Nottinghamshire County Council

Report to Pensions Sub-Committee

16 July 2015

Agenda Item:

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

NAPF LOCAL AUTHORITY CONFERENCE 2015

Purpose of the Report

1. To report on the NAPF Local Authority Conference 2015 held in the Cotswolds.

Information and Advice

2. The NAPF Conference 2015 was held on 18th to 20th May 2015 at the Cotswold Water Park Four Pillars Hotel in Gloucestershire. In accordance with prior approval and as part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills; the conference was attended by Councillor Parry Tsimbiridis and Mr Nigel Stevenson (Service Director – Finance and Procurement). The theme of this year's conference was Building a Strong and Sustainable LGPS.

3. ***Europe the Final Chapter***
   The conference commenced with a fringe meeting looking at how LGPS funds may be directly affected by whatever happens to investment markets after the Election when the UK's future membership of the EU will hopefully have become clearer. Funds may also face a changed legal landscape if EU membership is renegotiated, the so called BREXIT 2017. Experts from Squire Patton Biggs, AXA Investment Managers and Surrey County Council discussed the legal and investment ramifications of this key political question and also investigated the potential impact on asset allocation from LGPS fund perspective.

4. ***Joanne Segars, Chief Executive, NAPF***
   The main conference began with Joanne Segars welcoming everyone to the Conference and setting the tone for the event. She indicated that we now find ourselves in a period of more rapid change; with the scheme changes implemented in April 2014 (the CARE scheme), the changes to governance from April 2015, the work undertaken on the 'call for evidence' and fund mergers review and the continued pressure on LGPS funds to find savings in investment management fees.

5. ***That deflationary feeling: the outlook for the economy***
   With UK inflation reaching a record low and interest rates expected to only rise gradually, in this session Stephen King, Group Economist, HSBC provided his view on the prospects for both the UK and global economy over the next three years, and what this would mean for investors looking to get the "biggest bang for their buck".

He indicated that there were a number of oddities in the UK economy, including low inflation, negative real interest rates, central banks apparent lack of understanding of what is going on, the ever too optimistic view by forecasters of changes in GDP and UK's productivity still being poor post the financial crisis.

The key messages from Stephen were that interest rates were unlikely to rise for some time, growth would be weaker than it was, investor returns have been pumped by QE and there is a continued gap between financial hope and economic reality.

During questions Stephen alluded to the fact that history indicates that an increase in trade agreements has fed growth in global GDP, e.g. post war between Japan, USA and Europe, and in the 1990s with China reforms and the fall of the Berlin Wall; hence potential that increase in agreements with Africa, Southern Asia and Central Europe may boost GDP again. He believes Central Bankers would like to increase interest rates but for the fault lines that exist in the economies. His final concern was that, if there is another crash, then the ammunition to fight its effects may not be there.

6. ***Preparing for the 2016 valuation – benchmarking the LGPS***
The 2016 valuation will be critical to the sustainable future of the LGPS. This session was led by Graeme Muir, Partner, Barnett Waddingham, and looked at what funds can be doing to prepare and how the valuation process might change as a result of cost control and an increased focus on benchmarking across funds.

In short this was a brief run through the various valuation models and what questions they are trying to answer. He then concentrated on the discount rates used in the various models and the different results this may produce for similar funds. These results are justifiable for the funds concerned but this does not aid comparisons. Hence, if the question is one of comparison of funding level to determine good from bad then the LGPS has to agree one discount rate to be used in the model (solely for comparison purposes but not for the valuation). However, it is important to remember that funding level is not the only measure of determination of good from bad as this would include issues such as governance, deficit recovery plans, contribution rates and asset allocation.

7. ***Concurrent Sessions***
A number of concurrent sessions were delivered:
a) Hidden risks: genuine cost savings
Chaired by Kevin McDonald, Director, Essex Pension Fund, this session looked at the drive to make cost savings. In a world of increased austerity, scrutiny and potentially lower returns, minimising leakages is key. LGPS funds may be ignoring hidden risks. The hidden risks may not grab the headlines but there are genuine, quantifiable savings out there. Jo Holden, UK Head of Public Sector, Mercer and Clare Scott, Investment & Pensions Service Manager, Lothian Pension Fund set out their views on the pitfall of poor employee and employer provided data.

b) Advanced beta and the changing local government investment landscape
Chaired by Helen Forrest, Policy Lead: DB, NAPF, this session explored how to build an equity allocation that combines active investment styles (risk factors) with transparent and cost-effective passive implementation. It also explored active relative performance and how advanced beta will change the conversation with your active manager.

Ana Harris, Portfolio Strategist, State Street Global Advisors and Peter Wallach, Head of Pensions, Merseyside Pension Fund presented their views on how traditional passive management and active management (Alpha) could be enhanced by the use of Advanced Beta or Smart Beta (i.e. expanding valuation data to include factors such as volatility, size, momentum and quality). Unfortunately, Ana's presentation was distracted by analysis that translated historical passive data into a 'what if' they had used Advanced Beta technique. Overall this is an investment vehicle that sits between passive and active management and will attract corresponding management fees.

Peter indicated that Merseyside are only looking at one particular fund, however they have used a fund that included factors such as volatility in stock selection. Unfortunately, although this showed that during turbulent times it didn't go down as much as traditional passive funds, since its inception in 2009 this fund has performed below the benchmark.

c) Avoiding the bunkers as you navigate through change
Chaired by Nick Buckland, Head of Treasury & Pensions, Dorset County Pension Fund this session explored why more and more LGPS are employing transition managers and the benefits that effective transition management brings to a fund. It also looked at how transition management has evolved from simple manager changes to interim asset management assignments and bespoke derivative strategies.

Chris Adolph, Head of Transition Management, Russell Investments and Fiona Miller, Head of Pensions and Financial Services, Cumbria County Council set out in their presentations that use of such managers can potentially reduce costs when transitioning from one asset class to another, particularly when using hedge funds to lessen the impact of various risks such as inflation and exchange rate risks. However, this does depend on the volatility of changes to asset classes and the exposure to such risks.

8. ***Public service pensions reform: five years on***
The Rt Hon Lord Hutton of Furness, Chair of the Independent Public Service Pensions Commission reflected on the outcome of public service pension reform and whether the 25 year deal will really stick.

He started his speech by indicating that his review ran out of time to discuss the merger of funds. His good news was:
- The new LGPS is up and running with pensions for public servants at an affordable level for taxpayers
- There is little political appetite to go over this again
- 5m new pension savers added to the scheme, in part due to auto-enrolment.

The focus now for Government was to improve governance, improve transparency, efficiency and individual fund performance. The longevity of members is a worry to the LGPS as members live longer than in many other pension schemes. Consequently, the agenda for change is still here. Funds need to be more efficient. The argument of small is beautiful doesn't wash nor the argument of local accountability. His view is funds should merge and move more to passive management. However, he recognised that there is a need to concentrate effort more on poor performing funds.

He also saw the move to greater pension freedoms extending into LGPS which would allow members to withdraw money from DB schemes into DC schemes or to withdraw money as per DC schemes. He also indicated that employer contribution rates would inevitably need to be reviewed due to the cost cap and these potential new flexibilities.

In response to questions, Lord Hutton indicated that any incoming Government would have to do something to reform the LGPS. He felt this new Government would do it sooner rather than later. He ruled out the possibility of the Government taking the LGPS assets. In response to a question on the figure quoted for savings on management fees being unrealistic and the size of them being minuscule when taking into account performance, Lord Hutton indicated that the figure quoted is now in Ministers heads and that's the figure they want whatever the evidence.

He finished by indicating that he felt Pension Boards will fill the gap on scrutiny and are needed to make improvements in governance.

9. ***Concurrent Sessions***

A number of concurrent sessions were delivered.

a) What does good administration look like?

Chaired by Helen Forrest, Policy Lead: DB, NAPF, this session looked at one of the issues that the new local pension boards are likely to be exploring: what does good pensions administration in the LGPS look like? This session gave a chance to hear from members of the Shadow Scheme Advisory Board's Administration Committee about the work they have been undertaking to enhance data quality and ensure that issues like ill-health are dealt with efficiently and effectively.

Robert Plumb, Scheme Liaison Manager, The Pensions Regulator, gave a presentation on the role of the Pensions Regulator, where Pension Boards fit in and the expected role of Scheme Managers. Robert stressed that the Regulator would focus on education rather than enforcement with the aim to raise standards; however, enforcement option was still there.

Ged Dale, Assistant Executive Director for Pensions Administration, Greater Manchester Pension Fund basically stated that the aim of the Scheme Manager should be to pay the right people the right amount at the right time. Ged then expanded upon the topic of the need to maintain and evaluate accurate member data and the processes surrounding the Internal Dispute Resolution Process which the regulator will also review.

b) Emerging markets - are we there yet?

Chaired by Phil Triggs, Surrey Pension Fund, this session looked at the fact that 2014 was undoubtedly a challenging year for many emerging markets. However, maintaining some perspective is critical for any long-term investor. In relative terms, it may not be as bad as you think and over a longer timeframe you may even be pleasantly surprised.

Devan Kaloo, Head of Global Emerging Markets at Aberdeen Asset Management, began his presentation with the facts that emerging markets had not performed as expected over the last 5 years. However, he still believes the relative strength of emerging markets in 2014 reflects a fundamental soundness of the asset class, which has been helped by the fall in oil prices. China has been striving to balance reform and growth which was now switching back towards growth. EM corporates are still profitable with scope for improvements and valuations are still attractive. Hence Devan's overall message was to "stay in the car".

Jonathan Hunt, Director of Corporate Finance & Investment, Tri-borough Director for Treasury and Pensions indicated that funds under management was £2.5bn with only a very small amount in passive indices in emerging markets, hence their exposure was relatively small. He also indicated that there were still concerns and issues on EM, such as corruption, ethics, financial regulation, transparency, accounting standards, political etc. that need to be considered when investing.

c) How can engagement contribute to long-term investment performance?
Will Pomroy, Policy Lead: Corporate Governance, chaired a panel session regarding the acknowledgement that engagement by investors with investee companies can enhance value for both parties; it is also understood that effective engagement often requires investors to be willing to act collectively. Consequently, what role will the new Investor Forum play in facilitating collective engagement and ultimately contributing to the long-term investment performance desired by pension funds?

Simon Fraser, Chair, Investor Forum, provided an update on the progress with the establishment of the Investor Forum. This was a Community Interest Company who through constructive engagement with companies, representing all investors (who are party to the IF) aim to increase company value over the long term. There was still debate on what was meant by long term and the IF's aim to include fund managers and sovereign funds, which could ultimately dilute some legitimate issues. Concern was also raised that this would replicate existing forums for discussion with companies. Simon did indicate that the largest challenge to companies is the lack of succession planning for chief executives, with some notable declines in share value following departures of recent longstanding CEOs.

Alan MacDougall, LAPFF Research and Engagement Partner, explained what LAPFF was all about. He summed it up by saying that this was about risk mitigation in companies and the role LAPFF members play in raising concerns with companies. Alan explained a number of areas where LAPFF has been lobbying for change, e.g. capital market reform, and that there had been a number of successes; although this was tempered by some challenges such as voting rights through pool funds.

Richard McIndoe, Head of Pensions, Strathclyde Pension Fund, indicated that Strathclyde was signatory to many forums that aligned to their views on engagement with companies. They had recently joined NAPF and LAPFF because the time was right for collaboration and sharing. Although he was concerned that a proliferation of forums would add to confusion of what we are trying to achieve, Richard's view was that it was through forums that issues such as environmental reporting and challenging companies to come out of denial on some of their failed investment decisions would eventually succeed.

10. ***Managing freedom in the LGPS***
Jackie Wells, Head of Policy and Research, NAPF and Helen Forrest, Policy Lead: DB, NAPF provided feedback from a survey of pension funds, including a small number of LGPS regarding the impact of the new Pension Freedoms and how individuals are approaching retirement in this brave new world. This session also aimed to provide greater clarity on some of the more confusing aspects of the legislation and reflected on how funds are managing the implementation of the new rules.

Unfortunately, this required feedback on a lot of statistics, on freedoms only just being implemented and was probably something to map over time and report at a future event.

11. ***Risky changes***
Frank Furedi, Professor of Sociology at Kent University gave a fascinating presentation exploring our capacity to manage risk and change. He also considered how rumours are spread and how media, policy think tanks and online groups influence our perception of anything from cuts in public service to terrorist threats and health scares.

12. ***Outside influences: a view from the EU***
The UK's future in the EU may be uncertain, but the EU's impact on UK pensions arguably less so. With investment and growth supposedly at the heart of the new Commission's agenda, Paul Duijsens, Strategic Advisor, ABP explained how this is influencing the vision of public service pensions in Holland.

Paul began by explaining how the pension system works in Holland. This is very similar to the UK with one notable difference in that all public employees are in a funded pension scheme managed through ABP. Granting indexation for benefits from the fund each year is a decision taken each year rather than through regulation – referred to as a defined ambition scheme. The current gap through indexation is now 10%. Pension benefits are also paid out net of the state pension.

Investment performance is similar to the LGPS, with 70% of the £350bn assets managed in-house and the remainder managed externally. For ABP, active management had demonstrated better performance than internally managed funds over the last 5 years. However, its investment management fees are 3 times that of the LGPS on only twice the size of assets.

The Dutch Government is also reviewing the pension scheme in the belief that it is too generous and expensive. They also have issues with the discount rates used for valuation purposes. The Government has difficulty in separating its role as legislator to the pension funds and its role as contributor to the ABP managed scheme. ABP is privatised but the Government still believes it can dictate contribution rates and that it should invest more in the Dutch economy.

13. ***On trend – how the LGPS invests***
Local authority fund investment strategies are coming under increasing pressure, from the outcome of the law commission report to the need to cater for increasingly diverse employers, not to mention the push towards passive. This panel session, Chaired by Joanne Segars discussed how these, often conflicting, demands are impacting on the way funds invest.

Chris Rule, CIO, LPFA, began by setting out how the LPFA strategy is to take more control over the approach to investments. This is achievable by internalising some of the management and seeking partners to pool with other LGPS funds into larger investment vehicles.

Following on, Liz Woodyard, Investments Manager, Bath and NE Somerset Council, expressed concern over affordability. Mike Jensen, CIO, Lancashire Pension Fund indicated that it is because of this that they plan over time to pool people and investments between

Lancashire and the LPFA with the ultimate aim of having one fund. This will start with collaboration leading to unitisation and pooling of investments. Obviously Chris indicated that he would welcome other LGPS joining them.

The session concluded with the audience agreeing that the current investment regulations are seen as a major block to many opportunities, a drag on investment performance and in need of urgent reform.

14. **Election Reflection**
Peter Kellner, President, You Gov, concluded the Conference by providing his views on what the new political landscape would mean for local government, pensions and the LGPS.

Apart from apologising for getting the prediction of the election result wrong, Peter echoed many political commentators' thoughts on the result of the election, what it means for the economy, welfare reform, devolution (now that the genie is out of the bottle) and the likely result of the EU referendum.

Statutory and Policy Implications

15. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATIONS

1) That it be noted that attendance at key conferences is part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills.
2) That the report be noted

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Constitutional Comments

16. Because this report is for noting only, no Constitutional Comments are required.

Financial Comments (SRC 29/05/15)

17. There are no direct financial implications arising from this report.

Background Papers
None