PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.30 pm on 12 February 2013

Present

Councillor Paul Lynch (Chairman)
Councillor Julian Grainger (Vice-Chairman)
Councillors John Ince, Russell Mellor, Neil Reddin FCCA and Richard Scoates

65 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

There were no apologies.

66 DECLARATIONS OF INTEREST

Councillors Paul Lynch, Julian Grainger, Russell Mellor, Neil Reddin and Richard Scoates each declared an interest as members of the Bromley Local Government Pension Scheme.

67 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 15TH NOVEMBER 2012 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The minutes were agreed.

68 MATTERS OUTSTANDING FROM PREVIOUS MEETINGS

Members were updated on the matters below.

(a) Member Training

A training evening for Members, previously suggested at a Sub-Committee meeting, was held on 5th February 2013 covering a wide range of issues related to the Pension scheme.

The event was led mainly by Baillie Gifford and Co and the Chairman felt that it was an excellent training evening. Copies of the training presentation pack were provided at the meeting for the benefit of Sub Committee Members unable to be at the event. Councillor Mellor offered his apologies for not being able to attend in view of business commitments. The Finance Director indicated that the training was provided at no cost to the Council with the speakers meeting their own costs.

(b) Auto-enrolment

Concerning Auto-enrolment to the Pension Scheme, approval was being sought to a transitional period for deferring automatic enrolment to eligible jobholders. As at 1st March 2013, the Council has the option to defer until September 2017 the automatic enrolment of eligible jobholders who had opted out of the LGPS prior to 1st March 2013. A report on this would be considered by the General Purposes and Licensing Committee at their meeting on 14th February 2013. Approval would mean that Auto-enrolment would effectively only apply to new starters between 1st March 2013 and September 2017.

(c) London Mutual Pension Fund

Work continued on this and there was no proposal to seek a commitment from London Boroughs at this stage.

69 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

70 PENSION FUND PERFORMANCE Q3 2012/13

Report RES13030

Summary details were provided of the investment performance of Bromley's Pension Fund for the first three quarters of 2012/13 along with information on general financial and membership trends of the Fund and summarised information on early retirements. The Fund's external advisers, AllenbridgeEpic, provided further detail on investment performance and Fidelity and Baillie Gifford each provided an update on performance and economic outlook/prospects.

The market value of the Fund rose during the December quarter to £526.0m compared to a value of £462.1m at 31st December 2011. By 1st February 2013 the Fund value had increased to £558.8m.

Until 2006, the target for Fund managers was to outperform the local authority universe average by 0.5% over rolling three year periods. Following a review of management arrangements in 2006, both managers were set performance targets relative to their strategic benchmarks; Baillie Gifford's target to outperform benchmark by 1.0% -1.5% over three-year periods and Fidelity's to outperform by 1.9% over three-year periods. Although the 2012 strategy review saw maintenance of an 80%/20% split between growth seeking assets and protection assets, the growth element would comprise a 10% investment in Diversified Growth Funds (DGF) and 70% in global equities, the latter removing arbitrary regional weightings in favour of flexibility in world stock markets and potentially improved long-term returns.

Baillie Gifford and Standard Life each received £25m on 6th December 2012 from Fidelity's equity holdings to establish the 10% DGF allocation (Phase 1 of the new strategy) and market values of the allocations had since increased.

Performance from Baillie Gifford and Fidelity for the first three quarters of 2012/13 was outlined. Baillie Gifford returned 3.0% in the December quarter (0.4% below benchmark) and Fidelity returned 3.7% (0.7% above benchmark). The Pension Fund's medium and long-term returns remained strong with Bromley's performance in the last few years particularly good. Baillie Gifford's returns for three years and ten years ended 31st December 2012 (9.1% and 9.9% respectively) compared favourably with those of Fidelity (7.6% and 9.4% respectively), while Fidelity (at 5.8%) outperformed Baillie Gifford (at 5.7%) over five years.

Concerning Affinity Sutton Pension arrangements, officers were continuing to explore alternative options. Discussions were continuing and the LPFA and Affinity Sutton were due to meet again on 27th February 2013.

Details were also provided of the 2012/13 Pension Fund Revenue Account and membership figures to 31st December 2012. A net surplus of £5.6m was achieved in the first three quarters of the year (mainly due to investment income) and total membership numbers rose by 319. However, the overall proportion of active members continued to decline and fell from 36.4% at 31st March 2012 to 35.7% at 31st December 2012.

In discussion the Sub Committee's Independent Adviser, Mr Alick Stevenson, provided views on the Fund's performance. He briefly outlined a global context referring to the U.S., Eurozone and UK. Markets were consolidating around higher levels with investors currently moving in and out of fixed income. Mr Stevenson felt that 2013 could see some growth.

Delivering a 14% performance over the twelve month period was good. However, over a three year period to 31st December 2012, Fidelity had returned their benchmark at 7.6%; Baillie Gifford for the same period returned 9.1% against a 7.1% benchmark. This indicated successful asset selection by Baillie Gifford. Fidelity however was hugging its benchmark although its short term quarterly returns for September 2012 and December 2012 were particularly good. Nevertheless, Fidelity did not appear to allocate assets over central points.

On Phase 1 of the new Strategy, Mr Stevenson congratulated the Principal Accountant for his handling of documentation for a transfer of funds from the Fidelity Fund to the new Diversified Growth Fund. Fidelity also handled the transfer in a professional manner. The two new DGF Fund Mangers were appointed by the Sub Committee on15th November 2012 and funded on 6th December 2012. The transfer went smoothly and the new mandates had performed well. It was agreed to review Baillie Gifford's DGF performance at the next meeting when their representatives would be attending and agree a date for Standard Life's future attendance at a Sub-Committee meeting. Mr Stevenson recommended they are not seen for a year although he would monitor their performance in the meantime. As a consequence of the changes, Fidelity's benchmark reduced from 1.9% to 1.7% from 1st December 2012.

On the appointment process for Phase 2 (Global Equities), the Pre-Qualification Questionnaire (PQQ) stage was underway and it was anticipated there could be up to 50 responses. The expiry date was some 37 days after the date of OJEU notice i.e. around the end of March. An evaluation period would then follow to achieve a shortlist of 12 with further evaluation to follow before coming up with a short list, probably of six potential managers. It was suggested that the Sub Committee's 9th May meeting continue as planned with a special meeting scheduled for the end of May or early June to receive presentations and agree appointments. Mr Stevenson suggested the date be variable in consultation with the Chairman.

Councillor Grainger focussed on the fund achieving a return to meet medium to longer term liabilities. He referred to the US Federal Reserve and European Central Bank continuing to buy Government Bonds effectively increasing money supply with a resurgent inflation risk. The dollar was not strong and with Government Bonds returning some 5% he suggested the Sub-Committee consider other ways of generating (fixed) income without too much risk e.g. property. He felt that if the re-investment rate was lower than three years previously it would take longer for the Fund to meet its liabilities – the recovery period would lengthen.

Mr Stevenson suggested input from the Actuary who will have carried out early calculations by the end of March; for future meetings it was necessary to consider ways to nudge the income growth rate. Mr Stevenson felt that education on the scenario of long term risks was necessary and to have assistance from the Actuary. It could be that future infrastructure investment might be beneficial. It was also necessary to know the proportion of the long term risk already covered and to have ways of hedging or protecting the Fund long term. The Finance Director indicated that the Actuary had given an initial indication. Some 20 Pension Funds had already been looked at and their funding position had deteriorated. The issue was about people living longer and there was a low return on Gilts. There was a complexity within the liabilities and the risk was of the Pension Fund moving to a negative cash flow and lower returns. As staff reduced there would be a saving longer term but for the medium term i.e. 10 to 15 years, membership numbers needed for the Pension Fund would reduce and there would be lower returns. Consequently, the Finance Director referred to engaging the Actuary with Members at an early stage.

Councillor Grainger felt that it could be difficult to grasp how the Pension Fund can increase in value and yet have reduced funding. He suggested an early funding warning to Members with some training and it was confirmed that the Member Finance Seminar in June would include this.

It was indicated that the DGF Portfolio had a small property element and infrastructure was a developing area which could be considered during Phase

3 of the new strategy (fixed income). Additionally, the funding strategy was in transition and it was important to allow it time to be fully implemented and to then bed in. Mr Stevenson suggested infrastructure consideration for Phase 3 of the Strategy as the fixed income parameters had yet to be agreed. The Chairman was also wary of officer time being taken to work on property, infrastructure and other fixed income matters at a time when it was important to implement the new investment strategy in its entirety. He suggested adding property to the Sub-Committee's Matters Arising. The Finance Director also indicated a liquidity issue for property and having options to be able to sell properties. It was necessary to look at a longer time frame for the Pension Fund e.g. 15/20 years. He referred to timing and implementing the new strategy and looking at property investment in the future. He suggested a possible opportunities fund in the future but for the present it was important to "bed down" the strategy.

RESOLVED that the report be noted.

71 PENSION FUND - 2012/13 AUDIT PLAN

Report RES13042

Members noted the 2012/13 Audit Plan of the L B Bromley Pension Fund.

This was prepared by auditor PricewaterhouseCoopers LLP (PWC) to inform Members and officers of the responsibilities of the external auditors and how they plan to discharge those responsibilities in accordance with the Audit Commission's Code of Practice. The Plan was prepared in consultation with officers and includes an analysis of key risks, PWC's audit strategy, reporting and audit timetable and other matters.

The Council's accounts were being prepared in accordance with the requirements of both the LGPS Regulations and the CIPFA Statement of Recommended Practice and would be audited as part of the overall audit of the Council's Accounts by PWC.

RESOLVED that the Pension Fund Audit Plan for 2012/13 be noted.

72 LOCAL GOVERNMENT ACT 1972 AS AMENDED BY THE LOCAL GOVERNMENT (ACCESS TO INFORMATION) (VARIATION) ORDER 2006 AND FREEDOM OF INFORMATION ACT 2000

Under Part 2 proceedings, Mr Stevenson outlined his views on investing in Options (Derivatives) and selling them on i.e. insuring the Fund or hedging risk against future fluctuations in the FTSE value. The earliest derivatives were to 2014 and prices were being looked at to 2016 and 2018. Volatility was quite significant with this type of investment and hedging the FTSE would be imperfect as it would only cover about 20% of the Fund's equity portfolio - with the change to Global equities (Phase 2) it was not known at this stage what the UK equities would be on completion of Phase 2. There was also an illiquidity premium and it would be necessary to procure a Manager for the activity, tendering in compliance with OJJ requirements given a value of some £80m. There would also be legal fees which would not be small.

Councillor Grainger questioned why it was necessary to look beyond 2014 as such a fund would become more illiquid. He suggested hedging an amount at the Fund margins e.g. 10% and to assess how much comprised UK equities; without considering such an approach it would not be possible to act when needed.

Mr Stevenson advised that a specialised Fund Manager would be needed for hedging an amount at the margins. Although such an approach had worked in the past there had been infrequent benefits and it was costly. It was also complex and work was being taken forward with Phase 2 of the Strategy with Phase 3 to follow. There would also then be a Triennial Valuation. Mr Stevenson also referred to a previous liability driven target with Credit Agricole. Councillor Mellor indicated that capital was maintained with this venture but interest lost.

Councillor Grainger referred to such an option increasing in value at a time when the Pension Fund value drops and the option could therefore be sold at the right time.

73 CONFIRMATION OF EXEMPT MINUTES - 15TH NOVEMBER 2102

The Part 2 Minutes were agreed.

74 PENSION FUND - INVESTMENT REPORT

Quarterly reports (to 31st December 2012) from Baillie Gifford and Fidelity had been circulated prior to the meeting along with quarterly reports (to 31st December 2012) from Standard Life Investments and Baillie Gifford in respect of the Diversified Growth Fund investments.

Representatives from Fidelity attended the meeting to present their investment review and answer questions.

The Meeting ended at 9.08 pm

Chairman