DURHAM COUNTY COUNCIL

PENSION FUND COMMITTEE

At a Meeting of **Pension Fund Committee** held in Committee Room 2 - County Hall, Durham on **Thursday 15 March 2018 at 10.00 am**

Present:

Councillor M Davinson (Chairman)

Members of the Committee:
Councillors O Temple (Vice-Chairman), J Atkinson, J Carr, S Hugill, J Nicholson, J Shuttleworth and M Wilson

Also Present:
Advisers: County Council Officers
John Hewitt – Corporate Director of Resources
Nick Orton – Pensions Manager

Independent Adviser:
Jo Holden - Mercer

1 Apologies for Absence

Apologies for absence were received from Councillors C Carr and Darlington Borough Councillor S Harker.

2 Declarations of interest

There were no declarations of interest.

3 Minutes

The Minutes of the meeting held on 7 December 2017 were agreed as a correct record and were signed by the Chairman.

Matters Arising from the Minutes

Training Needs Analysis – Self-Assessment

Nick Orton advised that almost all self-assessment forms had been received but would contact those Members directly who had not yet returned the information. On receipt of all forms a gap analysis of training needs would be carried out.

Committee Membership

Nick Orton provided an update on progress with regard to the filling of the current vacancies on the Committee. Further Education Colleges had been approached which had resulted in an expression of interest from one person to date. The next communication with pensioners would include information about making application to fill the pensioner representative position, and employers within the scheme would be contacted about the vacant positions for an admitted bodies and a scheduled bodies representative.

4 Overall Value of Pension Fund Investments to 31 December 2017

The Committee considered a report of the Corporate Director of Resources which informed Members of the overall value of the Pension Fund's investments as at 31 December 2017, movement in the cash balance during the last four quarters and the projected cash flow position up to 31 March 2018 (for copy see file of Minutes).

Resolved:

That the information contained in the report be noted.

5 Short Term Investments for the Period Ended 31 December 2017

The Committee considered a report of the Corporate Director of Resources which provided information on the performance of the Pension Fund's short term investments as at 31 December 2017 (for copy see file of Minutes).

Resolved:

That the position at 31 December 2017 regarding the Pension Fund's short term investments where £31,895 net interest was earned in the three month period, be noted.

6 Performance Measurement of Pension Fund Investments to 31 December 2017

The Committee considered a report of the Corporate Director of Resources which provided an overview for Members of the performance of the Fund to 31 December 2017 (for copy see file of Minutes).

Resolved:

That the information contained in the report produced by JP Morgan be noted.

7 Investment of the Pension Fund's Cash Balances

The Committee considered a report of the Corporate Director of Resources which provided an update of the Treasury Management Service provided to the Pension Fund and reviewed the charges for the services and the calculation of interest on

short term investments administered by Durham County Council for 2018/2019 (for copy see file of Minutes).

Councillor Shuttleworth had made reference to the average return earned in the last quarter of 0.56%, and was informed that the interest paid previously in respect of its cash balances was based upon the LIBID three month rate. For 2018/2019 it was recommended that interest would be paid to the Pension Fund at the average three month rate of return earned by the Council on its own short term investments.

Resolved:

That with effect from 1 April 2018:-

(i) the Pension Fund continues to invest its cash balances with the Council in line with the Council's Treasury Management Strategy;

(ii) interest be paid quarterly to the Pension Fund at a rate based on the daily cash balance and the 3 month rate of return earned by the Council on its own short term investments;

(iii) an administration fee of £2,600 per quarter be paid to the Council for Treasury Management services; and

(iv) in the event of the loss of an investment, the Pension Fund will bear the loss in proportion of the value of cash balances held at the time of the investment with Durham County Council.

8 Agreement of Accounting Policies for Application in the 2017/2018 Financial Statements of the Pension Fund

The Committee considered a report of the Corporate Director of Resources which informed the Committee of the accounting policies to be applied in the preparation of the 2017/2018 Final Accounts and sought confirmation from the Committee that appropriate policies were being applied (for copy see file of Minutes).

Resolved:

That having reviewed the accounting policies:-

- Their use be approved in the preparation of the 2017/2018 financial statements for the Pension Fund, and

- the Corporate Director of Resources be authorised to revise the accounting policies as necessary and report any significant changes to the Committee.

9 Procedure for Reporting Breaches

The Committee considered a report of the Corporate Director of Resources which provided Members with a copy of the Council's Procedure for Reporting Breaches

in relation to the Pension Fund, and explained how it operated (for copy see file of Minutes).

Councillor Temple welcomed the proposed procedure and that future meetings of the Committee would be provided with updates on the breaches record.

Resolved:

That the information contained in the report which included the Reporting Breaches Procedure, be noted.

10 Internal Audit Plan 2018/2019

The Committee considered a report of the Corporate Director of Resources which presented the proposed Annual Audit Plan for 2018/2019 for approval (for copy see file of Minutes).

Resolved:

That the proposed Audit Plan for 2018/2019 be approved.

11 Audit Strategy Memorandum for Year Ending 31 March 2018

Consideration was given to the report of the External Auditor which set out the work proposed in respect of the audit of the Council's financial statements and the value for money conclusion for the financial year 2017/2018 in relation to Durham County Council Pension Fund (for copy see file of Minutes).

Sharon Liddle of Mazars highlighted key points from the Audit Strategy Memorandum which included the following:-

- Scope of the audit
- Significant risks and key judgement areas
- The Audit Team
- Fees

Resolved:

That the contents of the Audit Strategy Memorandum be noted.

12 Feedback from Local Pension Board

Nick Orton provided feedback from the Local Pension Board, which included a recommendation to the Pension Fund Committee to assist in its effective and efficient governance and administration of the Scheme.

Following the Pension Fund Committee on 7 December 2017 the Local Pension Board had noted that there was only a short time for the Investment Managers to make their presentations and answer questions from the Committee due the volume of business to be conducted in the time available. The Board appreciated

that the meeting was often long and received a large amount of detail in the reports. However the reports of the Investment Managers and the ability to question them was vitally important and should not, if possible, be constrained to a short time at the end of a long meeting. The Board had made the recommendation previously that the Committee should plan and allow for sufficient time for questioning of the Managers and if necessary start the meeting earlier or invite the Managers following a lunch break.

The Board therefore recommended that the Pension Fund Committee give consideration to the timing of the agenda items with a view to allowing for sufficient time for questioning of the Managers and if necessary start the meeting earlier or invite the Managers in at an earlier stage.

Members discussed the Board's recommendation and considered whether sufficient time was allocated to the Investment Managers and whether allowing more time would be reasonable in terms of the governance of the Committee. Members acknowledged that it was about balancing whether it was proportionate to allocate more time to Investment Managers which represented a small proportion of the Fund's assets, against the volume and importance of business the Committee had to consider.

The Chairman advised that when this was raised at a previous meeting discussions were held with DCC Pensions staff, the advisers and the Corporate Director of Resources to make the most of the opportunity for the Committee to gain knowledge from the Managers.

The following was put into place:-

1) Managers were sent a template of relevant information the committee needed
2) Managers were asked to keep their presentations relevant to the Fund and be concise
3) Advisers were asked to produce a brief overview of each visiting Manager and suggest some questions which members may wish to ask.

This approach received positive feedback from Members at the September 2017 meeting and it was proposed that the situation be reviewed again after the June 2018 meeting. As always the needs of the Pension Fund, Members of the Fund and the Committee were the primary concerns. Whether the meetings were helpful or a useful way to spend time for the Investment Managers was not the concern of the Committee.

Resolved:
That the recommendation of the Local Pension Board be noted and the response of the Committee as outlined above be agreed.

13 Any Other Business

The Chairman referred to the move towards paperless meetings and advised that he intended to explore the feasibility of continuing with paper copies of Agendas for future meetings of the Pension Fund Committee.

14 Exclusion of the Public

Resolved:

That under Section 100(A)(4) 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.

15 Minutes

The Minutes of the meeting held on 7 December 2017 were agreed as a correct record and were signed by the Chairman.

The Chairman agreed that the order of business be amended to consider the Internal Audit Progress Report before the remaining reports on the Agenda.

16 Internal Audit Progress Report to 31 December 2017

The Committee considered a report of the Chief Internal Auditor and Corporate Fraud Manager which outlined progress made in delivering the 2017/2018 internal audit plan relevant to the Pension Fund Committee (for copy see file of Minutes).

Resolved:

That the work undertaken by Internal Audit during the period ending 31 December 2017, be noted.

17 Report of the Pension Fund Adviser

The Committee considered a report of the Independent Adviser Jo Holden of Mercer (for copy se file of Minutes).

Jo Mercer advised that the Fund had outperformed its benchmark over the last 12 months but had fallen below its objective. Whilst it had underperformed over the long term, a more important comparison was against the target return in accordance with the actuarial valuation on 31 March 2016 of 4.5%. At 8.7% the Fund had outperformed by 4.2%.

In terms of the asset allocation the Fund was most overweight in global equities and this was where disinvestment would be recommended as part of the review of asset allocation.

Early in 2018 stock markets started to fall with US equity markets affected first due to concerns over a rise in interest rates. There had been some recovery with

performance in global equity markets being relatively flat and US equity markets rising. The UK equities market had not recovered but this was not an issue for the Fund as investments were mostly in US, global and emerging markets.

In terms of performance of the asset classes over the next 3 years Mercer anticipated that equities would perform better than bonds, and emerging markets would perform better than developed markets.

Members were informed of the performance of each of the Managers.

Aberdeen had a huge spread of returns over the short term, with performance being satisfactory in the 12 month period, but less so over 3 years. The Managers were due to attend the Committee and should explain why the performance had improved recently. The Managers had merged with Standard Life and the Committee would wish to ask how this was progressing and also about the impact of the loss of a very large client Scottish Widows. Whilst it only represented 5% of their revenue it was still a sizeable loss.

Walter Scott had performed satisfactorily in the 12 month period and were 1.5% ahead of the benchmark but had not met the target. The Managers were to attend the Committee and could be asked if they were satisfied with this position.

With regard to Mondrian, over the most recent year a return of 18.3% had been significantly less than the Emerging Markets Equity Universe of 25.8%. Of that 25% a quarter was from tech stocks which was unusual and this explained Mondrian's underperformance. This should not give cause for concern as Mondrian's style was defensive and stable, and she would not expect the Managers to invest in tech stocks.

BlackRock's performance had been positive compared to a year ago and the 8% return had been as a result of the Managers being overweight in equities.

Royal London and AB were performing well but CBRE had struggled in the last year. This was frustrating as it was difficult to appreciate the reasons for the underperformance in their reports. Jo Holden proposed to discuss this with the Managers to ensure that this was made clearer in their reports in future. This view was shared by Councillor Temple who also made reference to Mondrian, appreciating that volatility was above average but their performance was below the benchmark. This implied that the Managers had been taking risks but not getting the returns and were underperforming against the benchmark. The Member felt that if it was not for the move towards pooling the future of investment with Mondrian would be examined.

Resolved:

That the information given be noted.

18 Investment Strategy Review Update

The Committee considered a report of the Corporate Director of Resources which provided an update on progress made towards implementing asset allocation decisions (for copy see file of Minutes).

Nick Orton provided an update on the legal advice sought on the procurement process. The advice indicated that the selection of a passive equity manager and implementing an equity protection strategy would be exempt from procurement regulations but would need to be consistent with the Council's own procurement process.

With regard to investment in private markets the pool now anticipated a private equity offering before the end of the calendar year. It would therefore be prudent to invest through the pool, however progress with implementation of this within the timescale would be closely monitored.

Resolved:

That the information given be noted.

19 Report of Aberdeen Asset Management

Natalie Winterfrost and Jamie Cummings were in attendance to discuss the performance of the portfolio and give their views on the economy and future outlook.

The Managers commenced by discussing the merger with Standard Life to become one of the largest investment houses globally. Members were informed that by being a highly diversified business, offering a range of developed and emerging market equities, they could continue to be well-resourced and resilient. There was no change in equity leadership other than there was now a Deputy Head from Standard Life.

Councillor Shuttleworth asked if the merger was related to the loss of Scottish Widows. The Member was informed that the reason that Scottish Widows had terminated its existing arrangements following the merger was because they were competitors, however it was hoped that as the insurance element of the company was being sold that they could work with Scottish Widows again in the near future. It was important to point out that this loss was offset by a deal with Phoenix and an expansion plan to replace the loss with new business across a range of investment types.

Natalie Winterfrost continued that the Managers were aware that performance had been difficult and was therefore pleased that the last year had been strong, outperforming the benchmark by 2.2%.

Jamie Cummings explained that markets had been very strong and the Managers had benefitted from being underweight in the US. The US had performed well in the last year because of QE and positive growth compared to the rest of the world,

although the situation was now levelling out. Asia Pacific was performing well, as was Korea where exposure was large.

In terms of sector performance many of their companies had been successful. The Managers preferred stable businesses in consumer staples and healthcare for example but these were interest rate sensitive so a rise in rates may have an impact.

Aberdeen remained cautious going forward. Volatility in markets had been low recently and he questioned the sustainability of this.

In terms of key market influences loose monetary policy continued to play a significant role and whilst Central Banks had continued to expand their balance sheets this could potentially come to an end, and therefore Aberdeen remained cautious. US corporate tax cuts were a positive influence but there were concerns about how they would be utilised – cap ex, wages or shareholder returns. He was of the view that the cuts would utilised for wages which may boost consumer spending.

Members were provided with a summary of the portfolio's performance during 2017. Key contributors included the Asia Pacific Allocation; exposure to electronic companies in non-benchmark countries Korea, Taiwan and Thailand delivered strong outperformance. Japan outperformed the wider market in medical and chemicals, and in the financial stocks selection Asian and emerging market investments had improved.

Key detractors were their underweight position in Europe which had performed well in the quarter but Aberdeen was cautious about the sustainability of this performance. Consumer discretionary stocks in the US had been weak, as had health and energy investments. A lack of exposure in Amazon and Apple had also detracted from performance.

In summing up Jamie Cummings advised that Aberdeen's geographical and sector positioning remained unchanged since the last quarter and in terms of the market outlook Aberdeen would continue to take a cautious approach.

Councillor Shuttleworth asked the Managers' views of the impact on markets of a rise in interest rates. Jamie Cummings advised that if a rise was planned and expected he would not expect a significant impact on markets, but a sudden rise may cause volatility.

In response to a question from Councillor Atkinson about the merger Jamie Cummings advised that it was business as usual. The merger had been implemented cautiously and two separate portfolios were proposed as Standard Life's approach differed from Aberdeen's. Aberdeen were risk averse whereas Standard Life looked for price appreciation in the shorter term. Both however were team driven and this would not change.

Resolved:

That the information given be noted.

Councillor Davinson noted a discrepancy in the terminology used for reporting performance against the benchmark in the Manager's report and the information produced by JP Morgan. Members asked that this be addressed in future reports to ensure that the same terminology was used and that the Managers were reporting figures against the benchmark set by the Fund.

Nick Orton and Jo Holden advised that they would examine the IMA's and clarify the benchmarks for all Managers.

20 Report of Walter Scott (BNY Mellon)

Ken Tomlin, Tom Duff and Roy Leckie were in attendance to discuss the performance of the portfolio and give their views on the economy and future outlook.

Roy Leckie advised that their investment philosophy remained unchanged as did the Team which was essential to retain stability in an Asset Management firm that remained long-term, bottom up stock pickers.

Over the short term equity markets had been unpredictable, however in the medium term their companies' share prices had done well in reflecting wealth creation. By identifying companies capable of superior rates of growth, they had been able to deliver above the benchmark and their peer group since 1983.

In the last 12 months their philosophy had succeeded in achieving 14%, against the benchmark of 12%.

What had been most pleasing about their returns last year was how broadly based it was across the portfolio. Their bottom up stock picking approach had contributed to the positive returns.

Going forward investment conditions looked reasonably favourable but that was likely to change because of risks such as US trade policies and Brexit, however the Managers were optimistic because of their investment philosophy. Walter Scott invested in companies that would double in size in 10 years, and this would benefit Durham Fund's portfolio.

In response to a question from Councillor Shuttleworth in respect of the potential impact of a rise in interest rates, Roy Leckie advised that he did not anticipate interest rate rises to impact upon the portfolio but they would affect markets. About 12% of companies globally were not making enough profit to cover debt and policy makers would therefore implement rises that were low and progressive.

Councillor Temple noted that short term performance of the Managers was excellent and asked to be provided with information over the long-term in future

reports. The Member was informed that 10, 15 and 25 year figures showed that the Managers added 250+ bases points on excess returns annually.

The Managers were asked by Jo Holden to discuss ESG arrangements using Suncore and Canadian Oil as an example. Roy Leckie advised that unlike most oil companies Suncore mined not drilled. Historically oil production was an industry which used vast amounts of water and pollution levels were high. Walter Scott spent many months with the company and had found that it was leading the way in cleaning up the industry. The Managers had owned Suncore for 10 years but had recently sold the company as it appreciated that environmental impact was a key consideration. ESG was very important when investing in a company over a long period of time and the Managers were satisfied with their own environmental and social approach to investing.

Resolved:

That the information given be noted.

21 Report of Mondrian Investment Partners Ltd

Consideration was given to a report from Mondrian Investment Partners Ltd which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

22 Report of AB

Consideration was given to a report from AB which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

23 Report of CBRE Global Investment Partners

Consideration was given to a report from CBRE Global Investment Partners which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy

c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

24 Report of Royal London

Consideration was given to a report from Royal London which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

25 Report of BlackRock

Consideration was given to a report from BlackRock which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

26 Investment Benchmarking

The Committee considered a report of the Corporate Director of Resources which provided the Committee with the outcome of an investment benchmarking exercise comparing the effectiveness of the Fund's investment approach with some other Local Government Pension Scheme Funds and private sector schemes (for copy see file of Minutes).

Resolved:

That a training session be arranged for Members of the Committee with a representative of CEM invited to attend to explain their benchmarking report and give more information on their findings.