TEESSIDE PENSION FUND COMMITTEE

A meeting of the Teesside Pension Fund Committee was held on 12 December 2018.

PRESENT: Councillors Bloundele, (Chair), Brady, McGloin, D Rooney, Rostron and Walters

Other Local Authority Members:
Councillor Beall, Stockton Borough Council

ALSO IN ATTENDANCE: K Ettles, AON Hewitt
D Booth, P Campbell and A Stone, BCPP
A Martin and A Owen, CBRE
P Moon and W Bourne, Investment Advisors
G Coates and P Mudd, XPS

OFFICERS: W Brown, S Lightwing, N Orton, J Shiel

APOLOGIES FOR ABSENCE were submitted on behalf of Councillors Coupe, Lewis, Mohan.

DECLARATIONS OF INTERESTS

Name of Member	Type of Interest	Item/Nature of Interest
Councillor Beall	Non Pecuniary	Member of Teesside Pension Fund
Councillor Beall	Non Pecuniary	Agenda Item 19 - Named Substitute Member of the Tees Valley Combined Authority
Councillor Brady	Non Pecuniary	Member of Teesside Pension Fund
Councillor D Rooney	Non Pecuniary	Member of Teesside Pension Fund
Councillor Rostron	Non Pecuniary	Member of Teesside Pension Fund

1 MINUTES - TEESSIDE PENSION FUND COMMITTEE - 19 SEPTEMBER 2018

The minutes of the meeting of the Teesside Pension Fund Committee held on 19 September 2018 were taken as read and approved as a correct record.

2 STATEMENT FROM THE CHAIR

The Chair read out the following statement:

'As you know, the Committee decided over a year ago to allocate up to 5% of the fund to local investments, provided suitable investments could be found that would meet the Pension Fund's requirements in terms of risk and reward.

The main idea of local investments is to try to identify ways that the Pension Fund can help to regenerate the local area whilst still meeting its prime goal of getting good risk-adjusted investment returns.

It is absolutely vital to ensure confidentiality is maintained when evaluating local investments, otherwise (for example) information could be leaked which will give a competitive advantage to other organisations that may also look to acquire that investment opportunity. Failure to maintain confidentiality could jeopardise the whole local investment programme.

Since the last Pension Fund Committee meeting it has come to light that information on local investments that was circulated confidentially at that meeting has since appeared on the 'Middlesbrough Uncovered' Facebook page and has also been used to draft a letter sent anonymously to the resources directors of Stockton, Hartlepool, Redcar and Cleveland and Darlington Councils.

The letter and the Facebook page both quoted figures included in a confidential report circulated at the last Committee meeting. The letter also contained significant factual inaccuracies - for example saying that the Fund had decided to go ahead with an investment that was in fact rejected.

When information is leaked in this way it damages the Pension Fund's image as a credible investor as well as potentially providing a financial advantage to competitors. I am sure no-one on this Committee would want to undermine the Pension Fund or the local Investment programme by leaking confidential information. However, owing to the suspicion that the leak has come from within this Committee I have felt the need to give this message.

Thank you'.

NOTED

3 **INTRODUCTION TO NEW INVESTMENT ADVISORS, BORDER TO COAST CIO/CRM, AON AND XPS**

The Chair welcomed all present to the meeting and a round of introductions was made.

4 **FUND MANAGER'S REPORT**

A report of the Strategic Director Finance, Governance and Support was presented to inform Members how the Investment Advice recommendations were being implemented and to provide a detailed report on transactions undertaken and the Fund's valuation.

The Fund continued to favour growth assets over protection assets. It was considered that in the long run, Bond yields would rise, but at present and while central bank intervened in the Bond markets, through quantitative easing, yields did not meet actuarial requirements for the Fund and should continue to be avoided at around these levels unless they were held as a short term alternative to cash. The Fund had no investments in Bonds at this time.

At the June 2018 Committee it was agreed that, a maximum level of 20% of the Fund would be held in cash. Cash levels at the end of September 2018 were 17.7% The Fund would look to use this cash to move away from its overweight position in equities and invest further in Alternatives. If the value of other asset classes fell, particularly Equities, there was a possibility that the short term cash level could rise over the maximum set.

Investment in direct property should continue on an opportunistic basis where the property had a good covenant, yield and lease terms. A property costing approximately £16m was purchased in the quarter.

Investment in Alternatives, such as general and local infrastructure and private equity, offered the Fund diversification from equities and bonds. They came with additional risks of being illiquid, traditionally had costly management fees and investment could be a slow process. However the Fund was considerably underweight its customised benchmark and should look to increase its allocation in this asset class up to the customised benchmark. No new commitments were entered into this quarter. A summary of Equity Returns in the period was provided at paragraph 4.5 of the submitted report. It was highlighted that the second column showing the percentage return should be dated October 2017 to September 2018.

Appendix A to the submitted report detailed all transactions for the period 1 July 2018 to 30 September 2018. This period included the transition of the Fund's UK Equity Portfolio to Border to Coast and the Fund's US and European Equity Portfolios to State Street. There were net sales of approximately £9m in the period, this compared to net sales of £199m in the previous reporting period.

As at 30 September 2018, the Fund had £717.5m invested with approved counterparties at an average rate of 0.68%. This was an increase of £26.7m over the last quarter. The Strategic Director Finance, Governance and Support had authorised the following highlighted change in the Treasury Management Principles (TMPs) to the criteria for the approved counterparty list:

'Those banks, from Denmark, Finland, Norway or Sweden, with £5bn in assets (rounded to the nearest £100m), which also had a rating at least equivalent to AA-, and their wholly owned subsidiaries.'

The Fund Valuation detailed all the investments of the Fund as at 30 September 2018 and was prepared by the Fund's custodian, BNP. The total value of all investments, including cash, was £4,160 million. This compared with the last reported valuation, as at 30 June 2018, of £4,096 million.

An analysis of the summary valuation showed the Fund's percentage weightings in the various asset classes as at 30 September 2018, compared with the Fund's customised benchmark and the advisors' short-term asset allocation range.

For the first time the Fund now had passive equity investments and had agreed to aim for a ratio of 50:50 active to passive equity investments through investment into the Border to Coast Overseas Developed Markets Equity sub-Fund. The ratio at the end of September 2018 was 45:55 active to passive. For the longer term, the plan was divest a significant amount from equities, reducing the Fund's equity weighting to 50%.

The Fund did not have any investments in Bonds at the current time and the level of cash invested was 18%. Cash would be reduced through investment into other asset classes in the near term. In addition cash was being used to supplement the gap in contribution receipts and pension payments. However, in the medium to long term a planned programme of investment would be required to cover the gap rather than using cash.

The current strategy for property was to increase direct property investments by £50million on an opportunistic basis.

A number of investment opportunities in infrastructure and private equity funds were being considered. In the medium to long term, it was proposed that commitments would be made through Border to Coast once their sub-Funds were available. It was agreed at the September 2018 meeting that the Fund would commit £100 million in year 1 and £50 million per year for the subsequent 4 years to infrastructure to Border to Coast. The Fund was also looking at options for investing in secondary market funds in private equity at an amount of between £100 and £200 million.

ORDERED that the report was noted.

5 **EXTERNAL MANAGERS' REPORTS**

The Head of Pensions and Governance presented a report to provide Members with quarterly investment reports in respect of funds invested externally with Border to Coast Pensions Partnership Limited (Border to Coast) and with State Street Global Advisers (State Street).

Border to Coast had an active UK equity portfolio which aimed to produce long term returns of 1% above the FTSE All Share Index. The Border to Coast report, attached at Appendix A to the submitted report, showed the market value of the portfolio as at 30 September 2018 and the investment performance over this initial quarter.

State Street had a passive global equity portfolio invested across four different region tracking indices appropriate to each region. The State Street report, attached at Appendix B to the submitted report, showed the market value of the State Street passive equity portfolio and the proportions invested in each region as at 30 September 2018. Performance figures were also shown in the report: for Japan and Asia Pacific ex Japan these figures dated back 10 years, as the Fund had been investing a small proportion of its assets in these regions passively for some time. For North America and Europe ex UK the figures only covered a number of days as this represented a new investment for the Fund. The nature of passive investment - where an index was closely tracked in an automated or semi-automated way - meant deviation from the index should always be low.

The Fund held equity investments over the long-term, and performance could only realistically be judged over a significantly longer time-frame than a single quarter. However, it was important to monitor investment performance regularly and understand the reasons behind any under or over performance against benchmarks and targets.

ORDERED that the report was noted.

6 **INVESTMENT ADVISORS' REPORTS**

The Fund had recently appointed Peter Moon and William Bourne to act as its independent investment advisors. The advisors would provide written and verbal updates to the Committee on a range of investment issues, including investment market conditions, the appropriateness of current and proposed asset allocation and the suitability of current and future asset classes.

Written summaries of current market conditions had been provided by both advisors and verbal updates were given at the meeting.

ORDERED that the information provided was received and noted.

7 **CBRE PROPERTY REPORT**

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

In summary property fundamentals were still broadly as they were with the exception of retail. It was likely there would be some short term volatility next year.

At 30 September 2018 the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £282.58m. This reflected an overall Net Initial Yield of 5.38%, and an Equivalent Yield of 5.54%.

There were no sales in Q3 2018. The Fund acquired Congleton Retail Park in Q3 2018. The Fund purchased the property for 6.50% NIY, equating to a net purchase price of £15.1m. The Fund recently exchanged and completed on 16/20 High Street and 3 Bedford Street, Exeter for 4.74% NIY, equating to a net purchase price of £23.5m. As this property completed in early October, this acquisition was not reflected in the summary portfolio figures contained in the report.

The total Collectable Arrears on the entire portfolio was £61,457.69 at 12 October 2018. However that had now been reduced to £20,527 after further payments had been received. The Collectable Arrears excluded tenants that paid their quarterly rent in monthly instalments and were up to date with payments, tenants that were insolvent, those with new charges raised within the last month and those with overall credit balances on their accounts. Of the Collectable Arrears, 71.4% related to three tenants and the remaining 28.7% related to 23 different tenant accounts; all of which were being pursued for payment.

The Direct Property Portfolio held by the Fund was valued at £282.58m (Sept 2018), equating to 6.9% of the overall Fund value. The Fund's level of real estate exposure was generally considered underweight, compared with similar pension funds.

The Chair, on behalf of the Committee, thanked CBRE representatives for their hard work in increasing the Fund's property portfolio, securing good tenants and reducing rent arrears.

ORDERED that the report was noted.

8 **ASSET LIABILITY STUDY – UPDATE (AON)**

A Funding Update was provided by AON Hewitt. The Fund was in an excellent position following the 2016 valuation and funding levels had improved significantly. As at 31 March 2018 the funding level was 112% with £421.1m surplus.

The funding level had been driven by strong equity returns and there had been a strong appreciation in equity markets over quarters 2 and 3 of this year. There had been a fall in equity markets since September which would have reduced the funding position but it was estimated that it would be similar to that at the end of March. A graph showing the equity market performance from 31 March 2016 to 6 December 2018 was included at page 4 of the submitted report.

The markets were now in a transition phase and there was likely to be a period of volatility. It was anticipated that returns would be more modest than in recent years due to a reduction in liquidity in global markets. Eventually bonds could outperform equities. Whilst yields were currently low they would rise and this would impact negatively on the value of equities and bonds. There was however, potential in alternative assets. The transition phase had started to some degree in quarter 4 with significant reductions in global equities.

The Fund had previously agreed to reduce its equity allocation quite significantly by 15% and re-invest into alternative assets. Details of the asset classes were provided on page 7 of the submitted report. Figures showing the efficiency of the alternative strategy relative to the existing strategy were also included in the report.

In summary, AON's view, in line with the External Advisors' advice, was to continue to recommend and support the Fund's move into Alternative assets from equities.

ORDERED that the information provided was received and noted.

9 **EQUITY PROTECTION – (AON)**

The Committee received a detailed presentation from AON Hewitt in relation to Currency Hedging and Equity Options. A copy of the presentation was tabled at the meeting for Member's information.

The Chair confirmed that no decision with regard to investment was required by the Committee today and that the presentation was for information only at this stage. Further consideration would be given to options at a future meeting.

ORDERED that the information provided was received and noted.

10 **FUNDING STRATEGY STATEMENT, INVESTMENT STRATEGY STATEMENT & OFFICERS' SCHEME OF DELEGATIONS**

A report of the Strategic Director Finance, Governance and Support was presented which sought approval for revised wording for Funding Strategy Statement and the Investment Strategy Statement prior to their circulation to stakeholders for comments. The report also requested approval of the revised Officers' Scheme of Delegation.

The proposed revised wording for the Funding Strategy Statement was enclosed as Appendix A to the submitted report and the material differences from the previous version were as follows:

- Treatment of surplus revealed at an actuarial valuation was clarified. In particular it was made clear that in normal circumstances tax-raising employers would be able to use surplus to reduce their contributions below the cost of accruing benefits by spreading the surplus element over the maximum period for deficit recovery.

- Employers with guarantors who were in surplus or deficit when they exited the Fund would normally have that surplus or deficit transferred to the guarantor.

- Where an exit calculation was required, the Statement confirmed this can only commence once the necessary data had been supplied to the actuary.

- The Fund's target strategic benchmark had been updated to reflect the new details set out in the revised Investment Strategy Statement.

The proposed revised wording for the Investment Strategy Statement was attached at Appendix B to the submitted report. The material differences from the previous version were as follows:

- Reference was made to the Deputy Section 151 Officer in the roles and responsibilities.

- The Fund's long term target strategic asset allocation was updated in line with the proposal agreed at the 19 September 2018 Committee meeting.

The revised wording for the Officers' Scheme of Delegations was attached at Appendix C to the submitted report. The material differences from the previous version were as follows:

- The job roles and titles were updated to reflect changes within the team.

- The role of the Deputy Section 151 Officer was included to reflect new reporting lines.

- The stock limits had been increased to reflect the larger values typically involved in trading pooled funds instead of individual stocks.

Once the revised wording was approved, the Funding Strategy Statement and Investment Strategy Statement would be circulated to relevant stakeholders (principally the scheme employers) for comments. Following consultation if there were no significant amendments, the documents would be published in final form on the Fund's website. If significant amendments were requested, the documents would be brought back to the Committee for approval before publication.

ORDERED that the revised Funding Strategy Statement, the Investment Strategy Statement and Officers' Scheme of Delegation were approved.

11 **SHAREHOLDER GOVERNANCE REPORT**

The Head of Pensions Governance and Investments presented a report on action taken in implementing the Fund's policy on Corporate Governance.

The Fund's 2018/2019 Business Plan required that an annual report on voting activity was presented to the Committee.

A detailed report of the Fund's voting activity for the period October 2017 to July 2018 was available on the website www.teespen.org.uk The report was produced by the proxy voting advisory service advisory, PIRC.

The report provided a summary of voting activity by issue. In addition PIRC reported on voting outcomes where there was notable dissent (greater 10% of votes cast as opposed).

The Fund's UK equities transferred into a Border to Coast Pension Partnership internally managed fund in July 2018. However, the Fund remained responsible for corporate governance. As holder of the equities, Border to Coast carried out shareholder voting on behalf of the Fund, using a Corporate Governance Policy, collectively developed and agreed between all of the funds in the Pool. Border to Coast had engaged Robeco to support them, in the same way that PIRC assisted the Fund previously.

The Fund was in the process of developing a Responsible Investment Policy, which would encompass environmental, social and governance issues. The Policy would dovetail with the policies of external providers such as Border to Coast and State Street Global Advisors. An update would be provided at the next Committee meeting.

ORDERED that the report was noted.

12 **BORDER TO COAST RESPONSIBLE INVESTMENT POLICY AND CORPORATE GOVERNANCE VOTING GUIDELINES**

A report was presented to update the Committee on recent changes made by Border to Coast Pensions Partnership Limited (Border to Coast) to its Responsible Investment Policy and Corporate Governance Voting Guidelines. Copies of the policies were attached as appendices to the submitted report.

To allow a practical and consistent approach to pooled investments, Border to Coast had developed a Responsible Investments Policy and a Corporate Governance and Voting Policy for all twelve Partner Funds to approve that could be applied across all the investments held on their behalf.

Both policies had recently been updated and approved by Border to Coast Joint Committee and did not contain any changes to underlying principles. They had been updated following feedback from Border to Coast's voting and engagement partner, Robeco, to enable clearer implementation of the policies and reflect a more global (rather than UK-centric) approach to engagement. They also reflected the changes required to facilitate Border to Coast becoming a signatory to the UN Principles for Responsible Investment (UNPRI).

Border to Coast recognised that the best way to influence companies was through engagement rather than disinvestment. Collaboration with other like-minded investors, such as other Funds, Pools or via the Local Authority Pension Fund Forum (LAPFF) had a greater impact and could lead to better long term performance.

In response to a query as to whether engagement was preferable to disinvestment, the Chair confirmed that this issue had been discussed at the Committee and the proposals were supported unanimously.

As the holder to the equities, shareholder voting had been delegated to Border to Coast on behalf of the Partner Funds. Voting rights would be used to support good governance. Border to Coast aimed to vote in all markets in which it participated, where practicable. The voting record was public information and would be made available on the Border to Coast website. A quarterly voting and engagement report would be presented to the Committee.

ORDERED that the report was received and noted.

13 **XPS - ADMINISTRATION REPORT**

A report of the Strategic Director of Finance, Governance and Support was presented to provide an overview of administration services provided to the Teesside Pension Fund by XPS Administration, previously Kier Pensions Unit.

A copy of the Service Delivery Report was attached at Appendix A to the submitted report and provided information in relation to the work undertaken by XPS Administration as well as progress on recruitment to posts relating to the improvement to services.

A verbal update was provided at the meeting which included an overview of the service, additional work completed, complaints, performance statistics, customer service and recruitment.

ORDERED that the information provided was received and noted.

14 **EXCLUSION OF PRESS AND PUBLIC**

ORDERED that the press and public be excluded from the meeting for the following items on the grounds that, if present, there would be disclosure to them of exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 and that the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

15 **BORDER TO COAST UPDATE AND ALTERNATIVES**

A presentation was provided by Border to Coast Pensions Partnership Ltd which included a progress update report , alternative assets overview and private equity primer.

ORDERED that the information provided was received and noted.

16 **LOCAL INVESTMENTS UPDATE**

A report was presented that provided an update on local investments.

ORDERED that the report was received and noted.

17 **CUSTODIAN CONTRACT**

The Committee was informed that discussions were underway with a view to changing the Fund's Custodian.

NOTED

18 **PENSIONS OMBUDSMAN APPEAL AND HIGH COURT REFERRAL**

The Committee was provided with an update in relation to a Pensions Ombudsman Appeal and High Court Referral.

NOTED