PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.00 pm on 27 August 2019

Present

Councillor Keith Onslow (Chairman)
Councillor Gareth Allatt (Vice-Chairman)
Councillors Simon Fawthrop, Kira Gabbert, Simon Jeal, Christopher Marlow and Gary Stevens

Also Present

John Arthur, MJ Hudson Allenbridge Investment Advisers

26 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from Cllr David Jefferys and Cllr Kira Gabbert attended as alternate.

27 DECLARATIONS OF INTEREST

There were no declarations.

28 MINUTES OF THE PENSIONS INVESTMENT SUB-COMMITTEE MEETING HELD ON 24TH JULY 2019

The Part 1 minutes were agreed.

29 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

Three questions were received for written reply. Details of the questions and replies are at **Appendix A**.

30 UPDATES FROM THE CHAIRMAN AND/OR DIRECTOR OF FINANCE

There were no updates from the Chairman under Part 1 proceedings.

Updating matters provided by the Director of Finance comprise those summarised below.

<u>Annual Report and Accounts of the L B Bromley Pension Fund 2018/19</u>

Concerning the Annual Report and Accounts of the L B Bromley Pension Fund 2018/19, considered at the Sub-Committee's previous meeting, the report was subject to auditing by the Fund's external auditor.

It was intended to present the final report to the meeting for approval so it can be published to the Council's website by 1st December 2019. However, the external auditors had yet to complete their audit of the pension fund accounts. As the Sub-Committee's next meeting is after the report's required 1st December publication date, it was intended to publish the report and accounts following the audit's sign-off.

In the circumstances Members **resolved to delegate authority to the Director of Finance for approving the report, in consultation with the Chairman and Vice-Chairman, following conclusion of the audit.** (Democratic Services Note: the audited report would then be presented to the Sub-Committee's 3rd December meeting for information).

Good Governance Survey

No further update had been received on governance proposals outlined in the Government's Good Governance survey (highlighted to the Sub-Committee at its meeting on 15th May 2019) but the Director would keep Members updated should any significant developments arise.

Draft Statutory Guidance

Concerning pooling arrangements, the draft guidance uses terms such as *"best endeavours"* and *"common good"*; however, reference to transfers for the common good of pooling is not now expected to be in the revised Government guidance. Additionally, the April 2020 date for fully transferring assets to pooling bodies is expected to be delayed by a sufficient margin as this date is unrealistic to many local authority pension funds.

Local Authority Pension Fund Awards

For the third consecutive year, L B Bromley received recognition for the long term performance of its Pension Fund and is in the final shortlist for the LAPF awards. Bromley's performance has recently been highlighted in a professional press article.

LGPS community document

The Local Government Association Pensions Team recently published a new document called *'the LGPS Community'* which had been produced in response to a request from the Local Government Pension Committee (LGPC). The document's purpose is to explain the relationship between the different bodies making up the Local Government Pension Scheme (LGPS) community. Members were reminded that a link to the document had recently been emailed (the link was also emailed to LPB members).

31 PENSION FUND PERFORMANCE Q1 2018/19

Report FSD19084

Details were provided of the Fund's investment performance for the first quarter 2019/20. Additional detail was provided in an appended report from the Fund's external advisers, MJ Hudson Allenbridge. In advance of the meeting Members also received Fund Manager Reports on first quarter performance along with a quarterly Sustainable Investment Report from Schroders.

The market value of the Fund ended the June quarter at £1,094m (£1,039.2m at 31st March) and had further increased to £1,132m at 31st July 2019. The quarter total fund return of +5.60% against a +4.32% benchmark compared to a +3.8% average across the 64 LGPS funds in PIRC's universe. Detail on performance by individual fund managers was appended to Report FSD19084.

The Fund's medium and long-term returns remained very strong overall - the Fund ranking eleventh in the PIRC LGPS universe for the year to 31st March 2019, first over three years, second over five years and first over ten, 20 and 30 years. In addition to winning the LGPS Investment Performance of the Year in 2017, the LGPS Fund of the Year (assets under £2.5bn) in 2018, L B Bromley also recently won the Pensions, Treasury and Asset Management Award at CIPFA's Public Finance Awards 2019, recognising the consistent high performance of the Fund.

General financial Information was also appended to Report FSD19084, including final outturn details for the 2018/19 Pension Fund Revenue Account and the first quarter position for 2019/20. Details on Fund membership numbers were further provided along with summarised information on early retirements.

Following the Sub-Committee's previous consideration of Fidelity's Multi-Asset Credit Fund product, the appended report from MJ Hudson Allenbridge provided further comment on the fund.

Concerning admission agreements for outsourced services, the cessation debt and deficit repayment plan for Mytime Active was being finalised for agreement by the Director of Finance, in consultation with the Chairman and the Chairman of General Purposes & Licensing Committee under delegated authority from the General Purposes & Licensing Committee. For GS Plus, the final transfer payment was being considered by the Actuaries and four admission agreements were being arranged in relation to Academies having outsourced services. Discussions were also ongoing for a possible admission agreement following transfer of the Council's adoption service to Coram.

The report also outlined future Fund Manager attendance as:

3rd December 2019 – Baillie Gifford (global equities and fixed income)

3rd January 2020 – MFS (global equities)
13th February 2020 – Fidelity (fixed income, multi-asset income and property).

Mr Arthur indicated that the quarter had been positive for the Fund. Although there are signs of a slowing global economy this had been abated by the promise of further central bank easing. The Fund was performing very well long term. Six of the Fund's seven portfolios outperformed their benchmark in the quarter with only Fidelity's UK property marginally underperforming (the portfolio was funded just over a year ago and given the heavy cost of purchasing property assets, it is too early for performance figures to indicate the managers' true ability). In their performance assessment, MJ Hudson Allenbridge highlighted all portfolio performance green except for Baillie Gifford's Fixed Interest, marked amber. Mr Arthur also highlighted the sale of the Fund's final holding of approx. £11.5m in Blackrock's Global Equity Fund during the quarter (reinvested into Fidelity's Multi Asset Income Fund).

On the Baillie Gifford Fixed Interest allocation, Mr Arthur highlighted that the Manager's return (3.9% in the first quarter, outperforming benchmark by 1.8%) was less than the performance stated by the Fund's custodian BNY Mellon (suggesting some pricing discrepancy which Mr Arthur would look into).

On future outlook, the level of surprise in actions from central banks is low but political events are not so predictable. In terms of global economic slowdown, Mr Arthur felt this would probably not be in the next year or two; however, in maintaining the current extended recovery, there might be repercussions down the line.

In summary, Mr Arthur indicated that all Fund Managers are performing well and that Managers appointed in the past 18 months are achieving in line with what they have been asked to do.

The Director confirmed that the Fund is receiving the level of income needed to meet its liabilities. If the Fund has too much cash it is reinvested.

RESOLVED that the contents of the report be noted, including comments from MJ Hudson Allenbridge in their report appended to Report FSD19084 regarding Fidelity's Multi Asset Credit Fund.

32 PENSION FUND - INVESTMENT REPORT

Schroders were represented for the item by their Fund Manager and Client Director.

Before reporting on performance of their Global Diversified Income mandate (dollar based), Schroders indicated that an equivalent UK based sterling fund was now available. Members had previously agreed Schroders offer to switch the current fund to the sterling fund. Transfer costs would be fully met, and possibly exceeded, by a reduction in Schroders management fees.

Printed copies of the Schroders presentation were circulated to Sub-Committee Members in advance of the meeting. Schroders investment objective for Global Diversified Income comprises:

- an income objective with 3-5% p.a. distribution from coupons and dividends; and

- an objective consistent with a 30% equity/ 70% bond portfolio over a market cycle.

Schroders intend to deliver the investment objective by:

- diversification across a broad range of income generating assets;
- direct investment in underlying securities and active management;
- dynamic asset allocation across economic regimes and market cycles; and
- downside risk management to reduce drawdown during periods of market correction.

A graph included returns from the product since inception in April 2012 along with the fund return (GBP hedged) for Year to Date, I Year, 3 Years, 5 years, and since inception. Details of the fund return (GBP hedged) for each year from 2014 to 2018 were also provided. Although the MAI product had performed poorly in 2018 (-5.6%) the position was now recovered and for the year to date a return (GBP hedged) of 7.7% was achieved. A further slide showed year to date and 12 month contributions to the returns by asset class i.e. Equities, Fixed Income, Hybrids, Alternatives, and Cash and Currency with another slide highlighting yields for certain classes (Equity, Investment Grade, High Yield, Government Bonds, EMD, Alternatives and Hybrids) at points since inception.

Another slide highlighted percentage changes of allocation within asset classes between 31st December 2018 and 31st July 2019. Schroders now had a reduced exposure to Equities as of 31st July 2019 at 26.5% compared to 28.0% at 31st December 2018. Schroders were not now taking so much risk in equities other than for the U.S. Fixed Income had also reduced from 51.3% at 31st December 2018 to 49.0% at 31st July 2019 although Corporate Bonds continued to be favoured by Schroders, particularly those in the U.S. Schroders own a lot of 30-year bonds from which they receive significant return. Holdings in Hybrids increased to 13.3% at 31st July 2019 from 3.0% at 31st December 2018 whereas exposure to Alternatives reduced by -7.6% in the same period. The next slide showed the current allocation by asset class as at 31st July 2019.

In transitioning to Global Diversified Income, a further slide showed the current position and weightings of Equity, Fixed Income, Hybrids, Alternatives and Cash for Global Multi-Asset Income and Global Diversified Income. The next slide highlighted Schroders current allocation for Global Diversified

Income by Equities, Fixed Income, Hybrids, Alternatives and Cash. With further reference to Schroders transition to Global Diversified Income, details were provided of the difference in currency exposure (sterling and non-sterling) for Global Multi-Asset Income (GBP Hedged) and Global Diversified Income (with no overseas exposure for Global Multi-Asset Income). Further details outlined a breakdown of overseas exposure for Global Diversified Income by currency i.e. USD, JPY, EUR, Emerging Markets, AUD and Other.

The presentation also highlighted attractive income opportunities from high yielding European Equities; an active approach is required and details included sector exposure. Further details were also provided in relation to high yielding Asian Equities. It was felt that Asia had massive potential to continue raising its dividends and pay-out ratios. The slide highlighted that even though Asian dividends have more than tripled over the last twenty years, the region’s pay-out ratio remains one of the lowest in the world.

Before global outlook, ESG and appended slides (none of which were covered in Schroders meeting presentation), further details were provided on Hybrids, introduced to fit between Equities and Bonds (in terms of risk).

The Chairman requested a view on infrastructure particularly in light of the Government’s pooling requirement and encouragement towards infrastructure investment. Schroders responded. On any underwriting of infrastructure debt, Schroders have a team to invest in debt and to understand the nature of infrastructure debt. On Hybrids, a Member indicated that the asset was impacted hard during the 2008 financial crisis and if a passive investment, Hybrids are high risk. If between equity and bonds, she questioned why Schroders invest in bonds; however, although Hybrids (Preferred Securities) produce a similar yield to High Yield Bonds (Preferred Securities 5.8% and High Yield Bonds 6.3%), it is necessary to be concerned about issuer rating with Preferred Securities typically better. Starting yield is important and with almost 26% invested by Schroders in High Yield Debt (High Yield Bonds) as at 31st July 2019 it was necessary to find something else (sensitivity to cyclical risk can be better managed). For Convertible Bonds, Schroders take a conservative approach with investment quite wide. Schroders confirmed that most of the (increased) allocation to Hybrids came from Alternatives.

Concerning High Yield Bonds, Schroders mainly invested in the U.S. These are often referred to as “Junk Bonds” with companies at the lower end – they are not investment grade bonds. The biggest risk is default and they are purely corporate debt.

Schroders confirmed they do not use derivatives although they would be used to hedge equity risk. Mr Arthur confirmed that Schroders were not to use derivatives for income generation in the fund.

Although absolute yield was considered particularly appealing, Schroders focus on value. They expected more dividend cuts in the UK and felt that current dividends are not sustainable. It was suggested a good position if those companies are in dollars. Schroders advised that some are domestic companies that do not have revenues and where there are bond yields there was a view that this is an opportunity to reduce dividends. Global growth is low; if it is necessary to reduce, now would be a good time to do so. It was suggested that with Schroders sending representatives to company shareholder meetings it would be possible for Schroders to be able to influence companies to not have a cut in dividend.

Concerning Schroders having a difficult initial period with their mandate the Director of Finance asked what is different now. For global equities, Schroder's indicated that the fourth quarter 2018 was challenging. There were also significant concerns about how Alternatives performed. Schroders was working to get closer to asset performance - they try to be as conservative as possible, sacrificing yield and return to have a better risk balance. Concerned about the global economy, Schroders have also moved to longer end government bonds. Schroders had also added to the Japanese Yen and U.S. Dollar and introduced hedging to the portfolio.

Schroders indicated that the risk exposure for their new UK domicile fund is consistent with MAI fund risk exposure. Currency is to purely manage risk. On marketing the new fund, Schroders felt it important to grow the fund and to have success in local authority Treasury Funds where these have greater discretion to invest. The two funds (Dollar and Sterling) mirror each other in terms of risk and both are run by the same Schroders investments team. Schroders have no exposure to gold (no yield). Schroder's like the U.S. domestic market for returns; Europe and Asia are also high yielding markets. The U.S./China trade war would affect the world. Although Schroders would like to invest outside of the U.S., global market growth was needed.

Schroders confirmed to the Chairman that it would be possible to arrange a meeting towards the end of September/beginning of October about ESG. In thanking Schroders, the Chairman commended their presentation and felt the mandate is going well.

After the Schroders representatives left the room, the Member previously concerned about the Hybrids allocation raised the matter again. She felt that the level of exposure to Hybrids is high risk. However, Mr Arthur advised that Preferred Securities are less volatile than Equities; the Fund will always have investment risk and there might be some negative months. But yields were currently some 4.7% and the approach would try to be defensive. Another Member suggested monitoring the position in reports; if the exposure is too high, the Sub-Committee/Investment Adviser could possibly check. Mr Arthur confirmed to the Chairman that the position with Hybrids is in line with Schroders mandate.

33 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

34 EXEMPT MINUTES OF THE PENSIONS INVESTMENT SUB-COMMITTEE MEETING HELD ON 24TH JULY 2019

The exempt minutes were agreed.

35 UPDATES FROM THE CHAIRMAN AND/OR DIRECTOR OF FINANCE ON ANY EXEMPT MATTERS

Under Part 2 proceedings, Members considered matters related to the following areas:

- revised business permissions for the LCIV;
- the LCIV Staff Pension Scheme and pension guarantee agreement;
- the forthcoming Asset Allocation review for the L B Bromley Fund and a Multi-Asset Income Credit (MAIC) product to be considered further at the Sub-Committee's meeting on 3rd December 2019.

RESOLVED that: following the Sub-Committee's meeting on 3rd December 2019, a further special meeting of the Sub-Committee should be arranged for Tuesday 17th December 2019 to reflect any follow up matters from the draft outcome of the asset allocation review reported to the 3rd December meeting. (*Democratic Services Note: following the meeting the Director of Finance referred to 17th December being a provisional date with the final date to be confirmed*.)

The Meeting ended at 9.50 pm

Chairman

Appendix A

QUESTIONS TO THE PENSIONS INVESTMENT SUB-COMMITTEE FOR WRITTEN REPLY

From Gill Slater

1. Where or when can the advice to the Council that '*its primary responsibility is to secure the best returns for the fund in the interests of its council taxpayers and its members'*, the associated definition of 'best returns', and the detailed analysis of social and environmental impacts producing the ISS bulleted conclusions be provided?

Reply

The primary responsibilities of administering authorities are to deliver the returns needed to pay scheme members' pensions and protect local taxpayers and employers from high pension costs' (reaffirmed in CLG consultation, November 2012). In April 2014, the Local Government Association published legal advice on the fiduciary duties of LGPS administering authorities which said that the power of investment must be exercised for investment purposes and not for wider purposes. Any precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund. The ISS reflects this.

The Sub-Committee believe in working with their investment managers over the long term and to expect those managers to invest on this timeframe (as can be seen in the average holding period for both the Funds equity managers of 5-10 years, this is well about the industry average). Because we are working consistently on this timeframe, environmental issues become fundamental to the value our managers place on the investments they make on our behalf. All the managers the Fund employs have significant resources dedicated to ESG research and adopt a proactive engagement approach with the companies they invest in on these issues. ESG is reviewed by the Trustees on an ongoing basis.

Our fund managers always look at sustainability of returns and capital values of investments and we would not want restrictions that could impact on maximising returns in the interest of fund members and keeping costs to the council tax payer low.

We believe in active management and as such select managers who actively engage with the companies they invest in. Our asset managers take their responsibilities seriously, looking to support growth and promote good decision making at companies we invest in.

The long term sustainability approach is evidenced by the superior returns achieved over 1 to 30 years, recognised through National Awards.

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2. Will the Sub-Committee investigate and respond to the recognised financial risks associated with fossil fuel investments which are becoming increasingly vulnerable as the world transitions to low-carbon energy, risking very rapidly becoming 'stranded assets', at cost to taxpayers and fund members?

3. Can the Sub-Committee set out the timeframe for the review of the Investment Strategy Statement and advise how fund holders and taxpayers will be engaged in the consultation?

Replies

The Sub-Committee has agreed to progress with an asset allocation review of the pension fund investments including considering any changes necessary to the ISS and any consultation matters. The work is currently being commissioned and a timetable and more detailed arrangements will be reported to a future meeting of the Pensions Investment Sub-Committee. The Council is aware of the work being undertaken by the Scheme Advisory Board and a future consultation from Government of new Statutory Guidance which may impact on any final arrangements. This will be monitored closely by the Committee.

The Sub-Committee works closely with asset managers to help meet the ESG commitments. Currently, employers and members of the LGPS scheme can nominate members to the Local Pension Board and can more directly contribute to the development of strategies. Members of the scheme also receive an annual newsletter and the next one published will invite comments from scheme members on all aspects of the Annual Report 2018/19 which includes the ISS. The Annual Report 2018/19 is included in the public agenda which is available on the Council's website. This provides opportunity for comments and to help inform changes to the ISS.
