Bath and North East Somerset Council

AVON PENSION FUND COMMITTEE

Minutes of the Meeting held

Friday, 10th December, 2010, 2.00 pm

Bath and North East Somerset Councillors: Gordon Wood (Chair), David Bellotti (Vice-Chair), Tim Ball, Gabriel Batt and Victor Clarke

Co-opted Voting Members: Ann Berresford (Independent Member), Councillor Mike Drew (South Gloucestershire Council), Councillor Mary Blatchford (North Somerset Council), Councillor Tim Kent (Bristol City Council) and Steve Paines (Trade Unions)

Co-opted Non-voting Members: Richard Orton (Trade Unions) and Paul Shiner (Trade Unions)

Advisors: Tony Earnshaw (Independent Advisor) and Dave Lyons (JLT Benefit Solutions)

Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions), Matthew Betts (Assistant Investments Manager), Steve McMillan (Pensions Manager), Martin Phillips (Finance & Systems Manager (Pensions)) and Alan South (Technical and Development Manager)

17 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

18 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Rowena Hayward, Keith Kirwan, Bill Marshall and Liz Feinstein (Investments Manager).

19 DECLARATIONS OF INTEREST

There were none.

20 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

21 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

22 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

23 MINUTES: 24TH SEPTEMBER 2010

These were approved as a correct record and signed by the Chair.

24 UPDATE ON ACTUARIAL VALUATION

The Head of Business, Finance and Pensions presented the report. He said that the main aim of the valuation had been to maintain stability of contribution rates, where possible, in accordance with the Funding Strategy Statement agreed by the Committee in September 2010. There would, as a consequence, be a smaller prudential margin for the solvency of the Fund. In addition, although there was uncertainty as to how the Hutton Commission would impact the rates for future service, future service costs were expected to decline; however, there was less scope for potential changes to the scheme to significantly reduce the costs of past service. The 2010 funding level was 82%. The average employee contribution rate would be held at 16.6%, the same as for the 2007 valuation, which would mean that the deficit recovery period at the Fund level would be extended from 20 to 22 years. The impact on the individual employers would vary considerably and discussions were taking place with employers to explain individual outcomes.

A Member said that he considered the report inadequate as it contained insufficient detail and that there had not been enough opportunity to discuss it with the actuary, to whom the Fund paid large fees. He was concerned to note that the employers had been informed of future contribution rates before the report had come to the Committee. The Committee should have been provided with information about the impact of the valuation on each individual employer. He felt that the Committee could not accept the conclusions of the actuary without more detailed information. The Head of Business, Finance and Pensions replied that officers relied on the professional judgment of the actuary, who had a fiduciary duty to ensure that his valuation was prudent. Negotiations were taking place with some employers to help them within the Funding Strategy Statement. The Member wondered how negotiations could still be taking place with employers after they had been told what their contribution rates would be and before there had been any discussion with the Committee. Another Member said that the actuary only made recommendations; decisions were taken by the Committee and should be based on full information, which had not been provided. Another Member was concerned to note that contributions were going to be held at 16.6% even though the actuary had advised that they should be raised to 17.2%. She felt that the actuary's advice to increase rates for past service but none for future service was contradictory. Though Hutton would give some clarity on future service, there would still be uncertainties. The Fund would ignore future service at its peril. Another Member said that better information about actuarial valuations had been given to the Committee in the past. The Head of Business, Finance and Pensions replied that he did not think the involvement of the Committee in this valuation had been different from previous valuations. There was a great deal of pressure on the actuary's time and the Committee seemed to be seeking more information than the actuary could provide. A

Member said that there was strong pressure from central government to keep contribution rates down and that he felt that the actuary had succumbed to this pressure. The Chair suggested that in view of the strongly-expressed concerns of the Committee the actuary should attend a future meeting. A Member said that information should be provided as soon as possible and the actuary invited to attend the March 2011 meeting. The Head of Business, Finance and Information asked what kind of information Members wanted. A Member replied that she believed a copy of the actuary's valuation papers should be provided. Members agreed unanimously to amend the officer's recommendation to note "the outcome of the 2010 Actuarial Valuation" and to simply note the report.

RESOLVED to note the report on the 2010 Actuarial Valuation.

25 HUTTON COMMISSION AND UPDATE ON REGULATIONS - VERBAL REPORT

The Technical Development Manager briefed the Committee on three issues.

<u>Hutton Commission</u>

As Members were aware, the present Government had appointed a Commission chaired by Lord Hutton to review public sector pensions. The Local Government Pension Scheme (LGPS) was included, even though it had been reformed by the previous Government in 2008. The Commission was due to publish its main report in March 2011, having published its interim report in October 2010. In his foreword to the Interim Report Lord Hutton stated that he had rejected "a race to the bottom" and hoped that reformed public service pensions could be seen as once again providing a benchmark for the private sector to aim towards. The Interim Report had speculated about the future structure of benefits and had indicated that increased contributions would be required, but had said that the low-paid should be protected. The Interim Report said that the LGPS was one of only two funded schemes in the public sector and would remain so. Benefits would remain linked to pay, but based on career average rather than final salary and with the pension age raised to match the state pension age. The Fair Deal for public sector workers transferred out of the public sector was under review; some of the employers in the Fund had thought this was too political to comment on in the consultation. A Member said that the Fund's response to the consultation was a matter of policy and a draft response should have been circulated to members. The Technical Development Manager responded that consultation responses took the form of answers to specific questions posed by the Commission and that the replies had been put together by the Pensions Administration Team. The Head of Business, Finance and Pensions said that the questions had been answered from an administrative point of view, but promised that copies of the response would be circulated to Members.

<u>Changes to Pensions Tax Regime</u>

From April 2011 there would be changes to pensions tax relief. The maximum annual allowance for tax relief on pensions would be reduced from £250,000 to £50,000 and the lifetime allowance from £1.8m to £1.5m from 6 April 2012. For tax year 2011-2012 carry-forward would be available against excess contributions of an assumed annual allowance of £50,000 for the tax years 2008-09, 2009-10 and 2010-11. The capital conversion factor for annual allowance purposes would increase from

10:1 to 16:1 for accruals for active members effective from 6 April 2011. The Annual Allowance would not be applied in the year of death or in the case of lump sums paid where individuals are diagnosed with serious (terminal) ill health. The original proposals had been amended after consultation: the annual allowance had been raised from £30-35,000 to £50, 000 and the reduction of the lifetime allowance had been deferred for one year.

Equitable Life

Equitable Life had run into serious difficulties in 2000 and had been taken to court for reducing payments to policy holders. The new Government had agreed to pay total compensation to policy holders of £1.5bn against £4.3bn of estimated losses. Full compensation would be paid to individual policy holders up to a limit of £20m. A report was expected in January 2011 with compensation payments being made from April 2011. The Pensions Manager said that many pensioners in the Avon Pension Fund were affected because at one time Equitable Life was the only AVC provider available to them. Compensation would also be paid on behalf of deceased pensioners.

RESOLVED to note the information provided in the briefing.

26 ADMINISTRATION STRATEGY

The Pensions Manager presented this item. He said that it was the most important administrative document that the Fund had dealt with for some years. The Government had originally legislated for the Strategy to be a requirement for local authority pension funds, but this had been changed to a recommendation as good practice. Its purpose was to improve the quality of service to pension fund members. It should help the administration team to improve efficiency and for employers to provide information in a more timely fashion. An electronic data interface would be available to all employers from September 2012 (from April 2012 for large and medium employers). There would be increased accountability for the administration team and employers through the introduction of performance targets, which would be reviewed from time to time and updated. Employers had been consulted the Strategy and given assurance of their commitment to it.

RESOLVED to approve the draft Pensions Administration Strategy for the Avon Pension Fund to be effective from 1st April 2011.

27 INVESTMENT PANEL MINUTES

RESOLVED to note the Minutes of the meeting of the Investment Panel of 17th November 2010.

28 RECOMMENDATIONS FROM INVESTMENT PANEL

The Assistant Investments Manager presented the report. There was one recommendation from the Panel relating to the balance between UK and overseas equities in the Fund. This had arisen from the Panel's concerns about the holdings in

BP and the risk arising from sector and stock concentrations within the UK equity index.

A Member said that he was prepared to follow the recommendation of the Panel, but would be less likely to increase holdings outside the UK if he were acting as a private investor because of exposure to fluctuating currency rates and the risks arising from the global economy and global politics. He wished to seek assurance that there was more than a marginal benefit to be achieved from the recommendation. The Assistants Investment Manager replied that currency risk would be offset by active currency hedging, as already approved by the Committee. The reduction in the volatility of returns from the policy change might be marginal, but the Panel had felt it was worthwhile. Another Member said he understood the Panel's reasoning, but was concerned at the net effect on the UK and ultimately pension fund members of a trend of disinvestment in the UK. The Independent Adviser said that there was a trend among public and private pension funds to invest overseas, but this was a global trend and therefore disinvestment by UK funds was offset by increasing investment in the UK by institutions in other countries. Pension funds had at one time accounted for 40% of investment in the UK market, but this was now 25%. The Chair of the Investment Panel said that the key issue was the level of the Fund's exposure to BP and other oil stocks. The aim of the recommendation was to increase diversification and so to reduce risk, not to increase returns. There was an insignificant increase in returns to be achieved by increasing holdings in global equities, but a reduction in the current level of risk. Mr Lyons said that a 0.01% in volatility might seem insignificant, but in cash terms it was £25m. Tapping into global growth was a potential benefit of diversification, though UK companies would share in this too. Even if there was no long-term difference in returns, short-term volatility would be reduced and the currency risks could be managed. The only way of reducing risk with passively managed assets was to increase the spread.

RESOLVED

1. To reduce the allocation to UK equities from 45% to 30% of the equity portfolio and increase the allocation to overseas equities from 55% to 70%.

2. To implement the switch within the passively managed equity portfolio.

29 APPOINTMENT OF UNCONSTRAINED GLOBAL EQUITY MANAGER

The Assistant Investments Manager introduced this item. Members noted the report and the exempt appendix.

RESOLVED to note the appointment of Schroder as unconstrained global equity manager.

30 FRC STEWARDSHIP CODE

The Assistants Investments Manager explained the background to the Code.

Having considered the draft Statement of Compliance with the FRC Stewardship code, the Committee **RESOLVED** to approve it.

31 REVIEW OF INVESTMENT PERFORMANCE FOR QUARTER ENDING 30 SEPTEMBER 2010

The Assistants Investment Manager presented the report and summarised the key facts. There had been an increase in asset values of 8.1%, driven mainly by the rally in the equity markets. Over the year there had been an increase of 10.8%, to which all asset classes had contributed. Following the decision of the Committee at its meeting on 26 March 2010 to appoint a vote monitoring service, tenders had been invited and the contract had been awarded to Manifest.

Mr Lyons summarised the main points of the JLT performance monitoring report, attached as Appendix 2. He referred to the chart on page 17 of the monitoring report (page 97 of the agenda), which plotted each investment manager's annual risk against their annual absolute return. The equity managers were well to the right of the chart indicating very high levels of risk, whereas Fund of Hedge Fund managers and property managers were to the left. The location of the total Fund in the middle of the chart showed the benefits of diversification. At the last meeting Members had requested information over a three-year period, and this was provided in the chart on page 18 (agenda page 98). He commented on individual investment managers. Jupiter had underperformed its benchmark over the quarter, but had outperformed it over the year, producing an absolute return of 15.7% over the year. Against this, TT International had outperformed its benchmark over the quarter, but underperformed over the year. The varying performance of these two equity managers showed again the benefits of diversification. State Street had announced that they had acquired Bank of Ireland Asset Management (BIAM). He had no concern about this, as it was a case of a small company being taken over by a much larger one. Genesis had performed above the benchmark; developing markets had been strong over the past three years. Turning to the Fund of Hedge Funds, he said that Lyster Watson had identified that they had some involvement in a hedge fund one of whose managers was under investigation by the financial authorities. Further information was sought from five hedge funds and Lyster Watson established that they had only a very small exposure. Hedge funds were under review by the Investment Panel, and would appear on the agenda of the next meeting of the Panel in January 2011 and on the Committee's agenda in March 2011.

The Chairman of the Investment Panel noted the comment in paragraph 9.2 of the covering report that the Local Authority Pension Fund Forum (LAPFF) had raised health and safety governance issues with BP as far back as 2006. He said that the Panel had questioned one investment manager very closely about its decision to increase holdings in BP after Deepwater Horizon. He thought that if LAPFF were raising concerns with BP in 2006, a good deal of information about must have circulating about BP then and subsequently and that this should have been reported to the Committee. The Assistant Investment Manager replied that a section on LAPFF had been introduced in the performance report in order to improve the information provided to the Committee about LAPFF activity.

RESOLVED:

1. To note the information as set out in the report.

2. To note the appointment of Manifest to monitor the Fund's voting activity.

32 PENSION FUND ADMINISTRATION - BUDGET MONITORING AND PERFORMANCE INDICATORS FOR 3 MONTHS TO 30 OCTOBER 2010

The Finance & Systems Manager (Pensions) presented the Budget Report. He said that an underspend of £6,000 on administration costs would be more than offset by an increase in Investment Management fees arising from higher than budgeted market values. This would result in an overspend on the whole budget of £32,000.

The Pensions Manager presented the Performance Report. He said that following the data cleansing exercise for the triennial Actuarial Valuation there were "old" unprocessed leavers remaining to be cleared. The Government's decision to base pension increase on CPI instead of RPI in future had mean that transfers in and out had had to be stockpiled until revised factors were notified by the Government Actuary's Department. There had been no complaints and sickness absence had been extremely low. The Annual Benefit Statements had been sent to deferred members and all would be sent to all members by the end of January 2011. The Benefits Statement had been redesigned. Initial teething troubles with the new Altair software had been overcome. Heywood had been chosen to replace Gandlake as provider of member and employer access to personal member data. Gandlake had not developed their services and Heywood offered facilities that Gandlake did not. Globalscape software, recently purchased for other Council services, was now used to provide facilities to send and receive personal confidential data that had been previously provided by Gandlake. The number of employers in the Fund now stood at 110, increased from 97 in 2008. It was fully expected that the number of employers would continue to grow, necessitating the expenditure of more staff time on employer relations. A conference for the Fund's employers would be held on 2nd Feburary 2011.

RESOLVED:

1. To note the expenditure for administration and management expenses incurred for the seven months ending 31st October 2010.

2. To note the performance indicators for 3 months to 31st October 2010.

3. To note the changes to Fund Employers since 1st April 2010.

33 ANNUAL REVIEW OF INTERNAL CONTROL REPORTS

The Assistant Investments Manager presented the report, which set out the results of the review of the control reports of investment managers and the custodian. He noted that an internal controls report is not mandatory but that all the Fund's mangers provide them except for the hedge funds. However, this year one of the Fund's Hedge Fund Managers had produced an Internal Controls Report which showed some progress. In the case of the other Hedge Funds, the Officers review the audited accounts and the internal control reports of the Hedge Fund's administrator. This is important as it provides independent assurance of the control environment for the body responsible for safekeeping of assets and verification of asset values. The only issue identified was in the case of Royal London Asset Management (RLAM) where there was one exception, which had also been identified as one of two exceptions last year. Whilst action had been taken to mitigate the risk, the solution was not in place in time for the whole of the year under review and so was highlighted by audit. Officers are satisfied that adequate controls are fully in place.

RESOLVED to note the report and to request officers to continue to review the internal control reports and report to the Committee on at least an annual basis.

34 AVC MONITORING REPORT

The Pensions Manager presented the report. He explained that a review of the investment performance of AVC funds was conducted every two years to ensure that the return they gave to members of the Avon Pension Fund who had invested in them was acceptable. Accordingly Mercers had produced a Past Investment Performance Monitoring Report on Friends Provident (FP). Mercers had found that FP's cumulative investment performance relative to other funds was generally satisfactory, with 25 out of the 29 FP funds showing cumulative performance within the first quartile. In 2006, following poor performance from the FP funds, 3 additional providers on the FP platform with 15 funds between them had been added to the options available to Avon Pension Fund members. A letter had been sent to Fund members about the additional options, but few had taken them up. Mercers were now carrying out a strategic review of AVC provision, with a view to simplifying the choices available to members. It was expected that this would be presented at the March 2011 of the Committee.

A Member asked why Mercers was asked to do these reports rather than JLT. She felt that by appointing AVC providers the Fund was effectively endorsing them. Taking advice from JLT would ensure consistency of approach with the other investment monitoring that was being done for the Fund. She agreed that the number of AVC funds on offer should be reduced to improve clarity of choice for Fund members, but she was not sure that there would be sufficient information for the Committee to be satisfied, as it needed to be, that all the options available to Fund members were reliable. The Independent Advisor agreed that it would be sensible to take advice from an investment specialist. The Pensions Manager replied that Mercers, who were the Fund's actuaries, had always done the work on AVCs, though other arrangements could be considered for the future. The Head of Business, Finance and Pensions said that though the use of Mercers was partly a matter of tradition, their familiarity with the work did allow them to charge a reduced cost for the work. It might be possible to ask JLT to overview Mercers' work, rather than asking them do the whole thing from scratch.

RESOLVED

1. To note the content of the Investment Performance Monitoring Report to 31 March 2010 by Mercers on Friends Provident, the Fund's chosen AVC provider.

2. To note that Mercers are currently undertaking a review of the current AVC investment strategy with Friends Provident with a view to considering a smaller range of fund options available to members to simplify their choice.

3. To note that a further report will be brought to Committee in due course with the results of the review and any recommendation.

4. To note that the Fund's actuary has confirmed that it is still prudent to offer Friends Provident as the AVC provider following its takeover by Resolution PLC.

35 WORKPLANS

The Assistant Investments Manager presented the report. He advised the Committee that the Audit Commission, the Fund's external auditors, would present their audit plan at the March 2011 meeting of the Committee.

RESOLVED to note the workplans for the period to 31 March 2011.

The meeting ended at 3.41 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services