PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.30 pm on 18 September 2013

Present

Councillor Paul Lynch (Chairman)
Councillor Julian Grainger (Vice-Chairman)
Councillors Eric Bosshard, Neil Reddin FCCA, Richard Scoates and Stephen Wells

Also Present

Alick Stevenson, AllenbridgeEpic Investment Advisers

1 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from Councillor Russell Mellor.

2 DECLARATIONS OF INTEREST

Members present declared an interest as members of the Bromley Local Government Pension Scheme.

3 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 9TH MAY 2013 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The minutes were agreed.

4 MATTERS OUTSTANDING FROM PREVIOUS MEETINGS

It was noted that an update concerning the Triennial valuation would be provided at item 8 of the agenda.

5 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

6 PENSION FUND ANNUAL REPORT 2012/13

Report RES13168

Members considered the annual report and accounts of the Bromley Pension Fund for year ended 31st March 2013. It was intended to publish the Annual Report on the Council website by 1st December 2013 in accordance with regulations.

The annual report had been submitted in draft form to the external auditor, PricewaterhouseCoopers LLP (PWC). Feedback on their audit of the Fund accounts was also provided to Members.

With reference to Benchmarks for the Balanced Mangers at page 53 of the Annual Report, a typographic error was noted in relation to Fidelity's allocation range for its Bonds, UK aggregate asset class. The range should read 15 to 25% rather than 5 to 15%. The error would be corrected in the final version of the Annual Report to be published.

For the Pension Fund Revenue Account, Councillor Grainger noted a final administration outturn in 2012/13 of nearly £1.9m.

Noting the Governance Policy Statement and reference to the Sub Committee having management responsibility for the Council's additional voluntary contributions (AVC) scheme, it was indicated that the framework of AVC provision would be reviewed in future. When it was proposed to change the framework, a report would be provided to the Sub Committee.

Stock lending was also highlighted. Members were advised that institutions suffered market losses through the practice during the Lehman Brothers crises. The practice is typically run on segregated portfolios, although pooled funds have a prospective right to lend stock - unit holders would be indemnified. Stock lending is not a forbidden practice and it is possible for Baillie Gifford and Fidelity to be involved in stock lending with client approval. Councillor Grainger suggested that stock lending be considered further at the Sub Committee's next meeting, including whether the cost of stock lending is outweighed by segregated portfolios. Mr Stevenson suggested that any report be considered after completion of the Fund's restructure, which Councillor Grainger accepted.

Highlighting the deficit and the level of employer contributions from revenue funding, Councillor Bosshard suggested that these issues needed to be addressed in a Council context over the next four years. He suggested that employees needed to pay a higher contribution to the Fund. The Chairman predicted that such changes would come from central government level.

RESOLVED that the Pension Fund Annual Report 2012/13 be noted and approved and, on completion of the external audit by PWC, arrangements be made to ensure publication of the Annual Report by the 1st December 2013 statutory deadline.

7 PENSION FUND PERFORMANCE Q1 2013/14

Report RES13167

Summary details were provided of the investment performance of Bromley's Pension Fund for the first quarter 2013/14 along with information on general financial and membership trends of the Fund and summarised information on early retirements.

AllenbridgeEpic, provided further detail on investment performance and Fidelity and Baillie Gifford each provided commentary on recent developments in financial markets and their impact on the Council's Fund and future outlook.

A representative of the WM Company also gave a presentation on the Fund's 2012/13 results with a WM document for period ending 31st March 2013, providing a performance analysis. The WM UK Local Authority Annual Review 2012/13 had been provided to Members prior to the meeting.

The market value of the Fund fell slightly during the June quarter to £582.4m compared to £583.9m at 31st March 2013. The comparable value at 30th June 2012 was £486.6m. By 3rd September 2013, the Fund value had risen to £596.8m.

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 being 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 DGF allocation (Phase 1 of the new strategy) and details were provided of March and June quarterly returns for this allocation.

On 2012/13 performance, Baillie Gifford returned +16.9% (1.9% above benchmark and ranked in the 3rd percentile) and Fidelity returned +18.3% (3.4% above benchmark and ranked in the 1st percentile). Overall Fund performance (+2.8%) was 3.0% above the local authority average for the year achieving an overall ranking in the 4th percentile.

Details were also provided of 2013/14 first quarter performance for the two balanced fund managers. Baillie Gifford returned -0.5% in the June quarter (0.9% above the benchmark) and Fidelity returned +0.5% (1.7% above benchmark). L B Bromley's local authority ranking for the June quarter was in the 22nd percentile and, in the year to 30th June 2013, was in the 3rd percentile.

The Fund's medium and long-term returns also remained particularly strong with long-term rankings to 30th June 2013 in the 8th percentile for three years, the 3rd percentile for five years and the 2nd percentile for ten years. Returns for Baillie Gifford over three and ten years ended 30th June 2013 (12.8% and

10.4% respectively) compared favourably with those of Fidelity (12.4% and 10.0% respectively). Over five years to 30th June 2013, Fidelity (10.0%) outperformed Baillie Gifford (9.6%).

In his presentation, the WM representative covered the market environment; Fund performance against strategic benchmark, Fund performance against peers and risk return and strategy. The WM representative included the following points in his comments:

- there was a positive return for total assts during 2012/13 – a positive performance on all asset classes except property;
- with any reduction of quantitive easing (QE), bond yields would reduce; and
- 2012/13 was a strong year for total fund performance with strong performance against benchmark and peer group.

In addition to his report analysing performance and investments for the Fund, Mr Stevenson also provided comments. He suggested that markets were resigned to a degree of tapering but even if cut, there would continue to be a significant amount of liquidity. Markets had moved ahead since the end of June. The VIX index rose to 17 but then moved back to 14. Financial conditions in Europe had not changed substantially in the previous six months. Although gold had fallen nearly 30% since the beginning of the year to a three year trading low by the end of June, its value had now increased by 10%.

RESOLVED that the report be noted.

8 LONDON-WIDE COLLABORATIVE INVESTMENT VEHICLE

Report RES13170

Members considered an update on the public debate related to a possible merger of Local Government Pension Funds.

Proposals for a London Pensions Mutual entail plans to merge all London funds under the London Pension Fund Authority (LPFA) claiming a merged scheme to be more efficient compared to separate, smaller funds e.g. lower administration costs and better returns. However, there was inconclusive evidence to support the case for better returns and L B Bromley as a smaller fund had achieved excellent returns. Moreover, any underperformance as part of a bigger fund would result in costs to council tax payers. A merger of funds could lead to a more risk adverse approach to investments and longer term lower returns would have cost implications for meeting the Council's pension fund deficit level and future pension costs.

Alternative proposals from London Leaders (London Councils) promote the advantages of a Collaborative Investment Vehicle (CIV). The Leaders Committee of London Councils agreed in principle to move towards a CIV for interested boroughs, subject to consideration of outcomes from further work commissioned by a Working Group (a further report being due this autumn). Should London Councils decide not to proceed with a CIV, sufficient support remained for a lead borough arrangement to operate a CIV.

Report RES13170 itemised the main benefits of a CIV undertaken by one organisation on behalf of other local authorities. The CIV was expected to reduce costs and enable the choice of better performing fund managers. New asset classes could also be explored e.g. infrastructure.

Boroughs would retain their own control over asset allocation and accounting responsibilities. At each triennial valuation, local authorities would continue to agree their updated Funding Strategy and Strategic Asset Allocation and Statement of Investment Principles.

More generally, a *"Call for Evidence on the future structure of the Local Government Pension Scheme"* was issued by the Local Government Association (LGA) and the Department for Communities and Local Government (DCLG) for response by 27 September 2013. L B Bromley's response would be undertaken by the Director of Finance in consultation with the Sub-Committee Chairman.

L B Wandsworth was willing to host a London-wide CIV if required. A contribution of up to £25k towards set up costs was required but it was anticipated that ongoing CIV costs would be self financing through a negotiation of reduced management fees with fund managers. Any costs would be met by the Pension Fund.

With a CIV arrangement, each pension committee could choose whether to use a fund manager from the CIV, retain its current managers or use a combination of both. For example a CIV could be used to diversify into alternative asset classes such as infrastructure, with respective economies of scale not being possible through a single fund.

Greater collaboration was key for the future. Many of the best performing pension funds longer term have been the smallest, including L B Bromley. Potential savings could be made through collaboration without the need for costly and complex mergers. Asset allocation remained fundamental to improving investment returns and the CIV allowed local asset allocations to continue. Sharing services would enable managers to aggregate fees and Members were asked to consider the formation of a CIV, hosted by Wandsworth Council, requiring a contribution of up to £25k to support set up costs.

It was highlighted that the more work taken on by Baillie Gifford, the cheaper their fees would be. A CIV would not affect the Fund's asset allocation, but with insufficient members, there would be no advantages on fees.

Councillor Grainger acknowledged the potential of lower fees but had concerns for costs that might be associated with an administrative layer between the LPFA approach and the current approach of LAs. However, it was indicated that there should be no additional costs other than a £25k contribution towards support set up costs.

In principle, Councillor Reddin thought the CIV worth looking at, but wanted to be satisfied that, as a late entrant, there would continue to be a requirement for a £25k contribution. Also, that clarity is obtained on any extent to which L B Bromley might be tied into the scheme and whether it could leave if it wanted with money back. The Director advised that this would be a crucial part of due diligence. It was also confirmed to Councillor Grainger that there were no powers to direct L B Bromley to join a merged scheme promoted by the LPFA.

Councillor Bosshard felt that numbers in a CIV fund should be limited to five or six authorities - too many and there would be diverse opinions. He also referred to rules on how decisions are taken being strictly adhered to. Councillor Grainger referred to having information indicating the fund managers used by good performing LAs. He supported the recommendations in Report RES13170 subject to due diligence. Councillor Wells suggested there should be an optimum value in a CIV – the involvement of just two LAs would not be worthwhile.

The Director of Finance also updated Members on various pension matters and as outlined below.

<u>Auto- enrolment</u>

The fourth phase of implementation would be completed by 2017. Auto enrolment had led to more staff joining the L B Bromley Scheme.

<u>Changes to the LGPS from April 2014</u>

The LGPS would be further reviewed by the Treasury in 2017. There were affordability issues with changes to be implemented in 2014.

<u>Councillor Pensions</u>

There had been no feedback on changes.

<u>Governance</u>

It was intended that LAs should have a Scrutiny Committee look at the work of a Pensions Committee. The need to focus on a few poorly performing Committees in other LAs had created this development.

<u>Triennial valuation</u>

Fund deficits had increased nationally. Actuaries could look at a number of areas involved with a valuation e.g. discount rates in terms of returns, gilt yields and the impact of QE not lasting indefinitely. A valuation would make a difference to a fund in dealing with its liabilities. It was intended to have a

Pensions actuary authority look at the work of actuaries to ensure their work attained to a certain standard. If an actuary assesses a deficit too high, a fund's repayment could be affected. It could move to negative levels and cover would be needed i.e. the deficit and repayment period will have increased. The Director would provide more information on asset allocation and could provide an assessment on discount rates.

Fair Deal

It was expected that Fear Deal changes would be introduced in September 2013 and have immediate effect. Any company to whom a service is outsourced would be taken on as an admitted body of the local pension scheme with the LA acting as guarantor. Small companies would not be able to afford such bonds. There would be an exception clause whereby an outsourcing organisation having a good scheme would not have to transfer to the LGPS.

Fair Deal could potentially be a significant issue for the Fund by virtue of having to take on new companies as admitted bodies. Such companies could, for example, have potentially higher pay rates than the Council and/or better ill health retirement benefits. If such a company were to go out of business, the Council would have to guarantee and underwrite pension liabilities for the employees. Councillor Wells suggested an examination of admitted body companies and undertaking some calculations. He felt that a company such as Liberata would have little difficulty providing a liability fund unlike a smaller organisation e.g. an academy school admitted to the scheme. The Director referred a policy paper being produced on the Fair Deal scheme and a tough line had been taken. For some companies a bond could be quite onerous unless they had collateral. The Fair Deal arrangement would take immediate effect and with Liberata there were already built in controls. At tender stage, it would be necessary to identify the financial strength of an outsourcing body for admission to the Fund. If a member of staff transferred to an outsourcing company they would stay in the LGPS. Pay rises provided by the company would also feed into the Fund. Councillor Grainger suggested having a clause in outsourcing contracts about company pay rises and their effect on pensions. The Director advised that if the deficit valuation increased, the company would have to meet increased costs. Officers were of the view that the Fair Deal arrangement would work better for the Fund in the longer term.

In the area of commissioning education services, Councillor Wells suggested that liability bonds be modelled into arrangements with outsourced service providers. The Director offered to circulate a note on the issues discussed. Following the outcome of the Fair Deal proposals, a report would be put to the General Purposes and Licensing Committee.

A suggestion was made that part of the deficit reduction funds be earmarked elsewhere; the actuary might accept a longer recovery period than the Council preferred with the difference earmarked in reserves. It was understood that L B Wandsworth had undertaken a similar practice and this was confirmed. The valuation of their fund was unaffected. There was no formal actuary recognition of the reserve and L B Wandsworth could potentially redevelop it for another purpose.

Sums from an earmarked reserve would be invested strongly as they would be if invested from the Pension fund. The Director indicated that it might therefore be as well to place the sums in the Pension fund – this would also be the only way to legally lock them for pension investment. If the Deficit Recovery Period was made too short, Councillor Reddin suggested that the deficits could probably be lost in any funds merger. Government might also require LAs to use reserves for other purposes. The Director agreed - it was better to have the sums invested in the Pension fund. Councillor Wells was also unsure whether such an earmarked reserve could be taken forward legally.

Councillor Bosshard felt that it was necessary to consider what needed to be done to reduce the deficit recovery period.

RESOLVED that:

(1) the general update on pension matters detailed at paragraph 3.1 of Report RES13170 be noted;

(2) the update on the wider public debate related to the possibility of merging Local Government Pension Funds be noted;

(3) greater collaborative working be progressed in relation to participation in a London Collaborative Investment Vehicle (CIV); and

(4) the Director of Finance be authorised to undertake further due diligence on the establishment of a London wide CIV including contributing up to £25,000 from the Pension Fund to meet legal and setting up costs of the CIV.

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

RESOLVED that the Press and public be excluded during consideration of the items of business referred to below as it is likely in view of the nature of the business to be transacted or the nature of the proceedings that if members of the Press and public were present there would be disclosure to them of exempt information.

The following summaries
refer to matters
involving exempt information

10 CONFIRMATION OF EXEMPT MINUTES - 9TH MAY 2013

The Part 2 minutes were agreed.

11 REVISED INVESTMENT STRATEGY (PHASE 2) - GLOBAL EQUITIES MANAGER SELECTION

Report RES13169

Members considered a further report on Phase 2 of the revised investment strategy for the L B Bromley Pension Fund.

12 PENSION FUND - INVESTMENT REPORT

Quarterly performance reports (to 30th June 2013) from Baillie Gifford and Fidelity had been circulated to Sub Committee Members prior to the meeting along with quarterly reports (to 30th June 2013) from Standard Life Investments and Baillie Gifford in respect of the Diversified Growth Fund investments.

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

The Meeting ended at 10.19 pm

Chairman