TEESSIDE PENSION FUND & INVESTMENT PANEL

A meeting of the Teesside Pension Fund & Investment Panel was held on 9 December 2015.

PRESENT: Councillors S E Bloundele (Chair), J Rostron (Vice Chair); R Brady, J G Cole, D P Coupe, J Culley, T Lawton, D McCabe and G Purvis

Other Local Authority Members:

Councillor J Lindridge - Hartlepool Council
Councillor N Bendelow - Redcar and Cleveland Council
Councillor J Beall - Stockton Council

PRESENT AS OBSERVERS: Councillor N Walker - Chair of Teesside Pension Board
Mr G Whitehouse - Member of Teesside Pension Board

ALSO IN ATTENDANCE: Auditors - Ernst Young: D Houghton
Employers' Representative: Peter Fleck
Investment Advisors: F Green and P Moon
Property Advisors: A Owen and A Peacock
Unison: A Watson

OFFICERS: P Campbell, B Carr, M Padfield and K Rose

APOLOGIES FOR ABSENCE: Councillor N Hussain, Councillor J Rathmell, Councillor A Shan.

DECLARATIONS OF INTERESTS

Name of Member	Type of Interest	Item/Nature of Interest
Councillor J Beall - Stockton Council	Non Pecuniary	Member of Teesside Pension Fund
Councillor B Brady - Middlesbrough Council	Non Pecuniary	Member of Teesside Pension Fund
Peter Fleck	Non Pecuniary	Member of Teesside Pension Fund
Councillor J Lindridge - Hartlepool Council	Non Pecuniary	Member of Teesside Pension Fund
Councillor J Rostron - Middlesbrough Council	Non Pecuniary	Member of Teesside Pension Fund

1 MINUTES - TEESSIDE PENSION FUND AND INVESTMENT PANEL - 16 SEPTEMBER 2015

The minutes of the meeting of the Teesside Pension Fund and Investment Panel held on 16 September 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 16 September 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 16 September 2015.

Market prices had lowered in anticipation of the Federal Reserve increasing interest rates on 17 September 2015, however the anticipated rise in interest rates failed to materialise and the current uncertainty about the future of interest rates provided uncertainty in the market.

The Panel was advised that there was net disinvestment of approximately £66m in the period, compared to net disinvestment of £77m in the previous reporting period. Cash balances had decreased from £190m to £132m. 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 September 2015 at £2,938 million, compared to the last reported valuation of £3,123 million as at 30 June 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. They drew Members attention to the current volatility in markets and both expected this volatility to continue. Comments were also made on the investments made on market weakness during the quarter ending 30 September 2015 and both Advisors were pleased to see this action taken.

In the UK, the news flow from the Autumn Statement was dominated by the recalculation of future tax receipts. However, this news and other positive economic data had not transferred into the UK's major equity market (FTSE 100) which had lagged behind the other major markets. This was due to the comparative size of its Oil & Gas and Mining Sectors which over the past year had tracked lower with their underlying commodity process. This underperformance, compared to other markets, provided a buying opportunity in this market.

European markets and the Euro currency were dominated by political news. The threat from ISIS and the refugee crisis had dragged the markets and currency lower in spite of the European Central Bank's latest stimulus package.

The US economy continued to recover well which has strengthened the US markets and the US Dollar. There had not been an increase in interest rates yet, but the economic data and recent statements from the Chair of the Federal Reserve all indicate an increase was imminent. The response in the markets and to the US Dollar will be interesting and would provide an indicator for potential future rises.

Looking further afield, concern was expressed over China and the recent news of its falling economic growth rate, and the general uncertainties and fears for their economy. Brazil and Russia's commodity backed economies continued to be weak and would only recover once commodity prices picked up. Only India out of the emerging BRIC economies showed any strength at present.

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 would be an opportunity to invest further in equities on a company specific basis. If equity markets strengthened, this would be 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.

NOTED

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 CBRE's mandate as Property Advisors to the Fund began in January 2012. CBRE had held a Strategy Review meeting with the Fund Manager and the Fund Advisors following which, the current direct property strategy had been reviewed.

The Panel was advised that to date:-

- 61% of the original 2012 portfolio had been sold, which included 20 assets, representing an average of £1.3m;
- 50% of the current portfolio had been acquired by CBRE and this included 10 assets amounting to an average of £8.1m;
- The void average had reduced from 15% in October 2012 to 0% to date;
- The Average Weighted Income to lease expiry had increased from 9.2 years to 10.8 years;
- The 3 Year Total return to March 2015 was 10%.

The Panel was advised that the total value of the Fund's direct property portfolio as at 30 September 2015 was £171.68m and the indirect portfolio was valued at £25m outside of the CBRE mandate.

The portfolio was made up principally of prime and secondary assets and comprised of 23 mixed-use properties, located throughout the UK. This reflected an overall Net Initial Yield of 5.34%, and an equivalent yield of 5.52%.

From January 2016, the agreed strategy was to continue to manage the portfolio as existing, growing over a two year period where opportunities permitted.

The Fund would continue to maintain an overweight position in industrial and retail, aligned with an underweight position in respect of offices.

Acquisitions would be made having regard to location, the quality of the tenant(s) and investment yield.

The Fund would continue to acquire prime assets which typically would have a lower risk profile than the IPD Quarterly Universe average and dispose of smaller, higher risk assets.

ORDERED that the report be noted.

5 **ANNUAL REPORT AND ACCOUNTS**

The Chief Finance Officer submitted a report to present to Members the 2014/2015 Annual Report and Accounts for Teesside Pension Fund.

The Accounting Services Manager made particular reference to the following:-

Page 25 - Total membership of the Fund as at 31/3/15 was 68,054. The number of Active Members had decreased by 1,168 and there had been an increase of 411 in the number of pensioners. The number of Deferred Members had risen from 22,144 to 24,429, an increase of 2,285.

Page 45 - This set out the summary Fund Accounts for the year ended 31/3/15.

There had been a decrease in income from Contributions of just over £4m since 2013/2014. The cost of benefit payments had risen from £111m to £121m.

Transfers In had fallen by £25.9m. This was because of the bulk transfer of Durham Probation Service after its merger with the Teesside Pension Fund in 2013/14. The cost of Leavers had increased by £75m as a result of the members of the Durham and Tees Probation Trust transferring to the Greater Manchester Pension Fund. Investment income had risen by £5.5m due to the strong rise in equity markets during 2014/15.

The Panel was advised that the presentation of Management Expenses had changed in 2014/15. This was due to a new CIPFA requirement to disclose Oversight and Governance costs separately. The 2013/14 figures had been restated for comparative purposes.

The financial performance report highlighted that there had been a significant increase in Management Expenses between 2012/13 and 2013/14.This was because of new CIPFA guidance that required transaction costs to be included in Investment Management costs from 2013/14 onwards. When these costs are excluded, the cost of managing the Fund is comparable to previous years.

In terms of the overall position of the Fund, net assets stood at £3.2 billion as at the end of the 2014/15 financial year, an increase of £195m from 2013/14.

ORDERED that the 2014/2015 Annual Report and Accounts for the Teesside Pension Fund be noted.

6 **2015 INVESTMENT GOVERNANCE OVERVIEW**

The Chief Finance Officer submitted a report to inform Members of action taken in implementing the Fund's policy on Shareholder Investment Governance, as required by the Fund's Business Plan; to report on how the Fund had voted at Company Meetings over the past year; to provide an update on initiatives undertaken in collaboration with other Funds and to outline the options available when the Fund's current Shareholder Governance Advisory contract expired in September 2016.

The Panel was advised that the Fund used a Shareholder Governance Service (currently Pensions Investment Research Consultants - PIRC) to vote on behalf of the Fund in accordance with the Fund's Governance Policy.

A summary of votes cast in respect of companies in which the Fund was a shareholder was reported to the Investment Panel. The voting outcomes were shown in Appendix A for the period 1 October 2014 to 30 September 2015. The Panel was advised that a full copy of the report was available on the Teesside Pension Fund website.

It was highlighted that the Fund on its own could only have a limited impact on voting outcomes and board actions. For that reason, it collaborated with other Local Government Pension Schemes (LGPS) via the Local Authorities Pension Fund Forum (LAPFF). Members of the LAPFF were not bound to vote collectively however resources were shared to engage with companies to ensure that best Board practice was followed and that any other concerns could be raised. At the beginning of each year, LAPFF agreed a Work Plan to identify where resources would be directed to achieve the best effect.

A copy of the LAPFF Work Plan for 2015/2016 was attached at Appendix B to the report. The key objectives included:

- The need to hold companies accountable for a true and fair view of their financial position;
- The need to hold companies responsible for transparent tax practices, tax reform and disclosure; and
- The continued support for energy, carbon and environmental risk management strategies.

The Panel was advised that the Shareholder Governance Advisory contract was due to expire on 30 September 2016. The contract had historically been commissioned for a 4 year period at a fixed price. Tenders were invited from service providers with a proven track record in the delivery of voting and advice services to LGPS.

The Fund had previously tendered for a contract which involved voting on UK companies only. The Fund currently held more funds in international equities than UK. There were significant savings both contractually and internally in voting in respect of UK stocks only and the votes had greater effect in the UK. The Panel was advised that in terms of value for money, a continuation of the current arrangements in respect of voting on UK companies only, provided the most cost effective option.

ORDERED as follows:-

1. That the Shareholder Investment Governance voting report be noted.

2. That the Fund Managers be authorised to commence the tendering exercise for the provision of a UK Equity Shareholder Governance Service for a further 4 years.

7 **REFORM OF LGPS INVESTMENTS – UPDATE**

The Chief Finance Officer submitted a report, the purpose of which was to update Members with regard to:-

- The response to the consultation (Opportunities for collaboration, cost savings and efficiencies), published on 25 November 2015;
- The statements made in the Budget and Conservative Party conference;
- The Investment Reform Criteria and Guidance for collective investment vehicles published on 25 November 2015; and
- The new consultation (Revoking and replacing the LGPS Management & Investment of Funds Regulations 2009) published on 25 November 2015.

In September 2013 a report had been submitted to the Panel to update Members with regard to the structural reform of the LGPS and Teesside Pension Fund's response to the consultation 'Call for Evidence' (CfE). 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 the receipt of the responses to the CfE, the DCLG had commissioned Hymans Robertson (Hymans) to carry out research to quantify and compare the costs and benefits of fund merger and asset pooling. The report from Hymans had been published at the same time as the last LGPS consultation (Opportunities for collaboration, cost savings and efficiencies). Hymans 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). Their analysis demonstrated that this was the most cost effective and easiest to implement option.

Hymans had also analysed the benefits of managing listed assets passively, as opposed to 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 and active management was where it was believed that assets were mis-priced and the benchmark index could be bettered through stock selection. The Panel was advised that TPF managed its assets actively.

Following the meeting of the TPFIP held on 16 September 2015, a response to the consultation was published. The agreed response was that the TPF should continue to retain the decision making over investment management arrangements. The consultation response was published on 25th November 2015 and was attached at Appendix A to the report.

As part of the Chancellor's last Budget Statement, the Chancellor had advised that the Government would work with LGPS administering authorities to ensure that they pooled investments to significantly reduce costs, while maintaining overall investment performance. The Government would invite local authorities to submit their own proposals to meet common criteria for delivering savings. A consultation which would be published later in the year would set out detailed criteria together with backstop legislation which would ensure that those authorities that did not come forward with sufficiently ambitious proposals would be required to pool investments.

The Panel was advised that the criteria was evolving. It was proposed that there would be pools of up to six LGPS across the country not less than 25b in size. Funds could make strategic allocation decisions and could dictate whether to invest in UK or overseas equities. Everything was subject to negotiation including when the pools would be created and how they would be created.

It was suggested that a special meeting of the TPFIP be scheduled for February to bring forward a proposal in line with the guidance. The consultation would be split into two parts:

Proposal 1 - Adopting a local approach to investments which meant changing the current 2009 Regulations from the prescriptive limits on investment assets to a prudential approach. In order to demonstrate this, Funds would be required to replace their Statement of Principles with an Investment Strategy which must cover the following:-

- The requirement to use a wide variety of investments (diversification);
- The Fund's assessment of the suitability of particular investment and types of investments;
- The Fund's approach to risk, including how it will be measured and managed;
- The Fund's approach to collaborative investment, including the use of collective investment vehicles and shared services;
- The Fund's environmental, social and corporate governance policy; and
- The Fund's policy on the exercise of rights, including voting rights, attached to its investments.

Proposal 2 - Introducing a safeguard (Secretary of State power of intervention); the backstop legislation to ensure that all LGPS Funds pool their assets otherwise the Secretary of State would intervene and run the investment function of those Fund's that failed to pool.

A formal timetable had not yet been announced however the expected timeline was as follows:-

- Consultation (including backstop legislation - 25 November 2015;
- Consultation response and initial pooling proposals - 19 February 2016;
- Proposed date for new draft regulations - 1 April 2016;
- Refined and completed pooling submissions - 15 July 2016;
- Administering Authorities to publish a new investment Strategy Statement (replacing the Statement of Investment Principles) - 1 October 2016;
- Establishing collective investment vehicles - 1 April 2018;
- Transfer of liquid assets (estimate) - 1 October 2018;
- It was proposed that illiquid assets and existing property were to remain with individual Funds until they were either sold or reached termination. - On-going.

The Head of Investments and Treasury Management advised that guidance was required from the Panel to determine whether it was acceptable to move forward with a smaller sub-group consisting of the Chair of TPFIP, the Head of Investments and Treasury Management, an Investment Adviser and another Member of the TPFIP.

A Member suggested that the Panel should build into the formal consultation process, consultation or engagement with employers in the Fund. The Head of Investments and Treasury Management advised that employers could be contacted to ask for comments on the proposals. It was suggested that the Senior Finance Officers from the other local authorities in the Fund could be co-opted onto the Panel. The Panel was advised that it would be better if a small Sub-Committee was established to determine which pool the TPFIP would fit into. The importance of early engagement of the major employers in the Fund was emphasised.

The Chair advised that he had attended a training day where a senior civil servant had advised that if any LGPS did not adhere to the deadlines that had been set; the Secretary of State would intervene. The Chair advised that it would be July when the Fund would make the final decision with regard to the pooling submissions.

It was suggested that the Sub-Committee provide a response to the employers and the consultation and that the Finance Officers of the four major employers be contacted with regard to the response. The Head of Investments and Treasury Management advised that it was important that the TPFIP take a lead on this issue. Different Funds would have different objectives and those Funds that were in deficit would have different priorities to those that were fully funded. There could be opportunities for active management and this would be similar to how the TPFIP currently operated.

ORDERED as follows:

1. That Members note the report and a Special Teesside Pension Fund and Investment Panel meeting be arranged for early February 2016 before the response to the consultation is required to agree a proposed response.

2. That work on determining options on collaborating with other LGPS Funds in putting together pooling arrangements be progressed, and that these options be considered at the proposed special meeting of the Panel in February 2016.

8 **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 September 2015 was detailed at paragraph 6.1 of the submitted report.

As at 30 September 2015, the Fund had £118.97m invested with approved counterparties at an average rate of 0.495%. 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, 15.14% of the Fund's cash investments were repayable in the period 2 weeks to 1 month at an average interest rate of 0.400%.

ORDERED that the report be noted.

9 **EXTERNAL AUDIT TRANSITION**

A report was submitted by the Fund's new Auditor, EY, to advise Members of the arrangements with regard to the External Audit Transition.

The Panel was advised that for the financial year ended March 2016, EY would be replacing Deloittes, the Fund's previous External Auditor, following a tendering process for the Audit Commission contracts.

EY were currently responsible for the audit of 18 local government pension scheme audits, nationally and were one of only five audit firms carrying out audits in respect of local government pension schemes.

An overview of the Members of the Audit Team and a summary of the Team's experience was provided by Daniel Houghton, Manager of the Audit Team.

EY had reviewed the Fund's Annual Report for 2014/2015 and other information on the Fund's website, in order to develop a detailed understanding of the issues facing the Fund. The Auditors were liaising with the Fund's previous external auditor to obtain access to all the key documentation to assist in ensuring that there would be a smooth transition.

EY had held introductory meetings with the Head of Investments and Treasury Management and the Finance Manager at Kier Pensions Unit in order to understand the challenges involved in the 2015/2016 audit. EY had also met with Councillor N Walker, Chair of the Teesside Pension Board and Councillor Bloundele, Chair of the Teesside Pension Fund and Investment Panel. EY also intended to meet with Tees Valley Audit and Assurance Services to develop an approach of working together.

The Auditor advised that EY would provide the Panel with any report they were required to produce in line with auditing standards including the following:-

- Fee letters;
- Audit Plan;
- Reports to those charged with governance; and
- Annual Audit Letter.

The Auditor confirmed that EY would also share any publications produced by their technical team and provide training on any topics that the Panel considered necessary. EY would also be in attendance at the March 2016 and September 2016 Panel meetings.

The report included an overview of the Auditor's proposed approach to the Teesside Pension Fund audit.

ORDERED that the report be noted.

10 **REPORT ON PERSONAL SHARE DEALING**

The Chief Finance Officer submitted a report in accordance with the Management Agreement to inform Members of 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 28 September 2015, a purchase of 100 Vodaphone ordinary shares was undertaken, and in accordance with the above agreement the purchase of the shares had been reported to the Head of Investments and Treasury Management.

ORDERED that the report be noted.