PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the special meeting held at 7.30 pm on 5 April 2017

Present

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

Also Present

Councillor Graham Arthur, Resources Portfolio Holder
Brian Toms, Employer Representative – Local Pension Board
John Arthur, AllenbridgeEpic Investment Advisers
Alick Stevenson, AllenbridgeEpic Investment Advisers

41 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from the Chairman, Cllr Teresa Te, in view of illness and being unable to attend the meeting.

In the circumstances, Cllr Keith Onslow, as Sub-Committee Vice-Chairman, chaired the meeting.

42 DECLARATIONS OF INTEREST

There were no declarations (other than those declared at previous meetings of the Sub-Committee).

43 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 22ND FEBRUARY 2017

The minutes were agreed subject to -

- John Arthur from AllenbridgeEpic Investment Advisers being added to the list of those present at the previous meeting and

- The final sentence of paragraph 3 of Minute 37 being amended to read:

  "Allenbridge proposed that allocations to global equities and fixed interest be reduced from 70% to 60% and 20% to 15% respectively (which brings the fixed interest strategic allocation more in line with the current actual proportion); also that the DGF allocation be removed and allocations introduced to Property (various asset sub-classes) (5%), and Multi-Asset Income Fund(s) (20%)."

A question to the Chairman for written reply had also been received from Cllr Tony Owen prior to the meeting. The Chairman agreed to accept the question and details of the question and reply are at **Appendix A**.

44 PENSION FUND ASSET ALLOCATION STRATEGY REVIEW - FOLLOW-UP REPORT

Report FSD17039

Members considered further information from Allenbridge to supplement a review of the Fund's asset allocation strategy (considered at the Sub-Committee's previous meeting). The report considered at the Sub-Committee's February meeting was appended to Report FSD17039 and slides and notes from the Member Workshop, 24th January 2017, were also available on the Councillor pages of the Council's intranet.

With a focus on overall risk reduction, income generation, and capital preservation, it was necessary to reduce the fund's exposure on equities to prevent any adverse movements impacting the fund's solvency ratio. The current portfolio was heavily focussed towards growth with 70% invested in equities. Although equities had performed well for the fund in recent years, cash flow requirements had changed and income was now needed regularly and on a growing basis to meet the fund's obligations. As such, it was unlikely that the portfolio could meet cash flow demands going forward without having to sell assets, possibly at a disadvantageous time, and with a resultant negative impact on overall fund performance. Holding significant growth assets as the fund matures and cash outflows increase meant accepting a potential risk of underperformance adversely impacting the funding ratio and employer contribution levels. As such, it was necessary to implement a long term asset allocation structure with a built in capacity to migrate assets from growth to income in a timely, efficient, and cost effective manner.

Although there was consideration of options at the previous meeting, the supplementary material from Allenbridge provided further information on recommended options from its review, historical risk and return information for the various asset classes considered, and scenario analysis/charts for six asset allocation scenarios modelled. A Member thanked Allenbridge for a very clear and informative paper.

Two options were particularly highlighted to reduce allocations to global equities and fixed interest from 70% to 60% and 20% to 15% respectively. The Diversified Growth Fund (DGF) allocation would also be removed with allocations introduced to Property (various asset sub-classes) and Multi-Asset Income Funds (MAI).

Option A (v2) proposed allocations of 20% and 5% to Property and MAI respectively and Option B (v3) proposed allocations of 10% and 15% to Property and MAI respectively. Both options were expected to provide a total return of around 4.9%, and produce a similar level of income to help meet future cash-flow requirements.

Following approval of the proposed changes, information would be provided to the Sub-Committee's next meeting on their implementation.

Overall, Members supported Option B (v3). Supporting the option a Member felt that a significant part of the fund's growth from equities had been achieved through foreign exchange benefits suggesting the same opportunities for sterling might not be available in future. As the fund had liabilities in sterling he felt that these should also be matched with sterling assets, preferring to see more investment in UK equities rather than global equities. He was also unsure of the difference between DGF assets and MAI funds, noting that DGF had not been particularly successful. He suggested looking at simple and straightforward MAI assets and was particularly concerned that there should be no exposure to derivatives. The Chairman understood concern for global equities but it was now a global world for investment. On MAI assets, the principle of a future strategy was being considered at this point and detail and risks would be considered later. Nevertheless, risk level for MAI funds was an important consideration; should the level of required return be too high, a high level of funding in derivatives could be expected. However, for purposes of the fund a lower level of investment was considered appropriate and controlling clauses could be inserted into a contract limiting exposure to derivatives.

It was suggested that the next couple of years could be volatile; being in the same currency was worthwhile in principle but it might be necessary to be pragmatic. The Chairman reminded Members that a revised asset allocation was necessary *inter-alia* to address the fund's cash deficit over the next three years. There was also flexibility in the proposed arrangements should adjustments need to be made.

On future volatility and the market currently being high, reference was made to index-linked gilts. However, yields were particularly low and returns would not solve the fund's cash-flow requirements. If markets had fallen or inflation "spiked", index-linked gilts would be a good investment but without assurance of such scenarios the approach was difficult to justify. The authority's costs for index linked gilts could also rise alongside any increase in returns.

It was confirmed that the fund's cash flow position would be unaffected by its membership of the London CIV. Management fees on products via the CIV may be reduced but making the right investments was crucial for key net returns. At a future date (possibly in a further 12 to 18 months) it would be necessary to procure through the CIV but for now it was still possible for L B Bromley to decide upon and procure its own investments where the CIV does not have an appropriate sub-fund. Any product so procured would also continue under the existing regulations.

The proposals assumed that global equities would continue to be part of the fund's overall investment portfolio (for growth purposes) and a Member felt that a global approach should be retained. Income was also needed to pay benefits for pension fund members and Option B (v3) provided a framework to cover the fund for the next three years. The next step in the process was to reduce growth assets and provide income and in so doing reduce risk and exposure to currency. It was confirmed that assets would be taken from DGF to help fund the new property element of the asset allocations.

Members agreed Option B (v3) and also agreed that the proposed allocation to property in the option should be reduced from £94.2m to match that of the total DGF portfolio at the point of transfer (for indicative purposes, the total DGF portfolio was £77.7m as at 31st December 2016) with the excess moved to supplement the £141.3m allocation for multi-income funds.

At this point (8.09pm) Mr Arthur and Mr Stevenson left the room in order for the Sub-Committee to consider an additional tabled recommendation to delegate the Director of Finance with authority to appoint specialist advice (in consultation with the Chairman and Vice-Chairman) for the procurement of investment managers to implement the changes.

Members supported the recommendation and it was confirmed that the final decision would be on the basis of demonstrating value for money.

RESOLVED that:

(1) the content of Report FSD17039 be noted;

(2) changes to the asset allocation strategy be agreed in accordance with Option B (v3) outlined in proposals from AllenbridgeEpic detailed at Appendix A to Report FSD17039, adjusted so that the property allocation is equal to the total DGF portfolio at the point of transfer, with the difference moved to the allocation for Multi-Asset Income;

(3) the Director of Finance be delegated to appoint specialist advice (in consultation with the Chairman and Vice-Chairman) for the procurement of investment managers to implement the changes; and

(4) a further report be presented to the Sub-Committee's next meeting detailing arrangements for implementing the strategy.

The Meeting ended at 8.14 pm

Chairman