

**REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT****BENCHMARKS****Purpose of the Report**

1. To seek approval to recommendations made by the Pensions Working Party regarding changes to the current benchmarks used by the Fund.

**Information and Advice**

2. At its meeting on 30 October 2012, the Pensions Working Party considered the attached report on benchmarks. The allocation to emerging market equities referred to in the report was considered by the Pensions Investment Sub-Committee at the meeting on 8 November 2012. This report will concentrate on the benchmarks used by the Fund to define and evaluate performance.
3. After in depth discussions involving all members of the Working Party and the Fund's independent adviser, it was agreed that the current benchmarking arrangements do not provide a sufficiently robust link to the returns needed to achieve the long term funding objective and are failing to provide sufficient information on which to measure the overall performance of the Fund.
4. In order to measure whether the Fund is meeting its funding objectives, it is recommended that the following benchmarks be agreed:
  - a liability-based benchmark (LBM)
  - a Fund strategic benchmark
5. The LBM represents the closest match to changes in the value of liabilities and would generally consist of 85-90% long dated index-linked gilts and 10-15% long dated conventional gilts. It is important to note that this would not be used to formulate an investment strategy for the Fund (as the Fund is not approaching maturity and the funding level is not above 100%) but would give an indication of whether the agreed investment strategy is being successful in meeting the funding objective.
6. The investment strategy is decided following the outcome of the triennial valuation as the asset allocation most likely to produce the returns required. The Fund has agreed asset allocation ranges for each major asset class. These are shown below.

### Asset Allocation Ranges

Equities	55% - 75%
Property	5% - 25%
Bonds	10% - 25%
Cash	0% - 10%

7. The ranges give flexibility in investment strategy and to cover market movements but it would be difficult to create a benchmark to reflect these. It is suggested, therefore, to construct a benchmark from the mid-point of each range (with the exception of cash which would need to be set at 2.5% in order to add up to 100%). The mid-points are shown below along with the actual asset allocation and WM Local Authority average asset allocation as at 30 September 2012.

	Mid-point	Actual	WM LA
Equities (inc private equity)	65.0%	69.1%	66.0%
Property	15.0%	12.7%	7.3%
Bonds	17.5%	14.4%	18.3%
Cash	2.5%	3.8%	3.5%
Alternatives			4.9%
	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

8. The benchmarks would use high level indices for each asset class and would be determined in conjunction with the Fund's independent adviser. Setting these benchmarks would then enable an assessment of actual performance, in particular the impact of decisions to under or over-weight asset classes relative to the benchmark.
9. In terms of managers' benchmarks, the In-House portfolio and Schroders currently include reference to the CAPS (Mellon) consensus (using the average asset allocations from the BNY Mellon universe of funds). There are question marks over using consensus or average allocations to drive performance. Although it can be useful to compare to other funds, performance benchmarks should link to the Fund's particular circumstances rather than those of an average fund. An alternative would be to set a benchmark based on the proportion of each region in the global stock market. If it is still considered appropriate to use average allocations as a means of setting benchmarks, it would be better if these were based on WM Local Authority average allocations.
10. It would be sensible to involve each manager in discussions regarding changes to their benchmarks and it is suggested that these discussions take place within a wider review of strategic asset allocation as part of the triennial valuation process.
11. The final point considered by the Working Party was quarterly performance reporting. The overall objective of the Fund is very long term in nature but regulations require that performance is monitored on a quarterly basis. However, it is suggested that focusing reporting more on longer term performance would link more clearly to the long term objective of the Fund. If considered appropriate,

changes will be made to the quarterly reporting in conjunction with the Fund's managers.

## **RECOMMENDATION/S**

- 1) A liability-based benchmark is set for the Fund.
- 2) A strategic benchmark is set for the Fund based on the mid-point of the strategic asset allocation ranges.
- 3) Discussions are held with each manager regarding changes to their benchmarks within a wider review of strategic asset allocation as part of the triennial valuation process.
- 4) Changes are made to quarterly performance reporting in conjunction with managers to focus more on longer time frames in order to more clearly link to the Fund's long term objectives.

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### **Background Papers**