PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.00 pm on 24 July 2018

Present

Councillor Keith Onslow (Chairman)

Councillors Simon Fawthrop, Kira Gabbert, Simon Jeal, Gary Stevens and Pauline Tunnicliffe

Also Present

John Arthur, Allenbridge
Geoffrey Wright, Member Representative, Local Pension Board

42 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from Cllr Russell Mellor, Cllr David Jefferys, and Cllr Gareth Allatt.

Cllr Kira Gabbert attended as alternate for Cllr Jefferys and Cllr Pauline Tunnicliffe attended as alternate for Cllr Allatt.

43 DECLARATIONS OF INTEREST

Cllr Fawthrop declared an interest as a deferred Member of the Local Government Pension Scheme.

44 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 22ND MAY 2018 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The minutes were agreed.

45 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

46 PENSION FUND ANNUAL REPORT 2017/18

Report FSD18059

Members received the annual report and accounts of the L B Bromley Pension Fund for year ending 31st March 2018 which the Council is required to publish under the Local Government Pension Scheme Regulations 2013.

The annual report included the following documents requiring the Sub-Committee's approval:

- Governance Policy Statement
- Funding Strategy Statement
- Investment Strategy Statement
- Communications Policy Statement.

The annual report had been audited by the Fund's external auditor, KPMG LLP and included a draft statement from KPMG. The Council would publish the Annual Report on its website by 1st December 2018.

The Bromley Pension Fund had total net assets of £967.0m as at 31st March 2018 (£913.4m as at 31st March 2017). The Fund outperformed its benchmark by 3.6% over the year (+6.1% against a benchmark return of +3.1%). Performance compared to the 61 LGPS funds in the PIRC local authority universe (average return of +4.5%) was excellent, ranking in the 3rd percentile for the year. Rankings over the medium and long term were also excellent – first over three years and over ten years, and second over five years, 20 years and 30 years to March 2018.

Total membership of the fund increased from 16,404 at 31st March 2017 to 16,920 at 31st March 2018 when it comprised 6,198 employees, 5,185 pensioners and 5,537 deferred members. Payments into the Fund from contributions (employee and employer), transfers in, and investment income totalled £41.6m in 2017/18 (£44.9m in 2016/17) and payments from the Fund for pensions, lump sums, transfers out and administration totalled £40.9m (£71.0m in 2016/17). The large reduction in the value of payments made during 2017/18 is mainly the result of the group transfers out of Bromley College and GS Plus during 2016/17.

The accounts had been audited by KPMG and were made available in draft form on the Council's website before the end of May 2018. KPMG anticipated issuing an unqualified audit opinion on the financial statements of the Pension Fund and a draft statement to that effect was included in the Annual Report. *(Democratic Services note: the final opinion, issued after the meeting, was unchanged from the draft included in the Annual Report.)*

In discussion it was highlighted that there were only four investment managers in the second paragraph under "Investment Managers" at page 13 of the Annual Report (of the year to 31st March 2018), and that Schroders had been appointed since then.

RESOLVED that:

(1) the Pension Fund Annual Report 2017/18 be noted and approved;

(2) the Governance Policy Statement, Funding Strategy Statement, Investment Strategy Statement, and Communications Policy Statement, as outlined at paragraph 3.2 of Report FSD18059, be approved; and

(3) arrangements be made to ensure publication by the statutory deadline of 1st December 2018.

47 PENSION FUND - INVESTMENT REPORT

Initial Allenbridge assessment of second quarter performance

John Arthur (Allenbridge) provided a brief commentary on the Fund’s second quarter performance prior to the MFS presentation. In relation to Environmental, Social and Corporate Governance (ESG) considerations, the Director also updated Members on Government proposals to amend investment regulations for occupational pension schemes.

From outline figures on second quarter performance, the Fund slightly improved from benchmark but with a high level of volatility there was a greater level of uncertainty in markets. U.S. economic performance was good following tax cuts and subsequent volatility in Q1 passed; generally, the global economy was performing well. There had also been some political tensions in Europe e.g. new Italian Government.

Since the 2008 crash, economies had cut interest rates with extensive bond buying to encourage growth. The recovery had been the slowest on record but the economic picture was now becoming stable. The UK economy was growing stronger and central banks had dropped the level of bond buying with less money being pushed into the system. There was now substantive economic growth and a greater level of volatility. Assets were growing and it would have to a major political event(s) to impact the global economy.

With economies on the latter stages of recovery, markets had raised in Q2. Mr Arthur expected returns to be slightly volatile and medium term there was a reasonable level of returns. Although one of the best performing in England and Wales, it would not be easy for the Fund during the end stage of economic recovery.

ESG considerations on investments for occupational pension schemes

The Government had consulted on proposals to clarify and strengthen trustees’ investment duties and mandate for ESG considerations related to investments for occupational pension schemes. An amendment to the Occupational Pension Schemes (Investment) Regulations 2005 would require trustees to state their policies on evaluating risks for an investment long term. This would include risks related to sustainability arising from corporate governance or from environmental or social impact. Trustees would also have to consider and respond to members' ethical and other concerns.

Although the intentions were sound, there was a risk of the principles being politicised. Clarification would be provided on strengthening investment responsibilities and trustees would need to consider ESG in their investments. The regulations would also require ESG related decisions to be nondetrimental to the Fund financially. In response to the consultation, the Director indicated that any variation to regulations should be based upon strong evidence and not be overly bureaucratic. L B Bromley Fund Managers already take the long term into account in investments, ensuring that ESG related risks are limited as far as possible to diminish factors that might prevent a maximised return. Baillie Gifford had indicated that there was a greater chance of achieving good sustainable performance success with more freedom given to Managers. In regard to an updated Investment Strategy Statement (ISS), the Chairman confirmed that the section in the current ISS, that Members were being requested to confirm when considering the Pension Fund Annual Report 2017/18 (i.e. *"how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments"*), is robust.

Mr Arthur thought the proposed regulations worked well with L B Bromley given that Baillie Gifford and MFS have a holding period for investments of seven to eight years. ESG was long term and the Fund Managers would need to consider such matters; it was important to them given the timescale for investments and best left for their decision when looking at investments. It was better to engage with companies to help them change and Baillie Gifford and MFS both did this.

Under the Government guidance it was possible to make investments unless they are illegal but any investment decision should not risk financial detriment to the Fund. The regulations were intended to provide clarification and a Member indicated that the Fund appeared to be more or less covered by the proposals; additionally, the Fund's Investment Strategy was always long term.

A further Member indicated that ESG was also about seeking renewable/green bonds and environmentally friendly investments and to look at corporate governance. There were a number of active and passive ESG investments and he suggested that this was basically a move towards looking at other things apart from solely profit including achieving good or better returns with ESG. ESG was now a growing area and he suggested that stocks without these would lose out.

<u>MFS presentation</u>

As at 31st May 2018 assets invested by MFS had a value of £216,150,232 compared to a value of £210,442,797 at 31st May 2017. The presentation also referred to top sector overweights and top underweights with investments as well as sector contractors/detractors to performance in the year. MFS investments had seen a substantial lagging behind index over a five to nine month period.

The rolling relative performance of MFS Global Value Equity Composite (gross of fees) had delivered a long term performance (since the Fund's inception in July 2003) as shown below:

Rolling Time Period	% of outperforming periods	Average excess return
3 years	99%	3.3%
5 years	100%	3.3%
7 years	100%	3.2%
10 years	100%	3.3%

For the most part MFS had outperformed but more recently markets had been strong and MFS had struggled to maintain performance with a cautious approach taken. In down markets between July 2003 and March 2018, the MFS Global Value Equity Composite (gross of fees) had significantly more outperforming quarters against the MSCI World Index than underperforming quarters; during up markets there were slightly more underperforming quarters. Overall in the period, MFS achieved more outperforming quarters than underperforming quarters.

MFS adopted a consistent long term approach, marrying fundamentals and valuation to identify compelling investment ideas across the world. Their goal was to outperform the MSCI World Index over full market cycles with below average volatility (the MSCI World Value Index is a secondary benchmark). MFS believed that maintaining a long term investment focus provided the opportunity to exploit market inefficiencies along (i) valuation as one of the most important drivers of long term investment performance, and (ii) business durability, driving more persistent returns than the market recognises along with the compounding effect of excess returns and cash flows. On strategy, MFS analysed the long-term durability of businesses rather than try to forecast near-term earnings. They also invested in companies with attractive valuations and low market expectations, high sustainable return prospects, or significant potential for improvement. Their valuation approach was flexible, but rigorous, considering downside risk for each company they invest in, only investing where valuations compensate for it. MFS looked at firms with a competitive edge long term and saw their prime function as not losing money for the Fund.

Most of the MFS Global Value Equity was held for five to ten years as shown below:

Number of years held	Proportion of Portfolio
0 – 1	10.2%
1 - 3	17.8%
3 - 5	7.9%
5 - 10	32.6%
10+	31.2%

As of 31st May 2018, a market overview was also provided by region performance and the performance of specific sectors (MSCI World Sector Performance). Equity market volatility had jumped from historically low levels since February 2018, although the volatility spike appeared to have been technically driven. Continued synchronized global growth combined with historically low interest rates still supported the equity market. Economic indicators were not yet signaling the end of the business cycle/market cycle that started in 2009. With valuation remaining rich by historical measures, concerns around higher inflation, higher interest rates, peaking economic and earnings momentum, global trade friction, and geopolitical risks might continue to weigh on global equity markets going forward. Although the prospect is not looking so good for the future, the cycle had not ended and MFS expected returns of 4% or over in the next ten years. Reference was also made to a higher level of performance in the U.S.

Performance drivers in stocks and sectors for the year to 31st May 2018 were also highlighted. Although there were stock contributors, commentary to Members indicated that MFS performance had not been so good with poor stock selection over the recent period - there were no “stand-out winners” on MFS investment stocks in past years.

Further presentation summaries included significant transactions for the year to 31st May 2018 covering purchases and sales and investment weightings by sector. A further summary highlighted weights of investment by region and country.

Concerning an under-exposure by MFS in IT, reference was made to Google and Yahoo some years ago when both organisations had the same search market. Now it was mostly Google and leadership can change within companies. On early investment in IT companies such as those concerned with space technologies, reference was made to a list of portfolio holdings appended to the MFS presentation. Leadership changed less quickly with these companies and they were well stablished. MFS preferred to focus their attention on about 2,000 companies for potential investment, leaving exciting new areas for others. As long as the majority of stocks held by MFS do well, good returns are achieved and the risk is reduced.

Mr. Arthur indicated that MFS come into their own when markets fall and asked if MFS could put into context last year’s performance against the long term performance achieved by MFS. MFS indicated that the previous occasion they had such a period of poor performance was 1989. Nearly every year, the market’s most expensive stocks in the previous year tended not to perform the best subsequently. There were also certain disrupters to investment performance in sectors and MFS tended to avoid investment in companies involved.

Concerning ESG, reference was made to material appended to the presentation outlining the MFS approach to responsible investing. MFS integrated material ESG risks and opportunities into the fundamental research process to maximise long term investment performance. The formal commitment of MFS to ESG research was demonstrated by:

- Founding the MFS Responsible Investment Committee (2009);
- Signing the Principles for Responsible Investment (2010); and

- Hiring a dedicated ESG research analyst (2013).

On integrating ESG risks and opportunities in investment decisions, evaluation was based on: the research of individual MFS analysts and portfolio managers; the work of the dedicated MFS ESG analyst; and the research of third parties. When an ESG issue is identified as material for a particular firm, a member of the MFS investment team may engage with the management team or board of directors of that firm to better understand the risk or opportunity that the ESG factor presents. The MFS research analyst encourages additional dialogue on ESG topics through company-specific analysis, thematic research, and the development of portfolio “dashboards”.

On integration in ownership policies and practices, the MFS proxy voting policies are informed by ESG issues to help protect and enhance long-term shareholder value. The MFS proxy team engages with the MFS portfolio companies on many ESG topics, including executive compensation, board composition, and sustainability reporting. MFS publically disclose a report on their proxy voting and engagement activities annually; this includes details of the proxy team’s voting and engagement activity. The MFS emphasis on ESG reflects the MFS investment process, taking an integrated approach; MFS wanted to invest in businesses providing good returns and growth rates and this included ESG considerations. MFS had recruited an analyst to ensure that important matters on the long term business case of a company are properly considered and it was now part of day to day life.

On MFS performing above benchmark for most years since 2008 and a significant volatility (in returns) from year to year, standard volatility over a year was one level of risk looked at - it was about understanding the companies owned. Some good performance relative to index had been achieved with some not so good, particularly for last year. This could be expected and had not encouraged MFS to change its fundamental approach. MFS were confident of producing returns long term and had significant skill in those areas of most risk by choosing appropriate companies.

48 TRANSFER OF BAILLIE GIFFORD GLOBAL EQUITIES INTO THE LONDON CIV

Report FSD18061

Further to the Government requirement for administering authorities to pool assets into investment pools (to deliver management fee savings and increase capacity/capability for infrastructure investments), Members were asked to consider a transfer of the Fund’s Global Equities portfolio managed by Baillie Gifford into the equivalent portfolio in the London Collective Investment Vehicle (which the L B Bromley Pension Fund joined in October 2016). Assets such as equities and bonds (easier to transfer or sell) were expected to be pooled first.

In view of matters considered as exempt material which the Chairman wished to discuss with the Sub-Committee, Members agreed to consider the item under Part 2 proceedings of the meeting.

49 PENSION FUND RISK REGISTER

Report FSD18060

Comprising high level risks (underpinned by more detailed registers within individual business plans), the Pension Fund Risk Register (appended to Report FSD18060) feeds into the Corporate Risk Register via the Corporate Risk Management Group**.**

The Fund's agreed Asset Allocation Strategy (reviewed in 2016/17) balances the risks associated with a high allocation to growth assets, particularly equities, with the need to improve the funding level and maintain employer contribution rates at a relatively stable level, whilst also meeting the Fund's cash-flow requirements.

A summary of the main investment risks comprised:

- Concentration/credit – the risk of underperformance or default from a significant allocation to any single investment or type of investment;

- Illiquidity – the risk that the Fund has insufficient liquid assets to meet its cash flow requirements;

- Currency risk – the risk that the currencies of the Fund's assets underperform relative to sterling;

- Interest rate risk – the risk that the values or future cash flows from investments fluctuate as a result of changes in market interest rates; and

- Manager underperformance – the failure by the investment managers to achieve their benchmark rate of investment return.

A Member felt that governance around the CIV is a risk missing from the Register. Although the Fund continues to retain ownership of its investments in the London Collective Investment Vehicle (LCIV), Members supported the view and it was **RESOLVED that:**

(1) the current Pension Fund Risk Register be noted along with existing controls in place to mitigate the risks; and

(2) further commentary be added to the Register to reflect an additional risk of governance related to the London Collective Investment Vehicle.

50 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

51 CONFIRMATION OF EXEMPT MINUTES OF THE MEETING HELD ON 22ND MAY 2018

The exempt minutes were agreed.

The Meeting ended at 10.33 pm

Chairman