PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.00 pm on 24 July 2019

Present:

Councillor Keith Onslow (Chairman)
Councillor Gareth Allatt (Vice-Chairman)
Councillors Mark Brock, Simon Fawthrop, Simon Jeal, David Jefferys and Christopher Marlow

Also Present:

John Arthur (MJ Hudson)
Peter Turner, Chief Executive's Department

14 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from Cllr Gary Stevens and Cllr Mark Brock attended as alternate.

15 DECLARATIONS OF INTEREST

There were no new declarations of interest.

16 MINUTES OF THE PENSIONS INVESTMENT SUB-COMMITTEE MEETING HELD ON 15TH MAY 2019

The minutes of the meeting held on 15th May 2019 were agreed and signed as a correct record.

17 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

Two questions for written response had been submitted by Gill Slater.

The questions and answers have been appended to the minutes and Ms Slater has been provided with a copy of the answers via email.

18 UPDATES FROM THE CHAIRMAN AND/OR DIRECTOR OF FINANCE

The Director of Finance updated the Committee regarding the 'McCloud Judgement'.

The Local Government Pension Scheme faced ongoing uncertainty over compensation costs, after the Supreme Court ruled that changes made in 2015 to public sector pensions had discriminated against younger employees.

Judges had ruled in favour of the Fire Brigades Union (FBU) and a group of judges led by Victoria McCloud, challenging the rule changes, which protected the pension benefits of older workers.

The Supreme Court ruling meant that council pension funds would probably have to compensate and account for payments to ensure that no employee was left out of pocket.

The ruling said: “We have found that in both the judges’ and firefighters’ cases the manner in which the transitional provisions have been implemented has given rise to unlawful direct age discrimination’.

The Director informed Members that the ruling could potentially add another £10m to Bromley’s pension liabilities with further ongoing annual costs to the employer costs. The Director was disappointed by the ruling, and the exact cost impact would have to be determined by the Actuary.

The Director informed Members that Schroeder’s had an US Dollar denominated fund that would be moving to a sterling denominated product. The change had been negotiated by John Arthur (MJ Hudson) at no cost to the Council, and it could be the case that the Council would make a profit from the change.

A discussion took place concerning Neil Woodford’s Equity Income Fund which had got into difficulty due to the high volume of illiquid assets which was not able to meet demand when a large number of investors tried to withdraw their money at the same time.

RESOLVED that the update provided by the Director of Finance is noted.

19 PENSION FUND DRAFT ANNUAL REPORT 2018/19

Members noted that this report had been written as an introduction to the draft annual report and accounts for the Bromley Pension Fund for year ending 31st March 2019. Subsequent to scrutiny of the report by the Pensions & Investment Sub-Committee, the report would also be subject to auditing by the Fund’s external auditor. To comply with the Government Pension Scheme Regulations, the Council was required to publish the final version of the Annual Report on its website by 1st December 2019.

The four separate documents that were required to be incorporated into the report were noted:

- Governance Policy Statement
- Funding Strategy Statement
- Investment Strategy Statement

- Communications Policy Statement

Members noted and approved the statements.

The corresponding Governance Compliance Statement (for the Governance Policy Statement) had been presented to the GP&L Committee in July 2008, and was also attached to the meeting papers for Members' information.

Members were advised that as at 31st March 2019, the net assets of the Bromley Pension Fund were £1,039m.

The Committee was briefed that the Bromley Pension Fund performance for the last financial year was 7.99% which was slightly below the benchmark target of 8.27%. However, the performance of the fund was still strong and had been over the medium and long term.

Members were briefed that the external auditors (Ernst and Young) had not yet completed their audit of the pension fund accounts, and that the publication deadline for the audit (31st July) would not be met. It was anticipated that the audit of the accounts would be reported back to the GP&L Committee on 19th September 2019.

Members were updated regarding Risk Management. 'Risk' in this context was the risk that the funding strategy may fail, and that target funding levels would not be met. The Pension Risk Register was used as a key tool for the management of risk, and this had been incorporated into the agenda for the attention of Members. Further assurance in terms of risk management was provided by the internal control documents produced by both the investment managers and the custodian. These documents identified internal processes and procedures, along with the associated audit testing. Risk was minimised further because the Fund's independent investment adviser monitored the market and the activities of investment managers.

Regarding financial performance, the Committee was pleased to note that day to day income and expenditure for the Fund showed an overall surplus of £12.1m in 2018/2019.

The results of the Internal Audit undertaken in 2018/2019 showed that controls were in place and working well and had resulted in a 'substantial' audit assurance rating.

Members noted that the regulations required that an actuarial valuation be undertaken every three years and that the Pensions and Investment Sub-Committee (PISC) was responsible for considering the report. The most recent valuation was at 31st March 2016. Members were pleased to note that the value of the Fund's assets in the 2016 valuation represented 91% of the value of the liabilities, up from the previous valuation of 82% in 2013.

Members were encouraged to note that the current strategy was to achieve a funding level of 100% by 2028.

This would be re-assessed in the next full valuation as at 31st March 2019. The results of this would be known by the end of 2019/2020.

The Vice Chairman was concerned to note the problems highlighted in the report because of the methodology adopted by Cushman and Wakefield (C&W) when valuing the Council's property assets. Because of concerns raised by the External Auditors, the valuation process would have to be re-done. C&W's process for valuing council property assets had changed nationally, but had not been adopted at Bromley at the time of the valuation. No financial loss had been suffered by the Council. C&W had written a letter of apology to the Council and would provide compensation for officer time. The Director of Finance said that he would share the letter with the Committee. Monitoring of performance of Cushman and Wakefield would be considered by the Executive, Resources and Contracts, Policy Development and Scrutiny Committee.

It was noted that the External Auditors would not normally sign off the Bromley Pension Accounts until the overall Council audit was completed—the re-valuation of the Council's property assets had yet to be finalised as well as the 'McCloud' impact.

Councillor David Jefferys left the meeting at 9.05pm for another engagement.

RESOLVED that:

1) The Draft Pension Fund Annual Report 2018/2019 is noted.

2) The Governance Policy Statement, Funding Strategy Statement, Investment Strategy Statement, and Communications Policy Statement are approved.

3) The final Pension Fund Audit Report is reported to the Pensions and Investment Sub-Committee on 27th August.

4) The final Pension Fund Audit Report would be published to the Bromley Council website on 1st December 2019.

5) The Director of Finance would disseminate to the Committee the letter that had been received from Cushman and Wakefield regarding the valuation of the Council's property assets.

20 PRESENTATION FROM FIDELITY

Paul Harris (Relationship Director) and Steve Bramley (Investment Director-Fixed Income) attended from Fidelity to update the Committee on the Fidelity Global Multi Asset Credit Strategy.

Mr Harris commenced by providing an introduction and general overview of the Fidelity Global Multi Asset Credit Strategy (GMACS) and then the product was detailed in some depth by Mr Bramley.

It was noted that the current Fidelity UK Aggregate Bond Fund had served the Council well since its inception, and had yielded above market returns for that type of investment. The Fund had invested primarily in UK Gilts and GBP denominated investment grade corporate bonds. The Fund was moderately to highly sensitive to interest rates, yielded 2.0% in returns and invested in A+ bonds.

Mr Harris suggested that as circumstances had now changed and because interest rates could not really fall any lower, now may be the right time to consider an alternative investment strategy in the Fidelity Global Multi Asset Credit Strategy Fund. (GMACS). It was explained that the GMACS would provide wider flexibility to allow for a dynamic allocation to different types of bonds at varying points in the business cycle. The success or otherwise of the UK Aggregate Bond Fund had been judged by comparing its performance to similar investment strategies; the GMACS would be judged by its total return. The GMACS was less sensitive to interest rate changes and was anticipated to yield 4.7%. The average credit rating of investments would be BB+. The plan was to move away from a UK based strategy to a global one. Fidelity expressed the view that the GMACS was an outcome orientated product that was better suited to fulfilling longer term objectives. The objective was to achieve the best returns for minimum risk.

Mr Bramley explained the differences between the investment objectives and key investment parameters of the existing fund and the GMACS. He also explained the way that assets were allocated and Fidelity's approach to derivative usage. Derivatives could be used in a flexible manner to hedge out unwanted risks. It was also the case that the existing UK Aggregate Bond Fund used derivatives when it was thought appropriate.

A Member stated that LBB currently held about 60% of the current fund value in equities, and the existing fixed income bonds helped to de-risk this, so if LBB were to accept a six notch downgrade in the average credit quality; LBB would either need to reduce the current allocation to equities or do something else in order to maintain the aggregate risk of the portfolio. He further expressed the view that it would have been helpful if Mr Harris had mentioned that the fees would be 50% greater on the new fund, effectively going from 30 to 44 bases points. Mr Harris answered and said that he had not got to that slide in the presentation yet and was not attempting to hide anything from the Committee.

Mr Harris said that the fees would be higher on the GMACS as it was a much more complex portfolio to manage. It was also the case that the scale of returns from the new Fund were expected to be higher. There was a current relationship discount on the aggregate bond fund of 20%, and this would be retained on the GMACS fund. Mr Harris explained why the costs were higher and the amount of cost that would be absorbed by Fidelity. A Member asked how fluctuations in the currency markets would be handled and if currency hedging would be used. Mr Bramley responded that the foreign exchange risk would be denominated back to sterling.

A Member commented that Fidelity had provided data relating to the performance of the GMACS fund for the previous three years, but had not provided data that related to the performance of the fund since its inception. Mr Bramley answered that the Fund's performance was in the region of 4% per annum in dollar terms, which equated roughly to one percent lower in terms of sterling. This figure was slightly behind the return target as Fidelity had been conservative. The Member asked why Fidelity had adopted a conservative approach and the response was that the market had been suppressed by the Central Bank. It was noted that the current AUM (Assets Under Management) was $130m, which was in the region of £110m.

The Committee was presented with data on slide seven of the presentation which looked at the historical returns on various types of investment against historical volatility. It was clear that both the UK Aggregate Bond Fund and the GMACS Strategic Asset Allocation showed a similar risk and return profile over the last 15 years. However, it was the case that the correlation co-efficient between the two funds was only 27%, which revealed a material difference in the respective drivers. The UK Aggregate Bond Fund had benefited from a long compression of interest rates over the period, which Fidelity felt was unlikely to continue. In Fidelity's view, interest rates would not get any lower as there would then be a danger of the rates becoming negative, and this was generally regarded globally as being unacceptable.

Mr Bramley directed the Committee's attention to slide 5 which outlined the expected returns of various funds based on the future projection of historical volatility data. Over a ten year period, Fidelity was predicting approximately 0.5% growth for the UK Aggregate Bond and approximately 2.5% for the GMACS Fund. There was more credit risk in the GMACS Fund, but the credit markets looked positive and it was anticipated that there would be more value in corporate bonds than government stock. Brexit had not been factored into any risks. A Member suggested that it may be appropriate to consider varying the Aggregate Bond Fund.

The Chairman stated that it was not necessary to make a decision on the night and that matter could be re-visited in August.

A Member asked Fidelity how long they had been running an Emerging Markets Team for. Mr Bramley answered that the Emerging Markets Team had been running since 2012. It was clarified that these were 'total return' funds. A Member stated that he would feel more assured if Fidelity could provide more historical evidence of the success that they had seen in running GMACS type funds. Mr Bramley responded that he would investigate this and provide more information to the Committee.

The Vice Chairman said that he liked the idea of the GMACS Fund, but for the greater risk he would have expected to receive a higher return on investment. Another Member commented that it was expected that the pension fund liabilities would be fully funded this year, and LBB should be cautious about carrying extra credit risk, and losing the benefits of the current UK Aggregate Fund.

A Member asked if Fidelity invested in sub-ordinated instruments, and the answer was affirmative. Another Member asked for more details regarding what the GMACS Fund was invested in.

After discussing the GMACS Fund in some depth, Members then went on to discuss the Diversified Income Fund and the UK Real Estate Fund. The Diversified Income Fund (DIF) had delivered consistent and stable income in excess of 4%. It was noted that the monthly income figure from the DIF in December 2018 was double what would normally be expected. This was because any spare income was always paid into the Fund at the end of the year in December.

The UK Real Estate Fund had yielded a little less than the benchmark, but not much lower and still had an annual distribution yield of 4.5%. The income was purely rental income. A Member asked a question about what had happened to a large property in Solihull that was going to be bought, and wondered if it was now tenancied. The answer to this was affirmative and the property had been bought by N-Power on an 8 year lease. They had upgraded the property with air conditioning and new lighting.

A Member referred to the final paragraph of the disclaimer attached to the presentation. He queried the term ‘The Fidelity Qualifying Investors Fund’ and asked if this terminology was in fact correct. Fidelity agreed to look into this and update the Committee in due course.

LBB’s independent financial advisor (John Arthur from MJ Hudson) reiterated that the new UK Aggregate Bond Fund would not yield any higher returns unless interest rates dipped further which was unlikely. The downside to investing in the GMACS was the credit risk corresponding to equities as the LBB Pension Fund already had a large equity investment of 62% in equities. This was an issue that had to be considered. On balance he felt that it was good to diversify and that returns would be in the region of 4%. He felt that slow economic growth was no longer acceptable to the public and he expected to see the Government putting more money into the economy and more infrastructure building. He foresaw no long term decrease in interest rates.

A Member suggested that the Pension Fund invest in ‘More Homes Bromley’ rather than in fixed interest rate bonds. He felt it was safe; there would be a standard return, an asset and it would have an additional social benefit of providing more housing in the borough. He felt that it would be a good idea to investigate the possibility.

The Chairman referenced next year’s Asset Allocation Review and the need for a clear view as to how this should be carried out. There had been a Government consultation regarding the pooling of pension fund investments, and it had been suggested that local authorities invest 5% in local funds. Some boroughs were seeking to be able to invest 15% to 20% in local funds/projects. The Chairman stated that it would be important to seek the view of the Actuary.

The Director of Finance said that LBB was going for a 'Mears 2' and it was important to consider if LBB could be a potential lender based on expected returns. The overriding concern in this case would be what would be the best course of action for the Pension Fund. Liquidity issues would need to be considered.

The Chairman stated that this was definitely something that the Committee would look at, and that the prospect of building another 400 homes was attractive. This was something that could be discussed again in August.

Returning to the matter of the GMACS Fund, a Member re-iterated that he was not assured yet regarding Fidelity's experience of running such a fund for a full cycle and would like to get a comparison undertaken with other providers. Mr Arthur replied that Fidelity tended to avoid high risk scenarios and the fact that we already had existing managers with them would make it easier to move money around and simplify the procurement process. He agreed to investigate comparatives to investigate how Fidelity compared with other providers.

The Director of Finance referred to draft statutory guidance relating to the pooling of pension fund investments. The aim of central government was that the matter of pooling would be finalised by April 2020. However, the Director explained that the draft guidance would be subject to consultation and he felt that the deadline of April 2020 for implementation was optimistic. However, LBB was expected to complete the Asset Allocation Review as soon as possible after the Actuary had finished working on the Draft Pension Fund Annual Report.

A Member suggested that the use of GAN charts may be beneficial to the Committee. A Member recommended the use of Investment Grade Bonds, going passive and reducing fees. Mr Arthur stated that he was not keen on the idea of using passive bond fund as they tended to focus on companies that were in debt.

The Director of Finance asked if the Committee if they wanted to initiate the Asset Allocation Review. The Chairman asked the Committee for their feedback on this and it was agreed that the process to initiate the Asset Allocation Review commence forthwith, with an update being provided to the Committee at the next meeting.

The Vice Chairman queried what the costs would be for the Asset Allocation Review, and while this was being discussed, Mr Hudson was required to leave the Committee Room.

It was expected that the actuarial valuation of the Pension Fund would be provided in either November or December. The Actuary would be able to provide some guidance on Asset Allocation.

A Member asked if the Review would cover all asset classes, and it was confirmed that this was indeed the case.

It was agreed that the Director of Finance would liaise with Allenbridge/MJ Hudson to begin the Asset Allocation Review process, and that an update would be provided to the Committee in August.

RESOLVED that:

1) Fidelity would provide more data to the Committee regarding their historical record regarding the managing of GMACS type investments.

2) Fidelity would investigate the use of the term the term 'The Fidelity Qualifying Investors Fund' to ascertain if the term was correct in the context that it had been referenced.

3) Mr John Arthur would investigate comparatives to see how Fidelity compared with other providers of GMACS type investments.

4) The Director of Finance would liaise with Allenbridge/MJ Hudson to begin the Asset Allocation Review process, and that an update would be provided to the Committee in August.

21 PENSION FUND RISK REGISTER

The Committee was pleased to note that the Pension Fund Risk Register did not show any red flagged risks. There were only two amber risks that had been flagged. These were related to the possible under performance of fund managers and market risks.

A Member expressed surprise that the 'Governance Risk' was green.

RESOLVED that the Committee notes the current Pension Fund Risk Register and also the existing controls in place to mitigate risks.

22 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

23 FIDELITY UPDATE--EXEMPT INFORMATION

The element of the discussion regarding Fidelity that referred to confidential information was noted in the Part 2 minutes.

24 EXEMPT MINUTES OF THE PENSIONS INVESTMENT SUB-COMMITTEE MEETING HELD ON 15TH MAY 2019

The exempt minutes of the Pensions & Investment Sub-Committee that met on 15th May 2019 were agreed and signed as a correct record.

25 UPDATES FROM THE CHAIRMAN AND/OR DIRECTOR OF FINANCE ON ANY EXEMPT MATTERS

The updates from the Chairman regarding exempt matters were noted by the Committee.

The meeting ended at 10.05 pm

Chairman