TEESSIDE PENSION FUND & INVESTMENT PANEL

A meeting of the Teesside Pension Fund & Investment Panel was held on 16 September 2015.

PRESENT: Councillors S E Bloundele (Chair); J Rostron (Vice-Chair); D P Coupe, J Culley, G Purvis and A Shan

Other Local Authority Members:

Councillor J Lindridge - Hartlepool Council
Councillor J Beall - Stockton Council

PRESENT AS OBSERVERS: Mr C Monson - Deputy Chair - Teesside Pension Board

ALSO IN ATTENDANCE: Deloittes - Auditors: A Lince and H Taylor
Employers' Representative: Peter Fleck
Investment Advisors: F Green and P Moon
Property Advisors: A Owen and A Peacock- CBRE
Unison: A Watson

OFFICERS: C Allison, P Campbell, B Carr and K Rose

APOLOGIES FOR ABSENCE: Councillor N Bendelow, Councillor R Brady, Councillor J G Cole, Councillor N Hussain.

DECLARATIONS OF INTERESTS

Name of Member	Type of Interest	Item/Nature of Interest
Councillor J Beall	Non-Pecuniary	Member Teesside Pension Fund
Peter Fleck	Non-Pecuniary	Member Teesside Pension Fund
Councillor J Lindridge	Non-Pecuniary	Member Teesside Pension Fund
Councillor J Rostron	Non-Pecuniary	Member Teesside Pension Fund

1 **MINUTES - TEESSIDE PENSION FUND AND INVESTMENT PANEL - 17 JUNE 2015**

The minutes of the meeting of the Teesside Pension Fund and Investment Panel held on 17 June 2015 were taken as read and approved as a correct record.

2 **FUND MANAGER'S REPORT**

The Chief Finance Officer submitted a report to inform Members with regard to: (i) how the Investment Advisors' recommendations outlined at the meeting held on 17 June 2015, were being implemented; (ii) to provide information with regard to stock selection strategies, including a detailed report on transactions undertaken (Appendix A); and (iii) to present an independently produced valuation of the Fund's assets (Appendix B).

The report provided a summary of the advice received from the two Investment Advisors at the previous meeting of the Panel held on 17 June 2015.

The Head of Investments and Treasury Management highlighted the following:

Developed Economy Central Banks

Since the beginning of the financial crisis, the US Federal Reserve, the Bank of England, the Bank of Japan and ECB had expanded their balance sheets by more than $4trillion. The cash had been primarily used to purchase government bonds.

Emerging Market Currency Reserves

From 2000 to 2015, Emerging Market currency reserves had increased from $1trillion to

$6trillion. China had built up reserves as a way of stabilising currency against the dollar.

Defined Benefit Pension Plans

In the UK, many Funds had felt pressured to buy index linked securities often in competition with our own Central Bank. The consequence of how the market had evolved was that the market was seeing longer bull/bear phases and greater volatility. Low rates and indiscriminate buying had encouraged more misallocation of capital and as a consequence this suppressed long term returns.

The Panel was advised that there was net disinvestment of approximately £77m in the period 1 April 2015 to 30 June 2015, compared to net disinvestment of £10m in the previous reporting period. Cash balances had increased from £93m to £190m. The Panel was provided with a summary of each of the Fund's asset classes.

The Fund Valuation, attached at Appendix B to the report, prepared by the Fund's custodian BNP including the total value of all investments including cash was valued as at 30 June 2015 at £3,123 million, compared to the last reported valuation of £3,239 million as at 31 March 2015.

An analysis of the summary valuation provided a comparison between the Fund's weightings in the various asset classes, compared with the Fund's customised benchmark and the average of other funds, and was set out in a table in paragraph 6.2 of the report.

ORDERED that the report be noted.

3 **FUND ADVISORS' REPORT**

The Investment Advisors each gave their views on the current global economic, political and market conditions, and reviewed the current position of the Fund. Both Advisors followed up on their comments at the previous meeting about Greece, now agreement had been reached for Greece to remain in the Euro. It was reiterated that this resolution would only bring temporary relief.

The recent market falls as a result of news flow out of China and volatility in commodity markets was discussed. Concern continued with regard to the ISIS situation and the refugee crisis in Europe. The Advisors also stated that although the UK elections may be over without the projected hung-parliament, the spectre of the UK’s EU membership and possible further devolution would provide continued volatility in UK markets.

Finally, the Advisors followed up their previous comments on the possibility of tightening monetary policy in the US and UK and the impact of rising interest rates. Whilst both Advisors agreed that interest rates should rise at some point, there was a difference of opinion when US rates in particular would rise.

In discussing the short term asset allocation, both Advisors acknowledged the current allocation against the customised benchmark. Their general view was to carry on with the allocation strategy set at the previous Panel meetings with equity markets preferred over bonds. Previous comments were reiterated where the Advisors would be happy to see a reduction in bonds, even from the current low levels; bond yields at current levels did not meet the Fund’s actuarial obligations.

The Advisors also stated that if equity markets weakened, this was an opportunity to invest further in equities on a company specific basis. If equity markets strengthened, this was an opportunity to reduce the equity allocation. Both Advisors agreed that this strategy could lead to cash levels oscillating between uncomfortably high and uncomfortably low levels.

The property portfolio should continue to be managed and increased where opportunities allowed, after giving regard to location, the quality of the tenant and a good yield. Finally, in respect of Alternative Investments, the Advisors held the view that this asset class could be attractive to the Fund, particularly Infrastructure, but only where the investment provided the Fund with diversification at a reasonable cost.

4 **PROPERTY ADVISORS REPORT**

The Fund's Property Advisors submitted a report that provided an overview of the current property market and informed Members of individual property transactions relating to the Fund.

The Panel was advised that the total value of the Fund's direct property portfolio as at 30 June 2015 was £155.15m and the indirect portfolio was valued at £39m as at 31 December 2014.

The portfolio was made up principally of prime and secondary assets and comprised of 22 mixed-use properties, located throughout the UK. This reflected an overall Net Initial Yield of 5.22%, and an equivalent yield of 5.47%.

ORDERED that the report be noted.

5 **REFORM OF LGPS INVESTMENTS - UPDATE**

A report by the Chief Finance Officer was submitted, to update Members with regard to the outstanding consultation (Opportunities for collaboration, cost savings and efficiencies), which was launched on 1 May 2014, following the Call for Evidence (CfE) in June 2013, on the future structure of the LGPS and to inform Members of an announcement made in the Budget Statement.

A report had been submitted to the Teesside Pension Fund and Investment Panel held on 18 September 2013 which provided Members with an update on the structural reform of the LGPS and the response of Teesside Pension Fund to the CfE consultation.

The response focussed on the benefits that TPF had experienced from being internally managed and recommended that the reform should focus on the wider use of internal management throughout the LGPS.

Following receipt of all the responses to the consultation the Department for Communities and Local Government (DCLG) had commissioned research to quantify and compare the costs and benefits of fund merger and asset pooling and had appointed Hymans Robertson (Hymans) to carry out the research.

Hymans subsequently had recommended two common investment vehicles (one for all listed investments, e.g. shares and bonds, and one for all unlisted investments, e.g. property, infrastructure, private equity and hedge funds). The analysis demonstrated that this option appeared to be the most cost effective and simplest option to implement.

The Hymans report also considered the benefits of managing listed assets passively, as opposed to being actively managed. It was highlighted that passive management was where underlying assets were held in proportion to match a benchmark index, e.g. FTSE All-share for UK equities. Active management was the way in which the TPF manages its assets, and this is where it is believed that assets are mis-priced and the benchmark index could be bettered through stock selection. The Hymans report had recognised that internally managed Funds usually performed well. Research suggested that the rates of fees for passive management of a Fund were much higher if that Fund was managed externally.

Following the last report to the TPF on 18 June 2014, a response to the consultation had been sent which stated that the TPF should continue to retain the decision making over investment management arrangements. To date, there had been no determination, comment or decision made by the DCLG as a result of the consultation responses.

In the Government's May 2015 Budget Statement, the following paragraph was included in the

'Red Book' at Page 78, paragraph 2.19:

'Local Government Pension Scheme pooled investments - The government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments.'

The announcement had been made just over a year since the consultation by the DCLG which asked whether common investment vehicles (CIVs) would achieve economies of scale for listed and alternative investments.

There had been suggestions that there could be mergers of the 89 England and Wales funds into five so-called super funds. A number of consultations had been held where opportunities for collaboration and merging assets had been considered.

The Panel was advised that an agreed response to the consultation that was due to be published later in the year would be compiled; once more information became available from the government.

ORDERED that the report be noted.

6 **REVIEW OF INVESTMENT MANAGEMENT ARRANGEMENTS - UPDATE**

The Chief Finance Officer submitted a report to update Members with regard to progress made following the review of investment management arrangements presented to the Panel in March 2015.

It had been agreed in 2000, that a regime of formal reviews of the investment management arrangements of the Fund should be implemented. This arrangement was designed to bring the TPF in line with best practice, as proposed by the Myners Review of Institutional Investment. The first review had been carried out in 2001 with a subsequent review being presented in 2007.

The latest review had been presented to the Panel in March 2015 and Members had agreed to all of the six recommendations contained within the review, in principle, subject to a minor amendment to the wording of one of the recommendations. A table showing progress to date in respect of the six recommendations was attached at Appendix 1 to the report.

In respect of recommendation 3, reference was made to the two vacant posts (Investment Manager and Investment Officer) following an unsuccessful recruitment exercise. The Panel was advised that following the benchmarking exercise included at recommendation 4 of the report (which recommended comparing the TPF against LGPS funds and other pension funds to assess whether the current salary grades within the Fund were correct or required a market supplement); the posts could be regraded and this could attract a wider range of applicants. The posts could also be advertised more widely.

In terms of recommendation 5, once the outcome of the KPMG commission had been submitted to the LGPS Scheme Advisory Board (SAB), a detailed review would be conducted and any developments from the SAB review would be reported back to the TPFIP. A Member queried whether all of the local authorities who were part of the TPF would be consulted with regard to any proposals to change the governance of the structure of the Fund. The Panel was advised that the Administering Authority would take advice in respect of this issue.

In response to a query with regard to whether the Fund would be in a better position to resist the Government's proposals if it was a separate unit, it was not thought that it would make a great deal of difference.

ORDERED that the report be noted.

7 **TREASURY MANAGEMENT REPORT**

A report by the Chief Finance Officer was submitted, which included detail of the management of the Fund's cash balances, including the methodology used.

The counterparty list and associated limits as at 30 June 2015 was detailed at paragraph 6.1 of the submitted report. It was highlighted that the Fund did not have any cash invested with the Co-operative Bank at the current time. As at 30 June 2015, the Fund had £177.7m invested with approved counterparties at an average rate of 0.454%. A graph attached at Appendix A to the report showed the maturity profile of cash invested and the average rate of interest obtained on the investments for each time period. As an example, 20.9% of the Fund's cash investments were repayable in the period 2 weeks to 1 month at an average interest rate of 0.296%.

ORDERED that the report be noted.

8 **PERSONAL SHARE DEALING REPORT**

The Chief Finance Officer submitted a report in accordance with the Management Agreement to report on personal share dealing activity.

Members were advised that as part of the requirements of the Management Agreement officers were required to report all personal share dealings to the Head of Investments and Treasury Management who was responsible for maintaining the register for such dealings.

On 24 August 2015, the purchase of 108 Vodaphone ordinary shares and 104 BP ordinary shares were undertaken and reported to the Head of Investments and Treasury Management.

ORDERED that the report be noted.

9 **DRAFT EXTERNAL AUDIT REPORT**

The Chief Finance Officer submitted a report to inform Members of the Final Report on the Annual Audit carried out by the Fund's external auditors, Deloitte LLP, for 2014/15. Representatives from Deloitte presented the report, which summarised the principal matters that had arisen from the audit for the year ended 31 March 2015.

The Panel was advised that this was Deloitte LLP's final year as the external auditor of the Authority following the transition of the Audit Commission contract in 2015/2016. Deloitte LLP would however ensure a smooth transition to EY, the Council's new auditor from 2015/2016.

It was noted, that upon receipt of the draft accounts, the materiality of the Fund was determined as £25.2m (2013/14 £22.7m) with a reporting threshold of £504k (2013/14 £188k). When the planning report was issued materiality was estimated at £16.2m based on the most recent net assets valuation and information from other auditors at the time of issuing the planning report.

The final review and close down procedures could not be completed until the day of the signing of the Final Report. The signed letter of representation would be completed on the day that the accounts were signed.

The representative from Deloitte confirmed the auditor's independence and advised that the proposed fee for the audit for the current year was £29k which was in line with the Audit Commission's scale of fees. An additional fee of £8k relating to the 2013-2014 audit had been agreed with management and had been approved by Public Sector Audit Appointments Ltd.

In terms of the Key Audit Risks, it was highlighted that the calculation of contributions, the calculations of benefits paid, the valuation of investments and the management override of controls had been included as areas of significant risk.

In terms of contributions, testing had been completed with satisfactory results. As part of the testing process in respect of benefits, the Auditors had noted an extrapolated error relating to benefit liabilities not accrued for of £1,696,000. This had been included in the schedule of misstatements at Appendix 1 to the report. All other testing had been completed with satisfactory results.

As part of the testing of equities, the auditor noted an under valuation of £789,000 compared to the valuation provided by the custodian. This had been included within the schedule of misstatements at Appendix 1. The auditor was still waiting to receive two of the four banking letters that had been outstanding. In terms of management override of controls, from the auditor's testing of a risk based sample of journals and a review of minutes, they did not consider management's estimates to be unreasonable and nor had they identified any evidence of bias.

The report included, at Appendix 5, a copy of the Letter of Representation which the Section 151 Officer would be required to sign on behalf of the Administering Authority. It was highlighted that the annual report for the financial year for which the statements were prepared contained hyperlinks to some documents and the auditor had been unable to form a view on them.

The Panel Members confirmed the following:

(i) That they were not aware of any significant facts relating to any fraud, or suspected fraud which may affect the Fund;
(ii) That the Section 151 Officer was authorised to sign the Letter of Representation;
(iii) That the auditor be authorised to report to the Chair when the two outstanding banking letters had been received.

ORDERED that the report be accepted for the purpose of signing off the extract in the Middlesbrough Council accounts.

7 **ANY OTHER BUSINESS – TRAINING**

The Chair advised that details of the LGPS Training Fundamentals courses were now available. The Panel was advised that the training would be beneficial to all Members, in particular the third day of the training which looked at future developments and national legislation. He requested that details of the training be circulated to all Members of the Panel.

NOTED