London Borough of Hammersmith & Fulham

Audit and Pensions Committee
Minutes

Thursday 15 March 2012

PRESENT

Committee members: Councillors Michael Adam (Chairman), Nicholas Botterill, Marcus Ginn, Robert Iggulden, Michael Cartwright (Vice-Chairman) and PJ Murphy

Others in Attendance: Gillian Evans, James Wates and Emma Burnett-Ray, Goldman Sachs

Nikhil Aggarwal and , P-Solve

Jon Hayes, District Auditor, Audit Commission

Officers: Jane West, Executive Director of Finance and Corporate Governance, Hitesh Jolapara, Deputy Director of Finance, Jonathan Hunt, Tri-Borough Director- Pensions and Investment, Geoff Drake, Chief Internal Auditor, Michael Sloniowski, Principal Risk Consultant, and Owen Rees, Committee Coordinator

54. MINUTES OF THE PREVIOUS MEETING

RESOLVED THAT

The minutes of the meeting held on 8 December 2011 be agreed as a true and correct record.

55. APOLOGIES FOR ABSENCE

There were apologies from Eugenie White.

56. DECLARATIONS OF INTEREST

Councillors Cartwright and Murphy declared a personal interest in respect of items 57, 58, 59, 60, and 62 as members of the Pension Fund.

57. GOLDMAN SACHS- PRESENTATION

Gillian Evans, James Wates, and Emma Burnett-Ray, representing Goldman Sachs, attend the Committee to give a presentation on the performance of the element of the fund invested with Goldman Sachs.

Gillian Evans explained the nature of the mandate held by Goldman Sachs, the nature of the fixed income market, including the types of asset available, and the factors considered when selecting assets invested in. She described the value of the investment with Goldman Sachs, the benchmark for the investment and the investment objective. She said that performance since the inception of the mandate had achieved the objective set, but that performance in 2011 had been poor; she said that James Wates, who worked in the Fixed Income division, would set out the reasons fort that.

Mr Wates described the salient features of the market in 2011. Firstly, yields had been low at the start of the year, but had got lower still as the year went on, both for short-dated and long-dated bonds and securities, with a rally for "risk-free" assets, such as Government debt. Secondly, concerns regarding parts of the Eurozone prompted increasing spreads and increasing stresses in the market in the 3rd quarter of the year. Thirdly, in the wake of those stresses, spreads on other assets with credit characteristics, including corporate bonds, increased, particularly in the 3rd quarter, with the ECB's action reducing those stresses in the 4th quarter.

Councillor Iggulden asked how this turbulence had affected the portfolio. Mr Wates said that Goldman Sachs had taken the position at the start of 2011 that interest rates were too low and would rise within the year. They had accordingly held short-dated debt, and so did not get the full benefit of falling yields. He said that there had also been contagion as a result of market conditions, with high-levels of risk aversion, which made realising the fundamental value of assets difficult. He said that Goldman Sachs was cautious, and remained cautious, with regards to European Bonds, and believed that the injection of liquidity by the ECB was responsible for the rally. He said that Goldman Sachs had been surprised by the level of, and success of, ECB support, but remained very cautious. However, these positions had led to the underperformance.

Gillian Evans said that it was challenging to operate in an environment in which politics had superseded economics. She said that Goldman Sachs had invested where it was confident of the underlying value of assets. She said that the selection of assets had been correct, but that the duration chosen and the chances and effects of Government intervention misjudged. She said that the fund was up 201 basis points since the start of the year.

Councillor Murphy asked how Goldman Sachs had altered its views and process in light of the underperformance of 2011. Mr Wates said that the view had been based on improving data from the US, and though that showed signs of cooling, the cooling was a result of the mid-cycle slowdown; it proved much more serious than thought. He said that while Goldman Sachs believed that it brought insight to fixed income investment; it would not get every decision correct. He said that the process of analysis and fund management were fundamentally the same.

The Chairman asked whether Goldman Sachs believed that the underlying risk that had prompted the events of August 2011, and the subsequent intervention by the ECB had dissipated, noting that few had seen the market event coming.

Mr Wates said that there were still long term risks, despite the ECB's intervention allowing the opportunity for structural changes to be made. He said that the fund had been correctly positioned for the 4th quarter of the year. Further to a question from Councillor Botterill, he said that there had been little exposure to the European periphery, and the issues for Goldman Sachs had been contagion across asset classes. He said that Goldman Sachs saw more value in United States securities going forward, and remained concerned about European debt. The investments made were in line with the levels of risk implicit in the investment objective set.

In response to a question from P-Solve, Mr Wates said that a year was too short a horizon to judge performance, with 3 to 5 years a more sensible term. He said that the one year figure was affected by a large loss in Quarter 3 of 2011, which had included August.

He then took the Committee through the remainder of the presentation, pointing out that the allocations showed the way the fund was managed: he noted that the current cash allocation included derivatives which were sensitive to higher yields. He also highlighted the fund's current thinking on security selection, which was positive towards commodity currencies, certain types of credit impaired security and US Housing market securities issued by Freddie Mac, Fannie Mae and Ginnie Mae.

The Committee thanked Goldman Sachs for attending.

RESOLVED THAT

The presentation be noted.

58. <u>PENSION VALUE AND INVESTMENT PERFORMANCE</u>

Nikhil Aggarwal, P-Solve, presented the report, which outlined the fund's performance in the previous quarter. He said that, while the 6.8% return looked good, it hid considerable volatility. Returns in October had been strong following the announcement of another round of quantative easing, but November had seen fall back, in the wake of concerns about Europe, and growth forecast downgrades.
He said that market sentiment was the key driver for the quarter, with high demand for UK bonds causing a rise in liabilities of 9%, making for a 2.2% underperformance or the quarter.

With regards to the performance of individual mandates, he said that Majedie had underperformed their benchmark, but their strong performance in quarter 3 suggested that they were well protected against market shocks; they remained above target for the year. He said that they had taken the decision to close the Tortoise fund to new investors; a decision which P-Solve suggested was a welcome one.

With regards to the Legal & General mandate, he said that the new mandate, which would be bespoke to the fund's liabilities, had been implemented in February; the agreement had been signed in mid-January but had allowed Legal & General three months to implement the mandate, to allow it do so at a time when market conditions were most amenable. Quarter 1 performance figures would reflect this.

Councillor Iggulden asked what the final fees agreed were. Mr Agarwal said that he would send the Committee details of the fees agreed.

RESOLVED THAT

The report be noted.

59. ALTERNATIVE INVESTMENTS

The Committee received and considered a report on alternative investments.

Councillor Iggulden expressed concerns that the case for alternative investments had not been proven, with Ruffer themselves sceptical. The Chairman said that the Committee took his point on that, but sought diversification away from conventional equities, as recommended by P-Solve, through an increase in the percentage of the fund held in a Dynamic Asset Allocation mandate by Ruffer.

RESOLVED THAT

The Committee agree to increase the allocation of the Pension Fund's investments to Ruffer by 5% of the total value of the fund with 2.5% coming from each of Majedie and MFS.

60. COMMUNITIES AND LOCAL GOVERNMENT CONSULTATION ON PROPOSED AMENDMENTS TO THE LOCAL GOVERNMENT PENSION SCHEME (LGPS) REGULATIONS CONTAINED IN THE DRAFT LGPS (MISCELLANEOUS) REGULATIONS 2012

Jonathan Hunt, Tri-Borough Director- Pensions and Investment, introduced the report, which set out a number of technical amendments the Government proposed to make to the regulations governing local government pension schemes (LGPS). He said that the proposals were not of material concern for the Fund.

He said that, with regards to wider reform of the LGPS, meetings between unions and sector leaders were ongoing, with the aim of making proposals by the end of March 2012, with a view to implementation in March 2013. The suggested timescale would coincide with the actuarial valuation of the fund. He said that no announcement had been made, but that career averaging, the maintenance of the current accrual rate, and proposals for caps on employer contributions were under discussion.

RESOLVED THAT

The report be noted.

61. LONDON BOROUGH OF HAMMERSMITH & FULHAM AUDIT OPINION PLAN 2011/12

Jon Hayes, District Auditor, introduced the report, which set out the Audit Opinion Plan for the 2011-12 financial year. He said that the Audit Commission had recently announced the result of a tendering exercise, with the auditing of North London, the cluster of which the Council was a part, let to KPMG. He said that staff would be transferred to KPMG in October 2013. He said that tendering exercise had been carried out, as primary legislation required the Audit Commission to appoint local authority auditors. He said that the tendering exercise, combined with a reduction in central capacity and functions, would enable a 40% cut in fees to be made in future.

With regards to the 2011-12 audit, he said that key risks were identified on pages 63-64 and planned value for money work at pages 66 to 67 of the main agenda.

RESOLVED THAT

The report be noted.

62. LONDON BOROUGH OF HAMMERSMITH AND FULHAM PENSION FUND AUDIT OPINION PLAN 2011-12

Jon Hayes, District Auditor, introduced the report, which set out the Pension Fund Audit Opinion Plan for the 2011-12 financial year. He said that it would be the first audit working with Capita Hartshead, the new administrators, but noted that Capita Hartshead were experienced in the sector and had worked with the Audit Commission elsewhere. He drew the Committee’s attention to page 78, and said that the response was normally coordinated by the Chief Internal Auditor.

RESOLVED THAT

The report be noted.

63. CERTIFICATION OF CLAIMS AND RETURNS- ANNUAL REPORT 2010-11

Jon Hayes, District Auditor, introduced the report, which contained the last of the work done on the 201-11 accounts by the Audit Commission, and concerned the certification of grant claims. He said that, while the report used the term qualification with regards to some of the claims, it did not consider materiality in doing so. He said that, while he wished to see an improved performance, Hammersmith and Fulham’s performance was akin to that of other London Boroughs.

Councillor Iggulden asked if there was an opportunity to introduce materiality into the process. Mr Hayes said that the audit standards were set by the Government department making the grant, and that they tended to want a specific accounting of the claim: It was an area in which the Government was seeking to reduce burdens, and in which the Audit Commission had already succeeded in persuading some departments to allow sampling and statistical analysis.

RESOLVED THAT

The report be noted.

64. AUDIT COMMISSION RECOMMENDATIONS UPDATES & ANNUAL GOVERNANCE STATEMENT 2011 ACTION PLAN

Geoff Drake, Chief Internal Auditor, introduced the report, and said that all progress on implementation was as planned.

RESOLVED THAT

The report be noted.

65. INTERNAL AUDIT PLAN 2012-13

Geoff Drake, Chief Internal Auditor, introduced the report, which set out the work plan for internal audit work in the following financial year. He said that the plan was risk- based, and was driven by the corporate and departmental risk registers. He said that the internal audit service was working with the services in Westminster and Kensington & Chelsea on audits of tri-borough activity, and were trying to align reporting standards to facilitate this.

RESOLVED THAT

The draft 2012-13 audit plan be approved.

66. RISK MANAGEMENT PROGRESS REPORT

Michael Sloniowski, Principal Risk Consultant, updated on risk management activity since the Committee's last meeting. He said that meetings had taken place between risk managers in the three boroughs, with an aim to developing a single risk register, harmonising methodology, approach and reporting, while recognising differing views on risk appetite and what were sovereign matters.

Councillor Murphy asked about the contract outlined in 3.4.4 of the report, and asked at what stage the company might expect to receive payment. Jane West, Executive Director of Finance and Corporate Governance, said that the agreement allowed Agilisys to develop business cases, and the payment structure would depend on the nature of the saving and how it was realised. It would still be open to the Council to refuse to take up the proposal, should it have plans in place.

Councillor Iggulden asked about the existing arrangement with Agilisys, through the Hammersmith & Fulham Bridge Partnership, and asked whether it had generated any monies for the Council. Ms West said that the relationship had led to the development of products that were being marketed to other authorities, and that the Council had also received its profit share on its own contract and reinvested this.

Councillor Murphy raised the issue of recent events on the flyover. He said that the issue, and similar issues, did not appear on the risk register. Mr Sloniowski said that there were national and regional risk registers, which logged such risks. He said that he had begun liaising with the business continuity manager responsible for the service area regarding integration. Jane West, Executive Director of Finance and Corporate Governance, said that it seemed that an examination of the type of risk described was necessary, and that officers would undertake this.

RESOLVED THAT

The report be noted.

67. INTERNAL AUDIT QUARTERLY REPORT FOR THE PERIOD 1 OCTOBER TO 31 DECEMBER 2011

Geoff Drake, Chief Internal Auditor, introduced the report, which set out the work undertaken by internal audit in the quarter to 31 December 2011. He said that 12 reports were issued, 2 of which gave limited assurance. All the recommendations made in those reports were now recorded as implemented, and there were no outstanding reports or recommendations.

RESOLVED THAT

The report be noted.

68. EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED THAT

Under Section 100A (4) of the Local Government Act 1972, the public and press be excluded from the meeting during the consideration of the following items of business, on the grounds that they contain the likely disclosure of exempt information, as defined in paragraphs 1 and 3 of Schedule 12A of the said Act, and that the public interest in maintaining the exemption currently outweighs the public interest in disclosing the information.

69. EXEMPT MINUTES OF THE PREVIOUS MEETING

RESOLVED THAT

The exempt minutes of the meeting held on 8 December 2011 be agreed as a true and correct record.

70. ANNUAL BUSINESS PLAN FOR THE PENSION FUND

RESOLVED THAT

The annual business plan be agreed.

Meeting started: 7.00 pm
Meeting ended: 9.04 pm

Chairman ....

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