CLWYD PENSION FUND COMMITTEE
21 FEBRUARY 2018

Minutes of the meeting of the Clwyd Pension Fund Committee of Flintshire County Council held at Delyn Committee Room, County Hall, Mold CH7 6NA on Wednesday, 21st February, 2018

PRESENT: Councillor Dave Hughes (Chairman)
Councillors: Ted Palmer, Ralph Small, Haydn Bateman.

CO-OPTED MEMBERS: Councillor Huw Llewelyn Jones (Denbighshire County Council), Councillor Nigel Williams (Wrexham County Borough Council), Mr Steve Hibbert (Scheme Member Representative), Councillor Andrew Rutherford (Other Scheme Employer Representative).

APOLOGIES: Councillor Billy Mullin.

ALSO PRESENT (AS OBSERVERS): Gaynor Brookes/Steve Jackson (Clwyd Pension Fund Board)

IN ATTENDANCE:

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

Officers/Advisers comprising: Debbie Fielder (Pensions Finance Manager), Helen Burnham (Pension Administration Manager) and Megan Fellowes (Apprentice – Mercer - taking minutes).

Guest speakers presenting comprising: John Simmonds (CEM Benchmarking), David Cullinan (PIRC), Sasha Mandich (Russell Investments) and Duncan Lowman (Link Fund Solutions).

Prior to the start of the meeting the Chairman asked everyone to introduce themselves and welcome the members of the Pension Board. The Chairman welcomed Cllr Ted Palmer to his first Committee meeting.

99. DECLARATIONS OF INTEREST (INCLUDING CONFLICTS OF INTEREST)

No new conflicts were declared. Councillor Palmer confirmed he had completed the conflict of interest.

100. MINUTES

The minutes of the meeting of the Committee held on 29th November 2017 were submitted.

RESOLVED

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

101. **AGENDA**

The Chairman noted that the usual update was not included as the main items were the three presentations from the guest speakers. The only update was relating to the Clwyd Pension Fund on agenda item 7.

The Chairman passed over to Mr Latham for a short introduction.

Mr Latham stated that whilst the three presentations were different, they were closely connected to each other in terms of how the investments are managed and performance is measured and benchmarked in terms of risk versus return. They will provide a basis of debate for this meeting as well as future meetings.

The first two would look at the LGPS investment performance; the first presentation considers how well the LGPS as a whole has performed from an investment point of view and why, whilst the second considers how the Fund compares with its peers and looks at the impact on investment performance and costs for the Fund of our lower risk philosophy.

The third presentation was from the new Wales Pension Partnership (WPP) operator to demonstrate the process of appointing investment managers through the WPP as that, eventually would not be under the remit of the Committee.

Mr Latham reminded the Committee that the primary aim of the strategy is to provide sufficient investment return to pay for pensions many years into the future whilst trying to maintain a stable employer cost. To do this the Fund needs to achieve or beat the actuarial investment assumption for returns over CPI in the long term but that does not mean the highest investment return possible by taking undue risk.

102. **LGPS INVESTMENT PERFORMANCE**

The Chairman welcomed David Cullinan from PIRC to present the investment performance across the LGPS universe to the Committee.

During the presentation, a number of comments and questions were raised by the Committee and officers/advisers.

Mr Cullinan introduced himself and gave the Committee a brief summary of PIRC. His belief was that there are negative views in the press regarding the LGPS performance and he challenged these views. Key points from the presentation were;

- The statistics shown were based on facts not opinion and 60 Funds participate in the universe.

- The last 12 months performance has been very positive (21.4%) driven predominately by equities
- Over the longer term only 6 out of the last 30 years have had negative investment returns.
- Over the last 20 years the assets returns have been extremely positive with a real return above inflation of 6% p.a.
- Therefore the asset performance was not the problem with funding; the issues were with the liability costs.
- Over the last 30 years the asset allocations in the LGPS have become more complex moving from traditional assets (equities/bonds) with a few managers to more complex structures (10 or more managers and more active management) but this active management has added c0.4% pa to return.
- There is a positive link between risk and return as perhaps expected
- There appears to be some additional return impact for larger Funds (by asset size) over the long term but this is likely due to a quicker move to alternative assets such as private equity/property and possibly internal management capabilities reducing fees. This performance advantage has been much eroded more recently.
- Pooling across England and Wales should provide economies of scale (including internal management) and access to broader investment choices.
- Difficult to say at this point if pooling will provide stronger Governance and Decision making but it's critical the operator has robust processes around cost transparency and manager selection. It should be noted that lower fees are not a measurement of value for money – it's the return net of fees which is important.
- Different Pools possibly have different objectives e.g. London reducing manager numbers and costs but Wales leveraging scale for cheaper access to certain asset classes.

A number of comments were made and clarification questions were asked.

Mr Everett asked how can it be quantified whether the Fund is overpaying for some investment services and how the Fund evaluates fees to get value for money. Mr Cullinan noted this will be covered in the next presentation but in his view it could be done by comparing gross returns and net returns albeit this is a crude measure so other factors need to be borne in mind e.g., differences in allocations, risk profiles and added value.

Councillor Llewelyn-Jones queried the independence that the WPP has i.e. will there be pressure from the Welsh Government to invest in infrastructure projects in Wales. Mr Everett responded to this query by confirming that the Fund is independent and that they have to make decisions in the Funds best interest, However there will a number of projects which could be considered by the WPP in terms of the potential for investment by Funds.

Mrs Fielder commented that pooling could (in theory) give the Fund access to the "best in class" managers but aren't all pools chasing the same managers and could just individual Funds do the same? Mr Cullinan responded by stating that the biggest funds currently get access to best in class managers but the difference is the overall scale of access which would reduce costs if more

Funds enter into the arrangement. Other pools may well look to invest in the same managers but there will be different views to what is best in class and how the managers are accessed will be important (which will be different by each Pool).

Mrs McWilliam asked Mr Cullinan how he measured volatility. Mr Cullinan responded by stating that they are measured from the lowest to highest point as the standard deviation over a 36 month period.

Mrs McWilliam asked Mr Cullinan for clarification on the term “performance from active asset allocation” for the new members of the Committee when considering the issue of active management adding value. This was clarified as the actual performance of a Fund versus if it would have invested its assets in their benchmark allocations.

Mrs McWilliam enquired whether the performance quoted was measured net of fees. Mr Cullinan confirmed that the longer term figures were not net of fees.

The Chairman asked if Mr Cullinan had any thoughts on whether the LGPS as a whole will change investment allocations over the next 10 years. Mr Cullinan’s view was that allocation to traditional risk assets like equities would fall and we would see an increased allocation to investments in infrastructure, Diversified Growth Funds and other alternative asset classes.

Mr Latham noted that moving to higher allocations in alternative assets will increase costs so it is important that costs are not the only consideration in performance of the pools.

The Chairman thanked Mr Cullinan for his presentation.

103. **CLWYD PENSION FUND INVESTMENT RISK AND PERFORMANCE**

The Chairman welcomed John Simmonds from CEM benchmarking to introduce the company and give an update on the investment performance of the Clwyd Pension Fund. Mr Simmonds introduced CEM benchmarking and stated that it exists primarily to compare the costs of operating large Pension Funds around the world. He noted that 150 of the top Pension Funds work with CEM benchmarking. They currently benchmark 33 LGPS Funds. They compare the performance of the Clwyd Pension Fund with the rest of LGPS. The key points that Mr Simmonds addressed were;

- Two key metrics: performance versus other Funds and more importantly versus the liabilities
- The Pooling objective is predominately to achieve economies of scale.
- The Clwyd Pension Fund investment net return for 2017 was 21.5% which was identical to the LGPS median in that year.
- The 5 year net return was slightly below the median over 5 years but better than the median over 3 years.
- The “policy return” is the return from asset allocation decisions which will continue to sit with the Pension Fund Committee after pooling. For the

Fund these have been below the median mainly because of the lower equity allocation over the periods being measured.

- A critical component is the level of risk as a measure versus the liabilities. Based on that measure it can be seen the Fund is at the lowest level of risk which is positive as it means deficit outcomes are more predictable (all things being equal)
- Net added value for the Fund from active management was upper quartile.
- The costs of investments versus peer group are higher than the average but this is a reflection of asset mix. If this is removed by normalising versus a benchmark portfolio the differential in cost is much smaller.
- Costs are likely to rise for other Funds as the pools get more access to private market and alternative investments.
- The “cost effectiveness” of the Fund i.e. Net added value versus cost shows that for the Fund gets positive added value for the cost spent (materially so in the last 12 months),

Mrs McWilliam asked Mr Simmonds the process in which he measures and determines the risk factor. Mr Simmonds explained that they test at the relationship between the liabilities versus the level of volatility of asset risk. Mrs McWilliam asked if officers were surprised where the Fund sits when comparing funding level with asset-liability mismatch risk. Mr Latham confirmed that this is what would be expected given the level of focus on risk control via the Flightpath.

Mr Everett queried whether the position shown is where the Fund would want to be. Mr Middleman confirmed that the objective of the Fund was to control risk to provide more stable outcomes to employers as the tolerance to contribution volatility is much diminished with the shrinkage of budgets. The position of lower relative risk meets that objective so it is a position the Fund wants to be but if it can be improved further then that should be an aspiration of the Fund. An example of this is maintaining the equity protection strategy which is not allowed for in the analysis and reduces asset volatility. Mr Middleman believes this is where the LGPS is considering more generally as other Funds are focusing more closely on risk control as seen by the number of equity protection strategies being considered and implemented.

The Chairman asked Mr Simmonds whether he had any thoughts on how the Government will measure the performance of the Pools going forward. Mr Simmonds noted that the objectives would need to be clear at the outset e.g. cost savings have been delivered as promised, but it would be difficult to measure improved governance in isolation as you would have to be able to measure the position before pooling on a like for like basis which may not possible.

Pools will need to supply data in a consistent format so the “success” can be objectively measured and this should be based on whether the Funds are getting value for money. He noted that the transparency of costs shown by the Clwyd Fund is a very positive approach to help with this. Equally, any performance measurement will need to include some measure of risk versus liabilities to be a worthwhile comparator. CEM is working with Pools to develop this benchmarking analysis.

The Chairman thanked Mr Simmonds for the presentation.

104. **WALES PENSION PARTNERSHIP ASSET POOLING**

The Chairman welcomed Sasha Mandich (Russell Investments) and Duncan Lowman (Link Fund Solutions) and congratulated Link and Russell on their appointment as operator to the Wales Pension Partnership (WPP). Mr Lowman thanked the Chairman, introduced Link and Russell and briefly set out the agenda. Mr Lowman explained that Link will operate the pool on behalf of WPP and Russell Investments will advise WPP on manager selection. The presentation gave an overview of their businesses and experience in these areas.

Councillor Palmer, as a new member of the Committee, asked the presenters to explain the meaning of the acronyms during the presentations.

The Pool is an FCA Authorised Contractual Scheme (ACS) using Northern Trust as the custodian and administrator. The investment managers would be appointed to the platform. The benefit of an ACS structure is that it is possible to recover tax e.g. tax on dividends which can't be recovered under other arrangements.

The WPP objectives are critical to the set-up of the pooling arrangements and these are:

- To allow each Fund (through the use of sub-funds) to implement their own investment strategy which continues to be determined by the Committee for the Clwyd Fund
- To reduce and control costs and maximise tax efficiency
- Allow access to "best of breed" asset managers which complement each other through improved governance which is determined by WPP through its governance structure
- Improve scale by accessing a bigger pool of assets and adopt best practice portfolio management

The first phase of the project will be to implement Global Equity sub-funds as they are the largest Assets under Management (AUM) across Wales. The target date to approve the manager line-up is 15th March. Fee negotiations with the managers are ongoing. There is a project plan (as summarised in the slides) which targets FCA submission on 1 May.

Mrs McWilliam asked whether they have decided on the Fund managers and who makes this decision. It was confirmed that the decision will be approved by the Joint Governance Committee (JGC) in consultation with Russell and Link. Mrs McWilliam also asked whether it is realistic that the approval of equity managers will be completed by 15th March. Mr Lowman confirmed that, in his view, they will be and more discussions will be held on Monday 26th February which will discuss the various options.

Mr Mandich presented to the Committee and highlighted the key points;

- Within each sub-fund, rather than hiring one manager, Link and Russell help the Fund diversify manager risk. This is done by proposing a line-up

of managers that complement each other as the aim is for a better than median market return but a lower risk due to the diversification.
- Summarised details of Russell's manager research approach which is a combination of the 4 P's of manager research – Qualitative (People & Process) and Quantitative (Portfolio & Performance).
- Highlighted that past performance is a bad indicator of future performance. Therefore they do not rank a manager on how they have performed in the past; they base it on the future expected performance.
- A lot of high quality analysis is involved in gathering the best managers for the Fund (there are 44 full time manager research analysts). The analysis involves interviews, ongoing dialogue and analysing every trade that has been made with their portfolio.
- Each manager would be ranked based on these criteria.

Mrs Fielder asked whether there is a possibility of all the pools chasing the "best in breed" managers, which could cause capacity issues and put strain on the managers which impairs performance. Mr Mandich responded by stating that each manager has an individual manager style and some managers will have limitations on AUM. Mr Mandich confirmed that the recommendation from Russell would consider capacity issues and limits for investments placed would also be agreed.

Mrs Fielder also asked about the focus on responsible investment. Mr Mandich confirmed that this has been a big focus for a number of years and is one of the factors which is rated as part of the research. It was highlighted that all Funds would like to do something on ESG (Environmental, Social and Governance Investing) but to make it work on a pooling level, but there needs to be more consistency. This would mean getting Funds and possibly Pools to move to a common policy to gain the advantage of scale.

Mr Middleman asked whether they apply different weightings to the 4 P's depending on which asset classes e.g. if manager skill is seen to be more important than some process factors. Mr Mandich confirmed that they are fairly uniform and consistent across all classes.

Mrs McWilliam asked how the process would work in relation to some of the Welsh infrastructure opportunities. Mr Mandich replied stating that it is very early to tell but they can consider across the WPP and access expertise if necessary to gather more research. He confirmed that the Funds will be fully supported.

Mr Everett commented that it is likely that the relevant parties would come to the Funds regarding an investment opportunity rather than managers researching and finding these opportunities. Mr Mandich noted that it could be agreed to allocate a percentage of the assets to these opportunities and this would be discussed at the WPP.

The discussion moved onto the specific update for the Clwyd Fund. There were 6 strategy buckets discussed:

- Equities – Active mandates with Investec likely to move to Global equity sub-fund. Emerging markets sub-fund to be launched to by the end of the year. This will allow £200m to be moved. In addition the Blackrock asset (£70m) is already part of the passive mandate consolidation in Wales.

- Credit – current multi-asset credit holding (£200m) potentially of interest to other Welsh funds. Discussion is ongoing with Stone Harbor on how that can be implemented on the platform. Private credit (£14m) is more complex to move so would take more time to consider.
- Managed Platform – Russell/Link meeting to discuss this with ManFRM for the existing assets (£150m) as the platform is potentially scalable for other Welsh Funds.
- Tactical - DGF mandates (£170m) likely to benefit from lower fees through consolidation. Exploring options to move Best Ideas portfolio (£200m) onto platform.
- Real Assets and Private Markets – assets (£350m) unlikely to move in 2018 due to liquidity and lack of overlap with other Welsh Funds.
- LDI – assets (£400m) hardest to pool as customised and requires data feeds and specific reporting.

Mr Mandich emphasised it was not the intention to force assets onto the platform for the sake of it.

Mr Latham noted that the decisions regarding investments such as the Multi Asset Credit will now be made by the JGC so will require wider support from Wales. Mr Mandich confirmed this.

Mrs McWilliam asked whether there may be some other vehicles which are better for the assets to be managed other than the ACS. Mr Mandich responded by saying that, yes that is correct and needs to be considered. The ACS structure works is for global equities which is the starting point.

The Chairman asked whether there is anything else the Fund can do to support their work. Mr Mandich replied no stating that Mr Latham and Mrs Fielder have supplied excellent support in relation to how to move forward.

The Chairman thanked Mr Mandich and Mr Lowman for their presentation and looked forward to future updates.

105. **CLWYD PENSION FUND UPDATE**

The Chairman moved on to the last agenda item which was an overall update on the Clwyd Pension Fund since the last Committee meeting.

With regard to the Governance section 1.01, it was commented that dates need to be arranged in order for training to be undertaken. Mrs McWilliam commented an email would be circulated with options and that the key priority is for the newest members to have dates that suit them. The aim is for 2 training days, one in March and one in April.

Mr Latham referred to section 1.04; he stated that the new minister Rishi Sunak MP will be responsible for setting LGPS legislation. Mr Sunak is keen with background knowledge on pooling and investments and is looking at sustainability in the LGPS and what it means for authorities.

Section 1.05 summarised the current Scheme Advisory Board (SAB) agenda. Mr Latham mentioned that one area that has returned to the agenda in recent national discussions was the separation of LGPS Funds from the Council as legal entities. Any further updates on this will be given at future meetings.

Mr Latham noted that the change from Welsh Government to exclude Pension Fund accounts from the Council accounts will affect approval mechanisms on both sets of accounts and the timing is being discussed. This affects only Welsh (not English) Funds so would need to be considered across Wales potentially to make it as easy as possible.

Mr Middleman referred to section 1.07 and commented that the funding level has since dropped to 89% due to the drop in equity markets, which is still significantly ahead of where the Fund was expected to be. This emphasised the importance of the equity protection the Fund has in place to manage the risk of a large fall in markets. As previously reported the structure of this is being reconsidered before the existing arrangement expires in April.

Mr Harkin noted that at the end of January 2018 the Fund's assets were over £1.8 billion. He also noted that other LGPS Funds have also been considering equity protection as part of risk management.

Councillor Llewelyn-Jones asked for Mr Harkin to give a further explanation in relation to page 50 paragraph 2 of the conclusion of the Economic and Market update i.e. can the current growth continue and can central banks afford it. Mr Harkin explained that the key is whether the banks can afford further quantitative easing (QE) to stimulate the economy if needed. This has certainly been scaled back recently. Equally what the Government does with monetary policy (interest rates) is important. Currently Governments and Banks seem to support continued stimulus so there are no immediate signs of a downturn or recession indicators although different economies are in different positions. For the Fund inflation will be key as asset returns need to at least match any increase in inflation otherwise costs could increase.

The Chairman raised section 1.12 regarding the discretionary policies. Over time these need developing and the recommendation is the Committee to delegate the approval of these policies to the Chief Executive and Corporate Finance Manager. This was agreed.

Mr Everett informed the Committee that Home Farm Trust (HFT) has bid successfully and is now a new employer in the Fund which is positive.

RESOLVED:

1. That the Committee considered the update and commented accordingly.

2. That the Committee agreed the proposed changes to the 'Delegations of Functions to Officer' document in Appendix 6.

The Chairman thanked everyone for their attendance and all of the speakers for their presentations. He noted that the next Committee meeting will be 21 March 2018.

(The meeting closed at 1.10 pm)

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Chairman