CLWYD PENSION FUND COMMITTEE
4 SEPTEMBER 2019

Minutes of the meeting of the Clwyd Pension Fund Committee of Flintshire County Council, held at County Hall, Mold at 9.30am on Wednesday, 4 September 2019.

PRESENT: **Councillor Aaron Shotton (Chairman)**
Councillors Haydn Bateman, Adele Davies-Cooke and Kevin Hughes

CO-OPTED MEMBERS: Councillor Trevor Bates (Wrexham County Borough Council), Councillor Andrew Rutherford (Other Scheme Employer Representative), Mr Steve Hibbert (Scheme Member Representative).

APOLOGIES: Councillor Ralph Small (Flintshire County Council) Councillor Huw Jones (Denbighshire County Council), Councillor Nigel Williams (Wrexham County Borough Council).

IN ATTENDANCE:

Advisory Panel comprising: Colin Everett (Chief Executive), Philip Latham (Clwyd Pension Fund Manager), Gary Ferguson (Corporate Finance Manager), Karen McWilliam (Independent Advisor – Aon Hewitt), Kieran Harkin (Fund Investment Consultant – Mercer), Paul Middleman (Fund Actuary – Mercer).

Officers/Advisers comprising: Debbie Fielder (Deputy Head of the Clwyd Fund), Karen Williams (Pensions Administration Manager), Nick Buckland (Fund Investment Consultant – Mercer), Megan Fellowes (Actuarial Analyst – Mercer - taking minutes), Ieuan Hughes (Graduate Investment Trainee).

19. **DECLARATIONS OF INTEREST (INCLUDING CONFLICTS OF INTEREST)**

No declarations of interest

20. **MINUTES**

The minutes of the meeting of the Committee held on 12 June 2019 were submitted.

RESOLVED:

It was agreed the minutes could be received, approved and signed by the Chairman.

21. **FUNDING STRATEGY STATEMENT**

Mr Middleman presented the key factors to consider when developing a funding strategy.

He emphasised the importance of the Funding Strategy Statement as part of the Actuarial Valuation as it balances out a number of key risks.

Mr Middleman explained that fundamentally it is the “plan” for the Fund to ensure it has sufficient monies to pay members' benefits when they retire for as long as they live. This is financed through employer and employee contributions, and investment returns, so the balance between the two elements is what the FSS determines. The other critical aspect is an employer’s covenant. The covenant of an employer is the ability and willingness that an employer can pay their contributions that we require from them. This also affects the level and timing of contributions you would request from different types of employer. For example, a Council would be expected to be able to fund its pension liabilities over a longer timeframe with more certainly than, say, an employer who is reliant on specific funding streams. Therefore, the funding strategy has to take into account these differences.

Mr Middleman noted key points about the proposed assumption changes on the Funding Strategy Statement which was contained in the separate presentation. The key changes where:

- A reduction in the discount rate/return outlook relative to CPI inflation.
- A change in the life expectancy assumption resulting in a reduction in life expectancy for the Fund.
- A change in the short term pay growth to a minimum of 2% p.a. for 4 years to 2023.
- An average reduction in the recovery period of 3 years to target the same period to full funding.

Mrs McWilliam queried why there are two different discount rate assumptions; one for past and future. Mr Middleman confirmed that there are two elements for how contributions are set. Past service is looking at the deficit relating to the benefits that have already been earned. Future service is based on members who are in the Fund continuing to earn benefits, and these have a much longer timeframe to earn returns than the liabilities already accrued as this includes pensions in payment already.

Secondly, Mrs McWilliam asked about the recent announcement of the merging of RPI and CPI. Mr Middleman said that the announcement would not affect the valuation position as this was determined prior to the announcement so assets and liabilities are consistently measured. Equally it is not absolutely certain that the change will happen (although likely) and how it will manifest itself. Mr Middleman therefore recommended no change in the parameters at this valuation but consideration of this issue will be needed going forward. However, there was a market reaction to the announcement which will need to be considered in the context of the flightpath and hedging strategy adopted. Any impact will be reported at future Committee meetings where appropriate.

Mr Everett said that even the Councils are in different places in terms of affordability so it has to cater for all circumstances and he felt it does that. Mr Middleman agreed Mr Everett’s important point and noted it is becoming more difficult to balance across all employers although it is easier when the position is improving.

Cllr Rutherford queried the impact of the pay growth from the 2016 to 2019 valuation. Mr Middleman noted that at 2016 a 1% p.a. increase (including increments) was assumed. The data had shown the average increase on salary from the membership data shows c2.5%-3% p.a. over that period. This results in a bigger than expected increase in the final salary related liabilities (benefits earned up to 2014) hence a small increase in the deficit due to this factor. In terms of the forward looking short term pay assumption this is a reflection of the planned general pay increases in the sector (2% for 2019 and 2020) but employers will be asked to consider if a higher figure should be used as otherwise the impact of higher increases would come through at the next valuation (as in 2019). It is essentially a budget risk for employers to manage as they know better than the Actuary what the pay progression is likely to be in the next few years.

Mr Hibbert queried if the average deficit recovery period should be kept at 15 years. Mr Middleman noted that there is an expectation under the Section 13 valuation performed by the GAD that recovery periods would reduce over time and typically to maintain the same end point. Mr Middleman noted however that when the length becomes too short then it can cause contribution requirements to become too volatile. Depending on the final period adopted at this valuation it is possible that the average period would not reduce again or by less than three years.

Mr Middleman ran through the current policy issues highlighting the McCloud age discrimination case in relation to the benefit changes made in 2014 (and the protections given to certain members within 10 years of retirement) which means that there will be additional McCloud costs for all public sector schemes. Guidance has been issued from Government stating that the Fund policy in relation to the allowance for the potential McCloud remedy should be clear.

Mr Middleman explained that the remedy required in the LGPS will not be known before contribution rates are signed off. Whilst it cannot be costed with any certainty a cost can be assessed if the age criteria were removed in terms of the underpin. This provision will be communicated to employers based on their individual membership.

Mr Middleman proposed that employers should have the choice to make a provision for the potential costs in the valuation contribution rates for the McCloud judgment or to make provision in their budgets. If they make provisions in the contributions, then there would be no review of contributions before the next valuation to allow for the McCloud costs, whereas if a provision was made in the budget then if the remedy is known before the next valuation contribution requirements will be increased and backdated from 1 April 2020. Therefore, if an allowance is made in the contributions from 1 April 2020 to 31 March 2023 an employer will have budget certainty for this period.

Mr Middleman also added that this is the costing approach adopted for each employer in their annual accounts so is consistent.

Mr Middleman stated that on the basis of the proposed parameters the funding level at the 2019 valuation would be an increase to 91% resulting in a much lower deficit. However, the future service rate would increase to 17.3% of pay per annum. The McCloud provision across the Fund would be c0.5% of liabilities pay and 0.5% of pay per annum in relation to the future service rate.

He also confirmed the following key points regarding other policy issues;

- Cost management will not be allowed for at the 2019 Actuarial Valuation as it has been paused.
- The policy in relation to interim valuations and individual employer contribution rate reviews between valuations is being consulted on in terms of when the Fund would do that. However, it is looking increasingly possible that these provisions will not be brought in before the FSS is signed off. Even so it is his view the issues should be consulted on even if the policy was removed from this FSS and the FSS was updated again at a later date to introduce them again.
- Exit credits are where an employer can receive monies back on exit if the funding position shows a surplus (typically on an insurance basis). The policy was put in place in 2018 and Regulations are expected to be updated to close a loophole for some cases where another employer (e.g. a Council) guarantees the debt but does not receive the surplus back. These Regulations were expected before the end of the year and the FSS needs to reflect it, so employers are being consulted on whether the existing policy is sufficient.
- The policy in relation to when an employer would be allowed to become a “Deferred employer” e.g. where an employer to stay in the Fund with no active members. This would have limited application in the Fund given the employer base.

Mr Latham queried the timeline for taking the FSS for consultation. Mr Middleman said that the employer results and draft FSS will be issued before the AJCM in November so they can be discussed directly with employers.

Cllr Bateman raised the issue of the protection of employer default. Mr Middleman highlighted the importance that the policy is as comprehensive as possible because if one employer defaults then the guarantor or all other employers have to pick up their obligations. There are separate processes around general employer risk management and in particular covenant data is gathered on employer’s ability to pay contributions to make an assessment on the likelihood of employer default and actions are taken to minimise it e.g. higher contributions and/or security.

Cllr Bateman queried the number of employers in the Fund. Mrs Fielder confirmed that there are 43 employers.

The Committee agreed the main parameter changes and draft polices discussed.

RESOLVED:

(a) The Committee approved the draft Funding Strategy Statement; and

(b) The Committee delegated the refinement and finalisation of the draft Funding Strategy Statement to the officers before formal consultation with employers.

22. **RESPONSIBLE INVESTMENT POLICY**

Mr Buckland stated that the Fund had decided to review the current approaches in place relating to responsible investing to ensure they had the appropriate focus given recent developments. A survey was sent out to gather views from Committee members.

Mr Buckland emphasised that the fiduciary duty is to get the best possible return for investment, however he noted that there are considerations regarding ESG risks (Environmental, Social and Governance) that the Fund can and does take account of. There are already policies in place within the ISS (Investment Strategy Statement) such as responsible investment and sustainability policy. Mr Buckland explained the Fund is therefore starting from a well formed policy and is looking to enhance and develop it into something more effective.

He explained that the potential responsible investment approaches are:
- Integration – ESG factors are integrated – broader perspective and risk/opportunity
- Stewardship – exercising active ownership (voting rights and engagement)
- Investment – the aim is for long term growth within areas of positive responsible impact
- Negative Screening – avoiding investment with a negative responsible impact i.e. tobacco/coal

Mr Everett argued that blunt screening may well not be necessary if you applied integration well. He believed it would be good to see the process of thinking and challenge. Mr Buckland agreed.

Mrs Fielder stated that the Fund already has a number of investments in renewable energy and she is looking to integrate this more across the WPP. Mr Everett said that they should welcome WPP's commitment to drive progress in this area and in particular would assurance that the Fund's policy requirements could be delivered by WPP. Mr Latham responded that Russell and Link are at the next Committee therefore the Committee can ask them questions and get more clarity.

Mr Buckland explained that he attended the Scheme Advisory Board Investment, Engagement and Governance Sub-Committee meeting the previous week where responsible investment was on the agenda. The intention was that there will be Responsible Investment guidance issued to LGPS Funds. The DWP have issued regulations on 1 October outlining that corporate schemes need to have a responsible investment policy. It is also a requirement to have a policy on climate change however the current LGPS do not require this.

There was a debate around individual fund policies coming together as part of the WPP pool. It was highlighted that is up to each individual administering authority to set its own Fund policy and the pool should be there to implement those policies. However, this can be difficult with eight different administering authorities around the table.

Mr Buckland confirmed that the results of the RI survey that was undertaken showed four Committee member responses. In respect of the ESG issues, 75% of the results reflected that the Committee had a fairly well developed understanding on investment risk/opportunity and the other 25% felt that they are not that developed in this area.

Cllr Hughes asked whether the key focus is to look at climate change and at investments in the aerospace industry and so potential damage to climate change. Mr Buckland confirmed that there is a methodology of looking at any impact e.g. Global Index 2000 stocks NISI who do a lot of work around each individual stock against ESG factors, one of those being climate change and carbon emissions.

Mr Latham wondered what the reaction of the Committee would be if the Fund could reduce the carbon footprint with a low tracking error. Mr Latham also queried how much the Committee believed in screening. Mr Hibbert said that the issue with screening is where do you stop e.g. do you not invest in retailers because they sell tobacco? Cllr Rutherford noted his agreement with Mr Hibbert that there should be an element of screening from the start. He also asked for the Fund's investment reporting to be enhanced to include more information on ESG factors.

Mr Hibbert expressed concern around passive investing given the investment manager achieves a market return without actively screening stocks. Mrs Fielder stated that she has now seen passive managers develop over time; if people wish to exclude something, some managers are now adapting their approach. Mr Buckland added that it depends on what index they are looking to track.

Mr Buckland concluded by commenting that he felt a lot of good views were discussed and that he will look to embed all of the views into the revised policies.

The Chair said that it would helpful to understand the theory in practice. Mr Buckland confirmed that he would look to address this as part of the forthcoming training session in October.

Cllr Rutherford requested more detailed training on responsible investments aside from the usual agenda items so there can be in-depth discussions. Mr Harkin confirmed that this would be covered at the training day.

Cllr Rutherford wondered whether there had been any research on this topic i.e. gathering information regarding how the members in each Council feel. Mrs Fielder confirmed that she receives frequent queries from members asking for various information e.g. a member questioned how much the Fund invests in fossil fuels/arms etc.

The Committee considered the draft Wales Pension Partnership RI Policy and no further changes were requested in relation to it.

RESOLVED:

(a) The Committee expressed views on the Fund's RI beliefs, to help develop the Fund's policies; and

(b) The Committee agreed the Wales Pension Partnership RI Policy.

23. **GOVERNANCE UPDATE.**

Due to the length of the agenda, it was confirmed that the report in this item was noted and any questions taken.

Mr Latham confirmed that The Pension Regulator's survey results were released and one recommendation states that pension funds should have more freedom to pay salaries to attract and retain staff. Mrs McWilliam noted that local authority policies can result in difficulties in paying appropriate levels to pensions teams, which in turn can impact on retention. The Chairman asked where these thoughts and concerns of the Fund can be raised and heard nationally. Mrs McWilliam said that there are now workshops covering the issues and allowing debate.

RESOLVED:

The Committee considered the update and provided comments.

24. **LGPS UPDATE**

The report was noted and the Chair went straight to questions. Mr Hibbert queried an update on New Fair Deal. Mr Middleman confirmed that it is still being moved forward with a view to implementation in 2020 but it has been held back by other priorities. He noted that it could still be delayed and will keep the Committee updated.

RESOLVED:

The Committee members noted this report and made themselves aware of the various current issues affecting the LGPS and the Fund.

25. **PENSION ADMINISTRATION/COMMUNICATIONS UPDATE**

Mrs Williams drew attention to The Pension Regulator Data Quality report 2019 results. The Common Data score decreased from 92.7% last year to 92.1%. This slight decrease was a result of 3,867 more members in scope for testing this year. The Scheme Specific Data score had increased from 68.2% to 81.7%. However, based on the new factors the Scheme Specific score that will be reported to the TPR is 92.7% and the Common Data score is 96.8%.

Mrs Williams also noted that an action on the business plan is to complete the member tracing exercise which is in progress.

Mr Everett emphasised that there needs to be a continued push by all stakeholders for members to use the Member Self Service. This will assist greatly in freeing up resource on the administration team.

RESOLVED:

(a) That the Committee considered the update and provided any comments. In particular, the Committee noted the statistics highlighting the excellent progress with data cleansing (including the submission of valuation data) and the iConnect implementation; and

(b) That the Committee approved the change in timescales to the business plan as outlined in paragraph 1.01.

26. **FUNDING AND FLIGHT PATH UPDATE**

Mr Middleman noted that the critical part of the funding and investment is to control the risk which is done via the flightpath. He noted that the equity protection levels had been increased by 5% of the c£350m covered.

He noted that the opportunity was taken to increase the hedging protection on currency to c75% overall to lock in gains to date. This was on the basis that a No Deal Brexit was less likely.

Cllr Bateman queried whether the process of hedging is costly. Mr Middleman confirmed that there is a cost to hedging, varying from the cost of implementation and the ongoing cost of controlling that risk. The key is to consider the "value for money" of the hedging versus the cost and this is always done as part of the process of deciding whether to implement it. To date the overall benefit of the flightpath has far outweighed the cost.

Mr Harkin highlighted the cost on page 202, paragraph 1.07. He also noted that the depreciation of the pound resulted in a gain for the Fund because of the unhedged physical overseas equity exposure. He expressed that these gains needed to be banked so that if the pound strengthened, the Fund is able to keep the gains.

Mr Harkin said that there will be further details about this in the training session in October.

RESOLVED:

(a) That the Committee noted the updated funding position (on assumptions consistent with the 2016 valuation) and hedging position for the Fund and the progress being made on the various elements of the Risk Management Framework;

(b) The Committee noted that the equity protection structure has now been revised to increase the level of protection; and

(c) That the Committee noted that any currency risk associated with the market value of the synthetic equity portfolio and the developed equity markets which have now been fully hedged.

27. **INVESTMENT AND FUNDING UPDATE**

The report was noted and the Chairman went straight to questions. Mrs Fielder highlighted the commitment previously made with Threadneedle which is a Low Carbon Workplace Fund aiming to make buildings sustainable. It has also been agreed to commit to their second Fund.

RESOLVED:

The Committee considered and noted the update for delegated responsibilities and provided comments.

28. **POOLING INVESTMENTS IN WALES**

Mr Latham explained some key elements of this report.

On paragraph 1.09 on page 235, Mr Latham outlined that the pool had planned to create a European equity mandate, however the investors that had originally requested it will now invest into the Global mandate.

On paragraph 1.08 also on page 235, Mr Latham noted that the transition of fixed income assets is likely to be pushed to later than November 2019 (as originally stated in the report). It will now potentially be the first week of December 2019, however the closer to Christmas it is, will present some liquidity issues.

Mr Latham noted that after discussion it had been agreed that advisers will be able to attend Fund Manager engagement days.

Mr Hibbert noted again for the record the lack of member representatives at JGC and he wished for this to be formally raised at the agenda on the WPP. Mrs McWilliam highlighted that she was not aware that the ongoing meeting with Pension Board Chairs was intended to be instead of scheme member representation on the JGC. Mr Hibbert highlighted that Pension Board Chairs are often not scheme member representatives. The Chairman said that he would raise this at the next JGC. Mr Buckland noted that the scheme member representation within Pools' governance arrangements was being raised at a national level, and it had recently been covered at the SAB Investment, Engagement and Governance sub-committee meeting.

RESOLVED:

(a) That the Committee noted the report; and

(b) That the Committee discussed and agreed any comments or questions for WPP.

29. **<u>ECONOMIC AND MARKET UPDATE AND INVESTMENT STRATEGY AND MANAGER SUMMARY</u>**

The report was noted with Mr Harkin highlighting that all of the information on page 249 is dated to the end of June 2019 however things have moved on since. Since then there has been increase in volatility within growth assets such as equities and commodities.

Mr Harkin stated that it had been a strong quarter for investment returns resulting in over £90m appreciation of assets. He also confirmed that at 31 July 2019 the Fund tipped over £2bn in size.

<u>RESOLVED</u>:

(a) The Committee discussed and commented on the Market and Economic update for the quarter ended 30 June 2019, which effectively sets the scene for the Investment Strategy and Manager Performance summary; and

(b) The Committee discussed and commented on the Investment Strategy and Manager Performance summary for the quarter ended 30 June 2019.

The Chair thanked everyone for their attendance and updates at the Committee meeting. He noted that the special Committee meeting is on 7th October starting at 12pm to sign off the annual reports and accounts, followed by the training day.

The next formal Committee meeting is on 28th November. The meeting finished at 12:30pm.

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Chairman