

PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.00 pm on 3 December 2019

Present:

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

Also Present:

John Arthur (MJ Hudson Allenbridge)

CHAIRMAN'S ANNOUNCEMENT

Prior to the formal start of the meeting, the Chairman reported that Mr Keith Pringle the Democratic Services Officer who had supported the Sub-Committee for the last 9 years was retiring at the end of the year. Noting that he had been a great asset to the Sub-Committee, the Chairman and Members of the Sub-Committee thanked Mr Pringle for the invaluable support that he had provided and wished him well for a long and happy retirement.

36 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies for lateness were received from Councillor Simon Jeal. Councillor Jefferys apologised as he would need to leave the meeting at 9.40pm.

37 DECLARATIONS OF INTEREST

Councillor Keith Onslow declared that his son was employed by Fidelity but had no involvement with the Bromley Pension Account.

38 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 27TH AUGUST 2019 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

In response to a question concerning the Manager's return on the Baillie Gifford Fixed Income allocation, Mr Arthur confirmed that the issue had rectified itself in this quarter.

The minutes of the meeting held on 27th August 2019, were agreed and signed as a correct record.

39 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

Two questions for response at the meeting had been submitted by Gill Slater. The questions had been submitted for verbal response however Ms Slater had been unable to attend the meeting and had not provided a named alternate to put the question to the Sub-Committee. Consequently, the Sub-Committee provided a written response to the question and invited Ms Slater to submit any further supplementary questions to the next ordinary meeting of the sub-Committee (scheduled for 13 February 2020).

The questions and answers are attached at **Appendix A**.

40 UPDATES FROM THE CHAIRMAN AND/OR DIRECTOR OF FINANCE

There was no Part 1 update.

**41 PENSION FUND PERFORMANCE Q2 2019/20
Report FSD19105**

Details were provided of the Fund's investment performance for the second quarter of 2019/20. Additional detail was provided in an appended report from the Fund's external advisers, MJ Hudson Allenbridge.

The market value of the Fund ended the September quarter at £1,117.7m (£1,094m at 30th June) and had since reduced to £1,102m as at 31st October 2019).

The Fund's medium and long-term returns remained very strong overall – with 8.0% for 2018/19 and 6.7% for 2017/18.

Information on general financial and membership trends of the Pension Fund was also outlined along with summarised information on early retirements. Final outturn details for the 2018/19 Pension Fund Revenue Account were included as was the second quarter position for 2019/20 and fund membership numbers. A net surplus for the Fund of around £10.1m was expected for the year.

For the Sub-Committee's meeting on 30th January 2020, it was proposed to invite MFS (global equities).

Mr John Arthur (M J Hudson Allenbridge) commented on the Fund's performance for the quarter, noting that the fund had returned 2.4% - slightly below the benchmark for the quarter. Baillie Gifford had underperformed, however MFS had outperformed and it was noted that both fund managers were outperforming over the long-term.

The Sub-Committee noted that bonds had performed well as there had been a fall in global interest rates with the EU introducing an element of quantitative

easing. Equity markets had risen over the quarter. In relation to the fixed income holding, Mr Arthur noted that if there were to be an economic slowdown interest rates would remain low and quantitative easing was unlikely to work. In this event it was highly likely that there would be inflationary pressures as governments would seek to print and spend money. As a result of this it may be advisory to hold gilts in the event of an economic slowdown.

Mr Arthur confirmed that he was satisfied with the performance of all managers over the quarter. At 47% Schroders equity exposure was surprisingly high and for this reason he would arrange a meeting with the Fund Manager in order to understand the rationale. Baillie Gifford's equity performance had been exceptional in the last 3 to 5 years however it was unlikely that performance at this level could be sustained in the next 3 to 5 years.

The Sub-Committee noted that if interest rates were to increase the Fund would suffer a loss on fixed income if the investment did not reach maturity.

In response to a question concerning the negative correlation between MFS and Baillie Gifford, Mr Arthur confirmed that he could not envisage market conditions where the random performance of the two funds would correlate.

RESOLVED: That the report be noted.

42 PENSION FUND - INVESTMENT REPORT

Mr John Carnegie and Mr Paul Roberts, representatives from Baillie Gifford attended the meeting.

Mr Carnegie explained to the Sub-Committee that it had been an exciting year in the stock market and the bond market. 2019 marked the 20th Anniversary of Baillie Gifford's relationship with the London Borough of Bromley and it was a relationship for which Baillie Gifford were hugely grateful. In response, the Chairman recorded the Sub-Committee's thanks to Baillie Gifford for the performance that had been delivered and the work that had been done in respect of the Bromley Pension Fund. The Director of Finance reported that Baillie Gifford's outperformance had delivered over £100m extra into the Pension Fund over the past 20 years, compared with the performance of passive funds.

An overview of the Baillie Gifford portfolio was circulated to the Committee and Mr Carnegie confirmed that the company managed two mandates on behalf of the Pension Fund – global alpha (global equities) and fixed aggregate

Global Alpha

The perspective taken by Baillie Gifford was one of megatrends rather than headlines with a research agenda which promoted long-term thinking. Over

the past 12 months fund investment returns had increased by over 15% against a benchmark of an increase of 11%. Mr Carnegie explained that recent stock purchases had included companies involved medical equipment (such as Abiomed, Illumina, and Novocure), as well as established companies in emerging markets (such as Prudential, Reliance and Alibaba), and those involved in technological innovation (such as Axon and Microsoft). Members noted that whilst the personal IT market had experienced a period of boom in the last 10 years, the industrial market had lagged behind. Consequently, Baillie Gifford predicted a big shift towards industrial applications over the next decade or longer.

In response to a question concerning whether Baillie Gifford would retain its holding in M&G following the requisition of a holding in Prudential, Mr Carnegie explained that in general a view was not taken immediately and that M&G was a smaller part of Prudential. The position was under review and consideration would be given to the best course of action.

Fixed Income

In relation to fixed income Mr Roberts explained that Baillie Gifford aspired to improve performance in this area. Bond yields had fallen as markets had been suppressed, although a limited rise in yields was expected. It was noted that positive news on the position in relation to Brexit would help the Bank of England to raise interest rates. There was investment in selective currency markets (such as Norway).

In response to a question from the Chairman, Mr Roberts explained that the expectation was that yields would be moderately higher with a gradual rise to what was described as “semi-normal levels” over the next 3 to 10 years. In relation to the weighting of fixed income investment, Mr Roberts explained that three to four years ago the weightings had been reviewed in order to increase the yield of the portfolio.

A Member queried whether overseas government bonds were hedged back to sterling, noting that if unhedged the Council’s Pension Fund may be exposed. In response Mr Roberts confirmed that the Thai bonds were hedged however as the Norwegian bonds were linked to the EU market they were not hedged.

A Member noted that it would be helpful for the Sub-Committee to be provided with a more detailed breakdown of the elements of fixed income investments to enable members to further drill down, especially in relation to investment grade. Mr Roberts noted that under separate cover Members had been provided with the performance of indices. Broadly speaking, value had been added in corporate bonds however rates and currencies had fallen behind. Noting that no volatility data had been provided, another Member suggested that this would be useful information for Members of the Sub-Committee.

In response to a series of questions concerning the predicted global growth of the middle class, Mr Carnegie confirmed that Baillie Gifford did not make economic forecasts, instead the approach was to reduce exposure to stocks

that had been high in price for a prolonged period or had disproportionately increased in price. In the event of an economic downturn Baillie Gifford would also seek to place more money in funds that were predicted to more readily recover. In relation to a question about the effects of climate change on the portfolio, Mr Carnegie highlighted that insurance companies within the life and health market were less likely to be affected by the impact of changing weather patterns. When considering suitable investments for the portfolio there was a question concerning sustainability and the threat of climate change was taken very seriously by Baillie Gifford. The Chairman also confirmed that the Sub-Committee had sought assurance about the work that had been undertaken in respect of climate change.

In relation to the performance of fixed income investments, Mr Roberts confirmed that since inception performance had been positive. Baillie Gifford had concentrated its efforts on the government side of the portfolio. Lessons had been learnt and improvements had been made.

The Sub-Committee noted that there were significant opportunities in the China market making it one of the most exciting places to invest. Accordingly, Baillie Gifford had recently opened a research office in China.

The Sub-Committee also noted that the fixed income element of the Baillie Gifford portfolio was there for diversification. There was a clear role for this fixed income element if equities were to struggle.

The Chairman thanked Mr Carnegie and Mr Roberts for attending the meeting, noting the Sub-Committee's anticipation of the continuing strong performance of the investment.

43 PENSION FUND ANNUAL REPORT 2018/19 Report FSD19106

Under the Local Government Pension Scheme Regulations 2013, the Council was required to publish the annual report and accounts of the Bromley Pension fund for the year ended 31st March 2019. In accordance with the regulations, the annual report included a number of standalone documents requiring the approval of the Sub-Committee. The pension fund accounts had been audited by the Fund's external auditor – Ernst & Young LLP - and their report was included within the appendix. The Director of Finance reported that, as discussed at the previous meeting, there had been a delay in the audit of the pension fund accounts. Consequently authority had been delegated to the Director of Finance to publish the annual report, which incorporates the accounts, by the statutory deadline of 1st December 2019.

The Director of Finance raised that there is an unqualified opinion on the accounts which provides positive assurance to Members. Control issues had been raised about the use of separate and discreet company codes and separate bank accounts for reporting purposes and, in response to questions concerning addressing this, the Director of Finance advised that, in order to avoid costly manual overrides, this can only realistically be addressed by the

future replacement of the Council's Oracle financial system. The intention is to implement the required separation with the financial system replacement. There is a planned bid in the capital programme which will be reported to Executive in February 2020 requesting resources for the replacement of the financial system, which in its current form would no longer be supported by Oracle in two years' time. The Director of Finance advised that it was anticipated that the new financial system would be implemented in two years. Options for joint procurement with Bexley were being considered to help partly mitigate the significant costs of a replacement. There was discussion that the pension fund should make a proportionate contribution to the cost.

Members agreed that it was sensible to introduce the separation of accounting with the implementation of the replacement financial system. As such, Councillor Fawthrop proposed the following motion:

That the Committee is satisfied that processes are in place to implement a new financial system to address the known issues. The Pensions Investment Sub-Committee will be provided with regular updates and an update will be included in the next Pension Fund Annual Report. The motion was seconded by Councillor Allatt.

Councillor Jeal expressed concern about delaying any solution to the known problem in light of the fact that that implementation of replacement IT systems were often delayed/re-phased.

A vote was taken on the motion:

6 in favour
0 against
1 abstention

The motion was CARRIED.

RESOLVED:

- 1. That the Pension Fund Annual Report 2018/19 be noted;**
- 2. That it be noted that no changes have been made to the Governance Policy Statement, Funding Strategy Statement, Investment Strategy Statement and Communications Policy Statement as approved by this Sub-Committee on 24th July 2019;**
- 3. That it be noted that arrangements were made to ensure publication by the statutory deadline of 1st December 2019;**
- 4. That the external auditor's report on the Council's pension fund accounts be noted;**
- 5. That the letter of representation for the 2018/19 pension fund audit be noted; and**

6. That the Committee is satisfied that processes are in place to implement a new financial system to address the known issues. The Pensions Investment Sub-Committee will be provided with regular updates and an update will be included in the next Pension Fund Annual Report.

44 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**

45 CONFIRMATION OF EXEMPT MINUTES HELD ON 27TH AUGUST 2019

That the exempt minutes of the meeting held on 27 August 2019, were agreed and signed as a correct record.

46 ASSET ALLOCATION REVIEW FROM M J HUDSON ALLENBRIDGE - PRESENTATION

Mr John Arthur (MJ Hudson Allenbridge) presented the outcome of the asset only Strategic Asset Allocation modelling exercise, to generate a portfolio that maximised the expected returns for the Pension Fund, for a given level of risk, within the constraints of the Portfolio.

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

Councillor Jefferys left the meeting at the start of this item. As the time was approaching 10pm the Sub-Committee resolved to extend the meeting beyond the guillotine as required by the Constitution.

The Meeting ended at 10.17 pm

Chairman