PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.30 pm on 22 February 2017

Present:

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

Also Present:

John Arthur, AllenbridgeEpic Investment Advisers
Alick Stevenson, AllenbridgeEpic Investment Advisers
Jane Harding, Employer Representative - Local Pension Board
Brian Toms, Employer Representative - Local Pension Board

32 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

There were no apologies.

33 DECLARATIONS OF INTEREST

Cllr Simon Fawthrop declared an interest by virtue of his employment with BT.

34 CONFIRMATION OF MINUTES OF THE MEETINGS HELD ON 16TH NOVEMBER 2016 AND 31ST JANUARY 2017 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The minutes were agreed subject to the third paragraph of Minute 22 being amended to read:

"At a meeting with the Adviser to the Secretary of State for Communities and Local Government, the Director of Finance raised the following matters:

- *pension liabilities being a disincentive to small providers in submitting tender submissions; and*
- *Funds having the option in the future to invest in a product(s) from another pool."*

35 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

36 PENSION FUND PERFORMANCE Q3 2016/17

Report FSD17021

Details were provided of the Fund's investment performance for the third quarter, 2016/17. Additional detail was provided in an appended report from the Fund's external advisers, AllenbridgeEpic and Baillie Gifford provided commentary on its performance and view of the economic outlook. Information on general financial and membership trends of the Pension Fund was also outlined along with summarised information on early retirements.

The market value of the Fund ended the December quarter at £893.9m and had risen further to £907.6m as at 31st January 2017. The total fund return for the third quarter was 3.6% against a 4.0% benchmark. This compares to an estimated average of 3.2% across LGPS funds based on initial figures from PIRC, a new provider for LGPS comparator information.

Members were also updated on the transfer value of scheme assets and liabilities related to Bromley College (now merged with Greenwich Community College) – these to be transferred from the L B Bromley Fund to the Local Pensions Partnership (LPP). The transfer value would change over time until payment date in line with investment returns.

The actuary had updated the asset share for Bromley College using Pension Fund investment performance and cash-flow data to 31st December 2016. The illustrative asset share for the College at 31 December 2016 had risen to around £29.5m from an estimated value of £23.4m in May 2016, the main reason for the increase being attributed to the level of investment return for the Fund achieved since initial calculation. The final transfer payment would continue to be subject to further fluctuations and authority had been delegated to the Director of Finance, in consultation with the Chairman and Vice-Chairman, to agree transfer of the appropriate asset share following advice from Allenbridge. A final transfer value figure would be reported to the Sub-Committee following transfer.

Standard Life and Fidelity were also due to attend the meeting to provide investment reports but both had been asked to attend a later meeting to permit full consideration of other agenda items. The following Fund Manager attendance schedule was proposed for future meetings:

- 16th May 2017 – Baillie Gifford (global equities, fixed income and DGF)
- 19th September 2017 – Standard Life (DGF) and Fidelity (fixed income)
- 21st November 2017 – MFS (global equities)
- 20th February 2018 – Blackrock (global equities)
- 22nd May 2018 – Baillie Gifford (global equities, fixed income and DGF)

A Member commended the £175m rise in Fund value between 31st December 2015 and 31st January 2017.

RESOLVED that:

(1) the contents of the report be noted;

(2) the proposed Fund Manager attendance dates as detailed at paragraph 3.7.2 of Report FSD17021 be agreed; and

(3) the latest indicative increase in transfer value related to Bromley College as detailed at section 3.6 of Report FSD17021 be noted.

37 PENSION FUND ASSET ALLOCATION STRATEGY REVIEW

Report FSD17029

The Fund's cash flow position was expected to become cash-negative in the next few years - the cost of payments to pensioners, administration expenses and management fees exceeding cash flow income from employee/employer contributions and investment income. Members previously agreed to review the Fund's asset allocation strategy so that cash flow requirements can be met in future and a good investment return can continue to be provided for the Fund. As such, outcomes and recommendations from a review by Allenbridge (advisers to the Pension Fund) into a future asset allocation strategy were presented to Members, their report appended to Report FSD17029.

The Fund's actuary, Mercer, had also provided updated projections on contributions to, and benefits paid from the Fund as part of the triennial valuation and these had been included in total Fund cash flow projections. The Sub-Committee's Chairman, Vice-Chairman, the Resources Portfolio Holder and officers also met Fund Managers, Allenbridge and Mercer in October 2016 and a general consensus was reached on future market expectations and potential direction of travel for the Fund's investment strategy. Several managers brought projections on future returns for different asset classes. Allenbridge also presented a summary of their review work at a workshop to Members and Local Pension Board members on 24th January 2017.

The report from Allenbridge included further details of an options appraisal, including an option to retain the current strategy and sell assets when needed for cash flow requirements. The report also considered active versus passive investment and an explanation of the similarities and difference between Multi-Asset Income (MAI) funds and Diversified Growth Funds (DGFs). 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) (20%), and Multi-Asset Income Fund(s) (5%).

Following agreement on a strategy, work would begin on how to implement the strategy, including consideration of whether investment in the new funds is made through the London CIV.

In discussion, a number of views were outlined by Members on the recommended approach from Allenbridge.

A Member keen to see further work undertaken and supporting a more passive approach, suggested the fund was of sufficient value to meet liabilities, so warranting an emphasis on income unnecessary. Highlighting outperformance of the active global equity managers from December 2013 to December 2016, he suggested the good performance could be attributed to the fund's long term liability being denominated in sterling with an exchange rate benefitting the investments. It was only possible to take a view on underlying performance without the exchange rate benefit; on this basis it appeared that the investments were performing below index. With exchange rate benefits removed and the funds invested instead in the FTSE100 index, as a sterling denominated asset, more would have been earned in the period. An alternative investment in passive funds would achieve as much in return. Additionally, he suggested the opportunity for currency gains with global equities would not be available in the future and with currency gains removed it would be worth comparing the returns against those that would have been obtained from the FTSE. He was not supportive of illiquid investments and the associated level of risk but accepted that some long term investment is necessary. Putting funds in assets matching the FTSE100 reduces fund management costs and spreads the risk. He felt that further work was necessary with detailed information provided on expected performance from a mix of assets; looking forward, he suggested the removal of currency from any further work by Allenbridge.

A number of Members had alternative views. It was important that local Council taxpayers pay the least possible to help bridge the deficit gap. Allenbridge referred to strong investment returns made previously and the deficit had narrowed. The Mears gifting also contributed to this. The Fund was in a relatively strong position and it was now possible to take less risk to achieve full funding. It was necessary to protect the Fund's good position and the recommended approach provided for diversification, removing risk as much as possible. There was however an increased requirement for cash-flow. Allenbridge felt that removing currency gain was not worthwhile (and could not be predicted with accuracy); the Global Equity return was also in sterling and Allenbridge preferred a broad index to a narrow one.

It was necessary to meet the income deficit. The level of return proposed under Option 3 from Allenbridge was thought insufficient (for the long term) and further work was considered necessary in comparing to the current allocation strategy. With the fund in a good position it was possible to avoid higher risk and a portfolio was necessary to deliver income, with low to medium volatility, covering short to medium term cash flow requirements, without impacting growth expectations for the whole portfolio. Assets could be earmarked from equities and illiquid assets to specifically produce income

shortfall leaving a larger proportion of the Fund to be manged for growth. The cash flow position of the Fund was such that it would become increasingly negative without income to cover the shortfall. It would then be unnecessary to sell global equities stock to call back income. Sub-asset classes within property were recommended for income generation alongside Multi Asset Income Funds. Risks associated with such investments would be mitigated by appointing appropriate fund managers.

A Member highlighted products for growth and income based upon retail suggesting there could also be a wholesale equivalent for greater returns. However, UK income funds provided a steady income, but for the Fund's income need a broader range of investments were necessary, with less constraint, enabling a fund manager to hunt down the best returns worldwide. In this regard, Allenbridge referred to returns that could be achieved from certain Multi-Asset Income Funds. Allenbridge had predicted the level of income obtainable and there would also be a limited amount of asset growth. Some increase in asset value was sought (as well as income) and more information was necessary on fund managers for such a product (which could be available from potential fund managers at a future meeting should a Multi-Asset portfolio be chosen). Further (similar) information would also be of interest in all asset classes. A multi-assert approach would also lower risk and further information was requested along such lines.

To support a view for a more passive income approach, reference was made to assets returning about 5% net of inflation, considered an adequate return. Such an asset would yield around 5% over a period of 100 years or so. However, Allenbridge referred to the compounding nature of returns and there could be periods of time in the future when returns from such assets would be unable to meet income requirements.

It was suggested the Sub-Committee was morally obliged to further understand options (for income) with more work necessary to remove "outlyers of probability". The Government had also referred to passive investment and the Member supporting the approach asked whether a blend of passive investments was possible with a report outlining detail. He felt there were uncertainties in the Allenbridge report and suggested that illiquidity limited action - it was necessary to be able to sell stocks when needed in certain circumstances. He also wanted to see figures showing that equities would not achieve 5% over a 100-year period and wanted a report on an approach with a larger passive element (equity passive).

Allenbridge highlighted that the fund already had a passive manager alongside high conviction equity managers. Allenbridge were not "anti-passive" and passive was used in the current strategy to "dull-up" or "dull-down" and match the index. The FTSE100 was the largest option in this asset class but more money was generally invested into big stocks leading investors to buy shares at an expensive price and to sell cheaply. Allenbridge could not support quasi index matching to achieve the necessary income and a passive fund would only be used to "dull-up" or "dull-down" to meet benchmark. Supporting an element of passive investment, a Member suggested there

might be opportunity to use some of the passive investment within the London CIV, capitalising on saving and obtaining a benchmark for comparison. However, passive was not necessary to create a benchmark as this was already provided in the FTSE; using funds from the current DGF allocation for passive equity was not Allenbridge's recommended approach and choosing the right asset manager was key to a successful active approach. From 2018, any decision on procuring assets would be expected to be taken though the London CIV where suitable sub-funds were available; until then the Fund would continue to be able to procure assets. Post 2018 assets such as Mears could be retained outside of the CIV.

With a majority of the Sub-Committee preferring to see further work undertaken, Members sought to provide guidance to Allenbridge. A Member favoured diversification to achieve income for the short to medium term and some DGF funding transferred to Property (Option 4a). The Member was also favourable to Multi-Asset Income funds (Option 4b) but preferred to see more information on the option. He was also content to wait and assess proposals for the fixed interest allocation.

Referring to the structure proposed by Allenbridge (60% Global Equities, 15% Fixed Interest, 20% Income Property funds and 5% Multi Asset income funds), a Member suggested a 60%/15%/10%/15% allocation. With a 10% property allocation, another view suggested allocating more from fixed interest which appeared to remain relatively stable – further consideration was felt necessary on fixed interest and whether the current allocation is delivering what is needed. Allenbridge expected fixed income to deliver a lower level of return but it would help to provide diversification. Should the Sub-Committee wish to pursue a more passive approach to reduce risk Allenbridge also suggested that consideration could be given to introducing a global passive product.

Overall it was suggested that active is better for the Fund and such a view was supported by a majority of the Sub-Committee. In view of the impending cash deficit, a passive approach would be unable to provide the necessary returns with a risk of the Fund being inadequately funded; returns were necessary to meet the Fund's liabilities and provide income. Although active was the preferred way forward, particularly with appropriate fund managers being chosen, it was felt that further information/research is still needed before agreeing a strategy. For the minority view supporting a more passive approach, further information was suggested to prove that active is better for the Fund. Reference was also made to the Government's view on passive.

Members were asked whether some income should be re-invested. Allenbridge advised that part of this was covered in Option 3 whereby no change was proposed to the current 70%/20%/10% asset allocation but selected Managers would be instructed to transfer all or part of income generated to the Fund "cash account "on a regular basis to meet cash flow requirements. However, this would be re-considered pending further information to be provided based on the arguments for an active approach (i.e. further information based upon option 3 and an active approach at Option

4). Allenbridge were confident they had the necessary guidance from Members to undertake further work/research for a proposed strategy including consideration of a 10% allocation on property pooled funds to be funded from the current DGF allocation and consideration of a 5% allocation from Global Equities for Multi-Asset Income Funds. Allenbridge would also look again at Fixed Interest and whether it is worth moving some fixed interest allocation to Multi-Asset Income Funds. The Sub-Committee also suggested that the Director of Finance, in consultation with the Chairman and Vice-Chairman, and following the advice of Allenbridge, be delegated authority to pay back investment income to the Council rather than re-invest the income.

Members therefore confirmed that no changes should be made to the Asset Allocation Strategy at the present time with further work to be undertaken by Allenbridge for an active approach; this to take account of Member comments and based upon arguments supported by a majority of the Sub-Committee.

A special meeting of the Sub-Committee was suggested as soon as possible to discuss the additional work to be produced by Allenbridge.

RESOLVED that:

(1) the content of the report be noted;

(2) no changes be made at the present time to the asset allocation strategy, with further work to be undertaken by Allenbridge to be reported back to the next meeting, taking account of Member comments and based upon arguments supported by a majority of the Sub-Committee;

(3) the continued use of active management for investments be endorsed;

(4) a special meeting of the Sub-Committee be arranged to discuss the additional work that Allenbridge would produce; and

(5) the Director of Finance, in consultation with the Chairman and Vice-Chairman, and following the advice of Allenbridge, be delegated authority to pay back investment income to the Council rather than re-invest the income where a cash negative position arises.

38 PENSION FUND INVESTMENT AND FUNDING STRATEGY STATEMENTS

Report FSD17028

The new Investment Strategy Statement for the Pension Fund, reflecting the outcome of the 2016 actuarial valuation, was presented for approval as required by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. The regulations required administering authorities to publish an Investment Strategy Statement (ISS)

by 1st April 2017 replacing the Statement of Investment Principles (SIP) required under the 2009 regulations. The ISS had therefore been produced on the basis of the existing asset allocation strategy and would need updating to reflect any subsequent changes to the strategy. A revised ISS would then be presented to a future Sub-Committee meeting for approval.

Under the regulations, it was necessary to keep the ISS under review and revised from time to time, but at least every three years. At present, it was anticipated the statement would be reviewed annually and submitted for approval as part of the Pension Fund Annual Report along with the Funding Strategy Statement, Governance Policy Statement, and Communications Policy Statement.

The regulations also empowered the Secretary of State for Communities and Local Government to issue a direction if satisfied that an administering authority was failing to act in accordance with the guidance. This would help control any local authority not making investment decisions in the best interests of pension members. The DCLG Guidance on Preparing an ISS also reaffirmed that *"schemes should make the pursuit of a financial return their predominant concern"* and should not pursue policies contrary to UK foreign policy or UK defence policy.

Following completion of the 2016 actuarial valuation, the Funding Strategy Statement (FSS) was also updated – the FSS being a requirement of the Local Government Pension Scheme Regulations 2013. It was necessary to revise and publish an updated FSS to reflect any material changes; accordingly, Members were also asked to approve a revised FSS as presented.

As with the ISS, it was envisaged that the FSS would continue to be reviewed annually and submitted for approval as part of the Pension Fund Annual Report.

Members agreed both the ISS and FSS documents.

RESOLVED that:

(1) the content of the report, particularly the new powers for the Secretary of State to issue directions as detailed at paragraph 0 of Report FSD17028 be noted;

(2) the Investment Strategy Statement included at Appendix 1 to Report FSD17028 be approved;

(3) if required, a revised Investment Strategy Statement would be presented to a future Sub-Committee meeting to reflect any agreed changes to the Fund's Asset Allocation Strategy, and

(4) the Funding Strategy Statement included at Appendix 2 to Report FSD17028 be approved.

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

40 CONFIRMATION OF EXEMPT MINUTES - 31ST JANUARY 2017

The exempt minutes were agreed.

The Meeting ended at 9.11 pm

Chairman