

North Yorkshire County Council

Pension Fund Committee

Minutes of the Special Meeting of the Committee held on 20 June 2019 at County Hall, Northallerton, commencing at 11 am.

Present:-

County Councillors John Weighell OBE (Chairman), John Blackie, Michael Chambers MBE, Cliff Lunn, Patrick Mulligan, Andy Solloway, Helen Swiers and Angus Thompson.

Councillor Jim Clark - North Yorkshire District Councils.

David Portlock - Chair of the Pension Board.

In attendance - County Councillor Carl Les - Leader of the Council

Apologies were received from Councillor Ian Cuthbertson (City of York Council).

Copies of all documents considered are in the Minute Book

120. Exclusion of the Public and Press

Resolved -

That the public and press be excluded from the meeting during consideration of Minute No. 122 on the grounds that this involves the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972, as amended by the Local Government (Access to Information) (Variation) Order 2006.

121. Declarations of Interest

There were no declarations of interest.

Minute No. 122 – Global Equity Transition - included confidential details, as outlined at Minute No. 120, and, as such, the Minute below reflects the confidential nature of some of that information.

122. Global Equity Transition

Considered -

The report of the Treasurer:-

- (i) Updating the additional due diligence work carried out on the BCPP Global Equity Alpha Fund.

- (ii) Requesting Members to finalise the allocation to BCPP's Global Equity Alpha Fund.
- (iii) Requesting Members to consider the allocation of the residual global equities within the Fund.

The Treasurer provided an initial opening statement in relation to this matter highlighting that in February 2019 the Pension Fund Committee had agreed a £1bn investment in the BCPP Global Equity Alpha Fund, based on market conditions at the time and subject to due diligence. This was around 30% of the total Fund value and around 60% of global equities. Authority was delegated to the Treasurer, in consultation with the Chairman of the Committee, to carry out the necessary due diligence on the BCPP Global Equity Alpha Fund prior to final commitment being approved.

The meeting of the Pension Fund Committee in May 2019 was provided with an update on the managers selected and their weightings in the BCPP Global Alpha Sub-Fund and details of the managers chosen were outlined.

An informal meeting of the Committee was held on 24 May 2019 and representatives of BCPP attended to provide Members with further details on the selection process for the managers, including the complementarity process and the rationale behind the final portfolio construction. Details of this were appended to the report.

As the Sub-Fund was due to launch in Quarter 3 2019 Committees had been asked to confirm their final commitment by around mid-June. This decision could not be taken, however, in May, due to short timeframes between the final due diligence information being made available and the meeting itself and it was agreed, therefore, that a special meeting be undertaken to consider this. The importance of the global equity allocation to the NYPF Strategy was of such importance that the Committee felt that additional due diligence work should be carried out before a final decision could be taken.

Since the May meeting due diligence had been carried out by AON, in conjunction with BCPP and NYPF officers, and the final report was attached as an appendix. The aim of the report was to provide Members with comfort over the selection process for the Sub-Fund and also to look into the complementarity at a Fund level to determine the optimum amount to invest in BCPP and what to do with any retained global equities.

Representatives of AON presented their report relating to the BCPP Global Equity Alpha Fund selection process. They outlined the scope of their report as follows:-

- ◆ Was there confidence in the process followed by BCPP and, therefore, comfort in making an allocation to the BCPP Global Alpha Equity Fund, subject to any further required manager level due diligence.
- ◆ Was there a strategic case for holding equity assets outside of BCPP.
- ◆ What would be an appropriate allocation to BCPP Global Alpha Fund, LTGG and other global equity funds in the short and longer terms.
- ◆ It was noted that the report did not provide full due diligence on the five individual managers and strategies selected to form the BCPP Global Alpha Fund.
- ◆ Details of the background information provided, and of that not provided, were outlined.

A Member asked for clarification about the Investment Strategy of the Pension Fund and whether de-risking the Fund was still the objective. Details were provided in clarification of this position and it was emphasised that the aim was still to de-risk the investments, however, determination of the equity portfolio was being undertaken at this meeting.

The AON report set out the following:-

BCPP Pension Pool - Global Equity Alpha Fund Selection Process

- ◆ Process review.
- ◆ Overall process.
- ◆ Technical questions.
- ◆ Value for money.
- ◆ Complementarity.
- ◆ Baillie Gifford LTGG in BCPP procurement process.

In summary AON stated that, based on the information made available, they concluded that BCPP and Mercer (BCPP's Investment Advisors) had conducted a thorough and detailed procurement process.

In respect of Baillie Gifford's LTGG strategy it was their view that the managers business stability, strong alignment and record of performance delivery were under represented in the BCPP scoring weights.

No material flaws in the structure or execution of the assessment process had been identified in the details that had been made available. A number of specific points in relation to that were set out in the report.

The analysis of the characteristics of the NYPF existing equity strategy, particularly Baillie Gifford LTGG, was that it was meaningfully differentiated from other Investment Managers. Moreover although there was some overlap with its most obvious comparator in the BCPP portfolio again meaningful differentiation was apparent which was believed to be also recognised by BCPP.

It was believed that there was a strong case that a stand-alone allocation to Baillie Gifford LTGG would represent a strategic allocation to an unconstrained growth style which was not available through the BCPP Global Equity Alpha Fund. It was noted that LTGG's focused approach had the potential to significantly under perform under some market conditions.

NYPF, working with BCPP and AON, should undertake regular reviews (at least every three years) regarding the rationale for keeping assets outside the Pool.

A detailed discussion was undertaken in relation to this matter and the following issues and points were raised:-

- ◆ Some concern was expressed by Members in relation to the procurement process undertaken by BCPP in appointing the five managers, particularly around the information that had not been released to AON, in the development

of their report to the Pension Fund Committee. Representatives of BCPP, present at the meeting, highlighted why certain information had not been provided in relation to this. The Treasurer to the Fund emphasised that whilst this was not the most advantageous position in terms of the release of information, with the time constraints in place, it realised the best position for reporting to the Committee at this time. It was recognised that there were different parameters for BCPP, than the North Yorkshire Pension Fund (NYPF) in terms of the release of information. Representatives of AON emphasised that whilst not receiving all the information requested, they received sufficient to be able to undertake an analysis of the process and to provide a report to the Committee. The Committee's Independent Investment Adviser provided his thoughts on the process indicating that he agreed with AON that a thorough and detailed process had been carried out, however, he too considered that additional information should have been provided in relation to the development of the report.

- ◆ A Member noted that full due diligence had not yet been carried out on the five appointed managers by BCPP. In response the Treasurer explained that as two different Investment Consultants were involved in the process (AON and Mercer) care had to be taken so as not to set out their different views, which in the main would be subjective. The Chairman emphasised that Members had to be aware that the discussions at this meeting would not change the managers appointed by BCPP would not change at this stage and Members should focus on how NYPF was to allocate it's funding.
- ◆ BCPP representatives indicated that they had undertaken a robust process in appointing the five managers and had taken account of the needs of all 12 Funds involved in the Pool when making their decisions. A detailed discussion was undertaken in relation to the scoring and weighting process for the appointment of the managers and concern was expressed as to some of the weighting, which appeared to favour some managers over others. The representatives of BCPP highlighted their reasons for the weightings given and how that aligned with their overall strategy. The Fund's Investment Consultants, AON and the Independent Investment Adviser to the Fund both questioned the weighting and complementarity put in place for the process, by BCPP but again emphasised that the overall process had been materially sound.
- ◆ Discussions were undertaken in relation to the non-appointment of Baillie Gifford as one of the Fund Managers to the BCPP Global Equity Alpha Fund. The representatives of BCPP highlighted the reasons for not appointing Baillie Gifford noting that they were an excellent manager and had scored well in a number of categories within the process, however, ultimately the appointed managers had emerged as being more suited to the portfolio in terms of value for money and complementarity. The discussions highlighted the reasoning behind the decision and Members concerns in respect of that. The representatives of BCPP stated that they welcomed the challenge from the Pension Fund Committee and recognised the importance of Baillie Gifford to the NYPF, however, they highlighted their explanations as to the appointment of the five Fund Managers for the portfolio in respect of this.

The Strategic Case for Holding Equity Assets outside of BCPP

Representatives of AON outlined the following:-

- ◆ They had focused on Baillie Gifford's Long Term Global Growth (LTGG) strategy because it was the type of strategy which was most clearly not

included in BCPP's portfolio. They had considered whether there was a case to maintain a strategic allocation to Baillie Gifford LTGG strategy by answering the following questions:-

- Does the strategy provide exposure to an area of the market that would be expected to outperform over the long term?
- Is the strategy differentiated compared to peers?
- Is the strategy differentiated compared to other strategies in the BCPP portfolio?
- Is the strategy different enough to the Loomis Sayles global equity opportunities to justify a stand-alone allocation?
- It was noted that NYPF, working with BCPP and AON, should undertake regular reviews (at least every three years) regarding the rationale for keeping assets outside the Pool.

A detailed discussion was undertaken in relation to this matter and the following issues and points were raised:-

- ◆ A Member asked whether money could be kept outside the Pool, by the Pension Fund, and if this was the case whether a legal challenge could be implemented. In response it was stated that the only recourse that could be undertaken in relation to this would be intervention from the Secretary of State. It was emphasised if there was a similar product within BCPP's portfolio then a challenge was more likely, however, as indicated earlier in the meeting, there is no unconstrained growth fund managers within the BCPP Global Alpha Fund.
- ◆ A Member raised concerns regarding such a large scale disinvestment with Baillie Gifford based on a flawed selection process, in his opinion. It was noted that a certain amount of the Baillie Gifford portfolio was being considered for disinvestment in terms of reducing the risk attached to the Investment Strategy of the Fund, as discussed at previous meetings and agreed by Members. It was emphasised that there were large scale risks in holding too much of the overall funds with one company, which was why the Investment Strategy was being altered accordingly.
- ◆ Clarification was provided as to how pooling was expected to operate and how, if desired, BCPP could create another portfolio to take account of the alternative global equity strategy requested by NYPF and managed that on their behalf, however, that was unlikely at this stage.
- ◆ Members recognised that there were differences between the BCPP Global Equity Alpha Fund portfolio and that sought by the NYPF in terms of the Investment Strategy, however, it was also recognised that other sub-funds being created by BCPP would be more compatible with the NYPF Investment Strategy and, therefore, investments would be put into those, going forward.
- ◆ Details of how the NYPF investment strategy differentiated compared to growth manager peers were provided within the Appendix to the report and comparisons were made to the Baillie Gifford LTGG strategy as opposed to the Loomis Sayles global opportunities, which were in the BCPP sub-fund, to determine whether the BCPP portfolio could match the aspirations of the NYPF Investment Strategy.

- ◆ Details were provided as to the information known about the Fund Managers appointed to the BCPP Global Alpha Fund portfolio.
- ◆ Members considered it appropriate to ensure that the feelings of the Pension Fund Committee were made to BCPP in relation to the process, highlighting the concerns that they had in relation to this, and why consideration was being given to investing outside of the Pool, in terms of the global alpha equity portfolio. It was emphasised that the majority of investments still had to be made with BCPP from NYPF and these would be undertaken accordingly.
- ◆ In conclusion AON believed that there was a strong case for a stand-alone allocation to Baillie Gifford LTGG which would represent a strategic allocation to an unconstrained growth style which was not available through the BCPP Global Equity Alpha Fund. It was noted that LTGG's focused approach had the potential to significantly under perform under some market conditions. If the Committee decided on this approach then, working with BCPP and AON, regular reviews would be undertaken, at least every three years, regarding the rationale for keeping assets outside the Pool.

Recommendation on Appropriate Allocation

The representatives of AON highlighted the following:-

- ◆ Retaining an allocation to LTGG understandably shifted the style balance of NYPF's global equity exposure towards growth characteristics compared to the BCPP portfolio. By also retaining Dodge and Cox and Veritas, stock selection remained the dominant contributor to active risk, which was desirable in their view, but the shift was not substantial and the case for retaining these managers, long term, and investing in the BCPP portfolio, was weak.
- ◆ Taking these matters into account, as well as seeking to reduce transaction costs as the Fund moved into a longer term position with a 10% lower allocation to equities, as agreed at the May Pension Fund Committee meeting, they proposed that:-
 - In the short term, move to a global equity split of 60% BCPP, 20% LTGG, 10% Dodge and Cox and 10% Veritas, representing a 7% (around £100m) reduction in allocation to LTGG compared with March 2019 levels.
 - In the longer term, as NYPF moved towards the strategic allocation, with a lower allocation to equities, remove the allocations to Dodge and Cox and Veritas entirely whilst keeping the full allocation to Baillie Gifford LTGG.
- ◆ The recommendations were based on the assumption that the Pension Fund were comfortable making an allocation to BCPP of around 60% of global equities (around £1.1bn).
- ◆ Furthermore they reminded Members that LTGG's focused approach had the potential to significant under perform under some market conditions.

A detailed discussion of the proposals was undertaken and the following issues and points were raised:-

- ◆ Members discussed the suggested investments and, although with some reluctance, agreed to the suggestions by AON, but requested further

discussions, at this meeting in relation to the figures for the global equity split. A Member also considered that the holding with Baillie Gifford's LTGG was insufficient.

- ◆ AON representatives outlined their rationale behind the recommendations provided and produced appropriate figures in relation to that. They explained the reasoning behind holding the investments with Dodge and Cox and Veritas in the short term. It was considered that the proposals gave some flexibility in terms of the investment sums outlined.
- ◆ An update was provided on the current valuation of the Fund and how investments had performed since the previous meeting of the Committee.
- ◆ Members suggested that an allocation of £1bn be committed to the BCPP Global Equity Sub-Fund. The remaining funding would then be allocated accordingly to Baillie Gifford's LTGG, Dodge and Cox and Veritas. It was noted that the equity protection put in place would create some cover for the risk associated with maintaining the global equities in the short term. AON representatives provided figures in relation to the suggested recommendation by Members.
- ◆ The merits of the investments held with Dodge and Cox and Veritas were discussed and the reasons for maintaining these were highlighted.
- ◆ A Member raised concerns regarding the wording within the recommendations suggesting reference should be made to investing with an unconstrained growth manager, rather than simply highlighting the specific funds in which investment would be retained. It was agreed that some alterations would be made to the wording within the recommendations to reflect this.

Resolved -

- (i) That the additional due diligence work undertaken by AON, and the content of the Appendix 2 attached to this report, be noted.
- (ii) That an investment of £1bn into the BCPP Global Equity Alpha Fund, based on current market conditions, which represents around 55% of the global equity allocation, be approved.
- (iii) That in order to ensure an ongoing exposure to an unconstrained growth manager, NYPF intends to retain an allocation of 25% with Baillie Gifford LTGG.
- (iv) That, in the short term, allocations of 11% with Dodge and Cox and 11% with Veritas be retained, with the removal of these allocations in the long term, as the Fund moved towards its lower allocation to equities.
- (v) That a review of the allocations to Baillie Gifford LTGG, alongside future options that may come from BCPP, continue to be undertaken.
- (vi) That Members outline their thanks for the additional work undertaken by the Pension Fund's advisers in relation to this matter.
- (vii) That the following statement be issued to BCPP in line with the wishes of Members as requested during the meeting:-

“NYPF has considered the BCPP Global Alpha Equity Fund and the work carried out by AON Hewitt on our behalf as part of our due diligence. NYPF remains concerned that the Global Equity Fund does not wholly meet the wishes of NYPF and its Investment Strategy. We have been very clear throughout that we wish to retain an exposure to an unconstrained growth manager and it is clear that global alpha does not contain that opportunity. We are also disappointed that some of the requests for information as part of our due diligence exercise were not met and we believe that, as both a customer and a shareholder, we should have been dealt with in an even more transparent fashion.

Our overall Investment Strategy seeks to de-risk by reducing our equity holdings and protect our healthy funding position. As a consequence of this strategy and the issues outlined above, we have decided to invest £1bn in the BCPP Global Alpha Fund but with some reluctance. The investment is subject to satisfactory explanation as to how BCPP intend to monitor the risk of concentrated ownership of the five Fund Managers within global alpha (noting that one manager accounts for 40% of the Fund and 50% of the Fund’s Managers are ultimately owned by a French bank holding company). We felt that there was insufficient weighting and consideration of ownership and culture in the selection process. We hope that the Fund is truly successful and that our reluctance turns out to be misplaced. Given that BCPP will not offer an unconstrained growth global equity fund manager, and in order to comply with its Investment Strategy, NYPF intends to retain exposure to Baillie Gifford LTGG as this is largely uncorrelated to BCPP Global Alpha. We will, of course, keep this under review and should BCPP make a suitable equity fund, with a meaningful allocation to an unconstrained growth manager, available then we will clearly work with BCPP with a willingness to transition to BCPP should the mandate meet our Investment Strategy.

We see some great opportunities for BCPP to help deliver value for NYPF in the future, particularly in alternatives, bonds and multi-asset credit etc. We would urge BCPP to strengthen the way in which it engages with its customers on such future occasions in order to ensure that BCPP succeeds as its single purpose is to deliver for its customers - the partner funds.”

The meeting concluded at 2.15 pm

SL/JR