

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

Report to:	Pensions Committee
Date:	10 January 2019
Subject:	Pension Fund Update Report

Summary:

This report updates the Committee on Fund matters over the quarter ending 30th September 2018 and any current issues.

Recommendation(s):

That the Committee:

- 1) approves the changes to the risk register detailed below:
Risk 25 – Failure to meet requirements as a responsible investor - across all ESG risks – expand the wording to be Failure to meet requirements as a responsible investor - across all ESG risks (including, climate change and a move to a low carbon economy);
- 2) considers the recommendations from the Pension Board;
Risk 4 - Calculating and paying pensions correctly – expand the wording to be - Calculating and paying pensions correctly (inc. completion of the Guaranteed Minimum Pension Reconciliation and communication with Pensioners)
Risk 3 – Loss of key staff and loss of knowledge & skills – whether the current level of risk attached is appropriate;
- 3) considers whether they would like to visit the offices of Border to Coast;
and
- 4) note the report.

Background

Fund Summary

- 1.1 Over the period covered by this report, the value of the Fund increased in value by £62.8m (2.7%) to £2,363.3m on 30th September 2018. Fund performance and individual manager returns are covered in the separate Investment Management report, item 9 on the agenda.
- 1.2 Appendix A shows the Fund's distribution as at 30th September. Across the asset classes, Fixed Interest is slightly below the agreed tolerance

weighting, at 11.5% compared to a lower tolerance of 12%. The Fund's overall position relative to its benchmark can be described as follows:

Overweight Equities by 4.1%
 UK Equities underweight by 1.5%
 Global Equities overweight by 5.5%

Underweight Alternatives by 1.3%

Underweight Property by 0.3%

Underweight Infrastructure by 0.9%

Underweight Bonds by 2%

Overweight Cash by 0.4%

Movements in weight are due to the relative performance of the different asset classes. In light of the impending change of asset managers as we move towards the transition of assets into Border to Coast, it is not expected that any rebalancing would be undertaken, unless it is funded by reinvestment of cash. The strategic asset allocation change of a reduction in UK equities is covered in the Investment Management Report at item 9.

- 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 September 2018.
- 1.5 The table below shows the Fund's ten largest single company investments (equity only and includes pooled investments) at 30th September, accounting for 10.9% of the Fund, compared to 10.5% in the last quarter. Direct equity holdings in the Fund are now shown on the Pensions shared website (www.wyph.org.uk), and updated on a quarterly basis.

	Company	Total Value £M	% of Fund
1	ROYAL DUTCH SHELL	39.9	1.7
2	MICROSOFT	33.6	1.4
3	RECKITT BENCKISER	29.6	1.2
4	HSBC	24.2	1.0
5	BRITISH AMERICAN TOBACCO	24.1	1.0
6	UNILEVER	22.5	1.0
7	APPLE	22.0	0.9
8	VISA	21.2	0.9
9	AMAZON	20.9	0.9
10	BP	20.7	0.9
	TOTAL	258.7	10.9

- 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 27 company events and cast votes in respect of 217 resolutions. Of these resolutions, the Fund voted 'For' 155, 'Against' 46, abstained on 0 and withheld votes on 16.
- 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 and approved at the 22nd March 2018 meeting of this Committee.

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:
- During the last quarter, LAPFF engaged with 63 companies on issues ranging from employment standards to Sustainable Development Goals and shareholder rights.
 - The Forum issued two voting alerts ahead of the Ryanair and Sports Direct AGMs in September. Poor human capital management, along with continued concerns related to poor board oversight over governance issues led to recommendations to oppose annual reports

and the Chair at both companies. The Forum also attended both companies' AGMs.

- With an aim to better understand how companies approach the UN Sustainable Development Agenda, LAPFF liaised with 14 companies to discuss the topic of sustainable cities and climate risk management, as well as water stewardship and access to water and sanitation.
- The Forum has submitted its response to the Kingman Review that aims to review the role and power of the Financial Reporting Council (FRC). Despite the responses not being public, the Forum considers that its position on disbanding the current FRC is widely shared.

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 £12.6m for the year financial year to 30th September. The invested cash has outperformed the benchmark from 1st April 2018 by 0.15%, annualised, as shown in the table below, and earned interest of £46.2k.

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 September 2018				
Pension Fund Average Balance £'000	Interest Earned £'000	Cumulative Average Yield Annualised %	Cumulative Weighted Benchmark Annualised %	Performance %
12,600.4	46.2	0.75	0.59	0.15

4 TPR Checklist Dashboard

4.1 To assist in the governance of the Lincolnshire Fund, it assesses itself against the requirements of the Pension Regulator's (TPR's) code of practice 14 for public service pension schemes, as set out in a check list attached at Appendix E. This is presented to the Committee and Board at

each quarterly meeting, and any non-compliant or incomplete areas are addressed. This is seen as best practice in open and transparent governance.

4.2 No areas have changed since the last quarter's report.

4.3 The Areas that are not fully completed and/or 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, whilst all Board members have completed this training, certificates have not been received for all Committee 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 submissions and employer training are improving data accuracy, 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.

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 and employer training 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.

5 Breaches Reporting - update

- 5.1 In line with the Breaches reporting policy, any breaches that are reported to the Pensions Regulator (TPR) are brought to the attention of the Pensions Committee and Pension Board. Breaches reporting is included in the standard quarterly update paper of the Board, however this includes all non-material breaches that are not reported to TPR.
- 5.2 As the Committee are aware, LCC reported itself to the Pensions Regulator in April, following concerns raised by the Pension Board.
- 5.3 Since the last meeting of the Board in October, LCC have held regular meetings with WYPF and Serco and have kept officers and the Board updated on progress in clearing the backlogs. LCC have also kept the Pensions Regulator updated. Monthly monitoring meetings are now a standard part of the process put in place to ensure that LCC is aware of the performance of Serco in respect to the pensions responsibilities that it undertakes on LCC's behalf.
- 5.4 The Board will continue to monitor progress to ensure that LCC is meeting the standards required as an employer in the Pension Fund, as all employers should.
- 5.5 A paper has been brought to the Committee at agenda item 8 to update on the contributions monitoring for all employers. This will be a regular paper on the Committee's agenda.

6 Risk Register Update

- 6.1 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.
- 6.2 The October meeting of this Committee compared the Lincolnshire Pension Fund risk register with those of the partner funds of Border to Coast. Whilst no material differences were found, it was agreed that one risk should be amended. This is detailed below, with the proposed additional wording highlighted in italics:

Risk 25	Consequences	Controls	Risk Score	
			L	I
Failure to meet requirements as a	Reputational risk, loss of Fund value	Stewardship code compliance Managers reporting	1	2

responsible investor - across all ESG risks (<i>including climate change and a move to a low carbon economy</i>)		requirements LAPFF membership Voting RI Policy and Voting Guidelines		
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6.3 The Pension Board review the risk register regularly, and at their October meeting requested that two recommendations were taken to this Pensions Committee:

- 1) to consider whether the current risk score for Risk 3 – detailed below – was still appropriate given the imminent retirement of the Executive Director of Finance and Public Protection and the County Finance Officer, both of whom have extensive and historical knowledge of the Lincolnshire Pension Fund.

Risk 24	Consequences	Controls	Risk Score	
			L	I
Loss of key staff and loss of knowledge & skills	Inability to deliver service Statutory requirements not met Damaged reputation Pensioners not paid Inability to make investment/administration decisions Loss of professional investor status under MIFIDII	Diversified staff / team Look at other authorities with best practices to ensure LCC positions still desirable Attendance at pensions user groups, both WYPF and LCC Procedural notes which includes new systems as and when (LCC & WYPF) Section meetings / appraisals (LCC & WYPF) Regular team building (LCC & WYPF)	2	2

- 2) to consider the inclusion of additional words to risk 4 – detailed below – to add the Guaranteed Minimum Pension reconciliation and how the output of that will be communicated to pensioners in the event their pension is amended.

Risk 4	Consequences	Controls	Risk Score	
			L	I
Calculating and paying pensions correctly (<i>inc. completion of the Guaranteed Minimum Pension Reconciliation and communication with Pensioners</i>)	Damaged reputation Financial loss	Internal control through audit process Constant monitoring / checking Quality standard at WYPF Process management NFI and Tracing services Data Cleansing	2	2

- 6.3 There is still one red risk, risk 24, which was added in June 2016 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 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

- 6.4 The Committee is asked to approve the amendments to Risk 25 (paragraph 6.2) and to consider the recommendations from the Pension Board to amend Risk 4 and to consider whether the current level of risk attached to Risk 3 is appropriate (paragraph 6.3).
- 6.5 The full risk register is available from officers should any member of the Committee wish to see it.

7 Asset Pooling Update

- 7.1 The Committee received a presentation from representatives of Border to Coast at the December Pensions Committee meeting, providing an update on the governance arrangements for Border to Coast, the Global Equity Alpha Fund and the alternative investment proposal.

Sub Funds

- 7.2 Work on the first externally managed sub-fund for Border to Coast has progressed well, with three managers being appointed to the UK Equity Alpha Fund: UBS, Janus Henderson and Baillie Gifford. Transition of assets from the partner funds are expected to have completed by the time of this Committee.
- 7.3 Much work has also been done on the Global Equity Alpha Fund, as the Committee heard in December, and the expectation is for assets to transition in Q2/3 2019.

Potential Savings

- 7.4 The Committee will be aware of the potential savings that asset pooling could bring to the Fund, as detailed in the formal submissions to MHCLG, ahead of the final approval for the creation of the Border to Coast pool, and detailed in a number of Committee papers and training sessions.
- 7.5 The range of net savings for Lincolnshire at that time was: best case £3.7m p.a. and worst case £1.7m p.a. Since that time (March 2016), assets have grown from £1.76bn to the current value of £2.3bn, therefore the expected savings should be greater, as most savings are from manager fee reductions that are based on assets under management.
- 7.6 As no assets have transitioned across to Border to Coast, no direct savings as a result of investing in Border to Coast have been realised. However the change from the internal management of the passive UK equities to the external manager LGIM produced approximately 0.005% of a saving on the fee scale – this was directly as a result of the pooling agenda and fees were negotiated for all partner funds in Border to Coast. The scale of the saving was low as a result of the already very low cost internal management – other partner Funds where this was already externally managed achieved far greater savings.
- 7.7 Once assets transition from current managers into Border to Coast, actual fee savings will be shared with the Committee.
- 7.8 In addition, further work will be done as part of the year end process to identify savings that can be attributed to pooling, and this will be shown in the Fund's Annual Report.

Joint Committee Meetings

- 7.9 The Joint Committee (JC) last met on 21st November 2018, and the papers were circulated to all Pensions Committee members. The minutes will be circulated once approved, and below are the highlights:

- Scheme member representation – the appropriate number of scheme member representatives to sit as non-voting members on the JC and the process for appointing these members was agreed.
- Scheme employer representation – the SAB guidance is that Funds should consider this in addition to scheme member representation, and should explain the reasons if they decide against it. It was resolved at the previous JC meeting that employer representatives were not required, and the statement below approved at this meeting to explain the reasoning:

The Border to Coast Pensions Partnership Joint Committee has decided not to include a non-voting observer representing scheme employers who are not administering authorities within its membership. There are two reasons for this. Firstly, these employers are represented in the governance structures of the 12 Administering Authorities and there have, in contrast to scheme members, been no demands for such representation through this route. Secondly this is an incredibly diverse range of employers ranging from large unitary councils to small charities with one or two members and it is therefore considered that to provide effective representation of such a wide spectrum of organisations which participate in the Local Government Pension Scheme on different bases would be impractical. On balance it is considered that the common interest of this group of employers is in the achievement through an effectively implemented investment strategy of stable and affordable contribution rates, and that that interest coincides with a major part of the interest of administering authorities as employers who are represented on the Joint Committee.

- JC Budget - The JC noted that at the current time the forecast expenditure was broadly in line with the budget set in January 2018.
- JC Terms of Reference – as Border to Coast was now in a "business as usual" state, discussion was had about reviewing the initial terms of reference for the JC.
- Responsible Investment Policies Review – the draft RI Policy and Corporate Governance and Voting Guidelines were discussed. These have been brought to this Committee at agenda item 10.
- Chief Executive Officer (CEO) Report – Rachel Elwell updated the JC on the various interaction with Partner Funds.
- Border to Coast ACS Global Equity Alpha Fund – Chief Investment Officer (CIO) Daniel Booth updated the JC on the progress with the creation of the Global Equity Alpha Fund.
- Border to Coast Alternative capability and target operating model – CIO Daniel Booth updated the JC on the current proposition and process for building the alternatives capability within Border to Coast.

- Chief Operating Officer (COO) Report – COO Fiona Miller updated the JC on the core operational activities progressed since the last JC meeting, presented the out-turn for the Implementation Budget, explained the 2018-19 Operational Budget and the initial work undertaken on the 2019-20 Budget and the future governance process for approval by shareholders.

7.10 The next JC meeting is being held on 11th March 2019 and papers will be circulated to Committee members. Any questions or comments on the papers should be directed to Cllr Strengiel, who can raise them at the meeting.

Workshops

7.11 Officers continue to meet regularly with Border to Coast to ensure that the sub-fund offerings and the strategic asset allocations of the Partner Funds are aligned.

Shareholder Approvals

7.12 As the Committee are aware, there are two distinct roles that Lincolnshire County Council has with Border to Coast: the shareholder and the investor (or client). The Committee's role is that of investor, and is represented at the Joint Committee by the Chairman of the Pensions Committee. The shareholder role is undertaken by the Executive Director of Finance and Public Protection, and fulfils the role as set out in the Shareholder Agreement, which was approved by Full Council in February 2017.

7.13 Ahead of any shareholder approvals, officers, including S151 officers, work closely with Border to Coast to ensure full understanding of the resolution, the impact of it not being approved and discuss this with the JC ahead of any resolution being sent for approval. There are two important shareholder approvals due in the next few months:

- Alternatives Structure – the Committee had the structure for the alternatives vehicle explained to them at the December Committee meeting. As this is creating new subsidiaries of Border to Coast, it requires approval from all shareholders. 100% approval is required, and it needs to be in place for mid-January to meet the timetable for delivering the alternatives offering. To ensure that the proposed structure is suitable, additional legal advice has been commissioned by the Partner Funds.
- Strategic Plan (including budget and capital adequacy) – this sets the budget for 2019/20 and has been approved by the Border to Coast Board. It requires approval from 75% of shareholders (9 Partner Funds) and this approval is required to be in place for the end of February 2019.

Visit to Border to Coast Offices

- 7.14 To assist with building the relationship and understanding between the Fund and Border to Coast, there is an open invitation for the Committee to visit their offices in Leeds, where there will be the opportunity to meet more of the team. The Committee is asked to consider whether they would like to hold a future meeting at the offices of Border to Coast.

8 Conference and Training Attendance

- 8.1 It is stated in the Committee's Training Policy, approved each July, that following attendance at any conferences, seminars or external training events, members of the Committee and officers will share their thoughts on the event, including whether they recommended it for others to attend. This will now be a standing item within this paper, to enable members and officers to provide this feedback.
- 8.3 The Committee and officers are therefore requested to share information on relevant events attended since the last Committee meeting.

Conclusion

- 9 This reporting period saw the value of the Fund fall, increasing by £62.8m to £2,363.3m. At the end of the period the asset allocation, compared to the strategic allocation, was;
- overweight equities and cash; and
 - underweight fixed interest, property, infrastructure and alternatives.
- 10 The risk register has been amended to incorporate changes requested at the October meeting of this Committee, expanding the wording on risks 4 and 25. In addition, the Pension Board has recommended that the Committee consider whether the risk score associated to risk 3 is still appropriate.
- 11 The Committee is asked to consider whether it would be useful to visit the Border to Coast Offices in Leeds, to assist in developing the relationship and understanding between the Fund and Border to Coast.

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

Background Papers

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

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

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