

PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.00 pm on 5 March 2019

Present

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

Also Present

John Arthur, M J Hudson Allenbridge Investment Advisers
Joanne Job, M J Hudson Allenbridge Investment Advisers

78 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies for non-attendance were received from Cllr Gary Stevens.
Apologies were also received from Cllr David Jefferys for late arrival.

79 DECLARATIONS OF INTEREST

Cllr Russell Mellor and Cllr Simon Fawthrop each declared an interest as
deferred members of the Local Government Pension Scheme.

80 MINUTES OF THE MEETINGS HELD ON 7TH NOVEMBER 2018 AND 14TH JANUARY 2019 (SPECIAL MEETING)

The minutes for both meetings were agreed subject to the final sentence of
Minute 67 (7th November 2018 meeting) being amended to read:

*“Mr Arthur indicated that he would not naturally put forward a passive
investment in Fixed Interest.”*

81 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

82 CHAIRMAN'S UPDATE

The Chairman had no update on matters under Part 1 of the agenda.

83 PENSION FUND PERFORMANCE Q3 2018/19

Report FSD19034

Details were provided of the Fund's investment performance for the third quarter 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 December quarter at £963.7m (£1,045.5m at 30th September). Market conditions led to a significant negative performance for the Fund in Quarter 3 (echoed around the country) with year to date return at 7.94% against a 5.94% benchmark. Details of fund manager performance against benchmarks for the quarter, year to date, 1, 3 and 5 years, and since inception were appended to Report FSD19034. Medium and long-term returns remain particularly strong with the Fund ranking third against the 61 funds 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).

To implement the revised asset allocation strategy agreed on 5th April 2017 all Diversified Growth Funds and Global Equity assets held by Blackrock would be sold. At 31st January 2019, the Blackrock Global Equity Fund balance amounted to £10,953,304 and in line with the Sub-Committee's resolution on 14 December 2017 (*"the balance of the Blackrock sale, less £3m required to meet the cash-flow shortfall that had occurred during 2017/18, be invested in the Fixed Income Portfolio"*), Members were asked to confirm that the balance of the Blackrock fund be invested in the Baillie Gifford Fixed Income portfolio.

Recommendation 2.1(b) of Report FSD19034 sought agreement to invest the balance of the Blackrock Global Equity Fund in Baillie Gifford's Fixed Income Portfolio. However, it was suggested instead that the balance (£10,953,304) be transferred to the investment type suggested by Mr Arthur, providing a test case for the investment. Options could be looked at to invest the sum and Mr Arthur would meet Fidelity on 7th March. The Chairman suggested keeping the sum in Blackrock equities to retain options and for a final decision on the balance to be delegated to himself and Director in consultation with Mr Arthur. Options for alternative fixed interest investments can come back to the Sub-Committee from Mr Arthur's discussions with Fidelity. As such, Members agreed not to press ahead in selling the Blackrock global equities balance but to await the outcome of the review by MJ Hudson Allenbridge into alternative fixed interest options (for the Sub-Committee's May meeting). Should something urgent come forward in the meantime it was agreed to delegate any decisions to the Chairman, Vice-Chairman, and Director (in consultation with Mr Arthur).

Following WM Company (State Street) ceasing (from 2016) to provide performance measurement services to clients for whom they are not custodian, the Council's main custodian, BNY Mellon, has provided performance measurement information with Pensions & Investment Research Consultants Ltd (PIRC) providing LA universe comparator data. The performance

measurement contract with BNY Mellon expires in June 2019 and with no company offering performance measurement, or performance measurement and accounting without custody, approval was sought to agree an award of contract to BNY Mellon for a further three years at an estimated value of £30k per annum via an exemption to competitive tendering and subject to annual review.

Information on general financial and membership trends of the Pension Fund was also appended to Report FSD19034 including final outturn details for the 2017/18 Pension Fund Revenue Account, the third quarter position 2018/19, and fund membership numbers. A cash surplus for the Fund of around £3m is expected for the year. Following the merger of Bromley College and Greenwich Community College in 2016 and transfer of assets/liabilities to the Local Pensions Partnership, a final balancing transfer payment of £529k was made on 7th December 2018.

Summarised information on early retirements was also appended to Report FSD19034 and additionally approval was sought on Fund Manager attendance at future Sub-Committee meetings.

In discussion, Mr Arthur commented on investment performance for the Fund last quarter and outlined reasons for market volatility in the quarter which saw a major fall in markets. The Fund under-performed by more than 2% against the benchmark in the quarter, with Government Bonds the only positive area. The U.S. Federal Reserve raised interest rates with economic news of the slowdown. Equity markets bottomed out around 28th December, following more cautious messages from the Fed. Risk assets have shown some recovery. Although Mr Arthur expected further volatility going forward, and for it to be potentially more severe, it remained necessary to take investment risk even though returns will be low. Mr Arthur suggested diversified assets to counter volatility.

Mr Arthur highlighted three issues to account for the Fund's underperformance last quarter. As covered in the MJ Hudson Allenbridge quarterly report these comprised:

- the Fund entering the quarter overweight in equities against its Strategic Benchmark with a 65% exposure against the benchmark at 60% and correspondingly underweight in Bonds, Multi Asset Income, and Property;
- the multi asset income portfolios having an absolute benchmark related to short term interest rates generating a positive return for each quarter even if markets fall; and
- Baillie Gifford, managing most of the Fund's global equities, underperforming in the quarter.

Asset allocation changes over the last nine months, including a 60% strategic benchmark for equities, had mitigated the effect. The former allocation to equities was reduced by firstly funding the departure of Bromley College purely with equities and then by allocating 20% of the Fund to Multi Asset

income and 5% to UK property, both of which performed better than equities in the final quarter of the year and since inception last year. As the moves are reflected in the Strategic Benchmark, their benefit is not captured in the Fund's relative performance against its benchmark. However, they have had a beneficial impact on the total value of the Fund and therefore the funding level when the next actuarial revaluation starts in March. The Chairman felt the approach is on the right track and the changes had mitigated the downturn. Parameters were also thought necessary which can be reviewed every two years or so on the basis that should the number of asset classes increase there is a deviation from the fixed strategic benchmark. However, it is best to see how the latest asset allocation changes proceed rather than have more formal changes. Suggesting the Fund would not want to be too overweight in equities, a Member questioned how much risk it is necessary to take and where funds should be placed, if not in equities. Mr Arthur indicated that while we do not want to be too overweight in equities, the fund has been balanced by the reductions. Mr Arthur suggested MAI and bonds and to transfer low and high risk into medium risk. The Director suggested a red flag in monitoring reports to highlight any investment class moving to an underweight or overweight position. A Member welcomed this for the Sub-Committee's next meeting and would like to see any risk parameters that might be proposed. With more volatility, the Chairman thought it necessary to look at this area more regularly. An actuarial review will commence in March and the Asset Allocation Strategy could be reviewed once the outcome is known.

A Member urged caution about any future sale of the Fund's investments in equities. Long term equities are reliable and their benefit would be lost if underweight in the class. The position can be reviewed and monitored. Corporate Bonds and gold were suggested. Gold would not yield a dividend, but could be used as an asset. There should be no rush to sell (equities) and invest in Fixed Income – the outcome of the Actuarial Valuation should be awaited. Supporting this view, the Chairman highlighted that transitional costs would also be incurred with any change and he assured Members that no change would take place until after a review of the asset allocation strategy.

Predicting a volatile couple of years ahead, another Member referred to being at the end of a long economic cycle, reinforcing a need for active management. With a period of uncertainty it is necessary to be smarter. Currency could also unravel and reduce the Fund's value and it might be necessary to have more diversification. The Chairman indicated that he would be more worried if the Fund had not achieved the level of growth it had. The Chairman supported looking wider and encouraged MJ Hudson Allenbridge to provide any further thoughts.

On Fidelity's Fixed Income, Mr Arthur would discuss how to improve the low yield. Should interest rates rise, bonds are likely to fall in performance and Mr Arthur suggested corporate credit assets (multi-asset credit) as an example of a better way to generate returns. Mr Arthur will talk to Fidelity and bring further detail/proposals to the Sub-Committee's May meeting.

Mr Arthur brought forward a proposal from Schroders. Mr Arthur advised that the Schroders Multi-Asset Income (MAI) Portfolio is currently U.S. Dollar funded and it is then hedged back to Sterling (Sterling – Dollar – Sterling). When sterling and dollar interest rates are similar this did not matter. But now it is not cost efficient, Schroders had offered a new sterling based fund which would be more efficient and provide a marginally better return. It would take a couple of months to establish and Mr Arthur felt it would be sensible for the Fund to take advantage of the offer. The Bromley Fund would be the only holder of the units (probably making selling more complex). The Chairman favoured the product and Members supported the proposal. Another Member highlighted a real estate opportunity related to the lease of an Npower site in Solihull which expired in December 2018. The site comprises 75,000 sq.ft and Mr Arthur would investigate.

RESOLVED that:

- (1) the contents of Report FSD19034 be noted;**
- (2) sale of the Blackrock Global Equity Fund be deferred whilst awaiting the outcome of a review, by the Sub-Committee's financial adviser, of alternative income products;**
- (3) the further award of the Pension performance measurement contract via an exemption to competitive tendering (as set out at paragraph 3.3.3 of Report FSD19034) be agreed;**
- (4) the programme of Fund Manager attendance (paragraph 3.7.1 of Report FSD19034) be agreed as follows -**
 - 15th May 2019 – MFS (global equities) - rescheduled**
 - 24th July 2019 – Fidelity (fixed income, multi-asset income and property)**
 - 27th August 2019 – Schroders (multi-asset income)**
 - 3rd December 2019 – Baillie Gifford (global equities and fixed income)**
- (5) the proposal to switch the current Schroders dollar fund to a sterling fund, brought forward by the Sub-Committee's financial adviser for the Schroders Multi-Asset Income Fund, be agreed.**

84 PENSION FUND - INVESTMENT REPORT

Baillie Gifford presented their investment report covering management of the company's Global Equities and Fixed Income portfolios for the Fund. At 31st December 2018 the total value of both portfolios stood at £426,457,260 which had since risen to some £460m by 28th February 2019.

Baillie Gifford's Global Equity portfolio under-performed against benchmark in the past 12 months (a volatile period) but over three years, five years, and since inception it has outperformed the benchmark. Stock is selected for the long-term with Baillie Gifford looking at the fundamentals of companies when selecting. A period of volatility provides a particular opportunity for this

approach long term and stocks in Naspers, Prudential and Ryanair were provided as examples. Baillie Gifford often look at companies where conviction is high but their share price has dropped.

To 31st December 2018, Fixed Income under-performed against benchmark over periods of five and three years and 12 months (the latter showing the greatest difference against benchmark). Against falling Fixed Income yields solid returns had been provided but recent periods were more challenging. Relative returns have also been impacted by emerging market holdings. However, over the long term there has been a positive selection in corporate bonds. Currently, the Fixed Income is allocated neutrally (50%/50%) between Gilts (government bonds) and corporate bonds.

Although Baillie Gifford's portfolio performance was volatile there is evidence the market is recovering and its value rose in early 2019. The long term benefit (of Baillie Gifford's approach) had proved successful for the Fund. The Chairman considered Baillie Gifford a good example of active management and the Director of Finance indicated that £95m has been returned for the Fund through (Baillie Gifford's) active management.

On active managers being able to perform well during future volatility and recession, stock market returns are driven by big winners with rapid growth. Baillie Gifford also invests in stable companies such as Prudential. On global factors e.g. China (US/China trade war, slowing economy, reduced GDP etc), Japan adopting a "Japan First" approach, and considerations related to India, Baillie Gifford looked at fundamentals. China is urbanising, the number of patents has doubled, and there is growth in Artificial Intelligence (AI). China's economy (2nd largest market), remains structurally strong and it was thought they will become the largest economy at a future point; Baillie Gifford will look at China more in 2019 and plan to open a Shanghai office.

Concerning reliance on algorithms (with no real understanding of sentiment), Baillie Gifford saw an important human judgement aspect to what they are doing. It is also necessary to consider governance matters. Baillie Gifford management teams use intuition. However, Baillie Gifford is not complacent and use AI for assistance. On concerns about cyber hacking (e.g. of foreign governments and possibly world markets), this is tracked for companies in which they invest. Concerning any Chinese state interference in the stock of Chinese companies, Baillie Gifford understood the risk but there can be market opportunities if a Chinese company is supported by their state.

On the Fixed Income under-performance, Baillie Gifford had difficulties concerning overseas emerging market government bonds. It was particularly recent performance where Baillie Gifford had struggled and steps had been taken to remedy the position (an individual with macro experience had been recruited as well as someone for active decisions). Baillie Gifford suggested it will take about two to three years to see a change in performance.

When asked about future investment for the L B Bromley Fund, Baillie Gifford considered that equities provide the best returns (long-term), ten-years

providing a best indicator of yield. Over shorter time, there are benefits in diversification if interest rates stay low. Baillie Gifford has a range of Fixed Income Bonds; reference was made to looking at Corporate Bonds that outperform the market.

Mr Arthur understood the Baillie Gifford's Fixed Income Fund underperformance, but this provides an appropriate balance. Baillie Gifford had other ways to help with Fixed Income and the Chairman encouraged Baillie Gifford to come back with their thoughts. The Chairman referred to the sound relationship Bromley's Fund has with Baillie Gifford and he offered his thanks and appreciation to Baillie Gifford for what they are doing for the Fund. Baillie Gifford also highlighted their Investment and Training seminar for LGPS funds from 9th to 10th October 2019 in Edinburgh.

85 LBB RESPONSE TO DRAFT LGPS STATUTORY GUIDANCE ON ASSET POOLING CONSULTATION

Report FSD19032

Concerning the Government's consultation document "*Local Government Pension Scheme – Statutory Guidance on Asset Pooling*", appended to Report FSD19032, a proposed Council response was also appended to the report.

The guidance will replace the section at pages 7 to 8 of Part 2 of the *Guidance for Preparing and Maintaining an Investment Strategy*, issued in September 2016 and revised in July 2017, which deals with regulation 7(2)(d) of the 2016 Regulations. It will also replace the *Local Government Pension Scheme: Investment Reform Criteria and Guidance*, issued in November 2015.

Overall, the guidance is statutory but will require different levels of adherence. It uses 'should' or 'may' or 'are expected' and the statutory nature of some of the guidance is indicated by sections where pool members or pool companies 'are required' or 'must' comply. The draft guidance includes some aspects which reflect legislation or regulation and compliance with these is mandatory. Other aspects of the statutory guidance must be complied with, unless there are compelling reasons not to do so, which must be considered against the overall government framework for the LGPF. Some elements will be general guidance which must be considered and should be complied with unless there is good reason not to do so.

The Chairman encouraged Members to provide their comments on the draft response and to respond soon by email to himself and the Director. The Chairman, Vice-Chairman and Director would then meet to consider the responses before submitting the Council's formal response.

A Member commended the Director for the draft response as presented.

RESOLVED that:

- (1) the response to the consultation document “Local Government Pension Scheme – Statutory Guidance on Asset Pooling” at Appendix 1 to Report FSD19032 be noted;**
- (2) the consultation document “Local Government Pension Scheme – Statutory Guidance on Asset Pooling” at Appendix 2 to Report FSD19032 be noted;**
- (3) Sub-Committee Members email their comments on the draft response to the Chairman and Director of Finance;**
- (4) the Director of Finance, in consultation with the Chairman and Vice-Chairman, submits the formal consultation response which will incorporate views expressed by the Sub-Committee; and**
- (5) the final consultation response is to be emailed separately to all Members of the Pensions Investment Sub-Committee and to Mr John Arthur, MJ Hudson Allenbridge, as investment advisor for the Fund.**

86 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**

87 EXEMPT MINUTES OF THE MEETINGS HELD ON 7TH NOVEMBER 2018 AND 14TH JANUARY 2019 (SPECIAL MEETING)

The exempt minutes of both meetings were agreed.

88 CHAIRMAN'S UPDATE ON EXEMPT MATTERS

The Chairman reported back on the LCIV Shareholder meeting, 31st January 2019. Members also commented on a number of issues under Part 2 proceedings.

89 OPERATIONAL DUE DILIGENCE REVIEW OF LONDON CIV

Report FSD19031

Having previously considered a report on the due diligence investment review of the London CIV related to their *Global Alpha Growth Fund*, Members considered the report of an operational due diligence review on the London CIV. Both reviews were undertaken by the Council's independent investment adviser.

(Democratic Services Note: as the time was approaching 10pm, a vote was taken at the Chairman's initiative on whether to adjourn or continue the meeting. Upon a vote, a majority of Members voted to continue the meeting and conclude the Sub-Committee's business on the agenda).

RESOLVED that the commissioned MJ Hudson Operational Due Diligence Review of the LCIV be noted.

90 DUE DILIGENCE REPORT FROM LONDON CIV'S DEPOSITORY (NORTHERN TRUST)

As depository for the LCIV, Northern Trust provides an independent oversight of assets to protect investors' interests and provide confidence to them. At the Sub-Committee's meeting on 13th September 2018, the LCIV's Interim CEO, Mark Hyde-Harrison, indicated that it would be necessary to check whether a copy of the Depository's report can be provided to Sub-Committee Members. Upon L B Bromley following up the matter, the LCIV's Chief Operating Officer confirmed that the LCIV would be able to provide copies of the Northern Trust's current annual Depository Review of the LCIV under private (exempt) proceedings of the meeting.

The LCIV Chief Operating Officer, Mr Brian Lee, attended for the item and copies of the Depository Review were circulated to Sub-Committee Members at the start of the item. As previously agreed with the LCIV, and as a condition for Northern Trust agreeing to provide the report, the copies circulated for Member reference were collected upon conclusion of the item for custody by Mr Lee. Mr Lee also attended to answer questions as Compliance Officer of the LCIV.

91 LCIV - CHANGE OF BUSINESS DESCRIPTION LETTER

Report FSD19033

Members agreed that there appeared no reason for this report to have been published under exempt (Part 2) proceedings and accordingly it was agreed to consider the matter under Part 1 (public) proceedings of the meeting.

At their meeting on 31st January 2019, the LCIV General Meeting passed a resolution to amend the clause within the LCIV shareholder agreement to vary the LCIV's 'business purpose definition'. This was to reflect the evolution of the pooling concept. The LCIV summarised the proposal as follows:

The change in the legal definition of business purpose in clause 2 is “simple but important”. It achieves consistency with current expectations of pooling. London CIV will now be defined as “the FCA authorised company” rather than the “FCA authorised operator of an ACS”.

The current wording of Clause 2, of the shareholder agreement is “The business of the Company shall (unless and until otherwise determined in accordance with this Agreement) be confined to acting as the FCA authorised operator of an ACS to provide a collaborative platform through which the Administering Authorities of the LGPS funds can aggregate their pension monies and other investments. The Company will be branded as “London CIV”.

The proposed wording of Clause 2, of the shareholder agreement is “The business of the Company shall (unless and until otherwise determined in accordance with this Agreement) be confined to acting as the FCA authorised company to provide a collaborative platform through which the Administering Authorities of the LGPS funds can aggregate their pension monies and other investments. The Company will be branded as “London CIV”.

The report to the LCIV General Meeting provided context and was appended to Report FSD19033. It was also requested at the General Meeting that all LCIV shareholders sign a letter (copy appended to Report FSD19033) confirming approval to amend the Shareholder Agreement in the way described in the letter and report to the LCIV General Meeting. The LCIV articles and Shareholder Agreement regulate operation of the LCIV.

Although the agreement is not prescriptive on who should sign a document on behalf of shareholders it is common practice for the shareholder representative to have authority to sign such agreements. The shareholder representative can also seek the Sub-Committee’s view prior to any final authorisation. The Chairman confirmed that he would sign the document (Appendix 1 to Report FSD19033).

RESOLVED that:

- (1) the LCIV letter of 31st January 2019 requiring signature (Appendix 1 to Report FSD19033) be noted;**
- (2) the report to the LCIV General Meeting on 31st January 2019 (Appendix 2 to Report FSD19033) be noted; and**
- (3) the Council’s LCIV shareholder representative be authorised to sign the LCIV letter.**

On concluding the meeting, the Chairman thanked Members and officers for their involvement on the Sub-Committee during the previous year. The Chairman also thanked MJ Hudson Allenbridge and a Member offered his thanks to the Chairman.

The Meeting ended at 10.43 pm

Chairman