

PENSION BOARD

MINUTES of a meeting of the Pension Board held at CC1, County Hall, Lewes on 8 September 2015.

PRESENT Richard Harbord (Chair), Angie Embury, Councillor Kevin Allen, Sue McHugh, Councillor Brian Redman, Tony Watson and David Zwirek

ALSO PRESENT Marion Kelly, ESCC Chief Finance Officer; Ola Owolabi, Head of Accounts & Pensions; John Shepherd, Finance Manager (Pension Fund); Wendy Neller, Pensions Strategy & Governance Manager; Jason Bailey, SCC Pension Services Manager; Giles Rossington, Senior Democratic Services Adviser; Harvey Winder, Democratic Services Officer

1 MINUTES OF THE MEETING HELD ON 10 JULY 2015

1.1 The minutes of the 10 July 2015 meeting were approved.

Matters Arising:

1.2 Brian Redman (BR) asked for clarification of 3.2 in the draft minutes: whether Pension Board (PB) members who are also members of the LGPS needed to declare this as an interest. Giles Rossington (GR) told members that his advice was that this should not be deemed a prejudicial interest. However, members were free to declare a personal interest if they wished.

1.3 BR asked, regarding 4b.5 in the minutes, why PB members had been told at their last meeting that an up to date report from Hymans was not available to view, when Pension Committee (PC) had received such a report at its meeting. Ola Owolabi (OO) told members that the report had been issued shortly after the last PB meeting. The report showed no significant change in the fund's position, other than some improvements. The report is now linked to the PC committee papers on the council's website. Marion Kelly (MK) apologised for not ensuring that the report was circulated to PB members when it was released.

1.4 BR also enquired about forecast administration costs (point 5b.3 in the minutes). Officers agreed to provide a brief update on this matter at the next PB meeting.

2 APOLOGIES FOR ABSENCE

2.1 There were none.

3 DISCLOSURE OF INTERESTS

3.1 There were no declarations of interest.

4 PENSION COMMITTEE AGENDA

4.1 MK explained that the planned PC strategy session was an annual deep-dive focusing on investment performance over the past year. The session also presented a training opportunity in terms of what makes an effective pension fund, with expert independent input. In general, performance over the past 12 months has been good, but PC members will still need to decide whether the fund needs to change its strategy. This may involve opting to receive additional training in order to better understanding some investment options (e.g. property) before making decisions on the strategy. The PC may also take the opportunity to exit agreements with specific Investment managers.

4.2 The Chair noted that he was encouraged by recent fund performance, and by the percentage of the Pension Fund that was actually funded. He also found it refreshing that so much of the debate around the East Sussex fund was conducted in public, including the PC strategy session, which PB members could attend should they wish. This openness is in contrast to the way in which many other Local Government schemes are managed.

4.3 Sue McHugh (SM) asked how the ultimate aims of the fund are agreed. MK told members that this is via the strategy. The degree to which the strategy needs to be altered will depend on the fund's performance. Given the recent good performance, there may be relatively little need to make major changes, although decisions may well need to be made around crystallising recent gains. Employers are consulted on strategic issues via the annual Employers' Forum, but there is also a key role to be played by employer representatives on the PB.

4.4 SM questioned whether PB, and hence employer representatives sitting as PB members, would have an input into any plans to vary the strategy. MK noted that PC was the decision-making body in terms of the strategy, although she was not anticipating any fundamental changes being made. However, MK recognised that it was important to engage with employers. In the future these may include offering the opportunity for employers within the scheme to adopt differing investment strategies. The Cheshire LGPS is currently exploring this idea, although it would inevitably lead to increased Investment fees.

4.5 SM noted that she did not think it was the case that employer objectives were out of line with the fund strategy, but it would be helpful to have a more explicit understanding of how the fund calculated and managed risk both in the short and longer term. DZ echoed this.

4.6 The Chair added that there was a significant employer interest in the triennial actuarial evaluation also. This was particularly so because an individual employer's pension deficit might be very different from the liability profile of the entire fund, meaning that their preferred investment strategy might be at odds with that of the best strategy for the fund as a whole.

4.7 Angie Embury (AE) asked whether PC members were trained to make these key strategic decisions. MK told the Board that there was a considerable body of experience on the PC, and that this would be reinforced by additional training, but during and around the strategy event. The Chair added that the PC also had access to independent expert input from Hymans.

4.8 BR queried why the training event was public when it had previously been flagged as a private session. MK responded that it had been decided to run this year's session in public, but other options might be explored for future events.

4.9 DZ stated that, although recent performance has been good, longer term performance has been less impressive. It is important to recognise this, given the long term nature of the Pension Fund. MK agreed, adding that the key point was why performance had improved in

recent years. OO pointed out that the fund was now working with a more diverse group of Investment Managers than in previous years.

4.10 Cllr Kevin Allen (KA) asked how it could be that the fund was consistently outperforming against its benchmark, but underperforming when compared with the 'Local Authority Universe'? MK responded that it must be borne in mind that the East Sussex fund is well-funded in comparison with most LGPS funds. Consequently, the East Sussex fund takes fewer investment risks than other funds, which may well result in lower than average returns in years where higher risk investment choices have tended to be successful. Measuring performance against the benchmark or against other LGPS schemes may therefore be less relevant than assessing performance against the fund's strategic objectives.

4.11 Considering the statistical information included in the presentations for PC, PB members noted that some of the data was hard to understand, particularly so for graphs with unlabelled axes. SM remarked that it was difficult for PB to advise PC when PB members could not possibly comprehend the data in question. The Chair recognised that PB was looking at presentation slides rather than the full presentation, and that there would almost certainly be additional explanation provided during the actual presentations to PC. However, in future, it was important that material to be shared with PB was presented in a more accessible format (e.g. that graphs were correctly labelled). Officers agreed to work with external advisors to ensure that this was the case with future presentations.

5a OFFICERS' REPORT - BUSINESS OPERATIONS

5a.1 Jason Bailey (JB) told the Board that the Business Operations report included information intended to contextualise the data. He would be interested to know if members found this helpful. JB also noted that it was not currently possible to report benchmarking information on scheme administration costs as this information has not yet been released by CIPFA.

5a.2 In response to a query from DZ on vacancies, JB told members that he has hopeful that the imminent move from Uckfield to Lewes would increase the recruitment pool. Two new staff members have recently been recruited, but there are still two vacancies; and it may well be that they team, even with its full complement of staff, is slightly understaffed.

5a.3 JB told the Board that there was a significant backlog of deferred benefits to be calculated. There was a resource issue here, and the team would struggle to make up this backlog with current staffing levels.

5a.4 JB stated that providing prompt responses was a priority – it was not acceptable that people should be left waiting for information, particularly as people may be under significant stress when they contact the team. It should be noted that the team does prioritise the most urgent requests. Also the planned introduction of member self-service will give members more flexibility in accessing their pension information.

5a.5 In response to a question on complaints from TW, JB told members that the team received very few complaints. It may be that many members are in fact quite relaxed about the time taken in answering queries, or are unaware of service targets.

5a.6 JB told the Board that there has been positive feedback from employers following the launch of Pensions Web, although more work needs doing within ESCC Business Operations Management to start processing in this way. Wendy Neller (WN) commented Pensions Web is up and running, feedback from employers to the Fund has been good, as an example B&HCC are utilising Pensions Web well. WN commented that it was important that ESCC, as one of the largest employers in the Fund start utilising the system as soon as possible in order to realise

efficiencies. This in-turn would reduce the need for additional recruitment and improve processes. WN commented in addition that it was important to realise other efficiency savings which could be made within the administration such as Pensions to Payroll interface and barcoding.

5a.7 KA commented that it seemed as if some slightly more realistic service targets were required. JB agreed, and noted that the targets used were probably based on industry-wide benchmarks identified some time ago . However, given current financial pressures, it did make sense to challenge whether the targets accurately reflect key performance areas.

5a.8 JB told members that the annual benefit statement had been produced to a challenging (statutory) timescale. The initial deadline had been missed, but this was not something likely to impact upon scheme members.

5a.9 The Chair commented that, despite the best efforts taken to make the annual benefit statement comprehensible, it was still an extremely complex document. DZ agreed, but noted the inherent complexity of the information that had to be presented.

5b OFFICERS' REPORT - GENERAL UPDATE

5b.1 **Cash Flow.** OO told members that the forecast cash flow for this financial year is currently very close to target.

5b.2 **National Update.** OO told members that there had been much discussion around pooled investments, with East Sussex playing an active role in national debates as well as talking with SE7 partners. The Government is expected to launch a new consultation in the near future, with schemes being asked to comment on proposals that will require them to show how they are reducing costs and working effectively with other schemes. There is the possibility that the Government will go beyond this and insist on formal pooling of schemes. This would potentially be accompanied by 'backstop legislation' obliging schemes which do not come forward with their own proposals to pool in any case. Therefore, even if schemes are not enthusiastic about pooling, they need to be active in exploring its potential or else risk being obliged to adopt a standard pooling arrangement.

5b.3 DZ noted that this seemed to run counter to moves to 'individualise' scheme strategies – e.g. offering bespoke strategies to each employer. MK commented that the focus was likely to be more on encouraging joint procurement of investments in particular asset classes as a way of reducing Investment Manager fees across the whole LGPS.

5b.4 The Chair added that London Boroughs have already formed a common investment vehicle. However this does risk reducing future flexibility.

5b.5 DZ commented that moving to a 'mega' LGPS fund would surely risk distorting the market. MK agreed, suggesting this may be why the Government has moved away from proposing a single Local Government fund in recent months. The Chair noted that, if funds were pooled, then it would be important to spread investment risk by using common investment vehicles; it is important that we recall the lessons learnt from the collapse of BCCI and the consequent exposure of some local authorities who had over-invested in a single product.

5b.6 TW asked whether fees could be reduced by doing more work in-house? MK responded by saying that it was possible to run passive investment in-house, but doing so would be likely to cost more than using an external provider. This might be different for pooled funds, but it was important to recognise that pooling arrangements were complex and took time to negotiate – for example, the London arrangements had taken four years to agree. There is little or no scope to manage active investments in-house. Whilst pooled funds might enable schemes to lever

savings in active investment costs, this would probably only be delivered by a significant scaling up – e.g. a single national fund for absolute return investments.

5b.7 Exit Payment Cap. OO also explained that the Government was currently consulting on an exit payment cap, limiting total payments to public sector employees leaving a post. MK commented that, although ostensibly designed to limit payments to very senior officers, the proposed £95K cap could also hit long-serving mid-managers.

5b.8 TW commented that the cap would make it more difficult for organisations to get rid of poorly performing managers. The Chair agreed, pointing out that it would be particularly difficult to dispense with Chief Executives in the future should organisations be effectively barred from offering an attractive exit-package.

5b.9 MK told members that an ESCC response to this consultation would be agreed by Governance committee. Unfortunately there has been a very short window to respond to this consultation, and many local authorities have not responded at all.

5c OFFICERS' REPORT - INVESTMENT MANAGER FEES

5c.1 OO told members that this report had been requested at the last PB meeting. It should be noted that the issue of Investment Manager fees has been examined closely by the Pension Fund Investment Panel in past years. It was difficult to benchmark the performance of individual Investment Managers because the size and complexity of investments undertaken by any given Manager varied so much both between and within schemes. It was also important to understand Investment Manager fees in the context of the recent significant increases in fund value.

5c.2 DZ argued that ESPS Investment Manager performance was actually not all that impressive given the fact that markets had been rising for several years. The scheme should look for an Investment Manager willing to work for considerably less than those currently contracted. It must also be borne in mind that, whilst the annual fees of any single Investment Manager might not seem excessive, over the past 5 years the scheme had paid £49.1m in fund manager fees; however, the fund value has increased by £744.1m over the same period.

5c.3 TW asked how we compare with other schemes. OO replied that we benchmark well in terms of fees as a percentage of total assets managed. DZ noted that this may be so, but this may only indicate that all schemes are being exploited by Investment Managers. MK commented that it was important here to distinguish between different types of Investment Manager. Fees for actively managed funds are much higher than for passive investments. This is particularly so in the instance of absolute return funds, where the complexity of mitigating the inherent risks involved in investing in equities is held to justify high fees. MK also noted that Investment Managers typically claim that they do not charge Local Authorities any more than they would any other investor.

5c.4 TW asked what the likely result would be if the ESPS unilaterally announced that it intended to reduce the fees it paid to one or more Investment Managers. The Chair thought it would be unlikely that Managers would accept a fee reduction in this way, or that alternative Managers would offer to run similar funds for much lower fees. It would not be in Investment Managers' interest to do so in response to a single scheme, so any action on behalf of Local Government schemes would need to be sector-wide.

5c.5 The Chair noted that Pension Committee would be discussing Investment Manager performance at its next meeting, particularly in relation to Lazard where it is anticipated that PC may opt to appoint an alternative Investment Manager or to allocate the assets currently managed by Lazard to other funds. Should the preferred course of action be to appoint a new Investment Manager, then there will be an opportunity to push for one which can offer significantly lower fees than those currently charged by Lazard.

5c.6 SM agreed that this represented some real opportunities. There was also the possibility that Investment Manager fees could be more intelligently linked to performance – e.g. performance above a benchmark rather than the current relatively crude system which tends to reward Investment Managers simply for operating in a rising market. The Chair noted that there was a risk in tying fees more closely to performance in that it might tend to encourage Managers to take imprudent investment risks in order to increase their fees.

5c.7 RESOLVED – that Pension Board recommends to Pension Committee that, should it opt to seek a new Investment Manager for the assets currently managed by Lazard, every effort should be made who can offer the scheme better value for money (i.e. charging lower fees than Lazard).

6 SUBSTITUTE MEMBERS ON THE PENSION BOARD

6.1 Members discussed whether they should recommend to Governance Committee that no substitutes should be permitted on the Pension Board; that all representatives should be permitted substitutes; or that substitutes should be allowed for only some representatives (i.e. the Trade Unions).

6.2 Marion Kelly pointed out that, whilst it would be relatively straightforward for some Pension Board members to nominate substitutes (e.g. the Unions and Brighton & Hove City Council); it would be considerably more difficult for the other members because they represent a number of organisations or individuals who would need to be canvassed before a substitute could be appointed. There would inevitably be an expense involved here. The Chair noted that Governance Committee should be made aware of any cost implications before making its final decision on this matter.

6.3 Councillor Brian Redman (BR) commented that allowing substitutes risked undermining the effectiveness of the Pension Board, as substitute members, even if they were fully trained, would not have been party to previous Board debates and would inevitably lack an understanding of the interpersonal dynamics that had developed between members. He therefore opposed having any substitutes.

6.4 Councillor Kevin Allen (KA) stated that his preferred option would be to permit substitutes. Brighton & Hove City Council could readily appoint an experienced substitute, and this would ensure that the council was represented should Cllr Allen be indisposed.

6.5 Angie Embury (AE) stated that Unison did not intend to appoint a substitute for her, but that she was content for other members to have substitutes.

6.6 Sue McHugh commented that it would be tricky to identify a substitute for her as the representative of 90+ employers, and doing so would involve a disproportionate amount of work for a very limited benefit. However, she had no objections to other members having substitutes.

6.7 Tony Watson stated that he saw no pressing need for substitute members, and thought that the issue could have been avoided had the Trade Unions lobbied harder for an additional employee representative on the Board. However he was not opposed to members having substitutes.

6.8 The Chair, Richard Harbord, stated that his personal preference was for there to be no substitutes. However, he was prepared to accept substitutes for all voting members provided it was understood that they were to be used only *in extremis* and were not to be viewed as alternates. All Board members agreed that should substitutes be permitted, they must not be viewed as alternates.

6.9 David Zwirek commented that his preference was for all members to be permitted substitutes. He would be content with only the Trade Union representatives having substitutes if this was the preferred option; but he could not support the position that no substitutes should be permitted, as it was essential that employees were represented should he be unable to attend a meeting.

6.10 Pension Board members were unable to agree unanimously on a position regarding substitutes, but did agree to refer the matter to Governance Committee, with all members agreeing to accept Governance Committee's decision.

6.11 **RESOLVED** – that Governance Committee be asked to determine definitively the issue of allowing substitutes on the Pension Board, bearing in mind the comments made by Pension Board members.

7 PENSION BOARD FORWARD PLAN 2015/16

14.1 PB members discussed their training requirements, agreeing that their preference was to have a biannual training day (where possible) alongside colleagues from the Pension Committee. Officers agreed to discuss this with Pension Committee members.

8 ANY OTHER BUSINESS

(The meeting ended at 12:15pm)

Richard Harbord
CHAIR