

## Regulatory and Other Committee

### Open Report on behalf of Executive Director of Finance and Public Protection

Report to:	<b>Pensions Committee</b>
Date:	<b>06 October 2016</b>
Subject:	<b>Pension Fund Update Report</b>

#### Summary:

This report updates the Committee on Fund matters over the quarter ending 30th June 2016 and any current issues.

#### Recommendation(s):

That the Committee

- i) note this report;
- ii) delegate authority to the Executive Director of Finance and Public Protection, in consultation with the Chair and Vice Chair of the Pensions Committee, to approve Pension Fund spend up to a maximum of £350k in total, to enable the set-up of the operator (BCPP) and the ACS structure; and
- iii) approve the amended tolerance levels around the strategic asset allocation.

## Background

### 1 Fund Summary

1.1 Over the period covered by this report, the value of the Fund increased in value by £86.8m (5%) to £1,837.1m on 30<sup>th</sup> June 2016. Fund performance and individual manager returns are covered in the separate Investment Management report, item 7 on the agenda.

1.2 Appendix A shows the Fund's distribution as at 30<sup>th</sup> June. All asset classes are within the agreed tolerances. One manager, Invesco, exceeded their tolerance level of +/- 1.5% by +0.1%, to account for 21.6% of the Fund. This was not rebalanced as manager changes were due to be implemented. The Fund's overall position relative to its benchmark can be described as follows:

Overweight Equities by 2.1%

UK Equities underweight by 0.8%

Global Equities overweight by 2.9%

Underweight Alternatives by 1.0%

Underweight Property by 0.4%

Underweight Bonds by 0.6%

Neutral Cash

Movements in weight are due to the relative performance of the different asset classes.

- 1.3 The purchases and sales made by the Fund's portfolio managers over the period (including those transactions resulting from corporate activity such as take-overs) are summarised in Appendix B.
- 1.4 Appendix C shows the market returns over the three and twelve months to 30<sup>th</sup> June 2016.
- 1.5 The table below shows the Fund's ten largest single company investments (equity only and includes pooled investments) at 30<sup>th</sup> June, accounting for 10.3% of the Fund, compared to 9.6% last quarter. Equity holdings in the Fund are now shown on the Pensions website, and updated on a quarterly basis.

	<b>Company</b>	<b>Total Value £M</b>	<b>% of Fund</b>
1	ROYAL DUTCH SHELL	31.2	1.7
2	BRITISH AMERICAN TOBACCO	26.5	1.4
3	RECKITT BENCKISER	20.1	1.1
7	UNILEVER	18.5	1.0
6	HSBC	17.1	0.9
4	MICROSOFT	16.7	0.9
5	APPLE	16.0	0.9
9	GLAXOSMITHKLINE	15.0	0.8
10	BP	14.2	0.8
8	ALPHABET	13.6	0.8
	<b>TOTAL</b>	<b>188.9</b>	<b>10.3</b>

- 1.6 Appendix D presents summarised information in respect of votes cast by the Manifest Voting Agency, in relation to the Fund's equity holdings. Over the three months covered by this report, the Fund voted at 581 company events and cast votes in respect of 9,046 resolutions. Of these resolutions, the

Fund voted 'For' 6,299, 'Against' 2,517, abstained on 53 and withheld votes on 177.

- 1.7 A breakdown of the issues covered by these resolutions together with an analysis of how the votes were cast between 'For', 'Abstain' or 'Against' a resolution is given in Appendix D. Votes were cast in accordance with the voting template last reviewed at the 9<sup>th</sup> January 2014 meeting of this Committee, and effective from 1<sup>st</sup> March 2014.

## 2 Local Authority Pension Fund Forum

- 2.1 The Fund participates in the Local Authority Pension Fund Forum that has a work plan addressing the following matters:

- **Corporate Governance** – to develop and monitor, in consultation with Fund Managers, effective company reporting and engagement on governance issues.
- **Overseas employment standards and workforce management** - to develop an engagement programme in respect of large companies with operations and supply chains in China.
- **Climate Change** - to review the latest developments in Climate Change policy and engage with companies concerning the likely impacts of climate change.
- **Mergers and Acquisitions** - develop guidance on strategic and other issues to be considered by pension fund trustees when assessing M&A situations.
- **Consultations** – to respond to any relevant consultations.

- 2.2 The latest LAPFF newsletter can be found on their website at [www.lapfforum.org](http://www.lapfforum.org). Some of the engagement highlights during the quarter included:

- Strategic resilience shareholder resolutions were filed at Rio Tinto, Glencore and Anglo American. All three had high levels of support with votes in favour at 99.1%, 98% and 96% respectively.
- Being part of an investor coalition engaging with Total on strategic resilience, which has led to the company committing to report in line with the requests made in the shareholder resolutions mentioned above.
- LAPFF Vice Chair Ian Greenwood interviewed by the BBC on his participation at the BP AGM in April, discussing executive pay. LAPFF have requested a meeting with BP to discuss the remuneration policy ahead of their 2017 AGM.

- Attending 13 AGM's between April and June, raising issues ranging from remuneration, to climate risk, to supply chain management. A number of these AGMs have brought about opportunities for further engagements with the companies on issues of concern to LAPFF's members.
- LAPFF continuing to apply pressure at an EU level to ensure that IFRS 9 is not endorsed until it appropriately reflects the correct legal position on the 'target' of the true and fair view test (i.e. assets, liabilities, financial position and profit or loss), and the 'purpose' of the accounts (creditor and shareholder protection).
- LAPFF attending the Unilever AGM to find out more about the company's implementation of the 'Unilever Sustainable Living Plan', which it introduced in 2010. Unilever's efforts to integrate sustainability throughout its business model are very rare in the UK, and have attracted a lot of positive intention.

2.4 Members of the Committee should contact the author of this report if they would like further information on the Forum's activities.

### 3 Treasury Management

3.1 At the April 2010 meeting, the Pensions Committee agreed a Service Level Agreement with the Treasury team within Lincolnshire County Council, for the continued provision of cash management services to the Pension Fund.

3.2 The Treasury Manager has produced the outturn report detailing the performance of the cash balances managed by the Treasury. This shows an average cash balance of £8m. The invested cash has outperformed the benchmark from 1<sup>st</sup> April 2016 by 0.28%, annualised, as shown in the table below, and earned interest of £14.5k.

3.3 A weighted benchmark (combining both 7 day and 3 month LIBID) has been adopted by the Council, which is more reflective of the investment portfolio maturity profile.

<b>Pension Fund Balance – Q1 to 30<sup>th</sup> June 2016</b>				
<b>Pension Fund Average Balance £'000</b>	<b>Interest Earned £'000</b>	<b>Cumulative Average Yield Annualised</b>	<b>Cumulative Weighted Benchmark Annualised</b>	<b>Performance</b>
		<b>%</b>	<b>%</b>	<b>%</b>
8,246.3	14.5	0.73	0.45	0.28

## 4 TPR Checklist Dashboard

4.1 The Pension Regulator's (TPR's) checklist for how Lincolnshire meets the code of practice 14 for public service pension schemes is attached at Appendix E.

4.2 Areas that are not fully completed and compliant are:

B10 – Knowledge and Understanding – Is there a process in place for regularly assessing the pension board members' level of knowledge and understanding is sufficient for their role, responsibilities and duties?

*Amber - Training is a standing item on the agenda. No self-assessment is currently undertaken.*

B12 – Knowledge and Understanding - Have the pension board members completed the Pension Regulator's toolkit for training on the Code of Practice number 14?

*Amber – It is the intention that all PB and PC members carry this out, and provide copies of the completion certificate to the Pension Fund Manager, however completion certificates have not been received for all members.*

F1 – Maintaining Accurate Member Data - Do member records record the information required as defined in the Record Keeping Regulations and is it accurate?

*Amber - Scheme member records are maintained by WYPF. Therefore much of the information here and in later questions relates to the records they hold on LCC's behalf. However, as the scheme manager, LCC is required to be satisfied the regulations are being adhered to. Data accuracy is checked as part of the valuation process and the annual benefits statement process. Monthly data submission will improve data accuracy going forwards, however there are a number of historical data issues that are in the process of being identified and rectified.*

F5 - Maintaining Accurate Member Data - Are records kept of decisions made by the pension board, outside of meetings as required by the Record Keeping Regulations?

*Grey – not relevant as we do not expect there to be decisions outside of the PB. This will be monitored.*

H1 – Maintaining Contributions - Has an annual benefit statement been provided to all active members within the required timescales?

*Amber on compliance - 87.6% of Statements as at 31<sup>st</sup> August 2016 were issued. This compares to 38% across all members at this time last year. Total across all members this year is over 90%.*

H3 - Maintaining Contributions - Has a benefit statement been provided to all active, deferred and pension credit members who have requested one within the required timescales?

*Amber - 96.9% of Statements as at 31<sup>st</sup> August 2016 were issued. This compares to 38% across all members at this time last year.*

*Total across all members this year is over 90%.*

H5 - Maintaining Contributions - Has an annual benefit statement been provided to all members with AVCs within the required timescales?

*Grey – provided directly by Prudential, with no Pension Fund involvement.*

H6 – Maintaining Contributions - Do these meet the legal requirements in relation to format?

*Grey – provided directly by Prudential, with no Pension Fund involvement.*

H7 - Maintaining Contributions - Is basic scheme information provided to all new and prospective members within the required timescales?

*Amber - New starter information is issued by WYPF, **when they have been notified by employers**. This is done by issuing a notification of joining with a nomination form, transfer form and a link to the website. However, because the SLA relates to when notified, it does not necessarily mean the legal timescale has been met which is within 2 months of joining the scheme. The monthly data returns are improving this process.*

K7 – Scheme Advisory Board Guidance - Members of a Local Pension Board should undertake a personal training needs analysis and put in place a personalised training plan.

*Amber - Annual Training Plan of Committee shared with PB and all PB members invited to attend. Annual self-assessment not yet carried out and no personal training plans in place.*

## 5 Risk Register Update

5.1 The risk register is a live document and updated as required. Any changes are reported quarterly, and the register is taken annually to Committee to be approved. Over the quarter there have been no additions or changes to the register.

5.2 The only red risk is risk 28 which was added in June, as a result of the Brexit vote. Given the continuing uncertainty as to how this will play out, it is felt that the red status is still appropriate.

Risk 28	Consequences	Controls	Risk Score	
			L	I
UK leaving the EU	Volatility of market Lower gilt yields leading to higher liabilities Inflation increasing liabilities	Increased monitoring of managers Review investment strategy	4	3

	Uncertainty of political direction re pooling	Regular communications with Committee and Board		
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5.3 The full risk register is available from officers should any member of the Committee wish to see it.

## 6 LGPS Asset Pooling

6.1 As detailed in the monthly update letter, BCPP met the deadline for the final submission to DCLG. Work has continued over the summer months to ensure that BCPP will be in a position to progress things at the required speed once final approval by Government is given.

6.2 At the time of writing this report, the expectation is still that formal approval by Ministers to progress the creation of BCPP would be received in September. Officers have stressed on a number of occasions that any delay in receiving this approval, and in the laying of the Investment Regulations which give the Secretary of State the power of intervention, will impact the ability to meet the April 2018 deadline.

6.3 Fund S151 and Legal officers were invited to a BCPP meeting on 5<sup>th</sup> September. The meeting covered a review of what had been done so far and discussion about the next steps required, particularly from the Funds point of view. In particular this was about the process each Fund had to go through to get full council approval to create the Joint Committee structure and where the authority sat to buy a share in the Teckal company that would be created. David Coleman, Chief Legal Officer, represented Lincolnshire County Council at this meeting.

6.4 The next meeting of the Member Steering Group (MSG) is set for 30<sup>th</sup> September, and members will receive a number of papers updating them on the various meetings held and progress made since the last MSG meeting in June. Papers brought to that meeting include phase three project delivery proposals, budget requirements and proposed next steps. Once this has been agreed by the MSG, this report will be shared in the September monthly update letter.

6.5 To get BCPP to the final submission stage, an initial budget of £50k per fund was agreed in February. This provided a total budget of £600k. Very little of this has actually been spent to date (approximately £90k on advisory work) but the submission identified that to get the company into a position to manage assets from April 2018, the total cost may be as high as £4.2m across all 12 Funds (taken from figures provided by Deloitte). This figure included all set-up costs including staff, legal and professional, procurement, IT and infrastructure, regulatory costs for the operator (BCPP) and legal and professional costs for setting up the ACS structure. Taking account of the

£50k already allocated, this requires approval to spend up to another £300k per Fund to meet the cost requirements.

- 6.6 **Delegated authority request** - To ensure that funds are available when required and to meet the potential costs of the set-up of BCPP, it is requested that authority is delegated to the Executive Director of Finance and Public Protection, in consultation with Chair and Vice Chair of the Pensions Committee, to approve Pension Fund spend up to £350k (including the £50k already agreed).

## 7 Strategic Benchmark Tolerances

- 7.1 It is accepted practice to report to Committee on any asset class or portfolio that has moved outside of the agreed tolerances around the strategic benchmark. Following the termination of Neptune at the July Pensions Committee, it was agreed to reallocate the funds to Invesco and Morgan Stanley Global Brands. As a result of this, the existing tolerance levels were no longer appropriate and it was agreed to review these and bring them to this Committee for approval.

- 7.3 The table below shows the existing benchmark allocation and tolerance levels and the recommended tolerances following the asset allocation changes.

Investment	Current (%)		w.e.f. August 2016 (%)	
	Benchmark	Tolerance	Benchmark	Tolerance
<b>UK Equities</b>	20	+/- 1.5	20	+/- 2
<b>Global Equities</b>				
<b>Invesco</b>	20	+/- 1.5	22.5	+/- 2.5
<b>Threadneedle</b>	5	+/- 1	5	+/- 1
<b>Schroder</b>	5	+/- 1	5	+/- 1
<b>Neptune</b>	5	+/- 1		
<b>Morgan Stanley</b>	5	+/- 1	7.5	+/- 1
<b>Total Equities</b>	60	+/- 5	60	+/- 7.5
<b>Alternatives</b>	15	+/- 1.5	15	+/- 1.5
<b>Property</b>	11.5	+/- 1	11.5	+/-1.5
<b>Fixed Interest</b>				
<b>Blackrock</b>	6.75	+/- 1	6.75	+/- 1
<b>*Blackrock interim</b>	6.75	+/- 1	6.75	+/- 1
<b>Total Fixed Interest</b>	13.5	+/- 1.5	13.5	+/- 1.5
<b>Cash</b>	0	+/- 0.5	0	+/- 0.5

\*BMO were terminated in June, with the redemption carried out over a two month period and invested with Blackrock Corporate Bonds <5yrs Fund in September. This is an interim holding pending asset allocation discussions.

- 7.4 The changes make the tolerances more proportional to the size of the asset allocation than they were before, and are listed below:



- Increasing UK equities to +/- 2%
- Increasing Invesco to +/- 2.5%
- Increasing Total Equities to +/- 7.5%
- Increasing Property to +/- 1.5%

7.5 The Committee are asked to approve the amended tolerance levels.

## **8 GAD Section 13**

8.1 Section 13 of the Public Service Pensions Act 2013 (S13) is a piece of primary legislation that requires that an appointed person, in this case the Government Actuary's Department (GAD), to report on whether the LGPS formal funding valuations adhere to a framework that looks at the following criteria:

- Compliance – to confirm the valuation has been carried out in accordance with the Regulations
- Consistency – to confirm the valuation is not inconsistent with other valuations
- Solvency - to confirm the contributions are sufficient to ensure solvency
- Long Term Cost Efficiency – to confirm contributions are sufficient to meet benefit accrual and existing deficit

8.2 The 2016 LGPS Triennial Valuations will be the first carried out under this new review framework and, to understand the potential outcomes of such a review, a dry run was completed in August using the March 2013 valuation data. Throughout this process GAD have had considerable input from all LGPS Fund Actuaries in order to improve their understanding of LGPS funding valuations and to resolve specific queries relating to contribution schedules and funding plans.

8.3 GAD published the results for each of the LGPS Funds, using a RAG rating. The results against the criteria across the LGPS are shown below:

- Compliance – no compliance issues were found.
- Consistency – presentational and evidential inconsistencies were found in the valuation approaches adopted, in the assumptions used and in the disclosure of results.
- Solvency – concerns were reported on two closed transport funds and a number of funds raised amber flags on one or more metrics. No red flags were raised.
- Long Term Cost Efficiency – GAD named two funds they wished to have conversations with on their funding plans.

8.4 GAD clarified that meeting solvency and long term cost-efficiency requirements takes precedence in the regulatory framework over the desirability of stable contributions. Ensuring stability of contributions has always been a consideration in setting the rates for Lincolnshire employers, therefore this will have to be carefully considered when agreeing the

outcomes of the 2016 valuation, to ensure that at a Fund level no surprise amber or red flags were raised by GAD.

8.5 In the dry run, the Lincolnshire Pension Fund received green flags across all criteria.

## **9 LGPS Guidance on Preparing and Maintaining an Investment Strategy Statement**

9.1 Regulation 7 of the LGPS (Management and Investment of Funds) Regulations 2016 (not yet laid at the time of writing this report) requires the formulation, publication and maintenance of an Investment Strategy Statement (ISS) by each Fund, in accordance with guidance issued by the Secretary of State. The ISS replaces the need for a Statement of Investment Principles (SIP) which is currently prepared and was last reviewed by this Committee at the July meeting.

9.3 The ISS required by Regulation 7 must include:

- A requirement to invest money in a wide variety of investments;
- The authority's assessment of the suitability of particular investments and types of investments;
- The authority's approach to risk, including ways in which risks are to be measured and managed;
- The authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
- The authority's policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
- The authority's policy on the exercise of rights (including voting rights) attaching to investments.

9.2 This guidance has now been received (included at appendix F) and all funds must produce and publish their ISS by 1<sup>st</sup> April 2017. It is expected that additional guidance will be produced by CIPFA and consultants, to assist funds in preparing robust ISS's.

9.3 Officers will work with the Investment Consultant to bring a report and draft ISS to the Committee ahead of the 1<sup>st</sup> April deadline, highlighting how each of the requirements has been met.

## **10 Lincolnshire Pension Fund – Scheme Member Annual Meeting**

10.1 As agreed at the October meeting last year, the Fund is holding its first annual meeting for scheme members. This is taking place on 23<sup>rd</sup> November at the Alive Conference Centre in Lincoln. Attendance will be limited to 200 members, on a first come, first served basis. Booking is available on the WYPF website.

10.2 The Pension Fund Manager will chair the event, and presentations will be given by the Chair of the Pensions Committee and the Chair of the Pension Board. In addition, a joint presentation is being given by Trading Standards and the Police covering scams.

## Conclusion

- 11 This reporting period saw the value of the Fund rise, increasing by £86.8m to £1,837.1m. At the end of the period the asset allocation, compared to the strategic allocation, was;
- overweight equities;
  - neutral cash; and
  - underweight property, fixed interest and alternatives .
- 12 BCPP met the deadline for submitting their asset pooling proposal and awaits the Governments formal response.
- 13 Delegation of authority is requested to allow the Executive Director of Finance and Public Protection, in consultation with Chair and Vice Chair of the Pensions Committee, to approve Pension Fund spend up to £350k to enable the set-up of BCPP.
- 14 The Committee are asked to approve the amended strategic benchmark reporting tolerances, following the reallocation of the Neptune portfolio.
- 15 Officers will work with the Investment Consultant to bring a report and draft ISS to the Committee ahead of the 1st April 2017 deadline, highlighting how each of the requirements has been met.

## Consultation

### a) Policy Proofing Actions Required

n/a

## Appendices

These are listed below and attached at the back of the report	
Appendix A	Distribution of Investments
Appendix B	Purchases and Sales of Investments
Appendix C	Changes in Market Indices

Appendix D	Equity Voting Activity
Appendix E	TPR Checklist Dashboard
Appendix F	LGPS Guidance on Preparing and Maintaining an Investment Strategy Statement

### **Background Papers**

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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