London Borough of Hammersmith & Fulham

Audit, Pensions and Standards Committee

Minutes

Thursday 10 January 2013

PRESENT

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

P-Solve: John Conroy and Nikhil Aggarwal

Trade Union Representative: Sheela Selvajothy

Officers: Jane West, Executive Director of Finance and Corporate Governance, Hitesh Jolapara, Bi-Borough Director of Finance, Jonathan Hunt, Tri-Borough Director for Treasury and Pensions, Geoff Drake, Chief Internal Auditor and Michael Sloniowski, Principal Consultant- Risk Management

37. MINUTES OF THE PREVIOUS MEETING

RESOLVED THAT

The minutes of the meeting on 27 September 2012 be agreed as a true and correct record, and

38. APOLOGIES FOR ABSENCE

There were apologies from Councillor Ivimy and from Eugenie White.

39. DECLARATIONS OF INTEREST

Councillors Murphy and Cartwright declared an other interest in items 40 and 41 as members of the Pension Fund.

40. PENSION VALUE AND INVESTMENT PERFORMANCE

John Conroy and Nikhil Aggarwal, P-Solve, presented an update on the 3rd quarter performance of the pension fund, and gave a verbal update on the 4th quarter. Mr Aggarwal said that quarter 3 had been on-risk, after a period in which attitudes had switched from quarter to quarter between on and off-risk.

In response to a question from Councillor Iggulden, Mr Conroy said that the on-risk, off risk parlance reflected the way in which market sentiment was reflected in shifts between asset classes: these shifts had intensified, both in scale and frequency, since the financial crisis. As part of this shift, a smaller group of assets, specifically the sovereign debt of a small group of countries, including the UK, had been identified as off-risk.

Mr Aggarwal said that improved sentiment reflected the decision of the US Federal Reserve to continue its quantative easing programme, and the increased liquidity provided by the European Central Bank. The change saw a fall in gilt prices and a rise in the value of equities. The quarter 4 position had been more stable than recent quarters, but there remained concerns that the recovery in on-risk asset prices did not reflect economic fundamentals.

Mr Aggarwal said that, as gilt prices were closely linked to the fund's liabilities, this meant that the fund's liability benchmark had fallen during quarter 3, and the fund as a whole had performed well. Mr Conroy said that the LGIM mandate had performed as expected in tracking the liabilities, and this was reflected in its fall. He added that it also tracked the Quarter 4 rise in inflation expectations.

Councillor Murphy asked about the recent changes in fund managers at Barings. Mr Conroy said that the asset allocation sector was, after a long period of eclipse, experiencing growth again. As a consequence, experienced managers were in demand. He said that P-Solve were unconcerned about the change in managers, as the head and deputy head of the fund remained in place, and the replacement appeared to have the relevant experience and background. He said that a larger concern, in light of the growing investment in the sector, was the quantity of funds under management. He said that, while there was still some way to go before Barings reached the figure at which P-Solve believed it would be appropriate to close the fund, a decision to breach that limit, in contravention of their stated intention, would raise questions about their ability to move with the speed that effective asset allocation required.

The Chairman asked whether, in the light of the macro position, Barings and Ruffer had operated with sufficient tactical aggression in their asset allocation, in particular in relation to the equities market. Mr Conroy said that the Barings mandate had achieved its benchmark over the period required, and that the fund retained a significant exposure to equities through the MFS and Majedie mandates. It was open to Barings to substantially increase the equities held by the fund, but Barings remained cautious about the overall picture.

The Chairman asked whether the benchmark was sufficiently challenging. MR Conroy said that, for much of the period between 2008 and 2010, it had been very challenging. He added that it was difficult to maintain strategy when returns appeared to be improving.

The Chairman said that his impression was that the asset allocation mandates had insufficiently captured the rise in equity values. Mr Conroy said that Baring' view remained that the macro-economic outlook was poor, but they had moved into equities to some degree. With regards to Ruffer, who remained very cautious, he said that the concerns were more valid, and that P-Solve would meet with them to discuss their plans.

The Chairman asked whether Goldman Sachs had been sufficiently stretched by their benchmark. Mr Conroy said that the mandate had performed as the Committee had requested it to. He said that his view was that the Council's managers were performing as asked, with an appropriate time to review the structure and character of the fund being the next actuarial valuation.

He said that it was understandable that the Committee would wish to crystallise the gains made in bond holdings, but the underlying economic picture remained forbidding, with the risk of inflation high, and stagflation possible.

Councillor Iggulden said that there was growth in the world economy and the fund, if oriented correctly, could avoid the risk suggested, particularly if an appropriately long-term view was taken. Mr Conroy said that inflation in the UK would affect the liabilities of the fund, but that otherwise such a strategy could be effective. It would be a strategic decision, however.

Councillor Ginn asked if the fund had property holdings. Mr Conroy said that the illiquid nature of property made it difficult to manage property funds, with 12 month exit "gates" common. He said that Barings were seeking to create a fund that the Dynamic Asset Allocation managers would be able to invest in, and able to make decisions to enter and exit in accordance with market conditions. In response to a question from the Chairman on listed property, he said that the performance of listed property was too closely correlated to that of equities as a class to allow it to function as a discreet investment.

RESOLVED THAT

The report be noted.

41. P-SOLVE MATCHING FUND REPORT

John Conroy, P-Solve, introduced the report, which explained the recent performance of the Matching Fund, and possible options for the fund. By way of introduction, he described the historical change which had seen fund trustees move away from being solely concerned, and to pay closer attention to their liabilities, with the introduction of mark to market into actuarial practices. He said that this had led to a period of extreme volatility and sharply rising contribution rates.

He said that the actuary based their estimate of liabilities on gilt yields: funds could use a different benchmark (corporate bonds, for instance) but this exposed them to what was termed basis risk. He said that it was considered prudent to have an element of the fund which moved in line with its liabilities; ideally, the whole fund would do so.

He said that recent unanticipated market conditions had seen an extraordinary fall in gilt yields, due to their attractiveness to foreign investors. The high price of gilts made selling out, before what seemed an inevitable fall in value, attractive, though an alternative would have to be found that served something of the same liability tracking function. Mr Conroy said that there were three options:

1. Leave the Matching Fund as it is, or;
2. Alter the investment in gilts to other fixed interest investments, with the consequent increase in basis and credit risk, or;
3. Wait and see, with a decision to be made following the outcome of the actuarial review in 2013.

He said that he did not wish to be prescriptive, but said that, in his view, the fund should be invested with the long term in mind, and its current strategy adhered to until the actuarial review was complete.

Councillor Iggulden expressed concern that the view taken of the fund's liabilities was too negative, with the assumptions, over public sector pay, for instance, overly pessimistic (from the fund's point of view). He said that the fund's assets would, if inflation was as generally predicted likely, be best invested in equities that would not be adversely affected by it.

Jane West, Executive Director of Corporate Finance and Governance, said that, under the rules of the scheme, the Council's level of contribution to the fund was set by the actuary, with the investment of that fund in the Committee's hands. Jonathan Hunt, Tri-Borough Director of Treasury and Pensions, said that the contribution made per employee was, at 14.5% similar to those at the other two boroughs, with the larger element ordered by the actuary relating to Hammersmith and Fulham's larger historical deficit.

The Chairman said that it appeared that a wait and see approach, with the Committee making a decision on the bond market in 2013, appeared to be the most sensible approach.

RESOLVED THAT

The report be noted.

42. <u>TREASURY MID-YEAR REVIEW 2012-13</u>

Jonathan Hunt, Tri-Borough Director of Treasury and Pensions, introduced the report which set out the Council's debt, borrowing and investment activity in the six months to the 30th September 2012.

Councillor Iggulden asked why, given the comparably poor interest rates, the Council placed money with other local authorities. Mr Hunt said that it was best practice for the Council to spread its money between lenders, with some lent at as low risk as possible: local authorities were best placed to provide this.

Councillor Ginn asked about the borrowing requirement. Mr Hunt clarified that it included borrowing financed internally, with a figure of £44 million for external debt.

RESOLVED THAT

The report be noted.

43. ANNUAL GOVERNANCE STATEMENT AND AUDIT COMMISSION RECOMMENDATIONS UPDATE

Geoff Drake, Chief Internal Auditor, introduced the report which updated on Annual Governance Statement and Audit Commission Recommendations.

With regards to the implementation of health and safety plans, Councillor Murphy asked what liability had arisen. Michael Sloniowski, Principal Consultant- Risk Management, said that the reporting structures had been reinforced, and that work was underway to assess what, if any, what, if any action plans or legacy issues remain outstanding or if there are any further problems following improved risk assessments in the area.

RESOLVED THAT

The report be noted.

44. REVISED ANTI-MONEY LAUNDERING POLICY AND PROCEDURES

Geoff Drake, Chief Internal Auditor, introduced the report, which set out recent changes to the money laundering procedures. He said that the procedures had been amended, following changes to the CIPFA guidance, and were presented for the Committee's information, having been approved under delegated powers.

Councillor Ginn asked whether the Council received large cash payments frequently. Mr Drake said that they did, and that the figure used was that contained in the CIPFA guidance and was in use across Europe.

Councillor Ginn suggested that the figure was very high and asked whether the Council could set a lower limit for cash transactions. Jane West, Executive Director of Finance and Corporate Governance, said the Council would be reluctant to refuse payment if it was made legally.

Councillor Murphy asked whether there was a mechanism for recording repeated large cash payments. Mr Drake said that the Council did not, in line with the scheme itself.

RESOLVED THAT

The report be noted.

45. CORPORATE ANTI-FRAUD SERVICE SIX-MONTHLY REPORT

Geoff Drake, Chief Internal Auditor, introduced the report, which set out the performance of the Corporate Anti-Fraud Service in the first six months of the financial year. He said that CAFS had delivered 72 sanctions (including 7 prosecutions) in the first half of the year including 35 properties recovered or prevented from fraudulently being allocated. He added that section 11 of the report gave details of monies collected. He said that, going forward, the Committee would be able to use the information presented to assess what was recovered.

The Chairman asked whether the recovery rate was considered sufficient. Mr. Drake said that the rate appeared to be about 50%, but that the debt raised, on benefit overpayments, for instance, was often difficult to recover and took a long time to recover. Jane West, Executive Director of Finance and Corporate Governance, said that the figure was higher than she had feared, and positive in light of the upcoming localisation of Council Tax benefit.

Councillor Iggulden said that while it was understandable that the work of CAFS should be promoted, the value put on recovered properties by the Audit Commission seemed excessive. Mr Drake said the methodology was imperfect but the valuations were an accepted rate across local govt set by the Audit commission that helps for comparison purposes between councils. While in many cases there is no direct budget obvious impact there have been occasions where recovered properties have been sold.

Councillor Murphy asked if the Council had been awarded costs or compensation in the Smith case. Mr Drake said that he did not believe there had been assets to claim against, and that the courts did not always award as might be expected; he would confirm the position in that case in writing.

RESOLVED THAT

The report be noted.

46. COMBINED RISK MANAGEMENT HIGHLIGHT REPORT

Michael Sloniowski, Principal Consultant- Risk Management, introduced the report, which set out risk management activity in the previous period. He said that the creation of a Tri-Borough Risk Management function had been agreed, which would be hosted by RBKC. With this in mind, practices and principles were currently being harmonised.

He said that the members of the London Risk Group had met to compare risks, and found that the upcoming implementation of Universal Credit was identified as high risk.

Councillor Ginn asked what risks were associated with Universal Credit. Mr Sloniowski said that given the scale of the change in policy and implementation, there was inevitable risk around implementation. Jane West, Executive Director of Finance and Corporate Governance, said that there were also financial risks, in particular in relation to monthly payment and to the risk of rent arrears, given the change to Housing Benefit.

The Chairman asked whether the risk of flooding was covered by the Council's risk register. Mr Sloniowski said that the Council had a Floor Risk Manager, and that the associated risks would be contained on the departmental risk register.

Councillor Murphy said, with regards to media crisis management, that he was concerned about a large-scale and unforeseen event, and whether the Council's leadership had the ability to call for advice at short notice in such a case. The Chairman agreed that this would appear to be sensible.

RESOLVED THAT

The report be noted

47. INTERNAL AUDIT QUARTERLY REPORT FOR THE PERIOD 1 JULY TO 30 SEPTEMBER 2012

Geoff Drake, Chief Internal Auditor, introduced the report which set out internal audit activity in the quarter to 30 September 2012. He said that no limited assurance reports were issued in the period, and that follow up inspections had seen 100% implementation of follow up recommendations.

RESOLVED THAT

The report be noted.

48. 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 3 and 7 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.

49. EXEMPT MINUTES OF THE PREVIOUS MEETING

RESOLVED THAT

The exempt minutes of the meeting on 27 September 2012 be agreed as a true and correct record.

50. INFORMATION SECURITY RISK MANAGEMENT

RESOLVED THAT

The report be noted.

Meeting started: 7.00 pm
Meeting ended: 8.55 pm

Chairman ....

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