

PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.30 pm on 16 May 2017

Present

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

Also Present

Brian Toms, Employer Representative – Local Pension
Board
Jane Harding, Employer Representative – Local Pension
Board
Alick Stevenson, AllenbridgeEpic Investment Advisers

1 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from Cllr Richard Williams.

Apologies were also received from Lesley Rickards, Local Pension Board
(Member Representative).

2 DECLARATIONS OF INTEREST

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

3 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 5TH APRIL 2017

The minutes were agreed. In so doing thanks were conveyed to Cllr Teresa
Te for her work in chairing the Sub-Committee during 2016-17.

4 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

5 PENSION FUND PERFORMANCE Q4 2016/17

Report FSD17041

Details were provided of the Fund's investment performance for the fourth
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 March quarter at £943.8m and had fallen slightly to £943.0m as at 30th April 2017. The total fund return for the fourth quarter was 5.7% against a 4.5% benchmark. This compares to an estimated average of 3.7% across LGPS funds for the quarter based on initial figures from PIRC.

Report FSD17041 also advised that officers were currently liaising with relevant contractors for the Extra Care Housing contract and the proposed Libraries contract in relation to obtaining admitted body status with the L B Bromley Fund. Further updates would be provided in future quarterly performance reports.

A provisional net surplus of £5.6m was achieved during 2016/17 (mainly due to investment income of £7.5m) and total membership numbers rose by 733. The net surplus of £5.6m includes £7.5m investment income, which is currently reinvested in the fund. As such, the Fund had an estimated £1.9m cash deficit for the year in cash-flow terms – cash-flow being one of the main drivers for the recent asset allocation review.

Overall, the fourth quarter was considered good by Allenbridge and significant returns were achieved. Although performance had fallen a little at the end of April the position was understood to have recovered. There had been no major issues in the quarter.

In view of the intention to sell all holdings in Diversified Growth Funds there seemed little point in having Standard Life address the Sub-Committee at its meeting on 19th September 2017. Accordingly, the Sub-Committee agreed that an invitation for Standard Life to attend the meeting was no longer necessary.

A share of the Fund assets relating to Bromley College (now part of London South East Colleges) would be transferred to the Local Pensions Partnership as a result of the College leaving the Fund. A Member suggested that proceeds from the DGF disposal be considered first for funding the transfer. However, much depended on the position of markets at the time of transfer and the market should therefore be reviewed the time to decide what assets to sell to generate the cash needed. Another Member supported use of DGF funds unless there was a good case not to do so. However, it was indicated that (at this stage) it was best not to be too rigid in selling DGFs to fund the transfer. The proportions of the Fund's asset allocation would change and any final decision on funding the transfer would be subject to consideration by the Director of Finance, following the advice of Allenbridge, in consultation with the Chairman and Vice-Chairman of the Sub-Committee.

A Member also highlighted the level of employer contribution being paid to the Fund which he felt was unsustainable for the future. The scenario was

replicated nationally and there were a number of unfunded pension liabilities in the UK. The situation was such that it was necessary to lobby government on the problem for action to be taken. The Member suggested that the matter should be raised with the Government to address the unsustainable position for local government pension funds. The Chairman confirmed that he would write to Government on this issue. The Director highlighted that the Council's concerns are consistently raised in responses to consultation on pension matters and the Leader had met the Special Adviser to the Secretary of State for Communities and Local Government where the matter was raised. It had also been raised with the local M.Ps to seek to influence Government policy on such matters. Another issue of concern related to TUPE and the protection of staff pension liabilities when outsourcing work. This was off-putting to some tenderers and it was agreed that this would form part of the response to Government following the general election.

RESOLVED that the contents of the report be noted.

6 PENSION FUND - INVESTMENT REPORT

Quarterly reports from Fund Managers had been circulated to Sub-Committee Members and Members of the Local Pension Board with the meeting agenda pack.

A representative from Baillie Gifford attended the meeting reporting on the performance of its portfolio in Global Equities, Diversified Growth Funds and Fixed Interest. Net figures were provided throughout the presentation.

The total portfolio had a valuation of £456,520,316 at 15th May 2017 with previous valuations at 31st March 2016 and 31st March 2017 comprising £344,642,947 and £441,459,809 respectively. Against market developments (e.g. equity markets continuing to perform, a growing economic confidence in Europe, growth by technology companies and a loose monetary policy) and world regional and sector returns in various categories of stock, Baillie Gifford provided details of investment returns to 31st March 2017 with a strong performance from technology stock. U.S. industrial names also performed well. A number of healthcare holdings had, however, detracted from performance. Under the new U.S. administration deregulation was proceeding so providing a fiscal boost. In the U.K. an 18% fall in the value of sterling following the referendum benefitted companies and provided a good trading climate.

The presentation outlined the focus of Baillie Gifford's 2017 research agenda for Global Equities. This covered the improving U.S. economic position and a particular focus on interest rate rises, tax cuts, infrastructure spending and regulatory change. It was anticipated the Federal Reserve could increase interest rates. Technology platforms also featured in Baillie Gifford's research (e.g. capital light business models, strong network effects, stakeholder engagement and emergent areas) as did a focus on re-emerging markets with improving governance and new trade routes (e.g. structural reform focusing on China, India, Brazil and South Korea with expanded trade routes along the

old “Silk Road”). Further Baillie Gifford research focussed on healthcare demands and looking at areas such as harnessing new technologies and delivering better care at lower cost – the sector was also considered well positioned for regulatory change.

For Diversified Growth, the portfolio achieved a 5.5% p.a. net return to 31st March 2017 since initial investment in December 2012. This was slightly ahead of target at 4% (Base Rate + 3.5%). Investments making a significant contribution to DGF performance included: Listed Equities (equity markets were strong as the global growth outlook improved); High Yield Credit (benefitted from a continued search for yield in a low interest rate environment), Active Currency (selected overweight positions in emerging market currencies and a strengthening U.S. dollar helping to generate positive returns); and Emerging Market Bonds (supported by a combination of strong global growth and strengthening emerging market currencies along with progress on structural reforms and a stabilisation of commodity prices). Asset class weightings for the DGF portfolio were also outlined along with Baillie Gifford’s views that global growth expectations are rising, that monetary policy is likely to tighten, that several asset classes are at or above Baillie Gifford’s estimate of fair value; and that market volatility may create opportunities. In regard to stock selection, a Member suggested it more likely for stocks in India and China to grow rather than in Europe; he felt that developed markets were not growing so well and emerging market stocks were exciting.

Given the intention to pay more cash due to the Fund’s cash deficit position and to move investments away from DGF, a Member sought the representative’s thoughts for the future and how it might be possible to achieve the necessary returns without an excessive element of risk. As the Fund would be paying pensions into the next century the representative considered it necessary to continue with some global equities and also acknowledged the Sub-Committee’s proposal to replace DGF with assets providing a similar return for income. Baillie Gifford did not have a Multi-Asset Income Fund product.

7 OUTLINE PROCUREMENT PROCESS FOR FUND MANAGER APPOINTMENTS

Report FSD17042

Members considered a recommended approach for implementing the Pension Fund Asset Allocation Strategy agreed at the Sub-Committee’s previous meeting on 5th April 2017 i.e. no allocation to Diversified Growth Funds, reducing allocations to Global Equities and Fixed Interest, and introducing income generating allocations to Multi Asset Income (MAI) Funds and Property.

Report FSD17042 summarised the current and revised strategic allocations as:

	Current strategic allocation	Actual allocation 31/03/17	Revised strategic allocation	
	%	%	%	£m*
Global Equities	70	77.9	60	566.3
Fixed Interest	20	13.9	15	141.6
Diversified Growth Fund	10	8.2	0	0
Multi-Asset Income Fund**			16.8	158.5
Property**			8.2	77.4
				943.8
* Indicative allocation based on total fund value as at 31st March 2017				
** Allocation to property to equal actual DGF total value as at point of transfer, with the balance to adjust the allocation to MAI				

AllenbridgeEpic had been appointed to manage Fund Manager procurement for the new mandates and a brief Allenbridge report and indicative timeline for the MAI Funds was appended to Report FSD17042. Two Managers were proposed for the MAI Funds to increase diversification and aid performance appraisal.

For Property Funds, Report FSD17042 proposed to initially manage £50m in a pooled property fund with the remaining balance (around £27m based on fund values at 30th March 2017) being managed directly.

For both MAI funds and a pooled property fund a two-stage restricted tender process would be used advertised in the Official Journal of the European Union (OJEU). For both allocations it was proposed to delegate the Director of Finance (in consultation with the Chairman and Vice-Chairman) with authority to agree a shortlist of Fund Managers (to be recommended by AllenbridgeEpic) who would be invited to submit a tender following the PQQ process.

To implement the revised strategy it would be necessary to sell the Diversified Growth Funds and some 18% of assets in Global Equities (based on values at 31st March 2017). A decision on which Global Equities assets to sell was proposed for a later meeting.

The Chairman explained that procurement documentation would include a requirement for the submission of tenders based on 80% quality and 20% price (rather than 70% quality and 30% price). This would convey a particular focus on quality when selecting the Fund Managers. It was intended to complete the procurement process by the end of the calendar year with decisions to be made at the Sub-Committee's meeting on 21st November 2017 and at a special Sub-Committee meeting initially proposed for 12th December 2017.

It was proposed that the allocation be amended to 5% Property and 20% MAI; direct investment in property (approximately £27m) would not then be

necessary and the total property element could be managed in a pooled fund (value of some £50m).

A Member also reminded that the MAI funds were not to be weighted with derivatives; neither should the funds rely upon foreign exchange conditions for returns. Members were assured that PQQ documentation would highlight the need to limit use of derivatives. Stocks in futures could also be excluded if necessary. As the volume of MAI assets increased so the level of derivatives would reduce and derivatives would not be used for profit. On foreign exchange conditions, MAI investments could be hedged back to sterling.

Members agreed the recommendations in Report FSD17042 subject to the property allocation being in the range of £50m; having more than one Fund Manager for the MAI assets; having diversification; and having a minimal use of derivatives. Members also agreed that the Sub-Committee's meeting on 21st November 2017 would select Fund Managers for the MAI allocation and Fund Managers for Property would be selected at a special Sub-Committee meeting on 12th December 2017 (*Democratic Services Note: subsequently changed to 14th December 2017*). Careful consideration would be given to timetabling for both meetings.

More generally, Members discussed a preferred start time for future meetings of the Sub-Committee i.e. 7pm or 7.30pm. A vote confirmed that opinion was equally divided and it was agreed to consider the matter again at the Sub-Committee's next meeting.

RESOLVED that:

- (1) the contents of the report be noted;**
- (2) the proposed actions and indicative time-frames attached at Appendix 1 to Report FSD17042 be noted;**
- (3) the allocation to Property comprise a value of approximately £50m managed through a pooled fund;**
- (4) mandates be tendered for two Multi Asset Income Funds, and one Property Fund;**
- (5) the Director of Finance, in consultation with the Chairman and Vice-Chairman, be delegated authority to select the shortlist of managers to be invited to submit a tender following the PQQ process; and**
- (6) a Special Meeting of the Sub-Committee be held on 12th December 2017 (*Democratic Services Note: subsequently changed to 14th December 2017*) to award the Property pooled fund mandate (paragraph 3.3.3 of Report FSD17042).**

The Meeting ended at 8.58 pm

Chairman