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Brent Pension Fund Sub-Committee

Tuesday 20 November 2012 at 6.30 pm
Committee Room 4, Brent Town Hall, Forty Lane, Wembley, HA9 9HD

Membership:

Members Councillors:	**first alternates** Councillors:	**second alternates** Councillors:
S Choudhary (Chair)	Denselow	Gladbaum
Mrs Bacchus	Oladapo	Daly
Crane	Harrison	Hector
Mitchell Murray	Hirani	Hossain
Brown	CJ Patel	
Hashmi	CJ Patel	
BM Patel	HB Patel	Baker

Non Voting Co-opted Members

George Fraser	GMBU
Ashok Patel	College of North West London

For further information contact: Joe Kwateng, Democratic Services Officer
020 8937 1354, joe.kwateng@brent.gov.uk

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The press and public are welcome to attend part of this meeting

recycle for Brent

Agenda

Introductions, if appropriate.

Apologies for absence and clarification of alternate members

Item		Page
1	**Declarations of prejudicial interests** Members are invited to declare at this stage of the meeting, any relevant financial or other interest in the items on this agenda.	
2	**Minutes of the previous meeting**	1 - 6
3	**Matters arising**	
4	**Deputations**	
5	**Report from Alinda Capital Partners** Simon Rigall, a representative from Alinda Capital Partners, the infrastructure manager will attend the meeting for this item.	
6	**Monitoring report on fund activity for the quarter ended 30 September 2012** This report provides a summary of fund activity during the quarter ended 30 September 2012. It also examines the actions taken, the economic and market background, investment performance and comments on events in the quarter. I have circulated copies of the investment report for the quarter by Henderson Global Investors to members only. **Ward affected:** All Wards ***Contact Officer**:* Mick Bowden, Deputy Director of Finance Tel: 020 8937 1460 mick.bowden@brent.gov.uk	7 - 20

7 Socially responsible investment 21 - 36

This report responds to a recommendation by Health Partnerships Overview and Scrutiny Committee at its meeting on 18 July 2012 requesting the Brent Pension Fund Sub-Committee to reconsider its decision to reaffirm its existing investment policies included in its Statement of Investment Principles to continue investing in tobacco companies.

I have circulated copies of the appendices (Supplementary) to this report to members only. Spare copies will be available at the meeting.

Ward affected: All Wards

***Contact Officer**:* Mick Bowden, Deputy Director of Finance

Tel: 020 8937 1460
mick.bowden@brent.gov.uk

8 2013 Actuarial valuation of Brent Pension Fund 37 - 40

This report updates the Pension Fund Sub-Committee on the progress of the 2013 actuarial valuation currently under way.

Ward affected: All Wards

***Contact Officer**:* Mick Bowden, Deputy Director of Finance

Tel: 020 8937 1460
mick.bowden@brent.gov.uk

9 Any other urgent business

Notice of items to be raised under this heading must be given in writing to the Democratic Services Manager or his representative before the meeting in accordance with Standing Order 64.

10 Date of next meeting

The next meeting will take place on Tuesday 26 February 2013 at 6:30pm.

11 Exclusion of press and public

The following reports are not for publication as they contain the following categories of exempt information as specified in Schedule 12A of the Local Government Act 1972, namely:

"3. information relating to the financial or business affairs of any particular person (including the authority holding that information)".

This report provides progress on the contract for pension administration services.

Ward affected: All Wards

***Contact Officer**:* Andrew Gray, Pensions Team

Tel: 020 8937 3157
andrew.gray@brent.gov.uk

This report outlines the action taken by the Head of Exchequer and Investment on investment management fees incurred by the Brent Pension Fund.

Ward affected: All Wards

***Contact Officer**:* Mick Bowden, Deputy Director of Finance

Tel: 020 8937 1460
mick.bowden@brent.gov.uk

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- The meeting room is accessible by lift and seats will be provided for members of the public.
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LONDON BOROUGH OF BRENT

MINUTES OF THE BRENT PENSION FUND SUB-COMMITTEE
Tuesday 25 September 2012 at 6.30 pm

PRESENT: Councillor S Choudhary (Chair) and Councillors Mrs Bacchus, Crane, Mitchell Murray, Hashmi and BM Patel

Mr Valentine Furniss, the Independent Adviser was in attendance.

Apologies for absence were received from: Mr George Fraser

1. **Chair's announcement**

   The Chair introduced Anthony Dodridge the newly appointed Head of Exchequer and Investment to his first meeting. Anthony confirmed that although he started only six weeks ago, he had linked in with his predecessor prior to his departure to ensure continuity.

2. **Declarations of personal and prejudicial interests**

   None.

3. **Minutes of the previous meeting**

   RESOLVED:-

   that the minutes of the previous meeting held on 26 June 2012 be approved as an accurate record of the meeting subject to the following amendments:

   i) Add “Councillor Crane” to the list of members present at the meeting on 28 February 2012.

   ii) In item 6 last sentence, delete all after “monitoring should occur” and replace with “and appropriate action be taken where necessary”.

4. **Matters arising**

   None.

5. **Deputations**

   None.

6. **2011/12 Pension Fund Accounts**

Andre White (District Auditor) and Charlotte Goodrich (Audit Manager) from the Audit Commission were present for this item.

The District Auditor informed the Sub-Committee that she had reviewed the financial statements included in the annual report prepared by the Fund and confirmed that they were consistent with the pension fund statements she had audited. She added that the audit of the pension fund accounts was substantially complete and that she planned to issue her audit report including an unqualified opinion on the pension fund statements by 30 September 2012. She continued that the accounts were completed by the due date and were supported by good supporting working papers and audit trails. Members noted that to reflect the council's internal efficiency, the net fee amount payable to the audit Commission for its work had been reduced by £2,800 to £32,200.

Charlotte Goodrich the Audit Manager in outlining the key messages informed members that during the course of the audit she identified two main weaknesses; an internal control weakness over general ledger journals and the concentration of pension fund and investment knowledge. Controls over journals were found to not be operating effectively throughout the full financial year. Out of a sample of 20 journals tested by Internal Audit during the year, 4 were both prepared and authorised by the same officer. This raised the risk that erroneous or unauthorised amounts could be input into the general ledger. As a result, detailed testing on all material year end journals were carried out to obtain sufficient assurance over their validity.

Secondly, during the course of her audit it became apparent that the knowledge of the fund and its investments was largely concentrated in one key member of staff, the former Head of Exchequer who had retired. Other pension fund staff lacked sufficient overall knowledge and understanding of the Council's investments and how they were reflected in the accounts so as to answer audit queries efficiently. Consequently, the completion of the audit took longer than anticipated. In her closing remarks, the Audit Manager stated that despite the internal control issues identified, there were a limited number of errors and queries raised during the course of her audit. This reflected a good standard of working papers supported the accounts and a good working relationship between officers and the audit team. The Audit Manager thanked officers for their help and support throughout the audit.

In response to Councillor Hashmi's enquiry, the District Auditor clarified that her responsibility as the Council's auditor was to consider whether the Pension Fund had put adequate arrangements in place to satisfy itself that the systems of internal financial control were both adequate and effective in practice and in accordance with Auditing Practices Board's ethical standards and CIPFA code of practice. She suggested that in order to address the concentration of pension fund knowledge in one officer, the Council would need to implement systems and processes that would mitigate such risks.

Mick Bowden, Deputy Director of Finance stated that despite the weaknesses identified by the District Auditor, the preparation of the accounts had not suffered, adding that the retired officer cooperated fully with the Audit Commission in their audit prior to his departure. Anthony Dodridge, Head of Exchequer and Investments added that he linked in with his predecessor prior his departure.

RESOLVED

that the audit of the Pension Fund accounts and the findings of the District Auditor be noted.

7. **Report from the performance measurement company, WM**

Lynn Coventry of WM the performance measurement company attended the meeting for this item. With reference to her report circulated for the meeting, she gave a presentation on the market environment, the total fund performance against strategic benchmark and the local authority average and fund manager performance. Members learnt that over the last year the Fund performance had been poor with returns of -0.2% compared with the benchmark return of 2.8% and the local authority average return of 2.6%. She continued that the below benchmark performance had continued over the medium and longer term. Lynn Coventry added that over the longer term, stock selection had been unfavourable mainly due to the below average returns in overseas equities and the negative impact from asset allocation over the 3 year period mainly due to the Fund's above benchmark commitment to bonds and cash and below benchmark weighting in overseas equity and small cap in 2010. She then drew members' attention to the Fund's manager performance, the fund's return and benchmark return. Lynn Coventry was thanked for her presentation.

The Head of Exchequer and Investment informed the Sub-Committee that he would be reviewing the various asset class benchmarks currently in place with Lynn Coventry. Councillor Crane pointed out that poor returns of the funds was a result of collective harm by erstwhile fund managers.

RESOLVED:

that the report by WM performance measurement be noted.

8. **The proposed new Local Government Pension Scheme 2014**

In November 2011 officers reported on the consultation for cost saving measures for the Local Government Pension Scheme (LGPS). The proposals were that under the current scheme, increased employee contributions and reduced accrual would be the mechanisms used to achieve savings of £900 million by April 2015 – the proposed date of the new scheme. The consultation resulted in amended proposals to consolidate scheme design and cost savings in a new scheme in 2014. The report before members provided a summary of the proposals and officers' response to the recent consultation regarding the scheme.

Andy Gray, Pensions Manager in introducing the report stated that the aim of the Independent Public Service Pension Commission final report delivered in March 2011 was that all public sector pension schemes would move from a final salary to a Career Average Re-valued Earnings (CARE) scheme. He highlighted the main components of the outline agreement reached by employee unions, employers and the Government as follows:

- Career Average Revalued Earnings (CARE);
- 1/49th accrual rate with revaluation based on Consumer Prices Index (CPI);
- Retirement linked to State Pension Age (SPA);
- Contributions based on actual pay (including part time employees) with the average employee contribution remaining at 6.5%;
- Retention of banded employee contributions;
- 50/50 scheme option enabling members to pay half contributions for half the pension, with most other benefits remaining as they are currently;
- Protection of benefits for service prior to 1 April 2014 including 'Rule of 85'. Protected past service would continue to be based on final salary and current retirement age;
- Outsourced scheme members would be able to stay in the scheme on first and subsequent transfers;
- Vesting period (when members can get a refund on their contributions if they leave the scheme) would be increased from 3 months to two years.

He continued that it was the opinion of officers that the scheme was likely to remain relatively attractive and would continue to offer good quality salary related benefits although administratively more difficult to understand.

RESOLVED:

that the report on the proposed new Local Government Pension Scheme (LGPS) be noted.

9. **Monitoring report on fund activity for the quarter ended 30 June 2012**

The Sub-Committee received a report that provided a summary of fund activity during the quarter ended 30 June 2012 and examined the actions taken together with the economic and market background, and investment performance and comments on events in the quarter. The following headlines were noted:

Equity markets fell in the second quarter, and government bonds rose in value amid concerns over an uncertain economic outlook and the Euro debt crisis. The Fund fell in value from £485m to £478m however, its return of -1.2% was broadly in line with its quarterly benchmark of -1.1% and compared favourably to the WM Local Authority average fund return of -1.9% for the quarter. Members heard that the fund was within the top quartile of investment returns for the quarter ended 30 June 2012 with a ranking of 16 out of 82 LGPS funds who currently subscribe to the WM performance reporting service. The Head of Exchequer and Investments drew members' attention to the respective tables within the report which showed that the marginal underperformance could be attributed to poor results in emerging market equities, UK smaller companies equities, and hedge fund of funds. He then highlighted the salient aspects of the main market movements as set out in his report.

Valentine Furniss, the Independent Adviser circulated a further update on his investment report at the meeting. It was noted that equity returns were: the Asia/Pacific region (+5.4%) and Emerging Markets (+2.1%) and the other end of the spectrum was Japan with a negative return of 2.2%. He ascribed the positive equity returns for the month compared to the quarter ending June 2012 to overselling and most importantly, the perception that the ECB, IMF and the German Government might at last find a genuine fiscal solution to the Eurozone crisis.

In conclusion, he stated that although equity markets would become less volatile against a background of gradually improving macro-economic data. Within the Fixed Interest area most subsector returns were expected to be flat especially when adjusted for inflation.

10. **Work Programme**

The Head of Exchequer and Investments sought members' views on the formats of meetings and any specific topics they would like to be reported on at future meetings. The following suggestions were noted:

i) Review of fund managers' fees

ii) Training sessions on selected mandates prior to meetings.

iii) Review of format fund managers' reports to ensure reduced reliance on pictorial reports (graphs, charts etc.)

11. **Any other urgent business**

12. **Date of next meeting**

The next meeting will take place on Tuesday 20 November 2012.

13. **Exclusion of press and public**

RESOLVED:

that the press and public be excluded for the remainder of the meeting as the following reports to be considered contained a category of exempt information as specified in paragraph 12A of the Local Government (Access to Information) Act 1972, namely;

Information relating to the financial or business affairs of any particular person (including the Authority holding the information).

14. **Review of subscriptions**

Members gave consideration to a report that set out options to ensure that the Fund achieved value for subscriptions to bodies, given the significant squeeze on public sector spending.

RESOLVED:

that the recommendations set out in the report by the Head of Exchequer and Investments be agreed.

15. **Hedge funds of funds mandate - Fauchier Partners**

The report before members considered the hedge funds of funds mandate and proposed options for the future.

RESOLVED:

that the recommendations set out in the report by the Head of Exchequer and Investments be agreed.

The meeting closed at 8.45 pm

S CHOUDHARY
Chair

Brent	**Pension Fund Sub-Committee** 20 November 2012 **Report from the Deputy Director of Finance**
For Information	Wards Affected: ALL

Monitoring report on fund activity for the quarter ended 30 September 2012

1. SUMMARY

1.1 This report provides a summary of fund activity during the quarter ended 30 September 2012. It examines the actions taken, the economic and market background, and investment performance, as well as commenting on events in the quarter. The main points arising are:

a) The Fund has increased in value by £11.5m from £477.5m to £489.0m, and the Fund return of 3.0% was identical to its quarterly benchmark. The strong performance can be attributed to results in UK smaller companies equities which achieved an outstanding quarterly return of 12.8%, whilst UK equities, emerging market equities, and overseas developed market equities delivered returns of between 3.8% and 4.7%. Fixed income and the diversified growth fund outperformed their benchmarks with returns of 2.5% and 2.1% respectively, and the fund of hedge funds showed a positive return of 1.8%. Whilst less clear to gauge performance in the short term, private equity appears to be delivering a reasonable underlying performance over the longer term.

b) The positive performance for the quarter ended 30 September 2012 has continued during the month of October, where the Fund has continued to increase in value by an estimated £0.9m. An investment update for the month of October 2012, written by the Independent Adviser, is attached.

c) It should be noted that the Fund return of 3.0% represents an underperformance when compared to the WM Local Authority average fund return of 3.3% for the quarter, as a result of Brent's asset allocation with its relatively low exposure to equities which had a strongly positive quarter and high exposure to alternatives which performed rather less so.

2. RECOMMENDATION

2.1 Members are asked to note the investment report.

3. DETAIL

Economic and market background – quarter ended 30 September 2012

3.1 Equity markets rallied during the quarter ended 30 September 2012, buoyed by stimulus measures provided by the Federal Reserve, Bank of Japan and the European Central Bank.

3.2 Domestic equities returned around 5%, where financial and technology stocks performed strongly whilst more defensive sectors retreated. Geographically, Europe and the lesser Pacific markets performed best with returns in the region of 7% and 8% respectively. Japan was the only area to produce a negative return. However, a modest strengthening of Sterling reduced the locally experienced returns from unhedged international assets.

3.3 Whilst risk assets performed well over the quarter, returns also remained positive for safer haven assets such as gilts where stubbornly weak global economic data and central bank support continued to maintain yields at close to record lows.

3.4 As a result of the latest positive outturn, year to date and rolling 12 month returns have improved markedly from the previous quarter.

Asset allocation of the Fund

3.5 The WM Local Authority average asset analysis for the quarter ended 30 September 2012 shows increased allocations into the following asset classes:

Asset class	Increase in percentage allocation
UK equities	+0.9%
Bonds	+0.7%
Hedge funds	+0.3%
Cash	+0.3%
Infrastructure	+0.2%

3.6 Those asset classes out of favour with the WM Local Authority average during the quarter are shown as follows:

Asset class	Reduction in percentage allocation
Private equity	-0.9%
Overseas equities	-0.6%
Property	-0.6%
Diversified growth funds	-0.3%

Table 1: Asset allocation as at 30 September 2012 compared to the benchmark

Market (1)	Market Value 30.09.12 £M (2)	Market Value 30.09.12 % (3)	WM LA Average 30.09.12 % (4)	Fund Benchmark 30.09.12 % (5)	Market Value 30.06.12 £M (6)	Market Value 30.06.12 % (7)	WM LA Average 30.06.12 % (8)
Fixed Income							
Henderson – Total Return Bond Fund	79.1	16.2	19.1	15.0	77.1	16.1	18.4
Equities							
UK – Legal & General	68.2	13.9	25.8	13.0	65.1	13.6	24.9
UK - Small Companies Henderson	18.2	3.7	*	4.0	16.1	3.4	*
O/seas – developed Legal & General	105.9	21.7	30.4	19.0	102.1	21.3	36.4
O/seas – emerging Dimensional	29.5	6.0	5.4	8.0	28.4	5.9	*
Property							
Aviva	33.7	6.9	6.8	8.0	34.2	7.2	7.4
Private Equity							
Capital Dynamics	64.4	13.2	3.7	10.0	62.5	13.3	4.6
Yorkshire Fund	1.3	0.3	*		1.3	0.3	*
Hedge Funds							
Fauchier	40.2	8.2	2.7	10.0	39.5	8.2	2.4
Infrastructure							
Alinda	15.2	3.1	1.5	6.0	15.7	3.3	1.3
Henderson PFI Fund II	1.1	0.2	*		1.1	0.2	*
Pooled Multi Asset							
Baillie Gifford DGF	27.8	5.7	0.8	6.0	27.2	5.7	1.1
Cash	4.4	0.9	3.8	1.0	7.2	1.5	3.5
Total	**489.0**	**100.0**	**100.0**	**100.0**	**477.5**	**100.0**	**100.0**

3.7 Table 1 shows the changes in asset allocation, how asset allocation compares with the benchmark and with the average fund (WM Local Authority average), and how the change in the market value during the quarter is allocated across asset classes. Items marked (*) in columns 4 and 8 cannot be separately analysed, but are included within the relevant asset class. Aside from market movements, there have been no investment changes to the Brent Pension Fund during the quarter.

3.8 The independent WM Company measures the returns on the Brent Pension Fund. Table 2 sets out returns for the quarter to 30 September 2012.

Table 2: Investment Returns in Individual Markets

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 30.09.12			Year Ended 30.09.12			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
Fixed Income							
Total Return Bond Fund Henderson	2.5	1.5	3.0	n/a	6.0	9.2	Absolute return 6% p.a.
Equities							
UK – Legal & General	4.7	4.7	5.0	n/a	17.2	18.1	FTSE All share
UK - Small Companies Henderson	12.8	11.0	n/a	15.4	21.4	n/a	FTSE Small Cap
O/seas – developed Legal & General	3.8	3.9	4.1	17.9	18.0	17.0	FTSE Dev World ex UK
O/seas – emerging Dimensional	4.0	4.6	5.0	10.7	11.8	13.6	MSCI Emerging Markets
Property							
Aviva	0.1	0.6	0.5	0.4	3.5	3.2	IPD All Properties Index
Private Equity							
Capital Dynamics	0.5	2.5	-0.2	1.8	10.0	0.8	Absolute return 10% p.a.
Yorkshire Fund Managers	n/a	2.5	n/a	n/a	10.0	n/a	Absolute return 10% p.a.
Hedge Funds							
Fauchier	1.8	1.4	1.3	1.1	5.5	3.4	LIBOR + 5% p.a.
Infrastructure							
Alinda	1.9	2.5	2.7	7.6	10.0	4.5	Absolute return 10% p.a.
Henderson PFI Fund II	-2.3	2.5	-	-18.9	10.0	-	Absolute return 10% p.a.
Pooled Multi Asset							
Baillie Gifford	2.1	1.0	2.2	n/a	4.0	6.2	Base Rate + 3.5% p.a.
Cash	0.1	0.1	0.2	0.5	0.5	0.8	LIBID 7-day
Total	**3.0**	**3.0**	**3.3**	**10.0**	**11.7**	**12.6**	

3.9 The Fund's overall return of 3.0% was identical to its quarterly benchmark. UK smaller companies equities, diversified growth fund, fixed income, and fund of hedge funds outperformed their respective benchmarks, whilst private equity, emerging market equities, and property underperformed against their benchmarks.

3.10 Over one year, the Fund return of 10.0% when compared to its benchmark of 11.7% equated to a net underperformance of -1.7%. Equities performed well over the period and were broadly in line with their benchmarks. Property, fund of hedge funds, and private equity all delivered disappointing returns in relation to their benchmarks. The Brent Fund's return of 10.0% has also underperformed when compared to the WM Local Authority average fund return of 12.6%, mainly due to the strongly positive performance of equities for which Brent has a lower proportionate exposure and poor performance of alternative assets where Brent has invested to a greater extent.

Indicative performance of the Fund since September 2012

3.11 Following a strongly positive quarter ended 30 September 2012, the Fund has continued to increase in value by an estimated £0.9m:

	As at 31 October 2012 £M	As at 30 September 2012 £M	Movement
Fixed Income			
Henderson	80.0	79.1	↑
Equities			
UK - Legal & General	68.9	68.2	↑
UK - Small Companies Henderson	18.7	18.2	↑
O/seas – developed Legal & General	105.4	105.9	↓
O/seas – emerging markets Dimensional	29.2	29.5	↓
Property			
Aviva	33.7	33.7	=
Private Equity			
Capital Dynamics	64.4	64.4	=
Yorkshire Fund Managers	1.3	1.3	=
Hedge Funds			
Fauchier	40.3	40.2	↑
Infrastructure			
Alinda	15.2	15.2	=
Henderson PFI Fund II	1.1	1.1	=
Pooled Multi Asset			
Baillie Gifford DGF	28.0	27.8	↑
Cash	3.7	4.4	↓
Total	**489.9**	**489.0**	↑

4. FINANCIAL IMPLICATIONS

4.1 These are included within the report.

5. DIVERSITY IMPLICATIONS

5.1 The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from them.

6. STAFFING IMPLICATIONS

6.1 None.

7. LEGAL IMPLICATIONS

7.1 There are no legal implications arising from this report.

8. BACKGROUND INFORMATION

Henderson Investors – September 2012 quarter report
Legal & General – September 2012 quarter report
Fauchier Partners – September 2012 quarter report
Dimensional Asset Management – September 2012 quarter report

9. CONTACT OFFICERS

9.1 Persons wishing to discuss the above should contact the Exchequer and Investment Section, Brent Financial Services, on 020 8937 1472 at Brent Town Hall.

MICK BOWDEN
Deputy Director of Finance

ANTHONY DODRIDGE
Head of Exchequer and Investment

Report from the Independent Adviser

Investment Update for the Month of October 2012

The index returns and exchange rate movements for the month of October are shown in the tables below:

	Indices	Month ended 31st October 2012
		%
Equities		
Europe	FTSE Developed Europe (ex UK)	2.2
UK	FTSE All Share	1.0
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	1.0
Emerging Markets	MSCI Emerging Markets Free	-0.4
North America	FTSE North America	-1.4
Japan	FTSE Developed Japan	-1.7
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	0.7
UK Index Linked Gilts	FTSE British Government Index Linked Over 5 years	0.5
UK Gilts	FTSE British Government All Stocks	-0.7
Property	IPD*	Not available
Cash	Merrill Lynch LIBOR 3 Month	0.1

* The IPD UK Property return from 31st August 2012 to 30th September 2012 was 0.2%.

Currency movements for month ended 31st October 2012

Currency	28 September 2012	31st October 2012	Change %
USD/GBP	1.615	1.611	-0.2
EUR/GBP	1.255	1.243	-0.9
USD/EUR	1.287	1.296	0.7
YEN/USD	77.800	79.930	2.7

The equity returns in the above table are considerably more muted than the strong returns achieved in the quarter ended 30th September 2012. But this is quite understandable against the uncertain investment background that prevailed for most of October. As the figures show, most markets were visibly flat to lower except for Europe (+2.2%) which continued to be buoyed by the increasing perception that the Eurozone problem would eventually be solved with the qualification that this would take time.

Unsurprisingly, as is so often the case, the lowest return came from Japan (-1.7%) as the weak government showed little evidence that it possessed the ability to re-energise the nation and steer the economy away for the quagmire of deflation. Fixed interest returns virtually marked time and, as forecast by many, the gilt return (-0.7%) underperformed the return on corporate bonds (+0.7%). The reason for this was on comparative yield grounds with investors becoming increasingly nervous about the historically low yields on 10 year gilts standing around 1.5%. When expressed in real returns this level of yield appears to be increasingly untenable. Property maintained its snail's pace recovery inching up 0.2% (this return was for the month of September, those for October being unavailable).

During October the principal events, macro economic data and forecasts within the regions were as follows:-

UK

- The Confederation of British Industry (CBI) predicts output growth of zero for 2012, 1.4% for 2013 and of 2.0% for 2014. These estimates were somewhat higher than those made by the CBI only three months ago.

- The Coalition Government was humiliated with regard to the EU budget vote.

- The purchasing managers' index of manufacturing activity slipped to 47.5 in October from 48.1 in September.

- The Japanese group Hitachi is to purchase from Germany the Horizon nuclear project for approximately £700M. This is a most welcome boost for the UK's vital nuclear expansion plans and removes a high degree of uncertainty about the project.

- The Heseltine report was published recommending that some £58B of funding should be transferred from the Government to local and regional enterprises in order to spur economic growth and to bring forward essential decisions on both energy and aviation in particular.

- The sheer scale of the banks' mis-selling of Payment Protection Insurance (PPI) beggars belief.

- The Ford Motor Company announced plans to shut two plants at Southampton and Dagenham with a loss of 1,250 jobs.

- 10% of Heathrow Airport is to be acquired by CIC, China's main sovereign wealth fund. Qatar Holdings, a Middle Eastern sovereign wealth fund already owns 20% of Heathrow. For 30% of Heathrow to be foreign owned is indeed unfortunate, particularly at a time when the UK's principal airport is being severely challenged by Germany, France and Holland. It also comes at a time when the future location of the airport is by no means settled.

- The Office for National Statistics reported a welcome advance of 1.0% in the rate of GDP for the third quarter of the year, thus ending a double dip recession. This is the strongest single quarter for growth in 5 years and was certainly helped by the Olympic Games.

- In the quarter to 31st August the number of people in work rose to the highest level since records began in 1971. The number of unemployed fell by 50,000 to 2.53M whilst the rate of unemployment fell from 8.1% to 7.9%.

- Nearly 1,000 retail stores closed in the first half of 2012. This compares with the total closure of 174 stores for the whole of 2011.

USA

- 171,000 new jobs were created in October compared with an estimate of only 125,000. The rate of unemployment in October inched up to 7.9% from 7.8% recorded in September.

- In late October, Hurricane Sandy (estimated to be the largest in Atlantic storm history) reeked havoc in its aftermath by causing power cuts, flooding and high winds. The most affected areas were the North Eastern states, especially New York including lower Manhattan and New Jersey. Even the New York stock exchange was closed for 2 days.

- Output for the third quarter of the year increased by 2.0% (second quarter +1.3%) with consensus estimates of 1.8%. Part of this rise was attributed to federal government spending.

- Corporations have recently been reporting weaker global demand.

- New houses starts advanced by a robust 15.0% in September.

- The consumer sentiment index improved to 83.1 in October from September's 78.3.

Europe

- Eurostat reported that September unemployment in the Eurozone hit a record 18.5M people out of work. The unemployment rate increased to 11.6% in September (11.5% in August). A year ago the rate was 10.3%.

- The number of corporate share buybacks have dropped to the lowest levels since 2009 as these corporations have sort to retain liquidity levels.

- There have been severe cases of civil action in the beleaguered countries of Greece and Spain.

- The Eurozone's purchasing managers' index decreased from 46.1 in September to 45.8 in October.

- In Spain, prime minister, Mariano Rajoy's centre right party has kept control of Galicia in an important local election. This result is a distinct boost against the background of the government's unpopular spending cuts and tax increases.

- The European Union was awarded the Nobel Peace Prize for its role in bringing reconciliation and democracy to the continent. This award was seen by many to be controversial against the current climate in the Eurozone.

Japan

- No announcements of any major import were made in the month of October. Japan with its old fashioned and slow moving culture traditionally experiences a paucity of news and often late macro economic data.

Asia/Pacific/Emerging Markets

- China's purchasing managers' index rose to 49.1 in October from 47.9 in September.

- China's GDP growth rate for the third quarter of the year was 7.4% p.a. representing the seventh consecutive quarter of decelerating growth.

- The Chinese government has stated that it intends to maintain more accommodative conditions, to increase infrastructure investment and to help the property market to recover.

- Chinese industrial production for September grew by 9.2% p.a. (August +8.9% p.a.) and the rate of sales growth in September was lifted by 14.2% p.a. against 13.2% p.a. in August.

- On 17th October, Wen Jiabao, the Chinese premier, gave an optimistic assessment of the economy, stating that it had stabilised and that the government's target of GDP growth of 7.5% p.a. was "well within reach".

- China's September CPI inflation rate was marginally lower at 1.9% down from August's 2.0%.

- China's September exports advanced a strong 9.9% p.a

- On 1st October the Reserve Bank of Australia cut its interest rate by ¼% to 3¼%.

Conclusion

Over the month of October nothing has occurred to materially change the mildly optimistic conclusion contained in the investment report for the quarter ended 30th September 2012. That is to say, on a year's view, sufficient remedial measures appear to be in place to suggest further progress in markets both in the UK and globally. However, it should be stressed that there will inevitably be periods of nervousness and volatility as markets wax and wane in reaction to the latest macro economic data, forecasts and events, particularly from the Eurozone. On an overall view equities should out-perform fixed interest. The following synopsis covers the outlook for other asset classes.

The current background of historically very low interest rates; minuscule returns on cash and extremely small real yields on sovereign debt (both from UK gilts and elsewhere) have certainly created an urgent search for higher income returns. Therefore there has been a pronounced concentration on the following asset classes:-

- High yielding quality equities, particularly those with consistently growing dividend streams and well financed balance sheets

- Emerging market debt

- Corporate bonds, even though their yields are not as attractive as they were.

In addition to the traditional classes of equities and fixed interest there is clear evidence that pension funds are spreading overall risk by buying into alternative asset classes, namely:-

- Absolute return multi asset funds

- Diversified growth funds

- Infrastructure

- Emerging market equities.

Other popular alternative classes continue to be Private Equity, provided that patience is exercised. If the past performances are to go by then such patience should, over time, be amply rewarded.

Asset classes that are currently out of favour are Foreign Exchange, Commodities and Hedge Fund of Funds. Although this last asset class, after a period of under performance, is now reporting better results.

The theme of globalisation is becoming increasingly applied to all asset classes. This does make eminent long term sense.

Regional observations are as follows:-

<u>In the UK</u>

- The population will continue to grind its way through continuing austerity with all the harsh aspects that this imposes particularly with regard to job security.

- The Coalition Government is experiencing some wobbly moments not the least of which is to reach agreement on the way forward in relation to the UK's future relationship with Europe.

In the USA

- The current focus of attention is without doubt the presidential election as it approaches its climax on 6th November. Whichever party wins (and it is allegedly a very close race) they will have to hit the decks running in order to avoid the so called "fiscal cliff" timetable. Whether the result is Republican or Democrat much will depend whether the successful party has a working majority both in the Senate and also Congress. Failing to achieve such a majority would of course weaken the President's ability to enact the essential legislation so urgently needed at this time, especially with regard to the aforementioned fiscal cliff.

- The country will also continue to struggle with the after affects of the drought together with the flood and wind damage caused by the recent Hurricane Sandy.

In Europe

- The 27 members of the Eurozone, particularly the peripheral countries, will continue to suffer from their respective austerity programmes, high rates of unemployment (especially amongst the young) and weak rates of economic growth.

- Greece continues to be a financial and recession riddled basket case. It also continues to be the epicentre of totally irresponsible behaviour. As such its toxic and contagious tentacles affect most other Eurozone countries. That said, there are at last some signs that the European leaders are getting closer to the release of 31.3B Euros of aid with regard to Greece's bailout programme on the understanding that the Greek government agrees to new austerity measures. However, with Greece's appalling record of provisos this initiative does not appear to have any better chance than any of the others.

In Japan

- The most contentious issue for the nation remains the weak government's ability to fund its ballooning deficit.

In Asia

- In China nothing has occurred to diminish the expectation that this mighty nation is most surely destined to eventually surpass the American economy and to become the world's largest and most influential economy. It will not only be the greatest contributor to world trade, but will also be a major benefactor to regional growth in Asia. The benefits should also be felt in Japan. In the shorter term much will depend on the soon to be announced group of new leaders in China. Practically the only thorn in China's side at this time is its spat with Japan over the ownership of the Senkaku Islands in the south China Sea. With regard to China's ownership of Hong Kong, this territory will remain a useful conduit for finance and trade with the rest of the world. It has to be admired how both the political regime and the People's Bank of China manage the course of the renminbi currency and deal with problems like the over extension of the property market and also of course raising the vast population's standard of living.

In General

- The International Monetary Fund estimates global growth of 3.3% in 2012 and 3.6% in 2013 compared with its July estimates of 3.5% and 3.9% respectively.

- More banks are coming under scrutiny with regard to the scandalous manipulation of LIBOR.

- Many nations are accelerating their search for shale deposits which could have a dramatic effect on countries with only small reserves of traditional oil.

- Whether a Democrat or Republican the next president of the USA will not be sworn in until 21st January 2013 such are the archaic rules of the US constitution which appears to be in increasing need of modernisation to better cope with the demands of the 21st century. However, many Americans would consider this to be sacrilege.

Valentine Furniss
7th November 2012

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Brent	**Pension Fund Sub-Committee** 20 November 2012 **Report from the Deputy Director of Finance**
For action	Wards Affected: ALL

Brent Pension Fund – socially responsible investment

1. SUMMARY

1.1 At its meeting of 14 October 2010, the Health Partnerships Overview and Scrutiny Committee agreed to request that the Brent Pension Fund Sub-Committee should consider its investments in tobacco firms. At a meeting of the Pension Fund Sub-Committee on 30 November 2010, a decision was taken to reaffirm its existing investment policies included in its Statement of Investment Principles.

1.2 The Health Partnerships Overview and Scrutiny Committee requested at their meeting of 18 July 2012 that the Brent Pension Fund Sub-Committee reconsider the investments that the Fund holds in tobacco firms.

2. RECOMMENDATIONS

2.1 Members are asked to reaffirm their existing investment policies as set out in paragraph 3.3 of this report and in the Statement of Investment Principles.

3. DETAIL

Investment in tobacco

3.1 The Health Partnerships Overview and Scrutiny Committee met on 18 July 2012 and made recommendations to the Pension Fund Sub-Committee as follows:-

(i) that in the light of Brent's recent CLeaR Award for excellence in local tobacco control presented at the House of Commons on 15 May 2012, the Brent Pension Fund Sub-Committee reconsiders its decision to continue investing in tobacco companies. This policy is at odds with the Council's work on tobacco control and the support that it gives to the Tobacco Control Alliance and Smoking Cessation Team in the borough;

(ii) that in considering recommendation (i), the Brent Pension Fund Sub-Committee considers two reports - the CLeaR Model Assessment for Excellence in Local Tobacco Control, which is an assessment of the work of Brent's Tobacco Control Alliance; and, a report from ASH on local authority pension fund investments in tobacco companies, which deals with both the question of ethical versus financial considerations, and the issue of non-interference with fund managers' decisions, both of which reasons were given in the previous reply from the Brent Pension Fund Sub-Committee in November 2010 for not disinvesting in tobacco companies; and

(iii) that the Brent Pension Fund Sub-Committee notes that although investment in Tobacco Companies in Brent is around £2.5 million, the estimated cost to Brent of smoking, as shown in the graph on page 9 of CLeaR report is some £57.9 million. The number of annual tobacco-related deaths in Brent, as set out in Brent's Joint Strategic Needs Assessment is 230.

Corporate governance and socially responsible investment

3.3 The background to the development of the Pension Fund Sub-Committee policies on corporate governance and socially responsible investment (SRI) has been controversial. In order to confirm that the management of the Pension Fund was primarily concerned with generating the best investment returns within acceptable risks, the Council meeting of 13 February 1996 agreed that:

'The Council re-confirms its policy of non-political or administrative interference with the investment manager's investment decisions or involvement with companies in which the fund managers have acquired shares on behalf of the Fund.'

In other words, the fund managers will take investment decisions on the basis of the best interests of the Fund, which is held for the best interest of beneficiaries.

3.4 The key background to the Council's decision were poor experiences in the 1980s and the principles set out in the Cowan vs Scargill judgement in 1985 (the Megarry judgement). These included:

a) trustees are under a duty to exercise their powers in the best interests of the present and future beneficiaries. The best interests will usually be financial interests, unless the trust is a charitable foundation with a particular moral outlook

b) trustees must put aside their own personal interests and views and not exercise their powers for any hidden motive

c) trustees must take such care as would the 'ordinary prudent person'

d) trustees must consider the need to diversify the investments.

3.5 As part of the adoption of the Statement of Investment Principles (SIP) in 2000, the Pension Fund Sub-Committee agreed to adopt the 1998 Combined Code on Corporate Governance and to engage with UK companies on corporate governance and SRI issues. The Pension Fund Sub-Committee agreed that soundly managed companies were more likely to comply with best practice in corporate governance and to consider long-term and employment / environmental / sustainable issues (SRI issues) as part of their planning process.

3.6 It has become apparent that the number of SRI mandates in local authority funds has reduced as performance targets have not been met. Investment performance is difficult, and it has been accepted that allowing managers wide discretion should encourage improved performance. However, many funds have integrated SRI principles into their investment agreements to ensure that long-term environmental, social and governmental issues are addressed. There has been support for this approach from the United Nations sponsored Freshfields, Bruckhaus, Deringer opinion that 'integrating ESG (environmental, social and corporate governance) considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions.' Doubt has been cast on the validity of the opinion in the light of the Megarry judgement, but it is apparent that consideration of SRI issues can improve investment analysis. In particular, the risks involved in a large weighting to oil stocks were shown in the recent performance of BP shares when their oil rig exploded in the Gulf of Mexico. However, the questions here are more financial than ethical – similar questions have been raised with AllianceBernstein over their exposure to financial stocks in 2008.

3.7 Other organisations contact Brent Council periodically to raise other SRI issues. In particular, the Campaign Against the Arms Trade (CAAT) has previously asked for details of investment in companies producing weapons. Other areas could include alcohol, oil, drug testing, fatty foods, foreign regimes, investment only in UK, etc. These could be very subjective areas.

3.8 At their meeting on 20 February 2008, the Pension Fund Sub-Committee reconfirmed its policy of non-political or administrative interference with managers' investment decisions. A copy of the Council's SIP is attached as Appendix 1. Paragraph 34 sets out policy with regard to Corporate Governance and Socially Responsible Investment.

3.9 Investment in tobacco companies has been highly successful over the years. At present, the Fund indirectly invests in tobacco companies through pooled equity funds managed by Legal & General Investment Management – the value of the investment is an estimated £2.5m.

4. FINANCIAL IMPLICATIONS

4.1 These are included within the report.

5. DIVERSITY IMPLICATIONS

5.1 The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from them.

6. STAFFING IMPLICATIONS

6.1 None.

7. LEGAL IMPLICATIONS

7.1 In the case of *Cowan v Scargill and Others [1985] Ch. 270*, Vice Chancellor Sir Robert Megarry laid down a number of principles, which include the following:

(1) The duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust and this duty towards their beneficiaries is paramount.

(2) In considering what investments to make, trustees must put on one side their own personal interests and views.

(3) The benefit of the beneficiaries which a trustee must make his paramount concern does not necessarily mean solely their financial benefit. However, the Judge added that under a trust for the provision of financial benefits, the burden would rest heavily on the trustee who asserts that it is for the benefit of the beneficiaries as whole to receive less by reason of the exclusion of some of the possibly more profitable forms of investment. The Judge said that such circumstances would be rare and if such circumstances did not arise, the paramount duty of the trustee would normally be to provide the greatest financial benefit for the present and future beneficiaries.

(4) The required standard required of a trustee in exercising his powers of investment is that he must take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide. This includes the duty to take professional advice on matters which the trustee does not understand, such as the making of investments and, on receiving that advice, to act with the same degree of prudence.

(5) Trustees have a duty to consider the need for diversification of investments.

(6) The law relating to trusts is applicable to pension funds.

7.2 In the case of *Martin v City of Edinburgh District Council [1988] SLT 329*, Lord Murray ruled that the members of the Council, as trustees, when deciding to withdraw investments from companies which had links with South Africa, had not applied their minds separately and specifically to the question whether the changes in investments would be in the best interests of the beneficiaries of the trusts and that as a result, they were in breach of trust. In this case, the trustees did not consider or take professional advice on whether withdrawing investment from companies which had links with South Africa would be in the interests of the beneficiaries of the trusts. In that case, Lord Murray made the following observation: “I accept that the most profitable investment of funds is one of a number of matters which trustees have to consider. But I cannot conceive that trustees have an unqualified duty … simply to invest trust funds in the most profitable investment available. To accept that without qualification would, in my view, involve substituting the discretion of financial advisors for the discretion of trustees”. Lord Murray also said that an individual trustee must recognise that he has certain preferences, commitments or principles but none the less do his best to exercise fair and impartial judgment on the merits of the issue before him.

7.3 In the case of *Bishop of Oxford v (Church Commissioners) [1993] 2 All ER 300*, Vice Chancellor Nicholls accepted that there were at least two exceptions to the duty to maximise financial returns, but they relate mainly to charities. The first exception is where the aims of the charity and objects of investment are in conflict and the second exception is where particular investments detract from the charity's work. In both exceptions, the trustees must weigh the extent of financial loss from offended supporters and the financial risk of exclusion. It is not clear from the case law whether such principles set out in this case apply to all investment trusts such as pension funds.

7.4 There are a number of other requirements laid down by statute. Under section 4 of the Pensions Act 1995 ("the 1995 Act") and subordinate regulations, the trustees' powers of investment must be exercised in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole. Under section 4(2)(a) of the 1995 Act, the assets must be invested in the best interests of members and beneficiaries. Under section 2(2)(a) of the 1995 Act, the assets must be properly diversified. Under section 4(7) of the 1995 Act, the trustees must obtain proper advice when preparing their statement of investment principles and under section 36(5) of the 1995 Act, they must act in accordance with those principles as far as practicable.

7.5 There are also statutory requirements laid down under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) ("the 2009 Regulations"). Under regulation 11 of the 2009 Regulations, a local authority administering a pension fund must formulate a policy for the investment of its fund money, must invest in accordance with its investment policy any fund money that is not needed immediately to make payments from the fund, obtain proper advice at reasonable intervals about its investments and must consider such advice in taking any steps in relation to investments. Subject to these conditions, a local authority may vary its investments. Also under regulation 11, a local authority's investment policy must be formulated with a view to the advisability of investing fund money in a wide variety of investments and to the suitability of particular investments and types of investments.

7.6 Under regulation 12 of the 2009 Regulations, after consultation with such persons as they consider appropriate, a local authority administering pension funds must prepare, maintain and publish a written statement of the principles (known as Statement of Investment Principles – "SIP") governing its decisions about the investment of fund money. The SIP must cover the local authority's investment policy on various matters, including the extent, if at all, to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. The full list of criteria which the SIP must cover in respect of the local authority's investment policy, as set out in regulation 12(2) of the 2009 regulations, is as follows:

(a) the types of investment to be held;
(b) the balance between different types of investments;
(c) risk, including the ways in which risks are to be measured and managed;
(d) the expected return on investments;
(e) the realisation of investments;
(f) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments;

(g) the exercise of the rights (including voting rights) attaching to investments, if the authority has any such policy; and
(h) stock lending.

7.7 The SIP must be reviewed, and if necessary revised, by the local authority from time to and time and in the case of any material change in the local authority's policy on matters referred to in regulation 12(2), before the end of a period of six months beginning with the date of that change. A copy of the Council's SIP is attached as Appendix 1 to this report and the Council's policy on Socially Responsible Investment (SRI) is set out in paragraph 34 thereof.

8. BACKGROUND

8.1 Pension Fund Sub-Committee – Statement of Investment Principles

9. CONTACT OFFICERS

9.1 Persons wishing to discuss the above should contact the Exchequer and Investment Section, Brent Financial Services, on 020 8937 1472 at Brent Town Hall.

MICK BOWDEN
Deputy Director of Finance

ANTHONY DODRIDGE
Head of Exchequer and Investment

Appendix 1

LONDON BOROUGH OF BRENT PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES

Investment responsibilities

1 Responsibilities are allocated to ensure that the managers are given authority to manage their portfolios, but that there is monitoring and review both at individual portfolio and at total Fund levels. The Pension Fund Sub-Committee at Brent Council is responsible as administering authority for:

a) determining the overall investment strategy and strategic asset allocation

b) appointing the investment managers, the Independent Adviser and the Actuary

c) reviewing investment manager performance and processes regularly.

2 The Chair of the Pension Fund Sub-Committee is responsible for ensuring that councillors taking investment decisions are familiar with investment issues and that the Pension Fund Sub-Committee has sufficient members for that purpose.

3 The Director of Finance and Corporate Services at Brent Council is responsible for:

a) advising and reporting to the Pension Fund Sub-Committee

b) reviewing the activities of the investment managers on a regular basis

c) keeping the accounts for the Fund and managing cash flow to distribute new money to managers.

4 The investment managers are responsible for:

a) the investment of pension fund assets in accordance with legislation, the Statement of Investment Principles and the individual investment management agreements

b) preparation of monthly and quarterly reports detailing activity, investment performance and future strategy, and attendance at the Pension Fund Sub-Committee.

5 The actuary is responsible for:

a) undertaking a triennial revaluation of the assets and liabilities of the Fund

b) providing annual FRS17 / IAS19 valuations

c) providing advice on the maturity of the Fund.

6 The Independent Adviser is responsible for the provision of advice to the Pension Fund Sub-Committee and the Director of Finance and Corporate Services on all investment issues, in particular asset allocation, new developments and the monitoring of manager performance against the agreed benchmarks.

Risk management

7 There are three main definitions of risk:

a) severe market decline and funds losing value (absolute risk), as occurred in 2008

b) underperformance when compared to a peer group (WM2000, or other local authorities) or relevant stock / bond markets (relative risk)

c) not meeting the liabilities set out in the LGPS. The Fund had a deficit of £294m when valued in 2010, and is following a 25-year recovery period.

8 To reduce absolute risk the Fund is diversified between managers, asset classes, markets and sectors so that investments are not concentrated in one theme or country / region. Investment managers are also to observe the authority's investment restrictions, which are designed to reduce risk.

9 To add value, the Fund seeks exposure to a variety of risks and associated risk premia. The search for outperformance will, on occasions, involve the risk of underperformance through the adoption of contrarian positions. The extent of any underperformance, through relative risk, has been reduced by diversification and the use of index-tracking with regard to UK equities, index benchmarks and asset allocation ranges in fixed interest.

10 The third definition of risk – failure to meet liabilities – is the key risk and is managed in three ways. First, to enable the administering authority to meet benefit payments, managers may remit payments on a monthly basis when required. This will allow managers to plan any realisation of assets as necessary or, more likely, reinvest income from dividends or interest received. Second, assets and liabilities are valued at least on a triennial basis by an independent actuary (the actuarial valuation) to determine the financial health of the Fund. If a deficit is forecast, employers' contributions may be increased to ensure that all liabilities are met. Third, the Brent Fund is mature, there being many more pensioners than working members - to the extent that 61% of assets are 'owned' by pensioner liabilities. Therefore, there is a need to consider the risks involved in pursuing a long-term equity-based strategy when a market correction, and lower dividend payments, could reduce the value of the Fund. There is currently a 'mismatch' between the allocation of more than 90% of the fund to real assets (equities, alternative investments and property, that increase with the growth of the economy) and the maturity of the Fund. However, this is balanced by the expectation that equities will generate additional returns to facilitate the payment of both pensioners' and active members' benefits. Contributions from employers and employees are calculated on the basis that they will be sufficient to meet benefit payments over the foreseeable future. Managers will be able to continue to reinvest income and change their stock selections without concern about the need to realise assets quickly. However, most assets are liquid and invested in recognised stock exchanges.

11 If the Director of Finance and Corporate Services becomes concerned that there may be an imminent severe market correction, he is authorised in consultation with the Chair of the Sub-Committee and the Independent Adviser, to amend the Fund asset allocation and reduce exposure to those assets classes that may be affected.

Investment objectives

12 The prime investment objective is to maximise long-term investment returns subject to an appropriate level of risk implicit in the targets set for each investment manager. The current targets are:

a) UK equities – to match the FTSE All Share index

b) overseas equities (developed markets) – to match the FTSE All World ex UK Index

c) overseas equities (emerging markets) – to outperform the FTSE AW All emerging index by 2% per annum over rolling three year periods

d) fixed income – Horizon Total Return Bond Fund – to achieve a return of 6% per annum over rolling three year periods

d) UK Small companies – to outperform the FTSE Small cap ex IT index by 2% per annum

e) property – UK property to outperform the IPD All properties index by 0.5% per annum over rolling three-year periods, and European property to return an absolute 8% per annum

f) private equity – to achieve an average absolute return of 10% per annum over the life of the Fund

g) fund of hedge funds – to achieve an average return of LIBOR plus 5% per annum

h) infrastructure – to achieve an average absolute return of 10% per annum, comprising both income and capital growth

i) diversified growth fund – to achieve a return of Base Rate plus 3.5% per annum over rolling three years periods.

13 The achievement of these targets should attain a real rate of return of 4% - 5% above inflation per annum over rolling three-year periods (see asset allocation for returns expected from each market). The 2010 Actuarial Valuation assumed a return of gilts plus 3% per annum, giving a total return of 7.5% per annum.

Asset allocation

14 Four general points should be noted. First, LGPS regulations require that funds achieve ‘proper diversification’, which may be considered in terms of ensuring that investments are spread through a number of markets whose movements are not closely correlated. This affords some protection in the event of market corrections, and allows gains from a variety of sources. Second, equities have been the best performing asset class over the very long term, property has performed well over ten years but has tended to be slightly behind equities, whereas bonds and cash have usually performed less well. Third, exposure to fixed income provides increased certainty of returns for a mature fund. Fourth, exposure to other asset classes adds to diversification and allows additional returns in less well researched markets. The Myners’ report advocated that funds should consider all the main asset classes in setting its asset allocation, allowing the Fund access to different risk premia (such as time, currency and different asset valuations).

15 The asset allocation adopted for the fund is as follows:

Asset Class	Percentage of Fund %	Expected Return p.a. %	Benchmark
UK equities	13	6 – 9	FTSE All Share
UK small companies	4	6 – 9	FTSE Small Cap ex IT
O/seas equities – dev.	19	6 – 9	FTSE AW ex UK
O/seas equities - EM	8	6 – 9	FTSE AW - Emerging
UK fixed interest	15	6	Absolute return
Diversified growth	6	5 – 9	Base Rate + 3.5%
Property	8	5 – 9	IPD and absolute return
Private equity	10	10	Absolute return
Hedge funds	10	5 – 9	LIBOR + 5%
Infrastructure	6	10	Absolute return
Cash	1	1 – 5	Cash

16 For UK equities, the manager holds stocks in proportion to their weighting in the FTSE All share Index (known as index tracking, or passive, management). Index tracking has been chosen because the average manager has, in the longer term underperformed the UK index, and passive management is less expensive than active management. For overseas equities (developed markets), the manager tracks the appropriate index. Active management has been chosen for exposure to overseas equities (emerging markets) and UK small companies, because there are opportunities for the manager to outperform through stock and sector selection. For fixed income, the manager has discretion to change the asset allocation, using other bond-like instruments as permitted. Active management has been chosen to allow opportunities for improved performance through stock selection and asset allocation. For fixed income, property, emerging markets, UK small companies, hedge funds, infrastructure, diversified growth and private equity, the Fund has invested in pooled funds that will allow diversified investment whilst offering the opportunity for additional returns.

17 Asset allocation is reviewed regularly to consider new opportunities that may arise. The expected returns detailed above are taken from forecasts made by the actuary and investment managers. It is anticipated that equities will not outperform by the same margins seen in the twenty-year period 1980 – 1999, but it is expected that the asset class will (over the long term) outperform gilts. The next major review of asset allocation is expected to be in 2014, but allocations will be considered at least annually.

Investment manager arrangements

The current managers are:

UK equities	Legal & General Investment Management
Overseas equities	Legal & General Investment Management (developed markets), Dimensional Fund Managers (emerging markets)
Fixed income	Henderson Global Investors
Property	Aviva Investors
UK smaller companies	Henderson Global Investors
Private equity	Capital Dynamics Yorkshire Fund Managers
Fund of hedge funds	Fauchier Partners
Diversified growth fund	Baillie Gifford
Infrastructure	Alinda Partners Henderson PFI Fund II

18 Management fees are calculated on the basis of a percentage of funds under management, rather than a performance basis, with the exception of the private equity, infrastructure and fund of hedge fund managers. This basis has been chosen because basic fees should be sufficient to incentivise managers in traditional areas, but performance fees are felt to be necessary to align interests in other areas.

Investment restrictions

19 LGPS investment regulations state that the administering authority shall have regard both to the diversification and the suitability of investments. These were amended in 2003 to allow each fund more discretion over investment policy by allowing a range of limits within an overall ceiling. The Pension Fund Sub-Committee has decided that the Brent Fund may not:

a) invest more than 10% of the Fund in unlisted securities

b) invest more than 10% of the Fund in a single holding (unchanged), or more than 25% of the Fund in unit trusts managed by any one body

c) excluding loans to the Government, lend more than 10% of the value of the Fund to any one borrower

d) contribute more than 5% of the Fund to any single partnership

e) contribute more than 15% of the Fund to partnerships.

20 The reasons for this approach are:

a) diversification – the Myners report has highlighted the need to access a wider range of asset classes both to spread risk and add to returns. The main alternative asset classes under consideration by pension funds are private equity, hedge funds, infrastucture and property. The main route for access to private equity and hedge funds is through partnerships (sometimes known as ‘fund of funds’)

b) return opportunities – the Brent Fund has committed 10% of assets to private equity through partnerships, 6% to infrastructure and 10% to fund of hedge funds. This may increase in future as experience of private equity, infrastructure and fund of hedge funds develop.

21 The decision to increase limits will apply for ten years and complies with the new Investment Regulations. However, asset allocation decisions are regularly reviewed and the suitability of the limits will be subject to reconsideration at least every three years as part of the asset allocation review.

22 The authority has also imposed a number of restrictions to reduce risk and to maintain control of fee levels. The managers may not:

a) undertake stock lending arrangements

b) invest in any in-house fund without prior consent

c) exceed the limits set out in the asset allocation ranges detailed in the benchmark

d) borrow

e) engage in underwriting or sub-underwriting on behalf of the fund

f) enter into soft commission arrangements, by which business is directed to brokers in exchange for other services such as research or systems.

23 Managers may use derivatives to facilitate asset allocation decisions and trading, and to obtain exposure to markets / assets, to reduce trading costs. All open and completed transactions will be included in monthly transactions and quarterly reports.

24 The restrictions are designed to aid transparency, avoid speculative investments, reduce the volatility of returns, and facilitate the realisation of investments. However, research has indicated that indiscriminate restrictions reduce managers' opportunities to use skill to add value. On this basis, restrictions are kept to a minimum.

Manager Discretion

25 Managers are given wide discretion over both stock selection and asset allocation within the restrictions detailed above. This allows clear accountability for decisions. The managers have established procedures to monitor and control risk, and to research market trends.

Monitoring activity and performance – managers, adviser and trustees

26 LGPS regulations state that the administering authority should review, at least every three months, the investments made by managers and should have regard to professional advice. The Myners' review has emphasised the importance of monitoring dealing costs – these will be reviewed with other aspects of investment.

27 WM is an independent performance monitoring agency that measures the performance of the Fund and the individual managers against both the benchmark and peer group funds. Reports are produced quarterly and annually to allow proper consideration of performance over both the short and medium term. If a manager consistently underperforms in relation to their benchmark over a 'substantial' period (defined as two years), a review of the mandate will be considered.

28 The Director of Finance and Corporate Services monitors managers' activity on a daily, monthly and quarterly basis, and is in regular contact with investment houses. The Pension Fund Sub-Committee receives quarterly reports from the investment managers and the Director of Finance and Corporate Services detailing activity and investment performance.

29 The Pension Fund Sub-Committee will review the performance of the Fund's Independent Adviser on a triennial basis, looking at the quality of advice and inputs made.

30 The Pension Fund Sub-Committee (trustees) will agree an annual and three year business plan to ensure that all areas of activity, including member training and development, are adequately examined and reviewed. The Pension Fund Sub-Committee will review its own performance on an annual basis, looking at the performance of the Fund overall and progress against the business plan.

Review of the implementation of investment policy

31 The appointment of the investment managers will be reviewed regularly by the Pension Fund Sub-Committee to consider the desirability of continuing or terminating the appointment. Decisions will be based on monitoring the investment performance and processes at quarterly and other meetings.

32 Amongst the criteria by which managers will be selected are:

a) Investment process, including investment philosophy, research, the asset allocation process, controls on stock selection, and risk controls

b) Past performance, including spread of results and volatility

c) Personnel, including levels of experience, staff turnover, and the individual managers offered

d) Administration, including systems, contacts, references from other customers, and the ability to meet requirements on reporting

e) Resources, including the number of professionals employed, the number of funds serviced, the number of funds gained or lost over the last 5 years, and the controls on over-rapid growth

f) Professional judgement.

33 A manager may be replaced if, amongst other things, they fail to meet the investment objectives or it is believed that they are not capable of achieving the performance objectives in the future. Consistent underperformance over a two-year period would automatically place the manager's mandate under review.

Corporate governance and socially responsible investment

34 The Pension Fund Sub-Committee has agreed that the UK and overseas equities manager, Legal & General, will vote on behalf of the Fund on corporate governance issues overseas. The manager supports the fundamental principles expressed in the Shareholder Bill of Rights adopted by the Council of Institutional Investors, but also has a close knowledge of overseas companies that will facilitate careful consideration of individual issues. The manager does not make moral judgements on individual stocks.

Learning and development for councillors and officers

35 Councillors have agreed steps to support the learning and development of members of the Pension Fund Sub-Committee. In particular, there will be regular training opportunities through online packages or training sessions before Sub-Committee meetings. To date, there have been learning and development presentations on such items as the actuarial valuation, emerging market equity, overseas equity, private equity and fixed interest investment.

Representation

36 As well as councillors, the Pension Fund Sub-Committee includes representatives of a large employer (the College of North West London) and of employees (the GMBU) as non-voting, but participating, observers.

Communication

37 Considerable progress has been made in communicating with employers and employees. Developments include:

a) a website
b) annual benefit statements to active members and deferred pensioners
c) regular newsletters for active members and pensioners
d) employer updates on Fund developments and scheme changes
e) A Funding Strategy Statement, setting out how the Fund plans to meet future liabilities
f) Annual reports to both employers and employees
g) A biennial employee forum
h) Seminars to explain the scheme and proposed changes, including induction courses and pre-retirement seminars.

38 It is also considered to be important that stakeholders are aware of the service standards set for responses by both Brent Council and Capita Hartshead, the Council's administration provider. The following service standards should be expected:

Type of work	**Maximum Turnaround Time (working days)**
Letters answered or acknowledged	5
Estimates of benefits	5
Notifications to new pensioners	10
Transfer value quotations	20
Preserved benefits – calculate and notify	10
New starters – membership confirmation	10

Treasury Policy

39 The Pension Fund maintains cash balances both to pay for benefits and to meet private equity and infrastructure cash calls. The treasury policy will be to deposit cash balances with the Council's banker, NatWest, at an appropriate rate.

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Brent	**Pension Fund Sub Committee** 20 November 2012 **Report from the Deputy Director of Finance**
For Information	Wards Affected: ALL

2013 Actuarial Valuation of the Brent Pension Fund

1. SUMMARY

1.1 The purpose of this report is to update the Pension Fund Sub-Committee on the progress of the 2013 actuarial valuation currently under way.

2. RECOMMENDATION

2.1 That progress on the actuarial valuation at 31 March 2013 be noted.

3. DETAIL

3.1 The Brent Pension Fund actuary, Hymans Robertson, is required to value the assets and liabilities of the Fund every three years to determine its financial health in accordance with Local Government Pension Scheme (LGPS) regulations. The assets of the Fund are the equities, bonds, property, alternative investments (diversified growth, hedge fund, private equity, and infrastructure) and cash owned by the Fund. The liabilities are the current and future pensions and lump sums owed to pensioners, deferred pensioners and active members. If the actuary finds that the assets may not be sufficient to meet the estimated future liabilities when due, employers' contributions may need to be increased. If assets will be more than sufficient to meet liabilities, employers' contributions may be decreased. Employee contributions currently vary between 5.5% and 7.5%, depending on pay levels.

3.2 The 2010 actuarial valuation revealed the £457m of assets of the Fund covered 61% of £751m liabilities (from 72% in 2007). The main reasons for the deterioration in the funding level were:-

a) a lower discount rate arising from the historically low interest rate environment which, in turn, meant that future pension liabilities significantly increased in 'present value' terms
b) a higher allowance for future improvements in longevity – experience since 2004 suggested that pensioners are living longer than previously expected, increasing the cost of benefits
c) lower than expected investment returns.

3.3 Actuarial modelling currently indicates that a typical LGPS fund is likely to see its funding position deteriorate by a further 5% in the 2013 actuarial valuation since 2010. For Brent, this would mean a funding level of around 56%.

3.4 The proposals for the Local Government Pension Scheme 2014 reported to this Pension Fund Sub-Committee at its meeting of 25 September 2012 indicated a saving calculated by HM Treasury Government Actuary Service in the region of 1.5% - 2.0% of pay, although any savings for individual funds could vary significantly depending on their own particular circumstances. Whilst the specific impact on the Brent Pension Fund has yet to be determined, the new LGPS proposals may mean that the increases will be less than they would have been due to factors such as the increase in the retirement age and the increases in employee contributions.

3.5 Other things being equal, there is likely to be pressure to increase the overall level of employer contributions with effect from 1 April 2014 to eliminate the Fund's deficit over 25 years. Contributions for individual employers depend on their own particular circumstances.

3.6 Hymans Robertson have set out the following timetable for the Brent Pension Fund 2013 actuarial valuation:

- **September 2012**: Data request for setting the mortality assumption to allow time to process the data and produce a Fund-specific mortality assumption

- **December 2012**: data request sent to the Fund for membership data and accounting information

- **January 2013**: modelling work (ComPASS modelling) to set the stabilisation strategy for tax-raising bodies

- **March 2013:** agreement of approach for employer results, including pooling and deficit recovery periods

- **June 2013**: submission of data as at 31 March 2013

- **July 2013**: sign off of clean data

- **September 2013**: production of initial whole Fund results and discussion document

- **October 2013**: finalisation of whole Fund results and draft individual employer results

- **November 2013**: finalisation of employer results

- **March 2014:** sign off of final valuation report.

3.7 Work will continue on the actuarial valuation in line with the above timetable, the outcome of which will be reported to members of this Pension Fund Sub-Committee ahead of any decision on future employer contribution rates.

4. FINANCIAL IMPLICATIONS

4.1 The valuation may result in increased employers’ contributions to the Pension Fund.

5. STAFFING IMPLICATIONS

5.1 None.

6. DIVERSITY IMPLICATIONS

6.1 The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from them.

7. LEGAL IMPLICATIONS

7.1 There are no legal implications arising from the report.

8. BACKGROUND

8.1 None.

9. CONTACT OFFICERS

9.1 Persons wishing to discuss the above should contact the Exchequer and Investment Section, Finance and Corporate Resources, on 0208 937 1472 at Brent Town Hall.

MICK BOWDEN	**ANTHONY DODRIDGE**
Deputy Director of Finance	**Head of Exchequer and Investment**

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A of the Local Government Act 1972.

Agenda Item 12

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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Agenda Item 13

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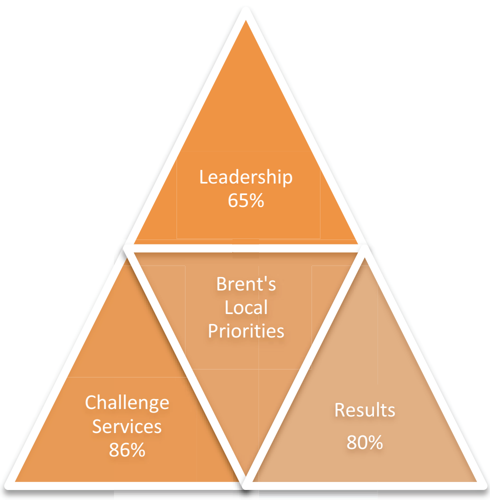
CLeaR Thinking

CLeaR Model Assessment for Excellence in Local Tobacco Control

London Borough of Brent

27th April 2012

Martin Dockrell, Ghazaleh Pashmi, Alison Gardner



Brent's CLeaR scores as a % of the total available in each domain

CLeaR Context

CLeaR is an improvement model which provides local government and its partners with a structured, evidence-based approach to achieving excellence in local tobacco control.

The model comprises a self-assessment questionnaire, backed by an optional challenge and assessment process from a team of expert and peer assessors. The purpose of the assessment is to test the assumptions organisations have made in completing the questionnaire and provide objective feedback on performance against the model.

The report also provides a number of recommendations (CLeaR Messages) and the assessors suggestions for revised scores accompanied by detailed feedback on specific areas of the model (CLeaR Results). In addition we suggest some resources you may find useful as you progress your work on tobacco control (CLeaR Resources).

CLeaR in Brent

Brent Tobacco Control Alliance invited the CLeaR team to pilot the CLeaR assessment process in Brent as part of the development of the CLeaR model, and in the context of early discussions around revising and updating their tobacco plan.

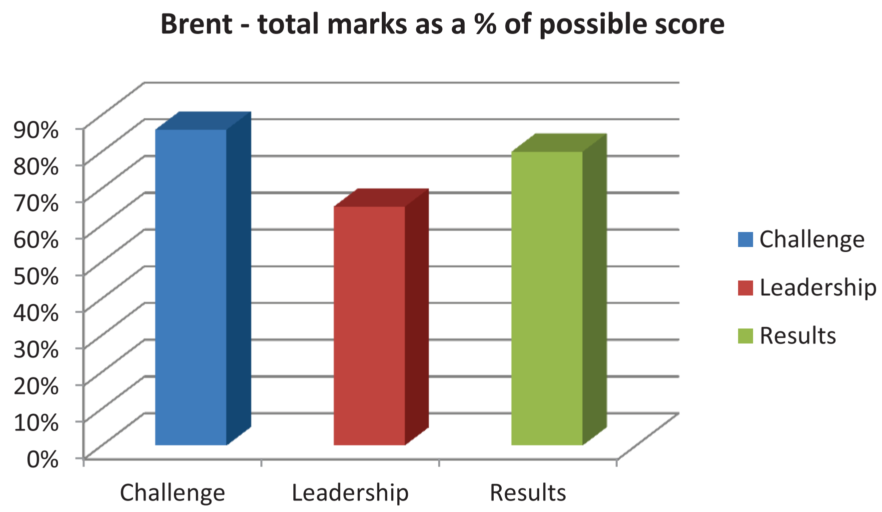
This report summarises conclusions of the CLeaR Assessment team following a workshop with members of the alliance on 27th April 2012. It sets Brent's challenge in context, providing information on the economic impact of smoking in Brent.

In carrying out the CLeaR assessment we built on Brent's own insights into areas that needed improvement, as recognised through their self-assessment questionnaire.

Special thanks go to Amanda Wilson for her assistance in responding to the self-assessment and organising the assessment visit.

Thanks also to all those who gave their time to attend and contribute to the CLeaR workshop – your lively engagement was greatly appreciated.

CLeaR Messages



CLeaR Domain	Max score	Self-assessment score	CLeaR Assessment score
Challenge Services	66	59	57
Leadership	54	37	35
Results	20	16	16

Your insights:

- The transition of public health to the local authority provides an opportunity for Brent to re-balance its programme of action to tackle tobacco, building support for tobacco control across the council and other public service partners.
- Though new governance arrangements for public health are still in development, you are currently putting building blocks in place to make strong links between the tobacco plan, JSNA and health and wellbeing strategy.
- You undertake a wide range of work on prevention of youth smoking, and the CLeaR model in its current form did not provide full scope to present this in detail.

Your strengths:

- We were impressed with the enthusiasm and engagement shown by the elected members present at the workshop, and would encourage them to champion tobacco control throughout the council, particularly as new governance and planning arrangements for public health fall into place.
- You presented innovative work looking at the prevalence of smoking and shisha amongst young people. You should ensure this is peer reviewed, to enhance your own learning, and widely shared.
- Brent takes a pro-active approach to compliance, which resists complacency and actively identifies emerging challenges.

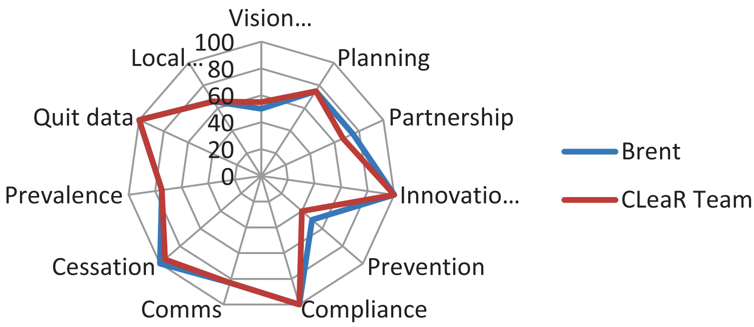
- There has been strong improvement in your smoking cessation service, delivering results that are now amongst the best in London.

Opportunities for development:

- We discussed the opportunities within transition to build commitment to tackling tobacco across the council and ensuring this is formalised within organisational strategies and action plans. This is an important step, but be careful as well not to lose your alliance's connections with primary and secondary care and community services.
- Although co-ordination of the alliance has been mainstreamed by NHS Brent, a sustained non-PAYE budget would be a wise invest-to-save measure and help maintain momentum for improvement. Youth work was another identified area where sustained funding could enable improved planning and usefully build on the innovative activity you already have in place.
- Consider monitoring your total spend on comprehensive tobacco control to mitigate the impact of any spending cuts and ensure that you achieve the outcomes you have planned.
- Further supra-local working could achieve greater economies of scale in areas such as marketing, advocacy, and improvement (for instance through the London Health Improvement Board). What could Brent do to make this happen?
- A communications strategy covering comprehensive tobacco control (as well as the stop smoking service) may be helpful in planning pro-active advocacy and communications.
- You have an active and enthusiastic tobacco alliance who are strong advocates for your work. Ensure that despite your success – "*Brilliant Brent!*" - you maintain the openness and enthusiasm for change that has helped you to improve to this point.

CLeaR Results

The chart below shows (in blue) Brent's original self-assessment scoring, as a % of available marks in each section and (in red) the CLeaR team's assessment results. Overall, the results of the peer assessment accorded closely with the self-assessment, with the CLeaR team identifying a few further areas for improvement.



Detailed comments on your assessment are as follows

CLeaR Theme	**Your score**	**Our score**	**Max**	**Comments**
Leadership				
Vision and leadership (including WHO FCTC)	9	10	18	We saw strong advocacy for tobacco amongst the elected members we met – we hope this enthusiasm will translate into sustained support and focus on tobacco control through your new public health governance arrangements, once they are in place. As you move through transition, pay attention to preserving connections with primary and secondary care and community services. The council could build on its advocacy work further by agreeing a policy in line with article 5.3 of the WHO Framework Convention on Tobacco Control
Planning and commissioning	9	9	12	We agree that increased member and management focus on performance against your comprehensive tobacco control plan (not just the Stop Smoking

				Service) could be supportive to your work – especially during transition. We recommend monitoring your total spend on comprehensive tobacco control (including partnership and in-kind contributions) A more comprehensive view of resources engaged in tobacco control could be useful to mitigate the impact of any spending cuts and ensure that you achieve the outcomes you have planned.
Partnership, cross-agency and supra-local working.	19	16	24	You achieved a lot through your full time tobacco alliance co-ordinator post. Now this position has been mainstreamed with wider responsibilities, ensure that momentum is not lost. We agree that a sustainable, flexible budget to support the work of the alliance would be a good invest-to-save measure. We saw good engagement from other council departments, this needs to be formalised more widely within organisational strategies and action plans. Brent should consider how it could lobby for supra local working to achieve further economies of scale in areas such as marketing, advocacy, and improvement (for instance through the London Health Improvement Board).
Challenging Your Services				
Innovation and learning	10	10	10	You have many strengths in this area –try to ensure that you learn systematically and consistently from your innovations.
Prevention	5	4	10	We look forward to seeing the results of your forthcoming smoke free homes programme. We accept your view that not all your prevention work was encompassed by CLeaR – but do satisfy yourselves that innovative activity accords with NICE guidance and is fully evaluated.
Compliance	14	14	14	Pro-active work on compliance and

				enforcement was a real strength, with a strong awareness of emerging challenges. Work on proxy purchasing, shisha and niche tobacco was interesting and should be shared with other boroughs.
Communications and denormalisation	10	10	12	We saw good evidence of community involvement in and through the work of the alliance. Consider a strategy to communicate and advocate for tobacco control as a whole (as well as the stop smoking service).
Cessation	20	19	20	Is there an opportunity to roll out brief advice training to a wider group of frontline employees in the local authority and other partner organisations?
Results				
Prevalence	6	6	8	Outcomes of your work to track youth smoking prevalence in cigarettes and shisha will be followed with interest.
Quit data	6	6	6	The stop smoking service is now performing to a high level.
Local Priorities	4	4	6	We support your point that as young people are a priority for you, funding for evidence–based prevention activity amongst young people needs to be sustained and protected.

CLeaR Partnerships

This section of the report summarises the feedback from the interactive session on partnerships.

You identified the following organisations as a possible source of **resources** to support your on-going work:

- London Mayors budget
- Multi-lingual resources
- Unions
- Faith groups
- Other community groups
- Councillors and MPs
- CCGs
- Research funding
- Charities
- ASH
- Tobacco control intelligence portal
- Corporate communications
- Large organisations in the private and public sector
- Tobacconists

You felt that engagement from the following **stakeholders** was important for future activity – though not necessarily through attendance at alliance meetings

- Housing
- Employers
- Children's services (facilitated through encouragement from elected members)
- Councillors (possibly using a scrutiny review to raise awareness)
- NHS primary
- Acute / mental health
- Schools
- Faith groups

You also made a number of **personal commitments** to partnership working which are included in a separate note.

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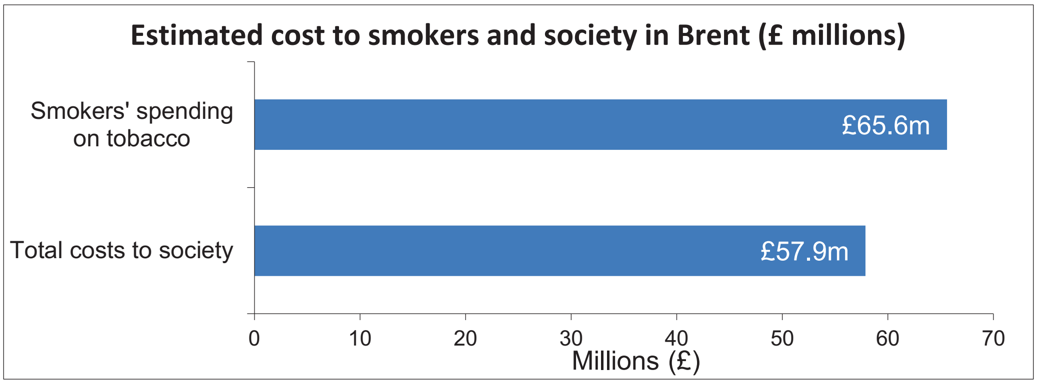
CLeaR Opportunities

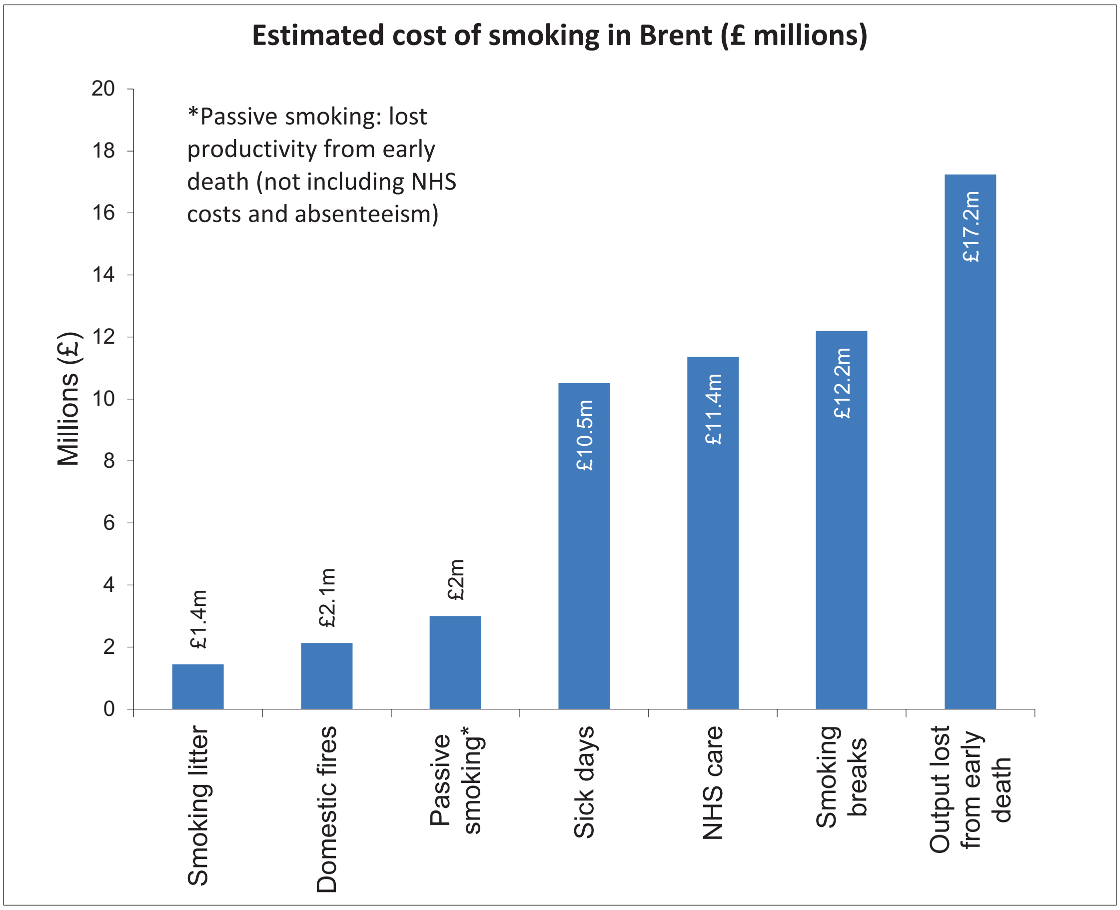
Brent's estimated (adult) smoking population is **37,100** people.

When the wider impacts of tobacco-related harm are taken into account, it is estimated that the cost of smoking to society in Brent is **£57.9m** each year. In addition the local population spend **£65.6m** on tobacco-related products.

As smoking is closely associated with economic deprivation, this money will be disproportionately drawn from Brent's poorest citizens and communities.

See www.ash.org.uk/localtoolkit/ for more details





CLeaR Resources

A briefing on investment and local authority pension funds - http://ash.org.uk/files/documents/ASH_831.pdf

NICE guidance on smoking and tobacco http://www.ash.org.uk/stopping-smoking/for-health-professionals/nice-guidance-on-smoking

Information on the business case for tobacco control, and a toolkit of resources for Directors of Public Health, local authority officers and members can be found at http://www.ash.org.uk/localtoolkit

Further local information on the business case for tobacco can be found at http://www.brunel.ac.uk/about/acad/herg/research/tobacco

The NCSCT have a range of resources which may interest you – see for instance

NCSCT Training and Assessment Programme (free) - developed for experienced professionals working for NHS or NHS commissioned stop smoking services who want to update or improve their knowledge and skills - as well as newcomers to the profession, who can gain full NCSCT accreditation.

http://www.ncsct.co.uk/training

Very Brief Advice on Smoking – a short training module for GPs and other healthcare professionals to help increase the quality and frequency of Very Brief Advice given to patients who smoke.

http://www.ncsct.co.uk/VBA

Very Brief Advice on Second-hand Smoke - a short training module designed to assist anyone working with children and families to raise the issue of second-hand smoke and promote action to reduce exposure in the home and car.

http://www.ncsct.co.uk/SHS

NCSCT Streamlined Secondary Care System (cost available on request) a whole hospital approach to stop smoking support for patients

(More information – http://www.ncsct.co.uk/delivery/projects/secondary-care - contact Liz.hughes@ncsct.co.uk)

NCSCT Provider Audit - is a system of national accreditation designed to support local stop smoking service commissioners and providers to demonstrate whether the support they provide meets minimum standards of care and data integrity. This aims to complements any existing internal quality assurance processes whilst its independent nature provides external assurance of quality and performance.

(More information - http://www.ncsct.co.uk/delivery/projects/audit-of-local-stop-smoking-services - contact Isobel.williams@ncsct.co.uk)

CLeaR next steps

Thank you for using CLeaR.

Having completed your self-assessment and CLeaR challenge workshop, you will now be awarded CLeaR accreditation until May 2014. This gives you the right to use the CLeaR logo and automatic entry to the forthcoming CLeaR awards which will be held for the first time in 2013.

In the meantime we invite you to:

- share the report with partners and stakeholders, and develop actions based on the recommendations;
- contact us if you'd like to discuss commissioning further support for tobacco control;
- take up CLeaR membership and train members of your staff as peer assessors, to enable you to participate in, and learn from, other assessments in your region;
- repeat self-assessment in 12 months time to track how your score improves; and
- consider commissioning a CLeaR re-assessment in 2014.

Contacts

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Ghazaleh Pashmi ghazalehpashmi@hotmail.com

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January 2012

Local authority pension funds and investments in the tobacco industry

Purpose of this briefing

This briefing is a position statement by Action on Smoking and Health and FairPensions which aims to inform stakeholders in local authority pensions, including councillors, pension fund members, local taxpayers and pension fund trustees.

Local authority pension funds in the UK have attracted public criticism for holding investments in the tobacco industry. There are three common responses to this criticism, each of which will be examined in this briefing:

1. Local authority pension funds have a legal duty to maximise financial return and cannot give consideration to ethical issues.
2. Pension fund trustees do not interfere with the day to day decisions of external investment fund managers.
3. Tobacco is a low risk, high return investment.

This briefing challenges the claim that local authorities are in effect ‘duty bound’ to invest in tobacco and:

1. clarifies the law regarding the legal duties of pension fund trustees and explains the options for trustees wishing to properly consider ethical concerns around investments in the tobacco industry;
2. counters common misconceptions about the fiduciary duties around investments; and
3. provides information on the financial risks facing the tobacco industry which raises doubts about its long-term investment viability.

Argument #1: ‘We have a fiduciary duty to maximise return’

Trustees’ legal obligations to pension fund members are known as fiduciary duties. Pension funds often justify tobacco investments by claiming that their fiduciary duty requires them to maximise returns and ignore ethical considerations. However, this conventional interpretation of the law is somewhat simplistic.

Response

Although local authority pension funds are governed by different laws to other types of pensions (see Box C), members of their pensions committees have similar fiduciary duties to pension fund trustees. The phrase ‘duty to maximise return’ does not appear in any UK statute or case law. Pension fund trustees have a fiduciary duty to invest “in the best interests of members and beneficiaries.”[1] This is based on the common law duty of loyalty, which exists to ensure that trustees avoid conflicts of interest and do not abuse their position to further their own ends.[2] Trustees also have a duty to invest prudently.[3]

In the 1984 case of Cowan v Scargill (see Box A), the judge ruled that, in a pensions context, *"the best interests of the beneficiaries are normally their best financial interests."*[4] This is often quoted as evidence that pension fund trustees are prohibited from considering ethical issues. However, the judgement explicitly denies this interpretation, going on to say: "*I am not asserting that the benefit of the beneficiaries which a trustee must make his paramount concern inevitably and solely means their financial benefit.*"[5]

Box A: Cowan v Scargill 1984

This case concerned the mineworkers' pension scheme. The five trustees appointed by the National Union of Mineworkers (NUM), led by Arthur Scargill, refused to approve an investment plan for the trust unless it excluded *all* overseas investments and all investments in industries directly competing with coal (e.g. oil and gas). The court upheld the employer-nominated trustees' contention that this was a breach of fiduciary duty, as:

- The trustees were motivated by their personal views and by a desire to pursue union policy, and were not putting the beneficiaries first (a breach of the duty of loyalty)
- Many of the beneficiaries, such as widows and dependants, would not be directly affected by the health of the mining industry, but would suffer any negative impacts from the likely sacrifice of return (a breach of the duty of impartiality)
- In any case, the social benefits of the policy were too speculative and remote: the pension fund's assets were not large enough to have any material impact on the prosperity of the mining industry or the national economy.

It is worth bearing in mind that, contrary to popular belief, the policy was not rejected on the grounds that it is unlawful for trustees to consider non-financial issues (see above). Rather, it was rejected on grounds specific to the facts of the case, including the trustees' decision-making process.

Indeed, it has been noted that the policy at issue bore little resemblance to a modern responsible or ethical investment policy. A landmark 2005 report by law firm Freshfields Bruckhaus Derringer concluded that "*No court today would treat Cowan v Scargill as good authority for a binding rule that trustees must seek the maximum rate of return possible with every individual investment and ignore other considerations*."[1]

1 UNEP-FI, 2005, 'A legal framework for the integration of environmental, social and governance issues into institutional investment'

Similarly, in the case of Martin v City of Edinburgh District Council (see Box B), the judge said, "*I cannot conceive that trustees have an unqualified duty... simply to invest trust funds in the most profitable investment available.*"[6]

Indeed, local authority pension schemes (in line with other occupational pension schemes) are required to say in their Statement of Investment Principles "*the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments*".[7] This provision was intended as a 'light-touch' intervention to clarify that it is indeed legitimate for pension funds to take ethical issues into account.[8]

Case law does indicate that it would be difficult for trustees to justify an ethical restriction which significantly damaged financial returns, largely because of their duty to act impartially: it would not be fair if the ethical preferences of one group of beneficiaries hurt the retirement prospects of another group who did not share their views.[9] However, this is not the same as a bar on considering ethical issues. In particular, it leaves open two scenarios in which trustees might be able to exclude certain investments: firstly, if it would make no material difference to investment returns (the '**ethical tie-break**'), and secondly, if they have reason to believe it would actually enhance performance over the long run (the '**responsible investment approach**').

Box B: Martin v City of Edinburgh 1995

In the case of Martin v City of Edinburgh District Council, a Conservative councillor sued his Labour colleagues for implementing a policy of disinvestment from apartheid-era South Africa. The judge ruled that the councillors had failed in their fiduciary duty because they had not undergone due process and taken proper advice. But he stressed that had they done so, the policy could have been legitimate: indeed, the fund's performance actually improved after the policy was implemented.

Moreover, the judge explicitly rejected the plaintiff's claim that Cowan v Scargill required trustees "*merely to rubber-stamp the professional advice of financial advisors*." On the contrary, he said:

"*I cannot conceive that trustees have an unqualified duty... simply to invest trust funds in the most profitable investment available. To accept that without qualification would, in my view, involve substituting the discretion of financial advisers for the discretion of trustees.*"

The ethical tie-break

In Cowan v Scargill, the union trustees were insisting on a blanket exclusion of all overseas investments, and of any industries in competition with coal. In a subsequent paper the judge speculated that a more nuanced policy – for example, of excluding certain investments 'all other things being equal' – might have been permissible.[10] More broadly, he suggested that an investment policy which accommodated the ethical concerns of some members without compromising the financial interests of others would be in the best interests of the beneficiaries as a whole. In other words, ethical criteria could be used to choose between two investment options that are equally attractive financially. This 'tie-break' principle has been restated several times in UK and US law and guidance.[11]

Of course, trustees cannot be expected to predict actual investment performance. For this reason, the test of whether two options were 'equivalent' is not outcome but process: did the trustees take appropriate advice, and, based on the information available at the time, was their decision reasonable? It is very possible to imagine that a decision to exclude tobacco could pass this test. Indeed, many funds with much broader ethical exclusions (for example, the Norwegian State Pension Fund which excludes investments in tobacco producers among other things[12]) have consistently matched or outperformed the market.

The responsible investment approach

Trustees may also decide that excluding a particular investment would have a positive impact on the fund's long-term performance. It is now widely accepted that environmental, social and governance (ESG) issues can affect company performance. In a landmark 2005 report, the law firm Freshfields Bruckhaus Derringer concluded that considering these factors is well within the scope of investors' fiduciary duties: indeed, "***it may be a breach of fiduciary duties to fail to take account of ESG considerations that are relevant and to give them appropriate weight.***"[13]

On this basis, there are various reasons why trustees might conclude that tobacco is a risky long-term investment and these reasons are explored below (see Argument #3). Indeed, the London Borough of Newham currently excludes tobacco on this basis, saying in its Statement of Investment Principles:
"*Fund managers are instructed not to invest segregated elements of their portfolio in companies that generate over half of their income from tobacco products, due to the risk that tobacco companies may face large liabilities from outstanding court actions.*"[14]

Where does this leave fiduciary duty?

All of this suggests that the law does not oblige pension funds to dismiss the ethical concerns of their members out of hand. Rather, the appropriate response is to analyse whether those concerns could be accommodated without compromising the performance of the fund. Moreover, non-financial issues which could affect the performance of the fund should be considered by funds as part of their normal investment analysis.

Argument #2: "It is not our policy to interfere with our fund managers' discretion"

Response:

It is common practice for pension funds to delegate day-to-day investment decision-making to external fund managers. However, this does not prevent them from instructing their fund managers in particular matters (as in the Newham example above). Indeed, the law is quite clear that, although trustees may delegate their investment functions, they cannot delegate their fiduciary responsibilities.

Final responsibility for investment decision-making rests with the trustees themselves. The judge in Martin v City of Edinburgh (see Box B above) stressed that trustees must "*appl*[y] *their minds separately and specifically to the question whether [the decision at hand] would be in the best interests of the beneficiaries.*"[15] Moreover, in order to fulfil their fiduciary duties, the law requires trustees to monitor their fund managers on an ongoing basis.[16] In other words, as FairPensions' recent report concluded, "*It is a vital principle of fiduciary obligation that fiduciaries cannot outsource their obligation to think*."[17]

Box C: Local authority pensions – a special case?

Local authority pension funds are governed by different *statutory* rules to other occupational pension schemes.[1] There is no statutory requirement for assets to be invested in the best interests of beneficiaries, and schemes must take account of the interests of local taxpayers.[2] In our view this does not amount to a significant difference in the underlying legal principles governing scheme investment. Common law fiduciary duties – to which the above analysis refers – still apply. However, given their duty to taxpayers, it is arguably also relevant for local authority pension schemes to consider the cost to the taxpayer both of measures to prevent smoking and of dealing with the public health impacts of smoking when evaluating their tobacco investments.

1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3093)

2 The Myners Principles, http://www.thepensionsregulator.gov.uk/docs/igg-myners-principles-update.pdf

Argument #3: The tobacco industry is a low risk, high profit investment

Response:
Tobacco shares have traditionally been a low-risk, high profit investment. However, there are a number of factors indicating that investments may be a risk in the medium and long term and there is a strong business case for reviewing investments in the short term.

There is a risk that some tobacco investments may currently be overvalued. In November 2011 Goldman Sachs downgraded Imperial Tobacco to "sell" from "neutral", having previously downgraded the stock from "buy" to "neutral" in September 2011[18,19] and an article by 'Smart Investor' on City Wire in August 2011 suggested that British American Tobacco shares may be overvalued.[20]

Is the tobacco industry in terminal decline?
Analyst Adam Spielman has argued that tobacco could virtually disappear in 30 to 50 years. In the Financial Times, Spielman argues that "*The percentage of smokers is declining across the developed world … If these trends continue, then by 2050 many important tobacco markets will have gone to zero smoking.*"[21]

The UK, European and American markets
Sales in the UK and Europe have been in long-term decline and are predicted to decline further. In the UK adult smoking rates have fallen from 27% in 2000 to 21% in 2009[22] and since 1990 there has been a decline in smoking rates in almost all EU states.[23]

The European Commission is currently revising the Tobacco Products Directive, which is likely to include proposals to make pictorial warnings mandatory and larger (80% of the pack) and to introduce plain packaging of tobacco products.[24] The UK government has set out its ambition to reduce adult smoking prevalence in England from 21% to 18% by 2015,[25] resulting in 210,000 fewer smokers every year. The Welsh Government plans to reduce adult smoking rates from 23% to 16% by 2020.[26]

The American market is also in long term decline, with cigarette sales falling steadily from 640 billion in 1981 to 380 billion in 2006.[27]

Imperial Tobacco is still highly dependent on its EU and American markets with 55% of net revenue coming from the declining EU market,[28] having sought to diminish dependence on the UK and expand sales through acquisitions in America and Europe, acquiring brands including Fortuna, Gauloises and Gitanes in 2008. However, the risk of this dependency on the European and American markets was demonstrated in 2010 when net revenue in the Americas decreased by 9 per cent to £780 million and adjusted operating profit declined by 15 per cent to £244 million following substantial increases in federal excise tax.[29]

Developing world markets
Tobacco companies have sought to manage the risk posed by declining EU volumes through investing in new, profitable markets, such as investments in Africa and China. However, excluding China where the transnational tobacco companies have little market share, global tobacco consumption is already declining[30,31,32] and with increased regulation these markets can no longer be relied on to provide the growth tobacco companies need to balance declining EU sales.

Regulatory Risk

Framework Convention on Tobacco Control

The World Health Organization's Framework Convention on Tobacco Control (FCTC)[33] aims to restrict smoking prevalence in the very countries where the industry has achieved its growth in recent years. More than 170 countries are now party to the FCTC. The FCTC covers price and tax measures to reduce the demand for tobacco products (Article 6), non-price measures to reduce demand (Article 7) product regulation (Article 9) packaging and labelling (Article 11), reducing advertising promotion and sponsorship (Article 13) and measures to reduce supply (Articles 15-17).

Countries across the globe are introducing measures to meet their FCTC requirements, including widespread legislation for smokefree workplaces and advertising bans. For example China, which accounts for over 40% of the total global tobacco market, introduced a range of measures to tackle tobacco in May 2011, including a ban on smoking in all public places.[34]

In Russia, the world's fifth biggest market, health warnings were introduced in 2010 and the national parliament is mandated to pass legislation to bring Russia into full alignment with the FCTC, which will mean smokefree indoor public places and public transport and a complete ban on all advertising, promotion and sponsorship by 2015.[35]

Uruguay has introduced a range of measures, including an increase in tobacco tax, graphic health warnings taking up 80% of the packet and a ban on all tobacco advertising.[36]

Tax increases

Several countries have introduced substantial increases in tobacco taxation. During 2010 Spain introduced a 28% increase in tobacco duty as part of a package to tackle the budget deficit,[37] Japan introduced a 33% increase[38] and in Australia tax was increased by 25%.[39] The Indonesian government announced a 15% increase in tobacco excise from January 2012.[40]

These abrupt, high level tax increases are likely to have a greater impact on tobacco industry profits. There is a significant risk that similar tobacco tax increases will become increasingly attractive to governments seeking to tackle budget deficits.

Plain packaging

Australia is set to become the first country in the world to require tobacco products to be sold in plain, standardised packaging with promotional features removed, from 1 December 2012.[41]

In the UK, the Government has committed to consult on options to reduce the promotional impact of tobacco packaging, including the introduction of plain packaging.[42] In addition to Australia and the UK, other countries are also examining the option of introducing plain packaging, including Turkey, New Zealand and Canada. According to the Financial Times: "*If the Australian proposals are implemented, similar laws will emerge elsewhere, with damaging effects on profits.*"[43]

Front cover of the tobacco industry journal warning of the business risk from plain packaging (2008)

In 2008 the industry journal Tobacco Journal International reported on proposals to require plain packaging for tobacco products, stating: "*standardisation of cigarette packaging* [would] *drive down pricing and put an end to the appeal of premium cigarettes which carry higher profit margins*". Although the article concluded the 2008 proposal had little chance of success at that time, the author observed "*how much industry regulation has come to pass, namely once it has been put on the table it never really goes away until one country becomes bold enough to implement it and then others soon follow suit.*"[44]

A report produced for Philip Morris by Jorge Padilla[45] argues that plain packaging will lead to substantial price reductions, by removing the brand loyalty that enables tobacco companies to charge premium prices. The report also argues that plain packaging will make market entry by new suppliers of super-low price "no-name" products easier. Although Padilla's claims have been challenged by a leading economist,[46] shareholders should be aware of the risk implied by the industry's own analysis.

Analyst Adam Spielman has also highlighted the risk to the industry's profitability posed by reduced brand equity likely to result from plain packaging. "*The industry is so profitable only because consumers are willing to pay a premium of £1.50 for certain brands.*"[47] "*If the proposal is carried out, it would reduce the brand equity of cigarettes massively… Anything that weakens this will dramatically reduce profitability.*"[48]

Litigation – from Nunavut to Nigeria

In 1998, 46 US states settled their Medicaid lawsuits against the tobacco industry for recovery of tobacco-related health care costs and were awarded $206 billion in compensation. The deal, known as the Master Settlement Agreement, was in addition to $36.8 billion awarded to the states of Mississippi, Florida, Texas, and Minnesota.[49]

The industry now faces a new threat from other governments around the world that are suing tobacco companies for the cost of providing healthcare. In recent years Argentina, Israel, Italy, Turkey, France, Poland India, Nigeria, Canadian provinces and Sri Lanka have all brought suits against tobacco companies relating to the healthcare costs arising from smoking. The EU took action in the US courts against tobacco manufacturers for colluding in tobacco smuggling under the Racketeering Influenced Corrupt Organisations Act.[50] In 2011, the Australian government announced that it was considering legal action to seek compensation from tobacco companies for the health care costs of smoking.[51]

Tobacco industry profits have suffered from over £250 billion paid out in litigation costs and if recent law suits are successful this is likely to open the door to encourage similar cases elsewhere.

The damage to the tobacco industry from litigation is not limited to the cost of settlements alone. "*There is also a risk that, regardless of the outcome of the litigation, negative publicity from the litigation and other factors might make smoking less acceptable to the public, enhance public restrictions on smoking, induce many similar lawsuits against JT and its subsidiaries, forcing them to deal with and bear the costs of such lawsuits, and so on.*" Japan Tobacco Inc., 2007[52]

Box D: Tobacco – an industry with a disappearing future

- 170 countries are parties to the Framework Convention on Tobacco Control, and committed to introduce price and tax measures to reduce the demand for tobacco products
- UK government plans to cut the number of smokers by 210,000 every year
- Plain packaging "*will dramatically reduce profitability*."

The questions that stakeholders should be asking

- Has the pension fund asked its fund managers for their view on the long-term financial viability of tobacco, in light of declining markets and regulatory or litigation risks?

- Has the pension fund asked its fund managers to undertake an analysis of the long-term impact of excluding tobacco from their portfolio, taking into account any measures that could be taken to compensate for the exclusion (for example, increasing weightings of other defensive stocks)?

- If not, will pension fund trustees:
  - commission these analyses;
  - make the results available to members; and
  - review their tobacco holdings, taking into account these findings as well as the ethical concerns of members?

- Will the pension fund develop and publish a statement of policy in relation to investments in tobacco companies?

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