

FALKIRK COUNCIL

Subject: PENSION FUND - INVESTMENT SUB GROUP UPDATE
Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD
Date: 10 DECEMBER 2015
Author: DIRECTOR OF CORPORATE & HOUSING SERVICES

1. INTRODUCTION

- 1.1 This report provides the Committee and Board with an update on the progress of the Sub Group charged with taking forward the Strategy review. A copy of the Sub Group's latest meeting minute is attached.

2. BACKGROUND

- 2.1 The meeting of the Pensions Panel and Committee on 11 December 2014 agreed that a review of Fund investment strategy should proceed on the following basis, recognising that the approach would be to work sequentially from a) to d)
- a) Determine the level of risk that the Committee was prepared to tolerate
 - b) Determine the mix of growth and defensive assets that the Fund should target
 - c) Determine the mix of assets that the Fund should hold in order to meet its objectives
 - d) Determine the managers who should manage these assets?
- 2.2 The Pensions Panel and Committee at their meeting on 12 March 2015 agreed that a de-risk plan be progressed and a Sub Group be formed to take forward a wider strategy review.
- 2.3 Under the new governance regime the Board and Committee at their meeting on 26 June 2015 crystallised the arrangements for the Sub Group.
- 2.4 A progress report was presented to the Board and Committee on 24 September 2015. It summarised the outcome of the 3 meetings to date and appended minutes of these meetings. The status of progress was summarised thus:-
- * a) 5% from Equities but how and to where?
 - b) Potentially increase allocation to Property, but with regard to the position with Schroders
 - c) Pursue Smart Beta mandate but to what extent? This would involve Manager search with one possibility being an in-house option via an extension of the shared service arrangement with Lothian
 - d) Increase Infrastructure allocation, probably via Grosvenor's new Fund and/or further direct fund exposure via collaboration with Lothian
 - e) Passive wind-down of Private Equity
 - f) Reluctance to pursue Bond/Debt at this time.
- * There are significant work elements to be addressed beyond the above e.g. approach to Environmental, Social and Governance (ESG) issues, at future meetings of the Sub Group.

3. CURRENT POSITION

- 3.1 The 4th meeting of the Sub-Group was on 2 October 2015 and a minute of the meeting is attached.
- 3.2 The position may be summarised as follows:-
- a) The topicality and importance of Environmental, Social and Governance issues was recognised and it was acknowledged that further work was needed to update the Fund Statement of Investment Principles. [the updated legal opinion being pursued by the National Scheme Advisory Board will inform this work]
 - b) It was agreed that pursuit of an allocation to “Smart Beta” was attractive. A training session on this would be arranged for the whole Committee and Board.
 - c) There was agreement that no movement on Bonds was appropriate at this time.
 - d) There was interest in increasing the allocation to Infrastructure via both Grosvenor and the Lothian Partnership. [note references to Infrastructure in other reports on today’s agenda]
 - e) With respect to Property the main points related to what to do about Schroders and the manner by which the allocation would be increased to 10%.
- 3.3 The next meeting of the Sub-Group is being arranged for late January/early February and it is expected this meeting will review the position reached to ensure coherence of the draft proposals and also tie-up loose ends. Whereas there may prove in the event to be a need for a further meeting, it is anticipated that a final report with recommendation will be available for consideration by the Committee and Board at their Spring meeting.

4. CONCLUSION

- 4.1 The Strategy review is progressing well and the Sub-Group has reached substantive positions on a range of key strands. A further report will be submitted to the Spring meeting of the Committee and Board.

pp **Director of Corporate & Housing Services**

Date: 30 November 2015

Contact Officer: Bryan Smail

LIST OF BACKGROUND PAPERS

NIL

FALKIRK COUNCIL

**MINUTE of MEETING of the PENSIONS COMMITTEE INVESTMENT REVIEW
SUB GROUP in the MUNICIPAL BUILDINGS, FALKIRK on FRIDAY 2 OCTOBER
2015 at 2.00 P.M.**

**SUB GROUP
MEMBERS:**

Committee:
Councillor Tom Coleman, Falkirk Council
Councillor Callum Campbell, Stirling Council
Andrew Douglas, Unison
Depute Provost John Patrick (Convener)

Officers:
Bruce Miller, Investment Manager, Lothian Pension Fund
Bryan Smail, Chief Finance Officer

ATTENDING:

Pensions Board:
Councillor Archie Drummond, Clackmannanshire Council
Sandy Harrower, UCA/T
Jennifer Welsh, SEPA

ALSO ATTENDING:

Simon Jones, Hymans Robertson
Antonia Sobieraj, Committee Services Officer

INV27. APOLOGIES

Apologies were intimated on behalf of Linda Selman, Hymans Robertson.

INV28. DECLARATIONS OF INTEREST

No declarations were made.

INV29. MINUTE

Decision

**The minute of the meeting of the Pensions Committee Investment Review Sub
Group on 9 September 2015 was approved.**

INV30. REVIEW OF STATUS OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) ISSUES

The Sub Group considered the Fund Statement of Investment Principles last updated in August 2012.

Discussion took place on the need to upgrade the Statement in particular at Section 9 relating to social, environmental and ethical considerations. The significance of these issues could not be understated.

Issues raised included the use of fossil fuels and the question of the morality of investments in companies not paying the living wage.

Clarification was also sought on whether there was a conflict of interest in Hymans Robertson acting as both actuary and adviser to the Fund. In response, the Chief Finance Officer advised that this was a legitimate question and that officers had become comfortable with the position. It was also noted that the actuarial services were shortly going out to tender.

Decision

The Sub Group agreed to consider further the issues associated with the updating of the Fund's Statement of Investment Principles.

INV31. EQUITY STRUCTURE - INTRODUCING AN ALLOCATION TO 'SMART BETA' AND LINK WITH 5% EQUITY REDUCTION

The Sub Group considered a report by Hymans Robertson on options for introducing an allocation to "smart beta" to the Fund.

The report highlighted:-

- The exploration of the merits of introducing an allocation to different "smart beta" strategies within the current equity structure;
- The specific consideration of three different equity structures assuming a 20% allocation of the total equity allocation (11% of Fund assets, following the proposed 5% reduction in the overall equity allocation);
- The modelling of an allocation to a value factor tilted strategy; and
- The introduction of an allocation to both a value tilted and low volatility strategies offers both the potential for extra return relative to a market cap weighted passive allocation and some dampening of absolute volatility.

The funding analysis had concluded that:-

- The funding of an allocation to "smart beta" strategies by way of a proportionate reduction in the overall equity allocation was an appropriate evolution of the equity structure although there didn't appear to be a case for targeting Aberdeen Asset Management; and the suggestion was moving to 20% of equity over circa 3 years;

- The allocation had to be sufficient in order to have a meaningful impact on the Fund, but reducing only the active equity mandates will impact on expected returns; and
- The appropriateness of rebalancing of the Legal and General Investment Management (LGIM) mandate to remove the current UK bias alongside the introduction of a “smart beta” strategy was worthy of discussion.

Decision

The Sub Group:-

- (1) noted the report; and
- (2) agreed:-
 - (a) to reach a position on each part of the strategy in the first instance;
 - (b) to thereafter review these decisions in the round to ensure their coherence; and
 - (c) to consider this matter further at the next meeting.

INV32. CONFIRMATION OF STANCE ON BONDS/DEBT

The Sub Group discussed in brief the stance on bonds/debt.

Decision

The Sub Group agreed that it was not minded to pursue more risky elements of the spectrum and that this was not the correct timing to switch into core bonds.

INV33. CONFIRMATION ON INCREASED INFRASTRUCTURE ALLOCATION

The Sub Group considered a report by Hymans Robertson on options for increasing the Fund’s infrastructure exposure to achieve the target investment allocation of 9%.

The report highlighted the current allocations to infrastructure within the portfolio through the shared services agreement with Lothian Pension Fund and the investment with Grosvenor Capital Management (“GCM”) and options to increase infrastructure exposure to the target allocation:-

- The extension of the commitment for Lothian Pension Fund to identify infrastructure assets beyond the current £30m allocation; and/or
- The further commitment to GCM (the Fund’s existing infrastructure manager).

The overall size of the target allocation to infrastructure (9%) equated to approximately £150 million. The Fund currently had an exposure of around £55 million, £40-45 million being managed by GCM and £13.5 million managed by Lothian Pension Fund.

The merits of increasing the allocation to Lothian Pension Fund and to GCM were considered in detail.

The report highlighted the need for the deployment of up to £150 million of capital over the next 3-5 years to achieve its target allocation of 9%. A further allocation to GCM along with an expanded allocation to Lothian Pension Fund was viewed as a positive way forward to be considered further.

Decision

The Sub Group agreed to a further allocation to GCM along with an expanded allocation to Lothian Pension Fund as a positive way forward and to be considered further.

INV34. PROPERTY OPTIONS

The Sub Group considered a report by Hymans Robertson on the potential evolution of the property allocation.

The Fund currently had a target allocation of 10% of assets to property. The Fund currently had £130m, equivalent to around 7% of assets, invested in a mandate managed by Schroder Investment Management.

The report highlighted:-

- The current portfolio including the structure/risk profile, the conflict of interest and the illiquidity;
- The desirability of migrating the current allocation to property in line with its long-term target allocation and of targeting a long-term allocation of 15% to property;
- The appropriateness of pursuing outperformance within the core balanced portfolio;
- The attraction of introducing an allocation to a real return property mandate and any further training required; and
- The possible implementation approaches for the future management of the property allocation.

Decision

The Sub Group:-

- (1) noted the report; and**
- (2) agreed to consider how the 7% allocation be increased to 10% and the current portfolio managed by Schroder Investment Management following further discussion at the next meeting of the Committee.**

INV35. DATES OF FUTURE MEETINGS

The dates for future meetings of the Sub Group would be confirmed in due course.