MINUTES OF THE PENSION FUND COMMITTEE

Date: Thursday 28th July 2016

Time: 10:00am – 12.35pm

Place: Kreis Viersen Room, Shire Hall, Cambridge

Committee Members present:
Councillors P Ashcroft, R Hickford (Chairman), N Kavanagh, M Leeke (Vice Chairman); G Deeble and M Pink

Officers: D Cave, S Heywood, R Perry, S Pilsworth, P Tysoe and M Whitby

Others in attendance: J Holden (Mercers) and Councillor M Shellens

Apologies: J Walker

75. DECLARATIONS OF INTEREST

Matthew Pink declared a personal interest as both he and his wife were active members of LGPS.

76. PENSION FUND ANNUAL REPORT AND STATEMENT OF ACCOUNTS

The Committee considered the draft Annual Report and Statement of Accounts (SOA) of the Pension Fund for the 2015-16 financial year. It was noted that there had been no major changes in format since last year, and the format was that prescribed by regulations and CIPFA. Both documents had had been subject to audit fieldwork by the County Council's new external auditor, BDO.

Members noted:

- the increase in contributions compared to the previous year, partly attributable to the increase in membership and number of active employers;

- less income had been earned from investments, and there was a corresponding reduction in Management Expenses (due to the reduction in performance related fees). This was due in part to market volatility, especially the fall in equity values the summer of 2015. Since the

Referendum, the Fund had benefitted from its investment in global equities;

- officer concerns regarding the approach and lateness of some of BDO's activities as part of the external audit. The Chairman asked what officers were doing to ensure that the situation was improved. Officers confirmed that there would be a post audit discussion to pick up issues, after the main audit of the County Council's accounts. It was noted that there was potentially an issue about the final pension audit feeding in to employers' accounts if it was received late.

At the invitation of the Chairman, Councillor Shellens addressed the Committee as Chair of the Audit & Accounts Committee, regarding a recent report presented to that Committee on the valuation of the County Council's pension liability as at 31/03/16. Those figures suggested an £80M improvement in the Council's liability, almost entirely due to the change in the discount rate used to evaluate cost to us of future benefits: that rate had increased from 2.1 to 3.5%. The Committee had expressed concerns that the improvement appeared to skew the reality of the funding position, when in reality there were declining funding levels. When questioned, officers advised that this figure came from Hymans. An explanation was therefore sought from Hymans, and once received Councillor Shellens would be happy to share this with the Pension Fund Committee. Officers advised that there were two different valuations, and the IAS19 accounting valuation was very prescriptive and gave very little latitude for the actuary or auditor to choose the discount rate. This was very different to the triennial valuation. Officers agreed that it was unfortunate that the accounting showed an apparent improvement when intuitively funding was falling. It was confirmed that every Fund would be following a 3.5% long term gilt rate. The Chairman thanked Councillor Shellens for bringing this issue to the Committee's attention, and said it was always right to challenge such things.

A Member queried the issues on the timing of BDO's audit and whether the concern was due to the slippage of the audit work programme, or comments made by BDO. Officers confirmed that the concern was that BDO had not concluded their work, and did not relate to comments or finding. Officers had engaged with BDO early and meaningfully, and completed all the work required of them.

A Member observed that the Pension Fund Committee did not appoint its auditors directly, and that this reduced any leverage the Committee may have, so any representation needed to go to those who did appoint, particularly the timescale issue. Officers confirmed that the audit had finished for the Northamptonshire Fund, and that BDO were not the auditors for that Fund.

A Member commented that whilst generally the Committee would welcome expenses going down, this was not the case for investment management fees where this arose from a reduction in performance related fees. He added that regrettably, the overall Fund return below benchmark by 2.1% was the most significant figure in whole report.

The statement in the covering report that retirees were not maximising their lump sum options and *"this may be significant for projecting future year costs"* was queried. Officers advised that this was likely to be a one off, not an indicative trend, and this was dependent upon decisions made by individual scheme members.

In response to a Member question, it was confirmed that when BDO took over, there had been a handover from the previous auditor. It was confirmed that officers would be having their own debrief on issues relating to the audit in August, and there would be a report to the next Pension Committee on progress. **Action required.** It was also agreed that officers would brief Councillor Shellens, as Chairman of the Audit & Accounts Committee, on these issues outside the meeting before September, as he was a signatory to the statutory accounts. **Action required.**

Scheme members and other stakeholders were aware of the pooling arrangements, and also whether the political impetus had changed i.e. the former Chancellor of the Exchequer had a strong appetite for large funds creating infrastructure investment opportunities – could this change? Officers advised that they were not envisaging any changes on the national pooling proposals. Employers were being advised of the pooling arrangements through the employer forums, and scheme members through communications on the web portal. Discussion with employers had been around infrastructure investment opportunities and the potential cost savings that pooling presented, and there were some concerns that the huge cost savings that government were predicting would not be realised. The Chairman commented that the focus on fee savings through pooling was misdirected, greater returns would be achieved by focusing on performance and returns from fee managers.

It was resolved unanimously to:

1. approve the Draft Annual report and note the Statement of Accounts of the Pension Fund for the 2015-16 financial year;

2. approve that the Chairman agrees with Officers any immaterial amendments to the Annual Report arising from External Auditor review comments.

77. WM STATE STREET GLOBAL SERVICES ANNUAL PERFORMANCE REVIEW TO 31 MARCH 2016

Jo Holden presented a report which reviewed the investment market environment and the performance of the Fund's investments for the year to 31st March 2016, relative to LGPS peers. She explained that this would be State Street/WM's final report, as they had ceased to provide performance reporting to the Local Authority (LA) Universe. PIRC, an organisation which provided stewardship services to LA forums, had recently indicated that they would be providing an alternative peer group analysis that would initially replace the State Street universe reporting.

Turning to the report, Members noted:

- returns from equities were generally poor globally for the year up to 31st March 2016, and bond performance was also much more subdued. In contrast, private equity and property had performed well over the last 12 months;

- equities and bonds had provided similar returns over the last twenty years. By contrast, property and private equities had provided better returns over the same period. The Investment Sub-Committee were currently reviewing Alternatives, and had expressed a preference for tangible, long term physical assets such as property, with simple, transparent structures. Increasingly, more Funds were diversifying into Alternatives, which now formed a greater part of the average Fund's allocation. Cambridgeshire had slightly more in equities, and less in Alternatives, than the average Fund;

- given future uncertainties, achieving real returns above inflation was crucial, not only against notional liabilities, but the very real pensioner payroll;

- over the last twelve months, returns would have increased by 0.2% had they been invested passively: actual performance was -1.9%. The report identified how much of this underperformance was due to bad asset allocation decisions, and how much was due to manager decisions;

- longer term, the Fund had underperformed slightly. Last year, the Investment Sub-Committee had gone through a rigorous selection process to appoint new asset managers. The two appointed – Dodge & Cox, and JO Hambro - had both significantly underperformed, but ultimately they had replaced poorly performing managers. A Member acknowledged this point, but observed that performance over 5 and 10 year periods should be better, but it was worse;

- the structure of the Cambridgeshire Fund was relatively simple compared to others, and part of the manager review last year had been to streamline it further. LGPS funds were criticised for churning managers too frequently – it was important not to change managers reflexively, following a bad year.

The Chairman commented that the one thing that needed to be right was the strategy, and this had to be consistent. Different advice had been given i.e. the Fund was advised to hedge against inflation with equities, then bonds, and was now being told that it needed to be less risk-averse, but chopping and changing strategy was wrong. He agreed with the analysis of the new fund managers appointed last year, as they had a long term strategy. If the position was reviewed as at the current date i.e. following the rally in markets after the Referendum, it would not look as bad, so to some extent the poor performance tabled reflected a timing issue. Another Member observed that the more that was invested in bonds, the harder the rest of the allocations had to work. Jo commented that there were two clear aims: (i) risk management and (ii) recovering funding level. Over time equities provided a good inflation hedge, but they would not provide protection against a shock, and that was what would give the Fund problems.

The Chairman reiterated the view he had given at previous meetings, that it was unrealistic to aim for 100% funding in the short term – the Fund needed to consolidate and take advantage of market movements, rather than having strategy dictated by an unrealistic expectation of being 100% funded. Another Member suggested that whilst he was concerned about funding levels, he was also very critical about how liabilities were valued. Was it possible for the Fund to have its own view of what overall liabilities should look like, so that the focus was on asset values? This would help the Fund achieve a stable regime looking forward, to deliver benefits when they are due, rather than on the whim of stock market. In response, Jo advised that whilst the four actuarial firms that worked within LGPS were all bound by the same rules and had to project liabilities going forward, all used different methods of valuing liabilities: (i) Inflation, (ii) gilts, (iii) smoothing of returns over time, (iv) projected real rates, so there was choice on how liabilities was valued. There would soon be more information available on how other LGPS funds value their liabilities. The Committee does have a say in what assumptions underlie those liabilities.

It was resolved to note the Annual Performance and Benchmarking Review.

78. EXCLUSION OF PRESS AND PUBLIC

It was resolved:

That under Section 100A of the Local Government Act 1972, the press and public be excluded from the meeting for the following item of business (item 10) on the grounds it contains exempt information under Paragraph 3 of Part

1 of Schedule 12A of the Local Government Act 1972, as amended (information which is likely to reveal information relating to the financial or business affairs of any particular person) and that it would not be in the public interest for this information to be disclosed.

79. ANNUAL REVIEW OF THE FUND'S INVESTMENT MANAGERS

The Committee received a presentation from Jo Holden on the Fund's Investment Managers.

It was resolved to note the Annual Review of the Fund's Investment Managers.

80. INVESTMENT MANAGER FEE REVIEW

The Committee received a report on the fees paid by the Fund to its Investment Managers.

It was resolved to note the review of the fees paid by the Fund to its investment managers.

81. CUSTODIAN MONITORING

The Committee considered a report on the performance of the Fund's Custodian, focusing on the efficiency of its Investment Managers for the year to 31st March 2016. Margaret Delman, Head of Monitoring at Mercer Sentinel, gave a presentation on the performance of the Fund's Custodian, Northern Trust.

It was resolved to note the Annual Custodian monitoring report.

74. DATE OF NEXT MEETING: 20 OCTOBER 2016 (10am)