

Pensions Sub-Committee

Minutes

Wednesday 13 February 2019

PRESENT

Committee members: Councillors Iain Cassidy, Rebecca Harvey, Asif Siddique and Matt Thorley

Co-opted members: Michael Adam

Officers: Phil Triggs (Director of Treasury & Pensions), Matthew Hopson (Strategic Investment Manager), Timothy Mpofu (Pension Fund Manager), and Amrita Gill (Committee Co-ordinator)

Guests: Kevin Humpherson (Deloitte), Andy Burgess and Gary Wilkinson (Insight)

1. MINUTES OF THE PREVIOUS MEETING

RESOLVED –

THAT, the minutes of the meeting held on 20 November 2018 were approved and signed by the chair

2. APOLOGIES FOR ABSENCE

There were no apologies for absence.

3. DECLARATIONS OF INTEREST

There were no declarations of Interest.

4. QUARTERLY UPDATE

The Chair welcomed Andy Burgess, and Gary Wilkinson, Insight Investment to provide a presentation in relation to the performance of the Bonds Plus Fund. The following points were outlined:

- Organisational functions had grown over the last few years, ensuring that teams were well resourced to manage sophisticated mandates. The team that was managing the Council's portfolio had been in place for many years, highlighting this as an advantage.

- An overview of the Fund's valuation and performance at 31 December 2018 was provided. It was noted that the performance of the Bonds Plus Fund was disappointing. As a result of the underperformance the Fund had not achieved the expected return on investment as anticipated.
- The difference between the German and U.S. government bond markets was highlighted.
- It was noted that the underperformance was driven by the Fund's position in emerging markets and oil related currencies such as Russian rouble and Norwegian krone. In addition, the Eurozone economy grew less than expected in the third quarter, particularly due to political aspects.

Phil Triggs, Director of Treasury & Pensions asked whether emerging market economies were sensitive to the increases in U.S. interest rates. In response Andy Burgess said that this did contribute to the Fund's under-performing position in emerging markets. Furthermore, another factor that was weighing on emerging markets was the U.S. and China trade/tariff discussions. This had led to an overall softness in global economic activity, i.e. trade expectations had fallen globally.

In response to a question from the Sub-Committee relating to risk allocation, Insight provided an overview of their risk framework and explained how this was managed in line with their risk budget. The role of the framework was to allocate risks between different asset classes. The risk budget was biased towards government bond type ideas rather than credit markets in the long-term. In addition, it was noted that the risk framework was closely monitored alongside the tracking error.

Michael Adam, Co-opted Member queried why Insight had been committed to the U.S. versus Germany trade, given that from a macro perspective there had been environmental changes over the last year. Insight said that their expectations for German government bond yields had fallen compared to 2018. In addition, European yields had also fallen faster than expected and were pricing in significantly weaker growth than what was forecasted. Although the absolute level of yields had dropped, the difference between these and the U.S. yields had remained attractive.

Michael Adam, Co-opted Member commented that given Insight's underperformance over the last three years, a cash deposit would have been a more suitable investment for the Fund. Furthermore, he felt that there was more risk involved when investing in macro type trades due to the uncertainty around the challenging market conditions.

Phil Triggs, Director of Treasury & Pensions queried whether there was any suggestion for a reduction in fees going forward. Insight explained that currently fees were 50bp, however given the performance of the fund the fees would be reviewed to reflect a reduction. However, in addition there would be a performance fee of 10% above the benchmark.

The Chair thanked Insight for the presentation and the contributions made to the meeting.

Kevin Humpherson, Deloitte provided an overview of the Pension Fund's overall investment performance. He noted that the total fund returned -5.8% over the quarter to 31 December 2018 on a net fee basis, underperforming the fixed weight benchmark by 2.4%. The three-year rolling excess return had remained negative over the quarter, declining slightly since the third quarter of 2018. The negative performance could be attributed to underperformance by Majedie, Ruffer and Oak Hill.

Michael Adam, Co-opted Member commented that, whilst Equity and Fixed income investments each reflected very different risk and return profiles, the figures had suggested that fixed income investments had proven to be more defensive given the current market conditions in comparison to equity investments.

Following a request from Members relating to the figures for Barnet Waddingham, these were tabled during the meeting and an update was provided relating to the September valuation.

The cashflow monitor showed both the current account and invested cash movements for the last quarter, as well as cashflow forecasts to September 2019. An analysis of the differences between the actuals and the forecasts for the quarter was provided to the Sub-Committee.

RESOLVED -

THAT, the Sub-Committee noted the report.

5. MHCLG POOLING CONSULTATION

Phil Triggs, Director of Treasury and Pensions explained that the Ministry of Housing, Communities and Local Government (MHCLG) had prepared a new statutory guidance on LGPS asset pooling. This guidance would set out the requirements on administering authorities and replace the previous guidance. The new guidance would expect pool members to manage their investment strategies in partnership with their LGPS pools going forward.

Views were currently being sought on the draft guidance and the consultation process would close on 28 March 2019. A summary of the key points was outlined on page 61 of the agenda pack.

The Chair raised some concerns around the challenges faced by the London Collective Investment Vehicle (LCIV) in comparison to other pools and questioned whether it was well equipped to offer the level of service required by Local Authorities. In addition, Michael Adam, Co-opted Member requested that the Council should continue to make tactical decisions in the best interest of the Fund. In response, Phil Triggs provided reassurances that any decisions would be made in line with the Councils fiduciary responsibility to

manage the Funds' investments. However, local authorities would be bound by any statutory instrument relating to the future appointment of investment managers.

The Sub-Committee requested that a response be drafted and circulated to members for any necessary comments and feedback be provided, prior to the consultation deadline.

Action: Phil Triggs

RESOLVED -

THAT, the Sub-Committee noted the draft guidance on pooling and would express any desired feedback for the consultation process, prior to the deadline.

6. FIXED INCOME STRATEGY REVIEW

Kevin Humpherson, Deloitte noted that the purpose of this report was to review the fixed income strategy within the Fund's portfolio. An overview was provided of the dynamic asset allocation which included managers such as Ruffer and Insight and the following points were noted:

- **Ruffer** was appointed to manage an absolute return mandate. Its main purpose within the Fund was to act as a return-seeking diversifier from mainstream equities.
- Over the past three years to 30 November 2018, the Absolute Return Fund had returned 2.8% p.a. and had underperformed its sterling based benchmark by 1.7% p.a. This was mainly due to its large defensive holdings in markets that had proven to be more stable than predicted.
- **Insight** was appointed to manage an active bond portfolio. The Fund invested across a range of bond and bond-like assets, with the aim of delivering positive absolute returns.
- The Fund had significantly underperformed its 3-month Sterling LIBOR benchmark and target over the year. Insight highlighted that longer term strategic investment decisions had been the key detractor to performance over this period, specifically the Fund's strategic country allocations.

Kevin Humpherson commented that Deloitte were of the view that Ruffer still offered an effective strategy and the Ruffer Absolute Fund worked well within the overall Fund. However, the Insight Bonds Plus Fund had underperformed its target over the past 3 and 5 years and since inception periods. While it was clear that the underperformance had not been as a result of any change in the investment approach or the risk profile of the strategy, it had highlighted that the current market environment had been particularly challenging for strategies that were reliant on directional macro-economic views. Therefore, it was recommended that the Sub-Committee should consider potential replacements for this strategy where there was more reliance on market returns (beta) as opposed to active manager calls (alpha). In addition, it was also advised that the Sub-Committee be provided with a training session on

Buy & Maintain bonds and Asset Backed Securities and interview a selection of managers.

Kevin Humpherson also outlined the secure income allocation which included managers such as Aviva, Oak Hill Advisors, and Partners Group. A breakdown of the performance, including the future direction of each manager was provided. Deloitte were of the view that there was no need to review the infrastructure portfolios as Partners Group and Aviva provided a significant level of diversification whilst producing favourable returns. Furthermore, the Oak Hill, diversified credit strategy offered the overall Fund a degree of liquidity, therefore there was no need to consider changing this investment. However, it was advised that the Sub-Committee should review the Partners Group multi asset credit allocation and should consider re-allocating the Partners Group investment as the Fund was in run-off.

Michael Adam, Co-opted Member commented that it was important to diversify away from corporate credit when considering re-allocating the Partners Group investment. In response Kevin Humpherson said that alternative strategies would be explored in the future.

The Chair thanked Deloitte and officers for the useful information shared and recommendations made relating to the current strategy for the Insight Fund and asked what options were available to the Council. Matt Hopson, Strategic Investment Manager said that should the Sub-Committee decide not to persevere with the Insight Bonds Plus Fund, the contract could be terminated on 15 March 2019. In addition, a cash fund could also be set up with Legal and General Investment Management (LGIM) whilst alternative arrangements were being made.

Councillor Asif Siddique asked whether there was potential for further losses, should the Sub-Committee continue with the Insight Bonds Plus Fund investment strategy. In response Kevin Humpherson, explained that Insight's underperformance over the past 3 years was largely due to the uncertainty around the challenging market environment for the types of strategies offered by the Fund. It was therefore advised that this strategy was no longer appropriate for the Pension Fund and it was recommended to look at potential replacements to avoid further losses.

The Chair asked whether there would be any transactional costs involved if the Council proceeded with the termination of the contract. In response Matt Hopson said that there would be no penalty charges, however transactional costs may apply.

Members agreed that the Insight Fund was no longer appropriate for the portfolio in the long-term. They felt that it would be better to terminate the contract and requested that the allocation be liquidated as soon as possible, given the reasons outlined above and alternative options should be explored that were better suited for the Fund.

RESOLVED –

- THAT, the Sub-Committee noted the current composition in the fixed income portfolio.
- THAT, the Sub-Committee approved the recommendation to continue with the investments with Oak Hill and Ruffer (held through LCIV) and agreed this in principle.
- THAT, the Sub-Committee approved the switch of fixed income strategy (currently the Insight Bonds Plus mandate) to a market return driven approach in either buy and maintain bonds or asset backed securities. As the current strategy with Insight is no longer fit for purpose, the Sub-Committee indicated they would like the Insight contract to be terminated as quickly as possible.
- THAT, the Sub-Committee noted the private asset allocation with the view to look at alternative options in the market before committing further to Partners Group.

7. TRAINING PLAN

Matthew Hopson, Strategic Investment Manager noted that the Knowledge and Skills Self-Assessment training form needed to be completed by members within the next two weeks.

Councillor Rebecca Harvey requested that a breakdown of the different fixed income areas be provided and a word version of the form be circulated to members.

Action: Matt Hopson

RESOLVED -

THAT, the Sub-Committee noted the Knowledge and Skills Self-Assessment training form.

8. EXCLUSION OF THE PUBLIC AND PRESS

The Chair requested for any members of the public and press to leave the meeting room, as all the public reports had been heard and the Committee were then moving onto exempt items.

RESOLVED –

THAT, under section 100A (4) of the Local Government Act 1972, the public and press be excluded from the meeting during the consideration of the following items of business, on the grounds that they contain the likely disclosure of exempt information, as defined by paragraph 3 of Schedule 12A of the said Act and that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

9. FIXED INCOME STRATEGY REVIEW - EXEMPT ELEMENTS

The exempt elements of this item were noted and discussed in conjunction with item 6.

10. ADDITIONAL ITEM - LCIV PENSIONS RECHARGE AND GUARANTEE AGREEMENT

Phil Triggs, Director of Treasury and Pensions provided an update and noted the current Local Government Pensions Scheme (LGPS) arrangements for LCIV staff. These were established in 2015. The reasons and requirements for a recharge and guarantee agreement concerning LGPS pensions liabilities were noted. The technical aspects of these agreements were also outlined.

The requirements were set by the City of London Corporation and were based on an actuarial assessment. The Corporation had authorised the admission of the LCIV as an external employer to the Corporation's LGPS Fund based on a guarantee agreement incorporated into the LCIV's Shareholder Agreement.

It was noted that London Local Authorities had requested an independent review of the LGPS pensions provision as well as the possibility of closing the LGPS to new members. Furthermore, the general feeling was that the current cap allocation was too high, given the absence of any similar defined benefit pensions provision within the financial sector.

The Chair suggested that it would be more appropriate for the Sub-Committee to consider the signing of the guarantee agreement following the outcome of an independent review of the LGPS pensions provision.

RESOLVED:

- THAT, the Sub-Committee noted the contents of the report and deferred the decision referencing the signing of the guarantee agreement until an independent review of the LGPS pensions provision was carried out.

Meeting started: 7pm
Meeting ended: 9pm

Chair

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Minutes are subject to confirmation at the next meeting as a correct record of the proceedings and any amendments arising will be recorded in the minutes of that subsequent meeting.