

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	27 September 2013
TITLE:	REVIEW OF INVESTMENT PERFORMANCE (for periods ending 30 June 2013)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT performance monitoring report Exempt Appendix 3 – Summaries of Investment Panel meetings with Investment Managers Appendix 4 - LAPFF Quarterly Engagement Monitoring Report	

1 THE ISSUE

1.1 This paper reports on the investment performance of the Fund and seeks to update the Committee on routine strategic aspects of the Fund's investments and funding level. This report contains performance statistics for periods ending 30 June 2013.

1.2 The main body of the report comprises the following sections:

Section 4. Funding Level Update

Section 5. Investment Performance: A - Fund, B - Investment Managers

Section 6. Investment Strategy

Section 7. Portfolio Rebalancing and Cash Management

Section 8. Annual Assurance on Control Environment of 3rd Party Suppliers

Section 9. Corporate Governance and Responsible Investment (RI) Update

2 RECOMMENDATION

The Avon Pension Fund Committee is asked to:

2.1 Note the information set out in the report

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund from 1 April 2013 will affect the next triennial valuation in 2016. Section 4 of this report discusses the trends in the Fund's liabilities and the funding level.

4 FUNDING LEVEL

4.1 Using information provided by the Actuary, JLT has analysed the funding position as part of the quarterly report at Appendix 2 (section 3). This analysis shows the impact of both the assets and liabilities on the (estimated) funding level. ***It should be noted that this is just a snapshot of the funding level at a particular point in time.*** (Please note, the Actuary is currently undertaking the triennial valuation which will calculate the funding position more accurately using membership data at March 2013).

4.2 Key points from the analysis are:

- (1) The estimated funding level at 30 June 2013 has increased to 74% from 69% at 31 March 2013.
- (2) The largest contributor to the improvement in the funding level was the increase in fixed interest gilt yields, which on a "like for like" basis has driven down the value of the liabilities to the extent that the deficit has reduced by approximately 25% (c. £300m). The overall 5% increase in the funding level was in spite of a return on assets being below the assumed return this quarter.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets decreased by £36m (c. -1.0%) in the quarter, giving a value for the investment Fund of £3,099m at 30 June 2013. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers. JLT's quarterly performance report is at Appendix 2. This report focuses on strategic performance of the Fund, with a summary of the performance of the managers. Manager performance is monitored in detail by the Panel. The Fund's investment return and performance relative to benchmarks is summarised in Table 1.

Table 1: **Fund Investment Returns**
Periods to 30 June 2013

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	-1.0%	14.9%	n/a
Avon Pension Fund (excl. currency hedging)	-0.9%	14.9%	10.4%
Strategic benchmark (no currency hedging) <i>(Fund incl hedging, relative to benchmark)</i>	-1.2% <i>(+0.2%)</i>	12.8% <i>(+1.9%)</i>	9.5% <i>n/a</i>
Local Authority Average Fund <i>(Fund incl hedging, relative to benchmark)</i>	-0.7% <i>(-0.3%)</i>	15.1% <i>(-0.2%)</i>	10.4% <i>n/a</i>

5.2 **Fund Investment Return:** Asset class returns were mixed in the quarter with declines in bond markets and emerging market equity markets. Developed equity markets performed better with UK equities falling slightly whereas other developed

overseas markets posted small positive returns. However, within the quarter, equity markets were particularly negative in June.

5.3 Over the one year period there have been positive returns across all asset classes except fixed interest gilts and overseas fixed interest bonds. Property is showing the weakest returns within the growth portfolio, although still positive over the year. Over three years the Fund has outperformed the return expectations underpinning the investment strategy. This is largely a result of strong three year returns from both bonds and equities. However, the prospects for similar high returns from these asset classes over the next 3 years are not as strong in face of concerns over global growth prospects and the historically low bond yields.

5.4 Fund Performance versus Benchmark: +1.9% over 12 months, attributed to

(1) **Asset Allocation:** The underweight to fixed income gilts, hedge funds and property (which all performed less well) contributed 0.3% to the outperformance over the twelve month period. The currency hedging programme was neutral over 1 year.

(2) **Manager Performance:** In aggregate, manager performance contributed 1.5% of the outperformance over the 12 month period, relative to the strategic benchmark.

5.5 **Versus Local Authority Average Fund:** Over one year, the Fund underperformed the average fund slightly due to lower than average allocation to equities which experienced a strong year.

5.6 **Currency Hedging:** This quarter Sterling weakened against both the Dollar and Euro, resulting in the returns from equity assets denominated in these currencies increasing in Sterling terms. Sterling strengthened against the Yen as the Yen continued to show weakness against most major currencies, resulting in returns from Yen denominated assets reducing in Sterling terms. On the c. £944m assets in the programme, the total effect of underlying currency movements had a negative impact of -0.5% over the quarter, with the hedging programme detracting 0.1% from this, resulting in a net currency return on the assets in the programme of -0.6%. The hedging programme detracted 0.1% from the Fund's total return in the quarter.

B – Investment Manager Performance

5.7 In aggregate over the 3 year period the managers' performance is in line with the benchmark. 10 mandates met or exceeded their 3 year performance benchmark, which offset underperformance by the Hedge Funds and TT. Genesis, RLAM, and Jupiter all continue to significantly outperform their 3 year performance targets.

5.8 Following the decision to divest last quarter, Man's portfolio is in the process of being redeemed.

5.9 TT's performance continues to improve since changes were made to address performance and whilst still short of their three year performance target, the one year performance is ahead of target.

5.10 JLT's report has highlighted that the SSgA European fund size has contracted again so that Avon Pension Fund's share of the pooled fund has risen to >95%. The Fund holds a similar share of the SSgA Pacific pooled fund. When the issue was last addressed by the Panel in November 2011, the shares of the funds were similar. At that time SSgA confirmed the fund was sustainable even if Avon were the only investor. The size of both funds is slightly higher than when the issue was last reviewed. Performance of both funds is consistently at or above target.

5.11 As part of the 'Meet the Managers' programme, the Panel met with RLAM on 18 July 2013. The summary of the Panel's conclusions can be found in Exempt Appendix 3.

5.12 Under the new Red Amber Green (RAG) framework for monitoring manager performance, the Panel consider updates on all managers not currently achieving Green status including progress on action points. Any change in the RAG status of any manager is reported to Committee with an explanation of the change. This quarter there have been no changes to the RAG status of any of the managers. This quarter has seen all Amber rated managers showing improvement and progress towards a Green rating. The only Red rated manager is Man from whom the Fund is in the process of divesting.

6 INVESTMENT STRATEGY

6.1 Changes to the Investment Strategy agreed in March 2013 are in the process of being implemented and progress is as follows:

	Project	Progress
1	New DGF Mandates	On track: Tender in progress. Due Diligence in progress. Appointment decision due w/c 30 September
2	New Emerging Market Equity Mandate	On track: Tender process commenced. Closed 10 September Due Diligence w/c 18 November Appointment decision due w/c 2 December
3	Restructuring passive equity portfolio	On track: Conversion to income distributing funds to coincide with funding of DGF and EM mandates
4	Rebalancing bond portfolio	Complete: Strategic allocation between UK gilts and corporate bonds implemented 16 August
5	New Infrastructure allocation	On track: Educational session held 4 September 2013

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 The rebalancing policy requires rebalancing of the Equity/Bond allocation to occur when the equity portion deviates from 75% by +/- 5%, and allows for tactical rebalancing between deviations of +/- 2 to +/- 5%, on advice from the Investment Consultant. The implementation of this policy is delegated to Officers. Revisions to this policy are being considered in another item on this Committee agenda.

7.2 There was no rebalancing activity undertaken during the quarter. Market movements have resulted in an Equity:Bond allocation of 78.7:21.3 as at 28 August 2013. This is within the tactical range for rebalancing. Officers will incorporate any rebalancing as the new strategy is implemented.

Cash Management

7.3 Cash is held by the managers at their discretion within their investment guidelines, and internally to meet working requirements. The officers closely monitor the management of the Fund's cash held by the managers and custodian with a particular emphasis on the security of the cash.

- 7.4 Management of the cash held internally by the Fund to meet working requirements is delegated to the Council's Treasury Management Team. The monies are invested separately from the Council's monies and during the quarter were invested in line with the Fund's Treasury Management Policy. The latest updated version of the Treasury Management Policy was approved on 22 March 2013.
- 7.5 The Fund continues to deposit internally managed cash on call with Barclays and Bank of Scotland. The Fund also deposits cash with the AAA rated RBS Global Treasury Fund and has another AAA rated fund with Deutsche Bank available for deposits if required. The Fund also has access to the Government's DMO (Debt Management Office); however the interest paid currently may not cover the transfer and administration costs incurred. Following the March Committee's approval of the revised Treasury Management Policy, the Fund has also been depositing cash with NatWest since the beginning of April.
- 7.6 During the quarter there was a net cash outflow of c. £3.8m as benefits paid and costs incurred exceeded contributions and income received. This is largely in line with the overall trend of the neutral scenario in the cash flow forecasting model used internally to monitor cash flow. This forecasts an average monthly outflow of c. £0.9m over the year to 31 March 2014, and greater outflows in subsequent years. However this could change as the effects of the 2013 valuation, auto enrolment and LGPS 2014 become clearer.

8 ANNUAL ASSURANCE ON CONTROL ENVIRONMENT OF 3RD PARTY SUPPLIERS

- 8.1 As part of the risk management process the Fund annually reviews the internal control reports (ICR) of the custodian and investment managers (and their administrators where relevant), and reports the findings to Committee. These reports are often designated SSAE16 or SSAE3402 reports (previously AAF 01/06 and SAS70 reports), that states which set of standards are being reported against.
- 8.2 ICR reports describe the internal control environment of an organisation. The management of the organisation are responsible for identifying the control procedures which they consider appropriate to enable certain control objectives to be met. External auditors verify that the controls identified are in place and comment on whether the controls will achieve the stated objectives or not.
- 8.3 For the reports reviewed in 2013, in each case the external auditor's report stated that the controls were in place and achieved the control objective and there are no issues to bring to the attention of the Committee. As part of the process, officers discuss the significance of the internal control reports with investment managers and custodian on an on-going basis and follow-up any issues flagged in the reports.
- 8.4 The ICRs of the pooled funds (and their administrators/custodian) and the Fund's custodian are also audited by the Fund's external auditor as part of the annual audit.

9 CORPORATE GOVERNANCE UPDATE

- 9.1 During the quarter, the Fund's external managers undertook the following voting activity on behalf of the Fund:

Companies Meetings Voted:	1,062
Resolutions voted:	15,046
Votes For:	14,052
Votes Against:	1,029

Abstained: 76
 Withheld* vote: 97

** A withheld vote is essentially the same as a vote to abstain, it reflects a view to vote neither for or against a resolution. Although the use of 'abstain' or 'withheld' reflects the different terms used in different jurisdictions, a 'withheld' vote can often be interpreted as a more explicit vote against management. Both votes may be counted as votes against management, where a minimum threshold of support is required.*

9.2 The Fund is a member of LAPFF, a collaborative body that exists to serve the investment interests of local authority pension funds. In particular, LAPFF seeks to maximise the influence the funds have as shareholders through co-ordinating shareholder activism amongst the pension funds. LAPFF's activity in the quarter is summarised in their quarterly engagement report at Appendix 4.

10 RISK MANAGEMENT

10.1 A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund's future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund and through the selection process followed before managers are appointed. This report monitors (i) the strategic policy and funding level in terms of whether the strategy is on course to fund the pension liabilities as required by the funding plan and (ii) the performance of the investment managers. An Investment Panel has been established to consider in greater detail investment performance and related matters and report back to the committee on a regular basis.

11 EQUALITIES

11.1 An Equality Impact Assessment has not been completed as this report is for information only.

12 CONSULTATION

12.1 This report is for information and therefore consultation is not necessary.

13 ISSUES TO CONSIDER IN REACHING THE DECISION

13.1 The issues to consider are contained in the report.

14 ADVICE SOUGHT

14.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Matt Betts, Assistant Investments Manager (Tel: 01225 395420)
Background papers	LAPFF Member Bulletins, Data supplied by The WM Company
Please contact the report author if you need to access this report in an alternative format	