THE HIGHLAND COUNCIL

RESOURCES COMMITTEE'S INVESTMENT ADVISORY GROUP

Minutes of Meeting of the Investment Advisory Group held in Council Headquarters, Glenurquhart Road, Inverness on Friday 23 May, 2008 at 2.00 pm.

PRESENT

Mrs P Munro
Mr F D S Black
Mr J Ford
Mr A Campbell (Western Isles Council)

Officials in attendance:-

Mr A Geddes, Director of Finance
Mr B Williams, Head of Corporate Finance, Finance Service
Mr R Niven, Principal Accountant (Treasury, Leasing & Investments), Finance Service
Mr A MacInnes, Administrative Assistant, Chief Executive's Service

Also in attendance:

Mr M Jaffray, Hymans Robertson, Investment Consultants

Mrs P Munro in the Chair

1. Apologies for Absence

Apologies for absence were intimated on behalf of Mrs C Wilson and Mrs H Carmichael.

2. Pension Fund Investment Report

There had been circulated to Members only Report No INV/2/08 dated 14 May, 2008 by the Director of Finance which highlighted the diversification of the Pension Fund's assets under the management of Baillie Gifford, Alliance Bernstein, Legal & General and Fidelity & Schroders for the quarter ended 31 March, 2008. The report also provided information on the Managers' investment performances, measured against their respective strategic benchmarks, the details of which were noted by Members.

It was reported that the investment performance of the Combined Fund for the quarter ended 31 March, 2008 showed a marginal out performance relative to the benchmark of 0.1%. Over the one and three year periods however the Fund had underperformed the relative benchmarks by 1.0% and 0.1% per annum respectively.

Following discussion on certain specific investment activities, the Committee **NOTED** the position.

3. Presentation by Hyman's Robertson, Investment Consultants

The Chairman welcomed Mr Mark Jaffray, Senior Investment Consultant from Hyman's Robertson, Investment Consultants to the meeting and the Group were given a presentation and update on a mini asset liability modelling exercise undertaken for the Pension Fund.

The Group had previously considered a mini asset liability modelling exercise and concluded that they were comfortable with the risk and return profile broadly inherent within the Pension Fund. The purpose of this part of the review was to consider ways to improve the structure of the Fund without materially changing the expected return and risk from the assets.

It was advised that the current asset allocation of the Fund (at 70% in equities, 20% in bonds and 10% in property) was heavily dominated by equities, and in particular UK equities. The heavy equity component meant that the long-term expected return from the assets relative to liabilities was a positive +4.5% per annum. However the risk inherent within the Fund was also significant at 15.5% per annum. The Fund was highly exposed to poorly performing (UK) equity returns. A number of proposals were therefore put forward to reduce the funds exposure to equity risk by diversifying some of the equities into alternative assets. In addition it was also proposed that Members consider some refinements to the current equity and bond structure of the Fund.

By way of summary and in relation to the refinements to the current equity and bond structure, it was recommended:

- *Alter the UK/Overseas equity split from 60/40 to 50/50 and to 40/60 over the longer term ;*
- *Discuss with the overseas equity managers and the global custodian hedging the currency risk in 50% of the overseas equities;*
- *Alter the overseas equity managers' benchmarks to a global market capitalisation based benchmark.*
- *Alter Fidelity Investment Services Limited's bond benchmark to a broad market based benchmark.*
- *The Property allocation should not be altered.*

The impact on the expected risk and return of the Fund of altering the UK/Overseas split to 50/50, and hedging 50% of the currency risk) was to improve further the expected return to +4.8% per annum and reduce the risk to 15.2%.

It was advised that should Members agree to the above recommendations a detailed implementation plan would be submitted to the next meeting for approval.

In relation to reducing the funds exposure to equity risk by diversifying some of the equities into alternative assets, it was proposed to:

- *Reduce the equity allocation by 10% and allocate this to 3 alternative assets – a 5% allocation to private equity; a 5% allocation to a basket of hedge funds: two active currency funds and one fund of long/short hedge funds*.

The impact of these alternative strategies on the fund would depend on the assumed ability of the underlying active manager (particularly in the case of the hedge funds and active currency funds). If assumed that the active funds achieve 50% of the active manager's target over the long term, then the expected return from the fund's assets would be increased marginally to +4.7% per annum (and expected risk would be reduced to 15.2% per annum).

It was advised that should Members wish to give further consideration to alternative assets, further training and manager presentations on private equity and active currency funds would be arranged for a future meeting.

Following consideration, the Group **AGREED in Principle** to recommend that the Resources Committee approve the recommendations/proposals shown in *italics* above, subject to discussion with the Fund's Investment Managers and Global Custodian and a detailed implementation plan to be submitted to the next meeting and further training and manager presentations on private equity and active currency funds being arranged for the Group.

4. Global Securities Lending

There had been circulated to Members only Report No INV/3/08 dated 30 April, 2008 by the Director of Finance which provided details of a proposal from the Pension Fund's Global Custodian (Northern Trust Ltd) for a global securities programme.

It had previously been agreed in principle to recommend that the Council enter into a Global Securities Lending arrangement with Northern Trust Ltd, subject to a report back with a formal proposal following discussions with Northern Trust and the Fund's Investment Managers, and an assessment of other public sector bodies' experiences in securities lending. In this respect, it was advised that Securities lending programmes were widely in place across the Scottish Local Government Pension Scheme Administering Authorities and no Authorities had experienced difficulties resulting from these arrangements although the recent market volatility had concerned some lenders. Securities lending in the UK was controlled by the Bank of England and the programmes were generally regarded as a relatively low risk means of providing income which could be applied to offset annual global custody fees. The main risk was borrower default but this was minimised by;

- restricting lending to institutions with high credit ratings
- spreading lending across a number of borrowers
- the use of collateral which is usually cash or cash-based. The collateral is re-valued daily and adjusted accordingly to reflect the value of securities lent.

Following consideration of the proposals, the Group **AGREED** to recommend to the Resources Committee:

i the introduction of a global securities lending programme with Northern Trust Ltd on the basis of an income split in the Council's favour.

ii that the amount of lendable securities be limited to a maximum of 25% of the value of the Fund; and iii this arrangement was to be regularly reviewed to take account of changing market circumstances.

5. Global Custodian – Benchmarking

The Head of Corporate Finance reported on a proposal to review the fees and performance of the Pension Fund's Global Custodian – Northern Trust by way of a benchmarking exercise using specialists from the pensions' industry.

It was advised that Northern Trust had been the Fund's Global Custodian for five years and the contract they had with the Council was open ended. Therefore it was considered appropriate that a review should be carried out to satisfy the Council that the service Northern Trust was providing and the fees they charged reflected current market standards. In this respect, Thomas Murray, a company that specialised in the field of monitoring and benchmarking Custodian Banks, could do a benchmarking exercise to evaluate the Fund's existing contract with Northern Trust. Other Scottish Local Government Pension Scheme Administering Authorities had used Thomas Murray and the results had been successful.

It was proposed that a contract be entered into with Thomas Murray to provide an annual Pension Fund Global Custodian benchmarking exercise. This would also include a fee review, foreign exchange analysis, a global custody agreement review and interest rate benchmarking. It was advised that this contract could be terminated at any time.

Following consideration the Group **AGREED to Recommend** to the Resources Committee to enter into a contract with Thomas Murray to provide a Pension Fund Global Custodian benchmarking exercise.

6. Any other Competent Business

<u>Alliance Bernstein Institutional Investments Presentation</u>

The Head of Corporate Finance advised that Alliance Bernstein Institutional Investments, one of the Pension Fund's Managers had offered to give a presentation on research carried out into the implications for investments as a result of global climate change.

Following consideration, the Group **AGREED**

(i) to accept this offer and that arrangements should be made to have the presentation on a date to be agreed.
(ii) that Members of Western Isles Council should also be invited to attend.

<u>Meeting with Investment Managers</u>

Members were asked to consider inviting one of the Pension Fund's Managers to the next meeting of the Group.

The Group **AGREED** to invite Baillie Gifford & Co to the next meeting of the Group to be held on 28 August, 2008.

7. Date of Next Meeting

The Group **NOTED** that the next meeting would be held in Committee Room 1, Council Headquarters, Glenurquhart Road, Inverness on Thursday, 28 August, 2008 at 2p.m.

The meeting ended at 3.50 p.m