SOUTH YORKSHIRE PENSIONS AUTHORITY

INVESTMENT BOARD

30 JUNE 2016

PRESENT: Councillor S Ellis (Chair)
Councillors: J McHale, A Sangar and R Wraith

Officers: J Hattersley (Fund Director,
S Smith (Head of Investments) and F Bourne (Administration Officer) (SYPA)

M McCarthy (Deputy Clerk) and M McCoole (Senior Democratic Services Officer) (BMBC)

Trade Union Members: G Warwick (GMB) and F Tyas (UCATT)

Investment Advisors: T Gardener, N MacKinnon and L Robb

Observer: Councillor Z Sykes (Sheffield CC)

Apologies for absence were received from:
Councillor M Stowe, Councillor M Maroof, Councillor P Wood, R Askwith 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 the following agenda items be considered in the absence of the public and press:-

Item 10 'Government Consultation on LGPS Pooling – Background Information'.

Item 11 'Government Consultation on LGPS Pooling Submission'.

5 DECLARATIONS OF INTEREST

F Tyas declared an interest as he had become the newly appointed Chair of Armthorpe Parish Council.

6 MINUTES OF THE MEETING OF THE BOARD HELD ON 10 MARCH 2016

RESOLVED – That the minutes of the meeting of the Investment Board held on 10 March 2016 be agreed and signed by the Chair as a correct record.

7 WORK PROGRAMME

The Board was presented with the Work Programme to 9 March 2017.

Councillor Ellis urged the new Members to contact M McCarthy if there were any additional items for inclusion onto the Work Programme.

Councillor Sangar referred to the training and development listed on the Work Programme. He suggested that further consideration should be given to evaluation and training, and to make the most of external presentations.

T Gardener referred to the valuation and the proposed Asset and Liability Study. He suggested that in terms of training, that Members should be kept ahead of the technical events.

The Fund Director said he had already broached potential training with the actuary with a view to organising an event during September/October 2016.

RESOLVED – That Members noted the Work Programme.

8 UPDATE ON MATTERS THAT HAVE ARISEN SINCE THE LAST MEETING

The Fund Director commented that a discussion would be held at the conclusion of today's meeting in relation to the Brexit EU Referendum.

9 WORKING TOWARDS THE 2016 ACTUARIAL VALUATION

The Fund Director commented that progress had been made towards the 2016 Actuarial Valuation, and that the returns from employers were ahead of schedule. Members noted that there would be Brexit implications.

Councillor Wraith queried the number of meetings held with the District Treasurers in relation to the Actuarial Valuation.

The Fund Director commented that the District Treasurers had met with the Actuary prior to the last Authority meeting, where they had been provided with a broad outline of assumptions and procedures that the Actuary was considering using; the District Treasurers had been content with the information provided. It was envisaged that an additional meeting would be held in September/October 2016, when the preliminary data was available and the implication of the contribution rates were known.

T Gardener referred to the Fund's previous interactions with the Actuary in relation to past valuations. He queried at what stage the Actuary would attempt to include layers of conservatism into the assumptions.

The Fund Director commented that the Fund had taken cognisance of market movements at the 2013 Actuarial Valuation, and that an allowance had been made for the changes in bond yields between the March and autumn dates. The new approach was more evolutionary and any smoothing would be taken account of. He had spoken to the Actuary yesterday, who had indicated that he was in the same mind frame, and that although he could not change the statutory valuation date he would not be bound by it.

Councillor Ellis queried whether the District Treasurers would seek independent advice or valuations as previously undertaken.

The Fund Director commented that if the circumstances changed and the proposals caused concern, that the District Treasurers may seek independent advice; there was no indication of this at present.

RESOLVED – That Members noted the update.

10 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.

11 GOVERNMENT CONSULTATION ON LGPS POOLING - BACKGROUND INFORMATION

A report of the Fund Director was submitted to update Members on the progression to a final detailed submission from Borders to Coast Pension Partnership (BCPP).

Members noted that all three of the Investment Advisors were content with the submission at this stage. T Gardener requested a copy of the CPM report.

RESOLVED – That Members:-

i) Noted the background material.

ii) Agreed the key combined aspects of the BCPP to be submitted in the single pool submission to DCLG in July 2016.

iii) Agreed that a report be submitted to the next Pensions Authority meeting to indicate the Board's broad approval to the submission, and to seek the Authority's agreement to the submission.

12 GOVERNMENT CONSULTATION ON LGPS POOLING SUBMISSION

A report of the Fund Director was presented to seek Members' views on the proposed submission to DCLG in July 2016.

RESOLVED – That Members:-

i) Considered the draft outline submission.

ii) Agreed that a report be submitted to the next Pensions Authority meeting to indicate the Board's broad approval to the submission, and to seek the Authority's agreement to the submission.

AT THIS POINT THE MEETING RE-OPENED TO THE PUBLIC AND PRESS

13 EQUALITY AND HUMAN RIGHTS COMMISSION REPORT INTO RECRUITMENT AND APPOINTMENT OF DIRECTORS IN FTSE350 COMPANIES

A report of the Fund Director was presented to inform Members that the Equality and Human Rights Commission had published their report into the recruitment and appointment of directors to FTSE350 companies.

The Equality and Human Rights Commission had stated that more than 60% of the individual companies had failed to meet the target set by Lord Davies. In relation to the executive roles, there was almost 75% of FTSE100 companies, and 90% of FTSE250 companies that had no female executive directors.

RESOLVED – That Members noted the report.

14 FRC: REVISED CORPORATE GOVERNANCE CODE

A report of the Fund Director was presented to inform Members that the Financial Reporting Council (FRC) had published an amended UK Governance Code which came into force this month.

Members noted that the Code had last been reviewed in 2014. The revised Code applied to the accounting periods commencing on or after 17 June 2016, and applied to all companies with a Premium listing of shares regardless of whether they were incorporated in the UK or elsewhere.

RESOLVED – That Members noted the report.

15 SHAREHOLDER ENGAGEMENT: STATEMENT ON CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY

A report of the Fund Director was submitted to amend the current policy Statement on Shareholder Engagement and the Authority's responsibilities as a shareholder.

Members noted that the Shareholder Engagement Statement was periodically reviewed by the Authority to ensure that it reflected the current best practice. Minor amendments had been made to the statement, in line with the changes to the voting guidelines, in relation to directors' availability and share buy-backs.

RESOLVED – That Members approved the proposed Statement on Shareholder Engagement.

16 RESPONSIBLE INVESTING AND THE COMMERCIAL PROPERTY PORTFOLIO

A report of the Fund Director was presented to seek Members' approval to publish a revised policy statement regarding the application of responsible investing to the management of the commercial property investment portfolio.

At the Investment Board meeting held in December 2008, the Board had agreed that a Responsible Investment (RI) policy would be produced for use in conjunction with its property portfolio.

The Fund Director informed Members that following the 2015 Paris Conference on Climate Change the policy had been revisited. However, no material changes had been made.

RESOLVED – That Members agreed the revised Commercial Property Responsible Investment policy.

17 PROPERTY PORTFOLIO: MANAGEMENT ISSUES UPDATE

A report of the Fund Director was presented to update Members on matters relating to the asset management of the investment property portfolio.

The Fund Director commented that there were a number of situations where costs could not be recovered from tenants but the bulk of the expenditure related to vacant units rather than occupied ones. It was envisaged that the cost would be substantially less this year but it was expected to rise later in the financial year following the planned acquisition of some partially developed units.

Members noted that the tender for property insurance was dealt with by Barnsley Metropolitan Borough Council (BMBC), through a framework agreement. In previous tenders the agricultural business had been awarded to a mutual insurer, but had not been a party to the framework agreement, and the insurance premium on the agricultural portfolio had risen by 20%. The Fund Director suggested that it would be prudent, next time the process was carried out, to ensure that the agricultural business was outside of the framework agreement. The Fund was responsible for the security of vacant premises, and as part of multi-tenanted estates, the Fund would install surveillance kits where appropriate; increasingly CCTV monitoring and alarm systems were used. The Fund had a good insurance record in terms of theft, although one of the retail units had recently been broken into for the second time in 12 months.

The Fund Director referred to Brantano and Austin Reed, the two tenants who had entered into administration during the period. The Brantano unit had been quickly re-let and the Austin Reed unit was subject to an assignment. As the Fund was increasing its development exposure within the portfolio, the void rate would increase.

Councillor Sangar queried the status of the wind turbine development proposal and whether any landlord had been fined for a breach of the energy efficiency regulations.

There was only one live wind turbine proposal within the Fund's portfolio and the developer continued to talk to the local authority concerned; the development of new large-scale projects had significantly slowed due to the digression of subsidy regimes and the recent policy changes.

The Fund Director commented that work was required to comply with energy certificates when disposing of a property; if a unit was not efficient then a lower price would be achieved. With regard to wind and solar power a significant problem within the UK was obtaining a grid connection. The Fund would continue to monitor the position.

Councillor Wraith referred to the empty property rates and in particular the Warrington property at a cost of £97,000 per year.

The Fund Director reported that following a number of inspections at the Warrington property, there continued to be three interested parties, although one party was subject to funding. Work was underway to attempt to reduce the Fund's rate liability as much as possible. Specialist advisors were employed each time a unit became vacant, to establish what could be done to avoid paying rates. Members noted the proposals to privatise the Land Registry, a new framework for compulsory purchase and legislation to change the law on easements.

RESOLVED – That Members noted the report.

18 <u>ASSET AND LIABILITY STUDY 2016</u>

A report of the Fund Director was submitted to suggest to Members and Advisors that consideration should be given to commissioning an Asset and Liability Study post the 2016 actuarial valuation.

The Fund Director commented that circumstances had clearly changed over the last 3 years in terms of the general economic background. In previous years a health check had been undertaken, rather than a full Asset and Liability Study because the changes made to the Fund's customised benchmark had been evolutionary and not revolutionary. The Fund Director suggested that there had been two significant changes since consideration had been given to the last Asset and Liability Study i.e. firstly, the ongoing low interest rate environment and its effect on bond yields and whether it was sustainable; secondly, what products could be invested in the future going via the pool and how it would limit the potential decision making at Authority level.

Councillor Ellis queried the length of time for procurement.

The Fund Director commented that depending upon the work the Authority wished to undertake, he expected that indicative quotes could be obtained from leading firms within 1 month. If a health check was the agreed option it might be prudent to approach the previous consultant again.

Councillor Ellis queried whether the Authority should give consideration today to determine whether a full study or health check should be carried out.

The Fund Director suggested that consideration should be given at the Investment Board meeting in September, when the preliminary results of the actuarial valuation would have been received.

T Gardener commented that in order to reach a decision, it would be helpful to obtain the indicative prices of the health check and the full study.

The Fund Director commented that previously, the health check had cost approximately £15,000 and the full study had been closer to £30,000.

RESOLVED – That Members:-

i) Considered the matters raised within the report.

ii) Agreed that consideration be given at the Investment Board meeting in September 2016, to determine whether a full study or health check should be undertaken.

19 ILLIQUID PREMIUM ALLOCATION

A report of the Fund Director was submitted to seek Members' guidance regarding the ongoing implementation of the portfolio.

The Fund Director commented that one of the Fund's greatest areas of expense was investing in alternative assets but, at the same time, this would provide the key asset class from which it could accrue savings within the pool. The Government had made it clear that if decisions needed to be unwound, that they would be done so at the Fund's cost. The Fund continued to invest in assets which were far more expensive than the other areas invested in; the Fund believed that they remained an attractive asset class. The Fund wanted to continue to add to that asset class.

L Robb queried how far away the Fund was from where it wanted to be initially.

The Fund Director commented that prior to the events of the last fortnight, officers were considering a gradual increase in exposure. The Fund was not currently arguing for an increase in the tactical range but it was looking to invest more.

T Gardener commented that he was very happy for the Fund to carry on with matters. He added that whilst the Government had specified that if a Fund had to unwind that it would be done so at the Fund's own cost. Government had also stated that it would not make a fund a forced seller, which would enable the unwinding to be made at the discretion of the Fund; the extra return was worth the potential cost.

S Smith commented that the Fund would not incur any additional costs, as assets would not be unwound, as the Fund would let them run off. Net of fees the performance had been good; the Fund's alternative benchmark was 2%, to which the Fund was already slightly above, but the Fund was happy to continue due to the tactical range of up to 7%.

RESOLVED – That the Board:-

i) Considered the issues raised within the report.

ii) Agreed to continue to invest in the asset class.

20 OVERSEAS EQUITY BENCHMARK

A report of the Fund Director was submitted to determine an overseas equity benchmark.

Members noted that background information had been provided at the last Investment Board meeting on the construction of the current benchmark, together with a paper prepared by the Advisors in relation to reviewing the benchmark and how it was constructed. A decision had not been reached at that meeting, but that further discussion would be held between the officers and Advisors to attempt to reach a solution, and for a recommendation to be brought to today's meeting.

S Smith commented that Members had agreed with the main thrust of the report to look at GDP ratings. The Advisors' paper had included a second step, and the views on the regions had been used to create a further benchmark. The Fund considered that if it took a view on this and then took an allocation as to whether the Fund should be underweight or overweight, the Fund could double up on some of those decisions. The Fund considered that if decisions were taken against that benchmark then it could be measured as to whether the decisions were right or wrong. Consideration had been given to those regions which had then been split between the developed and emerging markets for America, EMEA and Asia specific, which had resulted in different data. A large part of emerging markets was measured in GDP terms; those markets were very illiquid and the Fund could not invest in those types of money. The Fund then looked at the addressable market split by each region individually, and worked out a proposed benchmark. The emerging market element within the proposed benchmark equated to 21% of the Fund's overall overseas allocation, to which S Smith was cognisant to move forwards. She expressed concerned when entering into the pool, as to how such issues would be split.

L Robb commented that his expectation would be that when consideration was given to the emerging markets under the new pooling arrangements, that it would be prudent to think about emerging markets as an entity rather than three separate blocks; a factor to be taken into account by the new fund management group. He added that if Table 2 was adopted, that there would be no material changes arising from the emerging markets percentages, the main changes were between Japan, America and Europe; he suggested that there was no need to attempt to change the emerging markets components at this point. The broader part was the potential to increase Europe and reduce Japan and America. L Robb's personal view was not to increase in Europe at the moment due to the current environment, but to agree to note the recommendation, semi-endorse it, but not to implement it at the moment.

T Gardener was concerned that the benchmarks typically acted as anchors for fund managers. He queried how far S Smith was comfortable to move away from such an anchor.

S Smith commented that presently the Fund had a plus or minus 5%; the Fund would not move much further than that.

T Gardener expressed concern that this would anchor the Fund, he added that GDP was a reflection of past successes and not future successes. He suggested that the second stage of going from GDP to another stage was to allow a medium term view to be taken as to where GDP's were going. He expressed concern in relation to the 31% of developed Europe, which was a reflection of Europe up until now. He did not consider that Europe would become 31% of the world in the next 5 years, although he commented that if the Fund had this benchmark, that it would stay within 5% of it. He was concerned that it focused too much on past successes. He considered that responsibility would lie with the Investment Board and Advisors, and that the responsibility for making technical decisions would lie with the Investment Team. He considered that the benchmark would be 5 years; he suggested that the Investment Team should be comfortable with the suggestion.

S Smith commented that the Investment Team were happy with the process, but that they were concerned in relation to the timing and implementation.

L Robb agreed with T Gardener's suggestion, he was cautious to implement the benchmark at this stage. He added that he would be more positive with America and Asia rather than in Europe.

T Gardener commented that he was more positive in the long term in relation to America and Asia. He was happy with the process, but he considered that the process could come out with a result that did not make investment sense. He would have preferred a second stage, which would provide for a practical step overlaid on the mechanical quanta total step.

L Robb commented that he would have been keen for S Smith to state that the Fund did not mind to adopt the benchmark, but that it would not change much about what was currently undertaken.

T Gardner commented that he did not envisage any circumstances in which the Fund would want to implement such a weighting in Europe, due to the missing elements.

Councillor Sangar referred to Brexit, which had transformed the discussion today. He suggested that the report be noted and that further consideration should be given when the markets would have stabilised at the Investment Board meeting in September, to enable the Fund to agree upon a benchmark for the next 5 years.

T Gardener commented that there was something missing from benchmark process. He added that he would give further consideration to an additional solution, which he would discuss further with S Smith.

RESOLVED – That Members noted that T Gardener would relook at the overseas equity benchmark, and bring a report back on other suggestions before the end of the year.

21 QUARTERLY REPORT TO 31 MARCH 2016

The Board reviewed the performance of the Fund during the quarter ended 31 March 2016.

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

Transactions had been quiet during the quarter, the only significant feature being the reduction of UK equities due to the culmination of various takeovers during the quarter.

Performance for the quarter had returned 2.5% against the expected return of 3.2% with the Fund valuation rising from £6093.3m to £6220.2m. Fixed interest had returned 4.0% against the benchmark index of 3.2%. Index-linked gilts had returned 6.7% against the benchmark return of 7.5%. Higher income bonds had returned 4.5% against an expected return of 3.2%.

Emerging market bonds had returned 4.4% against an expected return of 3.2%. International equities had returned 3.0% against the benchmark return of 4.6%. Private equity had returned 2.3% against the benchmark return of 0.9%. Alternatives income had returned 2.9% against the benchmark return of 0.9%.

RESOLVED – That Members noted the contents of the report.

CHAIR