

**Decision Maker:** Pensions Investment Sub-Committee

**Date:** 2<sup>nd</sup> December 2014

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

**Title:** REVISED INVESTMENT STRATEGY - PHASE 3

**Contact Officer:** Martin Reeves, Principal Accountant (Technical & Control)  
Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk

**Chief Officer:** Director of Finance

**Ward:** All

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1. Reason for report

This report provides further information on “alternative fixed income (inflation proofing / illiquid)” assets as part of the 20% “protection” allocation under phase 3 of the investment strategy agreed in 2012. The Sub-Committee is asked to confirm the percentage allocations to illiquid assets and to fixed income and to then agree to a manager search for the illiquid element and to agree how the fixed income element will be managed.

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**RECOMMENDATION(S)**

**The Sub-Committee is asked to:**

**2.1 Note the report and to:**

- a) Agree the percentage split of the total approved allocation of 20% for Phase 3 of the revised investment strategy between “alternative fixed income (inflation proofing / illiquid)” and “conventional” fixed income;
- b) Agree which of the existing fixed income managers (Baillie Gifford and Fidelity) should manage the agreed allocation for fixed income; and
- c) Agree that a manager search be carried out seeking to appoint one or more managers to invest in the agreed allocation for “alternative fixed interest (inflation proofing / illiquid)” assets.

## 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: N/A.
  3. Budget head/performance centre: Pension Fund
  4. Total current budget for this head: £35.8m expenditure in 2014/15 (pensions, lump sums, admin, etc); £41.6m income (contributions, investment income, etc); £655.9m total fund value at 30<sup>th</sup> September 2014)
  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 2013
  2. Call-in: Call-in is not applicable.
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## Customer Impact

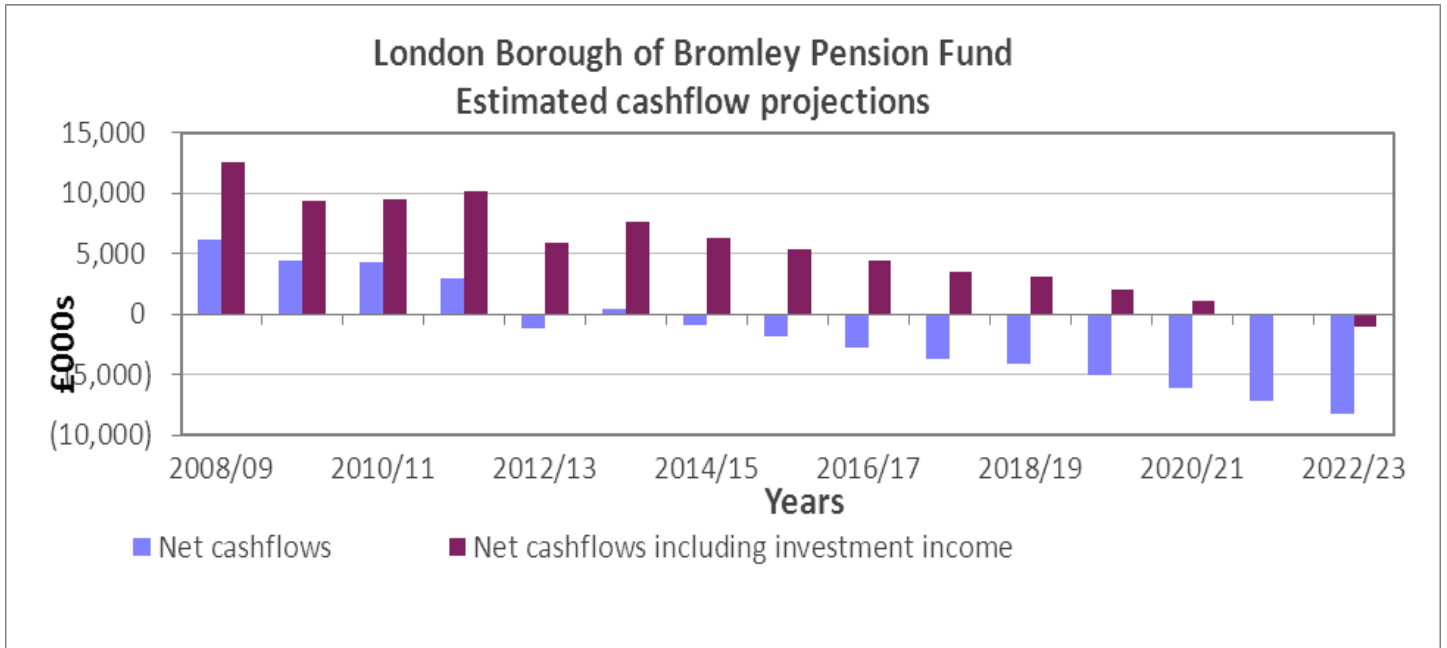
1. Estimated number of users/beneficiaries (current and projected): 5,355 current employees; 4,930 pensioners; 4,931 deferred pensioners (as at 30<sup>th</sup> September 2014)
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## Ward Councillor Views

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

### 3. COMMENTARY

- 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 6<sup>th</sup> 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 meeting in November 2013, 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. At that stage, the timetable indicated that Phase 3 should be completed (funded) by 31<sup>st</sup> 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 November 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 prepared a cashflow projection and this was attached as an appendix to a further update report from AllenbridgeEpic that was considered at the Sub-Committee meeting in February 2014. The actuary advised that, based on the numbers in the projections, the Fund was 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. The actuary’s cashflow projection is shown below.



3.5 At that February meeting, Members agreed to defer a decision on the final allocation to fixed income and requested a report to the next meeting of the Sub-Committee on alternative “protection type” assets as part of the fixed income allocation. The next meeting, originally scheduled in May, was cancelled because of the local elections and this was considered in August, when the Sub-Committee agreed that “a manager search be carried out seeking to appoint one or more managers to invest a total of up to 10% of the fund (c. £60m based on the current fund value) over the longer term in “alternative fixed interest (inflation proofing / illiquid)” assets; and that “the remaining balance of the 20% allocation for fixed income be managed by one (or both) of the existing fixed income managers (Baillie Gifford and Fidelity) on a global basis with an absolute return benchmark (as set out in the Statement of Investment Principles 2014).”

3.6 At the August meeting, there was some discussion around the appropriateness of investing 50% of the 20% “protection” allocation (c. £60m) in fixed income and it was agreed that AllenbridgeEpic should research further into assets matching the criteria contained in the August report. An update is attached as Appendix 1 and AllenbridgeEpic’s August paper is attached as Appendix 2. The issue of how to fund any new investments is addressed in a Part 2 appendix to this report. Alick Stevenson will be at the meeting to discuss/explain as necessary.

**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 None at this stage.

<b>Non-Applicable Sections:</b>	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	LGPS (Administration) Regulations 2008 (as amended) and LGPS Regulations 2013. LGPS (Management & Investment of Funds) Regulations 2009.