PENSION BOARD

MINUTES of a meeting of the Pension Board held at Council Chamber, County Hall, Lewes on 3 November 2015.

PRESENT Richard Harbord (Chair), Councillor Kevin Allen, Angie Embury, Sue McHugh, Councillor Brian Redman and David Zwirek

ALSO PRESENT Marion Kelly, ESCC Chief Finance Officer; Ola Owolabi, Head of Accounts & Pensions; John Shepherd, Finance Manager (Pension Fund); Jason Bailey, SCC Pension Services Manager; Giles Rossington, Senior Democratic Services Adviser

1 MINUTES OF THE MEETING HELD ON 8 SEPTEMBER 2015

1.1 It was agreed that point 6.5 of the draft minutes should be amended from “Unison did not intend to appoint a substitute” to read “Unison does not intend to routinely send a substitute”.

1.2 Cllr Brian Redman (BR) thanked officers for circulating additional information on forecast administration costs (point 1.4 in the draft minutes). However he remained concerned that large sums of money were not spent on minimising discrepancies, when it might be more sensible to stretch some targets. Jason bailey (JB) noted that the Local Government Association (LGA) was in discussions with the Treasury aimed at setting a national level of acceptable discrepancies. The Chair added that it was difficult to know what the significance of relaxing particular performance targets might be; it may be that the external auditors have a view on this issue.

1.3 Sue McHugh (SM) asked whether there was best practice available in terms of the role played by employer representatives on the Pension Board (in relation to points 4.4 and 4.5 in the draft minutes). The Chair noted the role played by the employers’ forum here. Members agreed it would be helpful if employer representatives were copied in to correspondence with employers, and employers were encouraged to use the employer representative as a conduit for communicating with the fund. MK agreed that officers would support this as well as continuing to monitor and disseminate emerging best practice. Ola Owolabi (OO) added that officers could also share with employers a link to Pension Board papers and minutes. In addition, a quarterly pensions newsletter is circulated amongst employers.

1.4 RESOLVED – that, with the inclusion of the amendment detailed at 1.1 above, the minutes be agreed as an accurate record of the meeting.

2 APOLOGIES FOR ABSENCE

2.1 Tony Watson sent his apologies.

3 DISCLOSURE OF INTERESTS

3.1 There were none.

4 PENSION COMMITTEE AGENDA

4.1 This item was introduced by Ola Owalabi (OO).

4.2 **Strategy Day** OO told the Board that the Pension Committee (PC) had held a successful Strategy Day in September. PC members received a number of presentations, discussed the Fund's investment strategy, and agreed the termination of the Fund's contract with Lazard and the re-allocation of the relevant holdings to other investment managers.

4.3 In response to a query from David Zwirek (DZ) as to why the funds managed by Lazard had not been transferred to Longview, given Longview's recent exceptional performance, OO told members that the PC had opted to move to funds with a lower risk profile than Longview, which is a very 'active' and hence relatively high risk investor. MK added that there were additional risks associated with over-investing in the current market leader, as markets operate in cycles and very high performance is rarely sustained over time.

4.4 Members discussed the policy of having a 'trigger point' which would require de-risking investments to be made should the Fund hit a pre-determined funding level (e.g. 85%). MK noted that the East Sussex Pension Scheme hit its trigger point last year and some de-risking was successfully undertaken.

4.5 Members discussed the decision to terminate the contract with Lazard, with BR commenting that the process seemed to have taken a very long time. OO told the Board that, although Lazard had been on 'watch' for a considerable period, it had only relatively recently been placed in the 'replace' category, and action to terminate following this re-classification had been relatively swift. The Chair remarked that replacing an investment manager was not a decision that should be taken lightly as there would always be considerable costs involved.

4.6 **Fossil Fuels** Cllr Kevin Allen (KA) informed members that a Notice of Motion proposing fossil fuel disinvestment had recently been debated at a Full Council meeting of Brighton & Hove City Council. The Notice of Motion was not passed, but the subject will clearly remain topical. DZ agreed, noting that there had been a good deal of local media focus on the issue in recent months. Angie Embury (AE) concurred, saying that this was an issue that some of her members have expressed concerns about, particularly in terms of investment in firms involved in fracking. MK told the Board that the Local Authority Pension Forum is very active in ethical and socially responsible investment, lobbying firms to act responsibly. RH added that one of the major difficulties in ethical investment lay in identifying major international firms that consistently and universally act in ethical ways.

4.7 **Fund Performance** MK told members that Schroders are now on 'watch', but this is due to recent changes in senior management not to the fund's performance.

4.8 **Re-procurement of Investment Consultancy and Actuarial Services** MK informed members that the council had tendered for this contract and had received a pleasing number of expressions of interests. The new contract will commence in January 16 which should give just enough time for the new contractor to arrange the triennial valuation. Replacing the actuary at this critical point was unavoidable; it would have been impossible to extend the current contract any further.

4.9 In response to a question from SM on what would happen if the valuation happened to be at a time when assets (e.g. equities) had suffered a temporary dip, MK told members that a smoothing process is employed to ensure that short term market fluctuations do not unduly influence the valuation.

4.10 **Risk Register** MK explained that it is the Board's role to monitor and suggest changes to the Risk Register.

4.11 DZ commented that he struggled to see how ***risk 12: fees and charges of investment managers*** could be rated as Green given the level of charges the Fund incurs. This risk ought to be Amber, not least so that PC members remain focused on the need to challenge excessive fees. Other Board members agreed with this approach. MK commented that this was a difficult risk to quantify, as there were no obvious actions to mitigate the risk that have not already been employed. BR added that recent Government moves to pool LGPS funds are clearly intended to address the problem of investment manager fees, and suggest that the Government sees little prospect of fees being reduced without pooling taking place.

4.12 The Chair questioned the Amber rating of ***risk 5: custodian bank goes bust***, noting that this could create complex problems, particularly as the custodian does not necessarily hold individual pension scheme investments separately from those of other schemes. KA agreed, suggesting that impact score for this risk should be amended from 3 to 4, more accurately reflecting the consequences of the custodian failing even if the overall risk score remains at Amber.

4.13 The Chair proposed including an additional risk – that of an investment manager failing/going bust. This is by no means an incredible scenario (e.g. Barings), and would cause major and long term problems for the Fund.

4.14 SM queried the risk assessment relating to the triennial valuation. The Chair noted that the risk relating to this (***risk 8: assets not enough to meet liabilities***) was rated as Red even though it seemed relatively unlikely that the valuation would show a significantly worse position than under the current valuation. However, there was a pressing risk that employers would be unable to make significant additional contributions to the Fund, and this should be recorded as a separate risk – and potentially scored as Red, since it is both likely and bound to have a high impact. MK agreed that, should the valuation require significant increases in employer contributions it was very likely that some employers would not be in a position to pay. Employers have a statutory responsibility to fund the LGPS and would have to sell assets and could potentially go into liquidation as a consequence. It is uncertain under what circumstances the Government would back an LGPS should some of its non-local authority employers go into liquidation.BR added that there were particular risks here for parish councils, which typically have very few assets and therefore have little capacity to make higher contributions.

4.15 SM pointed out that ***risk 16: communication with employers*** would read better as "inadequate communication with employers"

4.16 RESOLVED – that the Pension Board proposes the following suggestions in relation to the draft Pension Fund Risk Register:

- ***Risk 5 – custodian bank goes bust.*** Amend impact score from 3 to 4 to reflect how difficult this scenario would be to deal with (overall risk score would remain Amber)

- Introduce a separate risk of ***Investment Manager goes bust*** (impact score will be high).

- ***Risk 8 – assets not enough to meet liabilities.*** Consider amending likelihood score down.

- Introduce a separate risk of ***employers unable to pay increased contributions*** (both likelihood and impact likely to be high).

- ***Risk 12 – fees and charges of investment managers, actuary and investment adviser are excessive and not proportionate.*** Consider amending overall risk to Amber (e.g. by increasing likelihood to 2)

- ***Risk 16 – communication with employers.*** Amend title of risk to “inadequate communication with employers.”

5a OFFICERS' REPORT - BUSINESS OPERATIONS

5a.1 This item was introduced by Jason Bailey (JB). JB circulated details of September 2015 performance at the meeting – this information had not previously been available.

5a.2 JB noted that there were some additional Red scores in the September performance figures, but these have minimal risk implications.

5a.3 The service has ongoing recruitment issues – recently several candidates did not turn up for interview. Given the failure to recruit experienced pensions administrators, there may be a need to put out more generic recruitment adverts or to advertise for trainees. The service may also look at employing apprentices. These recruitment problems are not unique to East Sussex: many LGP schemes struggle to recruit experienced staff.

5a.4 In response to a question from DZ asking whether the Red performance areas represented long term performance concerns, JB told the Board that we have a long term improvement plan and that the current areas of underperformance will be remedied by plans to merge the various organisation databases over the next 12 months and apply process improvements.

5a.5 JB told members that the annual pension statement is currently being issued to members. This is later than the Government wanted, but very few schemes have found it possible to meet Government deadlines given the complexity of the transition to CARE. This is a one-off problem and will not be a factor in future years. Most scheme employers have now submitted data, and the 31 November deadline for the issuing of all statements should be met. Feedback on the format of this year’s statement has been very positive.

5a.6 Recent changes to the annual allowance will impact on the highest earners and the number of employees affected will increase over time.

5b OFFICERS' REPORT - GENERAL UPDATE

5b.1 This item was introduced by Ola Owolabi (OO)

5b.2 **MiFID** OO told members that the recently issued Markets in Financial Instruments Directive (MiFID) may impact upon the LGPS. Currently local government pension funds are classified as ‘professional clients’ of investment managers, essentially meaning that they are assumed to have a sophisticated understanding of investment risks. MiFID will change this default classification to that of ‘retail clients’ which will mean that investment managers will not be able to assume that clients are able to understand all aspects of investment risk, and will consequently be restricted in the types of investment opportunity they can offer.. This may make the LGPS market less attractive to fund managers. However, it seems that schemes can elect to assume professional client status, so the impact may in fact be limited.

5b.3 **Employers’ Forum** MK outlined plans for this year’s Employers’ Forum. It is hoped to attract as many employers as possible. In past years attendance has been good, with at least 40 employer representatives attending. The Pension Board will have a greater input into planning future forums, but timings have meant that this year’s event has been modelled on past practice.

5b.4 **Pooling Investments** OO explained the current understanding of Government plans to require LGPS funds to work more closely together. It appears that the Government will not seek fund mergers, and will not mandate only passive investment. However, it seems likely that local decisions will be permitted in terms of asset class allocation, but not in terms of choosing fund managers. Pooling of investments will be required, and there will be a push to increase LGPS investment in UK infrastructure.

5b.5 It is still unclear what infrastructure investment is intended to mean, or how investment in infrastructure projects will produce short term returns equivalent to investing in equities etc. Given that lower LGPS returns are likely to trigger increasing employer contributions, it is unlikely that employers will be content with a scheme that requires investment in low returning infrastructure projects in preference to investments which offer higher rates of return. It seems unfair for employers to retain liability for the LGPS but to be deprived of the ability to make investment choices. MK noted that the Government may be open to local authority ideas on increasing investment in UK infrastructure.

5b.6 It seems unlikely that there will be formal consultation on the Government's plans at this point, although there presumably will be consultation should there be a move to change pension regulations – for example to allow funds to invest heavily in a single sector (e.g. infrastructure) where the current regulations insist that investment is diversified in order to manage risk.

5b.7 The Government's intentions in relation to pooling are also unclear. There are a number of pooling schemes already operating, but with the possible exceptions of the schemes operated by London councils and by Welsh authorities, it seems unlikely that any of these schemes would be granted the status of regional pooled funds – unless they attract far more buy-in than any of them have currently achieved.

5b.8 The timescale for pooling is three years, although some elements of the plans (e.g. around infrastructure investment) are likely to take much longer. In any case, the timescales for schemes to divest assets can be very lengthy, and establishing complex joint governance arrangements is very time-consuming.

5b.9 SM commented that this seems like a massive upheaval, particularly given how well the current system operates. MK noted that local authorities had been assiduous in making this point to Government.

5b.10 BR commented that infrastructure investment has been looked at before at a local level, but that it proved impossible to reconcile it with the fiduciary duty to maximise investment returns. The Chair agreed, noting that London councils had previously explored LGPS funding for housing investment, but had not been able to make a case for it.

6 PENSION BOARD FORWARD PLAN 2015/16

6.1 The Forward Plan was noted.

7 ANY OTHER BUSINESS

7.1 There was none.

(The meeting ended at 12.15 pm)

CHAIR