PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.30 pm on 19 May 2015

Present:

Councillor Teresa Ball (Chairman)
Councillor Keith Onslow (Vice-Chairman)
Councillors Eric Bosshard, David Livett, Russell Mellor and Richard Williams, Simon Fawthrop

Also Present:

Peter Turner (Director of Finance)
Tracey Person (Chief Accountant)
Alick Stevenson (Financial Advisor)

33 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from Mr Martin Reeves, and Tracey Pearson attended as substitute.

34 DECLARATIONS OF INTEREST

Councillor Russell Mellor declared a personal interest by virtue of receiving a pension from the Local Government Pension Scheme (LGPS).

Councillors Eric Bosshard and Simon Fawthrop declared interests as former Members of the LGPS.

The Chairman declared an interest by virtue of her husband working for JP Morgan.

35 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 24TH FEBRUARY 2015, EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The minutes of the meeting held on the 24th February were agreed.

The Director of Finance (henceforward referred to as “Director”), updated the Committee concerning the London Collective Investment Vehicle (CIV). It was noted that LBB were currently still not a member of the CIV. The CIV is awaiting regulation by the FCA (Financial Conduct Authority). Individual councils have contributed £75k to date as part of joining the CIV and it is expected that the cost of joining the CIV (if LBB did decide to join) could be offset by reduced fund mangers’ fees, but this was currently unclear.

It is anticipated that a formal FCA regulation will be finalised this summer, and the Committee would be updated in due course.

The Director referred to the matter of **Pensions Freedom** that had been part of the recent budget, explaining that the impact of this was that individuals now had the right to transfer to private pension schemes, and this had raised some concerns. It was noted that this applied to the LBB pension scheme, but did not apply to NHS schemes.

The Director referred to the previous consultation paper on the issue of "**Active" v "Passive"** investments and this matter was not progressed further by the Government prior to the elections. The Committee would be kept informed of developments.

The Director gave the Committee an update on the "Parallel Fund". It was noted that this was a long term investment, and the allocated investment was £2.7m. The returns had been good so far, and it was hoped that this trend would continue.

Tracey Pearson (Chief Accountant) updated the Committee concerning the **Local Pensions Board.** The Committee were informed that the establishment of the LPB had been agreed at the meeting in February 2015. There had not been a good response to the canvassing for Board Members, and there had been only four responses; there had been no responses for Employer representatives. The matter was being raised at the GP&L meeting on the 27th May 2015, where a change to the terms of reference would be sought. Meetings had taken place with three of the four proposed members, and LBB would be meeting with the fourth person on the 8th June 2015. The GP&L Committee would be asked to agree changes to the Terms of Reference, and to agree the nominations for the Board.

Members referred to potential issues of non-attendance at meetings and the importance of appointed members of the Local Pension Board ensuring they attend the meetings.

A Member asked if the nominees were of sufficient calibre. Ms Pearson responded that it was difficult to find sufficient numbers of people that were interested. It was noted that the four candidates were of varying backgrounds and experience, and it was anticipated that each would bring different qualities and experience to the Board. It was important to note that the LPB had to be established within statutory deadlines.

A Member enquired if the PISC had the power to veto nominees if required; the answer to this was no—the power of veto rested with the GP&L Committee.

RESOLVED:

(1) that the minutes of the meeting held on the 24th February 2015 be agreed

(2) that the matters relating to the general update from the Director be noted and further updates will be provided at future meetings

36 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

No questions were received.

37 PENSION FUND PERFORMANCE Q4 2014/15

Report FSD15028

The report was brought to the attention of the Committee to provide an update concerning the investment performance of Bromley's Pension Fund in the 4th quarter of 2014/15.

It was noted by LBB's Financial Advisor that the Fund had performed very well, and that the rate of return over the last twelve months had increased by 18.5%. It was noted that over the three year period from 01/04/2012 to 31/03/15 the Fund's ranking was 7 which was very good, and this was a strong performance. It was further pointed out to the Committee that the Fund had maintained a ranking of 8 over the last 10 years which was excellent. The Financial Advisor stated that this showed the importance of picking good fund managers and asset allocations. The Financial Advisor (FA) commended the Fund to Councillors.

The Chairman directed the attention of Members to section 3.8 of the report, and the associated appendix. This dealt with the issue of early retirements, and the subsequent cost to the Fund. The Chairman expressed concern that the actuary had increased his assumed figure for early retirements from £82k to £1.m. The Chairman wondered if there was a way to reduce this assumed figure.

There was general concern amongst Members concerning the level of early retirements, and it was felt that this was a matter that should be referred to the GP&L Committee.

A Member expressed the view that the Diversified Growth Fund (DGF) was not performing as well as Global Equities, and felt that these investments were in low asset classes and exposed to currency risk. He regarded these products as unsuitable for a pension fund.

The Director of Finance felt that the DGF was less volatile and safer than equities, and suggested that this was a matter that should be raised with the fund managers.

It was noted that in terms of Fixed Income, Baillie Gifford managed assets of £50.4m, whilst Fidelity held fixed income assets of £65.7m; the total value of the Pension Fund as at 30/04/2015 was £731.5m.

The Financial Advisor stated that the DGF enabled managers to invest across a broader range of asset classes, without requiring separate mandates. He reminded the Committee that the DGF had been successful for the last twelve years and was a useful tool in the portfolio; he also reminded the Committee that the DGF only comprised 10% of total allocations. He described it as being able to gain equity like returns but with half the risk of equities. The FA also expressed the view that the DGF would not fall as quicker as equities in periods of market volatility.

A Member expressed the view that as the number of LBB employees fell, so the demand for cash on the Fund was proportionately increasing. This being the case, he expressed the view that the Fund should be managed to generate as much as cash as possible now as an investment for the future, and this may necessitate a requirement to invest in differing products.

RESOLVED:

(1) that the report on Pension Fund Performance Q4 2014/15 be noted

(2) that the GP&L Committee review the existing arrangements for ill health retirement

(2) that the programme for Fund Manager attendance as set out in paragraph 3.9 of the report be agreed

38 PENSION FUND - INVESTMENT REPORT

Mr Kenneth Barker attended from Baillie Gifford to provide a Pension Fund update, with specific reference to Fixed Income and the Diversified Growth Fund.

Mr Barker commenced with a general economic overview and stated that most asset classes had delivered good returns over the quarter. There had been a mixed bag of economic news, headlined by the collapse in the oil price and deflation. Quantitative Easing (QE) had been introduced in the Eurozone, and there had been big moves in foreign exchange rates during the quarter, with the dollar strong against most currencies. Corresponding to a decline in inflation, bond yields had fallen to record low levels.

Mr Barker informed the Committee that the return on the DGF (net of fees) to 31/03/15 was +7.9%, and over the past five years was +6.5% on an annualised basis. Volatility over the past five years was 4.4% per annum, and the return on the fund (net of fees) over the last quarter was 3.2%.

It was the case that in the first quarter of 2015, the best performers in the DGF were listed equities, active currency, high yield credit and absolute return.

Mr Barker stated that there had been a degree of volatility in the last quarter connected to a weakening of the Euro, and that funds were not hedged in the Equity portfolio.

Mr Barker informed the Committee that Baillie Gifford were looking with interest at countries like India which had good reform agendas and strong economic growth. A Member enquired if that meant that the Fund was exposed to currency volatility with respect to the Rupee. The answer to this was yes, currency was taken into account but not hedged. Mr Barker continued by explaining that recent USA gains had been partly via currency, and that it took around three to five years for currency to stabilise; it was also the case that the FTSE market was globalised.

A Member asked what sort of returns were coming from the Emerging Markets (EM). Mr Barker answered that currently the returns were good- around 7%. It was also the case that trends were favourable for EM as these countries did not have a debt problem. Countries that were previously regarded as “safe” were now vulnerable because of debt problems. It was the case that EM countries were in a crisis in the 90’s, but their fiscal situations had now stabilised.

Mr Barker explained about asset classes and local currency bonds. He explained that hard currency was measured in dollars, and the other option was to use local currency bonds which were bonds issued against the local currency of the issuing country. He felt that it was better in these cases to go down the local currency route, as banks liked to issue bonds and to lend based on their own currency. It would be expected that the currency would appreciate, and that subsequent industrial output would improve economic productivity. Some profits would be lost to inflation, and it was important to actively manage these positions.

It was noted that local currency bonds could be hedged as the issues were clearer.

The Chairman thanked Mr Barker for his informative and thorough presentation.

Mr Paul Harris and Mr Rob Marsden attended the Committee as the representatives from Fidelity. They attended to provide an update on the current Fixed Income Fund that they were managing for LBB which was the Fidelity Institutional UK Aggregate Bond Fund, and also to provide more information to the Committee with respect to the Fixed Income Diversified Alpha Fund (FIDA). It had been recommended at the last Committee meeting that funds be transferred from the Aggregate Bond Fund to the FIDA Fund, but this had been put on hold pending tonight's update. The current value of the Aggregate Bond Fund as at 31/03/2015 was £66.6m.

Mr Marsden outlined the strategy of the FIDA fund, and explained that it employed an absolute return strategy that was not restrained by traditional benchmark bound performance objectives; investors were offered returns relative to cash. He described the Fund as blending a global macroeconomic outlook with Fidelity's bottom up approach to investing. He felt that the Fund offered a best ideas approach and offered attractive risk adjusted returns.

Mr Marsden stated that the main benefits of the FIDA Fund were:

- Low volatility and attractive risk adjusted returns
- Diversification
- Strong capital preservation
- Liquidity management focus

A Member enquired what sort of liquidity existed in the FIDA Fund, and the response to this was that there was daily liquidity.

The Chairman asked how the Fund performed during the recent period of bond volatility. Mr Marsden responded that the portfolio had to be rebalanced—the Fund took a hit but was resilient.

A Member enquired if the FIDA Fund was an investment in Derivatives. Mr Marsden answered that the Fund invested in "money market instruments", and that these were AAA credit rated instruments. These were short term bonds used as collateral against Derivatives. A member enquired what sort of risk was attached to these bonds, and the response was that they were high quality instruments. The member also asked why bonds were used and not cash as collateral. Mr Paul Harris commented that the Fund used Bonds with equal and opposite views, and that in effect there was an overall zero risk balance because Fidelity would be running a neutral position. He added that it was not possible to get returns without some risk.

The Director of Finance asked how the "absolute return" aspect of the FIDA Fund differed from the Aggregate Bond Fund. The response to this was that the FIDA Fund was driven by both long and short ideas, rather than by the market. It was also the case that the Fund was market neutral. The Director enquired what the fees were for managing the Fund, and the answer was that the fee was 0.4%, but Fidelity offered flexibility on this. The Director also asked how confident Fidelity were with the target return of 1.5 to 3% over cash. Mr Marsden responded that it was expected that the market would start to ride on fundamentals after exposure to QE, and Fidelity were confident of hitting this target.

The Chairman asked for any other comments on the quarterly report. Mr Marsden responded that the last quarter was routine, and that the portfolio had performed well.

The Chairman thanked Mr Marsden and Mr Harris for their detailed and informative presentations.

RESOLVED that the presentations from Fidelity and Baillie Gifford be noted.

39 REVISED INVESTMENT STRATEGY - PHASE 3

Report FSD15029

It had previously been agreed that 20% of the Pension Fund be allocated to Fixed Income. Fixed Income assets provide cash for the pension fund which is required for cash to pay pension liabilities, but they have a lower return than global equities. At the meeting of the PISC in February 2015, consideration was given to allocating a pot of money from the current fixed income fund managed by Fidelity (UK Aggregate Bond Fund) into a new fixed income fund called the FIDA Fund. FIDA is an abbreviation for Fixed Income Diversified Alpha Fund. The decision on this was deferred in February to tonight's meeting, to give the Committee further time for consideration of this matter, and to speak to the Fidelity Fund Manager directly.

There was discussion amongst committee members concerning the correct balance between equities and fixed income. Some Members felt that a 20% allocation to fixed income was too high, and that the Fund should invest more in equities—others felt that 20% was fine, and that it may not be a good idea to have too much exposure in equities. It was a problem of balance.

The Committee discussed the two decisions that they were required to make on the night.

The first decision that the committee were asked to consider was to agree to invest £6m in the FIDA Fund, the money for this to be transferred from Fidelity's existing UK Aggregate Bond Fund.

The other decision that the Committee were asked to consider was invest £3m in Baillie Gifford's Global Credit Fund, and £3m in Baillie Gifford's Emerging Market Bond Funds—this money (total £6m) to be transferred from the existing Baillie Gifford Sterling Aggregate Bond Fund.

There was some discussion amongst Members concerning the role and recommendations of the Actuary. It was noted that the Fund had to be fully funded, and that if Actuarial advice was not followed, then in some cases this may be queried by external audit. It was noted however, that although the Actuary may have recommended a 20% allocation to Fixed Income, he had obviously not specifically recommended the FIDA Fund.

LBB's financial advisor commented that it may be prudent for Members to take a vote. However, he cautioned against an overweight equity position. He referred Members to page 23 of the agenda where there was a table showing Fund Value as at 31st March 2015. The percentage of the Fund currently allocated to global equities was 74%, and so it would not be wise to further extend this overweight position. This would naturally have the converse effect on fixed income which would then be proportionally underweight.

RESOLVED:

(1) that the Revised Investment Strategy Phase 3 report be noted

(2) the proposal to invest £6m in Fidelity's FIDA Fund was rejected

(3) it was agreed to invest £6m, split equally between Baillie Gifford's Global Credit and Emerging Market Bond Funds—the money for this to be transferred from Baillie Gifford's Sterling Aggregate Bond Fund

(4) that the Director, in consultation with the Chairman and Vice Chairman, arrange the transfer of £6m from Fidelity to one of the global equities fund.

40 IMPACT OF EXCHANGE RATES

Report FSD15030

It had been agreed at the last meeting of the Committee that the Pension Fund's financial advisor draft a report to the Committee on the effect that exchange rates have on transactions and profits.

The report recommended that no further action with respect to currency hedging was required.

The Chairman and Committee Members thanked the financial advisor for a clear and well-presented report.

RESOLVED that the report on the impact of exchange rates be noted

The Meeting ended at 10.00 pm

Chairman