REPORT FOR: Pension Board

Date of Meeting:	2 November 2015
Subject:	Pension Fund Committee Meeting 8 September 2015
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards Affected:	All
Enclosures:	None

Section 1 – Summary and Recommendation

Summary

The report sets out the matters considered by the Pension Fund Committee at their meeting on 8 September 2015 and invites the Board to agree any comments they might wish to make to the Committee.

Recommendation

The Board are invited to consider this report and agree comments to be passed on to the Pension Fund Committee.

Section 2 – Report

1. Matters considered by the Pension Fund Committee at their meeting on 8 September 2015 were as follows:

2. <u>Annual Report and Financial Statements 2014-15</u>

The Committee received the draft report and the final version is included, for the Board's consideration, elsewhere on the agenda.

3. <u>Work Programme for 2015-16</u>

The Committee agreed their work programme for the remainder of 2015-16. As a result of their decision and further officer consideration the agenda for their next meeting on 25 November is as follows:

Responsible and Ethical Investing
London Pension Fund Collaboration (CIV)
Benchmarking and Key Performance Indicators
Statement of Investment Principles
Issues Raised by Pension Board
Pension Fund Risk Register
Work Programme for 2015-16 and 2016-17
Performance of Fund Managers for Quarter ended 31 September 2015 and Valuation at 31 October 2015
Investment Manager Monitoring

As regards working with the Board, the discussion was minuted as follows:

It was noted that members of the Pension Board had been invited to attend the training and public sessions of the Pension Fund Committee but the legal advice received was that they could not attend the private sessions of the Committee. The Pension Fund Committee noted that the Board met twice a year but that it might wish to meet more frequently. Additionally, matters raised by the Board would be reported to the November 2015 meeting of the Pension Fund Committee.

4. <u>Options for Liability Driven Investments Strategy</u>

The Committee spent a considerable amount of time considering this matter and their discussion was minuted as follows:

The Committee received a confidential report of the Director of Finance, which included reports from Aon Hewitt, Council's Investment Adviser, and BlackRock, responding to the decision made by the Committee at its July 2015 meeting that reports from the Investment Adviser and Bonds Fund Manager be submitted to facilitate a decision as to the future Bonds Investment Strategy.

The Chair welcomed Colin Cartwright and Gayathri Varatharajan, representatives from Aon Hewitt, to the meeting. The Committee welcomed Colin Cartwright who had replaced Tony Baily and they looked forward to a positive working relationship with Colin.

Also present at the meeting were Christopher Head and Niren Patel of BlackRock Investment Management.

Colin Cartwright reminded the Committee that at their previous meeting they had received a paper from Aon Hewitt considering two options for the investment of the bonds portfolio in addition to the current investment in corporate bonds and index-linked gilts.

The Committee had discussed changing the asset allocation to provide somewhat greater protection against movements in the value of the liabilities. Consideration was given to whether this might be done through altering the mix of the current bonds portfolio or through the use of a pooled Liability Driven Investment (LDI) strategy.

One of the "Aon Hewitt" options was to transfer the funds invested in the bonds portfolio (13% of the total Pension Fund investments) to an LDI strategy. The Committee asked that Aon Hewitt carry out a modelling analysis covering three LDI options. In the paper provided by Aon Hewitt these options were presented to the Committee.

In addition to the presentation by Aon Hewitt, the representatives from BlackRock were invited to set out some of the practical implications, both advantages and disadvantages, of an LDI Strategy. They addressed the following issues and explained that the data included in their presentation was based on the 2013 actuarial valuation:

- *LGPS and liability risk reduction;*
- *Bond market outlook;*
- *how to address risks;*
- *efficient use of Capital;*
- *implementation considerations.*

BlackRock highlighted the key drivers of the liabilities of the Fund as inflation expectations and changes in real interest rates.

The Committee was also briefed on the downside of selecting an LDI mandate where the markets were restricted. However, it was also argued that LDIs allowed for improved stewardship and governance without significant risks.

BlackRock and the Committee's advisers discussed various detailed aspects of the LDI approach including the use of collateral and leverage. They indicated that, were the LDI approach to be adopted, it would need to be decided whether to; hedge interest rates and inflation or just one of these; implement immediately or delay until investment conditions might be more favourable; use predetermined 'trigger levels' to implement at a future date.

The presentation by BlackRock was followed by a question and answer session from the Committee and thereafter a debate and discussion on the three LDI options for the Fund ensued. Individual Committee members made the following comments:

- *which other local authorities pursued an LDI mandate;*

- *the implementation of an LDI option did not require implementation at this stage, particularly as interest rates were expected to rise, but that it ought to be explored at a future date;*

- *an 'in principle' decision was required and there was a need to be risk averse – be prudent;*

- *'locking' of returns on an LDI for a significant number of years required careful consideration;*

- *timing of an LDI option was crucial, including the collateral offered;*

- *inflation was the key ingredient rather than interest rates as rates were not expected to rise dramatically. It was important to wait and see how the index-linked Gilts would perform and that inflation and interest rates were historically 'locked' together and dependant on economics rather than on investment principles;*

- *clarification of the duties of the members serving on local authority Pension Fund Committees was essential. The functions of local authority Pension Funds was markedly different from that of private companies who were more suited to an LDI Strategy;*

- *liabilities, when valued in 2016, may fall as the Council would continue to shed its staffing resource. Option 1 was the preferred option as it help maximise investment returns which was the major purpose of managing a local authority Pension Fund. The Council did not have much control over its liabilities, including on the levels of employee contributions. It was therefore essential that the right asset classes were chosen. It was important to wait until 2016 and assess the valuation prior to choosing either an LDI Option1 or 2;*

- *the Committee needed to understand the risks associated with LDI and a considered view needed to be taken into account on whether or not to move to a LDI Strategy.*

Members sought advice from the Director of Finance and Aon Hewitt, who if the Committee were inclined to move into LDI were inclined towards Option 2. The other alternatives were LDI Option 1 or retention of the status quo. Members noted that Option 1 provided a simple change to the status quo but that Corporate Bonds were an expensive asset to sell and that the transaction costs were high. The gains from Option 1 would be minuscule. They noted that LDI Managers would provide all the support needed on any of the preferred LDI Options and that specialist Transition Managers would not add value.

The Chair was of the view that the timing of an LDI mandate was important and that the Committee could either review the Strategy when market events changed significantly or once the valuation had been carried out in 2016. A number of members supported Option 2 but felt that it ought to be pursued at a future date.

The Committee discussed the circumstances under which Option 2 could be visited and asked Aon Hewitt to provide guidance on the catalyst that could trigger a move to an LDI Option 2 Strategy.

RESOLVED: *That the status quo, a 13% Bond allocation invested in a combination of Corporate Bonds and index-linked Gilts, be retained in relation to the Fund's Bond portfolio and that Aon Hewitt be requested to provide guidance on the catalysts that would trigger a move to an LDI Strategy with Option 2 being the preferred Option.*

5. HB Public Law – Staff Transfer Arrangements

The Committee's discussion was minuted as follows:

The Committee received a confidential report of the Director of Finance setting out the conclusion in respect of negotiations with Barnet Council over the payment of Pension Fund liabilities relating to Legal Services staff that had transferred from Barnet to Harrow.

Members commented as follows:

- *the compromise set out in the report was reasonable;*

- *HB Public Law would continue to grow and officers needed to ensure that the corresponding Pension Fund liabilities were taken into account at an earlier stage. Additionally, any other Shared Services propositions needed to address this issue at an earlier stage. The Director of Finance acknowledged that such considerations would be undertaken at the Business Case stage;*

- *the level of materiality in terms of the contribution rate. The Director of Finance reported that the contribution rate would not alter until a valuation was undertaken. She acknowledged that paragraph 17 of the confidential report did not make the same assumption.*

In response to a question, a representative from Aon Hewitt stated that any interim obligations would have had to be met from Harrow's Pension Fund.

RESOLVED: *That*

(1) the offer made by Barnet Council that a sum based on a valuation of £2.57m, calculated under circumstances as at 1 September 2012, be transferred from the Barnet Pension Fund to the Harrow Pension Fund in respect of the transfer of legal staff from Barnet to HB Public Law;

(2) the Director of Finance, in consultation with the Chair of the Pension Fund Committee, be given delegated authority to agree the sum on the date of cash transfer so long as the shortfall does not exceed £0.616m.

6. London Borough of Harrow Pension Fund: Investment and Management Expenses 2014-15

A report on these matters is included elsewhere on the Board's agenda.

The Committee's consideration was minuted as follows:

The Committee received a confidential report of the Director of Finance which set out the details of investment and management expenses incurred by the Pension Fund during 2014-15.

The Pension Fund Committee noted the variances, particularly the significant one by Pantheon. An officer replied that a more sophisticated calculation tool was now being applied by Pantheon in relation to investment costs levied. A Member stated that the report and the discussion at the meeting had shown that a detailed debate was required on this topic.

In response to a question from an Independent Member, the officer explained the staff costs, including overheads, incurred in the payroll and pension section of the Council.

RESOLVED: *That the report be noted.*

7. Information Report – Investment Manager Monitoring

At each meeting of the Committee they receive a report from their Investment Adviser AonHewitt on each of the fund managers, evaluating their performance and rating them according to:

- Business
- Staff
- Process
- Risk
- Operational Due Diligence
- Performance Analysis
- Terms and Conditions

For each manager they provide an overall rating as follows:

- Buy – clients invest with or maintain their existing allocation to these products
- Buy (Closed) - clients invest with or maintain their existing allocation to these products which are closed to new investors
- Qualified – a number of criteria have been met and investment managers are considered to be qualified to manage client assets
- Sell – termination of investments is recommended
- In Review – rating is under review as factors are evaluated which may cause a change to the current rating

During the Quarter the rating for Standard Life had been increased from “Qualified” to “Buy” and all of the Harrow fund managers have been given either a “Buy” or “Qualified” rating.

8. Information Report – Performance of Fund Managers for Quarter Ended 30 June 2015 and Valuation at 31 July 2015

At each meeting the Committee consider the most recent performance and valuation available to them.

Financial Implications

9. Whilst this report discusses numerous matters relevant to the financial standing of the Pension Fund there are no financial implications arising directly from it.

Risk Management Implications

10. Relevant risks are included in the Pension Fund Risk Register.

Equalities implications

11. There are no direct equalities implications arising from this report.

Council Priorities

12. The financial health of the Pension Fund directly affects the level of employer contribution which in turn affects the resources available for the Council’s priorities

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert Date: 21 October 2015	✓	Chief Financial Officer
Name: Caroline Eccles Date: 16 October 2015	✓	on behalf of the Monitoring Officer

Ward Councillors notified:	**Not applicable**

Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager
0208 424 1450

Background Papers - None