1 SUMMARY

1.1 This report provides an analysis of investment management fees in 2014/15 and considers this in the context of the funding requirements and performance of the Fund.

1.2 The amount of fees paid in 2014/15 fell by £510,000 compared with the previous financial year. As a percentage of the value of the fund at the year-end fees were 0.93% compared with 1.1% in 2013/14. Active Equities fees fell by £1.2m this was off-set by an increase in the fees for the bonds mandate primarily due to performance and the Alternatives (primarily related to BlueCrest).

1.3 In overall terms the fund outperformed the benchmark by 3% net, therefore full cost of investment management fees has been more than covered.

1.4 The fund is invested entirely in active and alternative investments and this increases the amount of fees paid, however the fact that the return significantly exceeds the benchmark and covers the fees paid suggests that the fund is getting value from this active management.

1.5 Active listed equities management does carry some additional risk. The use of alternatives, property and bonds aims to mitigate some of this.
The reason the fund has adopted this active approach is to tackle the relatively high deficit identified by the actuarial valuation. The valuation is strongly influenced by the assumptions used but a review of the funding level using assumptions used by other funds and the Government Actuaries indicates that our investment strategy is still relevant.

2. RECOMMENDATIONS

2.1 Pension Fund Committee is recommended to:

2.1.1 Note the report

3 Background

3.1 The current Waltham Forest Investment Strategy was agreed in 2011 and was heavily influenced by the 2010 actuarial valuation, which estimated that the liabilities were only 60% funded. The fund needs to seek higher returns, which has entailed keeping a relatively high proportion of equities in active management. Mindful of equity volatility in preceding years the Committee has decided to use alternatives alongside equities in order to achieve strong returns but also provide some protection against volatility.

3.2 The 2013 actuarial valuation showed that the investment strategy made a positive contribution and exceeded the returns assumed in the 2010 valuation. However, the funding position remained broadly as it was in 2010 principally due to the increasing liabilities (which were to a significant extent affected by the continued low gilt rates). The investment strategy remained relevant and has continued in place.

3.3 A feature of our investment strategy is higher fees (mainly because of investments in alternatives but also the fact the active equity managers are used). In the case of equities it is important that we monitor the performance of active managers to satisfy the Pension Fund Committee that the returns justify the higher fees paid to active rather than passive managers.

3.4 As the 2011 investment strategy has been implemented we have experienced a steady increase in fees as a proportion of the fund. In 2011/12 fees accounted for 0.43% of the fund. This rose to 0.76% in 2012/13 and 1.10% in 2013/14. Fees in 2014/15 have fallen back to 0.93%.
3.5 In 2014/15 the fund returned 12.5%, exceeding the assumptions in the scheme’s Funding Strategy and the benchmark measure for the fund by 2.7%.

4 2014/15 Fees

4.1 Fees reduced by £500,000 compared with 2013/14 in 2014/15. As a percentage of assets the 2014/15 fees were 0.9% compared with 1.1% the previous year.

4.2 Appendix 1 presents the fees paid by manager/asset class.

4.3 The increase in the fees may be considered in the context of the increase in the value of the fund. The fund increased in value by £83.7m. In overall terms fees of 0.93% can be compared against the fund’s out-performance against the benchmark of 2.7%. As in previous years this suggests that the Fund’s active investment approach is delivering value.

4.4 There were two asset classes with significant increases in fees compared with the previous year: Alternatives which increased by £0.5m and Bonds, which increased by £0.2m.

4.5 The increase in the fees paid on the Wellington Mandate

4.5.1 The Wellington fees include a performance element where they exceed the mandated benchmark by 20%. Members will be aware of the action being taken concerning this mandate.

4.6 The increase in the fees paid to Bluecrest

4.6.1 The fees shown relate to the fees paid to managers within the overall mandate. There is actually no fee on the overall fund. This means the fees look high and are not easily compared with other pension funds making the Waltham Forest Fees look higher. However, more importantly we need to consider if the level of return achieved merits
the level of fees paid. Bluecrest’s performance was under review and a decision has been made to divest.

4.7 Fees paid on the equities allocation fell by £1.2m. As a percentage of investments this is 0.73% a drop from 1.12% in 2013/14. The main driver for this reduction was the reduction in the fees paid to JO Hambro, resulting from a reduction in the performance element.

4.8 Appendix 2 sets out the fee structures for the scheme’s fund managers. The base fees of the alternative asset class managers whilst higher than equities are generally around 1.5% - 2%. The 2014/15 accounts show the alternative managers fees combined at 3.03% of the value of assets under management as at 31 March 2015. This is because fees are based on commitments and the drawdown of funds may be over an extended period.

5 2014/15 Performance and fees

5.1 In 2014/15 the fund out-performed the benchmark by 2.7% and with a return of 12.5% outperformed the funding strategy assumptions.

5.2 Appendix 1 provides further information by asset class.

5.3 The strategy of using active equity management appears to be effective and contributing towards the Pension Fund’s overall performance improvement and success over the medium-term. Until 2007 the fund had adopted a predominantly passive strategy.

5.8 Equities comfortably exceeded the benchmark over the medium-term and the other alternatives are at an early stage of their investment cycle. Our investment strategy leads to a higher level of fees than other more passive and equity based funds, therefore, it is positive that the benchmark has been outperformed not just in the short but also medium-term.

6 Funding Level

6.1 The 2013 actuarial valuation was concluded during 2013/14 providing an estimation of the funding level and setting the employer contribution rates for 2014/15 to 2016/17. This in effect sets the challenge for the pension Fund going forward.

6.2 In overall terms the funding level continues to be a major concern. As at March 2013 it has been estimated that the funding level stands at 60% and ranks 84th out of 85 English and Welsh LGPS funds.

6.3 This low level of funding drives the requirement to have a more aggressive investment strategy and generate a higher return. This has led to using active equities and alternatives to mitigate some of the risks associated with equities volatility as well as earning a higher return. To date the approach has been successful; however, it also comes with a higher fees regime as referred to in the sections above. Therefore, it is important that the success of the approach is continually monitored.
6.4 The reported funding level and the future funding is affected by the assumptions used by the actuary. The Pension Fund Committee was consulted upon these. Clearly the Committee are reliant on advice from their actuaries and officers and different funds will make different assumptions. We have received information from Mercers that allows us to model the position of funds to consistent assumptions. In particular we have looked at the Government Actuarial Department’s (GAD) assumptions.

6.5 When applied the GAD assumptions tend to reduce overall reported funding levels. However, in the case of Waltham Forest our funding level raises significantly higher at 68% but our ranking only goes up one place. We can take a positive view of this in that it provides some evidence that our assumptions are reasonably prudent and may be seen as off-setting some of the risk that we are experiencing from the funding strategy.

6.5 It is interesting to note that using the GAD assumptions can present some very significant funding levels and rankings compared with those published. For example in London: The London Pension Fund Authority, funding level drops from 91% to 88% and the ranking from 5th to 25th; Greenwich, drops from 86% to 79% and ranking from 12th to 61st; Newham, funding level from 73% to 68% and ranking from 58th to 81st; and the City of London Corporation, funding level drops from 85% to 78% and ranking from 17th to 68th. Similar drops in rankings would arise if our assumptions were used for all funds although the drop in funding levels would probably be greater than using the GAD assumptions. For example: the City of London Corporation finding level would drop from 85% to 68%, ranking from 17th to 71st (only 8% and 11 places above Waltham Forest).

6.6 The published funding levels identified above are not wrong per se as is likely that those authorities have assumed different levels of risk in the valuation assumptions. In the case of the Waltham Forest the analysis of the fund using common criteria appears to support the more active investment strategy being adopted but we have to appreciate that active management and the risk mitigation in the investment strategy inevitably will lead to a higher level of fees.

7 OPTIONS & ALTERNATIVES CONSIDERED

7.1 Not applicable

8 SUSTAINABLE COMMUNITY STRATEGY PRIORITIES (AND OTHER NATIONAL OR LOCAL POLICIES OR STRATEGIES)

8.1 Not applicable

9 CONSULTATION

9.1 Not applicable

10 IMPLICATIONS

10.1 Finance, Value for Money and Risk

10.1.1 The success of the investment strategy and performance targets is key to the achievement of the funding strategy objectives taken into account in the 2013 triennial valuation. Monitoring and rebalancing asset allocation in line with our policy should achieve a closer alignment of actual asset allocations with the
investment strategy agreed by the Committee. Therefore less risk of unplanned outcomes following from differential performance of different asset classes.

10.2 Legal

10.2.1 No specific legal implications.

10.3 Equalities and Diversity

10.3.1 No direct implications

10.4 Sustainability (including climate change, health, crime and disorder)

10.4.1 None arising from this report.

10.5 Council Infrastructure

10.5.1 No direct implications, although, the aim of the fund is to finance employee benefits and minimize the cost of these to the employer, however the performance of the fund does not have an impact on the employees benefits which are guaranteed through legislation.

BACKGROUND INFORMATION (as defined by Local Government Act 1972 amended)

None.