Worcestershire County Council

Agenda

Pension Investment Sub-Committee

Wednesday, 12 June 2019, 9.30 am
County Hall, Worcester

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DISCLOSING INTERESTS

There are now 2 types of interests:
'Disclosable pecuniary interests' and 'other disclosable interests'

WHAT IS A 'DISCLOSABLE PECUNIARY INTEREST' (DPI)?

- Any **employment**, office, trade or vocation carried on for profit or gain
- **Sponsorship** by a 3rd party of your member or election expenses
- Any **contract** for goods, services or works between the Council and you, a firm where you are a partner/director, or company in which you hold shares
- Interests in **land** in Worcestershire (including licence to occupy for a month or longer)
- **Shares** etc (with either a total nominal value above £25,000 or 1% of the total issued share capital) in companies with a place of business or land in Worcestershire.

NB Your DPIs include the interests of your spouse/partner as well as you

WHAT MUST I DO WITH A DPI?

- **Register** it within 28 days and
- **Declare** it where you have a DPI in a matter at a particular meeting
  - you must **not participate** and you **must withdraw**.

NB It is a criminal offence to participate in matters in which you have a DPI

WHAT ABOUT 'OTHER DISCLOSABLE INTERESTS'?

- No need to register them but
- You must **declare** them at a particular meeting where:
  You/your family/person or body with whom you are associated have a **pecuniary interest** in or **close connection** with the matter under discussion.

WHAT ABOUT MEMBERSHIP OF ANOTHER AUTHORITY OR PUBLIC BODY?

You will not normally even need to declare this as an interest. The only exception is where the conflict of interest is so significant it is seen as likely to prejudice your judgement of the public interest.

DO I HAVE TO WITHDRAW IF I HAVE A DISCLOSABLE INTEREST WHICH ISN'T A DPI?

Not normally. You must withdraw only if it:

- affects your **pecuniary interests OR**
  relates to a **planning or regulatory** matter
- **AND** it is seen as likely to **prejudice your judgement** of the public interest.

DON'T FORGET

- If you have a disclosable interest at a meeting you must **disclose both its existence and nature** – 'as noted/recorded' is insufficient
- **Declarations must relate to specific business** on the agenda
  - General scattergun declarations are not needed and achieve little
- Breaches of most of the **DPI provisions** are now **criminal offences** which may be referred to the police which can on conviction by a court lead to fines up to £5,000 and disqualification up to 5 years
- Formal **dispensation** in respect of interests can be sought in appropriate cases.

Simon Mallinson Head of Legal and Democratic Services July 2012 WCC/SPM summary/f

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Pension Investment Sub-Committee
Wednesday, 12 June 2019, 9.30 am, County Hall, Worcester

Membership: Mr A I Hardman (Chairman), Mr R W Banks, Mr M E Jenkins, Mr L C R Mallett and Mr P Middlebrough

Co-opted Members

Vacancy (voting)	Herefordshire Council
Ms D Duggan (non-voting)	Employee Representative

Agenda

Item No	Subject	Page No
1	**Named Substitutes**	
2	**Apologies/Declaration of Interests**	
3	**Public Participation** *Members of the public wishing to take part should notify the Head of Legal and Democratic Services in writing or by e-mail indicating the nature and content of their proposed participation no later than 9.00am on the working day before the meeting (in this case, 11 June 2019). Further details are available on the Council's website. Enquiries can be made through the telephone number/e-mail address below.*	
4	**Actuarial Triennial Review**	1 - 4
5	**Nomura far east developed equities & emerging markets active manager Worcestershire Pension Fund Investment Quarterly Review**	5 - 38
6	**River & Mercantile Equity Protection Update and Future Considerations for Worcestershire Pension Fund**	39 - 54
7	**LGPS Central Active Bonds and Update on LGPS Central Investment Opportunities**	55 - 104

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To obtain further information or a copy of this agenda contact Simon Lewis, Committee Officer on 01905 846621, slewis@worcestershire.gov.uk

All the above reports and supporting information can be accessed via the Council's website

Date of Issue: Tuesday, 4 June 2019

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AGENDA ITEM 4

PENSIONS INVESTMENT SUB COMMITTEE
12 JUNE 2019

ACTUARIAL TRIENNIAL REVIEW

Recommendation

1. **The Chief Financial Officer recommends that the Pensions Investment Sub Committee note and comment on the update provided.**

Background

2. Every three years, in line with legislation, the Fund Actuary, Mercer, carries out a full Actuarial Valuation of the Fund to calculate how much the employers in the Scheme need to contribute going forward to ensure that its liabilities, the pensions due to current and future pensioners, will be paid as they fall due.

3. Once the valuation is agreed, the Fund Actuary provide a Funding Strategy Statement ("FSS") to set out a clear and transparent funding strategy that will identify how each Fund employer's pension liabilities are to be met going forward.

Discussions so far

4. Initial discussions have taken place with the actuary early in May to highlight the initial 2019 actuarial valuation. This described:

a) A recap on 2016 assumptions and existing funding strategy in place;
b) National issues affecting the fund;
c) Where we are now based on very preliminary 2019 valuation results; and
d) Where we are going, the key next steps for the 2019 valuation.

Current Funding vs expectations

5. As at the 31 March 2016 the Fund had a deficit of £654m. The projected deficit as at the 31 March 2018 if the valuation assumptions were borne out in practice was estimated to be £618m with a funding level of 78%

6. However, the actual deficit as at the 31 March (on a like for like assumptions) was £93m. Anticipated amendments to the discount rate (targeted rate of return) and mortality assumptions at the 2019 actuarial valuation would lead to an increase in this deficit. For example allowing for a reduction in the discount rate assumption of 0.5% per annum and allowing for updated life expectancy trends would increase the deficit at the 31 March 2018 to £287m. This would represent the Fund being £331m ahead of target allowing for an updated return outlook. This is equivalent to a funding level of 90% which represents a 12% improvement relative to expectations.

7. The projected deficit as at the 31 March if the 2016 valuation assumptions were borne out in practice was estimated to be £626m with a funding level of 79%. The deficit based on the anticipated 2019 actuarial valuation assumptions is estimated to be £245m with a funding level of 92%. This represents the Fund being £381m ahead of target.

What we are doing for Employers

8. There are a number of areas that we are developing or are working on with employers:

- Considering extending the Equity Protection Strategy (see separate report on agenda)
- Investment Strategy – considering the use of different investment buckets to reflect different degrees of risk and flightpath to reduce risk generally
- Covenant monitoring to further develop the employer framework / covenant policy
- Updated the Funding Strategy statement (FSS) to include termination policy, flightpath strategy and incorporate interim valuations
- Funding parameters = reduce risk profile subject to covenant and affordability. Link to risk framework and triggers
- Legislative changes – update FSS

National Issues

9. A number of national issues are currently being discussed and further updates will be provided as we progress the valuation such as:

- McCloud Discrimination case
- Exit credits
- 4 year valuation. Consultation until 31 July proposes an out of cycle valuation in 2022. Contributions from 2019 valuation will be set for 3 years to 2022. Contributions in 2022 valuations will then be set for 2 years to 2024
- Others such as Guaranteed Member pension equalisation, Fair deal, and
- Public sector pay cap removed and increase focus on data quality.

Where we are at the moment

10. There has been a demographics assumptions update, and assessment of data quality and indicative whole fund results, sensitivities and estimated contributions based on current benefits.

Next Steps

11. We currently know that there have been:

- positive returns up to the valuation date as at the 31 March 2019
- Further increase in funding due to life expectancy
- But outlook for future investment returns are lower, and
- It is still expected there will be a funding gain overall, but expected increase in future service benefits.

Key Strategy Milestones

12. These are as follows:

- Decisions regarding the financial and demographic assumptions to adopt

- Approach when setting employer contributions (e.g. length of recovery period and phasing)
- Review of the FSS and Fund policies (e.g. admission, termination, covenant)
- Consider the approach to take when communicating with employers, and
- How to spend the gains from the outcome of the demographic analysis.

13. Further updates will be provided as the actuarial triennial review progresses. Mercers are also providing training on the 19 June,

Contact Points

<u>County Council Contact Points</u>
County Council: 01905 763763
Worcestershire Hub: 01905 765765

<u>Specific Contact Points for this report</u>
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Background Papers
In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report:

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AGENDA ITEM 5

PENSIONS INVESTMENT SUB COMMITTEE
12 JUNE 2019

NOMURA FAR EAST DEVELOPED EQUITIES & EMERGING MARKETS ACTIVE MANAGER WORCESTERSHIRE PENSION FUND INVESTMENT QUARTERLY REVIEW

Recommendation

1. **The Chief Financial Officer recommends that the Pensions Investment Sub Committee note and comment on Nomura Far East Developed Equities and Emerging Equity Markets Active Manager Quarterly review as at the end of March 2019.**

2. The Nomura Far East Developed Equities and Emerging Equity Markets Active Manager provides:

   a) Big Picture;
   b) Asia ex Japan and Japan;
   c) Pooled Funds;
   d) Outlook and Strategy;
   e) Japanese auto industry;
   f) Benchmark discussion;

3. The Pensions Investment Sub is asked to note and comment on the presentation provided by Nomura Far East Developed Equities and Emerging Equity Markets Active Manager as at the end of March 2019.

4. **Please note that the Appendix contains exempt information (on salmon pages) and should members wish to discuss the information included in the Appendix they would need to consider passing the appropriate resolution and moving into exempt session.**

Supporting Information

Appendix – Nomura Far East Developed Equities and Emerging Equity Markets Active Manager as at the end of March 2019 (**Exempt – Salmon pages**)

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AGENDA ITEM 6

PENSIONS INVESTMENT SUB COMMITTEE
12 JUNE 2019

RIVER & MERCANTILE EQUITY PROTECTION UPDATE AND FUTURE CONSIDERATIONS FOR WORCESTERSHIRE PENSION FUND

Recommendation

1. **The Chief Financial Officer recommends that the Pensions Investment Sub Committee:**

   a) **Note and comment on the presentation provided by River & Mercantile on the Equity Protection strategy detailed in the Appendix; and**

   b) **Recommends to the Pensions Committee that:**

      i. **The Equity Protection current static strategy is extended to mid-2020 in order to protect employer contributions and provide certainty to the Actuary that the Equity Protection is in place when the 2019 actuarial valuation results and contribution requirements have to be signed off;**

      ii. **Those options are explored as to whether more upside participation can be implemented over this period without giving up too much downside protection is delegated to the Chief Financial Officer in in consultation with the Chairman of the Pensions Committee; and**

      iii. **The Equity Protection Strategy be considered as part of the Asset Allocation review that will be conducted from June 2019 through to around November 2019 to ascertain as to whether this should become an integral part of the Fund's future investment strategy.**

Purpose of the Equity Protection Strategy

2. It is worth reiterating the purpose of the Equity Protection Strategy that was implemented as follows:

- Reduce the likelihood that further deficit contributions will be required at the 2019 valuation due to a fall in equity markets, and
- Seek to "bank" some of the recent upside with a view to potentially reducing contributions at future valuations.

3. An alternative approach to equity protection was considered which would be to simply de-risk by moving funds from equities to other asset classes. The challenge with

this approach is that it would also reduce return commensurately which would have an impact on the affordability of providing future benefits.

Equity Protection Strategy update

4. A static options hedge solution was implemented to provide equities downside protection through to the next actuarial valuation. This was implemented for a period of 18 months to cover the period to the next actuarial valuation in 2019, at which stage a further review could be undertaken, in-line with the actuarial valuation process, to optimise the solution and align the equities protection to the Fund's funding strategy. The Strategy focused on providing downside protection to the Fund's passive UK, U.S. and European equities which have a combined market value of c. £1.1bn (including the Equity Protection) which equates to around 40% of the overall Fund value at the end of March 2019.

5. At the March 2019 meeting of the Pensions Committee, it was noted that further discussions had been held with River and Mercantile (R&M) on Equity Protection options on the 28 February 2019 and at that time no further action was required. R&M were to bring future detailed option proposals to the next Pensions Investment Sub Committee on the 12 June with recommendations brought to the Pensions Committee on the 21 June 2019. The current strategy expires between the 15 August 2019 and October 2019.

6. Attached as an Appendix is a presentation from River & Mercantile that provides an update on the current structure, as well as some current and potential future considerations.

Discussions with the actuary ' Mercers'

7. Initial discussions have taken place with the Actuary early in May to highlight the initial 2019 actuarial valuation outcomes. This described:

a) A recap on 2016 assumptions and existing funding strategy in place;
b) National issues affecting the fund;
c) Where we are now based on very preliminary 2019 valuation results; and
d) Where we are going, the key next steps for the 2019 valuation.

8. The Actuary provided a paper that showed that the pension deficit on the anticipated 2019 actuarial valuation assumptions is estimated to be £245m with a funding level of 92% (allowing for the reduced future return outlook since the 2016 actuarial valuation). Further details can be found on the update on the Actuarial Triennial review report on the same agenda. As part of this update a specific paper was presented and discussed on the impact of the Equity Protection on employer contributions. River & Mercantile were in attendance along with the Fund’s Independent Investment advisor.

9. This emphasised that the Fund had implemented an Equity Protection Strategy as at the 31 March 2018 for a specific reason; to protect from the risk of falls in the investment markets leading to a deterioration in the Pension Fund’s funding position with consequent increased contributions at the next valuation.

10. Given the expiry date, it was felt a good time to review whether the current structure should continue or whether an alternative long term approach should be adopted. A number of potential strategies were considered:

a) We no longer require the protection strategy, and the options are left to expire and not renewed;
b) The same static strategy is renewed;
c) A different static strategy which offers different downside protection and upside potential is adopted; and
d) A longer-term dynamic strategy is better suited to the Fund's objectives.

11. The paper provided by the Actuary considered these options for a number of different market scenarios to illustrate the impact competing structures have on contributions. It also provided a more in depth analysis of the static approach (protection for a certain fixed length of time) and dynamic approach (a longer term tool to control equity downside risk).

12. The caveat to all this was that the Actuary believes that the Fund could benefit from using an Equity Protection Strategy in terms of providing increased certainty and affordability of contributions if markets were to deteriorate.

13. In discussions it was felt that there were a number of aspects to consider being:-

a) **The Governance angle** to protect from the risk of increased employer contributions. This would mean extending the current static strategy to around mid-2020 slightly past the formal sign-off date for the 2019 actuarial valuation (31 March 2020). As part of this consideration it would be investigated as to whether more upside participation can be implemented over this period without giving up too much downside protection. This would also provide the Actuary certainty that the Equity Protection is in place when the actuary’s rates and adjustments certificate has to be signed off;
b) **The Risk profile** as technically the Equity Protection strategy does help provide diversification in the portfolio and reduces the risk profile as part of the valuation (admittedly at a cost similar to paying an insurance premium);
c) **A longer term dynamic strategy.** This needs to be considered as part of the Asset Allocation review that will be conducted from June through to around November 2019 to ascertain whether the Equity Protection Strategy should become an integral part of the Fund’s future investment strategy.

14. The Pensions Investment Sub Committee is therefore asked to recommend to the Pensions Committee that:

a) The Equity Protection current static strategy be extended to mid- 2020 in order to protect employer contributions and provide certainty to the Actuary that the Equity Protection is in place when the 2019 actuarial valuation has to be signed off;
b) Those options be explored as to whether more upside participation can be implemented over this period without giving up too much downside protection be delegated to the Chief Financial Officer in consultation with the Chair of Pensions Committee; and
c) The Equity Protection strategy be considered as part of the Asset Allocation review that will be conducted from June through to around November 2019 to ascertain as to whether this should become an integral part of the Fund’s future investment strategy.

Future Reporting

15. The Equity Protection Strategy value is currently reported quarterly as part of the overall performance data provided for the Fund. If the extension of the Equity Protection is agreed, then we will look at the way that this is reported in future. The aim will be to report what the underlying value of the Fund would have been with and without the Equity Protection in place.

16. **Please note that the Appendix contains exempt information (on salmon pages) and should members wish to discuss the information included in the Appendix they would need to consider passing the appropriate resolution and moving into exempt session.**

Supporting Information

Appendix - presentation from River & Mercantile that provides an update on the current structure, as well as some current and potential future considerations.(**Exempt – Salmon pages**)

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Background Papers

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PENSIONS INVESTMENT SUB COMMITTEE
12 JUNE 2019

LGPS CENTRAL ACTIVE BONDS AND UPDATE ON LGPS CENTRAL INVESTMENT OPPORTUNITIES

Recommendation

1. **The Chief Financial Officer recommends that the Pensions Investment Sub Committee:**

   a) **Note and agree the attached LGPS Central Active Bonds due diligence update and outcome attached as an Appendix;**

   b) **Recommends to the Pensions Committee the transition of the existing Active Bonds mandate with JPMorgan to LGPSC Active Bond mandate; and**

   c) **Note and comment on the other LGPSC investment opportunities available detailed as part of the Appendix.**

Background

2. As part of the Pensions Investment update to Pensions Committee on the 19 March 2019, it was highlighted that the potential next transition is likely to be the existing active corporate bonds mandate currently with JP Morgan with an existing value as at March 2019 of £145.8m. The mandate being proposed by LGPS Central is a 'Global active Investment Grade Corporate Bond Fund. The Pensions Investment Advisory Panel had been provided with the proposal by Gordon Ross the LGPSC Investment Director on the 17 September 2018.

3. A rigorous process similar to that of the GEMS detailed within the report to the Pensions Investment Sub Committee on the 11 June 2019 has been conducted to appoint 2 fund managers being Fidelity IL Pension Management and Neuberger Berman (Europe) Limited.

4. Detailed at the Appendix is an LGPSC presentation that shows the journey that was undertaken to agree the mandate with partners, the next steps to search for the Corporate Bond Managers and the outcome.

5. Slide 22 and 23 of the presentation provides a performance comparison of the appointed LGPSC fund managers to our existing manager JPMorgan and Slide 26 shows the comparative manage fees.

Due Diligence

6. As part of the necessary due diligence all partner funds also had the opportunity to meet and interview the 2 fund managers at a Partner Fund Investment Working Group on the 16 May 2019. Our Independent Investment Advisor also attended.

7. Based on the evidence provided in the presentation and the meetings with the 2 fund managers with all partner funds and their advisors it is recommended that the Pensions Investment Sub Committee agree to the transition of the existing Active Bonds mandate with JPMorgan to LGPSC Active Bond mandate and that this be forwarded to the Pensions Committee on the 21 June for final consideration and agreement.

8. LGPS Central are to arrange a product information day in order that Committee members can understand more about the proposed investment and ask questions directly to the appointed fund managers.

9. Other Investment products are being taken forward by LGPSC such as Multi Asset Credit and Global Emerging Market Debt and although the Worcestershire Pension Fund does not have existing investments in these areas, it is useful to provide an update and overview on these particular areas.

10. **Please note that the Appendix contains exempt information (on salmon pages) and should members wish to discuss the information included in the Appendix they would need to consider passing the appropriate resolution and moving into exempt session.**

Supporting Information

Appendix – LGPS Central process for appointment of GEMS fund managers and due Diligence interviews with LGPS Central Investment Director and with Fidelity IL Pension Management and Neuberger Berman (Europe) Limited appointed Active Bonds managers (**Exempt – Salmon pages**)

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Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the Pensions Investment update report to Pensions Committee on the 19 March 2019 provides the background to the subject matter of this report.

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