from boroughs about their target asset allocations. Additionally the consultation covered working with a group of officers and Treasurers to define pooling methods. It is intended to use the asset allocation information to shape a product launch- programme which would then be used to work with boroughs to understand how best to meet individual borough pooling plans. All 32 boroughs had been contacted and meetings had taken place with 30 boroughs since 1st May 2018. A total of 22 boroughs had returned their current and target asset allocations in line with the new asset classes and strategies. Further boroughs are finalising this with consultants under the new definitions. The presentation also outlined information totalling asset allocation classes and strategies from those boroughs who had returned details along with information by strategy on assets currently pooled. The allocations would be subject to ongoing discussions.

Additionally, the presentation referred to a new bespoke reporting system to provide commentary on a borough's personalised investment mandate along with updates provided in LCIV newsletters. Borough LCIV Valuations are also updated daily on the LCIV client portal and Information sheets are updated quarterly. Meet the Manager Days had also taken place with LCIV Managers making presentations (16th May 2018 for Fixed Income and 16th August 2018 for Equity with the LCIV Infrastructure manger likely to be present at a presentation on 15th November 2018). An organisation chart of the London CIV was included in the presentation.

Details were provided of the new LCIV Governance Structure and Mr Cullen commented that the LCIV is regulated by the Financial Conduct Authority (FCA). In addition to the LCIV Board and Shareholder Committee, the LCIV also has an Executive Committee, Investment Oversight Committee, Compliance Audit and Risk Committee, and Remuneration Committee. The Leaders of L B Merton and L B Wandsworth are on the LCIV Board to ensure shareholder representation. The Shareholders Committee, comprising eight Councillors, four Treasurers, and the London CIV Chair (plus a Trade Union observer), meet quarterly with the Committee's first meeting scheduled for October 2018. Decisions are taken at General meetings of the LCIV Board and the Shareholders Committee provides a key consultation forum for the Board's AGM.

Oversight of the LCIV is provided by:

- Independent non-executive directors on the LCIV Board acting in the interest of all shareholders and holding the Board to account;
- The FCA who had approved persons, permissions for business, and prospectus;
- The Depositary providing an independent oversight of assets to protect investors' interests and providing confidence to them;
- Auditors auditing the LCIV (company) and ACS (pooling vehicle);
- The Ministry of Housing, Communities and Local Government (MHCLG) assessing progress against pooling criteria.

Both the LCIV (company) and ACS (pooling) had received clean audits.

Reference was also made to the current Fund offering and latest AUM for each fund along with its launch date. Details were also provided of planned launches for further fixed income funds and three other funds (LCIV Infrastructure Fund, LCIV Property Fund, and LCIV Global Equity Core Fund).

The LCIV had established a Responsible Investment Policy which would be taken to the Shareholder Committee to be ratified. The LCIV had also become a UN PRI signatory and a member of the Local Authority Pension Fund Forum (LAPFF). The LCIV is also a signatory of the UK Stewardship Code and all LCIV Managers are required to have Responsible Investment policies (published on the LCIV client portal). When Boroughs are more activist, the LCIV will have products available for ethical investments for boroughs that wish to include such portfolios plus fund divestment (the LCIV already had low carbon trackers into which some boroughs had invested).

Concerning finances, the LCIV budget is set by the Medium Term Financial Strategy (MTFS) which sets the organisation's cost base. The MTFS is for the Shareholders Committee to approve. Most costs are fixed and not variable to assets (i.e. excluding individual investment activities). They are already committed and currently comprise £5m although this figure might change following the pooling strategy.

Regulatory Capital is the largest asset for the LCIV balance sheet (required by the FCA to enable an orderly closure of the business). Unless action is taken to reduce the level of LCIV liabilities there will be insufficient Regulatory Capital - the staff LGPS Pension Fund in particular having a significant impact on the balance sheet. The amount of regulatory capital required is impacted by AUM, FCA permissions operated, the net pension liability, and the Profit and loss account. There is currently £12bn of AUM headroom.

Gross savings of £8m p.a. were being achieved through fee reductions and tax benefits. Investments in LCIV funds result in lower fees paid to managers. These savings are then shared across boroughs through a lower fee to the investing borough and further fee reductions to existing investors in the LCIV fund. As the 2.5bps (on average) LCIV Management Fee doesn't currently meet all LCIV costs, due to the slower pace of pooling than anticipated, the Development Funding Charge (DFC) has been introduced, which is shared amongst all shareholders. The DFC for 2017/18 was £75k, and the intention is that once all of London's LGPS assets are pooled, the Management Fee earnings will negate the need for the DFC.

The management fee charge has varied by fund as it is perceived there is a need to ensure the LCIV fund is less expensive than the existing borough fund. As such there are lower charges for Passive and Fixed Income (the LCIV Fund management charge bearing no direct relation to costs).

In discussion, the Chairman outlined the reason for inviting the LCIV and referred to the Sub-Committee's request (at its previous meeting) for due diligence to be undertaken before deciding whether to transfer L B Bromley's Baillie Gifford Global Equities to the equivalent Baillie Gifford fund held by the LCIV. As such, L B Bromley's Investment Advisers, MJ Hudson Allenbridge, had submitted a proposal upon request to carry out the due diligence work.

The Chairman asked about the LCIV's approach to Environmental, Social and Governance (ESG) matters, having not seen ESG referenced in the presentation.

Concerning the Willis Towers Watson review of LCIV Governance, a Member asked whether the FCA had been made aware of the review outcomes; whether any comments had been received back from the FCA; and had the review been discussed with the FCA. The Member noted a current vacancy for the role of Compliance Manager at the LCIV. He also enquired of the LCIV's end goal and whether it aimed to be an asset manager or a vehicle for launching funds.

Mr Hyde-Harrison indicated that the review had not been shared with the FCA although it had been shared with the LCIV Depositaries providing the prime oversight. The LCIV's objective is to pool assets of boroughs and deliver cost savings/efficiencies for funds, discharging what boroughs want on assets (and their allocation) and how the LCIV can help in this regard. To this end, the LCIV have launched funds for boroughs to invest their assets. There is no LCIV wish to dilute savings and increase costs for boroughs; it provided vehicles for pooling and will continue to pool assets for the next three to five years. Upon launch of the LCIV's Investment Phase (Phase 3), different pooling vehicles will be included with a view to maximise fee savings and reduce costs for best efficiencies. Mr Hyde-Harrison also outlined the expected approach to infrastructure.

On matters such as operating procedures and LCIV staff job descriptions, core skills, calibre, competencies, and salaries, Mr Hyde-Harrison agreed that relevant documents would be provided to MJ Hudson Allenbridge when visiting LCIV offices (with personal data redacted), and that they would support the due diligence work.

The LCIV made a profit last year of around £160k, details of which are on the LCIV client portal. The profit is not passed back to shareholders but instead goes to the LCIV's reserves. A Member suggested that as L B Bromley had already contributed some £150k to the LCIV it had already invested in the LCIV. However, this is not shown as it is in the LCIV management accounts rather than the ACS. A loss of some £800k the previous year went from the LCIV reserves.

The Member also felt that LCIV staff costs are expensive and enquired on action to contain the costs. He asked whether all LCIV staff are in the LGPS. Mr Hyde-Harrison referred to a range of salaries and the LCIV was unable to close the LGPS to staff as the winding up debt would result in the closure of the organisation. It was necessary to ensure the LGPS has less input on LCIV regulatory capital. Should the last active LGPS member leave the scheme, protection is necessary (for the City of London fund) against liabilities for the scheme members (LCIV being an admitted employer to the City of London LGPS fund). All boroughs needed to contribute (through a pension guarantee agreement) to protect the LCIV and its responsibilities for liabilities to the City of London.

The Director suggested the LCIV would not necessarily have an immediate termination payment to make if the scheme was closed, but a repayment arrangement could be agreed. This would be less than the costs if the scheme was kept open (boroughs were also being asked to sign a pension recharge agreement to reduce the impact of any cessation of the scheme on LCIV regulatory capital). The bill to boroughs would be much more longer term (through contributing to the LCIV/City of London liabilities) and it is necessary for L B Bromley to know in full why the LGPS is needed at the LCIV.

Mr Hyde-Harrison referred to some boroughs taking a different view and it is necessary for the LCIV to consider its staff and their remuneration. Moreover, the LCIV Board did not want to take decisions which jeopardise the company's regulatory capital. If a cessation event occurred, arrangements are needed to smooth over (the liabilities issue) with all boroughs and to ensure the regulatory capital is not impacted. Should a cessation debt be in the order of £2m to £3m, the LCIV does not have the level of capital to pay such a liability and continue to manage the existing level of assets under management. A Member suggested that this reflected on LCIV governance and understood that LCIV Client Directors are also in the LGPS. He suggested the scheme can be stopped for new entrants and the whole position seemed akin to a monopoly situation; accountability is needed as is co-operation in bringing people together rather than by coercion. The Chairman added that he had raised the pension scheme at the Pensions CIV Sectoral Joint Committee (PCSJC) last November, recalling a suggestion that as a closed scheme, action could not be taken. He indicated disappointment that his concerns raised last November had not been taken up. The matter of LCIV Pension arrangements would be taken up further outside of the meeting.

The Vice-Chairman was unimpressed by the LCIV savings ratio and felt that a proposed infrastructure product aiming for a 4% return was inadequate for L B Bromley where the performance of some of its funds touched 8%. The LCIV organisation being set up is large and L B Bromley already has a good investment structure (direct with Fund Managers). He asked how the LCIV could improve on L B Bromley's funding level at almost 100%.

Mr Hyde-Harrison explained that he wanted to run the LCIV business without asking for more capital. With 27 staff the LCIV currently remained the lowest staffed pool. He conceded that savings at £8m across 32 funds was not particularly impressive and the LCIV was working to meet Government aims. A portfolio with 100% equities would achieve a higher return but some boroughs wanted different allocations/products in their portfolios. The LCIV tried to cater for a range of different views. When the Government required pools to be established there was a wide range of performance and the aim is to improve the performance of poorer funds being pooled. The Government initiated pooling to improve the average return across the whole. He added that the LCIV can offer fee savings but was unable to confirm that the LCIV can achieve more than that (for L B Bromley).

Mr Hyde-Harrison confirmed that all boroughs continue to hold their asset allocation strategy intact and the LCIV has no permission to move borough monies between funds. Additionally, it is not authorised by the FCA to direct funds. The Chairman could envisage a pressure in future to consolidate the number of funds downwards. But for the moment, boroughs have complete authority for their allocations.

Mr Hyde-Harrison also indicated that the LCIV aimed for the Development Fund Charge (DFC) to cease about 2023. Should substantial further levels of pooling not occur, this date would be difficult to achieve.

Including the LCIV Chief Executive position (Mark Hyde-Harrison being interim Chief Executive), a Member noted eight current vacancies within the LCIV staff structure and asked whether the positions are on hold. Mr Hyde-Harrison confirmed that the LCIV wanted to recruit for the positions and were actively doing so. On the Chief Executive and Chief Investment Officer vacancies Mr Hyde-Harrison understood that authority had been provided that afternoon to recruit for the two positions. It had been more difficult to recruit for some positions and the salary and LGPS benefit was not attractive for all. Appointments to the vacancies will cause costs to rise but as the pool increases savings will also rise.

On composition of the LCIV Shareholders Committee, Mr Hyde-Harrison explained that London Councils organised this through nominations. It was suggested the composition comprise representatives from top performing funds so the Committee is not political. However, the nominations were accepted at the LCIV Board’s AGM with the aim of looking to represent views across London. Highlighting London Councils involvement with the process, the Chairman didn’t disagree with the Committee’s political representation, but as a governance issue felt that London Councils needed to see the LCIV as a separate organisation and he would pursue the matter. He also highlighted that a Councillor and Treasurer from the same borough can be represented on the Committee and suggested this might present a potential conflict of interest. In this scenario a Treasurer might be better appointed to another LCIV Committee. Another Member indicated that the Willis Towers Watson report made reference to having a Committee free from political interference and he again emphasised a need to represent best performing boroughs on the Committee. Mr Hyde-Harrison indicated that the current form of representation did not always have to remain the same should shareholders think differently. The Chairman suggested the matter be left to the Shareholders Committee to consider.

With the LCIV a company, Mr Hyde-Harrison confirmed that its meetings are not open to the public although it is subject to Freedom of Information (FOI) requirements. For transparency, it was suggested the meetings are open and Mr Hyde-Harrison explained that shareholders can express views on the matter. The Chairman felt that the Shareholders Committee should (at least) be open for other Councillors to observe.

Returning to the LCIV's liabilities for its LGPS scheme, it was understood that a deficit in the order of £3.3m to £6.5m could be charged to boroughs under the LCIV's proposals (should this become necessary). As boroughs would effectively underwrite such a level of deficit, the Director again suggested the LCIV provide a detailed analysis (for boroughs) of the LCIV's case for keeping an "open" LGPS scheme, given the increasing liabilities from the scheme and other costs e.g. pension strain costs. This would be helpful along with the LCIV sharing its actuarial advice for the scheme. The deficit risk is a significant sum and the full business case is needed for transparency. On receipt of full information and costs, details can be provided to L B Bromley's Full Council so that a decision can be taken by Members on whether to sign the agreements. Mr Hyde-Harrison confirmed that the LCIV wanted to be engaged and he would try to provide the information.

In signing the Pensions Recharge agreement to protect the LCIV's regulatory capital, the Director highlighted that boroughs would not want to forego significant financial savings in order to avoid increasing regulatory capital. The Director felt that it is essential that LCIV provide comprehensive information about the reasons for the LGPS scheme and this is key before L B Bromley considers the recharge issue and it is necessary to have the facts about the financial impact of closing the LGPS scheme and any cessation arrangements.

The Director also enquired of any plans to obtain permissions to transfer between funds (e.g. in the event of a fund being overweight in a particular asset) and whether it will be possible to transfer between funds. Mr Hyde-Harrison indicated that the LCIV is planning to extend its permissions as it is now on a firmer footing and it is necessary for the permissions to align with its business model. If permissions allowed the LCIV to do more an IMA agreement would be necessary with each borough. This would be a separate cost to any boroughs above the 2.5bps management fee which should cover existing planned costs.

For Phase 3 (Investment), LCIV activity included looking at how borough investment strategies vary. Potential products will be shared with boroughs and the LCIV already has 140 possible funds. Boroughs can choose from the range. With the current phase about pooling resources, the Director sought confirmation that Phase 3 is not about managing investments. Mr Hyde-Harrison explained that if the LCIV had an IMA with boroughs it is possible to do this. With boroughs providing an IMA, the LCIV can help a borough (in managing its investments) but without running their strategic allocation. Permissions would allow the LCIV to *inter-alia* advise on investments and the LCIV would have an IMA (to do so in such circumstances). The LCIV can only operate a pooled vehicle (under current permissions). Should the LCIV apply for and receive the additional permissions, Mr Hyde-Harrison indicated that it would then be able to do what Pension Funds undertake. These would increase LCIV costs but other factors would also increase costs e.g. having more funds. Although Mr Hyde-Harrison was unable to confirm LCIV costs in a further three years, the LCIV aimed to not ask for more capital; to reduce the Development Fund Charge (DFC); and to reduce costs. He envisaged total costs in the region of £6m to £7m, much of which would be driven by investment and governance. Mr Hyde-Harrison also confirmed the LCIV's Depositary as Northern Trust and it would be necessary to check whether a copy of the Depositary's report can be provided.

Mr Hyde-Harrison referred to a diverse range of needs amongst boroughs in the LCIV. Nationally, the LCIV is ahead of a number of other pools and 40% of assets from boroughs have already been pooled. However, the Minister for Local Government wanted the LCIV (and other pools) to develop faster. Mr Hyde-Harrison was not party to the Government's policy decision on pooling but agreed with the Chairman that pooling is harder and more complicated than anticipated. The Government appeared committed to the principle of pooling and the LCIV existed to help boroughs and to achieve savings.

In drawing the item to a close, the Chairman expressed his appreciation for the time of Mr Hyde-Harrison and Mr Cullen in attending the meeting. He thanked both for coming and for their openness in answers. Both Mr Hyde-Harrison and Mr Cullen then left the room.

Subsequently, Members briefly assessed comments made by the representatives. The Chairman felt that a robust report is needed to Full Council on the LCIV staff pension scheme and the request for agreements on liabilities. The Resources Portfolio Holder, Cllr Graham Arthur, also briefly addressed the meeting. Cllr Arthur referred to the Bromley fund's history of good performance and was concerned about political involvement in LGPS developments over recent years. This included involvement by London Councils and ideally L B Bromley needed to be left alone to manage its Fund.

A meeting had been planned for the end of October between the Chairman, Vice-Chairman, Portfolio Holder, Director, and John Arthur to consider the due diligence report from MJ Hudson Allenbridge. The Chairman hoped it would then be available for the Sub-Committee's meeting on 7th November to inform any further consideration on transferring the Fund's Bailie Gifford Global Equities to the equivalent Baillie Gifford portfolio at the LCIV. A Member suggested that it might be necessary to say to the LCIV that L B Bromley will only transfer upon confirmation that the report's recommendations have been implemented.

59 PENSION FUND PERFORMANCE Q1 2018/19

Report FSD18069

Details were provided of the Fund's investment performance for the first quarter of 2018/19. Additional detail was provided in an appended report from the Fund's external advisers, MJ Hudson Allenbridge.

The market value of the Fund ended the June quarter at £1,017.9m (£970.7m at 31st March) and had further increased to £1,044.3m as at 31st July 2018. The quarter total fund return of +4.95% against a +4.43% benchmark, compared to a +4.9% average across the 61 LGPS funds in PIRC's universe.

Detail on performance by individual fund managers was appended to Report FSD18069.

The Fund's medium and long-term returns remained very strong overall - the Fund ranking third in the PIRC LGPS universe for the year to 31st March 2018, first over three years, second over five years, first over ten years and second over 20 and 30 years.

Information on general financial and membership trends of the Pension Fund was also outlined along with summarised information on early retirements. Final outturn details for the 2017/18 Pension Fund Revenue Account, the first quarter position for 2018/19, and fund membership numbers were also appended to the report.

Where the assets of an employer exiting a Fund are greater than its pension liabilities as published in a revised rates and adjustments certificate (Exit Credits), Report FSD18069 advised that recent changes to the LGPS 2013 Regulations required a Fund to pay any excess in credit to an exiting employer within three months of cessation of the admission agreement. Further information would be included in the LGPS 2018 (Amendment) Regulations to be considered by the General Purposes and Licensing Committee at its meeting on 26th September 2018.

The report also outlined future Fund Manager attendance as:

- Schroders (multi-asset income) on 7th November 2018 and
- Baillie Gifford (global equities and fixed income) on 5th March 2019.

The Chairman was pleased with the performance reported. Noting that the General Purposes and Licensing (GP&L) Committee will consider further information on Exit Credits to be included in the LGPS 2018 (Amendment) Regulations, the Chairman highlighted a preference to see the Sub-Committee a Committee in its own right rather than as a Sub-Committee of the GP&L Committee. Another Member, also pleased with the report, thanked MJ Hudson Allenbridge for the Quarterly Review appended to Report FSD18069.

A Member expressed concern at the continued underperformance of MFS. Mr Arthur indicated that MFS looked for certainty and hope in their approach whereas Baillie Gifford looked for more growth. Mr Arthur felt the two managers work well together in the Fund's portfolio - the MFS investment philosophy and process suggested their approach is unlikely to change.

A Member asked whether MFS are best placed to respond in the event of a downturn and whether there is an argument to reduce the MFS holding rather than Blackrock's holding should the latter perform better over a year. Mr Arthur explained that most of the MFS portfolio is now cheaper with its holdings in Facebook and Tesla expected to fall further. There are concerns about the scale of MFS underperformance and the market is not rewarding their processes. However, markets go through cycles and investors are now in a behavioural market. The market will rotate at some stage. Mr Arthur was not overly concerned with MFS but their underperformance is now noticeable. As such, he will have another meeting with MFS Managers. An important question is whether their way of performance is now outdated.

RESOLVED that the contents of the report be noted.

60 LOCAL GOVERNMENT ACT 1972 AS AMENDED BY THE LOCAL GOVERNMENT (ACCESS TO INFORMATION) (VARIATION) ORDER 2006 AND FREEDOM OF INFORMATION ACT 2000

RESOLVED that the Press and public be excluded during consideration of the items of business referred to below as it is likely in view of the nature of the business to be transacted or the nature of the proceedings that if members of the Press and public were present there would be disclosure to them of exempt information.

The following summaries refer to matters involving exempt information

61 CONFIRMATION OF EXEMPT MINUTES OF THE MEETING HELD ON 24TH JULY 2018

The exempt minutes were agreed.

62 LONDON CIV - GOVERNANCE UPDATE AND DUE DILIGENCE REVIEW

Report FSD18070

Members agreed that the Council's contract with MJ Hudson Allenbridge should be varied so the company can undertake due diligence of the London CIV and its governance arrangements on behalf of the Sub-Committee.

Members also noted that the Pensions CIV Sectoral Joint Committee had been formally dissolved and that Cllr Keith Onslow had been appointed to the new London CIV Shareholder Committee.

John Arthur left the room for the first part of discussion on this item and subsequently returned to provide clarification on some questions from Members before then leaving the room again in order for Members to conclude their discussion.

The Meeting ended at 10.08 pm

Chairman