**Bath and North East Somerset Council**

**AVON PENSION FUND COMMITTEE**

# Minutes of the Meeting held

Friday, 11th December, 2015, 2.00 pm

**Bath and North East Somerset Councillors:** David Veale (Chair), Christopher Pearce (Vice-Chair), Paul Myers, Cherry Beath and Shaun McGall

**Co-opted Voting Members:** Councillor Steve Pearce (Bristol City Council), Councillor Mary Blatchford (North Somerset Council), Councillor Mike Drew (South Gloucestershire Council), William Liew (HFE Employers), Richard Orton (Trade Unions), Ann Berresford (Independent Member) and Shirley Marsh (Independent Member)

**Co-opted Non-voting Members:**

**Advisors:** Tony Earnshaw (Independent Advisor) and Steve Turner (Mercer)

**Also in attendance:** Tony Bartlett (Head of Business, Finance and Pensions), Liz Woodyard (Investments Manager), Matt Betts (Assistant Investments Manager), Geoff Cleak (Pensions Benefits Manager) and Martin Phillips (Finance & Systems Manager (Pensions))

## 38 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

## 39 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Cheryl Kirby, Steve Paines and Wendy Weston.

## 40 DECLARATIONS OF INTEREST

There were none.

## 41 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

## 42 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

## 43 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

## 44 MINUTES: 25 SEPTEMBER 2015

A Member drew attention to a formatting problem at the bottom of page 4 of the minutes resulting in '**RESOLVED'** and the list of items resolved being split between pages.

The minutes were otherwise approved as a correct record and signed by the Chair.

## 45 LGPS POOLING OF INVESTMENTS - UPDATE

The Investment Manager presented the report.

Pooling of Investments

She drew attention to the DCLG's criteria and guidance document, which was attached as Appendix 4 to the report (agenda page 71). The key criteria were listed in paragraph 4.4 of the covering report. She drew attention to the criteria that pooling proposals must demonstrate reduced costs with no deterioration in investment performance, and that pools should improve the capacity to invest in infrastructure.

There were very tight deadlines for the next stages of the process as detailed in paragraph 4.4(b) of the covering report. An outline proposal has to be submitted by 19 February next year and a detailed proposal by 15 July 2016. The Government will examine whether initial pooling proposals are likely to meet their objectives and, if necessary, will have "conversations" with funds.

The SW group of funds is the most advanced on progress to pooling. They had commenced a joint project in August 2015 following the Chancellor's announcement in July. The SW group is looking for additional partners, including funds outside the Southwest, and has changed its name to Project Brunel. Oxfordshire Pension Fund had recently decided to join the group. It is expected that the £25bn pooled investment target will be achieved.

She suggested that it was important that the Government had set a baseline for cost savings and that this recognised that significant savings had already been achieved through framework agreements and changes to procurement, for example.

A meeting had been arranged in January 2016 for the Chairs and Vice-Chairs and Section 151 Officers of all the funds at which the business case would be discussed. All the relevant Councils/funds would have to decide on whether to accept the pooling proposal in principle by 5 February. This would leave two weeks for any remaining details to be settled before the 19 February deadline. Because of this timescale it was proposed that the power to approve any proposals or expenditure relating to the project be delegated to a working party, with an opportunity for all Members to comment.

The Committee then debated a number of issues including:

- the appropriateness or not of a geographical grouping
- ability to invest in local infrastructure
- the apparent lack of joined-up thinking in Government that could lead to projected costs savings from pooling being negated by MIFID II.

The Head of Business, Finance and Pensions responded that there was a history of co-operation between the funds in the Southwest, which made it easy for them to work together on pooling. Elsewhere large funds were establishing joint arrangements with smaller funds in other areas, like the London fund working with the Lancashire fund. In many cases geographical factors were not the main drivers. The Investment Manager added that shared values were important, and this would be made clear to potential new partners.

A Member said that having recently attended a recent LAPFF meeting, he was aware that civil servants recognised the difficulties in the way of co-operation because of differences between funds. He was not convinced that the Government would be able to comply with its own timetable.

A Member said that the Avon Fund was efficiently administered by its local officers and she was concerned that administration might be centralised.

The Head of Business, Finance and Pensions said that as the pooling model developed, there would have to be compromises because of the differences between funds. They had different investment managers and different governance arrangements, for example. The work would really begin after the detailed proposal is submitted next July. There would be a long transition period. However, the Fund's investment strategy would continue to be driven by the Committee in the interests of its members.

A Member said that she would regret any loss of local control over the Fund and that she would not wish to see investments being made to the detriment of the Fund's members. The Head of Business, Finance and Pensions responded that strategy and policy would remain with the Committee. For operational reasons powers would have to be delegated to managing the pool, but there would be a recall process if the Committee felt that the pool was not working effectively.

The following points were raised by members:

- the savings accruing to the Avon Pension Fund, the largest in the pool, would be less than those of the other funds. A request was made to officers to produce an assessment of the savings that could be expected for the Avon Fund

- votes on pool investment decisions should be weighted in accordance with the number of members in each fund, so that smaller funds did not have undue influence

The Investment Manager responded to these points. She agreed that further work needed to be done on potential savings; this was difficult because investment costs changed over time as the strategy evolves. However, it would be reasonable to assume the larger funds would save less as they may already benefit from lower fee rates; the project had been set up on the basis of equality across funds, hence one vote for each fund in a pool; equally the fund would not want to be disadvantaged by a large fund joining a pool and acquiring a dominant influence over the pooling decisions.

There was then a debate about the circulation of information outside the meeting agenda, investing in infrastructure, delegation to a working party and proposed governance for the pooled body.

Members were not supportive of a working party, so the Investments Manager replied that officers would be happy to arrange a special meeting, but it could only take place after the report was ready and long enough before the deadline for submission to Government for any details to be finalised. Information had been circulated outside the meeting agenda as not all documents were available at the time the Committee papers were published. The document had been sent to Members so that they would have the information before the meeting. Things were happening fast and the pace of developments did not always fit well with the Committee's meeting schedule and regular processes.

The Head of Business, Finance and Pensions explained that the detailed proposal to be submitted in July would have to be approved by the full council of each administering authority and by the Environment Agency. The submission in February would simply state that the pool would have a governance structure which could take one of various forms. Defining the structure would be part of the follow-on work, in which the Committee would be fully involved. The time frame was so tight that it was important that officers continued to work on the draft proposals. It was not certain that all the other funds in the Southwest would ultimately support pooling arrangements, though at present they seemed to be so inclined. A special Committee meeting would be arranged if Members wished to have one.

A Member objected to the Government doing things before legislation had been passed giving them the power to do them. When a Bill was eventually introduced, it might be amended in its passage through Parliament, and there might be conflict between new regulations and existing legal rules about the fiduciary duties of trustees, particularly in relation to infrastructure investment. How will it be decided whether such investment is in the interest of the members of the Fund? He felt that the Government knew in broad outline what it wished to achieve, but lacked a clear sense of the powers it had, or would need to have, to achieve it. What the Government wanted to do might not be in the interest of the members of the Fund. Another Member asked how a Government minister would be qualified to take decisions about which infrastructure projects to invest in.

The Head of Business, Finance said that in the draft Regulations the Treasury was given powers to intervene if funds did not co-operate; it was better for funds to submit their own proposals that they believe will be in the best interests of their members voluntarily rather than have something imposed on them by government.

A Member said that she was concerned about whether the Fund was actually empowered to do things in response to a Government initiative. As she saw it, the role of the Committee was to ensure that the assets of the Fund were managed effectively, and Members believed they were doing that. However, because of this Government initiative the Committee had agreed to spend £25,000 of members' money on a project on pooling, without knowing the amount, or the Fund's share, of any costs savings that were likely to be achieved. She wanted assurance that the Committee was legally empowered to do this; perhaps the Council should be paying for this work. The Head of Business, Finance and Pensions replied that he had consulted a Council lawyer and had been advised that the Council had delegated to the Committee the power to appoint investment managers. The Committee had

delegated that power to another body, though it was not entirely clear that it had the power to sub-delegate powers delegated to it by the Council. That is why any new arrangements would have to be approved by the Council. In response to a question from a Member, he explained that the proposal put to Council would be in the form of a recommendation from the Committee.

A Member said that she feared that responsibilities were being blurred, so it would be hard to identify who was to blame if anything went wrong. The Head of Business, Finance and Pensions that the new governance structure was emerging very slowly; the Southwest group had simply got on with work on this project on the basis that if they did not, something was likely to be imposed by Government. The Investment Manager said that what ultimately determined the Fund's performance were the Funding Strategy and the Investment Strategy, which would remain the responsibility of the Committee; she recalled that a Government document had stated that asset allocation would remain the responsibility of local funds.

A Member said that it was important that the Committee should meet in the Spring, at a stage when it could still influence outcomes, rather than being presented with a fait accompli in the Summer.

The Head of Business, Finance and Pensions said that the Chair, the section 151 Officer and he would be attending a Project Brunel meeting in January at which they would report the Committee's views and concerns.

The Chair assured the Committee that the officers and he recognised the seriousness of this issue. The Government was setting a challenging timetable, just as they were in relation to local devolution. He was confident that officers would continue to act in the interest of the Fund.

Consultation on LGPS investment Regulations

The Investment Manager reported that on 25 November DCLG had launched a consultation on revoking and replacing the current LGPS Regulations. New Regulations were required to facilitate the pooling of assets. Responses were required by 19 February 2016, the same date as the deadline for initial pooling proposals. The Regulations were based on a prudential framework. The requirement for a Statement of Investment Principles would be replaced by a requirement for a Statement of Investment Strategy, which would have to include the fund's approach to pooling assets. There would no longer be a requirement for short-term performance monitoring; the focus would be on the longer term. There will be powers allowing the Secretary of State to intervene. The consultation document would be circulated to Members by email, and they were invited to let the Investment Manager have their comments.

**RESOLVED:**

1. To note the information in the report.

2. That an emergency meeting of the Committee will be held in early February at which a report and recommendations on pooling proposals will be presented.

## 46 MIFID II - IMPLICATIONS FOR LGPS FUNDS

The Investment Manager presented the report.

She said that the Markets in Financial Instruments Directive (MIFID II) is an EU Directive, which was due to come into force from 1 January 2017. This directive classifies LGPS funds as retail not professional clients. An announcement that its implementation would be delayed until 2018 is anticipated. This would allow further time for its impact to be assessed. Investment managers would have to monitor compliance and would need to set up complex systems to do this. There was a risk was that some managers might not want to manage retail funds. In addition, MIFID II might make pooling of assets and investment in infrastructure more difficult for LGPS funds.

A Member asked whether it was possible to make a representation asking for LGPS schemes to be exempted from this Directive, which did not apply to private pension schemes. She also noted the statement in the report that LGPS funds were not separate entities from the local authorities and that this may be reviewed. The Investment Manager replied that there was discussions about the possibility of separating LGPS funds from their administering authorities, and that the implications of this Directive might feed into that. The LGPS Scheme Advisory Board was supposed to be doing work on this, but it was on hold because of delays in appointments to the Board. The LGA was in discussions about an exemption for LGPS funds with the FCA (responsible for MIFID II in UK).

A Member asked whether any work was being done in relation to the Avon Fund opting for professional status. The Investment Manager said this was not possible until the Government clarified the criteria. The fund was in discussions with managers. Most of the Fund’s managers probably would regard us as a professional investor, but evidence of that would have to be presented. It was hoped that discussions between Government and the LGA would result in a relatively straightforward process for LGPS funds to opt for professional status.

**RESOLVED** to note the potential impact of MIFID II on the Fund and the actions being taken to manage the risk to the Fund’s investment portfolio.

## 47 INTERIM VALUATION AND 2016 VALUATION PROCESS

The Investment Manager presented the report, which summarised the information given to the Committee at the workshop in October. She reminded Members that there had been a great deal of discussion at the workshop about the appropriate discount rate to use in the next valuation. The actuary was concerned that if gilt yields were again used to calculate this, too much prudence would be built into the funding strategy, resulting in higher than necessary contributions from employers. However, whatever the base used to calculate the discount rate, the same level of prudence would be sought as at the last valuation. Because this would the first experience of a valuation for many Members of the Committee, it was proposed that there should be a workshop in March to explain the principles of the Funding Strategy Statement (FSS). A draft FSS would be put before the Committee at the June meeting and would then be sent to employers for consultation. The final FSS would be approved by the Committee at the September meeting.

In reply to a question from a Member, the Investment Management clarified that calculation of the discount rate by the real expected asset return above the CPI

baseline assumption was the current recommendation from the actuary, and might change in accordance with the circumstances prevailing at the time of the valuation.

**RESOLVED** to note the information set out in the report including the timetable for the 2016 valuation.

## 48 REPORT ON INVESTMENT PANEL ACTIVITY

The Assistant Investments Manager presented the report.

Liability Management

He reminded Members that the aim was to put a framework in place to manage the mismatch between the changes in the value of assets and liabilities over time, thus allowing the Fund to minimise funding level volatility and stabilise employer contribution rates more effectively. In June the Committee had requested the Panel reviewed the range of investment options available to more effectively manage liability risks, how they could be implemented and the cost. The Panel had taken two decisions as noted at 4.2 a) and 4.2 b). The interim step recommended in 4.2 a) would be beneficial irrespective of whether the full proposal was eventually implemented, and would not reduce the expected return on assets.

Rebalancing policy

The policy of the Fund is to rebalance the portfolio back to the target allocations after market movements cause allocations to vary by a certain amount. Rebalancing is important because it ensures that the Fund is invested in accordance with strategic asset allocations. It can also add value over time as it forces selling of relatively expensive assets and the purchasing of relatively cheaper assets. The Committee was invited to agree the recommended changes to the rebalancing policy as set out in 4.3 a) of the report.

A Member expressed concern about the potential for overtrading. He was unable to find information in the papers about how often illiquid assets would be rebalanced. The Investments Manager referred to line 7 of the table on page 171 of the agenda. Mr Turner said that he did not think overtrading would take place; he considered that the proposed new policy would establish a much clearer framework for decision making. The Member requested that the Investment Panel should monitor trading frequency. Mr Turner suggested that the main issue would be ensuring that the Fund was close to the target allocation of some asset classes, which depended on the draw-down period and whether the manager had called on all the capital that the Fund had committed. The Fund might also find that it was below a target allocation, because the value of other assets had risen, in which case it would a question of catching up, rather than rebalancing back.

The Investments Manager said that it was proposed that a workshop on the funding strategy should be combined with a workshop on the concept of liability-driven investment (LDI), after which Mercer would draft a framework to be considered by the Panel before it came to Committee. The LDI strategy should be considered as part of the valuation debate.

**RESOLVED:**

1. To agree the recommendation to increase the benchmark allocation and allocation range to index-linked gilts as at paragraph 4.2 a) of the report, to better match liabilities.

2. To note the decision by the Panel to prepare a framework to more effectively use the investment assets to match the liabilities, as set out in paragraph 4.2 b) of the report.

## 49 INVESTMENT PERFORMANCE AND STRATEGY MONITORING REPORT

The Assistant Investments Manager presented the report. Over the quarter the funding level had decreased by 4%, because the value of the assets had fallen and a fall in the discount rate had increased the liabilities. Over the year since September 2014 the funding level had fallen from 83% to 72%, primarily because of the fall in gilt yields increasing the value of the liabilities. These figures were based on the 2013 valuation level, so are different to those given in the interim valuation report. The asset portfolio had underperformed the returns required by the Funding Strategy over the year, but returns were in was in line with the Strategy over three years. He invited the Committee to approve the revised Statement of Investment Principles (Appendix 4 of the report). The minor changes in the revised Statement reflected changes in the hedge funds and currency hedging mandates agreed by the Committee.

Mr Turner commented on the Mercer investment report. He said that market conditions had been difficult, with a general flight from risky assets, such as equities, into more secure assets, such as gilts. This had caused the “double-whammy” of a fall in the value of assets and an increase in the value of the liabilities. It was likely that US interest rates would rise next week, the first increase in ten years. This would the opposite of what most countries were doing. It was not clear how markets would respond to the rise. It might make it difficult for the Fund’s managers to continue to generate the level of outperformance they had achieved over the last 4-5 years. He drew attention the table of manager performance on agenda page 219. The relative performance of Jupiter appeared good, but the asset class in which they invested had fallen further than some others. Pyrford and Standard Life, despite their negative returns in the quarter, were playing the role they were expected to in the strategy. Mercer would introduce changes to this table to give a more informative picture of performance.

In response to a question from a Member he said that in the buoyant equity markets of the past view years it had been relatively to generate good returns. In the future, managers like Pyrford, who had an unconstrained approach, would be increasingly useful in navigating market volatility.

The Independent Investment Adviser suggested that the performance table was misleading because Pyrford and Standard Life had relatively high cash-based benchmarks. Mr Turner agreed this was the case.

A Member referred to the Government’s wish that funds should focus on returns in the long term rather than the short time, and suggested that a lack of monitoring in

the short term might result in an unpleasant surprise in the long term. Mr Turner said he agreed, but he thought the Government was trying to lessen the burden on administering authorities by reducing the amount of detail they had to consider. The Investment Manager said that the Government was worried that a focus on the short term resulted in funds changing managers too frequently, resulting in higher costs. Officers would continue to monitor managers quarterly in order to identify whether there was a trend of poor performance.

A Member expressed concern about the use of bank accounts by terrorist organisations. These accounts might be with a bank in which the Fund was invested, giving rise to a reputational and investment risk to the Fund. He wanted assurance that any banks in which the Fund had an investment were trying to prevent such use. The US Treasury had a project on terrorist funding and on recruitment by terrorist organisation, which would be reviewing internet and phone companies; there might be reputational and investment risk to Fund here as well. The Head of Business, Finance and Pensions replied that this was a real risk. He thought that the most the Fund could do was to ask its investment managers how they addressed this risk when considering investments. The Member responded that if the companies managing internet infrastructure did not know who was using it, then they were not in control of their business, which raised questions about whether it was appropriate to invest in them. He acknowledged this was a difficult issue for an individual fund, but felt it should be a concern for the wider investment community.

**RESOLVED:**

1. To note the information set out in the report.

2. To note the LAPFF Quarterly Engagement Report.

3. To agree the minor updates to the Statement of Investment Principles (SIP) as explained in section 7 of the report and to approve the revised SIP in Appendix 4.

## 50 BUDGET AND CASHFLOW MONITORING REPORT

The Finance and Systems Manager (Pensions) presented the report.

He said that the finance and administration reports had now been separated to permit a clearer focus on each aspect.

Directly-controlled administration budget expenditure was forecast to be £50,000 below budget. This resulted from the delay in appointing staff to assist in the GMP data reconciliation project, the delay in appointing a Custody & Finance Officer and savings on communication costs. In the part of the budget not directly controlled, expenditure was forecast to be under budget by £793,000, because investment manager fees were below the level assumed when the budget was prepared. The forecast net outflow of cash was £16m, compared with £24m forecast in the Service Plan 2015/16. The reasons for this were set out in paragraph 5.2 of the report.

A Member asked whether the termination deficit payment referred to in 5.2 was actually a cash inflow rather than an employer’s secure bond. The Investment Manager confirmed that it was.

**RESOLVED** to note:

1. The administration and management expenditure incurred for 7 months to 31 October 2015.

2. The cash flow forecast to 31 March 2016.

## 51 PENSION FUND ADMINISTRATION - PERFORMANCE INDICATORS AND RISK REGISTER

The Pensions Benefit Manager presented the report.

He said this was the first combined administration performance and Data Improvement Plan report (the latter being introduced as a requirement following the introduction of The Pension Regulator Code of Practice 14).

Performance

There were no significant issues to report. The Balanced Scorecard showed that the key performance indicators were all within or near target. However, there was a slight underperformance on the processing of early leaver cases, mainly due to the increased workload in this area following the year-ending data cleansing exercise. There had been a further increase overall in work cases during the reporting period, attributable mainly to data reconciliation and a build-up of aggregation cases.

The Avon Pension Fund also administers the Firefighters Pension Schemes on behalf of Avon Fire and Rescue Service. Recent developments relating to the Fire scheme had significantly impacted on workload:

- the scheme had become a CARE-based scheme in April 2015; much staff time was dedicated to implementing the new scheme and providing training events

- Retained firefighters had been granted access to the scheme on an historic basis. The Fund provided training to Fire Authority HR and Finance staff and detailed calculations on admission of qualified members

- The Ombudsman had made a decision in the case of Milne v. GAD in favour of Milne. As a result additional payments would have to be made to certain Firefighter scheme leavers whose pensions had commenced between December 2001 and August 2006. Payments in these cases would total about £2.2m and would be made within the next two months. All payments will be funded by Fire Authority

- DCLG had also advised that firefighters who had joined the old Firefighters Pension Scheme before the age of 20 and had 30 years of service would be allowed to take a contributions holiday from the age of 48 up to the age of 50. Further details on this are awaited from DCLG

There was a requirement to issue an Annual Benefit Statement to all members by 31$^{st}$ August. Only 105 statements were not issued by this deadline, and this was because nine employers failed to provide any year-end information at all. Penalties

charges would be imposed on employers who failed to meet the advertised criteria for correct and timely supply of data at year end. It was vital now the LGPS scheme was no longer a final salary scheme that current data was held for each member. He drew attention to the table of TPR Improvement Plan Data in Appendix 8 on agenda page 277; there was an increase in the number of leavers being identified. Additional efforts would be made to engage with and train employers. Officers would visit employers, because in general those employers attracting penalty charges were not interested in attending training workshops or conferences. Continuing refinement of the performance reports would allow problem employers to be targeted.

A Member asked whether it was possible to estimate the additional costs being imposed by new Government requirements. The Head of Business, Finance and Pensions replied that it was difficult to estimate the costs, but officers were spending much more time on compliance and employer engagement. There were 220 employers in the scheme, which would rise to over 400 as schools became Academies. Not all employers could be expected to understand their duties in relation to pensions. There was no doubt that the Fund's costs would increase. How much they would increase would depend on how effective the Fund's IT systems and the policing of the governance arrangements within employers were.

A Member asked about the accuracy of data in relation to the CARE scheme, for example about hours worked. The Pensions Benefit Manager replied that work would have to begin in the near future to identify gaps in data held. There would need to be reconciliation between contributions received and the CARE data collected from employers. Employers did not really understand their obligations, despite the large amount of information circulated and training offered. There were issues relating to unpaid sickness entitlement, APC's and AVCs that they did not have to deal with before.

A Member said she was encouraged by the level of data completeness and accuracy reported for the Fund, particularly in the light of a survey published that day, which had revealed a shocking picture for pension funds in general. It was obvious that The Pensions Regulator would need to address this, so the regulatory burden would not get lighter.

**RESOLVED** to note:

1. The Summary Performance Report to 30 September 2015.
2. Performance Indicators and Customer Satisfaction feedback for 3 months to 30 September 2015.
3. Progress on the Data Improvement Plan.
4. The Risk Register.

## 52 INTERNAL DISPUTES RESOLUTION PROCEDURE

The Pensions Benefit Manager presented the report. He said that the revised procedure reflected the new LGPS regulations and took into account guidance received from The Pensions Regulator as set out in its Code of Practice 14. He invited the Committee to approve the revised procedure.

A Member said that she thought two months before a response was sent was too long. She also thought it was not clear who was involved at Stage 2. The Pensions Benefit Manager replied that most cases would be dealt with by the employer, which is Stage 1. At Stage 2 cases are dealt with by the Fund. The attached appendix to the report outlines the responsibility at each stage of the process.

**RESOLVED** to approve the Internal Disputes Resolution Procedure as outlined in the report.

## 53 WORKPLANS

The Investments Manager presented the report. She reminded that Members' attendance at training events was reported in the Annual Report and Accounts and in the Annual Report to Council. Members had been invited to undergo training to meet the requirements of the CIPFA Knowledge and Skills Toolkit within their first year on the Committee.

**RESOLVED** to note the workplans and training programme for the relevant periods.

The meeting ended at 4.08 pm

Chair(person) ..........................................................................

Date Confirmed and Signed ...............................................................

**Prepared by Democratic Services**