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Pensions Committee
Friday, 6 October 2017, County Hall, Worcester - 10.00 am

	Minutes
Present:	Mr A I Hardman, Mr R C Lunn and Mr P Middlebrough Co-opted Members (voting) – Mr V Allison (Employer representative), Mr A Becker (Employee representative), Mr R Phillips (Herefordshire Council)
Available papers	The members had before them: A. The Agenda papers (previously circulated); and B. The Minutes of the meeting held on 16 June 2017 (previously circulated). **Mr R C Lunn, Vice-Chairman in the Chair.**
91 Named Substitutes (Agenda item 1)	None.
92 Apologies/ Declarations of Interest (Agenda item 2)	Apologies were received from Mr R W Banks and Mr P A Tuthill. Mr R Phillips declared an interest as Chairman of the LGPS Advisory Board. Mr A Becker and Mr V Allison declared interests as members of the Pension Fund.
93 Public Participation (Agenda item 3)	None.
94 Confirmation of Minutes (Agenda item 4)	**RESOLVED that the Minutes of the meeting held on 16 June 2017 be confirmed as a correct record and signed by the Chairman.**
95 Administering Authority - Administration Update (Agenda item 5)	The Committee considered the Administering Authority – Administration update report. The details were set out in the report. **RESOLVED that the general update from the Administering Authority be noted.**

96 **Pension Investment Update (Agenda item 6)**

The Committee considered a Pension Investment update report.

The Chief Financial Officer introduced the report and made the following comments:

- The Pension Fund was now valued at £2.5bn which was higher than anticipated by the Actuary. This was largely as a result of the improved performance in the equities markets. He thanked his staff for their work and in particular Mark Forrester and Philip Hebson, the Independent Investment Advisor
- Nomura had made a number of changes to their team and there was now greater confidence in their management structure. In particular, there had been positive performance in Japan and the developed markets
- JP Morgan – Bonds had outperformed their target by 0.3%. The aim was to continue this outperformance in the future
- JP Morgan – Emerging Markets had had a difficult time due to their overall investment strategy however their performance was steadily improving and had outperformed the market by 0.4%
- Schroders had traditionally been one of the better performing investment management firms and had outperformed the market for the last quarter by 2.9%
- There had been changes to the management team at First State however these changes would not impact on the decision to appoint them as the Infrastructure Manager to the Fund.

In the ensuing debate, the following principal points were raised:

- In response to a query about the performance of JP Morgan – Bonds and their approach to risk, Phillip Hebson commented that following intervention by officers, he was more confident about their future performance. He hoped that the company would take a less risk-averse approach to its investment strategy in the future. The Chief Financial Officer added that he would wish to see a prolonged period of improved performance before removing them from 'on watch' however at least the firm were moving in the right direction
- The positive performance across all the different asset classifications was welcomed. The Chief

Financial Officer added that overall performance was £450m above benchmark. The Venn Group investment focused on a different type of asset class with more short term commercial lending. It was important to continue to monitor performance in this area given the more active management

- It was surprising to see that yield was slightly down on benchmark returns. Phillip Hebson commented that the asset mix of the Pension Fund Portfolio had had an impact on yield, particularly in respect of its reduced investment exposure in bonds. The Pension Fund Portfolio asset mix was different to the benchmark and its performance varied against it. However it had been agreed not to rebalance the Portfolio
- The Portfolio Evaluation Performance Report indicated that the Total Risk of the Fund was consistent with that of a typical multi asset class Fund – was this a positive or negative statement? The Chief Financial Officer commented that members could take assurance from this statement in that the Pension Fund had taken a managed approach to control risk across a diversified multi-asset portfolio. Phillip Hebson added that the Fund's risk portfolio had been assessed during the Strategic Asset Allocation Review. The risk profile was out of line with the typical fund but less so that 5-10 years ago however the Fund remained in a positive financial position
- In response to a query, the Chief Financial Officer indicated that the Pension Fund was now 93% funded
- The Pension Fund appeared to be in a strong position therefore should a review be undertaken of its exposure to risk in any potential falls in equities markets? The Chief Financial Officer considered that it was appropriate at this stage to review the Fund's approach to investment and protect existing equities valuations
- As the Fund approached 100% funding, a decision needed to be made as to whether more resilience should be built into the Fund and with the aim of reducing volatility in employer contributions
- Whilst the Fund had benefitted greatly from the rise in the equity market, this could easily change and the Fund had a responsibility to council taxpayers to ensure that the gains made to date were not lost
- Any reduction in contributions as a result of equity

protection should include a consideration for a reduction to the employees' contributions
- Philip Hebson stated that any decision taken in respect of equity protection should bear in mind the additional complication that the Pension Fund remained an open fund. Clearly members would not wish for the Fund to fall back to a position of being 70% funded therefore a different approach to managing the risk needed to be considered.

RESOLVED that:

a) **the Independent Financial Adviser's fund performance summary and market background be noted;**

b) **the update on the Investment Managers placed 'on watch' by the Pension Investment Advisory Panel be noted; and**

c) **the update regarding First State be noted.**

97 LGPS Central Update (Agenda item 7)

The Committee received an update on LGPS Central.

The Chief Financial Officer introduced the report and made the following comments:

- LGPS Central was the best-positioned pool in the country in terms of progress made. He gave particular thanks to Geik Drever, the former Programme Director for her work in progressing the arrangements and Mark Forrester for his role in the project team
- Senior appointments within LGPS had been made and he was satisfied that the appropriate leadership of the Pool was in place
- The work undertaken to address the imbalance in the cost-sharing arrangements was continuing to benefit the Worcestershire Fund and a separate note wouldl be passed to the Chairman and Vice Chairman ahead of the next Shareholders meeting

In the ensuing debate, the following principal points were raised:

- At a recent LGPS update meeting in Wolverhampton, a commitment had been given for representatives of the Pool to visit Pension Committees of the participating Funds. The language used in the Government's letter to all pension funds and investment funds had caused a degree of disquiet amongst members. However the letter should be interpreted as a warning to those pools whose arrangements were not in place

- Philip Hebson commented that future meetings of LGPS should be held in venues other than Wolverhampton to avoid the associations with the West Midlands Fund
- There was potential that the arrangements for the pooling of pension funds could leave them liable to increased tax costs. The Chief Financial Officer commented that the establishment of a pool in the form of a company did open up tax implications for the pooled funds. The tax implications had been an unintended consequence of the change and the Government had been approached to look into the matter. A report on the arrangements for tax liability would be brought to a future Committee meeting
- Would a work force of 66 at the Central Pool be sufficient to undertake the necessary work? The Chief Financial Officer indicated that work on the staffing structure on the Pool was ongoing and a report would be brought to a future Committee meeting. Phillip Hebson added that the FCA were particularly focussing on the pooling compliance and governance arrangements.

RESOLVED that the LGPS Central Update be noted.

98 Equity Protection Strategy (Agenda item 8)

The Committee considered the Equity Protection Strategy.

The Chief Financial Officer introduced the report and made the following comments:

- The Fund was now approaching a fully funded position and therefore needed to review its funding strategy
- The valuation of the Fund was £442m ahead of the funding plan and consideration needed to be given as to how to protect that gain
- If the Fund decided to protect that gain, consideration needed to be given as to how the assets would be invested in the future
- The pace of change was important – any decision could and should be made relatively quickly. It was considered that the increase in interest rates

would affect the currency markets which in turn could have a negative impact on the equity markets. It was therefore considered that there was a window of opportunity to make the change.

Ian Kirk and Adam Lane from Mercer, the Pension Fund's actuary introduced their equity protection report and indicated that the fund had a deficit but was c£442m ahead of the funding plan. It was difficult to predict the expected position at future valuations with accuracy and in reality there was a spread of potential outcomes. Given that most of the improvement since the 2016 valuation was attributable to the rally in equity markets over the period, their recommendation was to consider using an equity protection strategy to reduce the likelihood of further deficit contributions would be required at the 2029 valuation, and seek 'to bank' some of the recent upside with a view to potentially reducing contributions at future valuations. Their report set out the various options open to the Council to achieve these aims.

In the ensuing debate, the following principal points were raised:

- In response to a query, Adam Lane explained that the dynamic equity hedging strategy would operate in a similar fashion to an insurance policy. If the Fund took the option to renew the policy on a monthly basis he considered that it would be a cheaper option for the Pension Fund in the long term
- What would happen if the Pension Fund adopted a dynamic equity hedging strategy should there be crash in the first month? Adam Lane advised that although there would be a loss, there would be a pay-off in terms of a reduction in the cost of insurance
- Adam Lane explained that the key issue for the Fund to consider was mitigation of its operational risk. The Fund needed to decide whether it was prepared to pay for a more expensive insurance to provide downside protection but at the expense of higher returns. This would provide the Fund with a structured investment approach to meet its precise needs. It was a different approach and required different skills sets. The challenge was to determine the appropriate level of operational complexity and to ensure that it was achieved in the right way
- Phillip Hebson commented that it was up to the Committee to determine its approach to equity

protection bearing in mind the detailed option review provided by the actuary in the report. The Fund had already agreed its strategic allocation approach. It was important therefore that any plans for equity protection were suited to the Fund's specific requirements. There were a number of Funds in a similar position however they had different strategic asset allocations and it was not appropriate to replicate their approach. It was important that the approach was kept as simple as possible and that Pension Fund was clear about what was happening at each stage and that members were comfortable with the strategy. He had no particular view as to which was the right strategy but it was important to give in-depth consideration before coming to a conclusion

- It would appear that there was very little benefit in dynamic hedging of equity in active portfolios given the approach taken to investment in those markets. Phillip Hebdon indicated that the passive portfolios were the most appropriate markets for the proposed approaches to equity protection
- If the Fund adopted the dynamic equity protection approach, it could leave the fund in a difficult position in terms of its open-ended nature. Adam Lane acknowledged that the static equity protection had the benefit of being a time-limited approach however although the dynamic approach was open-ended, the Fund did have the option to end the arrangements at any time. The advantage was that the dynamic approach would enable the Fund to respond to market conditions
- It was important to be clear by April next year what approach the Fund was taking to equity protection given the finalisation of the pooling arrangements. From a practical point of view, the static approach would seem more prudent than the dynamic approach at the point of handover
- The principal of equity protection was right and the Fund needed to be mindful that the public sector was subject to budget reductions. The Pension Fund had a duty to the council taxpayers to protect the gains made to date. There remained market conditions that could lead to a crash
- In response to a query, Philip Hebson commented that the approach could be agreed instantly however it was essential to ensure that the Fund was taking the right approach
- Equity protection should remain the responsibility of the Pension Fund not LGPS Central as the

Fund had responsibility for the strategic asset allocation

- The Chief Financial Officer requested that he be granted delegated authority in consultation with the Chairman and Vice-Chairman of the Committee and the Chairman of the Investment Advisory Panel to work with advisers and implement an equity spread protection strategy for the Fund's equities. A report would be brought back to the December Committee on the implementation of the Strategy.

RESOLVED that:

a) the equity protection report provided by the Fund's Actuary be noted; and

b) the Chief Financial Officer be provided with delegated authority in consultation with the Chairman and Vice-Chairman of the Committee and the Chairman of the Investment Advisory Panel to work with advisers and implement an equity spread protection strategy for the Fund's equities.

99 Implementation of the Markets in Financial Instruments Derivative (MiFID ll) (Agenda item 9)

The Committee considered the implementation of the Markets in Financial Instruments Derivative (MiFID ll).

In the ensuing debate, it was commented that there was a very tight timescale for implementation of the Markets in Financial Instruments Derivative (MiFID ll). It was the right approach and the Pension Fund needed to get on with it.

RESOLVED that the Chief Financial Officer be granted delegated authority in consultation with the Chairman and Vice-Chairman to elect for professional client status for Worcestershire County Council as Administering Authority for the Worcestershire County Council Pension Fund, subject to opt-up applications review.

100 Pension Fund Annual Report (Agenda item 10)

The Committee considered the Pension Fund Annual Report.

The Committee thanked Sean Pearce for his contribution to the work of the Committee and wished him well for the future.

RESOLVED that the Pension Fund Annual Report

and Accounts 2016/17 be approved.

The meeting ended at 12.15pm.

Chairman …………………………………………….