Havering
LONDON BOROUGH

PENSIONS COMMITTEE

14 September 2011

Subject Heading:	**PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 30 JUNE 2011**
Report Author and contact details:	Debbie Ford Pension Fund Accountant (01708) 432569 debbie.ford@havering.gov.uk
Policy context:	Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met.
Financial summary:	This report comments upon the performance of the Fund for the period ended 30 June 2011

The subject matter of this report deals with the following Council Objectives

Clean, safe and green borough	[]
Excellence in education and learning	[]
Opportunities for all through economic, social and cultural activity	[]
Value and enhance the life of every individual	[X]
High customer satisfaction and a stable council tax	[]

SUMMARY

This report provides the Committee with an overview of the performance of the Havering Pension Fund investments for the quarterly period to 30 June 2011. The performance information is taken from the Quarterly Performance Report supplied by each Investment Manager, the WM Company Quarterly Performance Review Report and Hymans Monitoring Report.

The net return on the Fund's investments for the **quarter** to 30 June 2011 was **1.5%.** This represents an out performance of **0.1%** against the combined tactical benchmark and an under performance of **-1.5%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 30 June 2011 was **17.4%**. This represents an out performance of **0.8%** against the annual tactical combined benchmark and an out performance of **11%** against the annual strategic benchmark.

Members should bear in mind that the markets have seen unprecedented volatility since the latter half of 2007, with further market falls during 2008. The markets did rally during 2009, erasing some of the losses from the year before.

In the quarter ending June 11 most of the focus was on the debt crisis in Greece. Once Greece agreed austerity measures this provided a boost to the markets at the end of the quarter with global equity markets finishing higher than at the start but the markets are still very volatile over global economic growth and high inflation.

It is now possible to measure the individual managers' annual return for the new tactical combined benchmark since they became active on the 14th February 2005. These results are shown later in the report.

RECOMMENDATIONS

That the Committee:

1) Considers Hymans performance monitoring report and presentation (Appendix A).
2) Receive a presentation from the Funds UK Equities Manager (Standard Life) and the Funds Investment Grade Bonds Manager (Royal London).
3) Notes the summary of the performance of the Pension Fund within this report.
4) Considers the quarterly reports provided by each investment manager.
5) Considers and notes any Corporate Governance issues arising from voting as detailed by each manager.
6) Considers any points arising from officer monitoring meetings (section 4 refers).
7) Notes the analysis of the cash balances (paragraphs 2.2, 2.3 and 2.4 refers).

REPORT DETAIL

1. Background

1.1 A major restructure of the fund took place in the first quarter of 2005. A further restructure of the fund took place during the first half of 2008 and these changes were reflected in a revised Statement of Investment Principles (SIP) adopted by members in September 2008 and subsequently updated in June 2010. Implementation of the revised strategy is currently ongoing.

1.2 As part of the SIP a strategic benchmark was adopted for the overall Fund of Gilts + 3.6% gross (3% net) per annum. In the revised SIP the strategic benchmark adopted for the overall Fund is Gilts plus 2.9% (net of fees) per annum. This is the expected return in excess of the fund's liabilities over the longer term. **The main factor in meeting the strategic benchmark is market performance.**

1.3 Individual manager performance and asset allocation will determine the out performance against the strategic benchmark. Each manager has been set a specific (tactical) benchmark as well as an outperformance target against which their performance will be measured. This benchmark is determined according to the type of investments being managed. This is not directly comparable to the strategic benchmark as the majority of the mandate benchmarks are different but contributes to the overall performance. No revisions were made to individual fund manager benchmarks as part of the investment strategy review. However the asset allocation has been revised and these are shown in the following table against the manager's benchmarks:

Manager and % of total Fund awarded	Mandate	Tactical Benchmark	Out performance Target
Standard Life 20%	UK Equities -Active	FTSE All Share Index	2%
State Street (SSgA) (Account 2) 25%	UK/Global Equities - passive	UK- FTSE All Share Index Global (Ex UK) – FTSE All World ex UK Index	To track the benchmark
State Street (SSgA) (Account 1) 15%	UK/Global Equities - Passive	UK- FTSE All Share Index Global (Ex UK) – FTSE All World ex UK Index	To track the benchmark
Royal London Asset Management 25%	Investment Grade Bonds	• 50% iBoxx Sterling Non Gilt Over 10 Year Index • 16.7% FTSE Actuaries UK Gilt Over 15 Years Index • 33.3% FTSE Actuaries Index-Linked Over 5 Year Index	0.75%
UBS 10%	Property	IPD (previously called HSBC/AREF) All Balanced Funds Median Index	To outperform the benchmark
Ruffer 5%	Multi Asset	Not measured against any market index – for illustrative purposes LIBOR (3 months) + 4%.	To outperform the benchmark

1.4 The Committee appointed a Multi-Asset Manager (Ruffer) and a Passive Equity Manager (State Street Global Advisors Limited (SSgA)) in February 2010. Both Managers commenced trading from 8th September 2010.

1.5 The mandate with the Global Equities Manager (Alliance Bernstein) was terminated in February 2011. Assets were transferred to State Street Global Advisors pending further consideration of the investment strategy.

1.6 UBS and SSgA manage the assets on a pooled basis. Standard Life, Royal London and Ruffer manage the assets on a segregated basis. Performance is monitored by reference to the benchmark and out performance target. Each manager's individual performance is shown in this report with a summary of any key information relevant to their performance.

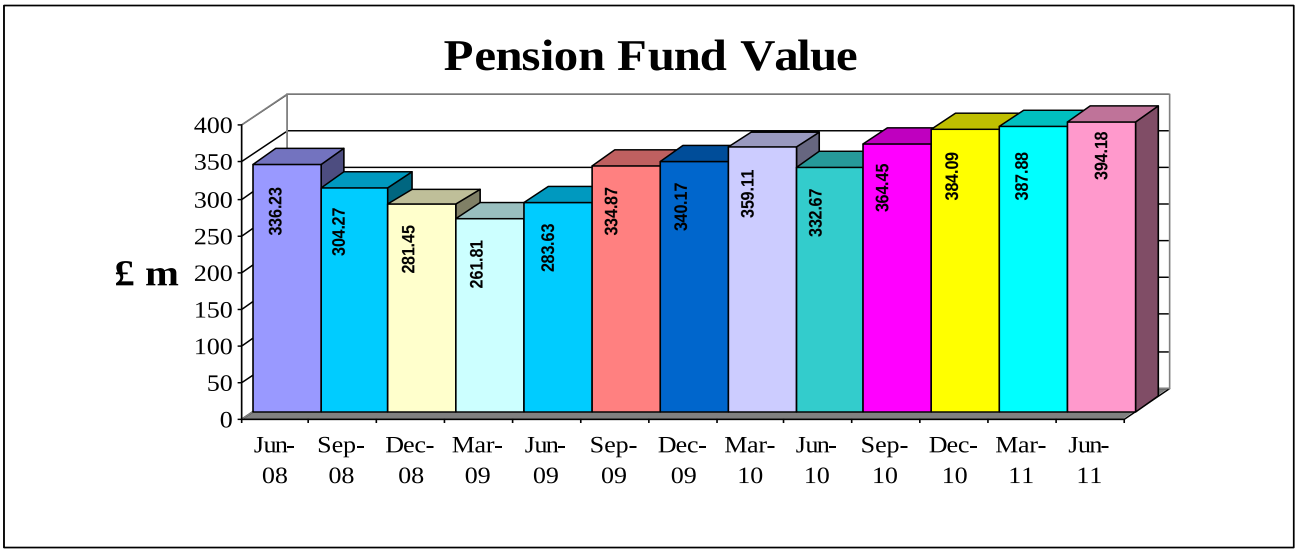
1.7 Since 2006, to ensure consistency with reports received from our Performance Measurers, Investments Advisors and Fund Managers, the 'relative returns' (under/over performance) calculations has been changed from the previously used arithmetical method to the industry standard geometric method (please note that this will sometimes produce figures that arithmetically do not add up).

1.8 Existing Managers are invited to present at the Pensions Committee Meeting every six months. On alternate dates, they meet with officers for a formal monitoring meeting. The exception to this procedure is the Multi Asset (Ruffer) and the Passive Equity (SSGa) Managers who will attend two meetings per year, one with Officers and one with Pensions Committee. However if there are any specific matters of concern to the Committee relating to the Managers performance, arrangements can be made for additional presentations.

1.9 Hyman's performance monitoring report is attached at **Appendix A.**

2. Fund Size

2.1 Based on information supplied by our performance measurers the total combined fund value at the close of business on 30 June 2011 was **£394.18m**. This valuation differs from the basis of valuation used by our Fund Managers and our Investment Advisor in that it excludes income. This compares with a fund value of £387.88m at the 31 March 2011; an increase of **£6.3m**. The movement in the fund value is attributable to a decrease in cash of £4.8m from £8.4m, which was reinvested in the fund and an increase in fund performance of £11.1m. The internally managed cash level now totals **£3.5m**, of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£3.5m** follows:

CASH ANALYSIS	**2009/10**	**2010/11 (Updated)**	**2011/12**
	£000's	£000's	£000's
Balance B/F	**-7999**	**-4763**	**-8495**
Benefits Paid	26926	25702	9276
Management costs	1939	1895	473
Net Transfer Values	2639	-3053	-419
Employee/Employer Contributions	-28251	-28333	-6629
Cash from/to Managers/Other Adj.	0	176	2214
Internal Interest	-17	-119	-6
Movement in Year	**3236**	**-3732**	**4909**
Balance C/F	**-4763**	**-8495**	**-3586**

The 2011/12 figures are based upon an interim report and are subject to further adjustments.

2.3 Internally managed cash had been decreasing during 2009/10; the significant factor being the reduction in net transfer values (more members of the fund transferring out than in). A clarification in the regulations was required before a number of 'Transfers In' could be processed. This has since been received and the numbers of 'Transfers In' processed had increased, hence why the cash levels have risen.

2.4 As agreed by members on the 24 March 11, internally managed cash of £7m was transferred to UBS in May 2011. Income received of £2.1m not needed for reinvestment by Fund managers was transferred from our custodian on the 25 May 2011 to top up the internally managed cash.

3. Performance Figures against Benchmarks

3.1.1 The overall net performance of the Fund against the new **Combined Tactical Benchmark** (the combination of each of the individual manager benchmarks) follows:

	Quarter to 30.06.11	**12 Months to 30.06.11**	**3 Years to 30.06.11**	**5 years to 30.06.11**
Fund	1.5%	17.4%	4.8%	2.7%
Benchmark return	1.3%	16.4%	7.0%	4.8%
*Difference in return	0.1%	0.8%	-2.0%	-2.0%

Source: WM Company

**Totals may not sum due to geometric basis of calculation and rounding.*

3.1.2 The overall net performance of the Fund against the **Strategic Benchmark** (i.e. the strategy adopted of Gilts over 15 years + 3% per and then revised to 2.9%) is shown below:

	Quarter to 30.06.11	**12 Months to 30.06.11**	**3 Years to 30.06.11**	**5 years to 30.06.11**
Fund	1.5%	17.4%	4.8%	2.7%
Benchmark return	3.0%	5.7%	10.3%	7.8%
*Difference in return	-1.5%	11.0%	-5.0%	-4.8%

Source: WM Company

**Totals may not sum due to geometric basis of calculation and rounding.*

The Fund's revised strategy adopted in September 2008 has not been fully implemented and historical performance greater than three years is no reflection of the revised strategy.

3.1.3 The following tables compare each manager's performance against their **specific (tactical) benchmark** and their **performance target** (benchmark plus the agreed mandated out performance target) for the current quarter and the last 12 months.

QUARTERLY PERFORMANCE (AS AT 30 JUNE 2011)

QUARTER	**Standard Life**	**Royal London**	**UBS**	**Ruffer**	**SSgA**
Return (performance)	1.8	2.9	2.9	1.3	0.6
Benchmark	1.9	2.6	1.8	0.2	0.1
***Over/(Under) Performance vs. Benchmark**	**-0.1**	**0.3**	**1.1**	**1.1**	**0.5**
TARGET	2.4	2.8	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**-0.6**	**0.1**	**n/a**	**n/a**	**n/a**

Source: WM Company, Fund Managers and Hymans

* Totals may not sum due to geometric basis of calculation and rounding.

ANNUAL PERFORMANCE (LAST 12 MONTHS)

ANNUAL	**Standard Life**	**Royal London**	**UBS**	**Ruffer**	**SSgA**
Return (performance)	28.7	7.6	10.2	n/a	n/a
Benchmark	25.6	6.0	7.6	n/a	n/a
***Over/(Under) Performance vs. Benchmark**	**3.1**	**1.6**	**2.6**	**n/a**	**n/a**
TARGET	27.6	6.7	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**1.1**	**0.8**	**n/a**	**n/a**	**n/a**

Source: WM Company, Fund Managers and Hymans

- Totals may not sum due to geometric basis of calculation and rounding.
- Ruffer and SSGa Inception from 8 Sept 2010

4. Fund Manager Reports

4.1. UK Equities (Standard Life)

a) Representatives from Standard Life are to make a presentation at this committee, therefore a brief overview of their Quarter 2 performance follows:

b) Market Value of the fund as at 30 June increased by 1.91% compared with the previous quarter.

c) Standard Life underperformed the benchmark in the quarter by -0.1% and underperformed the target in the quarter by -0.6%. Since inception they are below benchmark by -0.6% and -2.5% against the target.

4.2. UK Investment Grade Bonds (Bonds Gilts, UK Corporates, UK Index Linked, UK Other) – (Royal London Asset Management)

a) Representatives from Royal London are to make a presentation at this committee, therefore a brief overview of their Quarter 2 performance follows:

b) As agreed by the committee at its meeting on the 24 March 11 to reduce the funds holdings in Bonds by 5% in order to rebalance the fund, cash totalling £19m was transferred to Ruffer on the 20 April 11. Hence the market value of the fund as at 30 June decreased compared with the previous quarter. Aside from the decrease in value due to the transfer of cash the fund has since risen by 2.97%.

c) Royal London outperformed the benchmark for the quarter by 0.3% and 0.1% against the target. Since inception they outperformed benchmark by 0.5%.

4.3. Property (UBS)

a) In accordance with agreed procedures officers met with representatives from UBS on the 18 August 2011 at which a review of their Quarter 2 performance was discussed.

b) As agreed by the committee at its meeting on the 24 March 11 cash totalling £7m was transferred to UBS on the 17 May 2011. This was funded from internally managed cash; hence the value of the fund with UBS as at 30 June has increased.

c) Since the £7m transfer in May 11 there has been an increase of 1.3% as at 30 June 11 and a subsequent increase of .29% as at the end of July.

d) UBS out performed the benchmark in the quarter by 1.1% and out performed the benchmark in the year by 2.6%.

e) The number of properties in the pooled fund currently stands at 42.

f) The void rate as at 30 June 11 was 7.6% against a benchmark of just under 10%.

g) The main drivers of performance came from a unit in Central London. The main detractor from performance has come from units in a shopping centre in Newport. UBS have said that the long term aim is to sell the units in the shopping centre and currently is also holding some vacancies.

h) The redemption queue is now valued at c£10m.

i) UBS explained their sector weightings and whilst they are confident with their weightings in these sectors they are aiming to increase an underweight position in Industrials. They have a couple of sites under offer and are hopeful that the weighting will move closer to the benchmark in the next few months.

j) Since we last met with UBS they have explained that they have taken a number of steps to strengthen their governance arrangements around the rate of growth (as this is what has caused problems with the portfolio in the past). They have developed guidelines and introduced thresholds so any variance within the threshold would have to be sanctioned by their investment committee.

k) UBS also talked through the proposed alterations to its fee structure and why the changes were necessary. These proposals will be voted on at their EGM at the beginning of November.

l) Key Fee changes as follows:

- **Change the fund’s benchmark from median to a weighted average.** Currently there are 28 funds included in the benchmark, some of which have significant different portfolios to UBS Triton due to their size or strategy. The median measure treats each fund equally whereas the weighted average measure will provide a more consistent and comparable measure.
- **Increase the measurement period for performance fee calculation from 1 to 3 years.** More appropriate than one year to test performance and encourages manager to take a longer term view in making investment decisions.
- **Introduce tiered annual management fee which will decrease as the fund grows.** As the fund grows, the average annual management fee will reduce reflecting the economies of scale in managing the fund and also reducing the business pressure to grow the fund which may potentially compromise performance**.**

These changes will be discussed with the Fund's investment advisor before a decision is made on whether to vote for or against the proposal prior to the EGM meeting. The resolution will be passed if a 75% majority is reached.

4.4. Multi Asset Manger (Ruffer)

a) In accordance with agreed procedures officers will only meet with representatives from Ruffer once in the year with the other meeting to be held with members. Ruffer attended their first meeting with members at the 24 March 11 Pensions Committee meeting. Officers were not due to meet with officers but a brief review of their Quarter 2 performance follows:

b) As agreed at its meeting on the 24 March 11 the committee agreed to increase its investments with Ruffer as part of the Fund's rebalancing. Cash totalling £19m was transferred to Ruffer from Royal London on the 20 April 11. Hence the market value of the fund as at 30 June has increased.

c) Ruffer outperformed in the quarter by 1.1%.

d) Main contributor to performance came from Index linked bonds, with inflation generally rising and interest rates being kept low these were natural benefits. Main detractor from performance was in gold equities. Despite rises in underlying gold prices, gold mining stocks continued their dismal year buffeted by rising input costs (especially energy) and general equity risk aversion.

4.5. Passive Equities Manager (SSgA)

a) In accordance with agreed procedures officers will only meet with representatives from SSgA once in the year with the other meeting to be held with members. Officers were not due to meet with officers but a brief review of their Quarter 2 performance follows:

b) The value of the fund (Account 1) as at 30 June 11 increased by 0.65%. Since inception account 1 has out performed the benchmark by 0.02%.

c) On termination with the funds Global Asset Manager (Alliance Bernstein) a second wave of assets was transferred to SSgA on the 23 February 2011 to be managed passively (Account 2). The value of account 2 has increased by 0.45%. Since inception Account 2 has out performed the benchmark by 0.01%.

d) The second account is being kept separate, as the current intention is that this is a temporary measure until further discussions on the investment strategy have progressed.

e) Cash is continuing to be swept up by State Street from the Alliance Bernstein account (held by the custodian) and will continue until all dividends, tax reclaims and trades have all been settled in the Alliance Bernstein account.

f) Officers are still in discussion with the Fund's advisor regarding consideration of switching to currency hedging within the portfolio.

5. Corporate Governance Issues

The Committee, previously, agreed that it would:

1. Receive quarterly information from each relevant Investment Manager, detailing the voting history of the Investment Managers on contentious issues. This information is included in the Managers' Quarterly Reports, which is available for scrutiny in the Members Lounge.

2. Consider a sample of all votes cast to ensure they are in accordance with the policy and determine any Corporate Governance issues arising.

3. Receive quarterly information from the Investment Managers, detailing new Investments made.

   - Points 1 and 3 are contained in the Managers' reports.

   - With regard to point 2, Members should select a sample of the votes cast from the voting list supplied by the managers placed in the Member's room which is included within the quarterly report and question the Fund Managers regarding how Corporate Governance issues were considered in arriving at these decisions.

This report is being presented in order that:

- The general position of the Fund is considered plus other matters including any general issues as advised by Hymans.

- Hymans will discuss the managers' performance after which the particular manager will be invited to join the meeting and make their presentation. The managers attending the meeting will be from:

  Standard Life and Royal London

- Hymans and Officers will discuss with Members any issues arising from the monitoring of the other managers.

IMPLICATIONS AND RISKS

Financial Implications and risks:

Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met and consequently minimise any cost to the General Fund.

Legal Implications and risks:

None arising directly

Human Resources Implications and risks:

There are no immediate HR implications. However longer term, shortfalls may need to be addressed depending upon performance of the fund.

Equalities and Social Inclusion Implications and risks:

None arising directly

BACKGROUND PAPERS

Standard Life Quarterly report to 30 June 2011
Royal London Quarterly report to 30 June 2011
UBS Quarterly report to 30 June 2011
The WM Company Performance Review Report to 30 June 2011
Hyman's Monitoring Report to 30 June 2011