



Haringey Council

Agenda item:

Pensions Committee

On 16 September 2010

Report Title. **Fund Performance update**

Report of **Director of Corporate Resources**

Signed : *J. Power* 719/10

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Wards(s) affected: **All**

Report for: Noting

1. Purpose of the report

- 1.1. To consider the latest investment performance data for the Pension Fund and for each of the Fund's investment managers.
- 1.2. To report on key responsible investment issues using information provided by the Fund Managers and the Local Authority Pension Fund Forum (LAPFF).
- 1.3. To report on budget monitoring against the Pension Fund budget.

2. Introduction by Cabinet Member

- 2.1 Not applicable.

3. State link(s) with Council Plan Priorities and actions and /or other Strategies:

- 3.1. Not applicable.

4. Recommendations

- 4.1 That the Fund performance position as at end of June 2010 be noted.
- 4.2 That the responsible investments information provided be noted.
- 4.3 That the pension fund budget monitoring position be noted.

5. Reason for recommendations

- 5.1. This report is for noting.

6. Other options considered

- 6.1. Not applicable.

7. Summary

- 7.1 The investment return achieved in the quarter to June 2010 was minus 7%, which was 0.03% behind the benchmark and 0.44% behind the target. The Fidelity bonds portfolio is the only one to have met or exceeded the target since the inception of the investment strategy in April 2007.
- 7.2 The budget monitor shows an overall variance of less than 1% at the end of June 2010.

8. Head of Legal Services Comments

- 8.1 The Head of Legal Services has been consulted on the content of this report and has no specific comment to make.

9. Equalities & Community Cohesion Comments

- 9.1. There are no equalities issues arising from this report.

10. Consultation

- 10.1. Not applicable.

11. Service Financial Comments

- 11.1 Performance of the Fund Managers continues to be carefully monitored in the current market conditions. The investment strategy of the Fund is being reviewed during this year, which will address the performance issues.

11.2 In overall terms the budget monitoring position at 30th June 2010 is broadly as expected, although transfers in and out and investment income continue to be volatile. The Pension Fund is still generating a surplus of cash every month, as contributions are higher than benefits.

12. Use of appendices /Tables and photographs

12.1 Appendix 1: Top ten shares held and fund holdings.

12.2 Appendix 2: Fund performance to 30 June 2010.

12.3 Appendix 3: Responsible Investment update.

12.4 Appendix 4: Budget Management : monitoring to 30 June 2010.

13 Local Government (Access to Information) Act 1985

Northern Trust performance monitoring reports.

Fund performance update report to Pensions Committee on 21 June 2010.

14. Previous Quarter Investment performance

14.1 The investment performance of the Pension Fund was last reported to Pensions Committee in June 2010. That report covered the period up to 31 March 2010, at which time the following points were noted:

- Since monitoring against the new benchmark commenced on 1 April 2007, the combined Haringey fund had increased in absolute terms by 0.22% per cent up to 31 March 2010, underperformed the gross benchmark by 2.53% and also underperformed the gross target by 4.17%.
- The performance by the Fund Managers over the same period was as follows:
 - Fidelity's Bond mandate out performed the gross target by 1.03% and the Equity mandate under performed the gross target by 1.42% but achieved the benchmark.
 - Capital's Equity and Bond mandates were below target by 3.73% and 1.43% respectively.
 - ING were below target by 1.36%.

15. Total Fund investment performance for quarter to 30th June 2010

15.1 The current investment strategy was implemented on 1st April 2007 and so all the performance figures which follow show performance since that date.

15.2 Performance of the combined Haringey fund compared to benchmark and target for the three months to end of June 2010 and annualised performance to end of June 2010 are shown below. The target is shown gross of Fund Managers fees and assumes that returns above benchmark are achieved evenly throughout the year.

	3 months to end of June 2010	1 April 2007 to 30 June 2010 (annualised)
	%	%
Overall fund performance	(7.00)	(2.01)
Benchmark	(6.97)	0.28
Performance versus benchmark	(0.03)	(2.29)
Overall fund performance	(7.00)	(2.01)
Target	(6.56)	1.92
Performance versus target	(0.44)	(3.93)

15.3 This shows that in the period to 30th June 2010:

- The annualised performance of the combined Haringey fund was a reduction in absolute terms of 2.01%, the fund under performed the new benchmark by 2.29% and under performed the target by 3.93%;
- The annualised position has marginally improved since the report to the last meeting with the under performance versus target decreasing from (4.18) to (3.93).

15.4 At the Pensions Committee on 15th April 2010, it was decided to reduce the Fund's holding in gilts by 2%, index linked gilts by 0.3% and corporate bonds by 2.4% and to invest these funds in cash. This was carried out in the quarter and £29.5m of bonds were sold by Capital and the cash returned to the in-house team. The cash has been invested in line with the Council's Treasury Management Strategy Statement for 2010/11 – see cash management below. Appendix 1 shows the value of the Fund was split into the various types of investments at the end of June 2010 and for comparison the end of the previous quarter. The top ten equity holdings for the first time includes the whole of the Fund's exposure to equities including both directly held shares and those in pooled funds.

16. Fund Manager Performance

- 16.1 Appendix 2 shows investment performance to end of June 2010 for each Fund Manager, compared to benchmarks and targets as supplied by the custodian, Northern Trust. The data covers the period since 1 April 2007 when the current investment strategy was implemented.
- 16.2 The performance targets for each Fund Manager's mandate are shown below together with the fund managers' performance against those benchmarks since 1 April 2007 when the strategy was implemented. The contract with Legal & General has only been in place for one year and so long term performance data is not available. However their portfolio is invested in line with the benchmark, so the variation from the benchmark is minimal. The variation amounted to +0.07% since the contract started.
- 16.3 There have been 39 calls on the Pantheon Asia, Europe and USA funds totalling £15.4 million to date. Private equity is a long term asset class and therefore performance numbers are excluded as they are not considered meaningful when the funds are still in the drawdown phase.
- 16.4 Targets are set out in the table below and are gross of fees.

	% Target above benchmark	% annualised performance above / (below) benchmark in the period 1 Apr 07 to 30 Jun 10	% annualised performance above/ (below) target in the period 1 Apr 07 to 30 Jun 10
Capital - equities	2.0	(1.41)	(3.41)
Capital - bonds	1.0	(0.76)	(1.76)
Fidelity - equities	1.7	0.06	(1.64)
Fidelity - bonds	0.6	1.42	0.82
ING - property	1.0	(0.94)	(1.94)
Pantheon – private equity	0.75	N/A	N/A

- 16.5 The latest quarterly meetings took place in September 2010 between each active Fund Manager and the Head of Finance: Treasury & Pensions. A summary of the key issues discussed at those meetings is set out below.

Capital International

- Performance to date.
- Future outlook for markets.
- Review of Responsible Investment issues.

Fidelity

- Performance to date.
- Future outlook for markets.
- Review of Responsible Investments Issues.

ING

- Performance to date.
- Volatility in the property market and future estimated returns.
- Investment opportunities to become fully invested to increased property benchmark.

Pantheon

- Performance to date.
- Future outlook for markets.
- Change of ownership.
- Future pattern of cash flows.

17. Conclusions

- 17.1 Since monitoring against the new benchmark commenced on 1 April 2007, the annualised performance of the combined Haringey fund has shown a reduction in absolute terms of 2.01% up to 30 June 2010. During this period the Fund under performed the gross benchmark by 2.29% and also under performed the gross target by 3.93%.
- 17.2 Capital and ING are underperforming against both the benchmark and the target. Fidelity have outperformed the benchmark in both the bonds and equity portfolios, however the equity performance was below the target.
- 17.3 Investment returns in the equity markets were negative in the quarter, which was a reversal of the positive returns seen over the previous 12 month period. There are a number of ongoing issues which are likely to impact on future performance, and the situation will continue to be monitored carefully. These include:
- Sovereign debt issues, particularly in the Eurozone;
 - The price of oil and commodities;
 - The trends of inflation and risks of deflation;
 - Interest rates;
 - Property prices and rental values.

18. Responsible Investments

- 18.1 At Pensions Committee on 23 June 2008 a review of the Fund's Responsible Investment Policy was considered and agreed by members. One of the recommendations was that officers monitor the fund managers' approach to the revised Responsible Investment Policy. The Fund is a member of the Local Authority Pension Fund Forum (LAPFF) which provides information about responsible investment issues and undertakes engagement with companies on these issues on behalf of local authorities.
- 18.2 Appendix 3 compares responsible investment information provided by the Council's two core Fund Managers for the quarter ending 30 June 2010 with the information supplied by LAPFF over the same time period. This highlights engagement work on environmental and governance issues as well as highlighting the publication of the UK Stewardship Code for institutional investors.

19. Budget Management

- 19.1 The budget monitoring analysis to the end of June 2010 is shown in detail in Appendix 4.
- 19.2 The significant variances to date are:
- Transfers in and out of the Fund continue to be volatile, as the volume and timing varies throughout the year;
 - Investment income was £1.8m less than budgeted as the value of dividends paid by companies continues to remain low in the current economic climate;
 - Investment management expenses are lower than budgeted at this stage in the year due to the timing of the receipt of invoices from fund managers
- 19.3 In overall terms the variance was only £62,000 which represents less than 1% of the budget to 30 June 2010.

20. Cash Management

- 20.1 The Pension Fund is holding cash in-house for a number of reasons:
- Funding property investments – it was agreed in 2007 at the last investment strategy review to increase the allocation of the Fund to property. An amount of £18m was invested in cash to fund this. The balance still to be drawn down is £3.1m.
 - Funding private equity investments – at the last investment strategy review it was agreed that in addition to the original allocation, £10m a year be allocated to private equity and that this should be funded from cash surpluses and kept in cash pending drawdown. To date £15.4m has been drawn down and £20.3m remains in cash.

- Reduction in bond holdings – at the Committee meeting on 15th April 2010, it was decided to reduce the Fund’s holdings in bonds and invest in cash. Bonds were sold and cash of £29.5m was transferred to the in-house account.

20.2 The elements of the cash invested in-house cash held at the end of June 2010 can be summarised as follows:

Property allocation	£3.1m
Private equity allocation	£20.3m
Sale of bonds	£29.5m
Other surplus of contributions over benefits	£13.6m
Total	£66.5m

20.3 The Council’s standard risk protocols have been applied to all investments made on behalf of the pension fund and all investments were placed in accordance with the Council’s Treasury Management Strategy. Please see the item on the agenda on the Pension Fund Treasury Management Strategy relating to future investments.

20.4 The table below shows key statistics, which are used for the Council’s treasury management reporting, applied to the pension fund cash investments during the quarter. Descriptions of the statistics are provided below:

A	Credit score – value weighted	2.9
B	Credit score – time weighted	4.1
C	Weighted Average Maturity (days)	81
D	Interest Rate earned	0.64%

A & B: These measure score credit risk on a scale of 0 to 10 on both a value weighted and a time weighted basis and the table below demonstrates how to interpret the scores:

Above target	AAA to AA+	Score 0 - 2
Target score	AA to A+	Score 3 - 5
Below target	Below A+	Score over 5

C: This is a measure of how liquid the portfolio is. It shows the weighted average maturity of the fixed term deposits. In addition the Fund holds instant access funds in money market funds.

D: This is the interest rate earned in the quarter on the deposits placed.

20.5 The statistics show that the cash is invested in highly rated institutions with an average maturity of 81 days. This level of liquidity allows the Pension Fund to pay drawdowns to the property and private equity managers as required while investing long enough to achieve a reasonable rate of return. 0.64% was the rate earned which was 0.14% higher than the Bank of England base rate.

Appendix 1

a) Fund Holdings

Fund Holdings	As at 30 June 2010			As at 31 March 2010		
	Market Value £'000		% of Fund	Market Value £'000		% of Fund
UK equities		159,898	25.6%		181,718	27.4%
held in individual shares	32,453			36,727		
held in pooled funds	127,445			144,991		
Overseas equities		208,976	33.5%		237,193	35.8%
held in individual shares	76,267			85,473		
held in pooled funds	132,709			151,720		
Bonds		121,602	19.5%		148,149	22.4%
held in individual bonds	21,055			33,867		
held in pooled funds	100,547			114,282		
Property	46,063	46,063	7.4%	45,895	45,895	6.9%
Private Equity	15,575	15,575	2.5%	13,053	13,053	2.0%
Cash		72,423	11.6%		36,494	5.5%
held by Fund Managers	5,880			2,564		
held in-house	66,543			33,930		
Totals		624,537	100.0%		662,502	100.0%

b) Top Ten equity shares - held directly and in pooled funds

Company	Sector	As at 30 June 2010		
		Rank	Percentage of Equities	Market Value
			%	£m
Royal Dutch Shell	Oil & Gas	1	3.16%	11.67
HSBC	Banks	2	2.76%	10.19
Vodafone	Telecomms	3	2.13%	7.84
Glaxosmithkline	Pharmaceuticals	4	1.66%	6.11
BP	Oil & Gas	5	1.48%	5.47
Astrazeneca	Pharmaceuticals	6	1.40%	5.15
Rio Tinto	Mining	7	1.31%	4.83
BG Group	Oil & Gas	8	1.30%	4.81
BHP Billiton	Mining	9	1.14%	4.19
Barclays Bank	Banks	10	1.13%	4.16

Appendix 3
Comparison of Responsible Investment Activity Quarter ending 30 June 2010
Core Equity Fund Managers and the Local Authority Pension Fund Forum (LAPFF)

Fidelity	Capital International	LAPFF
Environmental Issues		
<p>Fidelity met with BP to discuss the shareholder resolution relating to the plans to extract oil from the Canadian tar sands in order to form their view about how to vote at the Annual General Meeting on the issue.</p>	<p>Capital met with both BP and Shell to discuss the shareholder resolutions requesting further information on the plans for extraction from the Canadian tar sands. In addition they attended shareholder briefings held by the companies to understand the issues more.</p>	<p>The LAPFF met with BP and Shell and the shareholders putting forward the resolutions against the management to understand all sides of the argument. The Forum believes that the dialogue between management and shareholders which this issue has started is positive step forward for engagement.</p>
Governance / Remuneration Issues		
<p>During the quarter Fidelity voted against management at a number of AGMs when they felt the remuneration policies were not aligned to shareholder interests or not in line with best practice on transparency.</p> <p>Specifically they met with Deutsche Boerse to discuss how executive remuneration relates to performance targets. They also met with Axa to discuss the severance arrangements for the Chief Executive Officer.</p>	<p>Following up from engagement activity with HSBC in the early part of the year, Capital met with the Chairman who informed them that the new Chair of HSBC's Remuneration Committee will be undertaking a review of policy with consultation with shareholders starting in the summer. This will seek to manage the level of remuneration for senior staff.</p>	<p>The LAPFF has undertaken joint lobbying activity with the National Association of Pension Funds (NAPF) of the FTSE 350 regarding director's pensions. They are seeking more transparency of pension benefits in companies' remuneration policies to enable shareholders to make informed decisions.</p>
Other Engagement activity		
<p>Fidelity voted at 31 AGMs during the quarter and took time to discuss with management the resolutions being put forward to ensure that the resolutions are in the best interests</p>	<p>Capital met with Kazakhmys, the Kazakhstan mining company to discuss their poor safety record and the number of fatalities. They emphasised action on this issue</p>	<p>The LAPFF continued it's engagement with Vedanta on the various issues arising in this mining company's operations in India in respect of safety and community</p>

<p>Fidelity</p> <p>of the Fund as a shareholder.</p> <p>They also met with BG Group to discuss governance issues and strategy.</p>	<p>Capital International</p> <p>needed to come from the top of the company. Since the engagement the company has introduced additional training and more safety devices and Capital believe they are committed to the target of zero fatalities.</p> <p>Capital met with a number of other companies in the quarter in advance of many AGMS to discuss the resolutions to be put forward and shareholders' views of them.</p>	<p>LAPFF</p> <p>relations. The LAPFF believe the underlying problem is the weak governance framework and dominance of one individual who is a majority shareholder. The forum is working with other forums to seek to bring a shareholder resolution recommending improvements.</p>
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<p>Other General Issues</p> <p><u>UK Investor Stewardship Code</u></p> <p>At the beginning of July the Financial Reporting Council published the first Stewardship Code for Institutional Investors. The aim of the Code is to improve the quality of corporate governance through promoting better dialogue between shareholders and company boards and encouraging more transparency about the way investors oversee companies they own. The Code includes principles on:</p> <ul style="list-style-type: none"> • The monitoring of investee companies; • The escalation of activities taken to protect or enhance shareholder value; • Collective engagement; • Voting policy; • Managing conflicts of interest; and • Public reporting and reporting to clients. <p>The Financial Reporting Council is encouraging all institutional investors to report publicly on the extent to which they follow the Code. In parallel the Financial Services Authority is proposing to amend its Conduct of Business sourcebook to require UK authorised firms managing investments on behalf of professional clients to disclose their commitment to the Code.</p> <p>Officers are discussing the Code with the fund managers and are awaiting guidance from the LAPFF, which will be published later in the year on how to apply the Code and hold fund managers to account.</p>

Reviews of Corporate Governance

In addition to the work in the UK described above the European Commission and the US authorities are undertaking consultations on ways to improve corporate governance. These reviews are looking both from the company's perspective in terms of how companies are run and investors' perspective in terms of responsible ownership.

Appendix 4

Pension Fund Budget Management - monitor at 30th June 2010

	2010/11 Budget £'000	Budget to 30 June 2010 £'000	Actual to 30 June 2010 £'000	Over/under (-) at 30 June 2010 £'000	Explanations of significant variations
Income					
Contributions and benefits:					
Employee Contributions	(10,700)	(2,675)	(2,712)	(37)	
Employer Contributions	(36,000)	(9,000)	(8,534)	466	
Transfer Values Received	(5,100)	(1,275)	(2,816)	(1,543)	Transfer values are very unpredictable in terms of volume and timing
Total income	(51,800)	(12,950)	(14,064)	(1,114)	
Expenditure:					
Pensions and other benefits	30,000	7,500	7,740	240	
Transfer values paid	5,300	1,325	708	(617)	Transfer values are very unpredictable in terms of volume and timing
Administrative expenses	800	200	148	(52)	
Total expenditure	36,100	9,025	8,596	(429)	
Net addition from dealings with members	(15,700)	(3,925)	(5,468)	(1,543)	
Returns on investment:					
Investment income	(15,200)	(3,800)	(1,986)	1,814	Dividends from companies continue to be low.
Taxation	190	48	91	43	
Investment management expenses	3,300	825	449	(376)	The timing of the submission of invoices from fund managers affects this figure
Net return on investments	(11,710)	(2,927)	(1,446)	1,481	
Totals	(27,410)	(6,852)	(6,914)	(62)	