Bath and North East
Somerset Council

AVON PENSION FUND COMMITTEE

Minutes of the Meeting held

Friday, 24th June, 2011, 2.00 pm

Bath and North East Somerset Councillors: Paul Fox (Chair), Gabriel Batt, Nicholas Coombes, Charles Gerrish and Katie Hall

Co-opted Voting Members: Councillor Mike Drew (South Gloucestershire Council), Ann Berresford (Independent Member) and Bill Marshall (HFE Sector)

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

Advisors: Tony Earnshaw (Independent Advisor) and John Finch (JLT Benefit Solutions)

Also in attendance: Andrew Pate (Strategic Director, Resources & Support Services), Tony Bartlett (Head of Business, Finance and Pensions), Liz Feinstein (Investments Manager), Matthew Betts (Assistant Investments Manager), Steve McMillan (Pensions Manager) and Martin Phillips (Finance & Systems Manager (Pensions))

1 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

2 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Councillor Mary Blatchford, Carolan Dobson, Councillor Clive Fricker, Rowena Hayward, Steve Paines, Paul Shiner and Councillor Mark Wright.

3 ELECTION OF VICE-CHAIR

Councillor Charles Gerrish was elected Vice-Chair for the Council Year.

4 DECLARATIONS OF INTEREST

There were none.

5 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

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

There were none.

7 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

8 MINUTES: 18 MARCH 2011

These were approved as a correct record and signed by the Chair, subject to the following amendment:

> page 3, item 46 (Review of Hedge Fund Portfolio), after "The Investments Manager replied that officers would ascertain the costs" insert "and report to the Investment Panel".

9 ROLES AND RESPONSIBILITIES OF THE COMMITTEE

The Investments Manager presented the report, which set out the roles and responsibilities of all those involved in the governance of the Fund. She drew attention to the need for the Committee to appoint three non-B&NES voting members to the Investment Panel.

A Member asked about the interpretation of "obtain proper advice at reasonable intervals about its investments", which was quoted from the LGPS (Management and Investment of Funds) Regulations 2009 in paragraph 4.9 of the report. The Investments Manager replied that the Committee's quarterly meetings would suffice for this purpose, though in fact additional advice was available from the external advisers who attended all meetings of the Committee and the Investment Panel.

RESOLVED:

1. To note the role and responsibilities of the members, advisors and officers.

2. To agree that the non-B&NES members of the Investment Panel will be Ann Berresford , Councillor Mary Blatchford and Bill Marshall.

To note that the B&NES members appointed to the Councillor places on the Investment Panel are Councillor Gabriel Batt, Councillor Nicholas Coombes and Councillor Charles Gerrish.

10 PRESENTATION BY MERCERS ON THE FAIR DEAL CONSULTATION

The Investments Manager reported that the Government's consultation on the Fair Deal had just ended. If the Fair Deal was abolished or substantially reformed there could be serious implications for the Fund.

The Chair welcomed Paul Middleman of Mercer Limited to the meeting. Mr Middleman made a presentation; a copy of his slides is attached as Appendix 1 to these minutes. He said that there were currently two options when functions were contracted out from the local authorities to the private sector: either outsourced staff could remain in the local authority pension fund through the use of admitted body status, or they could be enrolled in a broadly comparable scheme maintained by the contractor. It was the contractor's choice which of these would apply. The admitted body route was the more common one for employees in the Local Government Pension Scheme. Currently about 5% of the members of the LGPS were employed by admitted bodies. The Government was concerned that the current arrangements were a potential barrier for the outsourcing of public sector functions, so had initiated a consultation on whether the Fair Deal should be abolished or modified. The response to the consultation submitted on behalf of the Avon Pension Fund had argued that Fair Deal should be maintained but modified. Mr Middleman thought that if Fair Deal were abolished, it would be difficult for the LGPS to maintain current membership levels and that it would face increased volatility in relation to contributions and funding levels. As shown in the graph on page 4 of the presentation, the crossover point after which LGPS funds might have to use cash or sell assets to pay benefits could shift forward by about 8 years. Organisational restructuring resulting in a large number of redundancies at the same time would have a significant impact on LGPS funds.

A Member asked how additional costs could be incurred through staff leaving the Fund. Mr Middleman replied that while there were no additional costs when individual employees left the Fund, the Fund would be less able to pursue a higher-risk strategy and would have to invest more in defensive assets. A 4% decline in membership would cause a significant increase in volatility. Mr Middleman agreed with the Member's comment that the Fund would benefit from a reduction in the number of high earners who were members.

In reply to questions about the reasons for staff choosing to opt out of the Fund now, Mr Middleman said that people were behaving irrationally because of pressure on pay and a lot of misinformation. However, he would expect a fall in membership of about 20% if the Fair Deal was abolished. A Member responded that their behaviour might not seem so irrational when it was considered that employees were seeing steep rises in contributions and a fall in the value of their pensions; a contribution rate of 3.5% of total pay would mean a 50% increase in contributions and a change in the accrual rate from 1/80th to 1/100th would mean a 40% reduction in pension. The Chair suggested that a workshop could be arranged for Members to review this wider context after the Government had announced its decision on Fair Deal.

The Director of Resources and Support Services said that not only was there a danger of a "race to the bottom", as Hutton had warned against, but also of a race to the exit. The prospect of a 20% fall in membership was really worrying. There would probably be a bigger deficit to fund, but fewer active members, so the current investment strategy would have to be altered. Hutton had emphasised that the LGPS was different because it is a funded scheme. There was a need for more effective communication with fund members; it was important that they were not panicked into leaving the Fund.

The Chair asked how communications with members would be handled. The Head of Finance, Business and Pensions said that information would be added to the website the following week. A Member said that the information on the website was not enough; it was important to involve the employers. The Pensions Manager said that data on opt-outs was being collected and could be presented to the Committee. Members agreed that this information should be presented regularly.

The Chair thanked Mr Middleman for his presentation.

11 PRESENTATION BY SCHRODERS ASSET MANAGEMENT ON THE ECONOMIC/MARKET OUTLOOK

The Investments Manager explained that Schroders was one of the Fund's investment managers, specialising mainly in retail, property and global equities.

The Chair welcomed Lyndon Bolton, Schroders' Client Director, to the meeting.

Mr Bolton made a presentation. A copy of his slides is attached as Appendix 2 to these minutes. There were currently three main threats to the global economy:

(a) the spike in oil prices;
(b) inflation and the possibility of rises in interest rates;
(c) the crisis in the Eurozone.

These issues were discussed in depth based on the information included in the slides.

A Member observed that despite the Greek debt crisis the euro was appreciating against the pound. Mr Bolton responded that the key driver was the euro against the dollar. The dollar would appreciate against the euro if US interest rates rose.

A Member referred to slide 10 ("growth reliant on fall in savings ratio") and asked where the increase in spending necessary for the recovery would come from. Mr Bolton replied that one of the conditions for the bailout of the banks was that they would lend to businesses. However, the banks were reluctant to lend. That was part of the problem. Recovery required companies to spend more, and that was not happening at the moment.

The Investments Manager asked whether the main risk to the portfolio was through its investments in European financial institutions. Mr Bolton agreed, though a significant degree of Greek contagion risk was probably priced into valuations.

The Chair thanked Mr Bolton for his presentation.

12 REVIEW OF INVESTMENT PERFORMANCE FOR YEAR AND QUARTER ENDING 31 MARCH 2011

The Investments Manager presented the report. There had been a return of 7.8% over the year, with positive returns across all asset classes. It had been a good year for the Fund's managers, although in the last quarter they had slightly underperformed relative to their benchmarks. The return slightly lagged behind other LGPS funds, because of the Fund's lower than average allocation to equities and higher than average allocation to hedge funds. The funding level had marginally increased from 82% to 83% since March 2010. The change in the allocations between the hedge fund managers which had been agreed in March would be completed by end July.

Mr Finch commented on the JLT performance review, attached as Appendix 2 to the report. There had been strong returns in Asian, Pacific and emerging markets. The return on government bonds had been negative in the last quarter. Volatile markets had been tough for investment managers. The graph of risk versus return on page 19 showed that the Fund now had a more balanced profile. Lyster Watson is low risk, but had underperformed the benchmark during the last quarter, over the year and over the last three years, justifying the decision to disinvest from this manager taken in March. Gottex had generated reasonably good returns with low risk. Bonds had generated reasonable positive returns over the year. Jupiter had outperformed the benchmark by 7.2% over the year, though it had fallen back during the final quarter. The Fund's strategic allocation remained well diversified in terms of asset class and regional exposure.

The Investments Manager said that the Fund's asset allocation strategy would be covered in the next induction session for new Members of the Committee.

A Member suggested that the Fund might invest in land. The Investments Manager responded that this had not yet been considered by the Committee. The Chair observed that agricultural land appeared to be a good investment at the moment.

RESOLVED to note the report.

13 APPOINTMENT OF MANAGER TO HEDGE CURRENCY EXPOSURE

The Assistant Investments Manager presented the report.

RESOLVED to note the report.

14 ADMISSION OF COMMUNITY HEALTH AND SOCIAL CARE TO THE FUND

The Investments Manager presented the report. She explained that under the Local Government Pension Scheme (Administration) Regulations 2005 community admission bodies could be admitted to the Avon Pension Fund with the consent of the Committee. The Director of Resources and Support Services explained that only existing B&NES social care staff transferred to Community Health and Social Care CIC would become members of the Fund and that there would be other arrangements for new recruits to the CIC. A Member observed that this would prevent people who would have been previously eligible to join the Fund from becoming members, so that outsourcing was another factor threatening membership levels.

RESOLVED that Community Health and Social Care (CIC) be allowed entry into the Avon Pension Fund as a Community Admission Body with Bath & North East Somerset acting as a guarantor.

15 PENSION FUND ADMINISTRATION - BUDGET OUTTURN 2010/11 AND PERFORMANCE INDICATORS FOR 3 MONTHS TO 30 APRIL 2011

The Finance & Systems Manager (Pensions) presented the financial report. Expenditure for the year had been £660,394 under budget. £267,144 had been saved on investment manager fees because of a delay in appointing a new manager. There had also been less than expected expenditure on the guides, postage and the website. The Pensions Manager explained that these savings had been made without a reduction in the level of service provided.

The Pensions Manager presented the Administration Report. He referred to the key performance indicators in Appendix 3a of the report and asked members to note that most were on or ahead of target. There was 100% compliance with statutory targets, but some minor shortfall in the internal targets agreed with employers in service level agreements.

A Member asked about shortfalls in meeting service targets. The Pensions Manager reported that quite often delays by employers in providing information, e.g. about retirements, in time to enable the Fund to achieve the internal service target. He emphasised however that all statutory targets had been met. The new Administration Strategy which came into effect in April 2011 was expected to lead to improvements in service delivery to Scheme members through closer working with employers.

A Member noted that, only 0.3% of the Fund’s services were delivered to members electronically. The Pensions Manager replied that the aim was to deliver as much to members electronically as possible; this was easy with the Newsletter, but more difficult with personal confidential pensions information. The 0.3% level was achieved when members were asked some time ago whether they wished to receive the Newsletter electronically. The administration team would like to e-mail members advising them that their annual benefits statement was available online, but needed to check whether this met legal requirements. The Chair asked for a report at the next meeting on the progress made in achieving electronic service delivery.

The Pensions Manager drew attention to the delays which had been experienced last year in processing transfers in and out while waiting for the Government Actuaries Department to supply revised factor tables following the change in indexation from RPI to CPI. The backlog had now been cleared, although there was a similar situation since early 2011 in quoting for costs to members for buying additional pension (ARCs). This problem had now been resolved following a recent direction issued by CLG, and it was reported that the outstanding cases were now starting to be cleared. The Pensions Manager confirmed that members had been kept informed of the delay and the reasons for it.

RESOLVED

1. To note the expenditure and administration and management expenses incurred for the year ending 31 March 2011 and Performance Indicators for the 3 months to 30 April 2011.

2. To note the conclusions from the Internal Audit Report.

16 DRAFT STATEMENT OF ACCOUNTS 2010/11

The Finance and Systems Manager (Pensions) tabled a revised statement of accounts with changes highlighted. He said that the most significant change was the addition of note 22 (Financial Risk Management Disclosure). This had been included to comply with International Financial Reporting Standards (IFRS).

The addition of note 16 (Actuarial present Value of promised Retirement Benefits) was also required by IFRS. He drew attention to the Fund Account on page 4 of the revised Statement of Accounts, which showed that assets and benefits payable had both increased.

The Director of Resources and Support Services referred to note 4 (Contributions Receivable) and observed that this was why the Committee needed to monitor the numbers of members regularly.

RESOLVED to note the Draft Statement of Accounts for year to 31 March 2011 for audit.

17 COMMITTEE'S ANNUAL REPORT TO COUNCIL

The Investments Manager introduced this item. The Annual Report would be submitted to the Council in September. She invited Members to let her know of any matters they thought should be included.

RESOLVED to approve the Annual Report to Council.

18 WORKPLANS

The Investments Manager presented the report.

She said that the next training session would be held on 15th July 2011. It would deal with the Fund's investment strategy and investment managers. It was intended for new Members, but all Members would be welcome to attend. She invited Members to suggest items for inclusion in the work plans. A Member asked when Socially Responsible Investment (SRI) would be coming to the Committee. The Investments Manager replied that there would be two workshops on SRI during 2011.

RESOLVED to note the workplans.

19 DATES OF FUTURE MEETINGS

The dates of future meetings were noted.

It was agreed that meeting dates should be scheduled up to the end of 2015 with the preferred time Friday afternoon and the preferred location Bath.

Appendix 1: Mercers presentation on Fair Deal

Appendix 2: Schroders presentation on macro outlook

The meeting ended at 4.33 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services

MERCER

Consulting. Outsourcing. Investments.

24 June 2011

Avon Pension Fund

Fair Deal – Implications for the Fund

Paul Middleman FIA

Outsourcing contract – current pensions options

ADMITTED BODY ROUTE

CONTRACTOR'S BROADLY COMPARABLE SCHEME

- Stay within Fund
- Automatic continuation of pension rights
- Replicates benefits exactly

- Alternative to ABS for future service
- Bulk transfer for past service
- Benefits not exact

- Contactor's choice
- Impact of Fair Deal Consultation and removal of Two Tier Code?

Fair Deal Consultation

- Fair Deal applies to LAs in England under Best Value Authorities Staff Transfers (Pensions) Direction 2007
- HM Treasury consultation on the Fair Deal policy: treatment of Pensions on compulsory transfers of staff from the public sector
- Recommendation made in the Hutton report for "desirability" of only public sector employees being allowed access to public sector schemes
- Consultation ran from 3 March – 15 June 2011
- Mercer and Fund response supportive of Fair Deal but with modification / simplification

Possible Outcomes?

- Scrapped → no obligations (other than required under TUPE or NEST)
- Retained → as now but very likely will be amended

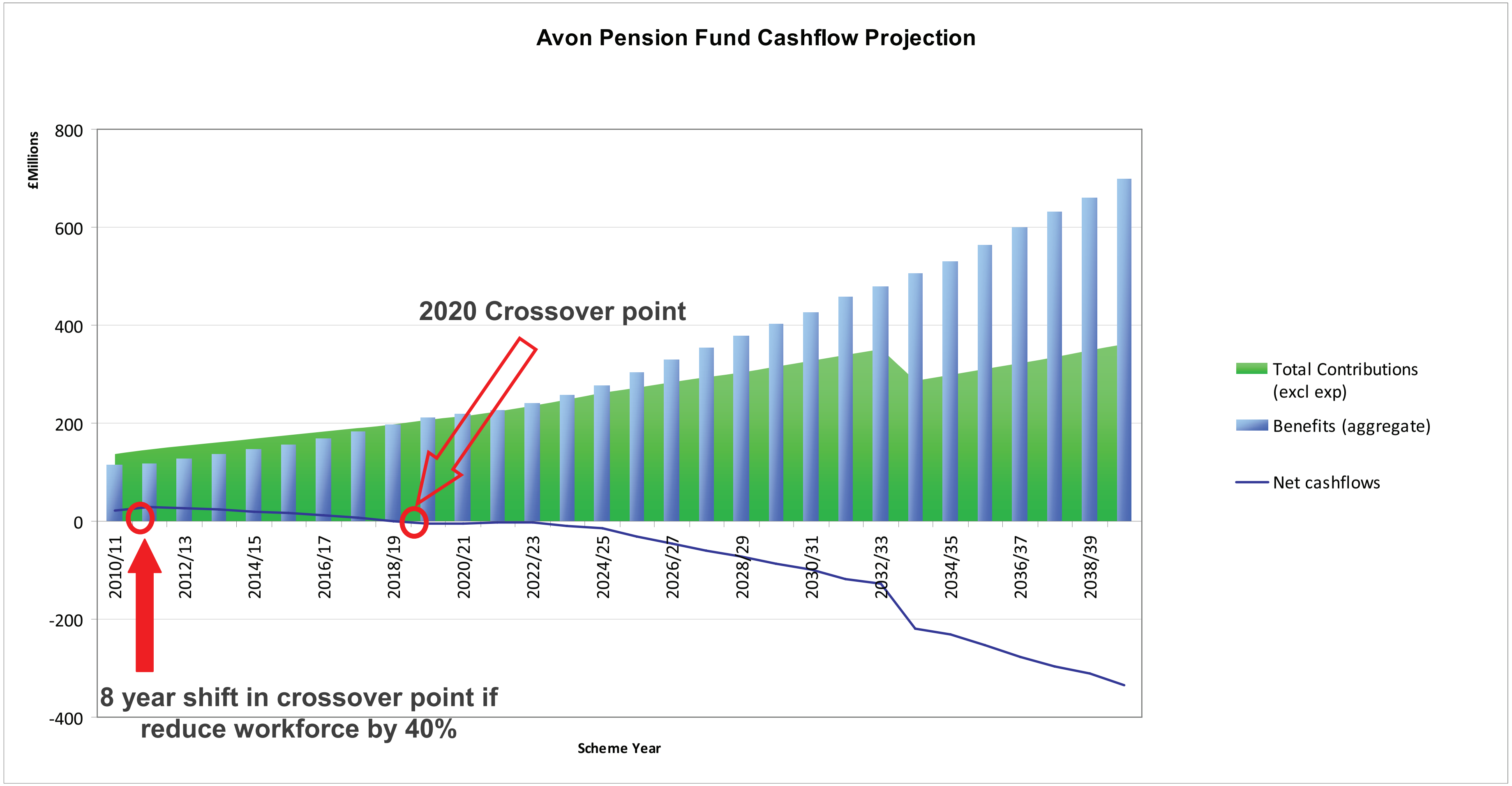
Implications of scrapping Fair Deal

- Current pressure on membership from restructure and opt-outs
- Scrapping Fair Deal → potential for an increased fall in numbers
- Further change in cashflow and Fund maturity profile
- Pressure on funding strategy, liquidity requirements and long term investment strategy

Possibly higher long term cost

Treasury management issues and constraints on investment strategy

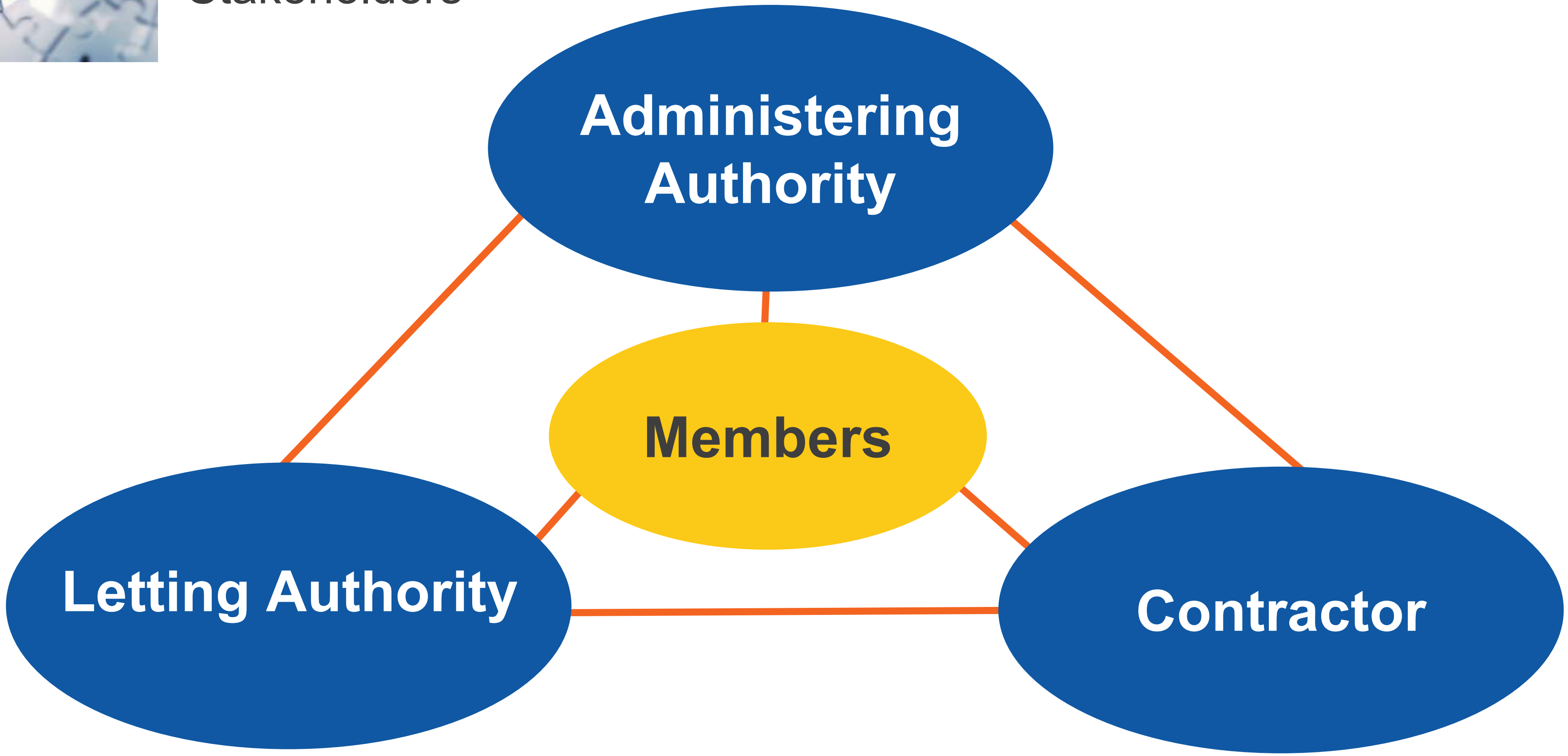
Impact of reducing membership
Cashflow Projection for Fund



ANY QUESTIONS

Appendix

Admitted Body Route
Stakeholders



- Admission Agreement → Administering Authority, Letting Authority and Contractor
- Commercial Agreement → Letting Authority and Contractor

Views on ABS Provisions

- Widely held view that ABS is a valuable mechanism for pension provision for transferring staff – part of our response on Fair Deal
- Concerns from contractors over a number of areas
  - Backdoor compulsion to offer ABS
  - Lack of control over pension risk
  - Lack of transparency or consistency of application
- Can lead to uncompetitive bids or even no bid at all (especially from smaller bidders)
- Test of beliefs will emerge from the Fair Deal Consultation

MERCER

Avon Pension Fund

Macro-economic outlook:

Will the oil shock and inflation derail the world economy?

Lyndon Bolton
Client Director
24 June 2011

Schroders

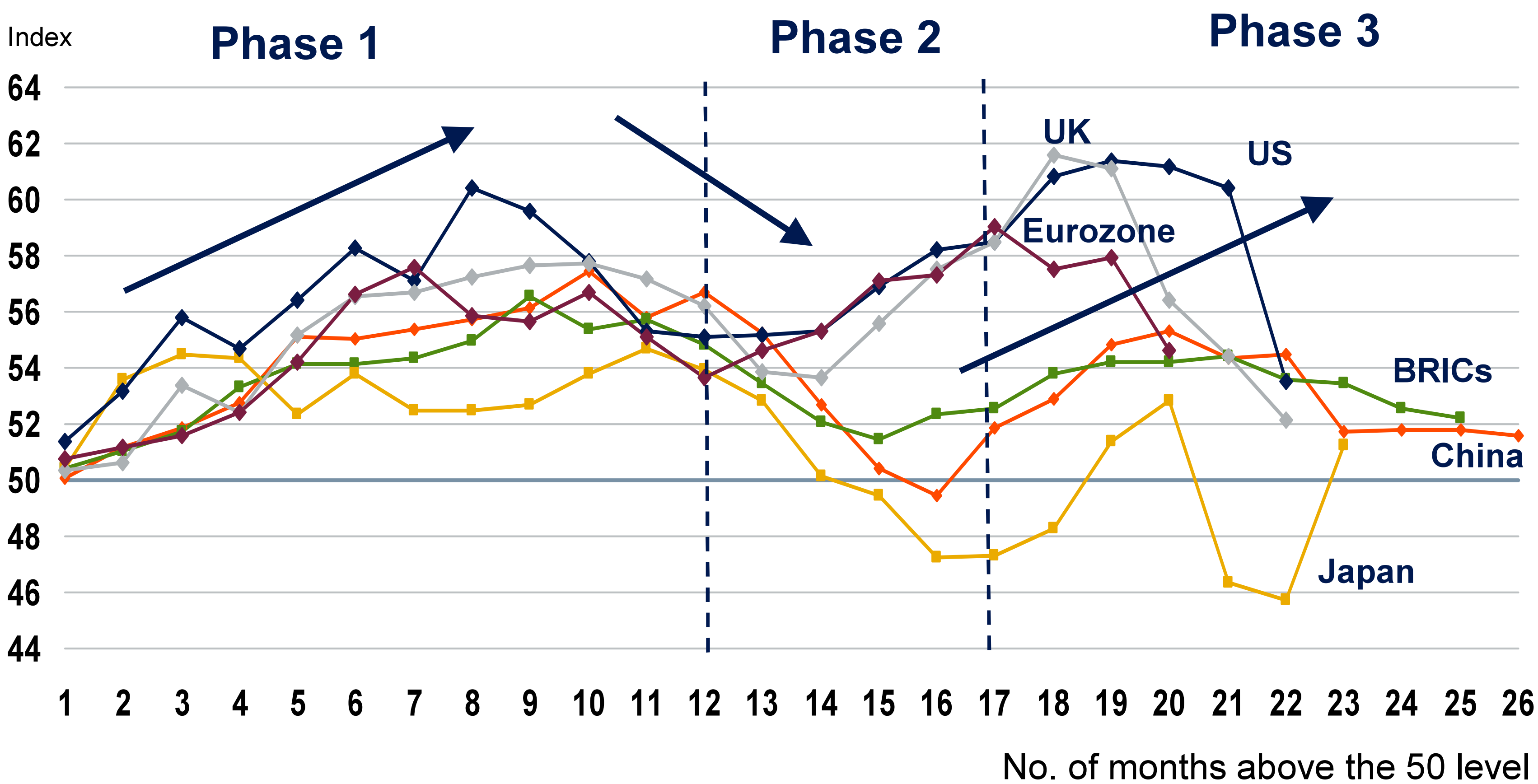
Themes for 2011

- Sweet spot for risk assets
- Search for yield
- East/ west divergence
- Sovereign debt restructuring in Eurozone

Sweet spot under threat

Oil, Japanese earthquake present near term challenge to recovery

Manufacturing Purchasing Managers Index



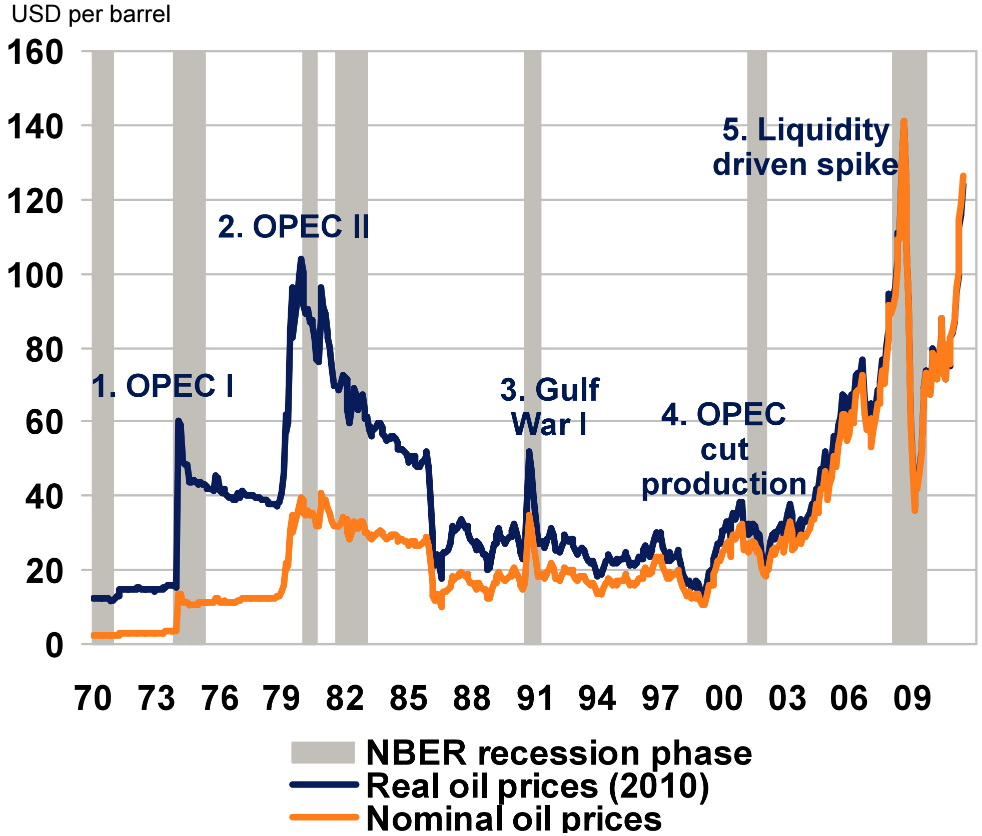
Source: Schroders, Markit PMI, June 2011. BRIC: Brazil, China, India & Russia.
GDP weights based on nominal GDP in USD from IMF.

Schroders

Will the rise in oil prices cause another recession?

Latest rise in oil prices is smaller than previous shocks

Oil prices in nominal and real terms (2010)



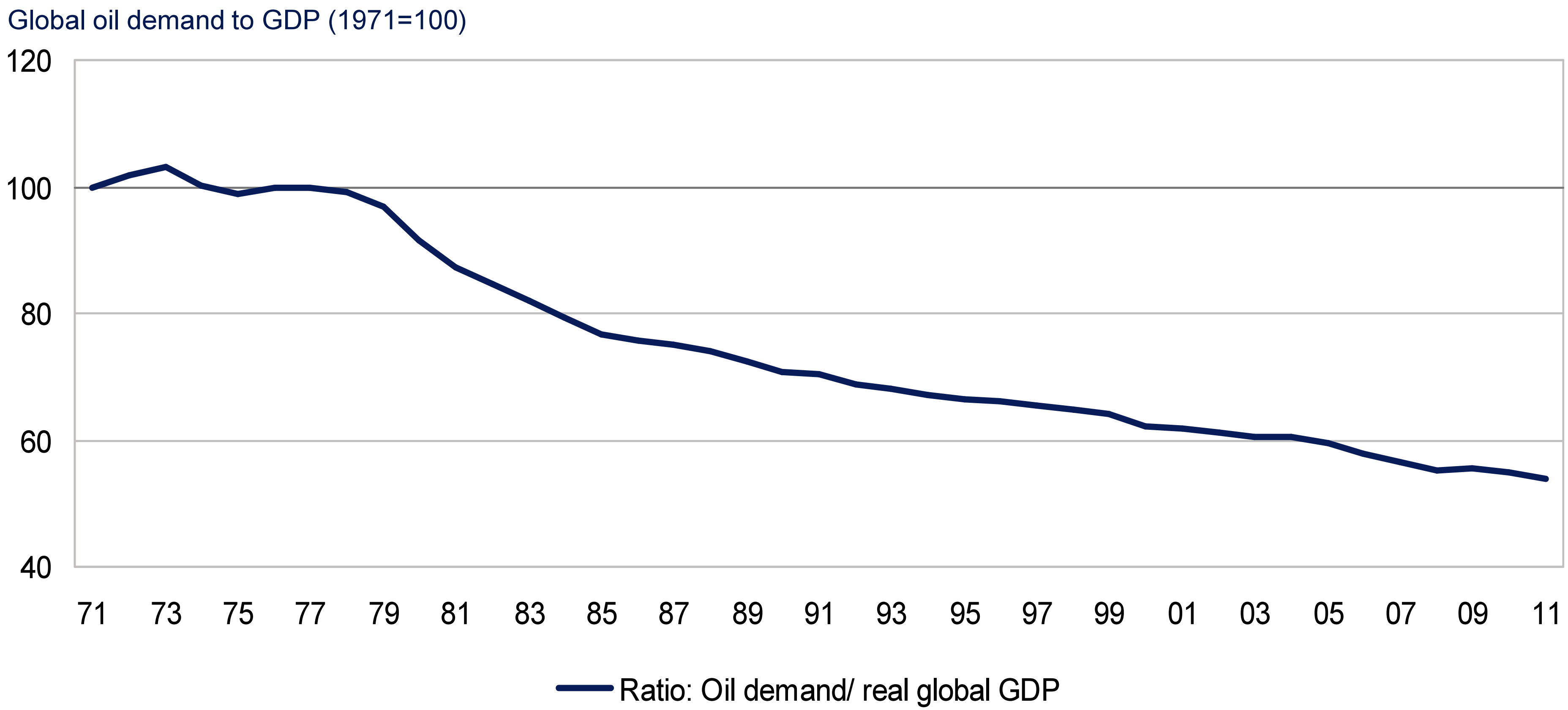
Oil shocks compared

Period	Oil price: % rise trough to peak		Duration	1-year after peak vs. trough
	Nominal	Real		
Dec-73 to Jan-74	293%	286%	1 month	179%
Nov-78 to Nov-79	201%	170%	12 months	170%
Jun-90 to Oct-90	133%	128%	4 months	-40%
Mar-99 to Nov-00	151%	142%	20 months	138%
Jul-07 to Jul-08	92%	83%	12 months	-10%
Jul-10 to May-11?	77%	73%	10 months	?

Source: Thomson Datastream, NBER (National bureau of Economic Research), Schroders, 19 May 2011.

Energy intensity has fallen

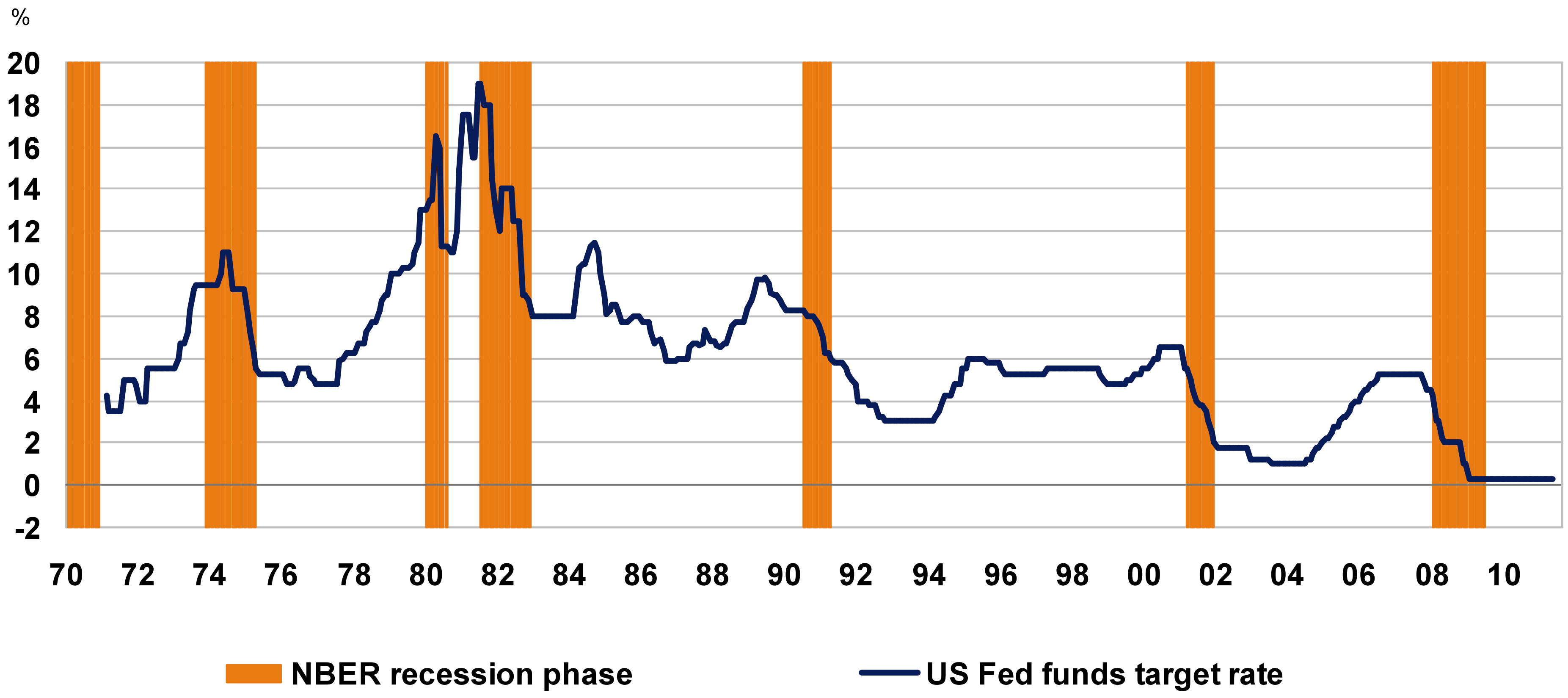
Oil's role in the world economy has halved



Source: Thomson Datastream, 19 May 2011

Link between interest rates and recessions is stronger

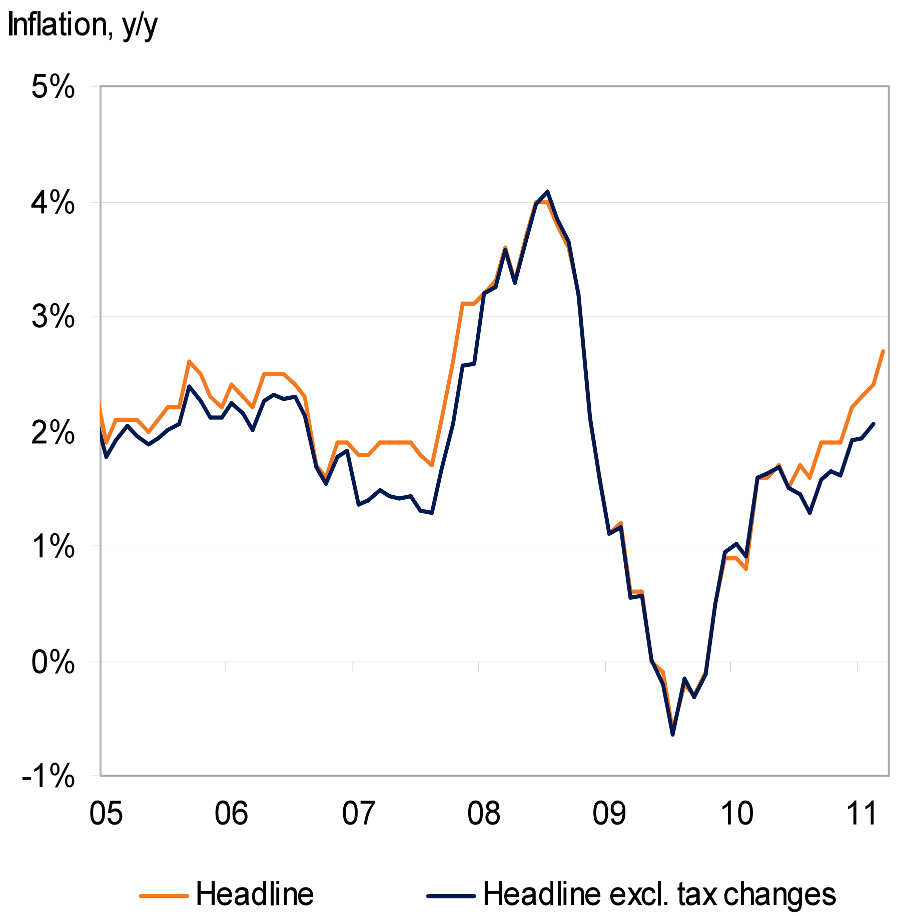
Policy response to oil price shocks critical and dependent on second round effects

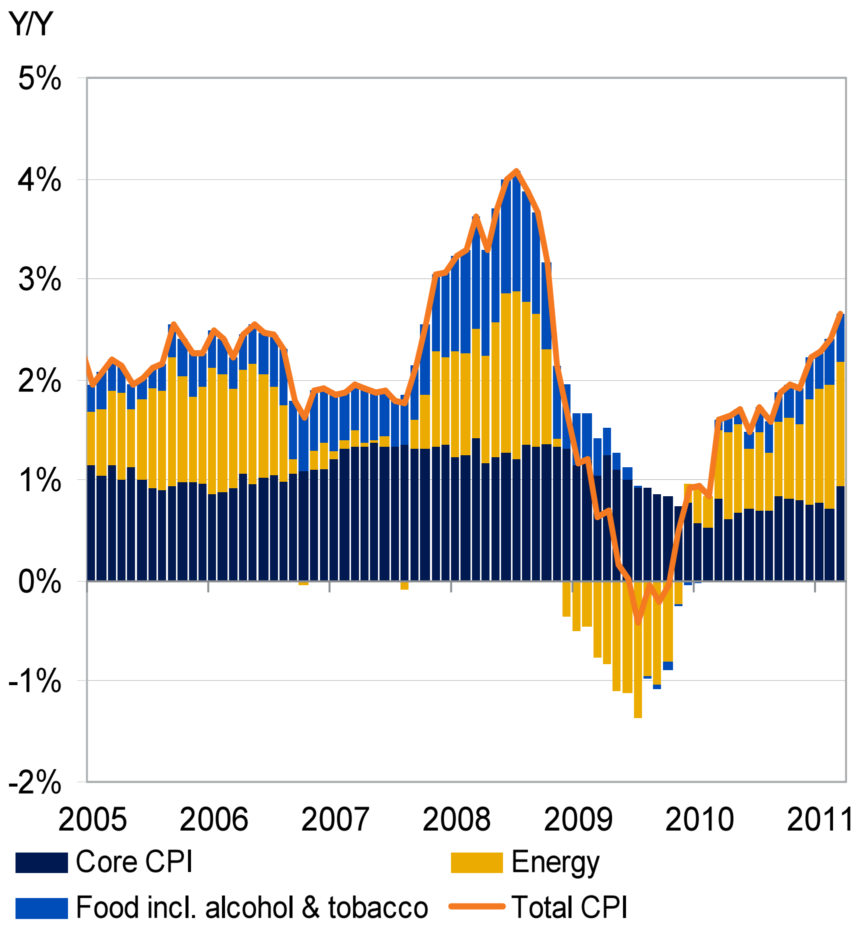


Source: Thomson Datastream, NBER (National bureau of Economic Research), 19 May 2011.

The ECB has started raising interest rates

Taxes and energy price inflation hurting consumers





Source: Thompson Datastream. Updated 5 May 2011.

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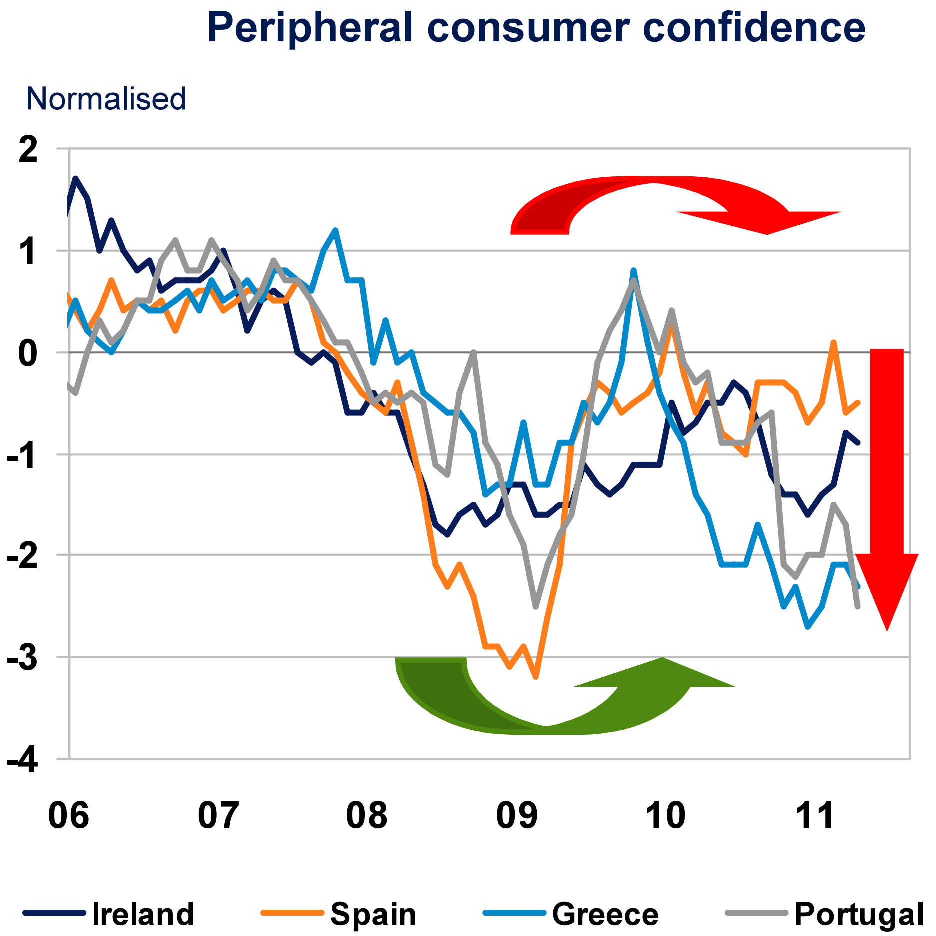
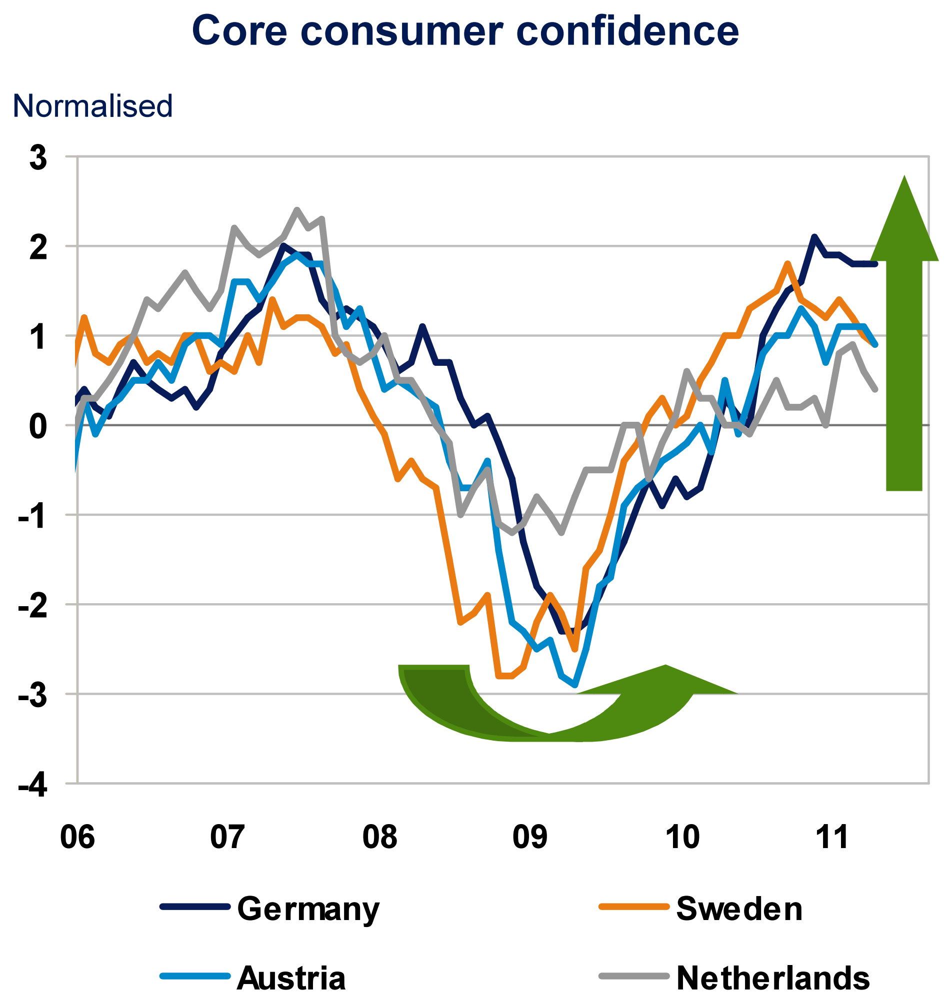
Growth divergence within Europe

A tale of two consumers



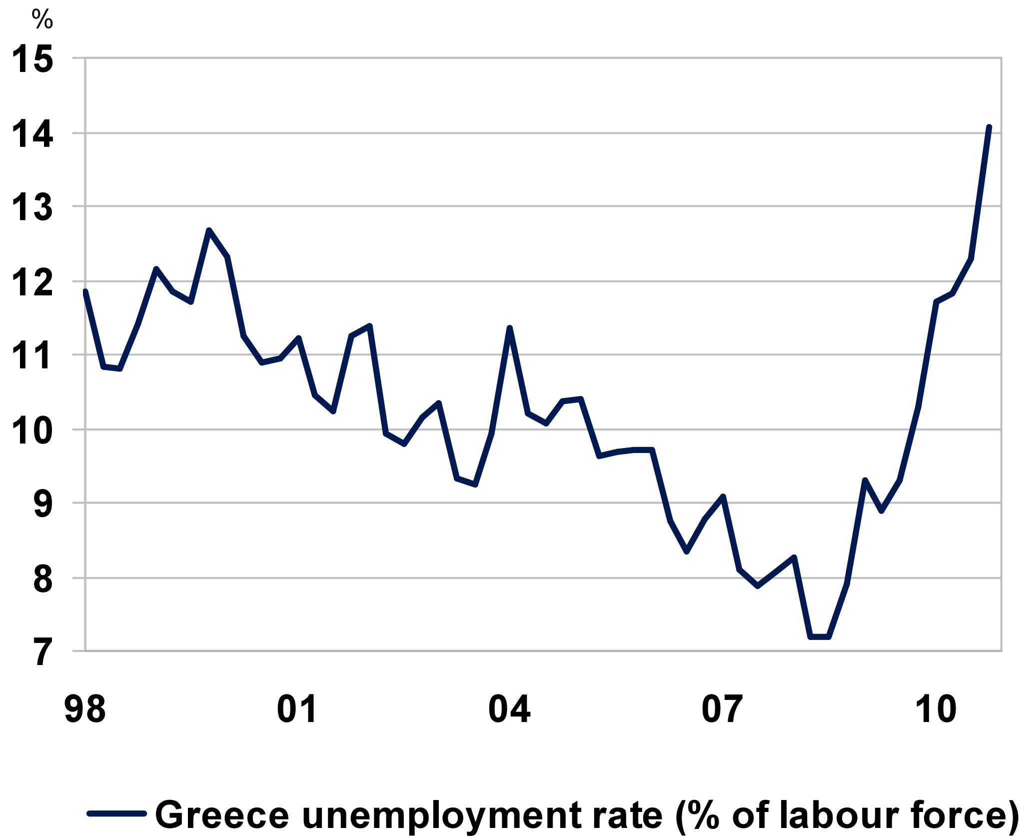


Source: Thomson Datastream, European Commission, 18 May 2011.

Schroders

The Euro crisis

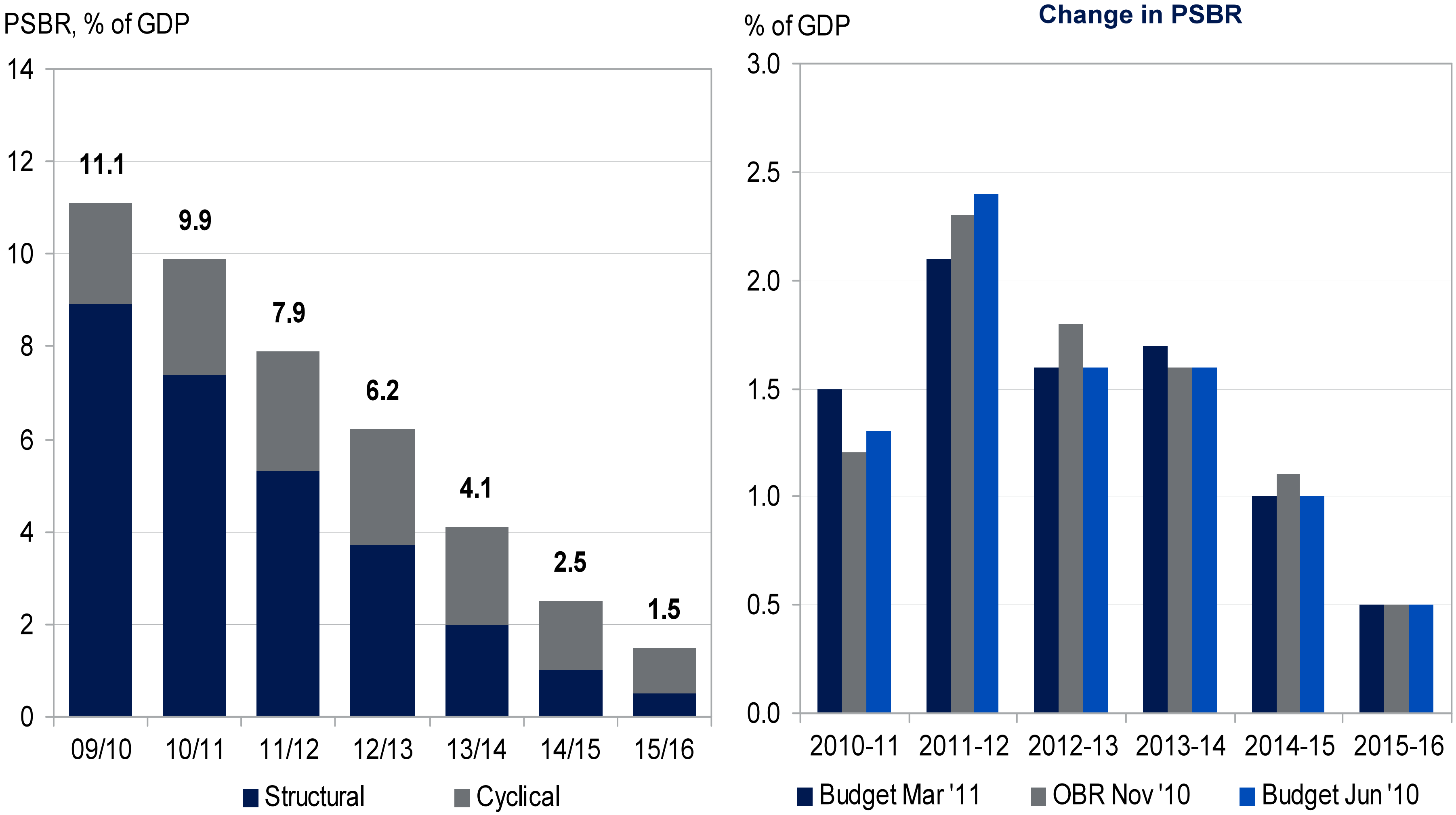
How far can government's cut spending?



Source: Thomson Datastream, 19 May 2011, BBC

Still following Plan A

Path of fiscal tightening in the UK



Source: ONS, Datastream, OBR, Budget March 2011, Schroders. 30 March 2011

Schroders

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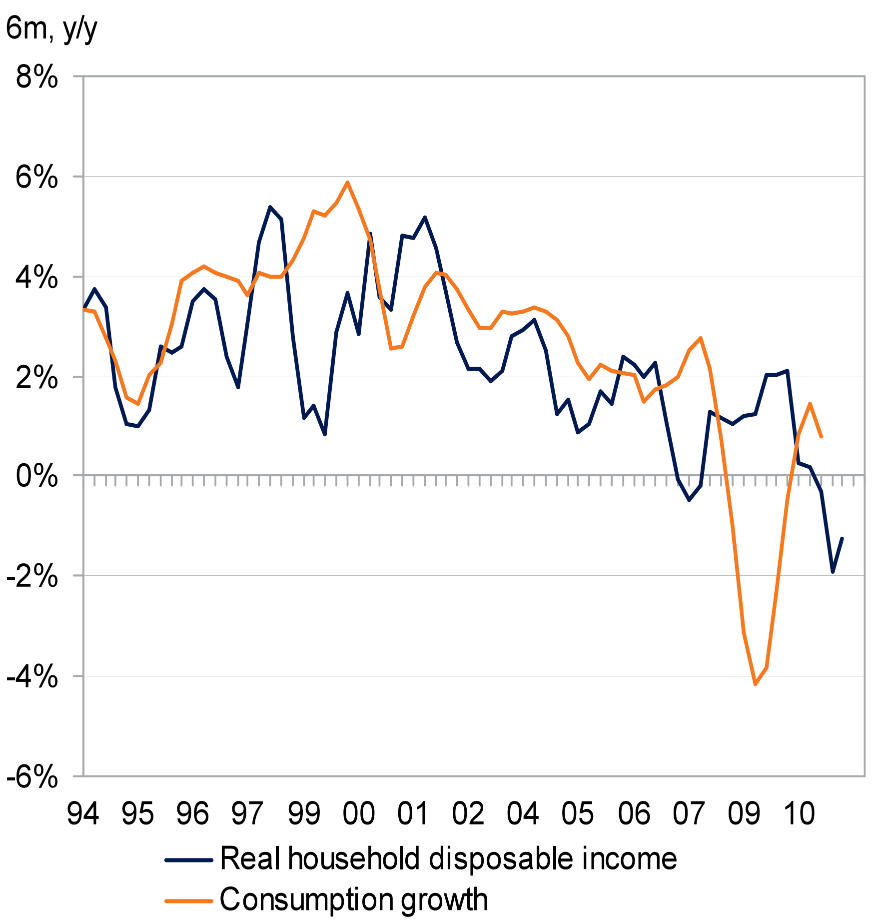
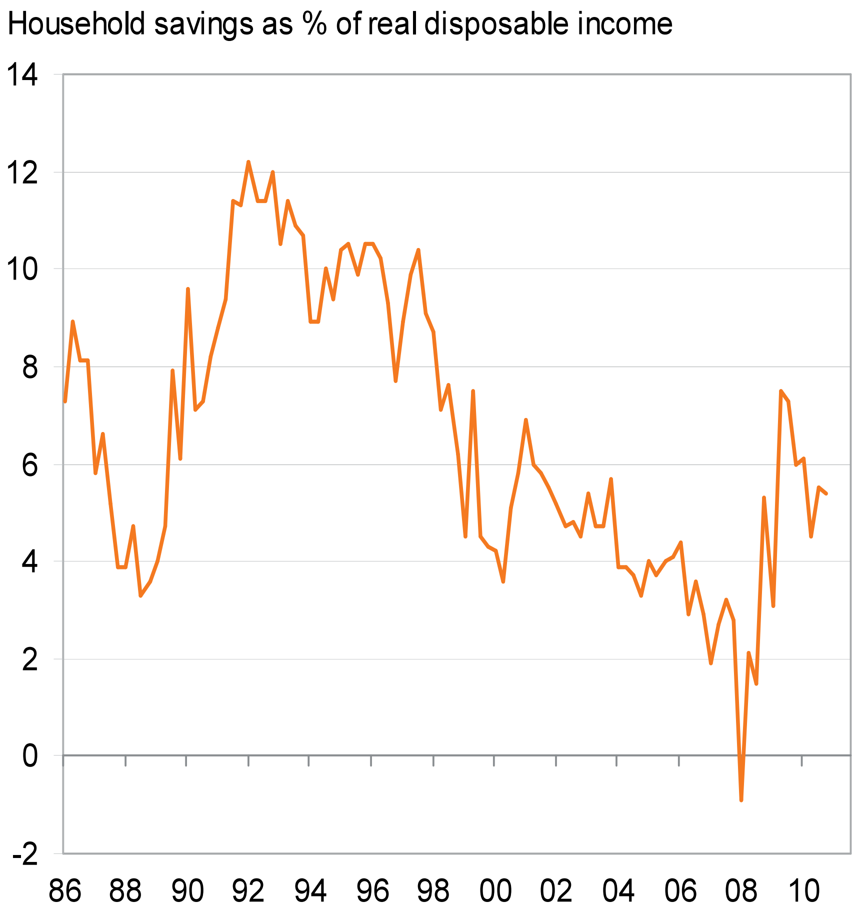
But can the UK withstand the fiscal squeeze?

Growth reliant on fall in savings ratio

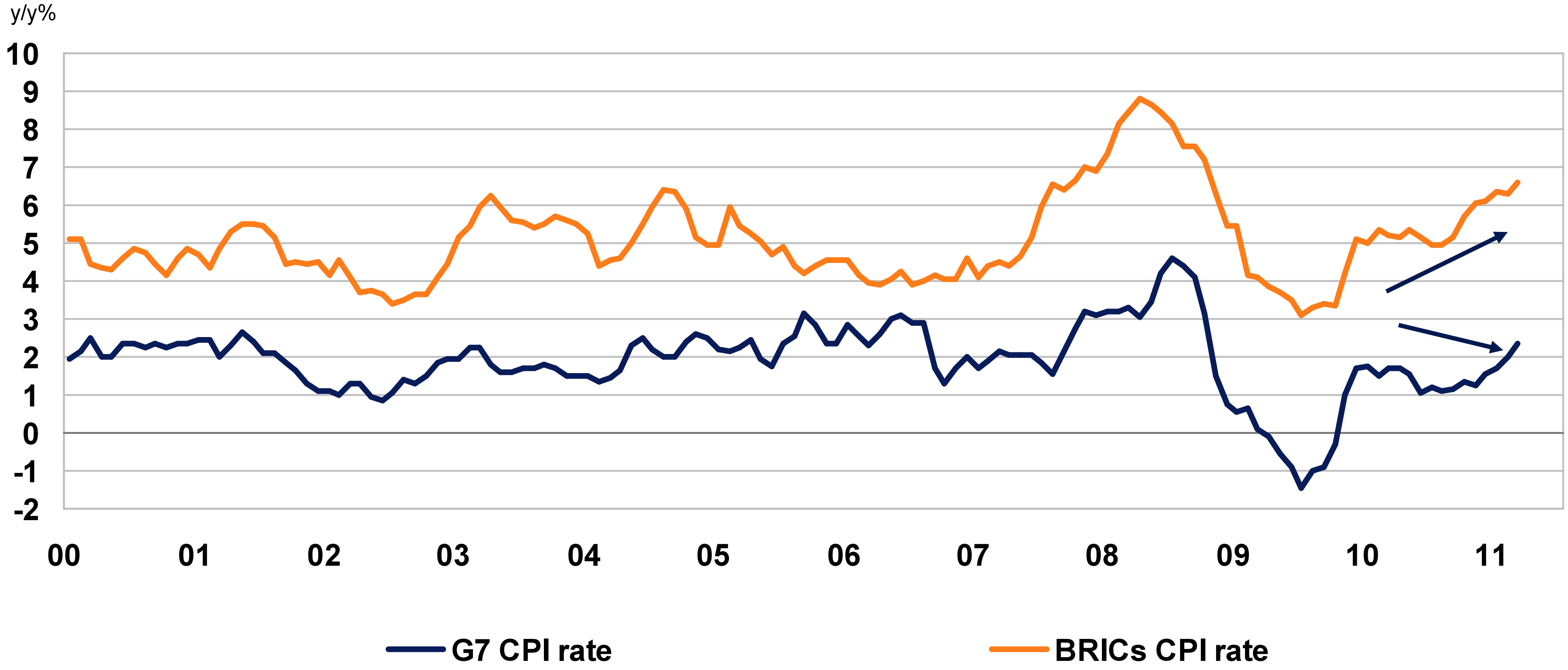




Source: ONS, Datastream. Updated 5 April 2011.

East/ west divergence

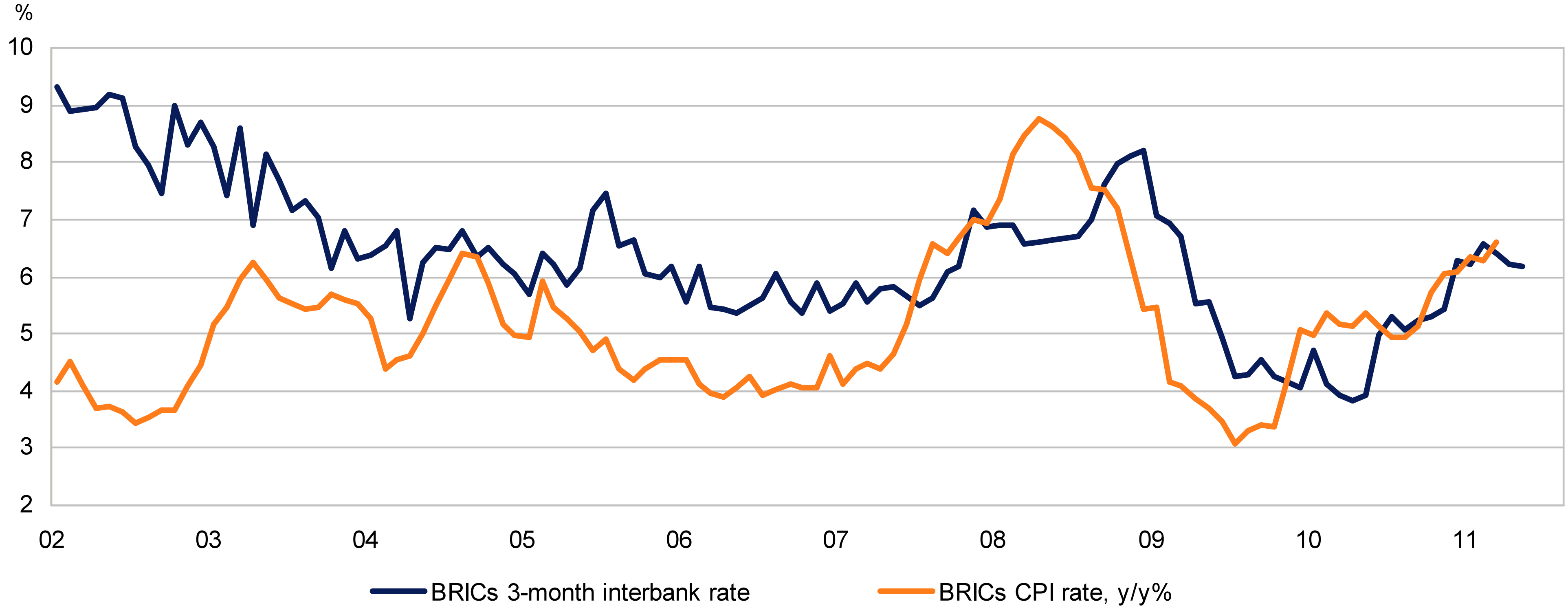
Inflation is diverging in the developed and emerging worlds



Source: Thomson Datastream, Schroders, 19 May 2011.
BRICs: Brazil, Russia, India and China. USD GDP-weighted.

Schroders

Tighter policy in emerging markets
Inflation and rates in the BRIC's

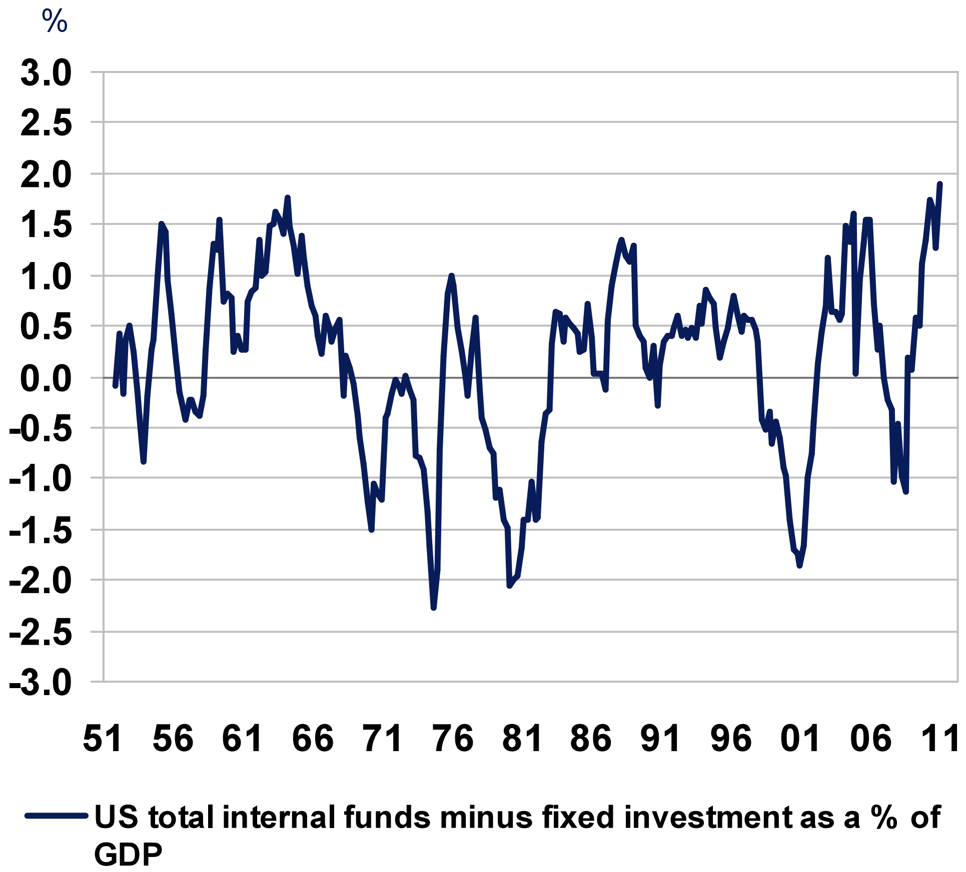


Source: Thomson Datastream, Schroders, 19 May 2011.
BRICs: Brazil, Russia, India and China. USD GDP-weighted.

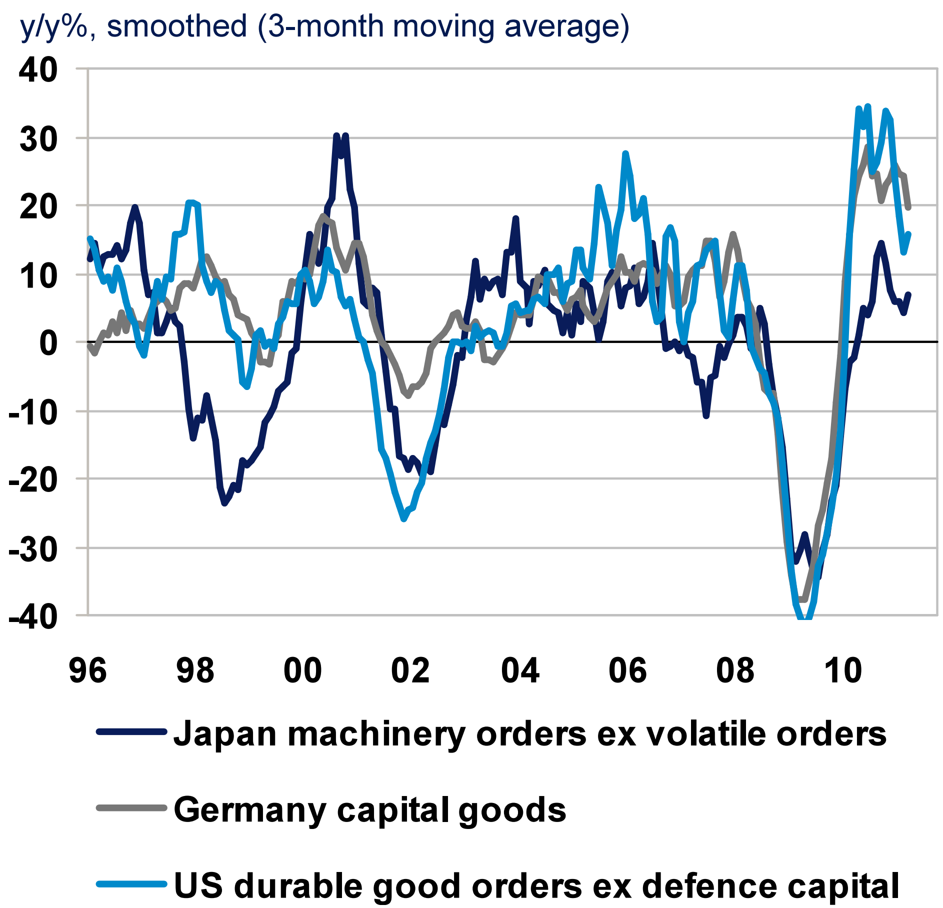
Schroders

Corporate spending is recovering

Cash flow surges – capex accelerates



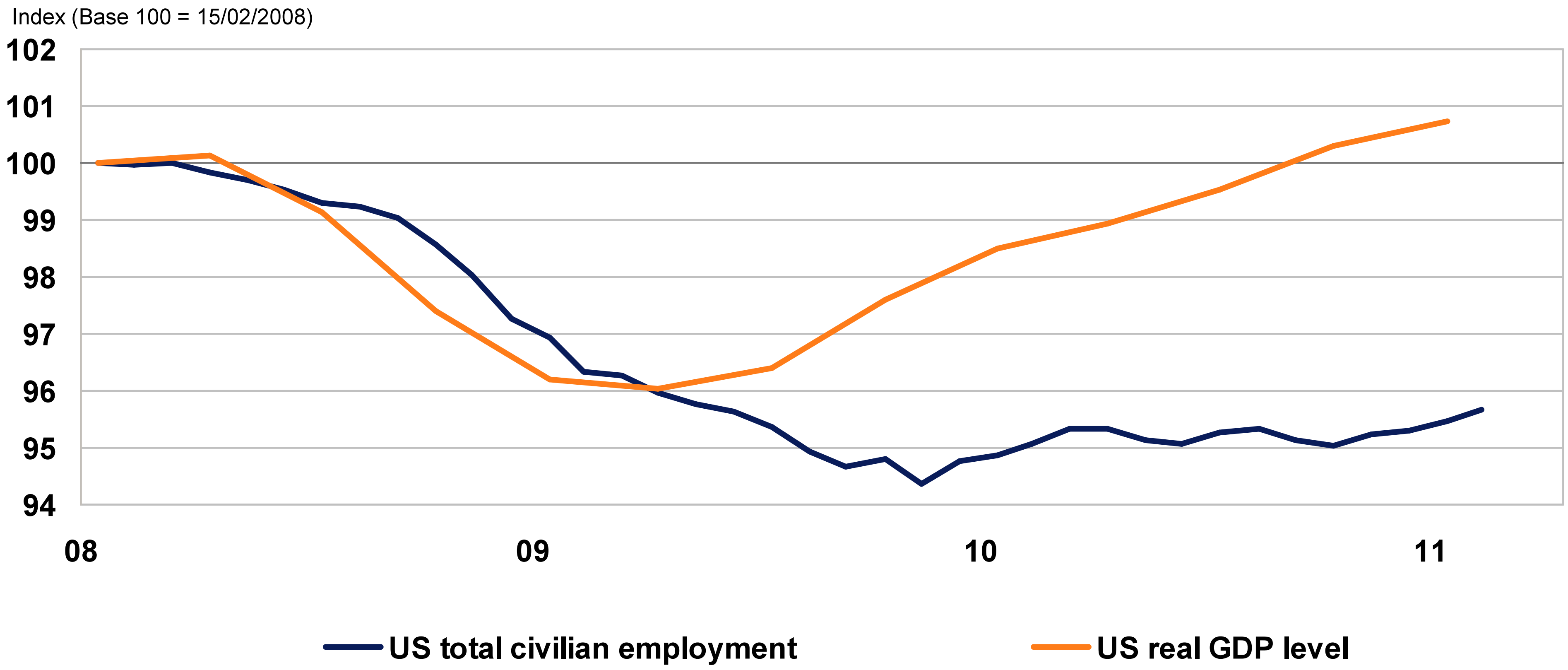
Source: Schroders, Thomson Datastream, 19 May 2011



Schroders

Waiting for a recovery in jobs

US GDP and jobs



Source: Thomson Datastream, 19 May 2011.

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Asset allocation

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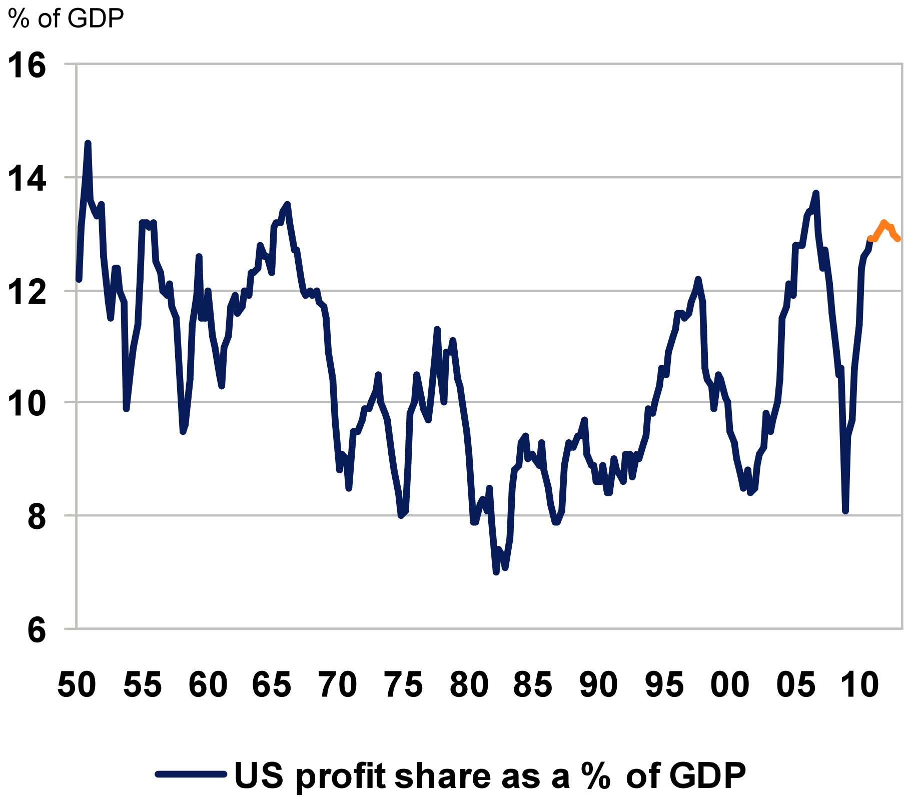
Equities: corporate profits are buoyant

Profit margins have risen sharply in the US



Source: Schroders, Thomson Datastream, Data to Q4 2010, 19 May 2011

Table: Profit and EPS forecasts

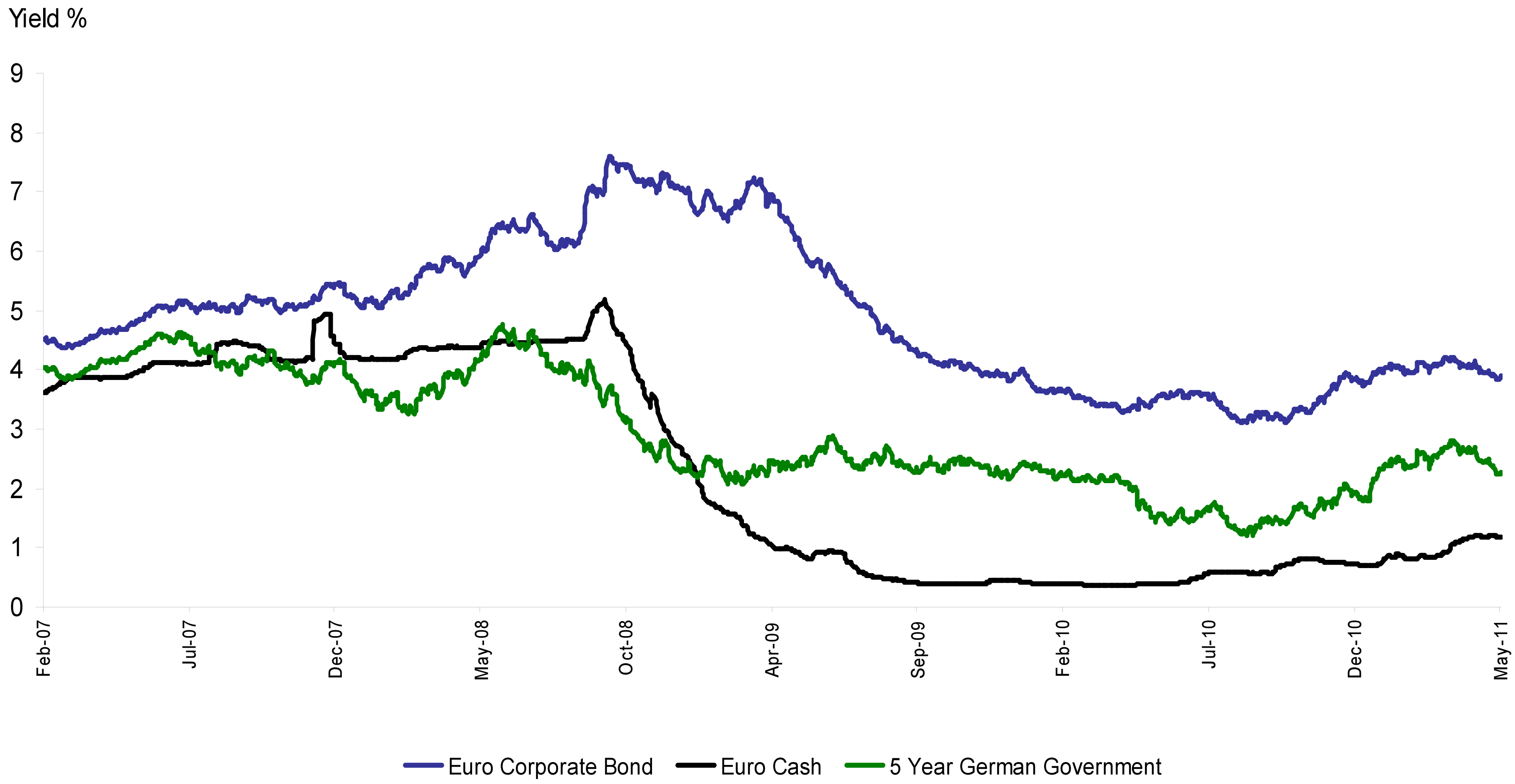
	2009	2010	2011	2012
Economic profits				
y/y%	-9.7	49.7	9.6	6.3
Nonfinancial share % GDP	5.8	8.2	8.7	8.8
S&P 500 EPS				
Operating $	$57	$84	$92	$98
y/y%	15	47	10	6
Reported $	$51	$77	$86	$93
y/y%	243	51	11	8
S&P 500 PE market at:	1115.1	1257.64	1330	1330
Based on operating EPS	19.6	15	14.4	13.5
Based on reported EPS	21.9	16.3	15.5	14.3

Source: S&P, Schroders, 1 March 2011

Schroders

Bonds: where is the bubble…

…and where is the opportunity today?



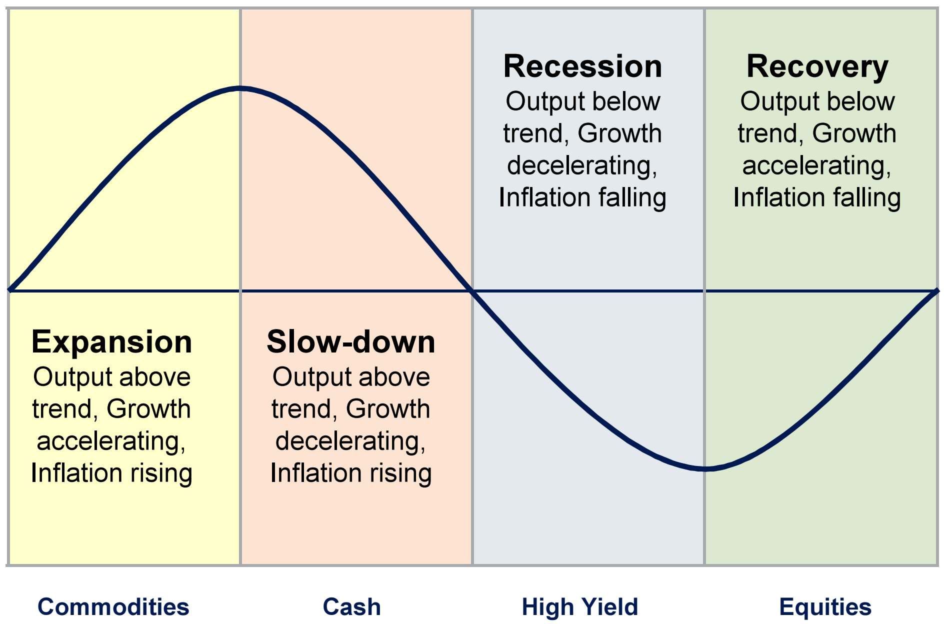
Source: Bank of America Merrill Lynch Indices using yield to worst (conventional) : ER00. Bloomberg 5 year government bond (GDBR5) BBA 1 month LIBOR (EU0001M Index). Month end dates. 31 May 2011

Schroders

Risk assets perform well in the recovery phase

"History does not repeat itself…but it does rhyme"

Phase/ Asset		Recovery	Expansion	Slowdown	Recession
Equity	Excess return*	8.6	8.4	-8.4	7.4
Government Bonds	Excess return	1.0	-1.0	0.0	2.1
High Yield	Excess return	6.7	2.0	-11.9	11.7
Investment Grade	Excess return	5.2	2.9	-1.9	7.3
Commodity	Excess return	2.9	15.3	7.9	-4.4



Source: Thomson DataStream, Schroders.
Data: Equity S&P 500 TR & US 10yr Govt. bonds from 1950 to 2010, BarCap US High Yield from 1983 -2010, BarCap US Corporate Investment Grade from 1973 -2010, S&P GSCI Commodity.
Data for capacity utilisation and the unemployment rate in the US are used to estimate the output gap.
All risk return figures are in % and annualised for each phase of the cycle. Risk return numbers are relative to cash.

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Asset allocation: themes and views

- Sweet spot for risk assets
  - Overweight equity/ underweight govt bonds
- Search for yield
  - Underweight cash/ Overweight high yield
- East/ west divergence
  - Underweight emerging market bonds/ neutral EM equity/ overweight EM currencies
- Sovereign debt restructuring in Eurozone
  - Underweight Eurozone equity/ overweight US

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