

Decision Maker: Pensions Investment Sub-Committee

Date: 19th August 2014

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

Title: PENSION FUND PERFORMANCE Q4 2013/14 & Q1 2014/15

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Chief Officer: Director of Finance

Ward: All

1. Reason for report

This report includes details of the investment performance of Bromley's Pension Fund in both the 4th quarter of the financial year 2013/14 and the 1st quarter of 2014/15. This is the first complete performance report since the implementation of phase 2 of the revised investment strategy in December 2013 and the fund managers' quarterly reports have been circulated with the agenda. The Sub-Committee would normally have considered the 4th quarter of 2013/14 in May, but that meeting was cancelled due to the local elections and two separate quarters are covered in this report (in summary form in the main body of the report and in more detail in Appendices 5 and 6). The report also contains information on general financial and membership trends of the Pension Fund and summarised information on early retirements. Baillie Gifford have provided a brief commentary on the three portfolios under their management and on their view of the economic outlook and this is attached as Appendix 2.

RECOMMENDATION(S)

The Sub-Committee is asked to:

2.1 Note the report and

2.2 Agree the programme for Fund Manager attendance as set out in paragraph 3.10.

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 2013, 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 administration costs estimated at £2.5m (includes fund manager/actuary fees, Liberata charge and officer time)
 3. Budget head/performance centre: Pension Fund
 4. Total current budget for this head: £35.8m expenditure (pensions, lump sums, etc); £41.6m income (contributions, investment income, etc); £637.0m total fund market value at 30th June 2014)
 5. Source of funding: Contributions to Pension Fund
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Staff

1. Number of staff (current and additional): 0.4 FTE
 2. If from existing staff resources, number of staff hours: c 14 hours per week
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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2013
 2. Call-in: Call-in is not applicable.
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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,339 current employees; 4,890 pensioners; 4,847 deferred pensioners as at 30th June 2014
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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

Fund Value

3.1 The market value of the Fund rose during the March quarter to £625.5m (£618.8m as at 31st December 2013) and rose further in the June quarter to 637.0m. The comparable value one year ago (as at 30th June 2013) was £582.4m. As at 31st July 2014, the Fund value had fallen slightly to £636.1m. Historic data on the value of the Fund, together with details of distributions of the revenue fund surplus cash to the fund managers and movements in the value of the FTSE 100 index, are shown in a table and in graph form in Appendix 1. Members will note that the Fund value tracks the movement in the FTSE 100 fairly closely, even though, since 2006, only around 30% of the fund has been invested in the UK equity sector.

Performance targets and investment strategy

3.2 Historically, the Fund's investment strategy has been broadly based on a high level 80%/20% split between growth seeking assets (representing the long-term return generating part of the Fund's assets) and protection assets (aimed at providing returns to match the future growth of the Fund's liabilities). Between 1998 and 2012, Baillie Gifford and Fidelity managed balanced mandates along these lines. This strategy was confirmed in 2012, following a further review of the Fund's investment strategy. This review concluded, however, that the growth element would, in future, comprise a 10% investment in Diversified Growth Funds (DGF - a completely new mandate) and a 70% allocation to global equities. The latter would involve the elimination of our current arbitrary regional weightings, which would provide new managers with greater flexibility to take advantage of investment opportunities in the world's stock markets, thus, in theory at least, improving long-term returns. A 20% protection element would remain in place for investment in corporate bonds and gilts.

3.3 It was agreed that this would be implemented in three separate phases and, following presentations by a short-list of four prospective managers to the meeting in November 2012, Phase 1 (a 10% allocation to Diversified Growth Funds) was implemented on 6th December 2012 with a transfer of £50m from Fidelity's equity holdings (£25m to each of the two successful companies, Baillie Gifford and Standard Life).

3.4 Following further presentations by four prospective managers to a special meeting in November 2013, Phase 2 (a 70% allocation to Global Equities was implemented on 20th December 2013, with £200m being allocated to Baillie Gifford (from within their former equities holdings), £120m to MFS International (transferred from Fidelity) and £120m to Blackrock (£70m from Baillie Gifford and £50m from Fidelity). A report elsewhere on the agenda discusses options for an investment strategy for Phase 3 (20% for fixed income "protection" assets).

Fund Performance

3.5 Performance data for 2013/14

In spite of this being a year of transition and change (some 70% of the total assets of the Fund was moved in December 2013 from the previous balanced mandates into new global equity mandates), the Fund as a whole returned +7.6% in 2013/14 compared to the benchmark return of +6.2%. With regard to the local authority universe average for the year (+6.4%), the Fund achieved an overall ranking in the 29th percentile (the lowest rank being 100%). This represented another good year. For comparison, the rankings in recent years were 4% in 2012/13, 74% in 2011/12, 22% in 2010/11, 2% in 2009/10 (the second best in the whole local authority universe), 33% in 2008/09, 5% in 2007/08, 100% in 2006/07 (equal worst in the whole local authority universe), 5% in 2005/06, 75% in 2004/05, 52% in 2003/04, 43% in 2002/03 and 12% in 2001/02.

3.6 Medium and long-term performance data

Since 2006, the WM Company has measured the fund managers' results against their strategic benchmarks, although, at total fund level, it continues to use the local authority indices and averages. Other comparisons with local authority averages may be highlighted from time to time to demonstrate, for example, whether the benchmark itself is producing good results. The Fund's medium and long-term returns have remained very strong. Long-term rankings to 31st March 2014 (in the 19th percentile for three years, in the 3rd percentile for five years and in the 2nd percentile for ten years) were very good and underlined the fact that the Fund's performance has been particularly strong in the last few years. Whole Fund returns and rankings for individual years are shown in the following table:

Year	Whole Fund Return	Benchmark Return	Local Authority average	Whole Fund Ranking
	%	%	%	
2013/14	7.6	6.2	6.4	29
2012/13	16.8	14.0	13.8	4
2011/12	2.2	2.0	2.6	74
3 year ave to 31/3/14	8.7	7.2	7.5	19
2010/11	9.0	8.0	8.2	22
2009/10	48.7	41.0	35.2	2
5 year ave to 31/3/14	15.8	13.4	12.7	3
2008/09	-18.6	-19.1	-19.9	33
2007/08	1.8	-0.6	-2.8	5
2006/07	2.4	5.2	7.0	100
2005/06	27.9	24.9	24.9	5
2004/05	10.6	11.7	11.7	75
10 year ave to 31/3/14	9.6	8.3	7.8	2

3.7 Quarters ended 31st March 2014 and 30th June 2014

Detailed reports on fund manager performance in the last two quarters are provided by the fund's external adviser, AllenbridgeEpic, in Appendices 5 and 6. In overall terms, the total fund returned +1.6% in the latest (June) quarter and 1.5% in the March quarter compared to the overall benchmark returns of +2.3% and 1.0% respectively. With regard to the local authority average, the fund's performance in the March quarter was in the 12th percentile. Local authority average data for the June quarter is not available yet and will be reported to the next meeting.

Fund Manager Comments on performance and the financial markets

3.8 Baillie Gifford have provided a brief commentary on recent developments in financial markets, their impact on the Council's Fund and the future outlook. This is attached as Appendix 2.

Early Retirements

3.9 Details of early retirements by employees in Bromley's Pension Fund in the current year and in previous years are shown in Appendix 3.

Fund Manager attendance at meetings

3.10 As Members will be aware, around 70% of the Fund (global equities) has only been under management for two quarters, so it was decided that none of the Fund managers would be invited to attend the meeting on this occasion. The global equity managers will all have completed their first year in December and the Diversified Growth managers will have completed two years then. It is important that the managers attend meetings, at least on a semi-regular basis, to discuss and report on their actions and performance and to answer any questions Members, officers and advisers may have. Further meetings have been scheduled in December, February and May and it is proposed that managers be invited to attend as follows, although Members reserve the right to request attendance at any time if any specific issues arise:

Meeting 2nd December 2014 – Baillie Gifford (global equities, DGF and fixed income)
 Meeting 24th February 2015 – Blackrock and MFS (global equities)
 Meeting 19th May 2015 – Fidelity (fixed income) and Standard Life (DGF)

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 2013, 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.

5. FINANCIAL IMPLICATIONS

5.1 Details of the final outturn for the 2013/14 Pension Fund Revenue Account and the position after the first quarter of 2014/15 (as at 30th June 2014) are provided in Appendix 4 together with fund membership numbers. A net surplus of £12.2m was achieved in 2013/14 (mainly due to investment income of £10.9m) and total membership numbers rose in the year by 682. In the first quarter of 2014/15, a net surplus of £0.7m was achieved (lower than expected, mainly due to an unusual excess of transfer values payable over receivable) and total membership numbers rose further by 141. The overall proportion of active members has, however, declined in recent years and has fallen from 36.4% at 31st March 2012 to 35.4% at 30th June 2014.

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 2013.

Non-Applicable Sections:	Personnel Implications
Background Documents: (Access via Contact Officer)	Analysis of portfolio returns (provided by WM Company). Monthly and quarterly portfolio reports of Baillie Gifford, Blackrock, Fidelity, MFS and Standard Life. Quarterly Investment Report by AllenbridgeEpic

MOVEMENTS IN MARKET VALUE & FTSE100 INDEX

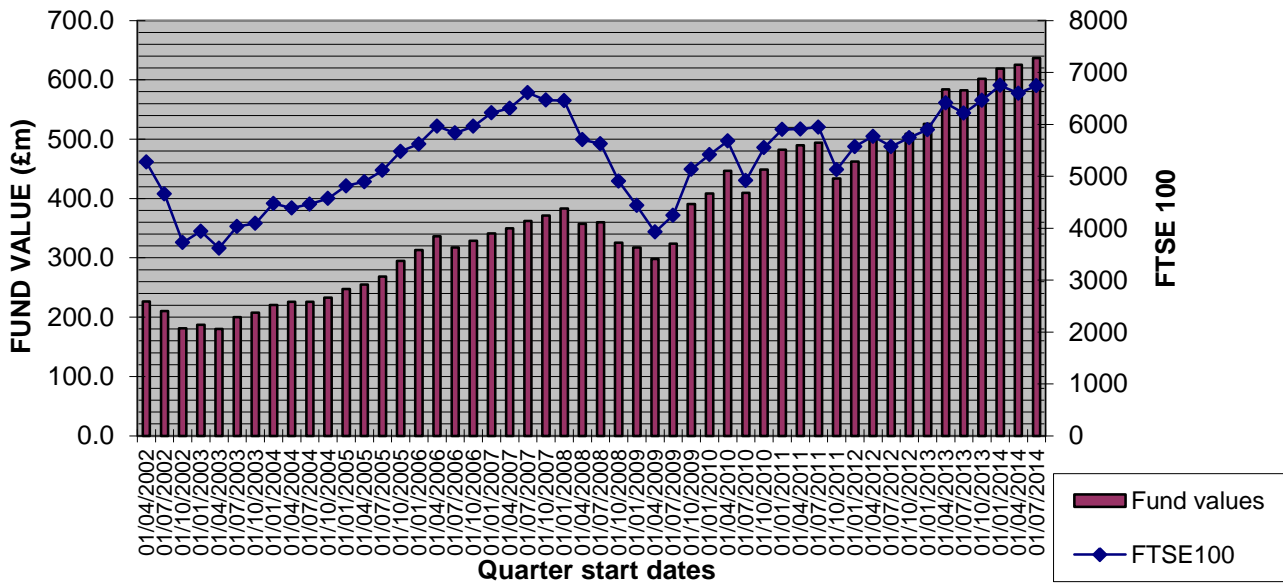
Market Value as at	Fidelity#	Baillie Gifford	CAAM	Black-rock	Standard Life	MFS	Total	Revenue Surplus Distributed to Managers*	FTSE 100 Index
	£m	£m	£m	£m	£m	£m	£m	£m	
31 Mar 2002	112.9	113.3	-	-	-	-	226.2	0.5	5272
31 Mar 2003	90.1	90.2	-	-	-	-	180.3	-	3613
31 Mar 2004	112.9	113.1	-	-	-	-	226.0	3.0	4386
31 Mar 2005	126.6	128.5	-	-	-	-	255.1	5.0	4894
31 Mar 2006	164.1	172.2	-	-	-	-	336.3	9.1	5965
31 Mar 2007	150.1	156.0	43.5	-	-	-	349.6	4.5	6308
31 Mar 2008	151.3	162.0	44.0	-	-	-	357.3	2.0	5702
31 Mar 2009	143.5	154.6	-	-	-	-	298.1	4.0	3926
31 Mar 2010	210.9	235.5	-	-	-	-	446.4	3.0	5680
31 Mar 2011	227.0	262.7	-	-	-	-	489.7	3.0	5909
31 Mar 2012	229.6	269.9	-	-	-	-	499.5	-	5768
31 Mar 2013	215.7	342.1	-	-	26.1	-	583.9	-	6412
30 June 2013	216.5	339.9	-	-	26.0	-	582.4	-	6215
30 Sept 2013	223.5	352.3	-	-	26.0	-	601.8	-	6462
31 Dec 2013@	56.7	290.7	-	121.8	26.9	122.7	618.8	-	6749
31 Mar 2014	58.4	294.9	-	122.1	27.0	123.1	625.5	-	6598
30 June 2014	59.7	298.0	-	126.5	27.3	125.5	637.0	-	6744
31 July 2014	60.1	297.0	-	126.5	27.8	124.7	636.1	-	6730

* Distribution of cumulative surplus during the year.

£50m equity sale Dec 2012 to fund Standard Life and Baillie Gifford DGF allocations.

@ Assets sold by Fidelity (£170m) and Baillie Gifford (£70m) in Dec 2013 to fund MFS and Blackrock global equities.

PENSION FUND - QUARTERLY VALUES AND FTSE100 INDEX



Baillie Gifford Report for the quarter ended 30 June 2014

Quarterly portfolio information

Summary portfolio valuation and performance			
	31 March 2014	30 June 2014	3 month Performance to 30 June 2014
Global Alpha (gross)	£207,778,411	£208,925,607	0.3%
<i>MSCI ACWI</i>			2.6%
Diversified Growth (net)	£26,822,419	£43,044,755*	2.2%
<i>Base rate +3.5%</i>			1.0%
Sterling Aggregate (gross)	-**	£46,133,655	1.93%
<i>50% FTSE Actuaries UK Conventional Gilts All Stocks Index & 50% BoAML Sterling Non- Gilt Index</i>			1.61%

Note: *Reflects an additional investment of £15,668,316 into the portfolio

Note: **Funds transferred to the Sterling Aggregate Portfolio in April 2014

Longer Term Performance

Baillie Gifford was appointed in 1999 to manage a multi asset portfolio for the London Borough of Bromley. This portfolio was re-organised in December 2013 to the new mandate, Global Alpha, with funds being transferred to separate bond and Diversified Growth portfolios. The longer term performance of the Global Alpha portfolio therefore incorporates the longer term performance of the multi-asset portfolio.

	Performance to 30 June 2014 (%)		
	Fund Gross	Fund Net	Benchmark
Since Inception* (Cumulative)	140.7	132.8	108.1
Since Inception* (p.a.)	6.2	6.0	5.2
Five Years (p.a.)	15.0	14.8	12.3
One Year	9.5	9.2	9.7
Since 31/12/13**	2.6	2.4	3.2
Quarter	0.3	0.2	2.6

*31 December 1999

** Global Alpha performance measurement began on 31/12/13

Background

Global equity markets continued to climb over the quarter. Unlike previous quarters, however, much of this was driven by Emerging Markets, with markets such as India, Turkey and Brazil showing particular strength. The Indian market rose in the light of Narendra Modi's success in the recent Indian election. Impediments to growth, and hence our enthusiasm in India, are well-known, but it is hoped that India finally has a strong and growth-oriented government that can implement the necessary reforms to tackle these hurdles. The Turkish and Brazilian markets experienced a bit of a relief rally. The European markets also rose over the period, reacting positively to the latest actions of the ECB which cut interest rates (with the deposit rate now below zero) and launched a series of steps to boost lending to companies. Europe's issues are far from over, with structural reforms still needed in many areas, but the hope is that these latest measures will enhance monetary

transmission, allowing inflation to rise and avoid too prolonged a period of low inflation while also encouraging the banks to lend to the real economy and stimulate economic growth.

Global Alpha Portfolio

While these macro events are interesting from a broad background perspective, we remain focused on the fundamentals of the companies that we invest in. It is therefore encouraging to see that the majority of your holdings continue to deliver operationally.

We continue to be fascinated by many healthcare companies. One end of the healthcare industry is dominated by traditional ‘big pharma’– companies that operate unattractive cumbersome business models. At the other end, we are excited by a number of nimbler more innovative companies in the area of personalised healthcare. We feel that these companies have the opportunity to disrupt the big players and importantly help to reduce the costs of healthcare provision and improve clinical outcomes for patients. Examples of such holdings include the genetic testing company Myriad Genetics (which we increased last quarter), the biotechnology company, Seattle Genetics, and the companion diagnostics company, Qiagen. These companies clearly have huge transformational potential. However, we do remain cognisant of whether future growth is fairly reflected in share price valuation. As such, we took advantage of the recent strength in the share price of Illumina (producer of gene sequencing machines) and sold the holding.

The US healthcare insurance market is another industry that has changed significantly over the past few years. The team recently reassessed the investment case for the holding in Wellpoint. Despite negative media over the recent past, we have become increasingly convinced that Wellpoint is in a strong position to benefit from the Affordable Care Act, which it is hoped will bring affordable healthcare insurance to an additional 30 million people. Not only has Wellpoint survived a full frontal political attack and introduced a new management team, it has also built a strong brand, successfully re-positioned its product offering and maintained a good track record of share buybacks – none of which appears to be appreciated by the market. As a result, we decided to increase the holding.

Over the past few months the team has reassessed the investment case for Walt Disney which has seen significant operational and share price recovery since we initially took a holding in the depths of 2008. While we continue to see upside from improving economic conditions driving demand for its content, park attractions and cruises, we felt that much of this now appears in the price. We therefore took the decision to trim the holding.

The final transaction over the quarter was the purchase of a new holding in Distribution NOW, a recent spin off from a previous holding, National Oilwell Varco. This is a distribution business serving mainly E&P, midstream and downstream oil and gas companies. It is a large player in a consolidating industry, with a global network of stores and distribution centres.

Outlook

As always, we continue to look for the most attractive growth companies from around the world. While this quarter saw fewer transactions than the previous three months, annualised stock turnover remains in the normal range of around 20% – entirely consistent with our long-term investment horizon.

EARLY RETIREMENTS

A summary of early retirements by employees in Bromley's Pension Fund in the current year and in previous years is shown in the table below. With regard to retirements on ill-health grounds, this allows a comparison to be made between their actual cost and the cost assumed by the actuary in the triennial valuation. If the actual cost of ill-health retirements significantly exceeds the assumed cost, the actuary will be required to consider whether the employer's contribution rate should be reviewed in advance of the next full valuation. In the three year period 2007-2010, the long-term cost of early retirements on ill-health grounds was well below the actuary's assumption in the 2007 valuation of £800k p.a. In the latest valuation of the fund (as at 31st March 2010), the actuary assumed a figure of £82k in 2010/11, rising with inflation in the following two years. In 2012/13, there were two ill-health retirements with a long-term cost of £235k, and, in 2013/14, there were six with a long-term cost of £330k. In the first quarter of 2014/15, there was one ill-health retirement with a long-term cost of £128k. Provision has been made in the Council's budget for these costs and contributions have been or will be made to reimburse the Pension Fund, as result of which the level of costs had no impact on the employer contribution rate.

The actuary does not make any allowance for other early retirements, however, because it is the Council's policy to fund these in full by additional voluntary contributions. In 2012/13, there were 45 other (non ill-health) retirements with a total long-term cost of £980k and, in 2013/14, there were 26 with a total long-term cost of £548k. In the first quarter of 2014/15, there were five non ill-health retirements with a long-term cost of £15k. Provision has been made in the Council's budget for severance costs arising from LBB staff redundancies and contributions have been or will be made to the Pension Fund in both years to offset these costs. The costs of non-LBB early retirements have been recovered from the relevant employers.

Long-term cost of early retirements	Ill-Health		Other	
	No	£000	No	£000
Qtr 1 – June 14 - LBB	1	128	3	15
- Other	-	-	2	-
- Total	1	128	5	15
Actuary's assumption - 2013 to 2016		1,000 p.a.		N/a
- 2010 to 2013		82 p.a.		N/a
Previous years – 2013/14	6	330	26	548
- 2012/13	2	235	45	980
- 2011/12	6	500	58	1,194
- 2010/11	1	94	23	386
- 2009/10	5	45	21	1,033
- 2008/09	6	385	4	256

PENSION FUND REVENUE ACCOUNT AND MEMBERSHIP

	Final Outturn 2013/14 £'000's	Estimate 2014/15 £'000's	Actual to 30/06/14 £'000's
INCOME			
Employee Contributions	5,580	5,600	1,410
Employer Contributions	23,967	23,000	5,700
Transfer Values Receivable	5,074	3,000	470
Investment Income	10,883	10,000	2,450
Total Income	<u>45,504</u>	<u>41,600</u>	<u>10,030</u>
EXPENDITURE			
Pensions	23,409	24,300	6,110
Lump Sums	5,884	6,000	850
Transfer Values Paid	1,559	3,000	2,250
Administration	2,413	2,500	150
Refund of Contributions	13	-	10
Total Expenditure	<u>33,278</u>	<u>35,800</u>	<u>9,370</u>
Surplus/Deficit (-)	<u>12,226</u>	<u>5,800</u>	<u>660</u>
MEMBERSHIP			
	31/03/2014		30/06/2014
Employees	5,254		5,339
Pensioners	4,862		4,890
Deferred Pensioners	4,819		4,847
	<u>14,935</u>		<u>15,076</u>