

Decision Maker: Pensions Investment Sub-Committee

Date: 24th February 2015

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

Title: REVISED INVESTMENT STRATEGY - PHASE 3

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Chief Officer: Director of Finance

Ward: All

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 consider the attached report from the Fund’s advisers, AllenbridgeEpic, which recommends a gradual move in Fidelity’s fixed income holding from the existing UK Aggregate Bond Fund to the Fixed Income Diversified Alpha (FIDA) Fund.

RECOMMENDATIONS

The Sub-Committee is asked to:

2.1 Note the report and to:

a) Agree to invest an initial £5m in Fidelity’s FIDA Fund, to be transferred from Fidelity’s existing UK Aggregate Bond Fund, with further quarterly transfers to be made dependent on investment performance and the overall size of the fund; and

b) Agree that Baillie Gifford continue to manage the remainder of the fixed income portfolio under their existing Sterling Aggregate Bond Fund.

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); £38.6m income (contributions, investment income, etc); £693.7m total fund value at 31st December 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

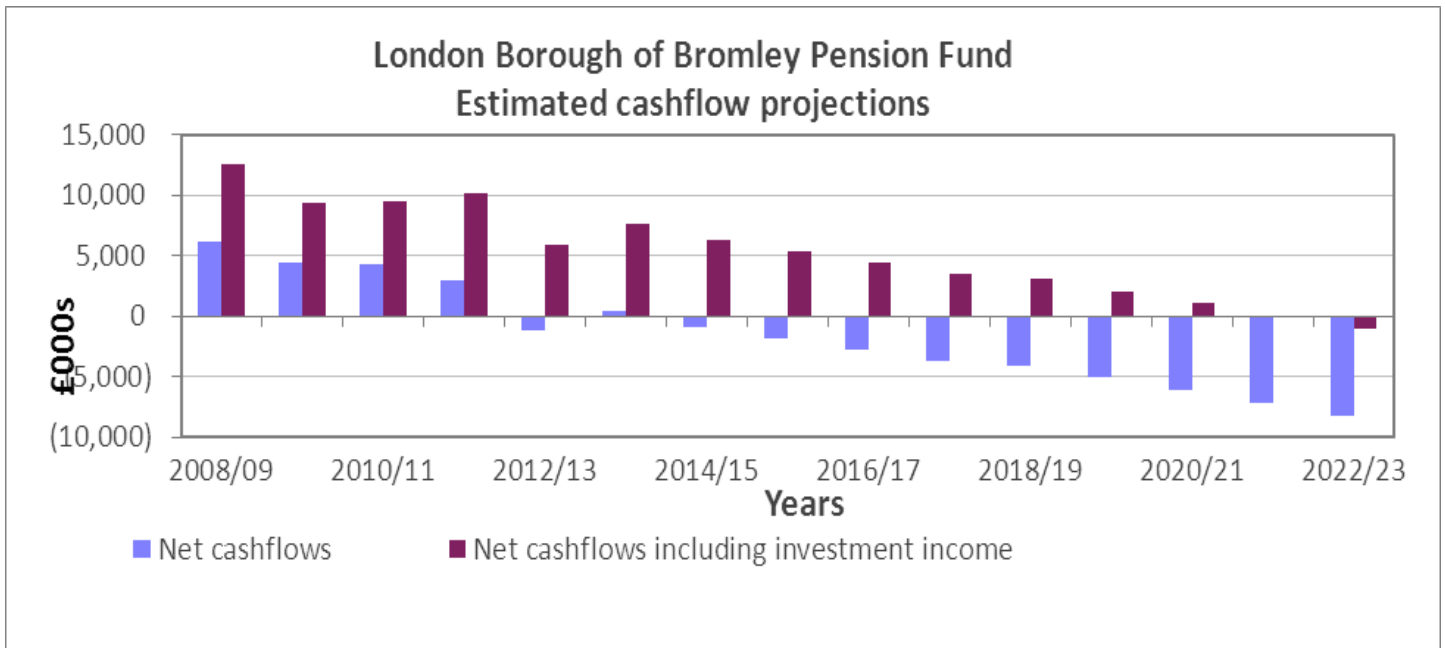
1. Estimated number of users/beneficiaries (current and projected): 5,637 current employees; 4,937 pensioners; 5,007 deferred pensioners (as at 31st December 2014)
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Ward Councillor Views

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 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 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 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 £140m. At the November 2013 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 the matter was considered again in August 2014, 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 at that time) in fixed income and it was agreed that AllenbridgeEpic should research further into assets matching the criteria contained in the August report. They reported back to the Sub-Committee in December 2014 and the Sub-Committee agreed that, in view of Member concerns over the illiquidity of potential funds highlighted by AllenBridgeEpic, existing conventional fixed income assets be retained. AllenBridgeEpic were asked to continue to search for options at an appropriate level of risk, reporting back to this meeting. An update is attached as Appendix 1 and this recommends that the Baillie Gifford fixed income mandate continues unchanged, while, with regard to Fidelity, they recommend that an initial £5m be invested in Fidelity’s FIDA Fund, to be transferred from Fidelity’s existing UK Aggregate Bond Fund, with further quarterly transfers to be made dependent on investment performance and the overall size of the fund.

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.

Non-Applicable Sections:	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.