

Open Report on behalf of Pete Moore, Executive Director of Finance and Public Protection

Report to:	Pensions Committee
Date:	5 October 2017
Subject:	Pension Fund Update Report

Summary:

This report updates the Committee on Fund matters over the quarter ending 30th June 2017 and any current issues.

Recommendation(s):

That the Committee

- 1) Approves the request to extend the Custodian's contract to 31st March 2021, to allow for the transition of assets to BCPP; and
- 2) Notes the report.

Background

Fund Summary

- 1.1 Over the period covered by this report, the value of the Fund increased in value by £21.8m (1%) to £2,121.7m on 30th June 2017. Fund performance and individual manager returns are covered in the separate Investment Management report, item 8 on the agenda.
- 1.2 Appendix A shows the Fund's distribution as at 30th June. All asset classes were within the agreed tolerances. The Fund's overall position relative to its benchmark can be described as follows:

Overweight Equities by 2.3%

UK Equities underweight by 1.0%
Global Equities overweight by 3.2%

Underweight Alternatives by 1.0%

Overweight Property by 0.3%

Underweight Infrastructure by 1.0%

Underweight Bonds by 1.2%

Overweight Cash by 0.5%

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 30th June 2016.
- 1.5 The table below shows the Fund's ten largest single company investments (equity only and includes pooled investments) at 30th June, accounting for 10.1% of the Fund, the same as last quarter. Direct equity holdings in the Fund are now shown on the Pensions shared website (www.wypf.org.uk), and updated on a quarterly basis.

	Company	Total Value £M	% of Fund
1	ROYAL DUTCH SHELL	29.2	1.4
2	UNILEVER	28.7	1.4
3	RECKITT BENCKISER	27.3	1.3
4	BRITISH AMERICAN TOBACCO	26.3	1.2
5	HSBC	24.8	1.2
6	MICROSOFT	19.7	0.9
7	APPLE	15.5	0.7
8	BP	14.8	0.7
9	GLAXOSMITHKLINE	13.7	0.7
10	JPMORGAN	13.1	0.6
	TOTAL	213.1	10.1

- 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 420 company events and cast votes in respect of 6,361 resolutions. Of these resolutions, the Fund voted 'For' 4,114, 'Against' 1,669, abstained on 440 and withheld votes on 138.
- 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 9th January 2014 meeting of this Committee, and effective from 1st 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 engagement report can be found on their website at www.lapfforum.org. Some of the highlights during the quarter included:

- On executive pay, voting alerts were issued to LAPFF members on binding pay policies at Carillion, Smith & Nephew, GlaxoSmithKline, BP, Shell, Babcock and WPP.
- LAPFF issued a number of voting alerts recommending members back shareholder resolutions on climate change disclosure at US energy firms PPL, Chevron and Exxon Mobil. The resolutions are in line with LAPFF's policy position to press companies to use scenarios to provide forward-looking analysis, and that companies should be positioning themselves for a low carbon future by disclosing strategic business transition plans.
- The Forum announced that it is partnering with the 50/50 Climate Project. The new partnership will enhance the Forum's actions to promote climate competent boards and enhance collective investor action advocating better climate strategies and decision making at board level.
- As part of the ongoing concern that the Financial Reporting Council (FRC) has been setting accounting standards that are not aligned with the law, in particular the requirement to reflect the solvency of a company, LAPFF submitted a response to the consultation on the Green

Paper on Corporate Governance. That response makes the recommendation that the problems with the FRC run so deep that the FRC is disbanded and that a proper competent authority is set up to replace it.

- LAPFF executive member, Ian Greenwood met with BT Chairman, Sir Michael Rake, for the second time in a year to discuss a range of issues, including Sir Michael's views on Brexit and the British economy, BT's recent accounting scandal and cybersecurity.
- Ian Greenwood met with the Chairmen of Aberdeen Asset Management, Simon Troughton, and Standard Life, Sir Gerry Grimstone, on the same day to discuss the imminent merger of the two companies. The meetings both focused on the extent to which each company had considered the human capital and cultural integration of the two Scottish firms.

2.3 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 £8.2m. The invested cash has outperformed the benchmark from 1st April 2016 by 0.36%, 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.

Pension Fund Balance – Q1 to 30th June 2017				
Pension Fund Average Balance £'000	Interest Earned £'000	Cumulative Average Yield Annualised %	Cumulative Weighted Benchmark Annualised %	Performance %
8,246.3	14.5	0.54	0.18	0.36

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 The Areas that are not fully completed and compliant are listed below.

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.

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.

Remaining Amber - Annual Training Plan of Committee shared with PB and all PB members invited to attend. Self-assessments were carried out in March, however no personal training plans have been put in place, as the

assessments have been used to identify training areas required across the Board.

4.3 The areas changed since the last Pensions Committee meeting are:

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

From Amber to Green on compliance – 97.9% of Statements as at the deadline of 31st August 2017 were issued. This is considered as meeting the requirements of the Regulator. The remaining 2.1% will be sent out in due course.

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?

From Amber to Green on compliance – 99.96% of deferred benefit statements were produced. When taking into account the actives too, this covers 99% of active and deferred members. This is considered as meeting the requirements of the Regulator.

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.

5.2 Two additional risks have been added over the quarter. Risk 27, concerning the Fund acting as a responsible investor and risk 28, concerning opting up to professional investor status, under the MIFIDII requirements.

Risk 27	Consequences	Controls	Risk Score	
			L	I
Failure to meet requirements as a responsible investor - across all ESG risks	Reputational risk, loss of Fund value	Stewardship code compliance Managers reporting requirements LAPFF membership Voting	1	2

Risk 28	Consequences	Controls	Risk Score	
			L	I
Failure to be opted up to professional investor status following the	Fire sale of assets, inability to implement investment strategy	Use of LGA/SAB templates and letters, trained Committee, professional officers,	2	4

implementatio n of MIFIDII		use of investment advisors and consultants		
-------------------------------	--	--	--	--

- 5.3 There are now three red risks. Risk 28 is shown above. Risk 24, which was added in June '16 as a result of the Brexit vote, and given the continuing uncertainty as to how this will play out, it is felt that the red status is still appropriate. Risk 22, which has been increased to red from blue, following discussion at the Pension Board meeting in July '17. The deputy post is still vacant, however a recruitment exercise has been undertaken. The outcome of this will be known in early October.

Risk 24	Consequences	Controls	Risk Score	
			L	I
UK leaving the EU	Volatility of market Lower gilt yields leading to higher liabilities Inflation increasing liabilities Uncertainty of political direction re pooling	Increased monitoring of managers Review investment strategy Regular communications with Committee and Board	4	3

Risk 22	Consequences	Controls	Risk Score	
			L	I
LCC team - workloads and resources - additional work of asset pooling along with team losses, means resources will be very stretched for the coming months	Statutory requirements not met Reputational risk Increase in key man risk	Monthly meetings with County Finance Officer Concerns reported to Pensions Committee and Pension Board Ability to recruit	3	3

- 5.4 The full risk register is available from officers should any member of the Committee wish to see it.

6 Asset Pooling Update

- 6.1 A detailed update was presented to the Committee at the training session on 21st September, and circulated to all Committee members, therefore there is no additional update to be provided on progress of BCPP.
- 6.2 On 22nd August, a letter was sent to all LGPS Pensions Committee and pool Chairmen, signed by Marcus Jones MP, Caroline Nokes MP and the Chief Secretary to the Treasury (Elizabeth Truss). It is attached at Appendix F for your information.
- 6.3 The theme of the letter was a reminder that all funds must fully participate in a pool, and that pools must have an authorised FCA operator. Where ministers were not satisfied that funds had a clear path and timetable for delivery, DCLG would consult on further action, including using the intervention powers that were included in the 2016 Investment Regulations.
- 6.4 Ministers have requested that pools complete a progress report as at 30th September (similar to the one provided in April this year) and it must be sent to them in October. The BCPP project team will draft a response, and it will be taken to the Joint Committee meeting on 20th October.
- 6.5 The Lincolnshire Fund is fully committed to pooling, and is working with BCPP to ensure that it is able to transition its assets at the most appropriate time.

7 Committee Training

- 7.1 The two day session held in York in September was very well received. It is expected that this will become an annual event in a similar format, with an update on BCPP and presentations from managers as training for Committee and Board members.
- 7.2 Any new Committee members who were unable to attend are recommended to undertake the LGA Fundamentals training, which was shared with the Committee in an email dated 3rd August. As approved in the annual training plan at the July Committee, all Committee members are expected to have attended a basic training course, in addition to induction training.
- 7.3 Should any Committee members wish to attend the Fundamentals training, they are asked to contact Jon Haw (jonathan.haw@lincolnshire.gov.uk) at their earliest opportunity, to ensure that a place can be secured.

8 Custodian Extension Request

- 8.1 The Lincolnshire Pension Fund entered into a seven year contract (five plus two) with JPMorgan, as its custodian, on 1st April 2011. This was reviewed in 2015 and the two year extension granted. The contract is now due to expire on 31st March 2018, having taken the extension. Officers are requesting an additional maximum three year extension to this contract,

taking it to 31st March 2021, for the reasons detailed below. Should the Committee approve this request, a paper will be prepared for the Executive Director of Finance and Resources to consider the contract extension, under his delegated authority to arrange for all necessary transactions associated with the management of the assets of the Pension Fund.

- 8.2 The custodian's role is a vital one for the Pension Fund, as it safeguards the Fund's assets, settles trades and receives and monitors investment income. The Fund is currently £2.2bn, of which segregated assets (those which the custodian holds) stand at around £765m. The balance is in pooled funds, where the custodian's role is merely to manage cash inflows and outflows and to use in the overall accounting and performance measurement of the Fund. The majority of the income earned by the custodian is for the safeguarding of these segregated assets.
- 8.3 The Government's requirement to pool assets from April 2018 will completely change the way that the Fund (and all other LGPS Funds) uses a custodian over the medium term. The custodian element of the role will disappear as the assets transfer, and the role for JPMorgan (or any other provider) will be for accounting and performance measurement only, the current ancillary services. However, there will be a transitional period where the custodian's normal role will still be required. This will mean a diminishing asset base for the custodian to manage, over the next two to four years.
- 8.4 Given the reducing income base for the custodian, it is expected that it will be very difficult to find someone to offer a competitive bid for custody services, should we have to retender, however the existing relationship with JPMorgan means that they would extend the contract on the same price basis that we have now.
- 8.5 The expectation is that within the 3 years of a contract extension, officers will have greater knowledge of the requirements in the new world of pooling, and be able to tender specifically for the services required going forwards.
- 8.6 A costing analysis has been done to look at the likely fees to be paid to the custodian, assuming a two or three year transition period from June '18, and they are below the EU procurement limit. Therefore, having sought advice from Legal Services, there should be no issue with extending the contract.
- 8.7 The Committee are recommended to approve the request to extend the Custodian's contract by three years, to March '21, to allow for the transition of assets to BCPP.

Conclusion

- 9 This reporting period saw the value of the Fund rise, increasing by £21.8m to £2,121.7m. At the end of the period the asset allocation, compared to the strategic allocation, was;
- overweight equities and cash; and
 - underweight property, fixed interest, and alternatives.
- 10 The Fund's contract with the custodian, JPMorgan, is due to expire in March 2018. The Committee are recommended to approve the request to extend the contract by three years, to March '21, to allow for the transition of assets to BCPP.

Consultation

a) Have Risks and Impact Analysis been carried out?

Yes

b) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the author of this report.

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	Joint Government Letter on Asset Pooling

This report was written by Jo Ray, who can be contacted on 01522 553656 or jo.ray@lincolnshire.gov.uk.