

Decision Maker: Pensions Investment Sub-Committee

Date: 11th February 2014

Decision Type: Non-Urgent Non-Executive Non-Key

Title: **REVISED INVESTMENT STRATEGY - PHASE 3 UPDATE
(FIXED INCOME)**

Contact Officer: Martin Reeves, Principal Accountant (Technical & Control)
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Chief Officer: Director of Finance

Ward: All

1. Reason for report

Following an initial update on Phase 3 of the revised investment strategy (fixed income) at the November meeting, this report presents another update and, following questions raised then, asks the Sub-Committee to give further consideration to the allocation to fixed income.

RECOMMENDATIONS

The Sub-Committee is asked to:

- 2.1 Note the report and, before the Phase 3 selection process progresses any further, consider and agree on a final allocation to fixed income.**
- 2.2 Request a report to the next meeting of the Sub-Committee on alternative “protection-type” assets as part of the fixed income allocation.**

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.
 2. BBB Priority: Excellent Council.
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Financial

1. Cost of proposal: No cost
 2. Ongoing costs: Recurring cost. Total fund administration costs estimated at £2.0m in 2013/14 (includes audit fee, fund manager/actuary/external advice fees, Liberata charge and officer time)
 3. Budget head/performance centre: Pension Fund
 4. Total current budget for this head: £35.0m expenditure (pensions, lump sums, admin, etc); £38.8m income (contributions, investment income, etc); £618.8m total fund value at 31st December 2013)
 5. Source of funding: Contributions to Pension Fund
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Staff

1. Number of staff (current and additional): 0.4 fte (current)
 2. If from existing staff resources, number of staff hours: c14 hours per week
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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2007 and LGPS (Administration) Regulations 2008
 2. Call-in: Call-in is not applicable.
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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,126 current employees; 4,852 pensioners; 4,741 deferred pensioners as at 31st December 2013
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Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.
2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

- 3.1 In February 2012, the Sub-Committee agreed a future strategy for the Fund, comprising a 10% allocation to Diversified Growth, a 70% allocation to global equities and a 20% allocation to fixed income (corporate bonds/gilts). It was agreed that the revised strategy would be implemented in three separate phases and, following a “beauty parade” in November 2012, Phase 1 was completed on 6th December 2012 with the award of two Diversified Growth Fund mandates of £25m to Baillie Gifford and Standard Life. A further “beauty parade” at the special meeting in October 2013 resulted in the completion of Phase 2 with the award of three global equities mandates to Baillie Gifford (£200m), Blackrock (£120m) and MFS (£120m).
- 3.2 AllenbridgeEpic have previously been appointed to provide specialist procurement advice for the implementation of the revised strategy and have managed the processes for Phase 1 and Phase 2. At the last meeting (in November), Members considered an initial update from AllenbridgeEpic on Phase 3 of the revised investment strategy (fixed income). It was agreed that the Fund should enter into arrangements with one or more managers for global fixed income pooled funds (at its meeting in February 2012, the Sub-Committee had originally agreed that two managers be appointed). It was also agreed that the procurement process for Phase 3 be run on the basis that investment would be made in global fixed income pooled funds. Pooled funds fall outside the EU procurement rules because they are considered to be direct investment decisions (there is an exemption for financial instruments). Accordingly, although we would still have to tender for the mandate(s), we would not have to follow the OJEU route, which would shorten the tender process. A revised timetable indicated that Phase 3 should be completed (funded) by 31st March 2014.
- 3.3 In accordance with the investment strategy agreed in 2012, 20% of the Bromley Fund would be allocated to fixed income, which, based on the current Fund value, would be around £120m. At the last meeting, however, a Member questioned whether 20% was too high given higher returns he felt could be achieved from other investments. Fixed income assets provide cash for the Fund, but are, over time, likely to generate a return of “only” 3% to 6%, which is considerably less than we would expect from, say, global equities. Members asked for the Scheme Actuary to prepare a cash flow projection for the Fund in order to better identify the length of time potentially remaining before the Fund moves to “cash neutral” and then to “cash negative”. The cashflow forecast would help inform subsequent investment debates and decisions by the Sub-Committee in terms of investing the assets of the fund in income generating assets (fixed income characteristics), rather than growth seeking “risk” assets (equities).
- 3.4 The actuary has prepared a cashflow projection and this is attached as Appendix 2. The actuary advises that, based on the numbers in the projections, the Fund is likely to move into a net cashflow negative position (including investment income receipts) in around 2020/21. The Fund is currently cash positive once income from equities being re-invested is taken into account, but, excluding investment returns, became cash-negative in 2012/13 and the actuary expects this position to generally get worse. Put simply, it is possible to say that net dealings with members put the Fund in a cashflow negative position and investment income might be needed each year going forwards from now on to pay benefits due.
- 3.5 A brief update report from AllenbridgeEpic is attached at Appendix 1 and this recommends that further consideration take place before they move forward on the procurement of fixed income managers. Accordingly, the Sub-Committee is asked to consider and agree a final allocation for Phase 3 of the revised strategy.

3.6 AllenbridgeEpic will circulate separately examples of alternative “protection-type” assets for discussion with this report. The outcome of the discussion at the meeting will assist in any subsequent report back to the Sub-Committee on alternative options. Depending on the final timing of changes to the fixed income allocation, AllenbridgeEpic will provide further advice at the meeting on whether changes to our current managers’ fixed income mandates should be made in the interim.

4. POLICY IMPLICATIONS

4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits. An Annual Report is required to be published under LGPS (Administration) Regulations 2008.

5. FINANCIAL IMPLICATIONS

5.1 There will be additional costs from the advertising and award of new mandates and a contract for procurement advice for all three phases of the revised strategy has been awarded to AllenbridgeEpic at a total cost of £35k plus VAT. Fund management fees will, in all likelihood, be higher than those we currently pay, but it is anticipated that higher returns would more than compensate for these. All costs will be chargeable to the Pension Fund as administration costs.

6 LEGAL IMPLICATIONS

6.1 The statutory provisions relating to the administration of the Local Government Pension Scheme are contained in the Local Government Pension Scheme (LGPS) Regulations 2007 and LGPS (Administration) Regulations 2008, which are made under the provisions of Section 7 of the Superannuation Act 1972.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	LGPS Regulations 2007 & LGPS (Administration) Regulations 2008. Reports to Pensions Investment Sub-Committee in February, May, September and November 2012 and in May, September, October and November 2013

REPORT PREPARED FOR

**London Borough of Bromley
Pension Fund on Phase 3 of revised investment strategy
(fixed income)**

27 January 2014

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Interim report on Phase 3 (fixed income)

An anonymised “Request for Information” (“RFI”) was sent out to the market via Camradata in November 2013 with a closing date of 3 December 2013. (A copy is provided in Annex A)

I am pleased to report there was a significant response to this request with a large number of respondents offering their investment products. As with most RFI’s, the next step was to sift out the non compliant responses

The five key tests were as follows:

- product not “global” in construction
- product utilised short positions and leverage
- product not UCITS compliant
- assets under management very small
- track record less than three years

As a result of this cull, the number of managers offering a compliant UCITS pooled product, broadly meeting the criteria set, was reduced to approximately twenty.

Before engaging in further analysis, however, which can be completed in relatively short order, I would draw the attention of the members to the discussion at the Pensions Investment Sub Committee meeting on 7 November 2013, when it was agreed firstly, to start the “search process” for Phase3, and secondly, to request the Scheme Actuary to prepare a cash flow projection for the Fund in order to better identify the length of time potentially remaining before the Fund moves to “cash neutral” and then to “cash negative”. This is attached as a further appendix to the covering report.

These cash flows would both help and inform any subsequent investment debates and decisions by the PISC in terms of investing the assets of the fund in income generating assets (fixed income characteristics), rather than growth seeking “risk” assets (equities).

In addition, the current national discussions on the LGPS and particularly in regard to the potential setting up of collective investment funds (ie grouping several, currently stand alone, Local Authority Pension Schemes under one collective investment umbrella) should be considered before any further significant changes to the investment structure are implemented.

Whilst I recognise that this further debate may impact on the completion date envisaged in the original paper, I do believe that there are currently a number of unresolved fundamental issues requiring amplification and discussion before a final decision is made.

Alick Stevenson
Senior Adviser
AllenbridgeEpic Investment Advisers

Date Required	Close of Business 3 Dec 2013
Investment philosophy and return objectives	Long term absolute return investment philosophy with a target return objective of 3.0% to 6.0% (net of fees) over one or three month LIBOR measured over a three or five year rolling basis
Investment vehicle	Pooled and regulated investment vehicle only, which must be able to demonstrate a strong and credible investment process together with clearly defined risk management metrics
Investment constraints	The client requires the investment manager to be in compliance with The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The client also expects that the investment product submitted will be managed as a long only fund and will offer a window into a wide range of fixed income assets
Track Record	An established live track record is preferred with no carve outs. Simulated or paper records will not be considered. <i>Fact sheets –as at 30 September 2013 are ESSENTIAL.</i>
Minimum requirements	Manager must have a minimum of £250m in this asset class. An indication of where a £50m portfolio would rank in the investor hierarchy is also required.
Reporting requirements	Monthly balance and quarterly executive summary and performance reports (electronic client access essential). Manager will be expected to present to the client on an annual basis. Manager will be expected to be available to meet or discuss the portfolio with fund executive and advisors on a quarterly basis
Management Fees	ad valorem. No performance related fees will be accepted and please additionally state your fee structure, clearly, outlining the relevant fee bands for a mandate of up to £100m.
Mandate Size	Approx £100m is on offer and may be awarded in more than one amount under more than one mandate.
Start date of mandate	End 1Q 2014 or beginning 2Q 2014
Beauty Parade and final decision	During 1Q 2014