Pension Fund Committee
SUPPLEMENTAL AGENDA

DATE: **Tuesday 6 September 2016**

AGENDA - PART I

7. INFORMATION REPORT - ACTUARIAL VALUATION 2016 (Pages 3 - 34)

Presentation to the Report of the Director of Finance.

10. INFORMATION REPORT - LOCAL GOVERNMENT PENSION SCHEME POOLING ARRANGEMENTS UPDATE (Pages 35 - 38)

Appendix to the Report of the Director of Finance.

11. CURRENCY HEDGING (Pages 39 - 40)

Appendix to the Report of the Director of Finance.

AGENDA - PART II - Nil

Note: In accordance with the Local Government (Access to Information) Act 1985, the following agenda items have been admitted late to the agenda by virtue of the special circumstances and urgency detailed below:-

Agenda item	Special Circumstances/Grounds for Urgency
7. Information Report – Actuarial Valuation 2016 – Presentation	The presentation had not been received at the time agenda was printed and circulated. Members are requested to consider this item, as a matter of urgency, to allow proper consideration of the triennial valuation.

Harrow COUNCIL LONDON

10. Information Report – Local Government Pension Scheme Pooling Arrangements Update – Appendix	The appendix was not available at the time the agenda was printed and circulated as the CIV is constantly updating their work programme. Members are requested to consider this item, as a matter of urgency, to allow consideration of up to date information on the subject matter.
11. Currency Hedging – Appendix	The appendix was not made available at the time the agenda was printed and circulated due to an erroneous omission. Members are requested to consider this item, as a matter of urgency, to allow proper consideration of the subject matter prior to making an informed decision.

London Borough of Harrow Pension Fund

2016 valuation – initial whole fund results

- Gemma Sefton
- 6 September 2016

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2016 progress report

Event	Timescale	Progress
Assumptions agreed with Pensions Committee	21 June 2016	
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What are we going to cover?

Recap of steps to date

Valuation results

Next steps

Steps to date

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Key assumptions for funding target

	2013 valuation	2016 valuation	Derivation of assumption
Discount rate (assumed future investment return)	4.6%	3.8%	No change in approach: Gilts plus prudent asset out-performance assumption (AOA) At 2013: AOA = 1.6% p.a. At 2016: AOA = 1.6% p.a.
Long term pay growth	3.8%	2.5%	Change in approach: At 2013: RPI + 0.5% At 2016: RPI – 0.7%
Pension increases (CPI)	2.5%	2.1%	Change in approach: At 2013: CPI = RPI - 0.8% At 2016: CPI = RPI - 1.0%
50:50 take up	10%	5%	Lower than anticipated take up
Longevity	Bespoke fund analysis, peaked improvements, CMI 2010 model for future improvements	CMI 2013 for future improvements	2013 to remove volatility experienced in last two years

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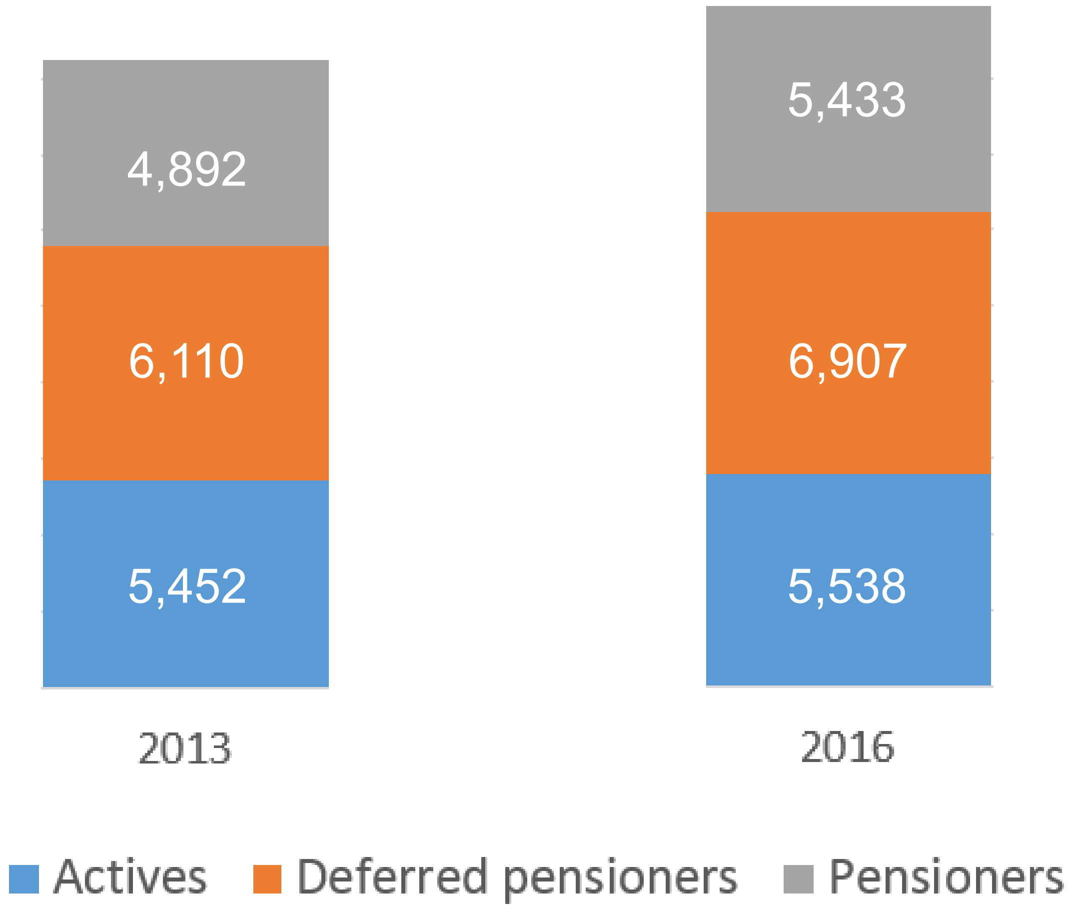
Membership data received and validated



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Whole fund results

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Whole fund valuation results

	31 March 2013	31 March 2016
Active	293m	275m
Deferred	133m	171m
Pensioner	360m	444m
Total liabilities	**786m**	**889m**
Assets	**552m**	**661m**
Deficit	**(234m)**	**(228m)**
Funding level	70%	74%

Deficit has fallen slightly in cash terms

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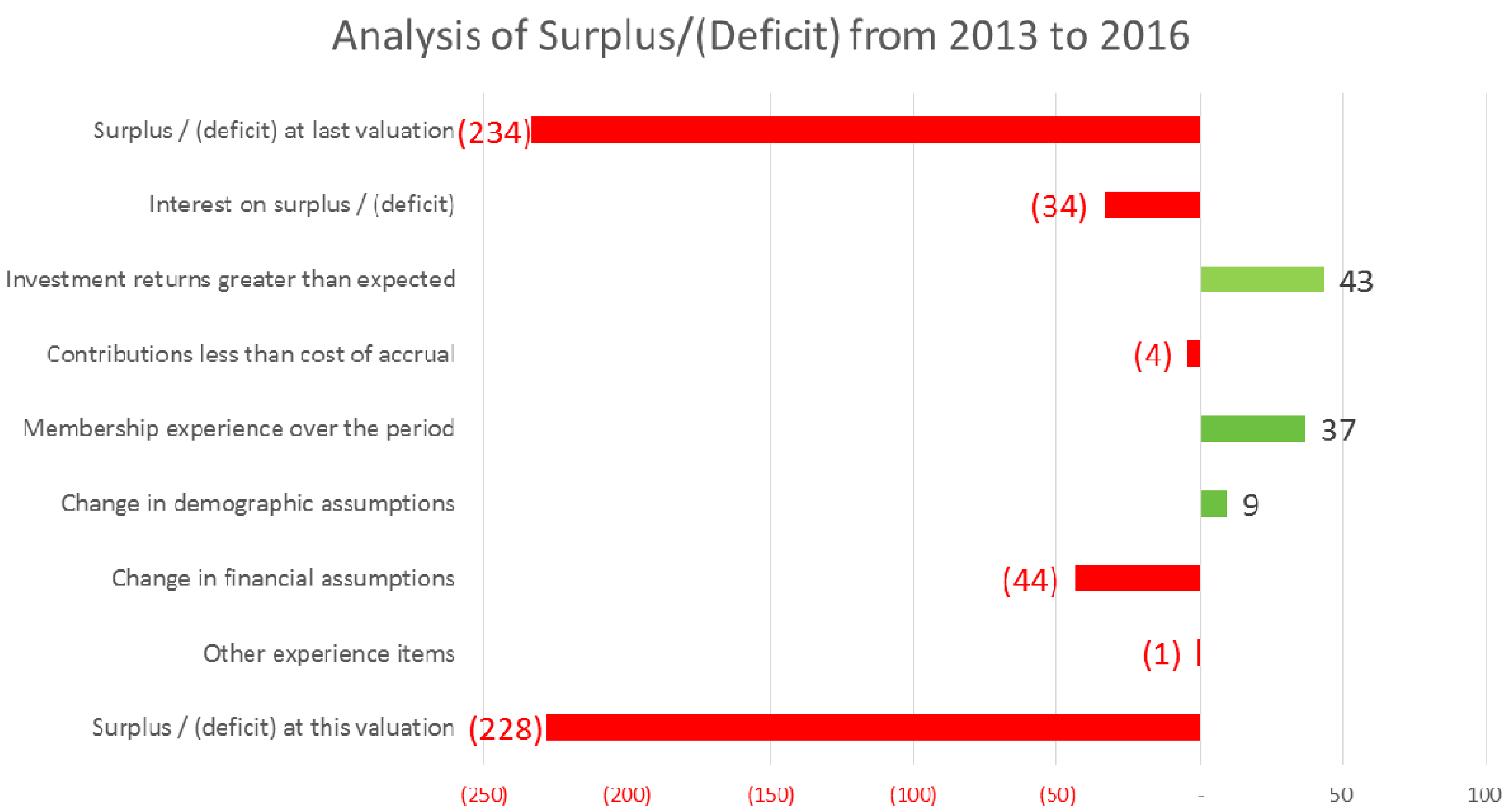
Why has the funding position changed?



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Membership experience

- **Pay growth**
  - Lower than expected
  - Does vary across employers
- **Pension increases** (pension increase orders)
  - Expected 2.5% p.a. (7.7%)
  - Actual 2.7%, 1.2%, 0.0% (3.9%)
- **Movements**
  - Fewer ill health retirements than expected
  - Fewer early leavers than expected
  - Fewer pensioner deaths than expected
- **50:50 take-up**
  - Lower that expected

Details, not the headlines

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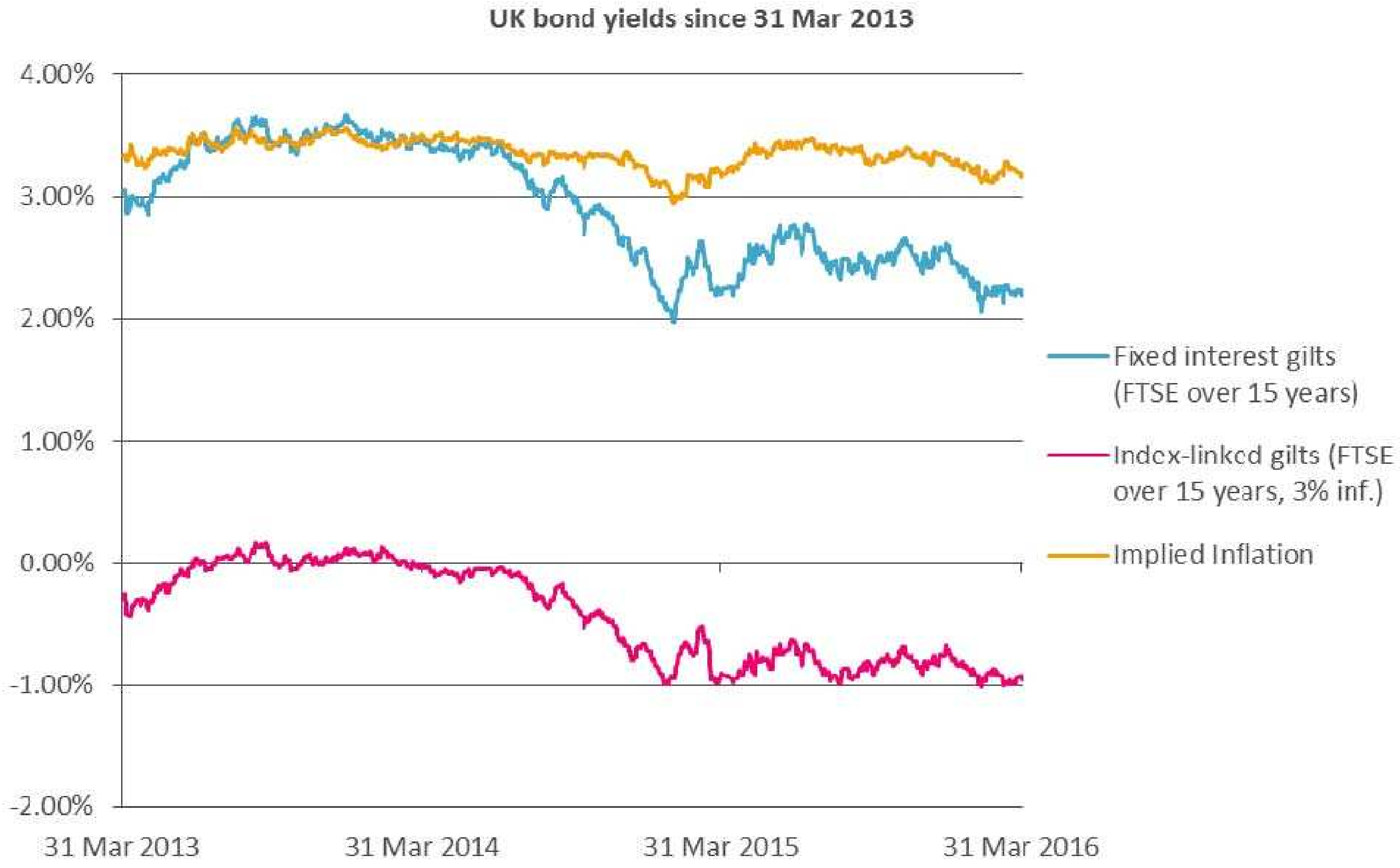
Experience since 2013



Falling bond yields have increased liabilities…

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Source: Hymans Robertson statistics based on index returns

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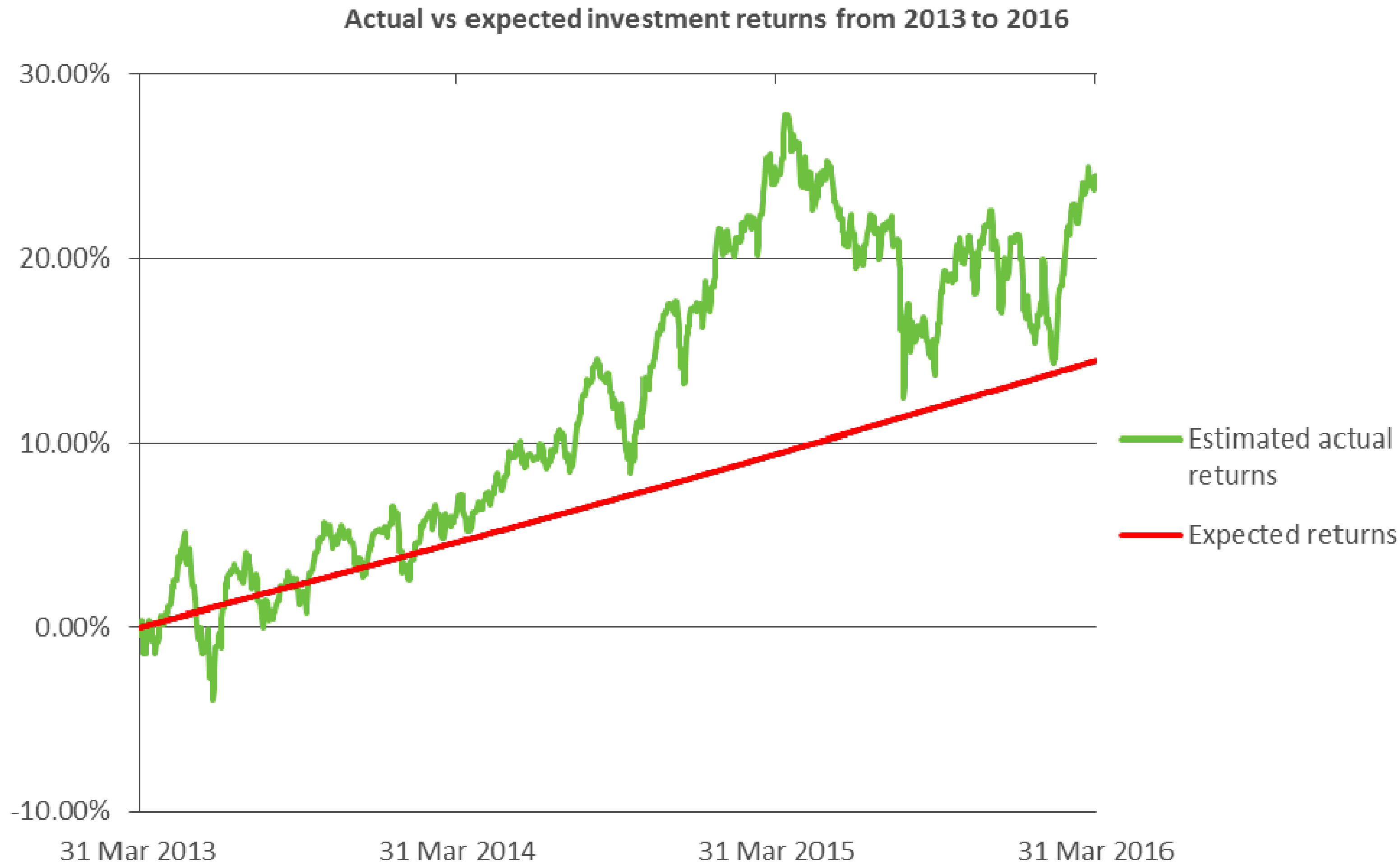
Experience since 2013 (cont.)



…but asset returns have been stronger than expected

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Outlook for financial markets

- Yes to
  - Heightened uncertainty and
  - Increased Sterling volatility

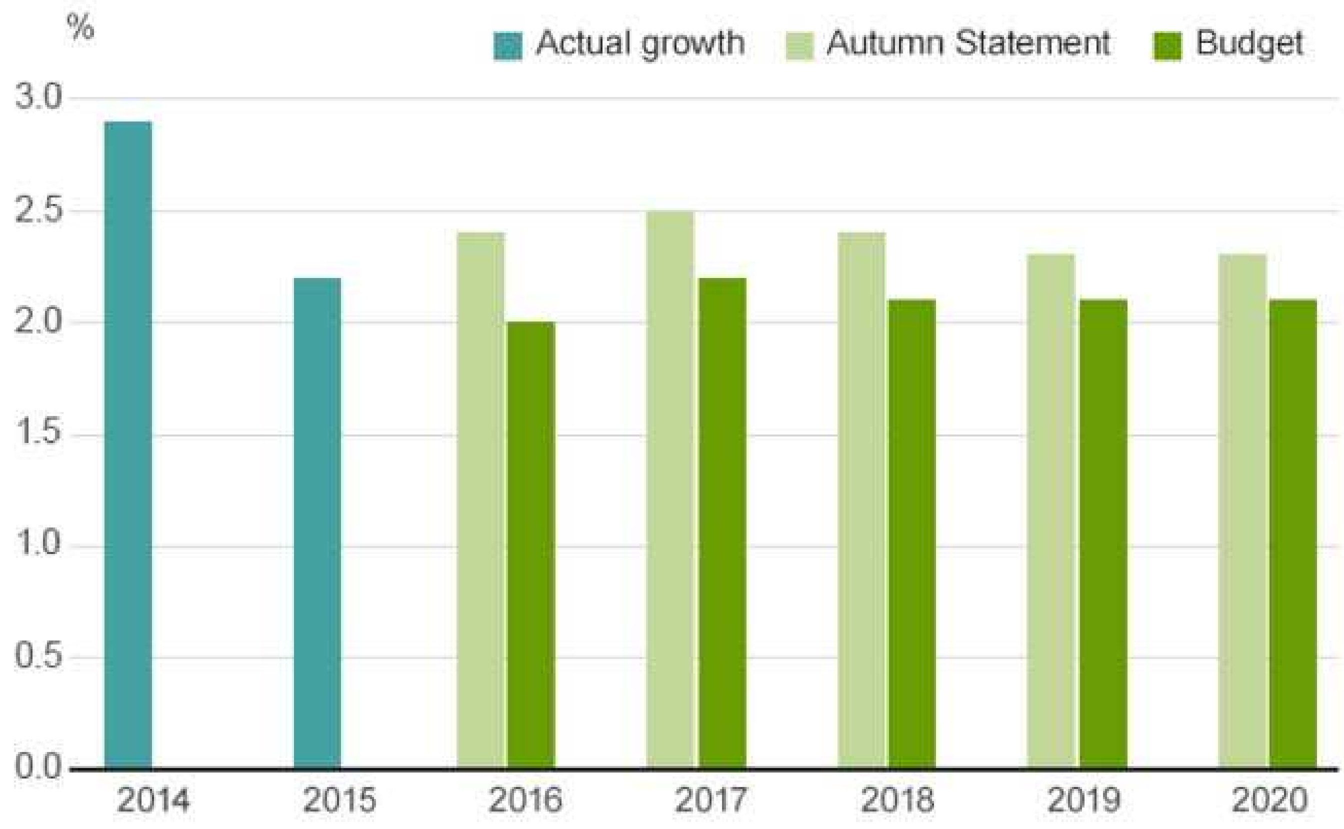
BUT….

- Many concerns pre-date the Brexit result

"Economic growth in the developed world since the Financial Crisis has been slower than at any comparable period except the Great Depression"   GMO, 2016

- OBR growth forecasts cut in Spring budget 2016

Lower expectations for growth



Source: ONS and OBR

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What does this mean for asset returns?

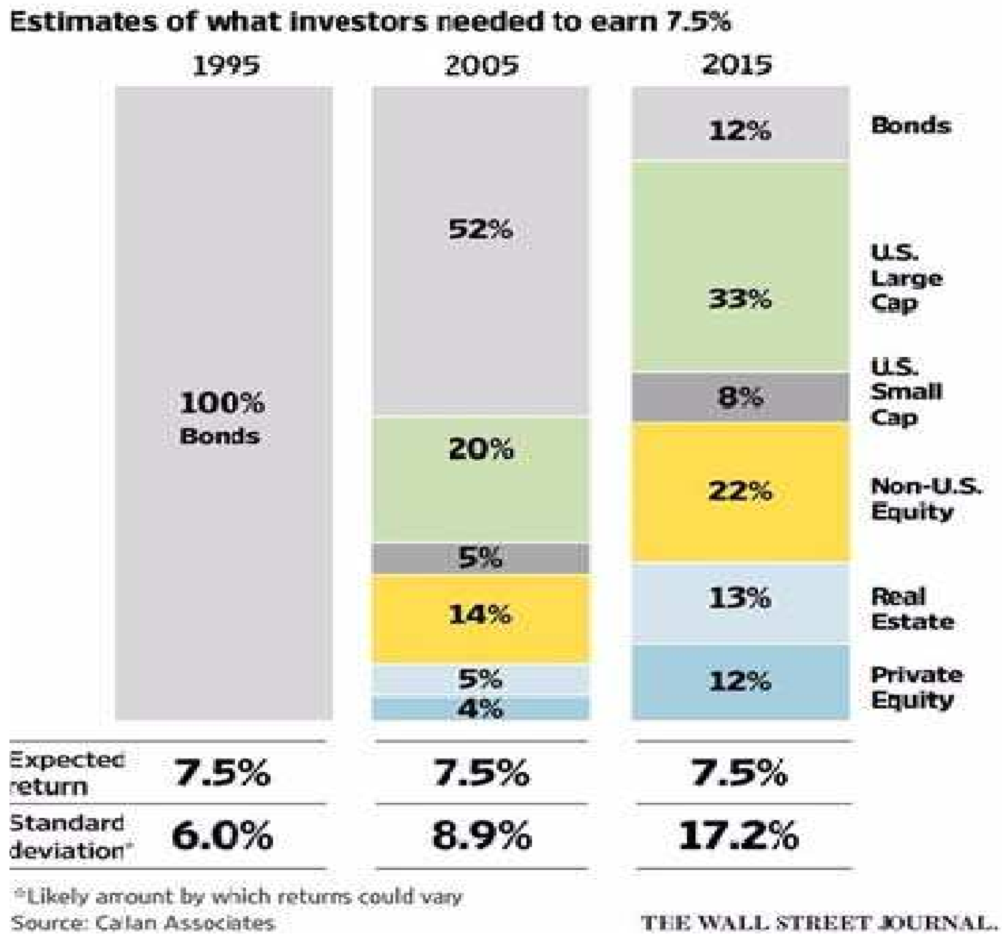
"Projected return forecasts for 2016 – 2026 have fallen for developed market government bonds, investment grade credit, high yield bonds and global equity markets"

Baillie Gifford, 2016

"Our 2016 assumptions anticipate a challenging investment environment as policy and economic conditions globally continue to diverge and many asset returns fall short of those achieved over the past 30 years."

JP Morgan 2016

What this means for investors (example)



More risk needed to generate the same returns

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Next steps

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Setting employer contribution rates

Understand employers

What is their funding target?

How long do we want to give each employer to get to the target?

How much risk can each employer take to hit the target?

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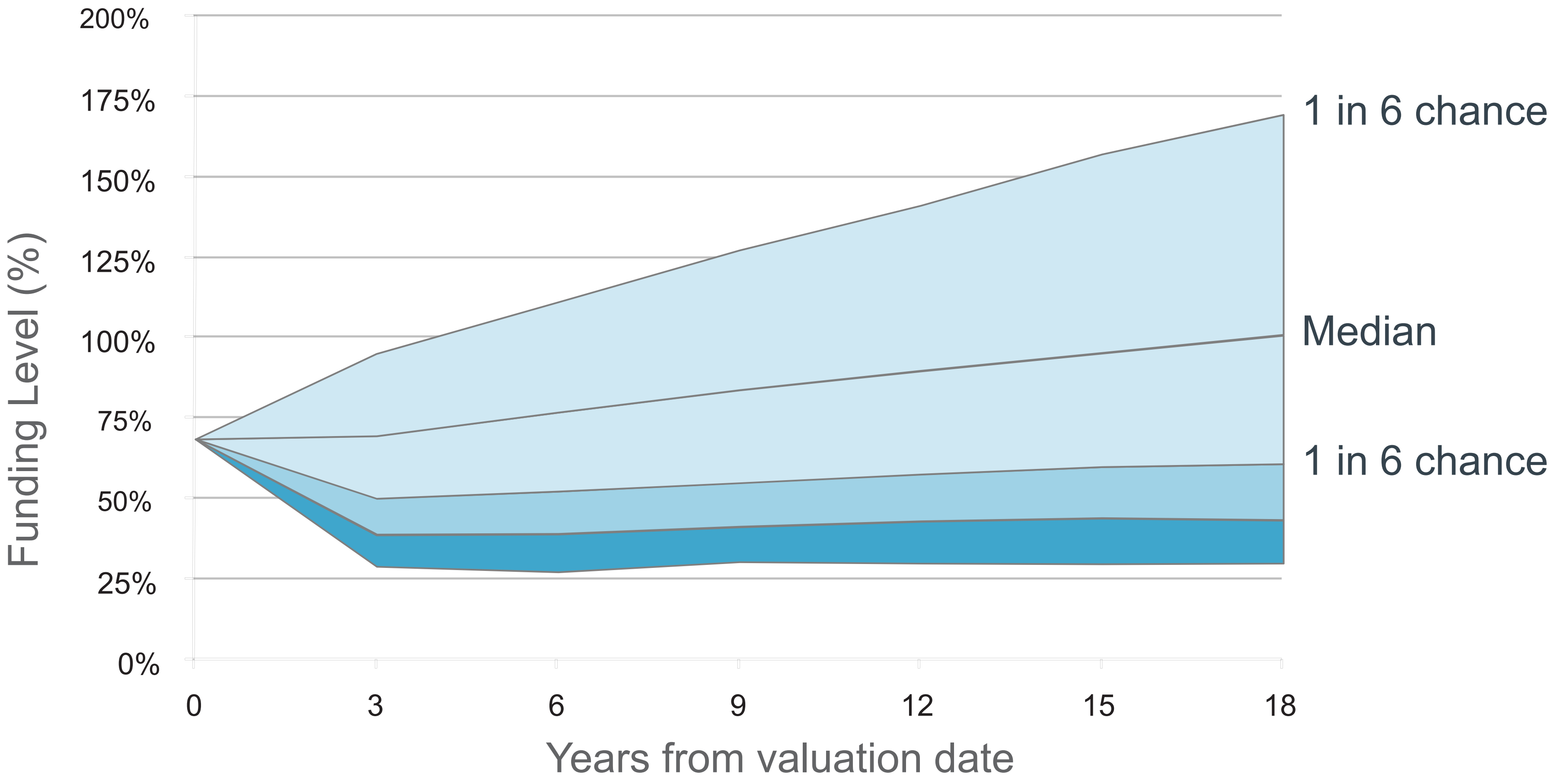
Setting contribution rates: Harrow Council



Need a good change of meeting funding objective to be prudent

Source: Hymans Robertson LLP, comPASS, sample output

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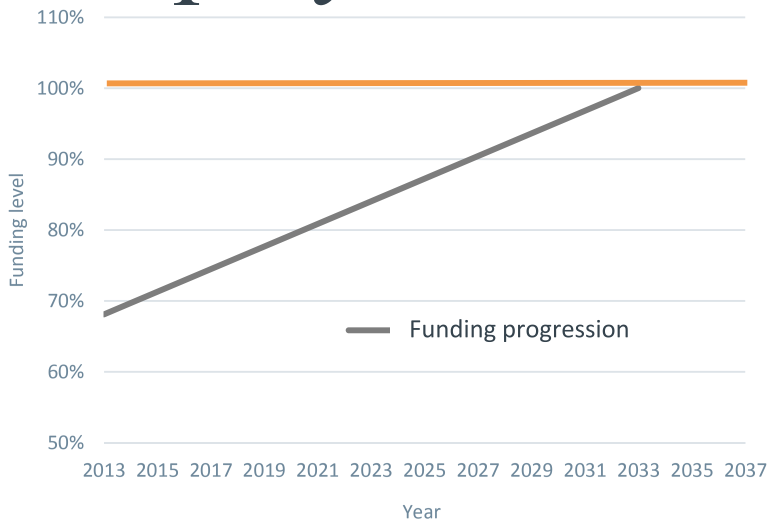
Setting contribution rates: other employers



The 'old' world

Risk based contribution rate strategies set for all

The 'new' world

CONTRIBUTION STRATEGY	LONG TERM LIKELIHOOD OF SUCCESS	AVERAGE OF THE WORST 5% OF FUNDING LEVELS IN 2035
Strategy 1	58%	39%
Strategy 2	77%	55%
Strategy 3	67%	45%

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Recognising all employers are different

Funding level

Financial strength

Type of employer

Contract length

Open or closed

Maturity

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Funding Strategy Statement review

3.3 The different approaches used for different employers

Type of Employer	Scheduled Bodies		Community Admission Bodies and Designating Employers		Transferee Admission Bodies
Sub-type	**Council Pool**	**Academies**	**Open to new entrants**	**Closed to new entrants**	**(all)**
Basis used	Ongoing, assumes long-term Fund participation (see Appendix E)		Ongoing, but may move to "gilts basis" - see Note (a)	Ongoing, but may move to "gilts basis" - see Note (a)	Ongoing, assumes fixed contract term in the Fund (see Appendix E)
Future service rate	Projected Unit Credit approach (see Appendix D – D.2)		Projected Unit Credit approach if open (see Appendix D – D.2)	Attained Age approach (see Appendix D – D.2)	Projected Unit Credit approach if open, Attained Age otherwise (see Appendix D – D.2)
Stabilised rate?	Yes - see Note (b)	Yes - see Note (b)	No	No	No
Maximum deficit recovery period – Note (c)	20 years	20 years	15 years – subject to security / covenant check	15 years – subject to security / covenant check	Outstanding contract term
Deficit recovery payments – Note (d)	Monetary amount	Monetary amount	Monetary amount	Monetary amount	Monetary amount
Treatment of surplus	Covered by stabilisation arrangement	Covered by stabilisation arrangement	Preferred approach: contributions kept at future service rate. However, reductions may be permitted by the Administering Authority		Reduce contributions by spreading the surplus over the remaining contract term
Phasing of contribution changes	Covered by stabilisation arrangement	Covered by stabilisation arrangement	None	None	None
Review of rates – Note (f)	Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations				Particularly reviewed in last 3 years of contract
New employer	n/a	Note (g)	Note (h)		Notes (h)& (i)
Cessation of participation: cessation debt payable	Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation debt		Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (j).		Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis.

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Source: London Borough of Harrow Pension Fund March 2014 Funding Strategy Statement

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Contribution rate definitions

- **Primary Contribution Rate**
- This refers to the cost of new benefits being earned by members. This was previously referred to as the Future Service Rate.
- **Secondary Contribution Rate**
- This refers to the contributions required to repair an employer’s deficit (surplus). This was previously referred to as Deficit Recovery Contributions

HM TREASURY

Public Service Pensions
(Record Keeping) Regulations

The Pensions Regulator

Governance and administration of
public service pension schemes

Local Pension Board

Local Government Pensions
SAB

Scheme Advisory Board

Communities
and Local Government

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The two "regulators"

Regulator	SAB	DCLG (GAD)
Powers?	Influence	Statutory
Request valuation info by	30 Sep 2016	Q2 2017
What requested?	Basket of Key Performance Indicators	Different Key Performance Indicators
Actuarial basis	HMT	Different
Publish results?	Possibly, in Q3 2016	Probably, in mid-2018

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Whole fund valuation results – SAB basis

	31 March 2016 (funding basis)	31 March 2016 (HMT basis)
Active	275m	221m
Deferred	171m	128m
Pensioner	444m	377m
Total liabilities	**889m**	**726m**
Assets	**661m**	**661m**
Deficit	**(228m)**	**(65m)**
Funding level	74%	91%

Funding basis is deliberately prudent – GAD have noted HMT basis isn't suitable for funding purposes

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2016 progress report

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Thank you

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Reliances and Limitations

- This presentation is addressed to the Pensions Committee of the London Borough of Harrow Pension Fund for its sole use as Administering Authority and not for the purposes of advice to any other party; Hymans Robertson LLP makes no representation or warranties to any third party as to the accuracy or completeness.
- This presentation discusses the current issues in the LGPS and was prepared purely for illustration to employers. Hymans Robertson LLP accepts no liability for any other purpose of this presentation.
- The following Technical Actuarial Standards* are applicable in relation to this presentation and have been complied with where material:
  - TAS R – Reporting;
  - TAS D – Data;
  - TAS M – Modelling; and
  - Pensions TAS.

* Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council and set standards for certain items of actuarial work, including the information and advice contained here.

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Appendix

Results are sensitive to assumptions about the future

Financial assumptions

Discount Rates	Benefit Increases			
	2.0%	2.2%	2.4%	
4.0%	(179) 79%	(204) 76%	(229) 74%	(Deficit) Funding Level
3.8%	(203) 76%	(228) 74%	(254) 72%	(Deficit) Funding Level
3.6%	(228) 74%	(254) 72%	(280) 70%	(Deficit) Funding Level

Demographic assumptions

	Peaked improvements	Non-peaked improvements
(Deficit) Funding Level	(228) 74%	(249) 73%

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London CIV Global Equities Search

Email from Assistant Director, Client Management, London CIV

30 August 2016

This is just to let you know that the London CIV global equities search went live on Friday, please see link to website below:

http://www.mytenders.org/search/show/search_view.aspx?ID=AUG130511

Please feel free to send the link on to your managers if you would like them to submit a tender for one of the lots.

As you may be aware we appointed Mercer and Redington to assist with the manager search and I've attached a list of the investment strategies we are looking for and the adviser assigned to that strategy. In terms of the timeline for appointment, we are due to receive responses by the 16th September and will be reviewing submissions after that with clarification meetings to be held with shortlisted managers. The global equity working group (part of the Investment Advisory Committee formed of treasurers and pension managers) is supporting the CIV in the procurement exercise and have already added considerable value in pulling the tender documents together. They are also due to review submissions and attend the manager meetings (time allowing). We are then aiming to hold information days for London Funds to meet the selected managers towards the end of the year, invitations will be sent out in due course.

We hope that this will provide funds with an exciting range of opportunities, particularly at a time when I know a lot of you will be considering your asset allocation and investment strategy following the triennial valuation.

As you may have also noted we are also working on looking at options around fixed income and cash generating assets over the next few months and will keep you updated of progress.

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GLOBAL EQUITIES PROCUREMENT – INVESTMENT STRATEGY LOTS

Lot 1 – Generic Global Equites, 6 investment strategies:

- Global Core (Redington) - Exposure to long-only listed global equity markets with tilts to a blend of multiple style factors. This might include (but not exclusively); a combination of Value, Momentum and Quality factors.
- Global Value (Redington) - Exposure to long-only listed global equity markets with persistent style exposure to “value” factors (relative to the MSCI World). This might include (but not exclusively); low price to earnings, price to cash-flow or price-to-book ratios.
- Global Quality (Mercer) - Exposure to long-only listed global equity markets with persistent style exposure to “quality” factors (relative to the MSCI World). This might include (but not exclusively); high return on equity, high return on assets, low volatility of earnings growth or low levels of financial leverage.
- Global Trend Growth (global unconstrained) (Mercer) - Exposure to long-only listed global equity markets with persistent style exposure to “trending” factors (relative to the MSCI World). This might include (by not exclusively); price momentum, fundamental momentum or earnings revisions.
- Global Income (Mercer) - Exposure to long-only listed global equity markets with persistent style exposure to “dividend yield” (relative to the MSCI World), and a portfolio-level yield persistently in excess of the dividend yield on the MSCI World.
- Global Low Volatility (Redington) - Exposure to long-only listed global equity markets with a focus on creating a portfolio of securities that primarily target a lower overall volatility than MSCI World.

Lot 2 – Emerging Markets Strategy:

- Emerging Markets (Mercer) - Exposure to long-only listed emerging market equities with the majority of portfolio invested in securities listed in countries defined as “emerging”.

Lot 3 – Sustainable Equities Strategy:

- Sustainable Equity (Redington) - Exposure to long-only listed global equity markets with a focus on explicitly considering environmental, social and governance (ESG) factors in portfolio selection and management.

Lot 4 – Incubator Managers:

- Emerging Managers/ Incubator (Mercer and Redington) - Exposure to long-only listed global equity markets with firm-wide AUM less than $2bn

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LB Harrow Pension Fund: Currency hedging and outlook for sterling

Comment by Colin Robertson, Independent Adviser

18 July 2016

Leaving aside the relatively small private equity holdings, foreign currency exposure is derived through the equity holdings which have no specific allocation to UK equities. The emerging markets exposure is unhedged and 50% of the remaining equity exposure is hedged back into sterling. Using the strategic asset allocation target weightings, this produces foreign currency exposure of 10% in emerging markets plus 50% of the remaining 52% of the fund invested in overseas equities. This amounts to 36% of the fund.

In comparison, using the State Street 2015/16 survey, the average LGPS fund has 60% invested in equities, of which about 21% is invested specifically in the UK and 39% is invested overseas. Assuming the overseas equities of other LGPS schemes are currency unhedged, the LBH fund has 36% foreign currency exposure compared to an average figure of around 39%. Given it is likely that some other LGPs schemes will have hedged overseas equity holdings to some extent, I think it is fair to say that the LBH fund has a typical foreign currency exposure.

This analysis ignores the fact that a high percentage of UK company earnings are derived from overseas and that a proportion of overseas company earnings are derived from the UK. Furthermore, we do not know the extent to which companies hedge their own foreign currency exposure. Nevertheless, if we are just considering the performance of equity indices and exchange rates, then it seems reasonable to assume the LBH fund's sensitivity to movements in sterling is not atypical.

I will not cover the theoretical merits or otherwise of currency hedging in my comments since I assume I am commenting in the context of Brexit. However, I would say that as the fund has a particularly high 62% exposure to global equities, some level of currency hedging does not appear unreasonable.

Turning to the outlook for sterling, sterling has now fallen by close to 10% against both the US dollar and the euro since the Brexit vote. A major reason for the fall is the UK's very large current account deficit (about 7% of GDP and much greater than in the other major developed economies) and concerns over how this deficit will be financed post Brexit. How keen will foreigners be to invest in the UK when its future is so uncertain, not least with respect to our ability to trade with other countries? However this issue can be overstated since our *trade* deficit is very much smaller than our current account deficit and the difference between the current account and trade deficits consists of items which will shrink markedly because of the fall in sterling (for example investment income received from abroad will rise in sterling terms but the investment income we pay foreigners will remain unchanged).

Other factors which affect exchange rates have not moved in a manner favourable to sterling. UK interest rates will remain lower for longer but then this also applies elsewhere so the impact should be very limited. Economic growth will be hit in the short to medium term and forecasts for aggregate GDP growth over the next two years have come down by around 2% or so. This is meaningful but hardly disastrous.

Crucially, we need to consider the extent to which these negative factors are already priced in to the exchange rate. Against the US dollar, sterling is down some 15% from the range it has traded in since 2008. Against the euro, sterling is trading at fairly typical levels over the last 10 years, reflecting the poor performance and subdued prospects for the eurozone. Therefore, it appears that while bad news has been taken on board, there remains scope for sterling to fall further if political mistakes are made. On the other hand, policy making in the UK could turn out to be better than expected and developments in other countries could be perceived poorly (for example Trump as President).

This is all entering into the realm of tactical currency asset allocation, rather than strategic asset allocation which should be the focus of the Committee's attention. However I would say that it is not clear to me that the shorter term tactical outlook for sterling is sufficiently negative as to justify changing the strategic allocation at this juncture. Horses bolting and stable doors come to mind.