Minutes of the Pension Fund Investment Sub-Committee meeting held on 12 December 2016

Present:

Members
Councillors Bill Gifford (Vice Chair), Brian Moss, Bob Stevens (Chair) and Alan Webb

Officers
John Betts – Head of Finance
Gary Dalton - Solicitor
Andrew Lovegrove - Head of Corporate Financial Services
Ben Patel-Sadler - Democratic Services Officer

Invitees
Robert Bilton – Hymans Robertson
Kerry Duffain – Markham Rae
Peter Jones – Independent Investment Adviser
Paul Potter – Hymans Robertson
Karen Shackleton – Independent Investment Adviser

Observers
None

No members of the public attended.

1. General

(1) Apologies for absence

Apologies for absence had been received from Councillor John Appleton and Mathew Dawson - Treasury and Pension Fund Manager

(2) Members Disclosures of Pecuniary and Non-Pecuniary Interests

None

(3) Minutes of the previous meeting held on 12 September 2016

The following amendments to the minutes of the meeting held on 12 September 2016 were proposed and agreed:

a.) At page 2 (item 3) the sentence should read 'with no passive US fund now to balance, it was recommended to the Committee by Karen Shackleton to suspend the rebalancing of US equities'.

b.) at page 4 (bullet point number 6), the sentence should read 'The recommendation from actuary in relation to salary increases was that the weighted average single assumption of salary increases would be -0.4%'.

The minutes of the meeting held on 12 September 2016 were agreed as a true and correct record and were signed by the Chair.

2. Investment Performance

Andrew Lovegrove - Head of Corporate Financial Services introduced the report and informed the Committee that the overall value of the fund had seen an increase of 6.88% on the previous quarter.

Members noted that the Equity Asset Class was in an overweight position – the Infrastructure Asset Class was slightly underweight. Members noted that work would be undertaken to rebalance the Asset Classes accordingly.

The Committee noted that the government was keen to encourage spending and investment around infrastructure – it was the Committee's view that over the long term, the government would be seeking to direct investments into local infrastructure projects. Members noted that the definition of infrastructure was changing – an example of this was the classification of investments in social housing now being placed within the infrastructure investment category.

Members noted that all fund managers apart from Schroders Property were currently outperforming their benchmark targets. Andrew Lovegrove informed the Committee that recent turmoil in the property sector had played a part in Schroders not reaching their benchmark target. Members noted that the three year Fund Manager Performance data indicated exceptional performance. Peter Jones – Independent Investment Adviser expressed a view that this justified the choice of the current active fund managers. Members noted that the pressure to move from active to passive fund managers was not justified at the present time because of the excellent performance figures outlined in the report – this data represented benefits of several millions of pounds by using active managers.

The Committee noted that that due to the recent US elections result, there was a possibility of interest rates rising.

Karen Shackleton – Independent Investment Adviser informed the Committee that it was preferential to keep equity investments in foreign currency on an un-hedged basis so that diversification benefits could be obtained (depending upon the fluctuation of the market rates).

Resolved

The Sub-Committee noted the fund value and investment performance for the second quarter of 2016-17 to 30 September 2016.

3. The Stewardship Code

Andrew Lovegrove - Head of Corporate Financial Services introduced the report and informed the Committee that it was the aim of the pension fund to become classified as Tier 1. Members noted that in November 2016 the Financial Reporting Council (FRC) had stated that the fund would now be assessed as Tier 1.

Members queried why the FRC had originally classed the pension fund as Tier 2 – Andrew Lovegrove informed the Committee that no reasons had been given by the FRC as to why. This was now largely academic, as the fund was now classed as Tier 1.

The Committee noted that the Stewardship Code was reviewed every three years.

Resolved

The Sub-Committee agreed to approve the revised statement at Appendix A of the report.

4. The 2016 Actuarial Valuation.

Robert Bilton – Hymans Robertson introduced the report and guided members through the 2016 progress report where the following points were noted:

- The primary aim of investors was to guard against the risk of high inflation.

- Hymans Robertson recommended that there should be no allowance made for an Inflation Risk Premium (IRP) – an analysis of UK gilt yields and implied RPI inflation since 1 January 2007 had not indicated that RPI inflation would rise dramatically in the future. Peter Jones – Independent Investment Adviser informed the Committee that there had been some opposition to not including an IRP. It was Peter Jones' view that the current method was too prudent and might have an adverse effect on smaller bodies within the fund. Robert Bilton assured the Committee that this exercise sought to make calculated future assumptions using checked and tested methodologies. Members sought assurance that the actuary had taken into account future uncertainty around inflation when recommending that no allowance for an IRP was included. Robert Bilton informed the Committee that this uncertainty was considered when determining the potential contribution rates.

- In relation to the whole fund valuation results, members noted that the deficit of the fund at 31 March 2016 was £358m which was down from £419m at 31 March 2013 – this was positive.

- Members noted that the Warwickshire Pension Fund was currently in the upper quartile of funds nationally in terms of its standardised funding ratio.

- The Committee noted that employer level valuation results had a wide range of outcomes. Factors affecting this included salary increases for staff in certain organisations, the number of ill health lay-offs and those organisations with little or no active members remaining. Members noted that there would be a significant amount of churn as new employees began their employment with employers within the fund – active members of the fund would increase which would result in funding plans being tailored as a result of this. Actuary sought to effectively balance the liabilities of the fund against the assets of the organisation, future contributions and anticipated future investment returns.

- Members noted that the Funding Strategy Statement was the Warwickshire Fund's funding blueprint – the Committee noted that the 2016 funding strategy review used the 2013 strategy as a starting point, looked at what could be done better and whether or not the current funding plans were still appropriate. Members noted that the Fund was required to consult with employers during the review process. Robert Bilton informed the Committee that the 2016 review had identified areas for improvement, including better understanding of employers, looking at the funding target of each employer, how long would be given to each employer to get to their target and how much risk each employer could take to reach their target.

- In relation to the actuary and fund agreeing one set of assumptions and with actuary then calculating contribution rates, it was likely that the Warwickshire Fund would be fully funded in around twenty years' time. Members noted that 5000 potential successful and unsuccessful outcomes were considered during the 2016 review. The Committee noted that it was crucial to effectively balance the level of risk, prudence and affordability when determining contribution rates now and in future years.

- If organisations within the fund could no longer afford the set contribution rate, then conversations would take place to determine whether or not that employer wished to remain in the Warwickshire scheme. In relation to the 2016 funding strategy update, members noted that a risk based approach would be used to set contribution rates for all employers. It was also noted that actuary would recognise the relative riskiness of an employer in the funding plan by using a higher likelihood of success.

- Members noted that long-term employers such as the police and the Council would seek stabilised contribution rates over time – a stabilisation mechanism was used to keep these long term employers' contributions at a stabilised level. Members noted that actuary had conducted testing around lower, medium and higher risk employers in the fund to determine the final contribution rates. The age profiles of each employer also had an effect on the rates paid by employers and employees. In setting the contribution rates for each employer, it was possible to mitigate risks in terms of financial shortcomings by utilising the funding levels of each employer. Members noted that the current stabilisation mechanism was still appropriate for the lower and medium risk employers. However, testing results in relation to the higher risk employers suggested that +2%/-1% was a more appropriate contribution strategy. The Committee noted that these higher risk employers were aware that their contributions to the fund were likely to increase.

- In relation to the assessment of academies, the fund proposed to lower the 'risk bar' to match that of the lowest risk employers i.e. precepting bodies. Members noted that work was being undertaken nationally to determine how academies may or may not participate in the Local Government Pension Scheme (LGPS)

Resolved

The Sub-Committee agreed to note the results in Appendix A and;

1.) Approve the initial Funding Strategy Statement in Appendix B and;

2.) Approve the proposal in 4.2 and Appendix C and;

3.) Receive the final report at the March 2017 meeting.

5. Pooling Update

Andrew Lovegrove - Head of Corporate Financial Services introduced the report and informed the Committee that final confirmation was being awaited from the government before the formal pooling arrangements could begin. Members noted that the submission made to government by Border to Coast had not encountered any issues.

Karen Shackleton – Independent Investment Adviser informed the Committee that Border to Coast had been meeting with all Independent Investment Advisers. After the initial meeting, it was the view of the Independent Investment Advisers that too many sub-funds were being suggested by Border to Coast – there was still a large number of fee savings to be achieved.

John Betts – Head of Finance informed the Committee that some concerns had been made on a national level in relation to the proposed remuneration for those individuals tasked with managing each Pension Pool. Members agreed that because this was a completely new and unique role, it was difficult to determine an appropriate salary for the position.

John Betts informed the Committee that it was hoped that the final details around the pooling arrangements would be considered by Full Council in March 2017. Members noted that this was a significant decision to be made by the Council.

Resolved

The Sub-Committee agreed to note the report.

6. Presentation from Markham Rae

Kerry Duffain – Markham Rae presented to the Committee in relation to the possibility of the Pension Fund investing in Trade Finance via Markham Rae.

Members noted that other Local Government Pension Schemes had invested with Markham Rae – some of those were also members of the Border to Coast Pool.

Kerry Duffain explained to the Committee about what Trade Finance was and what role Markham Rae played in the process.

Members noted that the Preferred Return (hurdle) rate was set at 8% with a net target return of 10-12%.

The Committee acknowledged that as more competitors entered the market offering the same service as Markham Rae then rates were likely to fall.

With regards to the regulation of the work undertaken by Markham Rae, the Committee noted that an advisory board operated to ensure that all negotiations and transactions were within the specified mandate.

It was the view of the officers and Independent Investment Advisers present at the meeting that this presented an opportunity to invest in a newly developing market which had the potential to achieve good investment returns in the short-term.

Councillor Bill Gifford moved, seconded by Councillor Brian Moss that further due diligence work be undertaken by officers to determine whether or not the Fund would be investing with Markham Rae.

7. Any Other Items

None

8. Reports Containing Confidential or Exempt Information

To consider passing the following resolution:

'That members of the public be excluded from the meeting for the items mentioned below on the grounds that their presence would involve the disclosure of exempt information as defined in paragraph 3 of Schedule 12A of Part 1 of the Local Government Act 1972'

9. Exempt Minutes of the meeting held on 12 September 2016

The exempt minutes of the meeting held on 12 September 2016 were agreed as true and correct records to be signed by the Chair.

10. Investment Update

The meeting rose at 12.50pm

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Chair