Minutes: Part 1 Pensions Panel held on 2 February 2015

Attendees: Mr Michael Brown (Chairman), Mrs Deborah Urquhart, Dr James Walsh, Mr Andrew Smith, Mr Peter Metcalfe, Mr Bernard Smith, Mr Daniel Sartin and Mr Nigel Peters

Apologies: Mr Michael Jones

In Attendance: Tim Stretton, Vickie Hampshire, Rachel Wood and Caroline Burton (Independent Adviser to the Panel), Steven Law and Paul Potter (Hymans Robertson)

Welcome and Apologies

1250. David Bailey was welcomed to the meeting as a member of the public observing Part I of the agenda.

1251. Apologies had been received from Michael Jones.

1252. The Chairman reminded the Panel that there would be a session after lunch led by Aberdeen Asset Management to provide training on property portfolio management. This would count towards the Panel's training requirement.

Declaration of Interests

1221. Members and officers were invited to make any declaration of personal or prejudicial interests that they may have in relation to items on the agenda and are reminded to make any declarations at any stage during the meeting if it becomes apparent that this may be required when a particular item or issue is considered.

1222. It is recorded in the register of interests that:

- Mr Brown's son is a Director of Deloitte
- Mrs Urquhart is a Governor of Chichester College and on the Board of the South Downs National Park Authority
- Mr. A Smith is a deferred member of Mercers
- Dr. Walsh is a Member of Littlehampton Harbour Board, Arun District Council and Littlehampton Town Council.

These financial interests only need to be declared at the meeting if there is an agenda item to which they relate.

Approval of Part I Minutes of the Pensions Panel held on 7 November 2014 and matters arising

1253. The minutes were agreed.

1254. The Panel asked whether there had been any update on the active v passive consultation or on the governance regulations.

1255. The Chairman advised that the Regulations had been laid on governance changes. On initial reading there did not appear to be any crucial changes to what West Sussex had assumed when formalising its Terms of Reference. However officers would make further enquiries and consult the Head of Law and Governance and the Scheme Advisory Board before providing a note to all Pension Panel Members later this week. Pension Panel Members would also be advised when the member and employer recruitment process starts. The Local Pension Board must be established by 1 April and be operational four months after.

1256. Nothing further has been provided following the Government's consultation on active v passive management. It was suggested that any response is likely to be after the election.

Application of Administering Authority Discretions

1257. The Deputy Director of Finance introduced the paper. The paper was a standard report for noting. There had been several flexible retirements authorised by employers in the Fund. Where a flexible retirement is granted, any strain cost is chargeable to the employer. Regarding Administering Authority discretions, attention was drawn to the large number of employers joining the fund, principally through maintained schools converting to Academies.

1258. The Chairman noted that the Local Pension Board could have a role for the application of discretions in the future.

1259. The report was noted.

Asset Liability Modelling by the Actuary

1260. The Fund Actuary started his presentation by recapping on the decisions made by the Pension Panel to date specifically:

- To maintain a 2/3 or better chance of success of being fully funded (in an on-going basis) over 20 years.
- To de-risk when the Fund approaches full funding.

1261. The Actuary considered that de-risking was highly desirable when nearing a fully funded position and were of the opinion that this could be done within the current mandates albeit with costs of 20-40bp associated with transaction costs for switching from equities to bonds. It was emphasised that de-risking was not about moving to a purely stabilised portfolio. Even when fully funded, the investment portfolio would still need to return 1.6% over gilts (over the long term) so there was still a need to hold a decent amount of growth assets (i.e. c.60%).

1262. Responding to questions the Actuary advised that the discount rate is current very volatile but continues to be very low at less than 3%. This means that the hurdle for investment returns is quite low but also that liabilities are highly valued. In real terms German Government Bonds have a negative interest rate.

1263. The Pension Panel contrasted the current funding position (89%) to the highs of 2014. The Actuary indicated that the fall in the funding position was primarily liability driven. The assets were doing fine compared to his assumptions and were the reason that the funding position had been maintained compared to the 2013 valuation.

1264. The Fund Adviser considered that the decision was between higher long term returns and protection against short term volatility. Stabilising assets can be expected to return more than gilts, but would still have an expected return well below growth assets. In addition the Adviser noted that some assets classed as bonds can be as volatile as equities during a crisis.

1265. Following the discussions by the Pension Panel in October and November 2014 the Fund Managers were asked to consider further how de-risking may be applied within the existing mandates. The Actuary had summarised their comments but noted that the full documents were available from officers.

- Baillie Gifford considered that de-risking may be desirable when the Fund approaches full funding. However the Pension Panel would need to consider the effects of a lower growth strategy on returns. The key driver of volatility was asset allocation and not management style, or active v passive investment approaches. Within the current mandate, Baillie Gifford suggested that the equity allocation could be reduced in favour of bonds or revise the bond holding to better match liabilities.
- UBS were generally supportive of moving away from growth assets if de-risking. For substantial shifts from growth, UBS considered there would be a risk of losing some market return and the potential additional return from active management. If more material changes were considered then this would require a change to the mandate. They Actuary noted that he was not proposing that a change to the mandate was considered.

1266. The Actuary outlined his principles for a de-risking plan, namely that it should be simple, straightforward by working within existing mandates, long term goal oriented and cost effective. The presumption should be that when a funding level trigger is met the Fund should de-risk. Whilst the Panel were supportive of this approach they considered that it should not be a completely mechanistic process and should consider the factors applicable at the time.

1267. The Actuary proposed a de-risking plan which reduced growth assets to 70% when the funding level reached 95%. At this point the target

contribution rate would be reduced from 19% to 16.5% to allow employers to share in the success of the Fund, which the Chairman had indicated he was keen to consider in previous conversations. The next step would be to reduce growth assets to 60% when the funding level reached 105%. At this point the target contribution rate would be reduced from 16.5% to 14%. The Actuary indicated that it would be doubtful if it would be possible to reduce growth assets below 60% as the Fund still requires some equity risk and return to keep contribution rates low. The Pensions Panel discussed whether a single trigger at 100% would be more appropriate.

1268. The Panel considered that it was important for a decision to de-risk should not be dependent on the quarterly meetings but that an emergency meeting would be difficult to coordinate. Therefore the Panel considered that a virtual consultation or a delegation to the Chairman with corroboration by the Pensions Panel were more appropriate.

1269. The Actuary also considered when the Fund should re-risk when the funding level falls below 85%. At this point the Actuary considered that it would be appropriate to revise the contribution target or increase growth assets, or a combination of the two. In re-risking, it would not mean that de-risking was the wrong decision. The Actuary considered that this should be a looser step and could delay until a conversation for the Pensions Panel at a quarterly meeting, rather than requiring the urgency of a de-risking scenario.

1270. The Panel agreed the principles of the de-risking strategy.

1271. The Panel agreed that the process when a trigger is met should be a discussion between advisers, officers and the Chairman with any action taken corroborated by the Pensions Panel at the meeting following the action.

1272. The Panel commissioned officers and advisers to consider what the lower risk strategy might look like and the type and frequency of trigger monitoring, the governance issues, the cost of implementation (transaction and officer and Member time) and employer issues. On this latter point the Pension Panel considered that the presumption should be to retain a simple structure rather than a plethora of bespoke strategies for employer.

Signed:

Date: