SOUTH YORKSHIRE PENSIONS AUTHORITY

INVESTMENT BOARD

17 SEPTEMBER 2015

PRESENT: Councillor S Ellis (Chair)
Councillors: R Wraith (Vice-Chair), K Rodgers, A Sangar, M Stowe and B Webster

Officers: J Hattersley (Fund Director SYPA), M McCarthy (Deputy Clerk), S Smith (Head of Investments SYPA), F Bourne (Administration Officer SYPA), R Bywater (Principal Policy and External Relations Officer) and M McCoole (Senior Democratic Services Officer)

Trade Union Members: R Askwith (Unison) and F Tyas (UCATT)

Investment Advisors: T Gardener, N MacKinnon and L Robb

K Thrumble (State Street Investment Analytics)

Apologies for absence were received from: Councillor J Scott, G Warwick and F Foster

1 APOLOGIES

Apologies for absence were noted as above.

2 ANNOUNCEMENTS

None.

3 URGENT ITEMS

None.

4 ITEMS TO BE CONSIDERED IN THE ABSENCE OF THE PUBLIC AND PRESS

RESOLVED – That agenda item 20 entitled ‘Corporate Class Action Law Suits: Shareholder Rights, Class Actions and Portfolio Monitoring’ be considered in the absence of the public and press.

5 DECLARATIONS OF INTEREST

None.

6 MINUTES OF THE MEETING HELD ON 25 JUNE 2015

T Gardener commented that the minutes had indicated that the following reports should have been presented at today's meeting:-

i) Overseas Equities.
ii) Emerging Market Equity Exposure.

Councillor Ellis commented that the Fund Director had given her assurance that the reports would be presented to the Board Meeting in December, with the proviso that updates would be provided if the reports were incomplete.

RESOLVED – That the minutes of the meeting of the Investment Board held on 25 June 2015 be agreed and signed by the Chair as a correct record.

7 WORK PROGRAMME

The Board considered its' Work Programme to 23 June 2016.

Councillor Sangar referred to Item 11 on today's agenda entitled 'Government Consultation on LGPS'. He felt that the report did not give a sense of urgency in relation to the recent statements made by the Chancellor of the Exchequer, and the possibility of an additional meeting to be arranged between now and the next Board Meeting in December.

The Fund Director commented that the report detailed all of the officially known information, and that a verbal update would be provided at today's meeting.

T Gardener suggested that the new work stream should be identified within the Work Programme.

RESOLVED – That the Board:-

i) Agreed that Government Consultation on LGPS be included onto the Work Programme.

ii) Noted the contents of the Work Programme.

8 VERBAL UPDATE ON MATTERS THAT HAVE ARISEN SINCE THE LAST MEETING

M McCarthy informed Members that permission had been granted by the Secretary of State for a joint local pension board to be established in South Yorkshire. This would serve both this Fund and the South Yorkshire Passenger Transport Pension Fund.

RESOLVED – That the update be received.

9 WORKING TOWARDS THE 2016 ACTUARIAL VALUATION

The Fund Director referred to the Actuarial Valuation 2016 report which was submitted to the last Board Meeting. Since then there had been correspondence exchanged with the Fund Director, Advisors and Actuary and a meeting would shortly be held with Mercers to obtain an update.

The Fund considered that the outcome of the 2016 valuation was unlikely to be favourable largely due to the effect historically low bond yields would have on the Fund's liabilities. Looking further forward it was likely that investment returns would be poorer rather than stronger in comparison to those earned recently. As in previous years it was intended to present a report to the December Board Meeting seeking Members' and Advisors' input into the assumptions used by the Actuary. It was planned to submit a report to the October Pensions Authority Meeting providing a draft valuation timetable. The Fund was not the only LGPS fund to be under pressure in relation to the 2016 valuation, and the actuarial community was looking at ways to address the issues.

As Members were aware the Fund was currently encountering data issues arising from UPM, the new administration system. Other LGPS funds faced similar administration difficulties due to technicalities in uploading the new 2014 Scheme. The valuation would be an item on the agenda of the forthcoming meeting with district treasurers (who, incidentally, were keen for the actuarial contract to go out to tender). The issue would also be discussed at an Employers' Forum later in the year.

The Fund Director reminded the Board that it had traditionally awarded an asset and liability contract following an actuarial valuation and wondered whether it would be prudent to prepare a tender earlier than in the past. Members were informed of the pros and cons of commissioning such a study.

Councillor Ellis commented that the last valuation had taken too long and she asked that this one should be undertaken in a timelier manner.

The Fund Director commented that the actuarial valuation was due as at the end of March 2016. Data processing should be complete by July/August 2016; preliminary results from the actuary would be available in August/September 2016 at which point discussions would be held with individual employers to give them a feel for the likely contribution rates. A formal report would be presented in March 2017 and the certificates would be produced in March 2017.

T Gardener suggested that more should be done prior to the end of March 2016 to ease the process. His personal view was that a decision on an asset and liability study should be deferred until the valuation result was available and queried whether one would be required at all given the work done surrounding the 2013 valuation.

L Robb suggested that an additional meeting or conference call with the Advisors should be arranged, if required, in between the meeting with Mercers and the December Board Meeting, to help progress matters further and explore a number of ideas.

The Fund Director commented that one of the lessons learnt over the years was that the change should not be too dramatic and the Fund should expect evolutionary change. If the outcome of the actuarial valuation indicated a dramatic deterioration, then independent input could be required to reassure the 300 plus employers that there was independent surveillance of the Scheme: otherwise it could be appropriate just to undertake a health check. The key issues included how much should be put into protection and growth assets, whether the Fund considered that the amount of risk prepared to be taken would achieve its aim and whether this was prudent. The Fund Director suggested that enquiries could be made to test the market now.

T Gardener agreed that a health check would be a sound governance procedure.

Councillor Ellis asked if the districts would look towards commissioning their own work into the valuation; last time KPMG had been engaged.

The Fund Director commented that the districts or employers were entitled to commission work from wherever they felt appropriate, as long as they knew this would not be financed by the Fund. The districts had concerns that Mercers were over prudent, which the Fund Director considered to be incorrect. It was likely that the Fund would be in a worse position now if it had followed the recommendations from KPMG.

RESOLVED – That Members:-

i) Agreed to make preparations now prior to proceeding with either a health check or an asset and liability study.

ii) Noted that the Fund Director and Advisors would meet prior to the Board Meeting in December.

iii) Noted that a report outlining the timetable would be taken to the Pensions Authority Meeting in October.

10 <u>GOVERNMENT CONSULTATION ON LGPS</u>

A report of the Fund Director was presented to advise Members that the Government intended to consult over the pooling of LGPS investments to reduce costs. Members were provided with background information on the brief paragraph in the Summer Budget documents which related to the LGPS reform and a later message sent by the Department for Communities and Local Government.

The Fund had been invited to be 1 of 17 funds to attend a meeting at the Local Government Association to talk to Treasury representatives and CLG, to gain some background knowledge as to what the Government wanted to achieve. The consultation last time had theoretically focused on both cost savings and deficit management though, in fact, the latter had not been considered.

The Chair and S Smith had attempted to attend a follow-up meeting in London on 21 August but suffered rail disruption. S Smith had attended a subsequent meeting at the beginning of September, which had been attended by the same Members who attended the initial meeting. S Smith commented that the meeting had not conveyed a clear message but had indicated that Government was seeking pools of monies in excess of £20bn. Whilst detail was extremely limited at this stage it was almost certain that the proposals would significantly increase this Fund’s costs.

Notes of the meeting held on 21 August suggested that responses were sought from all 89 funds to set out costings and how it was considered these could be reduced or how to pool with other funds. A representative from the London CIV, which was hoped to be established in December, had indicated that internal management was something that they would like to offer. A number of people had accepted that internal management was cheap, but that consideration should be given to pooling arrangements.

The Fund Director referred to the northern funds i.e. South Yorkshire, West Yorkshire, East Riding, Greater Manchester, Merseyside, Tyne and Wear and Lincolnshire, which had met separately to discuss future areas of collaboration. It was noted that South Yorkshire, West Yorkshire, East Riding and Teesside were internally managed funds. Conference calls had been hosted by Hymans Robertson who had agreed to act as a co-ordinator for responses.

S Smith referred to the conference call following the meeting on 21 August, which had given a different perspective of the view of the CLG. Hymans Robertson had indicated that they did not want 89 responses but 3 or 4 solutions going forwards, and they had approached various funds in relation to a piece of research to be put forward by December. A total of 10 funds had indicated that they would fund the research which totalled £100,000; Hymans Robertson had indicated that other interested funds could also be included.

The Board gave approval for the Fund Director to explore the research being undertaken by Hymans, and gave approval to enter into this providing the costing was circa £10,000; the Fund Director would report back to the Board.

The Fund Director referred to the various arguments being voiced over the level of cost savings being sought and the integrity of those numbers. It was widely accepted within the industry that the figures quoted in the original Hymans Robertson report were open to challenge. However, notwithstanding these criticisms the media continually referred back to them. Although the Budget statement had indicated that any savings should not be achieved at the expense of investment returns it was difficult to see how the sums being sought could be found without severe curtailing of active overseas equity management across the LGPS.

The Fund Director referred to the LGA meeting where an individual from London had made a point that their best performing managers were not interested in cutting the fees and would rather forego the business. At that meeting one of the items put forward was that CLG should impose a cost cap to which individual funds could manage.

The Fund was already cheap due to it being internally managed and it performed well; it would be very difficult to dramatically cut costs. If the Fund was forced to move to a pooled collective vehicle then the costs would increase. If the internally managed funds were amalgamated together, they would not be big enough to hit one of the original pools of £25bn to £40bn. S Smith reminded Members that the Fund was one of a small number of funds that had outperformed its benchmark and if it was forced into a passive vehicle then there would automatically be an under performance due to the fees.

T Gardener commented that the LGPS Scheme Advisory Board had indicated that this would be imposed, but it was a question of what was an appropriate vehicle.

L Robb commented that the big question was whether the Authority wanted to act as a vehicle or manager to attract funds from elsewhere.

The Fund Director commented that the Authority had an advantage as it was FCA registered, it managed two separate funds, used two sets of trustees, had two benchmarks and two actuaries; though there would be resource implications if the assets under management were expanded. It was noted from the Hymans Robertson's conference calls that there was an inherent hostility from other funds at the suggestion to migrate to other local authority funds. In the previous consultation, the Fund had put forward in its submission the suggestion that it could mentor other funds. There was a danger that the exercise could bring down the common denominator rather than bring the poorer funds up. The Fund Director had raised at the LGA that the Fund could become an investment manager for other funds but the response was to suggest an amalgamation of all internally managed funds instead.

Councillor Sangar commented that the Chancellor's Statement had indicated that the Hymans Robertson's savings would happen within 12 to 18 months. He suggested that the Fund had to set the agenda and go out in terms of pooled vehicles; the Fund needed to be upfront in terms of advertising its low costs.

Councillor Rodgers commented that this reminded him of how the Government was looking at devolution; he envisaged that other funds would encounter difficulties, and that the Fund should be upfront and ready.

Councillor Ellis noted the consensus for the offer of proactive work to grow the Fund, but she was aware that the Government's cost cap had not been picked up.

T Gardener referred to a recurring theme from Government and politicians which was the failure of the LGPS to invest in UK infrastructure projects when compared to the initiatives made by overseas funds.

Councillor Stowe suggested holding a special meeting to consider the framework of good practice, which could present an opportunity to consider all options, create a business plan to sell the ideas to mentor other funds and to potentially become a hub for other investment pots to build upon the expertise and low costs.

Councillor Webster expressed concern at the ambiguity of what the Government had asked for at this stage and he was reassured to learn of the conversations commencing between officers and other funds. He questioned how officers could reach the stage to have certainty that was needed to make a submission to the consultation, and how to ensure that Members were involved in the process.

The Fund Director commented that the starting position would be to indicate that the Fund was cost effective and efficient and anything that the Government may do to the Fund would damage the Fund. If the same was done to other internally managed funds they would be damaged too, and he questioned whether this was politically acceptable. The Fund would then have to argue the case for extending the remit for internal management within the LGPS against all political hurdles, and to offer the facility to run customised or passive portfolios along the lines of what is undertaken for the Passenger Transport Pension Fund. The Fund Director considered that CLG could be more proactive with the poorer funds to suggest that they needed a mentor. The Fund expressed concern on the matter, and it was exploring options with colleagues elsewhere. It was suggested that initially a response would be sent to Government to highlight the political consequences if this was undertaken with internally managed funds.

T Gardener disagreed with the Fund Director's suggestion, and he considered it to be inappropriate to indicate to the Government that the Fund was perfect; the Government required an indication that the savings would be achieved.

L Robb suggested that thought should be given to the style of approach. It was naturally the case that everyone wanted to be collaborative, but the Government could require conclusions in February 2016 and there could be a number of authorities who had not been prepared to establish a connection with other funds. He suggested that the Fund should be in the market place as an investment management firm to sweep up all such funds, rather than just doing it collaboratively, and for the Fund to become more aggressive and less collaborative about the situation if necessary.

T Gardener suggested a meeting to discuss the various methods and ascertain which method the Board felt most comfortable with; he considered that if the Board waited until all the information was known, it would be too late to have such a discussion.

Members agreed that a workshop be held to determine the way forward. T Gardner suggested that a representative from the Transport Fund be in attendance, and Councillor Ellis suggested that all 12 Members be present.

The Fund Director confirmed that it remained the Government's intention that the administering authorities would continue and the asset allocation decisions would remain at the administering authority level. Instead of the internal team carrying out the instructions, it would be a choice of which pooled vehicle to use. The amalgamation of funds issue was part of a separate discussion. Furthermore, the Shadow Advisory Board work on how far the funds should be removed from their administrative authorities was not affected by the cost saving exercise.

The Fund Director commented that a holding letter would be submitted to Government this month to explain the position and the areas the Fund wanted to explore further.

T Gardener commented that the criteria would be established in the autumn, following which a consultation process would be undertaken on the new investment regulations in terms of back stop legislation but not on criteria. He suggested that the workshop should be held in early November to allow the Fund Director time to prepare the agenda and further information would be known from the Government due to a number of consultation meetings being held on the process. T Gardener envisaged the Government to issue the criteria by the end of October.

RESOLVED – That the Board:-

i) Agreed that a workshop be arranged in early November, to be attended by all 12 Pensions Authority Members, Officers, Advisors and a representative from the Transport Fund.

ii) Gave approval for the Fund Director to explore the research being undertaken by Hymans Robertson, and gave approval for the Board to enter into this providing the costing was circa £10,000; the Fund Director would report back to the Board.

iii) Agreed that a holding letter be submitted to the Government this month, to explain the Fund's position and the areas it wanted to explore further.

11 STATE STREET PRESENTATION

The Board received a presentation from State Street Investment Analytics (formerly WM Company). K Thrumble provided information on the Fund's Performance Review for the period ending March 2015.

The Board noted the following key points:-

- The Fund's recent performance, relative to other funds, had been very good.
- The Fund had produced a better than average return at a lower than average level of risk.
- The Fund had slightly underperformed its benchmark in the latest year.
- Strong results from private equity were offset by more mixed returns elsewhere.
- In the longer term, the Fund remained broadly ahead of its benchmark.
- The Fund's bond performance was well ahead of average.
- A good investment selection was being offset by asset allocation decisions.
- Relative to other funds, the Fund outperformed in the latest year, which was largely as a result of the different allocation of the bond benchmark; the Fund was well ahead over the longer term.
- The average local authority had returned 13.2% during 2014/15 compared to this Fund's 14.2%.
- The longer term investment returns for LGPS had been very strong.
- Over the last 5/6 years active management had had a strong run. This had ceased in the UK last year, but funds had continued to outperform in overseas markets.
- Over the last 10 years, internally managed funds had tended to be the best performing funds.
- KT highlighted that the Fund had outperformed its benchmark by 0.1% per annum over the last decade whereas the average fund had underperformed by 0.1% and the differential was a further 0.2% net of fees.

T Gardener referred to the slide showing asset returns over the year and highlighted the fact that index-linked bonds had returned 20.2% which was the third highest return from any class (Japan and North American equities returned 27.3% and 24.8% respectively). Because liabilities were measured against bond yields this meant that it was almost de facto that deficits will have increased last year.

Councillor Ellis gave thanks to K Thrumble for an informative and interesting presentation.

RESOLVED – That Members noted the presentation.

12 RESPONSIBLE INVESTMENT POLICY: FOSSIL FUELS AND THE EFFECT OF CLIMATE CHANGE UPON INVESTMENT PORTFOLIOS

A report of the Fund Director was submitted to bring to Members' attention the latest thinking on the implications of climate change for institutional investors.

The Authority had a Responsible Investment Policy which was periodically reviewed in light of industry developments, and was last reviewed at the December 2013 Board meeting. Then there was an in-depth consideration of the risks and opportunities associated with investing in carbon industries and how environmental issues could be reconciled with the fiduciary duties of pension funds. The Fund was aware of the increased interest in the effect of fossil fuel and stranded assets; oil continued to be the commodity most frequently referred to although coal was the most polluting fuel.

A Conference of Parties Conference would be held in Paris in December, which aimed to agree a new deal on limiting global warming.

Members noted the background information on climate change and the implications of carbon risk for institutional investors. It had been stated in the IPCC Fifth Assessment Report (2014) that if substantial efforts were not made to curb greenhouse gas emissions, then global temperatures could rise by 4oc compared to pre-industrial revolution temperatures by the end of the 21st century.

The Fund accepted that there should be a long term tilt towards a low carbon economy within its portfolios.

The Fund Director referred to an email received yesterday from Sheffield Climate News, which was a small pressure group. SCN strongly endorsed the Board's first three recommendations within this report, but was critical of the others.

RESOLVED – That the Board:-

i) Affirmed its policy of active engagement with investee companies and reiterated that it would not divest from investments solely on environmental, social and governance grounds.
ii) Agreed to monitor carbon risk within its investment portfolios and would engage a specialist contractor to conduct a carbon footprint of the portfolio at an estimated cost of £4,000 (plus VAT).
iii) Formally confirmed that the Fund would continue not to directly invest in pure coal and tar sand companies.
iv) Agreed to revisit the subject following the Conference of Parties Conference to be held in Paris in December, and after completion of the carbon audit of the Fund.
v) Agreed that the Fund should become a signatory of the Carbon Disclosure Project (CDP).

vi) Noted that the Fund would seek to engage with pressure groups and fund members on the subject.

13 LOCAL AUTHORITY PENSION FUND FORUM: JUNE 2015 BUSINESS MEETING

A report of the Fund Director was presented to inform Members that the minutes of the March 2015 business meeting had been issued.

The last business meeting of the Forum had been held on 16 June 2015 in London, where regular reports from the officers of the Forum together with the notes of the last Executive Meeting had been discussed. Membership of the Forum remained at 64, although two new funds had expressed an interest in joining.

The Forum had recently agreed to establish an All-Party Parliamentary Group.

RESOLVED – That the report be noted.

14 STATEMENT OF INVESTMENT PRINCIPLES: RENEWAL

A report of the Fund Director was submitted to seek Members' approval to adopt a revised Statement of Investment Principles for twelve months with effect from 1 September 2015.

The Authority had a statutory obligation to produce and publish a Statement of Investment Principles.

RESOLVED – That the revised Statement of Investment Principles was adopted with effect from 1 September 2015 for a period of not less than twelve months.

15 SHAREHOLDERS' CONCESSIONARY DISCOUNTS

A report of the Fund Director was presented to seek renewal of the Authority's policy on not utilising shareholders' concessionary discounts.

RESOLVED – That the Board determined not to utilise shareholders' concessionary discounts at all.

16 HEALTH AND SAFETY AT WORK ACT 1974: COMMERCIAL PROPERTY PORTFOLIO ANNUAL AUDIT

A report of the Fund Director was submitted to inform Members of the outcome of the annual health and safety audit of the Fund's commercial property investment portfolio.

Standard Life Investments had been appointed by the Authority as its commercial property advisor, to monitor and report upon the managing agent's (Cushman and Wakefield) health and safety performance. Following an audit of the whole portfolio over the year, a total of 1543 risks had been identified with almost 98% being controlled, and only 36 uncontrolled risks had been identified.

RESOLVED – That the Board noted the annual health and safety report prepared by Standard Life Investments.

17 ILLIQUID PREMIUM ALLOCATION UPDATE: AFFORDABLE HOUSING

A report of the Fund Director was presented to provide Members with an update regarding the proposal to invest in a vehicle involved in the provision of affordable housing.

At the last Board Meeting Members had endorsed the principle of investing in residential property, and had requested further exploration to private rented, affordable and sheltered housing. Members had agreed, whilst not rejecting healthcare property investment, that affordable housing was an appropriate activity for the Fund, although they had expressed caution.

It was noted that a London based real estate asset manager had been contacted, with a view to developing a specialist vehicle to meet the perceived need for physical housing stock and produce an attractive rate of return; another regional LGPS Fund had indicated interest in the concept.

Members noted the shift in the investment climate since the May Budget and the changes to Government policy which included the proposed introduction of 'right to buy' legislation for HA tenants, which had unsettled the investment sector, together with changes to the housing benefit provision and a cut to social rent which would reduce forecast cash flows. This had resulted in some HAs shelving development plans and had caused increased uncertainty.

RESOLVED – That the Board:-

i) Noted the report.

ii) Agreed that it would be interested in pursuing matters further, if the position improved.

18 ILLIQUID PREMIUM ALLOCATION: UPDATE ON CREDIT FUND IMPLEMENTATION AND IDENTIFICATION OF POTENTIAL NEW THEME

A report of the Fund Director was submitted to bring Members up to date with aspects of the portfolio's theme implementation.

The Board considered whether there could be any potential reputational risk involved in exploring 'water' as a theme. It was noted that when the portfolio restructuring was first considered, sustainable investing had been a theme which arose, and water had been a readily identifiable sub-text in the space.

RESOLVED – That the Board:-

i) Noted the report.

ii) Agreed that further exploration be given to the theme "water".

iii) Requested in future, that rather than seeking Board sanction to invest in a "theme" prior to conducting research, officers undertake research first and then report to the Board if it was considered it was an area worth pursuing further.

19 QUARTERLY REPORT

The Board reviewed the performance of the Fund during the quarter ended 30 June 2015.

The Fund ended the last quarter with an underweight position to bonds and UK equities, and an overweight position to alternative income funds, private equity funds, property and cash.

For the quarter, the Fund returned -2.5% against the expected return of -2.7%, with the Fund valuation falling from £6245.2m to £6096.2m.

Fixed interest returns were Henderson in-line at -1.5% against the benchmark; index-linked gilts returned -3.5% against a benchmark of -3.8%; higher yield bonds returned -2.7% against an expected return of -3.9%; emerging market bonds returned 0.3% against an expected return of -1.0%.

UK equities had returned -1.2% against the expected benchmark return of -1.6%. International equities had returned -4.8% against the benchmark return of -5.0%. Property had returned 2.3% against the benchmark return of 3.6% whilst private equity had returned 3.6% against the benchmark return of 1.4%; and alternatives income had returned -1.4% against the benchmark return of 1.4%.

Reference was made to the recent volatility in markets triggered by investors' belated concerns over the overheating in the Chinese stock market and the slowing down of growth in China's underlying economy. There had been knock-on consequences for emerging markets and currencies.

N MacKinnon referred to the regular policy meeting of the US Federal Reserve scheduled for today, which would include an announcement on interest rates, and this had raised a great deal of interest in the market. In the event of an increase in interest rates, it was anticipated that this would have a minimal impact on markets. N MacKinnon's view was that interest rates would rise, although it was unclear as to what decision the US Federal Reserve was likely to make.

RESOLVED – That Members noted the contents of the report.

20 EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED – That under Section 100(A) of the Local Government Act 1972, the public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act and the public interest not to disclose information outweighs the public interest in disclosing it.

21 CORPORATE CLASS ACTION LAW SUITS: SHAREHOLDER RIGHTS, CLASS ACTIONS AND PORTFOLIO MONITORING

A report of the Fund Director was submitted to keep Members informed of progress regarding the portfolio monitoring system on securities fraud.

RESOLVED – That Members noted the report.

CHAIR